CORVEL CORP
Form 10-Q
August 14, 2006

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarter ended June 30, 2006

or

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

For this transition period from __________ to __________

Commission file number O-19291
CORVEL CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	33-0282651
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
2010 Main Street, Suite 600 Irvine, CA	92614
(Address of principal executive office)	(zip code)

Registrant s telephone number, including code: (949) 851-1473

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 þ No o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yeso Noþ

The number of shares outstanding of the registrant s Common Stock, $0.0001 Par Value, as of June 30, 2006 was 9,417,025.

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Part I Financial Information
Item 1. Financial Statements
CORVEL CORPORATION
CONSOLIDATED BALANCE SHEETS UNAUDITED

	March 31, 2006	June 30, 2006
Assets		
Current Assets		
Cash and cash equivalents	$ 14,206,000	$ 21,365,000
Accounts receivable, net	39,521,000	39,155,000
Prepaid taxes and expenses	2,221,000	1,956,000
Deferred income taxes	4,521,000	5,426,000
Total current assets	60,469,000	67,902,000
Property and equipment, net	26,459,000	25,021,000
Goodwill and other assets	13,170,000	13,157,000
TOTAL ASSETS	$ 100,098,000	$ 106,080,000
Liabilities and Stockholders Equity		
Current Liabilities		
Accounts and taxes payable	$ 13,712,000	$ 16,837,000
Accrued liabilities	12,160,000	9,823,000
Total current liabilities	25,872,000	26,660,000
Deferred income taxes	6,190,000	5,925,000
Commitments and contingencies		
Stockholders Equity		
Common stock, $.0001 par value: 20,000,000 shares authorized; 16,517,387 shares (9,416,900, net of Treasury shares) and 16,517,512 shares (9,417,025, net of Treasury shares) issued and outstanding at March 31, 2006 and June 30, 2006, respectively	2,000	2,000
Paid-in-capital	61,084,000	61,903,000
Treasury Stock, (7,100,487 shares at March 31, 2006 and 7,100,487 shares at June 30, 2006)	(132,205,000)	(132,205,000)
Retained earnings	139,155,000	143,795,000
Total stockholders equity	68,036,000	73,495,000

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 100,098,000	$ 106,080,000

See accompanying notes to consolidated financial statements.

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CORVEL CORPORATION
CONSOLIDATED INCOME STATEMENTS UNAUDITED

	Three months ended June 30, 2005	2006
REVENUES	$ 70,667,000	$ 69,762,000
Cost of revenues	58,663,000	53,435,000
Gross profit	12,004,000	16,327,000
General and administrative expenses	7,434,000	8,720,000
Income before income tax provision	4,570,000	7,607,000
Income tax provision	1,760,000	2,967,000
NET INCOME	$ 2,810,000	$ 4,640,000
Net income per common and common equivalent share		
Basic	$ 028	$ 0.49
Diluted	$ 0.28	$ 0.49
Weighted average common and common equivalent shares		
Basic	9,960,000	9,417,000
Diluted	10,020,000	9,446,000

See accompanying notes to consolidated financial statements.

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CORVEL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED

	Three months ended June 30, 2005	2006
Cash flows from Operating Activities		
NET INCOME	$ 2,810,000	$ 4,640,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,855,000	2,587,000
Loss on disposal of assets	12,000	85,000
Tax benefit from stock options exercised	270,000	642,000
Stock compensation expense		285,000
Write-off of uncollectible accounts		667,000
Provision for deferred income taxes	(814,000)	(1,170,000)
Changes in operating assets and liabilities		
Accounts receivable	1,695,000	(301,000)
Prepaid taxes and expenses	926,000	265,000
Accounts and taxes payable	2,259,000	3,125,000
Accrued liabilities	(1,277,000)	(2,337,000)
Other assets	11,000	7,000
Net cash provided by operating activities	8,747,000	8,495,000
Cash Flows from Investing Activities		
Additions to property and equipment	(3,322,000)	(1,228,000)
Net cash used in investing activities	(3,322,000)	(1,228,000)
Cash Flows from Financing Activities		
Purchase of treasury stock	(6,212,000)	
Tax effect of stock compensation expense		(111,000)
Exercise of common stock options	1,812,000	3,000
Net cash used in financing activities	(4,400,000)	(108,000)
Increase in cash and cash equivalents	1,025,000	7,159,000
Cash and cash equivalents at beginning	8,945,000	14,206,000
Cash and cash equivalents at end	$ 9,970,000	$ 21,365,000

