

JOINT Corp  
Form 10-K  
March 10, 2017

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2016**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 001-36724**

**The Joint Corp.**

*(Exact name of registrant as specified in its charter)*

**Delaware**

**90-0544160**

(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation) Identification No.)

**16767 N. Perimeter Drive, Suite 240, Scottsdale**

**85260**

**Arizona**

(Address of Principal Executive Offices)

(Zip Code)

**(480) 245-5960**

(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

<u>Title Of Each Class</u>	<u>Name Of Each Exchange On Which Registered</u>
Common Stock, \$0.001 Par Value Per Share	The NASDAQ Capital Market LLC

Securities Registered Pursuant to Section 12(g) of the Act:

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes

No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment of this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer      Accelerated filer      Non-accelerated filer      Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes      No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was approximately \$21.2 million as of June 30, 2016 based on the closing sales price of the common stock on the NASDAQ Capital Market.

There were 13,054,531 shares of the registrant's common stock issued and outstanding as of March 1, 2017.

### **Documents Incorporated by Reference**

Portions of the registrant's Proxy Statement relating to its 2017 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission ("SEC") pursuant to Regulation 14A within 120 days after the registrant's fiscal year ended December 31, 2016, are incorporated by reference in Part III of this Form 10-K.



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## Forward-Looking Statements and Terminology

*The information in this Annual Report on Form 10-K, or this Form 10-K, including this discussion under the headings “Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” contains forward-looking statements and information within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, which are subject to the “safe harbor” created by those sections. All statements, other than statements of historical facts, included or incorporated in this Form 10-K could be deemed forward-looking statements, particularly statements about our plans, strategies and prospects under the headings “Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “could,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “potential,” “negative of these terms or other comparable terminology. All forward-looking statements in this Form 10-K are made based on our current expectations, forecasts, estimates and assumptions, and involve risks, uncertainties and other factors that could cause results or events to differ materially from those expressed in the forward-looking statements. In evaluating these statements, you should specifically consider various factors, uncertainties and risks that could affect our future results or operations as described from time to time in our SEC reports., including those risks outlined under “Risk Factors” in Item 1A of this Form 10-K. These factors, uncertainties and risks may cause our actual results to differ materially from any forward-looking statement set forth in this Form 10-K. You should carefully consider the trends, risks and uncertainties described below and other information in this Form 10-K and subsequent reports filed with or furnished to the SEC before making any investment decision with respect to our securities. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by this cautionary statement. Some of the important factors that could cause our actual results to differ materially from those projected in any forward-looking statements include, but are not limited to, the following:*

*• we may not be able to successfully implement our growth strategy if we or our franchisees are unable to locate and secure appropriate sites for clinic locations, obtain favorable lease terms, and attract patients to our clinics;*

*• we have limited experience operating company-owned or managed clinics, and we may not be able to duplicate the success of some of our franchisees, and in the case of certain company-owned or managed clinics that we have or may close, we were not able to duplicate the success of our most successful franchisees;*

*• we may not be able to acquire operating clinics from existing franchisees or develop company-owned or managed clinics on attractive terms;*

*• any acquisitions that we make could disrupt our business and harm our financial condition;*

*• we may not be able to continue to sell franchises to qualified franchisees;*

*• we may not be able to identify, recruit and train enough qualified chiropractors to staff our clinics;*

*new clinics may not be profitable, and we may not be able to maintain or improve revenues and franchise fees from existing franchised clinics;*

*the chiropractic industry is highly competitive, with many well-established competitors, which could prevent us from increasing our market share or result in reduction in our market share;*

*recent administrative actions and rulings regarding the corporate practice of medicine and joint employer responsibility may jeopardize our business model;*

*we may face negative publicity or damage to our reputation, which could arise from concerns expressed by opponents of chiropractic and by chiropractors operating under traditional service models;*



*legislation, regulations, as well as new medical procedures and techniques could reduce or eliminate our competitive advantages; and*

*we face increased costs as a result of being a public company.*

*Additionally, there may be other risks that are otherwise described from time to time in the reports that we file with the Securities and Exchange Commission. Any forward-looking statements in this report should be considered in light of various important factors, including the risks and uncertainties listed above, as well as others.*

As used in this Form 10-K:

· “we,” “us,” and “our” refer to The Joint Corp.

· a “clinic” refers to a chiropractic clinic operating under our “Joint” brand, which may be (i) owned by a franchisee, (ii) owned by a professional corporation or limited liability company and managed by a franchisee; (iii) owned directly by us; or (iv) owned by a professional corporation or limited liability company and managed by us.

· when we identify an “operator” of a clinic, a party that is “operating” a clinic, or a party by whom a clinic is “operated,” we are referring to the party that operates all aspects of the clinic in certain jurisdictions, and to the party that manages all aspects of the clinic other than the practice of chiropractic in certain other jurisdictions.

· when we describe our acquisition or our opening of a clinic, we are referring to our acquisition or opening of the entity that operates all aspects of the clinic in certain jurisdictions, and to our acquisition or opening of the entity that manages aspects of the clinic other than the practice of chiropractic in certain other jurisdictions.

## **PART I**

### **ITEM 1. BUSINESS**

#### **Overview**

Our principal business is to develop, own, operate, support and manage chiropractic clinics through direct ownership, management arrangements, franchising and the sale of regional developer rights throughout the United States.

