

CORVEL CORP  
Form 10-Q  
November 07, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2012

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 0-19291

**CORVEL CORPORATION**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)  
**2010 Main Street, Suite 600**

**33-0282651**  
(IRS Employer  
Identification No.)

**Irvine, CA**  
(Address of principal executive office)  
**92614**  
(zip code)  
**Registrant's telephone number, including area 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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) 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 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 Exchange Act). Yes  No

The number of shares outstanding of the registrant's Common Stock, \$0.0001 par value per share, as of October 30, 2012 was 11,211,289.

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**CORVEL CORPORATION**

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Part I - Financial Information

Item 1. Financial Statements

**CORVEL CORPORATION****CONSOLIDATED BALANCE SHEETS**

	March 31, 2012	September 30, 2012 (Unaudited)
<b>Assets</b>		
Current Assets		
Cash and cash equivalents (Note A)	\$ 6,597,000	\$ 20,014,000
Customer deposits	5,816,000	7,311,000
Accounts receivable, net	49,334,000	48,747,000
Prepaid taxes and expenses	12,263,000	7,811,000
Deferred income taxes	7,237,000	7,389,000
Total current assets	81,247,000	91,272,000
Property and equipment, net	47,364,000	45,611,000
Goodwill	36,814,000	36,814,000
Other intangibles, net (Note F)	6,146,000	5,898,000
Other assets	311,000	259,000
<b>TOTAL ASSETS</b>	<b>\$ 171,882,000</b>	<b>\$ 179,854,000</b>
<b>Liabilities and Stockholders Equity</b>		
Current Liabilities		
Accounts and taxes payable	\$ 12,773,000	\$ 11,400,000
Accrued liabilities	31,989,000	31,829,000
Total current liabilities	44,762,000	43,229,000
Deferred income taxes	16,738,000	16,738,000
Commitments and contingencies (Note G and H)		
Stockholders Equity		
Common stock, \$.0001 par value: 120,000,000 shares authorized at March 31, 2012 and September 30, 2012; 26,261,874 shares issued (11,308,773 shares outstanding, net of Treasury shares) and 26,350,824 shares issued (11,238,777 shares outstanding, net of Treasury shares) at March 31, 2012 and September 30, 2012, respectively	3,000	3,000
Paid-in capital	105,907,000	109,122,000
Treasury Stock (14,953,101 shares at March 31, 2012 and 15,112,047 shares at September 30, 2012)	(270,574,000)	(277,510,000)
Retained earnings	275,046,000	288,272,000
Total stockholders equity	110,382,000	119,887,000
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 171,882,000</b>	<b>\$ 179,854,000</b>

See accompanying notes to consolidated financial statements.



**Table of Contents****CORVEL CORPORATION****CONSOLIDATED INCOME STATEMENTS    UNAUDITED**

	Three Months Ended September 30,	
	2011	2012
<b>REVENUES</b>	<b>\$ 104,552,000</b>	<b>\$ 105,458,000</b>
Cost of revenues	78,940,000	82,622,000
<b>Gross profit</b>	<b>25,612,000</b>	<b>22,836,000</b>
General and administrative expenses	12,592,000	11,981,000
<b>Income before income tax provision</b>	<b>13,020,000</b>	<b>10,855,000</b>
Income tax provision	5,139,000	4,225,000
<b>NET INCOME</b>	<b>\$ 7,881,000</b>	<b>\$ 6,630,000</b>
Net income per common and common equivalent share		
Basic	\$ 0.68	\$ 0.59
Diluted	\$ 0.68	\$ 0.58
Weighted average common and common equivalent shares		
Basic	11,526,000	11,270,000
Diluted	11,672,000	11,376,000
See accompanying notes to consolidated financial statements.		

**Table of Contents****CORVEL CORPORATION****CONSOLIDATED INCOME STATEMENTS    UNAUDITED**

	Six Months Ended September 30,	
	2011	2012
<b>REVENUES</b>	<b>\$ 206,860,000</b>	<b>\$ 210,064,000</b>
Cost of revenues	155,704,000	164,047,000
<b>Gross profit</b>	<b>51,156,000</b>	<b>46,017,000</b>
General and administrative expenses	24,886,000	24,155,000
<b>Income before income tax provision</b>	<b>26,270,000</b>	<b>21,862,000</b>
Income tax provision	10,191,000	8,636,000
<b>NET INCOME</b>	<b>\$ 16,079,000</b>	<b>\$ 13,226,000</b>
Net income per common and common equivalent share		
Basic	\$ 1.39	\$ 1.17
Diluted	\$ 1.37	\$ 1.16
Weighted average common and common equivalent shares		
Basic	11,572,000	11,292,000
Diluted	11,729,000	11,401,000
See accompanying notes to consolidated financial statements.		

**Table of Contents****CORVEL CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED**

	Six Months Ended September 30,	
	2011	2012
<b><i>Cash flows from Operating Activities</i></b>		
<b>NET INCOME</b>	\$ 16,079,000	\$ 13,226,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,987,000	7,944,000
Loss on disposal of assets	116,000	390,000
Stock compensation expense	1,329,000	387,000
Write-off of uncollectible accounts	1,305,000	1,142,000
Deferred income tax	(461,000)	(152,000)
Changes in operating assets and liabilities		
Accounts receivable	(3,167,000)	(554,000)
Customer deposits	433,000	(1,495,000)
Prepaid taxes and expenses	(191,000)	4,669,000
Other assets		52,000
Accounts and taxes payable	3,366,000	(1,590,000)
Accrued liabilities	(9,923,000)	(160,000)
Net cash provided by operating activities	15,873,000	23,859,000
<b><i>Cash Flows from Investing Activities</i></b>		
Purchase of property and equipment	(11,658,000)	(6,334,000)
Net cash (used in) investing activities	(11,658,000)	(6,334,000)
<b><i>Cash Flows from Financing Activities</i></b>		
Purchase of treasury stock	(10,005,000)	(6,937,000)
Tax effect of stock option exercises	973,000	1,845,000
Exercise of common stock options	525,000	823,000
Exercise of employee stock purchase options	157,000	161,000
Net cash (used in) financing activities	(8,350,000)	(4,108,000)
<b><i>Increase (decrease) in cash and cash equivalents</i></b>	(4,135,000)	13,417,000
Cash and cash equivalents at beginning of period	12,269,000	6,597,000
Cash and cash equivalents at end of period	\$ 8,134,000	\$ 20,014,000
<b>Supplemental Cash Flow Information:</b>		
Income taxes paid	\$ 7,288,000	\$ 3,010,000
Purchase of software license under finance agreement	\$ 861,000	\$
See accompanying notes to consolidated financial statements.		