Supplemental Cash Flow Information:

Income taxes paid	$	14,000	$	116,000
Interest paid		1,000		

See accompanying notes to consolidated financial statements.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2006 (Unaudited)

Note A Basis of Presentation

The unaudited financial statements herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. The accompanying interim financial statements have been prepared under the presumption that users of the interim financial information have either read or have access to the audited financial statements for the latest fiscal year ended March 31, 2006. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the March 31, 2006 audited financial statements have been omitted from these interim financial statements. The consolidated financial statements include the accounts of CorVel and its wholly-owned subsidiaries. Significant intercompany accounts and transactions have been eliminated in consolidation.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending March 31, 2007. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended March 31, 2006 included in the Company s Annual Report on Form 10-K.

Note B Stock Based Compensation

Prior to the quarter ended June 30, 2006, the first quarter of fiscal year ending March 31, 2007, the Company accounted for its stock-based compensation under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25). Under APB 25, no stock option expense was reflected in net income because the Company grants stock options with an exercise price equal to the market price of the underlying common stock on the date of grant.

Effective April 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. (SFAS) 123 (revised 2004), *Share-Based Payment* (SFAS 123R), which requires the measurement and recognition of compensation expense for all share-based payment stock options based on estimated fair values and eliminates the intrinsic value-based method prescribed by APB 25.

The Company adopted SFAS 123R using the modified prospective transition method. Under this transition method, compensation expense is recognized over the applicable vesting periods for all stock options granted prior to, but not yet vested, as of March 31, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123. In accordance with the modified prospective transition method, the Company s consolidated financial statements for prior periods have not been restated to reflect the impact of SFAS 123R.

The Company has historically issued new shares to satisfy option exercises.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note B Stock Based Compensation (continued)

The table below shows the amounts recognized in the financial statements for the three months ended June 30, 2006 for stock-based compensation.

		Three months Ended June 30, 2006
Cost of revenues	$	225,000
General and administrative		60,000
Total cost of stock-based compensation included in income, before income tax		285,000
Amount of income tax benefit recognized		111,000
Amount charged against income	$	174,000
Effect on diluted income per share	$	(.02)

For purposes of pro forma disclosures under SFAS 123 for the three months ended June 30, 2005, the estimated fair value of options was assumed to be amortized to expense over the vesting period of the award. There is not pro forma presentation for the three months ended June 30, 2006 as the Company adopted SFAS 123R as of April 1, 2006, as discussed above. The following table illustrates the effect on net income had the Company applied the fair value recognition provisions of SFAS 123, *Accounting for Stock-Based Compensation* (SFAS 123), as amended by SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS 148) for the three months ended June 30, 2005 (in thousands):

		Three Months Ended June 30, 2005
Net income	$	2,810,000
Deduct: Stock-based compensation cost, net of income taxes		(183,000)
Pro forma net income	$	2,627,000
Net income per share basic		
As reported	$	0.28
Pro forma	$	0.26

Net income per share diluted		
As reported	$	0.28
Pro forma	$	0.26

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note B Stock Based Compensation (continued)

The Company records compensation expense for employee stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes option-pricing model with the assumptions included in the table below. The Company uses historical data among other factors to estimate the expected volatility, the expected option life, and the expected forfeiture rate. The risk-free rate is based on the interest rate paid on a U.S. Treasury issue with a term similar to the estimated life of the option. The weighted average expected option term for 2006 reflects the application of the simplified method defined in the Securities and Exchange Commission Staff Accounting Bulletin No. 107, which defines the life as the average of the contractual term of the options and the weighted average vesting period for all option tranches. Based upon the historical experience of options cancellations, the Company has estimated an annualized forfeiture rate of 9.0%. Forfeiture rates will be adjusted over the requisite service period when actual forfeitures differ, or are expected to differ, from the estimate. The following assumptions were used to estimate the fair value of options granted during the three months ended June 30, 2005 and 2006 using the Black-Scholes option-pricing model:

	Three Months Ended June 30,	
	2005	2006
Risk-free interest rate	4.0%	4.9%
Expected volatility	37%	40%
Expected dividend yield	0.0	0.0
Expected forfeiture rate	9.0%	9.0%
Expected weighted average life of option in years	4.7 years	4.8 years