We are a rapidly growing franchisor and operator of chiropractic clinics that uses a private pay, non-insurance, cash-based model. We seek to be the leading provider of chiropractic care in the markets we serve and to become the most recognized brand in our industry through the rapid and focused expansion of chiropractic clinics in key markets throughout North America and abroad. We strive to accomplish our mission by making quality care readily available and affordable in a retail setting. We have created a growing network of modern, consumer-friendly chiropractic clinics operated by franchisees and by us that employ licensed chiropractors. We have priced our services below most competitors' pricing for similar services and below most insurance co-payment levels (i.e., below the patient co-payment required for an insurance-covered service).

Since acquiring the predecessor to our company in March, 2010, we have grown our enterprise from eight to 370 clinics in operation as of December 31, 2016, with an additional 115 franchise licenses sold but not yet developed across our network. In the year ended December 31, 2016, our system registered 4.1 million patient visits and generated system-wide sales of \$98.6 million. As of December 31, 2016, 309 of our clinics were operated by franchisees and 61 clinics were operated as company-owned or managed clinics. Our future growth strategy will focus on rapidly growing our franchise base through the sale of additional franchises and through a robust regional developer network, and opportunistically adding and operating clinics owned or managed by us. We collect a royalty of 7.0% of revenues from franchised clinics. We remit a 3.0% royalty to our regional developers on the gross sales of franchises opened within certain regional developer protected territories. We also collect a national marketing fee of 2.0% of gross sales of all franchised clinics. We receive a franchise sales fee of \$39,900 for each franchise we sell directly and a franchise fee ranging from \$19,950 to \$25,400 for each franchise sold through our network of regional developers.

On November 14, 2014, we completed our initial public offering, or the IPO, of 3,000,000 shares of common stock at an initial price to the public of \$6.50 per share, and we received net proceeds of approximately \$17.1 million. Our underwriters exercised their option to purchase 450,000 additional shares of common stock to cover over-allotments on November 18, 2014, pursuant to which we received net proceeds of approximately \$2.7 million. Also, in conjunction with the IPO, we issued warrants to the underwriters for the purchase of 90,000 shares of common stock, which can be exercised between November 10, 2015 and November 10, 2018 at an exercise price of \$8.125 per share.

On November 25, 2015, we closed on our follow-on public offering of 2,272,727 shares of our common stock, offered and sold by the Company, at a price to the public of \$5.50 per share. We granted the underwriters a 45-day option to purchase up to 340,909 additional shares of common stock to cover over-allotments, if any. On December 30, 2015, our underwriters exercised their over-allotment option to purchase an additional 340,909 shares of common stock at a price of \$5.50 per share. After giving effect to the over-allotment exercise, the total number of shares offered and sold in our follow-on public offering increased to 2,613,636 shares. With the over-allotment option exercise, we received aggregate net proceeds of approximately \$13.0 million.

For the years ended December 31, 2016 and 2015, we had net losses after taxes of \$15,173,872 and \$8,797,321, respectively.

We deliver convenient, appointment-free chiropractic adjustments in an inviting, open bay environment at prices that are approximately 68% lower than the average industry cost for comparable procedures offered by traditional chiropractors, according to 2016 industry data from Chiropractic Economics. In support of our mission to offer affordable and convenient care and value for our patients, our clinics offer a variety of customizable membership and wellness treatment plans which offer additional value pricing even as compared with our single-visit pricing schedules. These flexible plans are designed to attract patients and encourage repeat visits and routine usage as part of an overall health and wellness program.

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As of December 31, 2016, we had 370 franchised or company-owned or managed clinics in operation in 30 states. The map below shows the states in which we or our franchisees operate clinics and the number of clinics open in each state as of December 31, 2016.

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Our retail locations have been selected to be visible, accessible and convenient. We offer a welcoming, consumer-friendly experience that attempts to redefine the chiropractic doctor/patient relationship. Our clinics are open longer hours than many of our competitors and our patients do not need appointments. We accept cash or major credit cards in return for our services. We do not accept insurance and do not provide Medicare covered services. We believe that our approach, especially our commitment to affordable pricing and our ready service delivery model, will attract existing consumers of chiropractic services and will also appeal to the growing market of consumers who seek alternative or non-invasive wellness care, but have not yet tried chiropractic.

Our patients arrive at our clinics without appointments at times convenient to their schedules. Once a patient has joined our system and is returning for treatment, they simply swipe their membership card at a card reader at the reception desk to announce their arrival. Typically, within three to five minutes (the average throughout our system), the patient is escorted to our open adjustment area, where they are required to remove only their outerwear to receive their adjustment. The adjustment process, administered by a licensed chiropractor, takes approximately 15 –20 minutes on average for a new patient and 5 – 7 minutes on average for a returning patient. Each patient's records are digitally updated for ready retrieval in our proprietary data storage system by our chiropractors in compliance with all applicable medical records security and privacy regulations.

Our consumer-focused service model targets the non-acute treatment market, which we believe to be the largest segment of the \$15 billion chiropractic services market. As our model does not focus on the treatment of severe, acute injury, we do not provide expensive and invasive diagnostic tools such as MRIs and X-rays. Instead we refer those with acute symptoms to alternate healthcare providers, including traditional chiropractors.