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**CORVEL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2012**

**Note A Basis of Presentation and Summary of Significant Accounting Policies**

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, 2012. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the March 31, 2012 audited financial statements have been omitted from these interim financial statements.

The Company evaluated all subsequent events or transactions through the date of filing this report. During the period subsequent to September 30, 2012, the Company repurchased 30,628 shares for \$1,355,000 for an average of \$44.24 per share. These shares were repurchased under the Company's ongoing share repurchase program described in Note C.

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 considered necessary for a fair presentation have been included. Operating results for the three and six months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2013. For further information, refer to the consolidated financial statements and footnotes for the fiscal year ended March 31, 2012 included in the Company's Annual Report on Form 10-K.

*Basis of Presentation:* The consolidated financial statements include the accounts of CorVel and its subsidiaries. Significant intercompany accounts and transactions have been eliminated in consolidation.

*Use of Estimates:* The preparation of financial statements in compliance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements. Actual results could differ from those estimates. Significant estimates include the values assigned to intangible assets, capitalized software development, the allowance for doubtful accounts, accrual for income taxes, purchase price allocation for acquisitions, shared-based payments related to performance based awards, loss contingencies, estimated claims for claims administration revenue recognition, estimates used in stock option valuations, and accrual for self-insurance reserves.

*Cash and Cash Equivalents:* Cash and cash equivalents consist of short-term highly-liquid investment-grade interest-bearing securities with maturities of 90 days or less when purchased. The carrying amounts of the Company's financial instruments approximate their fair values at March 31, 2012 and September 30, 2012.

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**CORVEL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2012**

**Note A Basis of Presentation and Summary of Significant Accounting Policies (continued)**

*Fair Value of Financial Instruments:* The Company applies ASC 820, Fair Value Measurements and Disclosures which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements with respect to fair value measurements of (a) nonfinancial assets and liabilities that are recognized or disclosed at fair value in the Company's Consolidated Financial Statements on a recurring basis (at least annually) and (b) all financial assets and liabilities. ASC 820 prioritizes the inputs used in measuring fair value into the following hierarchy:

Level 1 Quoted market prices in active markets for identical assets or liabilities;

Level 2 Observable inputs other than those included in Level 1 (for example, quoted prices for similar assets in active markets or quoted prices for identical assets in inactive markets); and

Level 3 Unobservable inputs reflecting management's own assumptions about the inputs used in estimating the value of the asset.

The carrying amount of the Company's financial instruments (i.e. cash, accounts receivable, accounts payable, etc.) are all Level 1 and approximate their fair values at March 31, 2012 and September 30, 2012. The Company has no Level 2 or Level 3 assets.

*Goodwill:* The Company accounts for its business combinations in accordance with the Financial Accounting Standards Board (FASB) ASC 805-10 through ASC 805-50 *Business Combinations* which requires that the purchase method of accounting be applied to all business combinations and addresses the criteria for initial recognition of intangible assets and goodwill. In accordance with FASB ASC 350-10 through ASC 350-30, goodwill and other intangible assets with indefinite lives are not amortized but are tested for impairment annually, or more frequently if circumstances indicate the possibility of impairment. If the carrying value of goodwill or an intangible asset exceeds its fair value, an impairment loss shall be recognized.

*Revenue Recognition:* The Company recognizes revenue when there is persuasive evidence of an arrangement, the services have been provided to the customer, the sales price is fixed or determinable, and collectability is reasonably assured. For the Company's services, as the Company's professional staff performs work, they are contractually permitted to bill for fees earned in fraction of an hour increments worked or by units of production. The Company recognizes revenue as the time is worked or as units of production are completed, which is when the revenue is earned and realized. Labor costs are recognized as the costs are incurred. The Company derives its revenue from the sale of Network Solutions and Patient Management services. Network Solutions and Patient Management services may be sold individually or combined. When a sale combines multiple elements, the Company accounts for multiple element arrangements in accordance with the guidance included in ASC 605-25.

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**CORVEL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2012**

**Note A Basis of Presentation and Summary of Significant Accounting Policies (continued)**

In accordance with ASC 605-25, the Company allocates revenue for transactions or collaborations that include multiple elements to each unit of accounting based on its relative fair value, and recognizes revenue for each unit of accounting when the revenue recognition criteria have been met. The price charged when the element is sold separately generally determines fair value. When the Company's customers purchase several products, the pricing of the products sold is generally the same as if the product were sold on an individual basis. As a result, the fair value of each product sold in a multiple element arrangement is almost always determinable. In the absence of fair value of a delivered element, the Company would allocate revenue first to the fair value of the undelivered elements and the residual revenue to the delivered elements. The Company recognizes revenue for delivered elements when the delivered elements have standalone value and the Company has objective and reliable evidence of fair value for each undelivered element. If the fair value of any undelivered element included in a multiple element arrangement cannot be objectively determined, revenue is deferred until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements. Based upon the nature of the Company's products, bundled products are generally delivered in the same accounting period. The Company recognizes revenue for claims administration services over the life of the contract with its customers. The Company estimates, based upon prior experience in managing claims, the deferral amount from when the claim is received to when the customer contract expires.

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**CORVEL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2012**

**Note A Basis of Presentation and Summary of Significant Accounting Policies (continued)**

*Recent Accounting Pronouncements:* In September, 2011, the FASB issued ASU 2011-08, Intangibles—Goodwill and Other (Topic 350), Testing Goodwill for Impairment. ASU 2011-08 simplifies how a company is required to test goodwill for impairment. Companies will now have the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If after considering the totality of events and circumstances an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, performing the two-step impairment test is unnecessary. The amendment is effective for the Company beginning January 1, 2012, with early adoption permitted. The Company adopted this guidance in the quarter ended December 31, 2011. The adoption of this guidance did not have a material impact on the financial statements.