Under the Company s Restated 1988 Executive Stock Option Plan, (the Plan) as amended, options for up to 5,955,000 shares of the Company s common stock may be granted at prices not less than 85% of the fair value of the Company s common stock on date of grant, as determined by the Board. Options granted under the Plan may be either incentive stock options or non-statutory stock options, and options granted generally have a maximum life of five years. Options will generally become exercisable for 25% of the options shares one year from the date of grant and then ratably over the following 36 months, respectively. All options granted in the three months ended June 30, 2005 and 2006 were granted at fair market value and are non-statutory stock options. Summarized information for all stock options for the three months ended June 30, 2005 and 2006 follows:

	Three months ended June 30, 2005		Three months ended June 30, 2006	
	Shares	Average Price	Shares	Average Price
Options outstanding, beginning	969,887	$ 25.29	847,082	$ 25.92
Options granted	33,300	20.25	193,550	23.30
Options exercised	(98,815)	17.69	(125)	20.20
Options cancelled	(17,989)	27.92	(83,599)	24.63
Options outstanding, ending	886,383	$ 25.90	956,908	$ 25.50

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note B Stock Based Compensation (continued)

A summary of the status for all outstanding options at March 31, 2006 and June 30, 2006, and changes during the quarter then ended is presented in the table below:

	Number of Options	Weighted Average Exercise Per Share	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value as of June 30, 2006
Options outstanding at March 31, 2006	847,082	$ 25.92		
Granted	193,550	23.30		
Exercised	(125)	20.20		
Cancelled forfeited	(6,188)	22.07		
Cancelled expired	(77,411)	24.84		
Ending outstanding	956,908	$ 25.50	3.32	$ 2,218,036
Ending vested and expected to vest	875,597	$ 25.73	0.84	$ 2,031,549
Ending exercisable	492,214	$ 27.20	2.10	$ 1,089,344

As of June 30, 2006, unrecognized compensation expense related to unvested stock options totaled approximately $1.1 million, which will be recognized over a weighted period of 2.2 years.

The weighted-average grant-date fair value of options granted during the three months ended June 30, 2005 and June 30, 2006, was $6.34 and $8.08, respectively. The total intrinsic value for options exercised (i.e., the difference between the market price at exercise and the price paid by the employee to exercise the options) during the three months ended June 30, 2005 and 2006 was $702,000 and $1,000, respectively.

Prior to the adoption of SFAS 123R, the Company presented the tax benefit of all tax deductions resulting for the exercise of stock options and restricted stock awards as operating activities in the Consolidated Statements of Cash Flows. SFAS 123R requires the benefits of tax deductions in excess of grant-date fair value be reported as a financing activity, rather than an operating activity.

Note C Treasury Stock

The Company s Board of Directors approved the commencement of a share repurchase program in the fall of 1996. In June 2006, the Company s Board of Directors approved a 1,000,000 share expansion to its existing stock repurchase plan, increasing the total number of shares approved for repurchase to 8,100,000 shares from 7,100,000 shares. Since the commencement of the share repurchase program, the Company has spent $132 million to repurchase 7,100,487 shares of its common stock, equal to 43% of the outstanding common stock had there been no repurchases. The average price of these repurchases is $18.62 per share. During the quarter ended June 30, 2006, the Company did not repurchase any shares of its common stock. These purchases have been funded primarily from the net earnings of the Company, along with the proceeds from the exercise of common stock options, the employee stock purchase plan and related income tax benefits from the exercise of these options. CorVel has 9,417,025 shares of common stock outstanding as of June 30, 2006, after reduction for the 7,100,487 shares in treasury.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note D Weighted Average Shares and Net Income Per Share

Weighted average basic common and common equivalent shares decreased from 9,960,000 for the quarter ended June 30, 2005 to 9,417,000 for the quarter ended June 30, 2006. Weighted average diluted common and common equivalent shares decreased from 10,020,000 for the quarter ended June 30, 2005 to 9,446,000 for the quarter ended June 30, 2006. The net decrease in both of these weighted share calculations is due to the repurchase of common stock as noted above offset by an increase in shares outstanding due to the exercise of stock options in the Company s employee stock option plan.