## **Our Industry**

Chiropractic care is widely accepted among individuals with a variety of medical conditions, particularly back pain. A 2016 Gallup report commissioned by Palmer College of Chiropractic shows that 35.5 million U.S. adults (11% of the total U.S. population) now seek chiropractic care each year, an increase of 1.9 million as compared to the 33.6 million U.S. adults reported in the inaugural 2015 Gallup-Palmer report. These numbers represent a marked increase over the 2012 National Health Interview Survey that measured chiropractic use at 20.6 million U.S. adults, or 8% of the population. According to the American Chiropractic Association, 80% of Americans experience back pain at least once in their lifetime. According to the 2016 Gallup report commissioned by the Palmer College of Chiropractic, over half of adults in the United States (55%) say they are likely to see a chiropractor if they had significant neck or back pain. Chiropractic care is increasingly recognized as an effective treatment for pain and potentially for a variety of other conditions. The American College of Physicians (ACP) now recommends for patients with chronic low back pain, non-drug therapy such as spinal manipulation as a first line of treatment. The ACP states that treatments such as spinal manipulation are shown to improve symptoms with little risk of harm. The National Center for Complementary & Alternative Medicine of the National Institutes of Health has stated that spinal manipulation appears to benefit some

people with low-back pain and also may be helpful for headaches, neck pain, upper- and lower-extremity joint conditions and whiplash-associated disorders. The Mayo Clinic has recognized chiropractic as safe when performed by trained and licensed chiropractors, and the Cleveland Clinic has stated that chiropractors are established members of the mainstream medical team.

The Bureau of Labor Statistics estimates that \$90 billion is spent on back pain each year in the U.S. The chiropractic industry in the United States is large, growing and highly fragmented. According to a report issued by IBIS World Chiropractors Market Research in August 2016, expenditures for chiropractic services in the U.S. are \$15.0 billion annually. The United States Bureau of Labor Statistics expects employment in chiropractic to grow faster than the average for all occupations. Some of the factors that the Bureau of Labor Statistics identified as driving this growth are healthcare cost pressures, an aging population requiring more health care and technological advances, all of which are expected to increasingly shift services from inpatient facilities and hospitals to outpatient settings. We believe that the demand for our chiropractic services will continue to grow as a result of several additional drivers, such as the increased awareness of the benefits of regular maintenance therapy coupled with an increasing awareness of the convenience of our service and of our pricing at a significant discount to the cost of traditional chiropractic adjustments and, in most cases, at or below the level of insurance co-payment amounts.

Today, most chiropractic services are provided by sole practitioners, generally in medical office settings. The chiropractic industry differs from the broader healthcare services industry in that it is more heavily consumer-driven, market-responsive and price sensitive, in large measure a result of many treatment options falling outside the bounds of traditional insurance reimbursable services and fee schedules. According to First Research, the top 50 companies delivering chiropractic services in the United States generated less than 10% of all industry revenue. We believe these characteristics are evidence of an underserved market with potential consumer demand that is favorable for an efficient, low-cost, consumer-oriented provider.

Most chiropractic practices are set up to accept and to process insurance-based reimbursement. While chiropractors typically accept cash payment in addition to insurance, Medicare and Medicaid, they continue to incur overhead expenses associated with maintaining the capability to process third-party reimbursement. We believe that most chiropractors who use this third-party reimbursement model would find it economically difficult to discount the prices they charge for their services to levels comparable with our pricing.

Accordingly, we believe these and certain other trends favor our business model. Among these are:

- People have increasingly active lifestyles and are living longer, requiring more medical, maintenance and preventative support;

- People are increasingly open to alternative, non-pharmacological types of care;

- Utilization of more conveniently situated, local-sited urgent-care or “mini-care” alternatives to primary care is increasing; and

- Popularity of health clubs, massage and other non-drug, non-invasive wellness maintenance providers is growing.





## **Our Competitive Strengths**

We believe the following competitive strengths have contributed to our initial success and will position us for future growth:

*Retail, consumer-driven approach.* To support our consumer-focused model, we use strong, recognizable retail approaches to stimulate brand-awareness and attract patients to our clinics. We intend to continue to drive awareness of our brand by locating clinics mainly at retail centers and convenience points, displaying prominent signage and employing consistent, proven and targeted marketing tools. Most of our clinics offer patient care six or seven days per week at convenient locations. We offer our patients the flexibility to visit our clinics without an appointment and receive prompt attention. Additionally, we offer extended hours of operation, including weekends, which is not typical among our competitors.

We attracted an average per clinic of 880 new patients during the year ended December 31, 2016, as compared to the 2016 chiropractic industry average of 364 new patients per year for traditional insurance-based non-multidisciplinary or integrated practices, according to a 2016 Chiropractic Economics survey.

*Quality Service.* Across our system we have a community of over 800 fully licensed chiropractic doctors, performing more than 4 million adjustments annually. Our doctors provide patient care focused on pain relief and ongoing wellness to promote healthy, active lifestyles. We provide our doctors one-on-one training, as well as ongoing coaching and mentoring through our partnerships with two of the profession's preeminent instructors in chiropractic technique and adjusting. Our doctors continually refine their skills, as our clinics see an average of 228 patients per week, as compared to the 2016 chiropractic industry average of 132 patients per week for non-multidisciplinary or integrated practices, according to a 2016 Chiropractic Economics survey. Our service offerings encourage consumer trial, repeat visits and sustainable patient relationships.

By limiting the administrative burdens of insurance processing, our model helps chiropractors focus on patient service. We believe the time our chiropractors save by not having to perform administrative duties related to insurance reimbursement allows more time to see more patients, establish and reinforce chiropractor/patient relationships, and educate patients on the benefits of chiropractic maintenance therapy.