*Accounts Receivable:* The majority of the Company's accounts receivable are due from companies in the property and casualty insurance industries, self-insured employers, and government entities. Accounts receivable are generally due within 30 days and are stated as amounts due from customers net of an allowance for doubtful accounts. Those accounts outstanding longer than the contractual payment terms are considered past due. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company and the condition of the general economy and the industry as a whole. No one customer accounted for 10% or more of accounts receivable at either March 31, 2012 or September 30, 2012. No one customer accounted for 10% or more of revenue during either of the three month periods ended September 30, 2011 or 2012.

*Property and Equipment:* Additions to property and equipment are recorded at cost. Depreciation and amortization are provided using the straight-line method over the estimated useful lives of the related assets, which range from one to seven years. The Company accounts for internally developed software costs in accordance with FASB ASC 350-40, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, which allows for the capitalization of software developed for internal use. These costs are included in computer software in property and equipment and are amortized over a period of five years.

*Long-Lived Assets:* The carrying amount of all long-lived assets is evaluated periodically to determine if adjustment to the depreciation and amortization period or to the unamortized balance is warranted. Such evaluation is based principally on the expected utilization of the long-lived assets and the projected, undiscounted cash flows of the operations in which the long-lived assets are deployed.

*Income Taxes:* The Company provides for income taxes in accordance with provisions specified in ASC 740, *Accounting for Income Taxes*. Accordingly, deferred income tax assets and liabilities are computed for differences between the financial statement and tax bases of assets and liabilities. These differences will result in taxable or deductible amounts in the future, based on tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences become deductible. In making an assessment regarding the probability of realizing a benefit from these deductible differences, management considers the Company's current and past performance, the market environment in which the Company operates, tax-planning strategies and the length of carry-forward periods for loss carry-forwards, if any. Valuation allowances are established when necessary to reduce deferred tax assets to amounts that are more likely than not to be realized. Further, the Company provides for income tax issues not yet resolved with federal, state and local tax authorities. The balance of the unrecognized tax benefits as of March 31, 2012 and September 30, 2012 was \$983,000 and \$991,000, respectively.

**Table of Contents****CORVEL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****September 30, 2012****Note A Basis of Presentation and Summary of Significant Accounting Policies (continued)**

*Earnings Per Share:* Earnings per common share-basic is based on the weighted average number of common shares outstanding during the period. Earnings per common shares-diluted is based on the weighted average number of common shares and common share equivalents outstanding during the period. In calculating earnings per share, earnings are the same for the basic and diluted calculations. Weighted average shares outstanding decreased in the September 2012 quarter compared to the same quarter of the prior year primarily due to repurchase of shares under the Company's share repurchase program. See also Note D.

**Note B Stock Based Compensation and Stock Options**

Under the Company's Restated Omnibus Incentive Plan (Formerly The Restated 1988 Executive Stock Option Plan) (the Plan) as in effect at September 30, 2012, options for up to 9,682,500 shares of the Company's common stock may be granted over the life of the Plan to key employees, non-employee directors and consultants at exercise prices not less than the fair market value of the stock at the date of grant. Options granted under the Plan are non-statutory stock options and generally vest 25% one year from date of grant and the remaining 75% vesting ratably each month for the next 36 months. The options granted to employees and the board of directors expire at the end of five years and ten years from date of grant, respectively.

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. Based upon the historical experience of options cancellations, the Company has estimated an annualized forfeiture rate of 9.36% and 11.86% for the three months ended September 30, 2011 and 2012, respectively. 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 September 30, 2011 and 2012 using the Black-Scholes option-pricing model:

	Three Months Ended September 30,	
	2011	2012
Risk-free interest rate	1.13%	0.61%
Expected volatility	47%	47%
Expected dividend yield	0.00%	0.00%
Expected forfeiture rate	9.36%	11.86%
Expected weighted average life of option in years	4.7 years	4.5 years

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All options granted in the six months ended September 30, 2011 and 2012 were granted at fair market value and are non-statutory stock options.

The table below shows the amounts recognized in the financial statements for stock compensation expense for time based options and performance based options during the three and six months ended September 30, 2011 and 2012, respectively.

	Three Months Ended	
	September 30, 2011	September 30, 2012
Cost of revenues	\$ 125,000	\$ 115,000
General and administrative	546,000	(26,000)
<b>Total cost of stock-based compensation included in income before income tax provision</b>	<b>671,000</b>	<b>89,000</b>
Amount of income tax benefit recognized	(262,000)	(35,000)
<b>Amount charged against net income</b>	<b>\$ 409,000</b>	<b>\$ 54,000</b>
Effect on diluted net income per share	\$ (0.04)	\$
	Six Months Ended	
	September 30, 2011	September 30, 2012
Cost of revenues	\$ 250,000	\$ 228,000
General and administrative	1,079,000	159,000
<b>Total cost of stock-based compensation included in income before income tax provision</b>	<b>1,329,000</b>	<b>387,000</b>
Amount of income tax benefit recognized	(520,000)	(150,000)
<b>Amount charged against income</b>	<b>\$ 809,000</b>	<b>\$ 237,000</b>
Effect on diluted income per share	\$ (0.07)	\$ (0.02)

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Summarized information for all stock options for the three and six months ended September 30, 2011 and 2012 follows:

	Three Months Ended September 30, 2011		Three Months Ended September 30, 2012	
	Shares	Average Price	Shares	Average Price
Options outstanding, beginning	797,377	\$ 29.87	651,903	\$ 34.59
Options granted	29,550	43.73	20,550	44.14
Options exercised	(26,429)	23.51	(36,106)	24.55
Options cancelled	(1,625)	25.31	(4,082)	45.05
Options outstanding, ending	798,873	\$ 30.62	632,265	\$ 35.41

  

	Six Months Ended September 30, 2011		Six Months Ended September 30, 2012	
	Shares	Average Price	Shares	Average Price
Options outstanding, beginning	813,622	\$ 29.26	751,323	\$ 34.19
Options granted	45,225	45.75	31,700	43.06
Options exercised	(54,973)	23.17	(101,679)	25.13
Options cancelled	(5,001)	28.20	(49,079)	43.08
Options outstanding, ending	798,873	\$ 30.62	632,265	\$ 35.41

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September 30, 2012

**Note B Stock Options and Stock-Based Compensation (continued)**

The following table summarizes the status of stock options outstanding and exercisable at September 30, 2012:

Range of Exercise Price	Number of Outstanding Options	Weighted Average Remaining Contractual Life	Outstanding Options Weighted Average Exercise Price	Exercisable Options Number of Exercisable Options	Exercisable Options Weighted Average Exercise Price
\$ 15.55 to \$ 25.42	159,872	2.39	\$ 20.60	138,553	\$ 20.32
\$ 25.43 to \$ 35.20	156,145	2.36	\$ 29.55	110,754	\$ 29.47
\$ 35.21 to \$ 46.00	133,177	5.09	\$ 40.97	45,955	\$ 39.58
\$ 46.01 to \$ 52.76	183,071	3.30	\$ 49.28	22,341	\$ 46.85
<b>Total</b>	<b>632,265</b>	<b>3.22</b>	<b>\$ 35.40</b>	<b>317,603</b>	<b>\$ 28.16</b>

A summary of the status for all outstanding options at September 30, 2012, and changes during the three months 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 September 30, 2012
Options outstanding at July 1, 2012	651,903	\$ 34.59		
Granted	20,550	44.14		
Exercised	(36,106)	24.55		
Cancelled forfeited	(904)	44.40		
Cancelled expired	(3,178)	44.86		
Ending outstanding	632,265	\$ 35.40	3.22	\$ 6,744,814
Ending vested and expected to vest	568,347	\$ 34.09	3.14	\$ 6,638,441
Ending exercisable at September 30, 2012	317,603	\$ 28.16	2.71	\$ 5,318,951

The weighted-average grant-date fair value of options granted during the three months ended September 30, 2011 and 2012, was \$17.59 and \$17.34, respectively.

Included in the above-noted stock option grants and stock compensation expense are performance based stock options under which vesting occurs only upon the Company achieving certain revenue or earnings per shares targets as determined by the Company's board of directors. These options were valued in the same manner as the time vesting options. However, the Company only recognizes stock compensation to the



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extent that the targets are determined to be achieved which allow the options to vest. The Company recognized \$334,000 and \$0 of stock compensation expense for the three months ended September 30, 2011 and September 30, 2012, respectively, for performance based stock options.

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**CORVEL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2012**

**Note C Treasury Stock and Subsequent Event**

The Company's Board of Directors initially approved the commencement of a share repurchase program in the fall of 1996. In February 2012, the Board approved a 1,000,000 share expansion of the repurchase program to 16,000,000 shares over the life of the share repurchase program. Since the commencement of the share repurchase program, the Company has spent \$278 million to repurchase 15,112,047 shares of its common stock, equal to 57% of the outstanding common stock had there been no repurchases. The average price of these repurchases is \$18.36 per share. These purchases have been funded primarily from the net earnings of the Company, along with the proceeds from the exercise of common stock options. During the three months and six months ended September 30, 2012, the Company repurchased 72,274 shares for \$3.3 million and 158,946 shares for \$7 million, respectively. The Company had 11,238,777 shares of common stock outstanding as of September 30, 2012, net of the 15,112,047 shares in treasury. Subsequent to the end of the quarter, through October 28, 2012, the Company repurchased 30,628 shares for \$1,355,000 for an average of \$44.24 per share.

**Table of Contents****Note D Weighted Average Shares and Net Income Per Share**

Weighted average basic common shares decreased from 11,526,000 for the quarter ended September 30, 2011 to 11,270,000 for the quarter ended September 30, 2012. Weighted average diluted common and common equivalent shares decreased from 11,672,000 for the quarter ended September 30, 2011 to 11,376,000 for the quarter ended September 30, 2012. 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 under 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 and six months ended September 30, 2011 and 2012, are as follows:

	Three Months Ended September 30,	
	2011	2012
Net Income	\$ 7,881,000	\$ 6,630,000
<b>Basic:</b>		
Weighted average common shares outstanding	11,526,000	11,270,000
Net Income per share	\$ 0.68	\$ 0.59
<b>Diluted:</b>		
Weighted average common shares outstanding	11,526,000	11,270,000
Treasury stock impact of stock options	146,000	106,000
Total common and common equivalent shares	11,672,000	11,376,000
Net Income per share	\$ 0.68	\$ 0.58
	Six Months Ended September 30,	
	2011	2012
Net Income	\$ 16,079,000	\$ 13,226,000
<b>Basic:</b>		
Weighted average common shares outstanding	11,572,000	11,292,000
Net Income per share	\$ 1.39	\$ 1.17
<b>Diluted:</b>		
Weighted average common shares outstanding	11,572,000	11,292,000
Treasury stock impact of stock options	157,000	109,000
Total common and common equivalent shares	11,729,000	11,401,000
Net Income per share	\$ 1.37	\$ 1.16

**Table of Contents****CORVEL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****September 30, 2012****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 November 2008, the Company's Board of Directors approved an amendment to the Shareholder Rights Plan to extend the expiration date of the rights to February 10, 2022.

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 exceptions, 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 Other Intangible Assets**

Other intangible assets consist of the following at September 30, 2012:

<b>Item</b>	<b>Life</b>	<b>Cost</b>	<b>Six Months Ended September 30, 2012 Amortization Expense</b>	<b>Accumulated Amortization at September 30, 2012</b>	<b>Cost, Net of Accumulated Amortization at September 30, 2012</b>
Covenants Not to Compete	5 Years	\$ 775,000	\$ 29,000	\$ 690,000	\$ 85,000
Customer Relationships	18-20 Years	7,922,000	211,000	2,243,000	5,679,000
TPA Licenses	15 Years	204,000	7,000	70,000	134,000
Total		\$ 8,901,000	\$ 247,000	\$ 3,003,000	\$ 5,898,000

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**CORVEL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2012**

**Note G Line of Credit**

In September 2012, the Company renewed a credit agreement that had been in place throughout fiscal 2012 and the six months ended September 30, 2012. The line is with a financial institution to provide a revolving credit facility with borrowing capacity of up to \$10 million. Borrowings under this agreement, as amended, bear interest, at the Company's option, at a fixed LIBOR-based rate plus 1.50% or at a fluctuating rate determined by the financial institution to be 1.50% above the daily one-month LIBOR rate. The loan covenants require the Company to maintain the current assets to liabilities ratio of at least 1.25:1, debt to tangible net worth not greater than 1.25:1 and have positive net income. There were no outstanding revolving loans at any time during fiscal 2012 or the six months ended September 30, 2012, or as of the date hereof, but letters of credit in the aggregate amount of \$8.0 million have been issued separate from the line of credit and therefore do not reduce the amount of borrowings available under the revolving credit facility. The renewed credit agreement expires in September 2013.