Net income per common and common equivalent shares was computed by dividing net income by the weighted average number of common and common stock equivalents outstanding during the quarter. The calculations of the basic and diluted weighted shares for the three months ended June 30, 2005 and 2006, are as follows:

	Three months ended June 30,	
Basic Income Per Share:	2005	2006
Weighted average common shares outstanding	9,960,000	9,417,000
Net Income	$ 2,810,000	$ 4,640,000
Net Income per share	$ .28	$ 0.49

	Three months ended June 30,	
Diluted Income Per Share:	2005	2006
Weighted average common shares outstanding	9,960,000	9,417,000
Treasury stock impact of stock options	60,000	29,000
Total common and common equivalent shares	10,020,000	9,446,000
Net Income	$ 2,810,000	$ 4,640,000
Net Income per share	$ .28	$ 0.49

For the quarters ended June 30, 2005 and June 30, 2006, 531,039 and 770,253 anti-dilutive shares, respectively, have been excluded from the diluted weighted shares outstanding calculation.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note E Shareholder Rights Plan

During fiscal 1997, the Company s Board of Directors approved the adoption of a Shareholder Rights Plan. The Shareholder Rights Plan provides for a dividend distribution to CorVel stockholders of one preferred stock purchase right for each outstanding share of CorVel s common stock under certain circumstances. In April 2002, the Board of Directors of CorVel approved an amendment to the Company s existing shareholder rights agreement to extend the expiration date of the rights to February 10, 2012, increase the initial exercise price of each right to $118 and enable Fidelity Management & Research Company and its affiliates to purchase up to 18% of the shares of common stock of the Company without triggering the stockholder rights. The limitations under the stockholder rights agreement remain in effect for all other stockholders of the Company. The rights are designed to assure that all shareholders receive fair and equal treatment in the event of any proposed takeover of the Company and to encourage a potential acquirer to negotiate with the Board of Directors prior to attempting a takeover. The rights have an exercise price of $118 per right, subject to subsequent adjustment. The rights trade with the Company s common stock and will not be exercisable until the occurrence of certain takeover-related events.

Generally, the Shareholder Rights Plan provides that if a person or group acquires 15% or more of the Company s common stock without the approval of the Board, subject to certain exception, the holders of the rights, other than the acquiring person or group, would, under certain circumstances, have the right to purchase additional shares of the Company s common stock having a market value equal to two times the then-current exercise price of the right.

In addition, if the Company is thereafter merged into another entity, or if 50% or more of the Company s consolidated assets or earning power are sold, then the right will entitle its holder to buy common shares of the acquiring entity having a market value equal to two times the then-current exercise price of the right. The Company s Board of Directors may exchange or redeem the rights under certain conditions.

Note F Components of the Balance Sheet

	March 31, 2006	June 30, 2006 (Unaudited)
Accrued liabilities		
Payroll and related benefits	$ 6,859,000	$ 5,906,000
Self-insurance accruals	3,644,000	3,722,000
Other	1,657,000	195,000
	$ 12,160,000	$ 9,823,000

Note G Recent Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board (FASB) issued FAS No. 154, Accounting Changes and Error Corrections (FAS 154). SFAS No. 154 is a replacement of APB No. 20 and SFAS No. 3. SFAS No. 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application as the required method for reporting a change in accounting principle. SFAS No. 154 provides guidance for determining whether retrospective application of a change in accounting principle is impracticable and for reporting a change when retrospective application is impracticable. SFAS No. 154 also addresses the reporting of a correction of an error by restating previously issued financial statements. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS No. 154 is not expected to have a material impact on the Company s financial statements.

In March 2005, the FASB issued FASB Interpretation No. (FIN) 47, Accounting for Conditional Asset Retirement Obligations, which is effective for fiscal years ending after December 15, 2005. The interpretation requires a conditional asset retirement obligation to be recognized when the fair value of the liability can be reasonably estimated. The interpretation is not expected to have a material impact on the Company s financial statements.

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, which defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authority. A tax position that meets the more-likely-than-not criterion shall be measured at the largest amount of benefit that is more than 50% likely of being realized upon ultimate settlement. Interpretation No. 48 applies to all tax positions accounted for under SFAS No. 109, Accounting for Income Taxes. Interpretation No. 48 is effective for fiscal years beginning after December 15, 2006. Upon adoption, we will adjust our financial statements to reflect only those tax positions that are more-likely-than-not to be sustained as of the adoption date. Any adjustment will be recorded directly to our beginning retained earnings balance in the period of adoption and reported as a change in accounting principle. The Company is currently analyzing the effects of adopting Interpretation No. 48.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note H Business Enterprise Segments

We operate in one reportable operating segment, managed care. The Company s services are delivered to its customers through its local offices in each region and financial information for the Company s operations follows this service delivery model. All regions provide the Company s patient management and network solutions services. Statement of Financial Accounting Standards, or SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, establishes standards for the way that public business enterprises report information about operating segments in annual consolidated financial statements. The Company s internal financial reporting is segmented geographically, as discussed above, and managed on a geographic rather than service line basis, with virtually all of the Company s operating revenue generated within the United States.