Our approach has made us an attractive alternative for chiropractic doctors who want to spend more time treating patients than they typically do in traditional practices, which are burdened with greater overhead, personnel and administrative expense. We believe that our model helps us to recruit chiropractors who want to focus their practice principally on patient care.

*Pricing Structure.* We believe that our strongest competitive advantages are our price and convenience. We offer a much less expensive alternative to traditional chiropractic services by focusing on non-acute care and by not participating in insurance or Medicare reimbursement. We can do this because our clinics do not have the expenses of performing certain diagnostic procedures and processing reimbursement claims. Our model allows us to pass these savings on to our patients. According to Chiropractic Economics in 2016, the average fee for a chiropractic treatment involving spinal manipulation in a cash-based practice in the United States is approximately \$74. By comparison, our average fee as of December 31, 2016, was approximately \$24, approximately 68% lower than the industry average price.

We believe our pricing and service offering structure helps us to generate higher usage. The following table sets forth our average price per adjustment as of December 31, 2016, for patients who pay by single adjustment plans, multiple adjustment packages, and multiple adjustment membership plans. Our price per adjustment as of December 31, 2016 averaged approximately \$24 across all three groups.

	The Joint Service Offering		
	Single Visit	Package(s)	Membership(s)
Price per adjustment	\$39	\$20 – \$33	\$15 – \$20

*Proven track record of opening clinics and growing revenue at the clinic level.* We have grown our clinic revenue base consistently since we acquired our predecessor in March 2010. From January 2012 through December 31, 2016, we have increased monthly sales at our clinics from \$0.4 million to \$9.3 million. During this period, we increased the number of clinics in operation from 33 to 370.

We continue to be encouraged by the ability of individual clinics to generate growth. While there is significant variation in results among our system, and the results of our top-performing clinics are not representative of our system overall, we believe it is worth noting that in January 2012, the highest-performing clinic in our system was a franchise clinic which had monthly sales of approximately \$45,000, and in December 2016, the highest performing clinic in our system was a franchise clinic which had monthly sales of approximately \$88,000.

*Strong and proven management team.* Our strategic vision is directed by our President and Chief Executive Officer Peter D. Holt, who has more than 30 years of experience in domestic and international franchising, franchise development and operations. His appointment confirms our commitment to the continued strengthening of operations, the continued cultivation and management of our franchise community, as well as a strong commitment to future clinic development both domestically and internationally. Mr. Holt was most recently president and chief executive officer of Tasti-D-Lite & Planet Smoothie. He has also served as chief operating officer of 24seven Vending (U.S), where he directed its franchise system in the U.S., and as executive vice president of development for Mail Boxes Etc. and vice president of international for I Can't Believe It's Yogurt and Java Coast Fine Coffees. Mr. Holt directs a team of dedicated leaders who are focused on executing our business plan and implementing our growth strategy. We believe that our management team's experience and demonstrated success in building and operating a robust franchise system, will be a key driver of our growth and will position us well for achieving our long-term strategy.

## **Our Growth Strategy**

Our goal is not only to capture a significant share of the existing market but also to expand the market for chiropractic care. We are accomplishing this through the rapid geographic expansion of our affordable franchising program and the opportunistic addition of company-owned or managed clinics. We do not expect to acquire or to open any company-owned or managed clinics in 2017; however, at the appropriate time, we intend to resume the addition of company-owned or managed clinics. Accordingly, our long-term growth tactics include:

- the continued growth of system sales and royalty income;
- the opening of clinics already in development;
- the sale of additional franchises;
- the sale of additional regional developer protected territories;
- increasing the capability and capacity of our existing regional developer network;
- improving operational margins and leveraging infrastructure;
- the opportunistic acquisition of existing franchises; and
- the continued development of company-owned clinics in clustered geographies.

Our analysis of data from over 450,000 patient records from 362 clinics across 30 states suggests that the United States market alone can support at least 1,700 of our clinics.

### ***Continued growth of system sales.***

System wide comparable same-store sales growth, or “Comp Sales,” for 2016 was 27.5% for the full year of 2016. Comp Sales refers to the amount of sales a clinic generates in the most recent accounting period, relative to the amount of sales it generated in a similar period in the past. Comp Sales include the sales from both company-owned or managed clinics and franchised clinics that in each case have been open at least 13 full months and exclude any clinics that have closed. We believe that the experience we have gained in developing and refining management systems, operating standards, training materials and marketing and customer acquisition activities has contributed to our

system's revenue growth. In addition, we believe that increasing awareness of our brand has contributed to revenue growth, particularly in markets where the number and density of our clinics has made cooperative and mass media advertising attractive. We believe that our ability to leverage aggregated and general media digital advertising and search tools will continue to grow as the number and density of our clinics increases.

We acquired our first company-owned or managed clinic on December 31, 2014. In the first full calendar quarter after that acquisition, total revenue from company-owned or managed clinics was \$0.4 million, growing to approximately \$2.4 million in the quarter ended December 31, 2016. Total revenue from our 61 company-owned or managed clinics was approximately \$8.6 million for the year ended December 31, 2016 as compared to \$3.7 million for the year ended December 31, 2015. Through December 31, 2016, revenue from company-owned or managed clinics consisted of revenue earned from 32 franchised clinics that we acquired, as well as 29 clinics that we developed.