**Note H Contingencies and Legal Proceedings**

On March 25, 2011, George Raymond Williams, MD. ( Williams ), as plaintiff, individually and on behalf of those similarly situated, filed a First Amended and Restated Petition for Damages and Class Certification in the 27th Judicial District Court, Parish of St. Landry, Louisiana, against CorVel Corporation ( CorVel ) and its insurance carriers, Homeland Insurance Company of New York and Executive Risk Specialty Insurance Company and several other unrelated parties. Williams alleges that CorVel violated Louisiana's Any Willing Provider Act (the AWPA ), which requires a payor accessing a preferred provider contract to give 30 days' advance written notice or point of service notice in the form of a benefit card before the payor accesses the discounted rates in the contract to pay the provider for services rendered to an insured under that payor's health benefit plan.

On March 31, 2011, CorVel entered into a Memorandum of Understanding with attorneys representing the plaintiffs and the class setting forth the terms of settlement of this class action lawsuit. The Memorandum of Understanding provides that subject to the execution of a mutually acceptable settlement agreement and final non-appealable approval of such settlement by the Louisiana state court, CorVel will pay \$9 million to resolve claims for which CorVel recorded a \$9 million pre-tax charge to earnings during the March 2011 quarter. In addition, CorVel will assign to the class certain rights it has to the proceeds of CorVel's insurance policies relating to the claims asserted by the class. The class action arbitration filed with the American Arbitration Association against CorVel in December 2006 by Southwest Louisiana Hospital Association dba Lake Charles Memorial Hospital as previously disclosed by CorVel is encompassed within the settlement terms of the Memorandum of Understanding. Pursuant to the Memorandum of Understanding, the parties have also agreed to request that the appropriate courts stay all related proceedings in State and Federal Court, as well as the Louisiana Office of Workers Compensation and the arbitration proceeding before the American Arbitration Association in which the parties are named, until the settlement agreement is prepared, executed and receives final court approval. The settlement does not constitute an admission of liability.

On June 23, 2011 CorVel and class counsel executed a definitive settlement agreement. The settlement agreement contains the same terms and conditions as were set forth in the Memorandum of Understanding. Accordingly, CorVel made a \$9 million cash payment into escrow on July 6, 2011. As set forth in the settlement agreement, certain contingencies such as preliminary court approval, resolutions of objections filed by class members challenging the fairness of the settlement, class members excluded from the settlement not exceeding a materiality threshold, and final court approval, must be satisfied before the settlement can become final.

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**CORVEL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2012**

**Note H Contingencies and Legal Proceedings (continued)**

On June 23, 2011, the 27th Judicial District Court for the Parish of St. Landry, Louisiana granted preliminary approval of settlement and set a deadline of October 16, 2011 for parties to opt out of or object to the proposed settlement. Notice of the settlement was given to Class Members. The Court gave final approval of the settlement on November 4, 2011. No appeal was filed, so the judgment became final on January 17, 2012. CorVel is in the process of completing the dismissal of all claims covered by the settlement in state and federal court.

In exchange for the settlement payment by CorVel, class members released CorVel and all of its affiliates and clients for any claims relating in any way to re-pricing, payment for, or reimbursement of a workers' compensation bill, including but not limited to claims under the AWPA. Plaintiffs have also agreed to a notice procedure that CorVel may follow in the future to comply with the AWPA.

In February 2005, Kathleen Roche, D.C., as plaintiff, filed a putative class action in Circuit Court for the 20th Judicial District, St. Clair County, Illinois, against the Company. The case sought unspecified damages based on the Company's alleged failure to direct patients to medical providers who were members of the CorVel CorCare PPO network and also alleged that the Company used biased and arbitrary computer software to review medical providers' bills. The Company denies that its conduct was improper in any way and denied all liability. On October 29, 2010, the Company entered into a settlement agreement providing for the payment of \$2.1 million to class members and up to an additional \$700,000 for attorneys' fees and expenses, and as a result the Company accrued \$2.8 million of estimated liability for this settlement agreement during the quarter ended September 30, 2010. In exchange for the settlement payment by the Company, class members consisting of Illinois medical providers (excluding hospitals) have released the Company and all of its affiliates for claims relating to any PPO or usual and customary reductions recommended by the Company on class members' medical bills. On January 21, 2011, the Circuit Court gave final approval to the settlement and awarded class counsel \$700,000 in attorneys' fees and expenses. A modified final judgment approving the settlement and addressing certain class notice issues was approved on January 20, 2012; the modified judgment did not change the financial terms of the settlement or the release. Final payments were sent to class members on July 16, 2012 and the final report and accounting to the Court should be completed in November 2012.

The Company is involved in other litigation arising in the normal course of business. Management believes that resolution of these matters will not result in any payment that, in the aggregate, would be material to the financial position or results of the operations of the Company.

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**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This report 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, predicts, believes, seeks, estimates, potential, continue, strive, ongoing, may, 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, except as required by law. 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 including a decreasing number of national claims due to decreasing number of injured workers; cost of capital and capital requirements; existing and possible litigation and legal liability in the course of operations and the Company's ability to resolve such litigation; 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; 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, (TPAs), governmental entities, 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, 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, and inpatient bill review. Network solutions services also includes revenue from the Company's directed care network, including imaging and physical therapy.

**Patient Management 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 Executive Vice-President of the Company. Each of these regional vice-presidents is responsible for all services

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provided by the Company in his or her particular region and for the operating results of the Company in multiple states. These 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**

The Company operates 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. FASB ASC 280-10 establishes standards for the way that public business enterprises report information about operating segments in annual and interim 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 FASB ASC 280-10, 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, 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. The Company believes each of its regions meet these criteria as each provides similar services and products to similar customers using similar methods of productions and similar methods to distribute the services and products.

