CORVEL CORP
Form 10-Q
November 08, 2007

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

(Mark One)

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

For the quarterly period ended September 30, 2007

or

o **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)

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 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 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. (check one)

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).

Yes o No þ

The number of shares outstanding of the registrant s Common Stock, $0.0001 Par Value, as of October 24, 2007 was 13,863,808.

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

	March 31, 2007	September 30, 2007 (Unaudited)
Assets		
Current Assets Cash and cash equivalents	$ 15,020,000	$ 9,347,000
Accounts receivable, net	41,027,000	39,048,000
Prepaid taxes and expenses	3,090,000	3,492,000
Deferred income taxes	5,150,000	5,139,000
Total current assets	64,287,000	57,026,000
Property and equipment, net	24,864,000	28,586,000
Goodwill	22,341,000	35,386,000
Other intangibles, net	1,970,000	3,693,000
Other assets	306,000	220,000
TOTAL ASSETS	$ 113,768,000	$ 124,911,000
Liabilities and Stockholders Equity		
Current Liabilities Accounts and taxes payable	$ 13,418,000	$ 13,132,000
Accrued liabilities	15,851,000	17,418,000
Total current liabilities	29,269,000	30,550,000
Deferred income taxes	5,302,000	6,092,000
Commitments and contingencies		
Stockholders Equity		
Common stock, $.0001 par value: 60,000,000 shares authorized; 25,320,089 shares (13,960,692, net of Treasury shares) and 25,372,945 shares (13,860,622, net of Treasury shares) issued and outstanding at March 31, 2007 and September 30, 2007, respectively	3,000	3,000
Paid-in-capital	75,554,000	77,554,000
Treasury Stock, (11,359,397 shares at March 31, 2007 and 11,512,323 shares at September 30, 2007)	(154,091,000)	(158,212,000)
Retained earnings	157,731,000	168,924,000

Total stockholders equity	79,197,000	88,269,000
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 113,768,000	$ 124,911,000

See accompanying notes to consolidated financial statements.

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CORVEL CORPORATION
CONSOLIDATED INCOME STATEMENTS UNAUDITED

	Three Months Ended September 30,	
	2006	2007
REVENUES	$ 67,329,000	$ 73,510,000
Cost of revenues	50,933,000	54,856,000
Gross profit	16,396,000	18,654,000
General and administrative expenses	8,489,000	9,398,000
Income before income tax provision	7,907,000	9,256,000
Income tax provision	3,084,000	3,624,000
NET INCOME	$ 4,823,000	$ 5,632,000
Net income per common and common equivalent share		
Basic	$ 0.34	$ 0.41
Diluted	$ 0.34	$ 0.40
Weighted average common and common equivalent		
Basic	14,123,000	13,889,000
Diluted	14,229,000	14,062,000

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CORVEL CORPORATION
CONSOLIDATED INCOME STATEMENTS UNAUDITED

	Six Months Ended September 30, 2006	2007
REVENUES	$ 137,091,000	$ 147,847,000
Cost of revenues	104,368,000	111,012,000
Gross profit	32,723,000	36,835,000
General and administrative expenses	17,209,000	18,475,000
Income before income tax provision	15,514,000	18,360,000
Income tax provision	6,051,000	7,167,000
NET INCOME	$ 9,463,000	$ 11,193,000
Net income per common and common equivalent share		
Basic	$ 0.67	$ 0.80
Diluted	$ 0.67	$ 0.79
Weighted average common and common equivalent		
Basic	14,124,000	13,927,000
Diluted	14,199,000	14,111,000

See accompanying notes to consolidated financial statements.

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CORVEL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED

	Six Months Ended September 30, 2006	2007
Cash flows from Operating Activities		
NET INCOME	$ 9,463,000	$ 11,193,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,146,000	5,645,000
Loss on disposal of assets	91,000	108,000
Stock compensation expense	585,000	730,000
Write-off of uncollectible accounts	1,554,000	1,398,000
Changes in operating assets and liabilities		
Accounts receivable	(2,060,000)	1,943,000
Prepaid taxes and expenses	(34,000)	(402,000)
Accounts and taxes payable	1,360,000	396,000
Accrued liabilities	(175,000)	(2,228,000)
Provision for deferred income taxes	(1,069,000)	128,000
Other assets	10,000	(38,000)
Net cash provided by operating activities	14,871,000	18,873,000
Cash Flows from Investing Activities		
Assets purchased in acquisition		(12,300,000)
Capital additions	(3,016,000)	(8,712,000)
Net cash used in investing activities	(3,016,000)	(21,012,000)
Cash Flows from Financing Activities		
Purchase of Treasury Stock	(5,411,000)	(4,121,000)
Tax effect of stock compensation expense	(228,000)	(285,000)
Exercise of employee stock purchase options	192,000	172,000
Exercise of common stock options	1,374,000	700,000
Net cash used in financing activities	(4,073,000)	(3,534,000)
Increase/(Decrease) in cash and cash equivalents	7,782,000	(5,673,000)
Cash and cash equivalents at beginning of period	14,206,000	15,020,000
Cash and cash equivalents at end of period	$ 21,988,000	$ 9,347,000