***Opening clinics in development.***

In addition to our 370 operating clinics, as of December 31, 2016, we have granted franchises either directly or through our regional developers for an additional 115 clinics that we believe will be developed in the future. We will continue to support our franchisees and regional developers to open these clinics and to achieve sustainable performance as rapidly as possible.

During the year ended December 31, 2016, we terminated 17 franchise licenses for undeveloped clinics that were in default.

***Selling additional franchises.***

We will continue to sell franchises. We believe that to secure leadership in our industry and to maximize our opportunities in our markets, it is important to gain brand equity and consumer awareness as rapidly as possible, consistent with a disciplined approach to opening clinics. We believe that continued sales of franchises in selected markets is the most effective way to drive brand awareness in the short term. Our longer-term strategy includes the resumption of opening or acquiring company-owned or managed clinics, and we believe that a growth strategy that includes both franchised and company-owned or managed clinics has advantages over either approach by itself.

***Continue to improve margins and leverage infrastructure.***

We believe our corporate infrastructure can scale to support a clinic base greater than our existing footprint. As we continue to grow, we expect to drive greater efficiencies across our operations, development and marketing programs and further leverage our technology and existing support infrastructure. We believe we will be able to control corporate costs over time to enhance margins as general and administrative expenses grow at a slower rate than our clinic base and sales. At the clinic level, we expect to drive margins and labor efficiencies through continued sales growth and consistently applied operating standards as our clinic base matures and the average number of patient

visits increases. In addition, we will consider introducing selected and complementary branded products such as nutraceuticals or dietary supplements and related additional services.

***Acquiring existing franchises.***

While we do not expect to acquire any operating franchised clinics in 2017, we do not rule out the opportunistic acquisition of existing franchised clinics that meet our criteria for demographics, site attractiveness, proximity to other clinics and additional suitability factors. Following the completion of the IPO through December 31, 2016, we acquired a net of 32 existing franchises and now operate them as company-owned or managed clinics.

***Development of company-owned or managed clinics.***

In June, 2016, we ceased additional expansion of our company-owned or managed clinic portfolio to allow our portfolio of clinics to mature and to focus resources on the growth of our franchise system. In January, 2017, we sold the assets of six of our 11 clinics in the Chicago area for a nominal amount to a limited liability company that includes existing franchisees as members, and recorded a related impairment charge in 2016. The limited liability company will operate the clinics pursuant to a franchise agreement. We closed the remaining five Chicago-area clinics, as well as three company-managed clinics in upstate New York.

We do not rule out the opportunistic development of company-owned or managed clinics that meet our criteria for demographics, site attractiveness, proximity to other clinics and additional suitability factors.

When we resume the acquisition and development of company-owned or managed clinics we intend to target geographic clusters where we are able to increase efficiencies through a consolidated real estate penetration strategy, leverage cooperative advertisement and marketing and attain general corporate and administrative operating efficiencies. We also believe that the development timeline and point of break-even for company-owned or managed clinics can be shortened and that our revenue from company-owned or managed clinics will ultimately exceed revenue that would be generated through royalty income from a franchise-only system.

## **Regulatory Environment**

### ***HIPAA***

In an effort to further combat healthcare fraud and protect patient confidentiality, Congress included several anti-fraud measures in the Health Insurance Portability and Accountability Act of 1996 (HIPAA). HIPAA created a source of funding for fraud control to coordinate federal, state and local healthcare law enforcement programs, conduct investigations, provide guidance to the healthcare industry concerning fraudulent healthcare practices, and establish a national data bank to receive and report final adverse actions. HIPAA also criminalized certain forms of healthcare fraud against all public and private payors. Additionally, HIPAA mandates the adoption of standards regarding the exchange of healthcare information in an effort to ensure the privacy and security of electronic patient information. Sanctions for failing to comply with HIPAA include criminal penalties and civil sanctions. In February 2009, the American Recovery and Reinvestment Act of 2009 (ARRA) was enacted. Title XIII of ARRA, the Health Information Technology for Economic and Clinical Health Act (HITECH), includes substantial Medicare and Medicaid incentives for providers to adopt electronic health records (“EHR”) and grants for the development of health information exchange (“HIE”) systems. Recognizing that HIE and EHR systems will not be implemented unless the public can be assured that the privacy and security of patient information in such systems is protected, HITECH also significantly expands the scope of the privacy and security requirements under HIPAA. Most notable are the new mandatory breach notification requirements and a heightened enforcement scheme that includes increased penalties, and which now apply to business associates as well as to covered entities. In addition to HIPAA, a number of states have adopted laws and/or regulations applicable in the use and disclosure of individually identifiable health information that can be more stringent than comparable provisions under HIPAA and HITECH.

We believe that our operations substantially comply with applicable standards for privacy and security of protected healthcare information. We cannot predict what negative effect, if any, HIPAA/HITECH or any applicable state law or regulation will have on our business.