### **Summary of Quarterly Results**

The Company generated revenues of \$105.5 million for the quarter ended September 30, 2012, an increase of \$0.9 million, or 0.9%, compared to revenues of \$104.6 million for the quarter ended September 30, 2011. The increase in revenues was primarily due to a 10% increase in patient management, which includes case management services and all services sold to TPA customers. The 10% increase in revenue was partially offset by a decrease in network solutions due to a decline in volume and the loss of a few customers which were not significant in size. The increase in patient management services was primarily due to an increase in the level of services provided to new TPA customers.

The Company's cost of revenues increased by \$3.7 million, from \$78.9 million in the September 30, 2011 quarter to \$82.6 million in the September 30, 2012 quarter, an increase of 4.7%. TPA services require additional labor. As we have added customers in this area, we have had to hire additional direct labor resources, causing the increase in cost of revenues. In addition, pharmacy costs have increased as the volume of prescription processing has increased.

The Company's general and administrative expense decreased by \$0.6 million, from \$12.6 million in the September 30, 2011 quarter to \$12.0 million in the September 30, 2012 quarter, a decrease of 4.9%. This decrease is primarily due to an increase in efforts to manage the Company's general and administrative costs during a period of slower revenue growth.

The Company's income tax expense decreased by \$0.9 million, or 17.8%, from \$5.1 million, in the September 30, 2011 quarter to \$4.2 million in the September 30, 2012 quarter. The decrease in income tax expense was primarily due to the decrease in income before income taxes.

Weighted diluted shares decreased from 11.7 million shares in the September 30, 2011 quarter to 11.4 million shares in the September 30, 2012 quarter, a decrease of 296,000 shares, or 2.5%. This decrease was due primarily to the repurchase of 402,682 shares of common stock in the December 2011, March 2012, June 2012, and September 2012 quarters.

Diluted earnings per share decreased from \$0.68 in the September 30, 2011 quarter to \$0.58 in the September 30, 2012 quarter, a decrease of \$0.10 per share, or 14.7%. The decrease in diluted earnings per share was due to the decrease in income before income taxes offset by a reduction in the number of shares outstanding due to the shares repurchased.



**Table of Contents****Results of Operations for the three months ended September 30, 2011 and 2012**

The Company derives its revenues from providing patient management and network solutions services to payors of workers' compensation benefits, auto insurance claims and health insurance benefits. Patient management services include claims management, case management, 24/7 nurse triage, utilization management, vocational rehabilitation and life care planning. Network solutions services include medical bill review, PPO management, enhanced bill review, provider reimbursement, professional review, pharmacy services, directed care services, Medicare solutions and clearinghouse services. The percentage of total revenues attributable to patient management and network solutions services for the quarters ended September 30, 2011 and September 30, 2012 are as follows:

## Percentage of Revenues

	September 30, 2011	September 30, 2012
Patient management services	47.3%	51.7%
Network solutions services	52.7%	48.3%

The following table sets forth, for the periods indicated, the dollar amounts, dollar and percent changes, share changes, and the percentage of revenues represented by certain items reflected in the Company's consolidated income statements for the three months ended September 30, 2011 and September 30, 2012. The Company's past operating results are not necessarily indicative of future operating results.

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2012	Change	Percentage Change
Revenue	\$ 104,552,000	\$ 105,458,000	\$ 906,000	0.9%
Cost of revenues	78,940,000	82,622,000	3,682,000	4.7%
Gross profit	25,612,000	22,836,000	(2,776,000)	(10.8%)
Gross profit as percentage of revenue	24.5%	21.7%		
General and administrative	12,592,000	11,981,000	(611,000)	(4.9%)
General and administrative as percentage of revenue	12.0%	11.4%		
Income before income tax provision	13,020,000	10,855,000	(2,165,000)	(16.6%)
Income before income tax provision as percentage of revenue	12.5%	10.3%		
Income tax provision	5,139,000	4,225,000	(914,000)	(17.8%)
Net income	\$ 7,881,000	\$ 6,630,000	\$ (1,251,000)	(15.9%)
<b>Weighted Shares</b>				
Basic	11,526,000	11,270,000	(256,000)	(2.2%)
Diluted	11,672,000	11,376,000	(296,000)	(2.5%)
<b>Earnings Per Share</b>				
Basic	\$ 0.68	\$ 0.59	(\$ 0.09)	(13.2%)
Diluted	\$ 0.68	\$ 0.58	(\$ 0.10)	(14.7%)

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### **Revenues**

#### **Change in revenue from the quarter ended September 30, 2011 to the quarter ended September 30, 2012**

Revenues increased from \$104.6 million for the three months ended September 30, 2011 to \$105.5 million for the three months ended September 30, 2012, an increase of \$0.9 million, or 0.9%. The increase in revenues was primarily due to an increase in patient management, which was partially offset by a decrease in network solutions due to a decline in volume and the loss of a few customers which were not significant in size. The increase in patient management services was primarily due to an increase in the level of services provided to new TPA customers.

### **Cost of Revenues**

The Company's cost of revenues consist of direct expenses, costs directly attributable to the generation of revenue, and field indirect costs which are incurred in the field offices of the Company. Direct costs are primarily case manager salaries, bill review analysts, related payroll taxes and fringe benefits, and costs for independent medical examination (IME) and diagnostic imaging providers. Most of the Company's revenues are generated in offices which provide both patient management services and network solutions services. The largest of the field indirect costs are manager salaries and bonus, account executive base pay and commissions, administrative and clerical support, field systems personnel, prescription drug costs, PPO network developers, related payroll taxes and fringe benefits, office rent, and telephone expense. Approximately 35% of the costs incurred in the field are costs which support both the patient management services and network solutions operations of the Company's field offices, such as district managers, branch clerical, account executives, related payroll taxes and fringe benefits, rent, and telephone.

#### **Change in cost of revenue from the quarter ended September 30, 2011 to the quarter ended September 30, 2012**

The Company's cost of revenues increased from \$78.9 million in the three months ended September 30, 2011 to \$82.6 million in the three months ended September 30, 2012, an increase of \$3.7 million or 4.7%. TPA services require additional labor. As we have added customers, in this area we have had to hire additional direct labor resources, causing the increase in cost of revenues. In addition, pharmacy costs have increased as the volume of prescription processing has increased.