Under SFAS 131, two or more operating segments may be aggregated into a single operating segment for financial reporting purposes if aggregation is consistent with the objective and basic principles of SFAS 131, if the segments have similar economic characteristics, and if the segments are similar in each of the following areas: 1) the nature of products and services, 2) the nature of the production processes; 3) the type or class of customer for their products and services; and 4) the methods used to distribute their products or provide their services. We believe each of the Company s regions meet these criteria as they provide the similar services to similar customers using similar methods of productions and similar methods to distribute their services.

Note I Employee Stock Purchase Plan

There were no shares issued under the Company s Employee Stock Purchase Plan during either the quarter ended June 30, 2005 or June 30, 2006.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management s Discussion and Analysis of Financial Condition and Results of Operations may include certain forward-looking statements, 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, including (without limitation) statements with respect to anticipated future operating and financial performance, growth and acquisition opportunities and other similar forecasts and statements of expectation. Words such as expects, anticipates, intends, plans, believes, se estimates and should and variations of these words and similar expressions, are intended to identify these forward-looking statements. Forward-looking statements made by the Company and its management are based on estimates, projections, beliefs and assumptions of management at the time of such statements and are not guarantees of future performance.

The Company disclaims any obligations to update or revise any forward-looking statement based on the occurrence of future events, the receipt of new information or otherwise. Actual future performance, outcomes and results may differ materially from those expressed in forward-looking statements made by the Company and its management as a result of a number of risks, uncertainties and assumptions. Representative examples of these factors include (without limitation) general industry and economic conditions; cost of capital and capital requirements; competition from other managed care companies; the ability to expand certain areas of the Company s business; shifts in customer demands; the ability of the Company to produce market-competitive software; changes in operating expenses including employee wages, benefits and medical inflation; governmental and public policy changes; dependence on key personnel; possible litigation and legal liability in the course of operations; and the continued availability of financing in the amounts and at the terms necessary to support the Company s future business.

Overview

CorVel Corporation is an independent nationwide provider of medical cost containment and managed care services designed to address the escalating medical costs of workers compensation and auto policies. The Company s services are provided to insurance companies, third-party administrators (TPA s), and self-administered employers to assist them in managing the medical costs and monitoring the quality of care associated with healthcare claims.

Network Solutions Services

The Company s network solutions services are designed to reduce the price paid by its customers for medical services rendered in workers compensation cases, and auto policies and, to a lesser extent, group health policies. The network solutions offered by the Company include automated medical fee auditing, preferred provider services, retrospective utilization review, independent medical examinations, MRI examinations, and inpatient bill review.

Patient Management Services

In addition to its network solutions services, the Company offers a range of patient management services, which involve working on a one-on-one basis with injured employees and their various healthcare professionals, employers and insurance company adjusters. The services are designed to monitor the medical necessity and appropriateness of healthcare services provided to workers compensation and other healthcare claimants and to expedite return to work. The Company offers these services on a stand-alone basis, or as an integrated component of its medical cost containment services.

Organizational Structure

The Company s management is structured geographically with regional vice-presidents who report to the President of the Company. Each of these regional vice-presidents is responsible for all services provided by the Company in his or her particular region and for the operating results of the Company in multiple states. These

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regional vice presidents have area and district managers who are also responsible for all services provided by the Company in their given area and district.

Business Enterprise Segments

We operate in one reportable operating segment, managed care. The Company s services are delivered to its customers through its local offices in each region and financial information for the Company s operations follows this service delivery model. All regions provide the Company s patient management and network solutions services. Statement of Financial Accounting Standards, or SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, establishes standards for the way that public business enterprises report information about operating segments in annual consolidated financial statements. The Company s internal financial reporting is segmented geographically, as discussed above, and managed on a geographic rather than service line basis, with virtually all of the Company s operating revenue generated within the United States.

Under SFAS 131, two or more operating segments may be aggregated into a single operating segment for financial reporting purposes if aggregation is consistent with the objective and basic principles of SFAS 131, if the segments have similar economic characteristics, and if the segments are similar in each of the following areas: 1) the nature of products and services, 2) the nature of the production processes; 3) the type or class of customer for their products and services; and 4) the methods used to distribute their products or provide their services. W