*State regulations on corporate practice of chiropractic.*

In states that regulate the “corporate practice of chiropractic,” our chiropractic services are provided by legal entities organized under state laws as professional corporations, or PCs. Each of the PCs is wholly owned by one or more licensed chiropractors, and employs or contracts with chiropractors in one or more offices. We do not own any capital stock of (or have any other ownership interest in) any such PC. We and our franchisees that are not owned by chiropractors enter into management services agreements with PCs to provide the PCs on an exclusive basis with all non-clinical administrative services needed by the chiropractic practice. In November, 2015, the California Board of Chiropractic Examiners commenced an administrative proceeding to which we were not a party, in which it claimed that the doctor who owns the PC that we manage in southern California violated California’s prohibition on the corporate practice of chiropractic, among other claims, because our management of the clinics operated by his PC involved the exercise of control over certain clinical aspects of his practice. The California Board of Chiropractic Examiners has subsequently dismissed claims against the doctor who owns the PC in congruence with findings of the overseeing administrative judge. In June 2015, the New York Attorney General announced that it had entered into an Assurance of Discontinuance with a provider of business services to independently owned dental practices in New York, pursuant to which the provider paid a substantial fine and agreed to change its business and branding practices. While the effect of the proceeding before the California Board of Chiropractic Examiners and the New York Assurance of Discontinuance is that our business practices in California and New York may be under stricter scrutiny than elsewhere, we believe we are in substantial compliance with all applicable laws relating to the corporate practice of chiropractic.

***Regulation relating to franchising***

We are subject to the rules and regulations of the Federal Trade Commission and various state laws regulating the offer and sale of franchises. The Federal Trade Commission and various state laws require that we furnish a Franchise Disclosure Document or FDD containing certain information to prospective franchisees, and a number of states require registration of the FDD at least annually with state authorities. Included in the information required to be disclosed in our FDD is our business experience, material litigation, all fees due to us from franchisees, a franchisee's estimated initial investment, restrictions on sources of products and services we impose on franchisees, development and operating obligations of franchisees, whether we provide financing to franchisees, our training and support obligations and other terms and conditions of our franchise agreement. We are operating under exemptions from registration in several states based on our qualifications for exemption as set forth in those states' laws. Substantive state laws regulating the franchisor-franchisee relationship presently exist in many states. We believe that our FDD and franchising procedures comply in all material respects with both the Federal Trade Commission guidelines and all applicable state laws regulating franchising in those states in which we have offered franchises. We have not elected to sell franchises in certain states where the time and cost associated with registering our FDD in that state is not, in our judgment, justified by current demand for franchises in that state. As of December 31, 2016, we were registered to sell franchises in 30 states.

***Other federal, state and local regulation***

We are subject to varied federal regulations affecting the operation of our business. We are subject to the U.S. Fair Labor Standards Act, the U.S. Immigration Reform and Control Act of 1986, the Occupational Safety and Health Act and various other federal and state laws governing such matters as minimum wage requirements, overtime, fringe benefits, workplace safety and other working conditions and citizenship requirements. A significant number of our clinic service personnel are paid at rates related to the applicable minimum wage, and increases in the minimum wage could increase our labor costs. We are continuing to assess the impact of recently-adopted federal health care legislation on our health care benefit costs. Many of our smaller franchisees will qualify for exemption from the mandatory requirement to provide health insurance benefits because of their small number of employees. The imposition of any requirement that we or our franchisees provide health insurance benefits to our or their employees that are more extensive than the health insurance benefits that we currently provide to our employees or that franchisees may or may not provide, or the imposition of additional employer paid employment taxes on income earned by our employees, could have an adverse effect on our results of operations and financial position. Our distributors and suppliers also may be affected by higher minimum wage and benefit standards, which could result in higher costs for goods and services supplied to us.

In August, 2015, the National Labor Relations Board (or "NLRB") adopted a more expansive definition of what it means to be a "joint employer," making it easier for employees of franchisees to organize and bargain collectively. This NLRB action, as well as a July 2014 NLRB action holding that McDonald's Corporation could be held jointly liable for labor and wage violations by its franchisees, may also make it easier for a franchisor to be held responsible as employer for a franchisee's misconduct.

We are required to comply with the accessibility standards mandated by the U.S. Americans with Disabilities Act of 1990 and related federal and state statutes, which generally prohibit discrimination in accommodation or employment based on disability. We may, in the future, have to modify our clinics to provide service to or make reasonable accommodations for disabled persons. While these expenses could be material, our current expectation is that any such actions will not require us to expend substantial funds.

We are subject to extensive and varied state and local government regulation affecting the operation of our business, as are our franchisees, including regulations relating to public and occupational health and safety, sanitation, fire prevention and franchise operation. Each franchised clinic is subject to licensing and regulation by a number of governmental authorities, which include zoning, health, safety, sanitation, environmental, building and fire agencies in the jurisdiction in which the clinic is located. We require our franchisees to operate in accordance with standards and procedures designed to comply with applicable codes and regulations. However, our or our franchisees' inability to obtain or retain health or other licenses would adversely affect operations at the impacted clinic or clinics. Although we have not experienced and do not anticipate any significant difficulties, delays or failures in obtaining required licenses, permits or approvals, any such problem could delay or prevent the opening of, or adversely impact the viability of, a particular clinic. In addition, in order to develop and construct our clinics, we need to comply with applicable zoning and land use regulations. Federal and state regulations have not had a material effect on our operations to date, but more stringent and varied requirements of local governmental bodies with respect to zoning and land use could delay or even prevent construction and increase development costs of new clinics.

## **Competition**

The chiropractic industry is highly fragmented. According to First Research's August 2015 report, the top 50 providers of chiropractic services in the United States generate less than 10% of industry revenue. Our competitors include approximately 39,000 independent chiropractic offices currently open throughout the United States as well as certain multi-unit operators. We may also face competition from traditional medical practices, outpatient clinics, physical therapists, med-spas, massage therapists and sellers of devices intended for home use to address back and joint discomfort. Our three largest multi-unit competitors are HealthSource Chiropractic, AlignLife Chiropractic & Natural Health Centers and ChiroOne Wellness Centers, all of which are insurance-based models.