### **General and Administrative Expense**

For the quarter ended September 30, 2012, general and administrative expense consisted of approximately 60% of corporate systems costs which include corporate systems support, implementation and training, amortization of software development costs, depreciation of the hardware costs in the Company's national systems, the Company's national wide area network and other systems related costs. The remaining 40% of the general and administrative expense consisted of national marketing, national sales support, corporate legal, corporate insurance, human resources, accounting, product management, new business development and other general corporate matters.

#### **Change in general and administrative expense from the quarter ended September 30, 2011 to the quarter ended September 30, 2012**

General and administrative expense decreased from \$12.6 million in the quarter ended September 30, 2011 to \$12.0 million in the quarter ended September 30, 2012, a decrease of \$0.6 million, or 4.9%. This decrease is primarily due to the Company's efforts to manage non-systems related general and administrative costs by selective reductions in staff during a period of slower revenue growth.

**Table of Contents****Income Tax Provision****Change in income tax expense from the quarter ended September 30, 2011 to the quarter ended September 30, 2012**

The Company's income tax expense decreased by \$0.9 million, or 17.8%, from \$5.1 million for the quarter ended September 30, 2011 to \$4.2 million for the quarter ended September 30, 2012 due to the decrease in income before income taxes from \$13.0 million to \$10.9 million during the same periods. The income tax expense as a percentage of income before income taxes, also known as the effective tax rate, was 39.5% for the quarter ended September 30, 2011 and 38.9% for the quarter ended September 30, 2012. The income tax provision rates were based upon management's review of the Company's estimated annual income tax rate, including state taxes. This effective tax rate differed from the statutory federal tax rate of 35.0% primarily due to state income taxes and certain non-deductible expenses offset by tax credits.

**Results of Operations for the six months ended September 30, 2011 and the six months ended September 30, 2012**

The following table sets forth, for the periods indicated, the dollar amounts, dollar and percent changes, share changes, and the percentage of revenues represented by certain items reflected in the Company's consolidated income statements for the six months ended September 30, 2011 and September 30, 2012. The Company's past operating results are not necessarily indicative of future operating results.

	Six Months Ended September 30, 2011	Six Months Ended September 30, 2012	Change	Percentage Change
Revenue	\$ 206,860,000	\$ 210,064,000	\$ 3,204,000	1.5%
Cost of revenues	155,704,000	164,047,000	8,343,000	5.4%
<b>Gross profit</b>	<b>51,156,000</b>	<b>46,017,000</b>	<b>(5,139,000)</b>	<b>(10.0%)</b>
Gross profit as percentage of revenue	24.7%	21.9%		
General and administrative	24,886,000	24,155,000	(731,000)	(2.9%)
General and administrative as percentage of revenue	12.0%	11.5%		
<b>Income before income tax provision</b>	<b>26,270,000</b>	<b>21,862,000</b>	<b>(4,408,000)</b>	<b>(16.8%)</b>
Income before income tax provision as percentage of revenue	12.7%	10.4%		
<b>Income tax provision</b>	<b>10,191,000</b>	<b>8,636,000</b>	<b>(1,555,000)</b>	<b>(15.3%)</b>
Net income	\$ 16,079,000	\$ 13,226,000	\$ (2,853,000)	(17.7%)
<b>Weighted Shares</b>				
Basic	11,572,000	11,292,000	(280,000)	(2.4%)
Diluted	11,729,000	11,401,000	(328,000)	(2.8%)
<b>Earnings Per Share</b>				
Basic	\$ 1.39	\$ 1.17	(\$ 0.22)	(15.8%)
Diluted	\$ 1.37	\$ 1.16	(\$ 0.21)	(15.3%)

**Revenues****Change in revenue from the six months ended September 30, 2011 to the six months ended September 30, 2012**

Revenues increased from \$206.9 million for the six months ended September 30, 2011 to \$210.1 million for the six months ended September 30, 2012, an increase of \$3.2 million, or 1.5%. The Company's patient management revenues increased \$9 million, or 9%, from \$98 million in the six months ended September 30, 2011 to



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\$107 million in the six months ended September 30, 2012. The increase in patient management services was primarily due to an increase in the level of services provided to new and existing TPA customers. The Company's network solutions revenues decreased from \$109 million in the six months ended September 30, 2011 to \$103 million in the six months ended September 30, 2012, a decrease of \$6 million, or 6%. The decrease in network solutions revenue was primarily due to a decrease in volume of higher priced services offset by an increase in volume of lower priced services.

### **Cost of Revenues**

#### **Change in cost of revenue from the six months ended September 30, 2011 to the six months ended September 30, 2012**

The Company's cost of revenues increased from \$155.7 million in the six months ended September 30, 2011 to \$164.0 million in the six months ended September 30, 2012, an increase of \$8.3 million, or 5.4%. This increase was partially due to the increase in the volume of services which generated the 1.5% revenue increase for the same periods. Additionally, the Company had an increase in volume of lower margin services offset by a decrease in higher margin services which resulted in a cost increase greater than the revenue increase. Direct salaries increased from \$40 million for the six months ended September 30, 2011 to \$45 million for the six months ended September 30, 2012. Direct pharmacy costs increased from \$21 million for the six months ended September 30, 2011 to \$24 million for the six months ended September 30, 2012.

### **General and Administrative Expense**

#### **Change in general and administrative expense from the six months ended September 30, 2011 to the six months ended September 30, 2012**

General and administrative expense decreased from \$24.9 million in the six months ended September 30, 2011 to \$24.2 million in the six months ended September 30, 2012, a decrease of \$0.7 million, or 2.9%. This decrease is primarily due to the Company's efforts to manage non-systems related general and administrative costs during a period of slower revenue growth.

### **Income Tax Provision**

The Company's income tax expense decreased by \$1.6 million, or 15.3%, from \$10.2 million for the six months ended September 30, 2011 to \$8.6 million for the six months ended September 30, 2012 due to the decrease in income before income taxes from \$26.3 million to \$21.9 million. The income tax expense as a percentage of income before income taxes, also known as the effective tax rate, was 38.8% for the six months ended September 30, 2011 and 39.5% for the six months ended September 30, 2012. The income tax provision rates were based upon management's review of the Company's estimated annual income tax rate, including state taxes. This effective tax rate differed from the statutory federal tax rate of 35.0% primarily due to state income taxes and certain non-deductible expenses offset by tax credits.