We have identified two competitors who are attempting to duplicate our cash-only, low cost, appointment-free model. Based on publicly available information, these competitors operate ten clinics and two clinics, respectively, as franchises. We anticipate that other direct competitors will join our industry as our visibility, reputation and perceived advantages become more widely known. We believe our first mover advantage, proprietary operations systems, and strong unit level economics will continue to accelerate our growth even with the spawning of additional competition.

## **Employees**

As of March 1, 2017, we had 94 employees on a full-time basis. None of our employees are members of unions or participate in other collective bargaining arrangements.

## **Facilities**

We lease the property for our corporate headquarters and all of the properties on which we own or manage clinics. As of March 1, 2017, we leased 47 facilities in which we operate or intend to operate clinics.

Our corporate headquarters are located at 16767 North Perimeter Drive, Suite 240, Scottsdale, Arizona 85260. The term of our lease for this location expires on July 31, 2019. The primary functions performed at our corporate headquarters are financial, accounting, treasury, marketing, operations, human resources, information systems support and legal.

We are also obligated under non-cancellable leases for the clinics which we own or manage. Our clinics are on average 1,200 square feet. Our clinic leases generally have an initial term of five years, include one to two options to renew for terms of five years, and require us to pay a proportionate share of real estate taxes, insurance, common area maintenance charges and other operating costs.

As of March 1, 2017, our franchisees operated 322 clinics in 29 states. All of our franchise locations are leased.

## Intellectual Property

### *Trademarks, trade names and service marks*

“The Joint Chiropractic” is our trademark, registered in December 2016, under registration number 5095943. We have also registered “Relief. On so many levels” in December 2015, under registration number 4871809, and “The Joint” in April 2015, under registration number 4723892.

Additional trademarks previously registered include “The Joint... the Chiropractic Place” registered in February 2011, under registration number 3922558. We also registered the words, letters, and stylized form of service mark, “The Joint... the Chiropractic Place” in April 2013 under registration number 4323810.

## ITEM 1A. RISK FACTORS

### Risks Related to Our Business

**Our expansion into new markets may be more costly and difficult than we currently anticipate which would result in slower growth than we expect.**

As experienced with our entry into the Chicago market, clinics we open in new markets may take longer to reach expected sales and profit levels on a consistent basis and may have higher construction, occupancy, marketing or operating costs than clinics we open in existing markets, thereby affecting our overall profitability. New markets may have competitive conditions, consumer tastes and discretionary spending patterns that are more difficult to predict or satisfy than our existing markets. We may need to make greater investments than we originally planned in advertising and promotional activity in new markets to build brand awareness. We may find it more difficult in new markets to hire, motivate and keep qualified employees who share our vision and culture. We may also incur higher costs from entering new markets, particularly with company-owned clinics if, for example, we hire and assign regional managers to manage comparatively fewer clinics than in more developed markets. For these reasons, both our new franchised clinics and our new company-owned or managed clinics may be less successful than our existing franchised clinics or may achieve target rates of patient visits at a slower rate. If we do not successfully execute our plans to enter new markets, our business, financial condition and results of operations could be materially adversely affected.

**New clinics, once opened, may not be profitable, and the increases in average clinic sales and comparable clinic sales that we have experienced in the past may not be indicative of future results.**

Our clinics continue to demonstrate increases in comparable clinic sales even as they mature. The annual Comp Sales for clinics that have been open for greater than 48 months was 16.1%. However, we cannot assure you that this will continue for our existing clinics or that clinics we open in the future will see similar results. In new markets, the length of time before average sales for new clinics stabilize is less predictable and can be longer than we expect because our limited knowledge of these markets and consumers' limited awareness of our brand. New clinics may not be profitable and their sales performance may not follow historical patterns. In addition, our average clinic sales and comparable clinic sales for existing clinics may not increase at the rates achieved over the past several years. Our ability to operate new clinics, especially company-owned or managed clinics, profitably and increase average clinic sales and comparable clinic sales will depend on many factors, some of which are beyond our control, including:

- consumer awareness and understanding of our brand;

- general economic conditions, which can affect clinic traffic, local rent and labor costs and prices we pay for the supplies we use;

- changes in consumer preferences and discretionary spending;

- competition, either from our competitors in the chiropractic industry or our own clinics;

- the identification and availability of attractive sites for new facilities and the anticipated commercial, residential and infrastructure development near our new facilities;

- changes in government regulation; and

- other unanticipated increases in costs, any of which could give rise to delays or cost overruns.

If our new clinics do not perform as planned, our business and future prospects could be harmed. In addition, if we are unable to achieve our expected average clinics sales, our business, financial condition and results of operations could be adversely affected.

**Our failure to manage our growth effectively could harm our business and operating results.**

Our growth plan includes a significant number of new clinics, focused currently on franchised clinics, but in the long term, also including company-owned or managed clinics. Our existing clinic management systems, administrative staff, financial and management controls and information systems may be inadequate to support our planned expansion. Those demands on our infrastructure and resources may also adversely affect our ability to manage our existing clinics. Managing our growth effectively will require us to continue to enhance these systems, procedures and controls and to hire, train and retain managers and team members. We may not respond quickly enough to the changing demands that our expansion will impose on our management, clinic teams and existing infrastructure which could harm our business, financial condition and results of operations.