### **Liquidity and Capital Resources**

The Company has historically funded its operations and capital expenditures primarily from cash flow from operations, and to a lesser extent, stock option exercises. Working capital increased \$11.6 million, from \$36.5 million as of March 31, 2012 to \$48.0 million as of September 30, 2012, primarily due to an increase in cash from \$6.6 million as of March 31, 2012 to \$20.0 million as of September 30, 2012. Cash increased due to less spending on share repurchases and no legal settlements during the current period.

The Company believes that cash from operations and funds from exercises of stock options granted to employees are adequate to fund existing obligations, repurchase shares of the Company's common stock under its current share repurchase program, introduce new services, and continue to develop healthcare related businesses for at least the next twelve months. The Company regularly evaluates cash requirements for current operations and commitments, and for capital acquisitions and other strategic transactions. The Company may elect to raise additional funds for these purposes, through debt or equity financings or otherwise, as appropriate. Additional equity or debt financing may not be available when needed, on terms favorable to the Company or at all.

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As of September 30, 2012, the Company had \$20 million in cash and cash equivalents, invested primarily in short-term, interest-bearing, highly liquid investment-grade securities with maturities of 90 days or less in federally regulated banks.

In September 2012, the Company renewed a credit agreement that had been in place throughout fiscal 2012. The line is with a financial institution to provide a revolving credit facility with borrowing capacity of up to \$10 million. Borrowings under this agreement, as amended, bear interest, at the Company's option, at a fixed LIBOR-based rate plus 1.50% or at a fluctuating rate determined by the financial institution to be 1.50% above the daily one-month LIBOR rate. The loan covenants require the Company to maintain the current assets to liabilities ratio of at least 1.25:1, debt to tangible net worth not greater than 1.25:1 and have positive net income. There were no outstanding revolving loans at any time during fiscal 2012 or the six months ended September 30, 2012, or as of the date hereof, but letters of credit in the aggregate amount of \$8.0 million have been issued separate from the line of credit and therefore do not reduce the amount of borrowings available under the revolving credit facility. The renewed credit agreement expires in September 2013.

The Company has historically required substantial capital to fund the growth of its operations, particularly working capital to fund the growth in accounts receivable and capital expenditures. The Company believes, however, that the cash balance at September 30, 2012 along with anticipated internally generated funds, will be sufficient to meet the Company's expected cash requirements for at least the next twelve months.

### **Operating Cash Flows**

#### ***Six months ended September 30, 2011 compared to six months ended September 30, 2012***

Net cash provided by operating activities increased from \$15.9 million in the six months ended September 30, 2011 to \$23.9 million in the six months ended September 30, 2012. The increase in cash flow from operating activities was primarily due to the fact that in the prior fiscal year the Company paid down accrued liabilities of \$9 million due to a one-time payment of a legal settlement. The current fiscal year has not had any large litigation settlements.

### **Investing Activities**

#### ***Six months ended September 30, 2011 compared to six months ended September 30, 2012***

Net cash flow used in investing activities decreased from \$11.7 million in the six months ended September 30, 2011 to \$6.3 million in the six months ended September 30, 2012, a decrease of \$5.4 million. The decrease in net cash used in investing activities is primarily due to a decrease in the software development activity and a decrease in remodeling and furnishing office space in the six months ended September 30, 2012 compared to the same period in the prior fiscal year.

### **Financing Activities**

#### ***Six months ended September 30, 2011 compared to six months ended September 30, 2012***

Net cash flow used in financing activities decreased from \$8.4 million for the six months ended September 30, 2011 to \$4.1 million for the six months ended September 30, 2012, a decrease of \$4.3 million. The decrease in cash flow used in financing activities was primarily due to a decrease in the amount spent on treasury share repurchases from \$10.0 million for the six months ended September 30, 2011 to \$6.9 million for the six months ended September 30, 2012.

**Table of Contents****Contractual Obligations**

The following table summarizes the Company's contractual obligations outstanding as of September 30, 2012.

	Total	Payments Due by Period			
		Within One Year	Between One and Three Years	Between Three and Five Years	More than Five Years
Operating leases	\$ 44,915,000	\$ 12,369,000	\$ 19,896,000	\$ 10,818,000	\$ 1,832,000
Uncertain tax positions*	991,000	991,000			
<b>Total</b>	<b>\$ 45,906,000</b>	<b>\$ 13,360,000</b>	<b>\$ 19,896,000</b>	<b>\$ 10,818,000</b>	<b>\$ 1,832,000</b>

\* See Note A

Operating leases are rents paid for the Company's physical locations.

**Litigation**

On March 25, 2011, George Raymond Williams, MD. ( Williams ), as plaintiff, individually and on behalf of those similarly situated, filed a First Amended and Restated Petition for Damages and Class Certification in the 27th Judicial District Court, Parish of St. Landry, Louisiana, against CorVel Corporation ( CorVel ) and its insurance carriers, Homeland Insurance Company of New York and Executive Risk Specialty Insurance Company and several other unrelated parties. Williams alleges that CorVel violated Louisiana's Any Willing Provider Act (the AWPA ), which requires a payor accessing a preferred provider contract to give 30 days' advance written notice or point of service notice in the form of a benefit card before the payor accesses the discounted rates in the contract to pay the provider for services rendered to an insured under that payor's health benefit plan.

On March 31, 2011, CorVel entered into a Memorandum of Understanding with attorneys representing the plaintiffs and the class setting forth the terms of settlement of this class action lawsuit. The Memorandum of Understanding provides that subject to the execution of a mutually acceptable settlement agreement and final non-appealable approval of such settlement by the Louisiana state court, CorVel will pay \$9 million to resolve claims for which CorVel recorded a \$9 million pre-tax charge to earnings during the March 2011 quarter. In addition, CorVel will assign to the class certain rights it has to the proceeds of CorVel's insurance policies relating to the claims asserted by the class. The class action arbitration filed with the American Arbitration Association against CorVel in December 2006 by Southwest Louisiana Hospital Association dba Lake Charles Memorial Hospital as previously disclosed by CorVel is encompassed within the settlement terms of the Memorandum of Understanding. Pursuant to the Memorandum of Understanding, the parties have also agreed to request that the appropriate courts stay all related proceedings in State and Federal Court, as well as the Louisiana Office of Workers Compensation and the arbitration proceeding before the American Arbitration Association in which the parties are named, until the settlement agreement is