**Our long-term strategy involves opening new, primarily company-owned or managed clinics, and is subject to many unpredictable factors.**

One component of our long-term growth strategy will be to open new company-owned or managed clinics and to operate those clinics on a profitable basis. After the sale or closing of 14 company-owned or managed clinics in Chicago and Upstate New York, we currently own or manage 47 company-owned or managed clinics. We have suspended the development of new company-owned or managed clinics, and when we resume this activity, we may not be able to open new company-owned or managed clinics as quickly as planned. In the past, we have experienced delays in opening some franchised clinics, for various reasons, including the landlord's failure to turn over the premises to our franchisee on a timely basis. Such delays could happen again in future clinic openings. Delays or failures in opening new clinics could materially and adversely affect our growth strategy and our business, financial condition and results of operations. As we operate more clinics, our rate of expansion relative to the size of our clinic base will eventually decline.

In addition, one of our biggest challenges is locating and securing an adequate supply of suitable new clinic sites in our target markets. Competition for those sites is intense, and other medical and retail concepts that compete for those sites may have unit economic models that permit them to bid more aggressively for those sites than we can. There is no guarantee that a sufficient number of suitable sites will be available in desirable areas or on terms that are acceptable to us in order to achieve our growth plan. Our ability to open new clinics also depends on other factors, including:



• negotiating leases with acceptable terms;

• identifying, hiring and training qualified employees in each local market;

• timely delivery of leased premises to us from our landlords and punctual commencement and completion of construction;

• managing construction and development costs of new clinics, particularly in competitive markets;

• obtaining construction materials and labor at acceptable costs, particularly in urban markets;

unforeseen engineering or environmental problems with leased premises;

generating sufficient funds from operations or obtaining acceptable financing to support our future development;

securing required governmental approvals, permits and licenses (including construction permits and operating licenses) in a timely manner and responding effectively to any changes in local, state or federal laws and regulations that adversely affect our costs or ability to open new clinics; and

avoiding the impact of inclement weather, natural disasters and other calamities.

**Opening new clinics in existing markets may negatively affect revenue at our existing clinics.**

The target area of our clinics varies by location and depends on a number of factors, including population density, other available retail services, area demographics and geography. As a result, the opening of a new clinic in or near markets in which we already have clinics could adversely affect the revenues of those existing clinics. Existing clinics could also make it more difficult to build our patient base for a new clinic in the same market. Our business strategy does not entail opening new clinics that we believe will materially affect revenue at our existing clinics, but we may selectively open new clinics in and around areas of existing clinics that are operating at or near capacity to effectively serve our patients. Revenue cannibalization between our clinics may become significant in the future as we continue to expand our operations and could affect our revenue growth, which could, in turn, adversely affect our business, financial condition and results of operations.

**Any acquisitions that we make could disrupt our business and harm our financial condition.**

From time to time, we may evaluate potential strategic acquisitions of existing franchised clinics to facilitate our growth. We may not be successful in identifying acquisition candidates. In addition, we may not be able to continue the operational success of any franchised clinics we acquire or successfully integrate any businesses that we acquire. We may have potential write-offs of acquired assets and an impairment of any goodwill recorded as a result of acquisitions. Furthermore, the integration of any acquisition may divert management's time and resources from our core business and disrupt our operations or may result in conflicts with our business. Any acquisition may not be successful, may reduce our cash reserves and may negatively affect our earnings and financial performance. We cannot ensure that any acquisitions we make will not have a material adverse effect on our business, financial condition and results of operations.

**Damage to our reputation or our brand in existing or new markets could negatively impact our business, financial condition and results of operations.**

We believe we have built our reputation on high quality patient care, and we must protect and grow the value of our brand to continue to be successful in the future. Our brand may be diminished if we do not continue to make investments in areas such as marketing and advertising, as well as the day-to-day investments required for facility operations, equipment upgrades and staff training. Any incident, real or perceived, regardless of merit or outcome, that erodes our brand, such as, failure to comply with federal, state or local regulations including allegations or perceptions of non-compliance or failure to comply with ethical and operating standards, could significantly reduce the value of our brand, expose us to adverse publicity and damage our overall business and reputation. Further, our brand value could suffer and our business could be adversely affected if patients perceive a reduction in the quality of service or staff.

**We may be unable to maintain or improve our operating margins, which could adversely affect our financial condition and ability to grow.**

If we are unable to successfully manage our growth, we may not be able to capture the efficiencies and opportunities that we expect from our expansion strategy. If we are not able to capture expected efficiencies of scale, maintain patient volumes, improve our systems and equipment, continue our cost discipline and retain appropriate chiropractors and overall labor levels, our operating margins may stagnate or decline, which could have a material adverse effect on our business, financial condition and results of operations and adversely affect the price of our common stock.

**We have experienced net losses and may not achieve or sustain profitability in the future.**

We have experienced periods of net losses, including consolidated net losses of approximately \$15.2 and \$8.8 million for the years ended December 31, 2016 and 2015, respectively. Our revenue may not grow and we may not achieve or maintain profitability in the future. Even if we do achieve profitability, we may not sustain or increase profitability on a quarterly or annual basis in the future. Our ability to achieve profitability will be affected by the other risks and uncertainties described in this section and in Management's Discussion and Analysis. If we are not able to achieve, sustain or increase