Supplemental Cash Flow Information:		
Income taxes paid	6,154,000	7,670,000
Interest paid		
Non cash financing activity related to tax benefits	642,000	
Accrual of earnout related to acquisition		2,500,000

See accompanying notes to consolidated financial statements.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2007 (Unaudited)

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, 2007. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the March 31, 2007 audited financial statements have been omitted from these interim financial statements.

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 and six months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending March 31, 2008. For further information, refer to the consolidated financial statements and footnotes for the year ended March 31, 2007 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 conformity 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 allowance for doubtful accounts, accrual for bonuses, and accruals for self-insurance reserves.

Cash and Cash Equivalents: Cash and cash equivalents consists of short-term highly-liquid investments 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, 2007 and September 30, 2007.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2007 (Unaudited)

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

Revenue Recognition: The Company s revenues are recognized primarily as services are rendered based on time and expenses incurred. A certain portion of the Company s revenues are derived from fee schedule auditing which is based on the number of provider charges audited and on a percentage of savings achieved for the Company s customers. We generally recognize 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. We reduce revenue for estimated contractual allowances and record any amounts invoiced to the customer in advance of service performance as deferred revenue.

Accounts Receivable: The majority of the Company s accounts receivable are due from companies in the property and casualty insurance industries. Credit is extended based on evaluation of a customer s financial condition and, generally, collateral is not required. Accounts receivable are due within 30 days and are stated at amounts due from customers net of an allowance for doubtful accounts. 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, 2007 or September 30, 2007. No customer accounted for 10% or more of revenue during the fiscal year ended March 31, 2007 or either six month period ended September 30, 2006 or 2007.

Property and Equipment: Additions to property and equipment are recorded at cost. Depreciation and amortization are provided using the straight-line and accelerated methods over the estimated useful lives of the related assets, which range from three to seven years.

The Company capitalizes software development costs intended for internal use. The Company accounts for internally developed software costs in accordance with SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained 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.

Goodwill: Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, became effective beginning in 2003, and provides that goodwill, as well as identifiable intangible assets with indefinite lives, should not be amortized. Accordingly, with the adoption of SFAS 142 on April 1, 2002, the Company discontinued the amortization of goodwill and indefinite-lived intangibles. In addition, useful lives of intangible assets with finite lives were reevaluated on adoption of SFAS 142. Impairments are recognized when the expected future undiscounted cash flows derived from such assets are less than their carrying value. The Company measures any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model. A loss in the value of an investment will be recognized when it is determined that the decline in value is other than temporary. No impairment of long-lived assets has been recognized in the financial statements.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2007 (Unaudited)

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

Income Taxes: The Company provides for income taxes under the liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities as measured by the enacted tax rates which are expected to be in effect when these differences reverse. Income tax expense is the tax payable for the period and the change during the period in net deferred tax assets and liabilities. The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* (FIN 48) on April 1, 2007. As a result of the implementation of FIN 48, the Company recognized no material adjustment in the liability for unrecognized income tax benefits.

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 increased for diluted earnings per share due to the effect of stock options.

Stock Split: During the quarter ended December 31, 2006, the Company s Board of Directors declared a three-for-two stock split in the form of a 50% stock dividend with a record date of November 20, 2006 and a distribution date of December 8, 2006. The September 30, 2006 share and per share calculations in these financial statements have been retroactively adjusted to reflect this split.

Reclassification: Certain amounts for the quarter ended September 30, 2006 have been reclassified to correspond to the quarter ended September 30, 2007.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2007 (Unaudited)

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, 2007, options for up to 9,682,500 shares (adjusted for the three-for-two stock split in the form of a 50% stock dividend distributed on December 8, 2006 to shareholders of record on November 20, 2006) of the Company s common stock may be granted to 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 non-employee members of the board of directors, expire at the end of five years and ten years from the date of grant, respectively. Prior to fiscal year 2007, the Company had not granted any performance-based stock options under the Plan. In May 2006, however, the Company granted 149,000 options at fair market value at the date of grant, which will only vest if the Company attains certain earnings per share targets, as established by the Company s Board of Directors, for calendar years 2008, 2009, and 2010. The Company s current operating results are below the targets established by the Board of Directors. There is no guarantee that the Company will achieve these targets in order for the options to vest. The Company has historically issued new shares to satisfy option exercises as opposed to issuing shares from treasury stock. 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.

CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2007 (Unaudited)

Note B Stock Based Compensation and Stock Options (continued)

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 table below shows the amounts recognized in the financial statements for the three and six months ended September 30, 2006 and 2007, respectively.

	Three Months Ended	
	September 30, 2006	September 30, 2007
Cost of revenues	$ 225,000	$ 115,000
General and administrative	60,000	256,000
Total cost of stock-based compensation included in income, before income tax	285,000	371,000
Amount of income tax benefit recognized	(111,000)	(145,000)
Amount charged against income	$ 174,000	$ 226,000
Effect on diluted income per share	$ (0.01)	$ (0.02)

	Six Months Ended	
	September 30, 2006	September 30, 2007
Cost of revenues	$ 465,000	$ 226,000
General and administrative	120,000	504,000
Total cost of stock-based compensation included in income, before income tax	585,000	730,000
Amount of income tax benefit recognized	(228,000)	(285,000)
Amount charged against income	$ 357,000	$ 445,000
Effect on diluted income per share	$ (0.03)	$ (0.03)

The stock compensation expense did not include the cost of the performance based options noted above as the Company is presently not achieving the targeted earnings per share performance. If the Company achieves the earnings per share targets in calendar years 2008, 2009, and 2010, the Company will recognize the related expense, based upon the fair values on the date of grant, during the period when it is determined that it is probable that the performance options will be earned.

CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2007 (Unaudited)

Note B Stock Based Compensation and Stock Options (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. Based upon the historical experience of options cancellations, the Company has estimated an annualized forfeiture rate of 6.6% and 6.4% for the three months ended September 30, 2006 and 2007, 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, 2006 and 2007 using the Black-Scholes option-pricing model:

	Three Months Ended September 30,	
	2006	2007
Risk-free interes trate	4.90%	4.60%
Expected volatility	38%	39%
Expected dividend yield	0.00%	0.00%
Expected forfeiture rate	6.60%	6.40%
Expected weighted average life of option in years	4.8years	4.8years

Under the Company s Restated Omnibus Incentive Plan (formerly the Restated 1988 Executive Stock Option Plan), (the Plan) as in effect at September 30, 2007, options for up to 9,682,500 shares of the Company s common stock may be granted at exercise prices not less than 100% of the fair value of the Company s common stock on date of grant. Of this amount, 1,294,134 shares of the Company s common stock remain available for future grant or issuance under the Plan. Options granted under the Plan are non-statutory stock options, and options granted generally have a maximum life of five years for employees and 10 years for non-employee directors. Options will generally become exercisable for 25% of the options shares one year from the date of grant and then, for the remaining 75% of the options, ratably over the following 36 months, respectively. All options granted in the six months ended September 30, 2006 and 2007 were granted at fair market value and are non-statutory stock options.

CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2007 (Unaudited)

Note B Stock Based Compensation and Stock Options (continued)

Summarized information for all stock options for the three and six months ended September 30, 2006 and 2007 follows:

	Three Months Ended September 30, 2006		Three Months Ended September 30, 2007	
	Shares	Average Price	Shares	Average Price
Options outstanding, beginning	1,440,650	$ 17.01	1,027,280	$ 18.08
Options granted	67,275	18.09	46,100	26.86
Options exercised	(103,505)	17.05	(32,027)	14.73
Options cancelled	(40,055)	17.59	(14,887)	18.82
Options outstanding, ending	1,364,366	$ 17.05	1,026,466	$ 18.57

	Six Months Ended September 30, 2006		Six Months Ended September 30, 2007	
	Shares	Average Price	Shares	Average Price
Options outstanding, beginning	1,272,176	$ 17.28	1,021,141	$ 17.84
Options granted	357,600	16.01	73,800	26.97
Options exercised	(103,692)	17.05	(46,718)	16.00
Options cancelled	(161,718)	16.61	(21,757)	18.51
Options outstanding, ending	1,364,366	$ 17.05	1,026,466	$ 18.57

The following table summarizes the status of stock options outstanding and exercisable at September 30, 2007:

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
$8.08 to $15.55	279,243	3.29	$ 12.94	138,598	$12.46
$15.76 to $15.79	273,701	3.50	$ 15.77	46,559	$15.77
$16.67 to $23.55	270,989	3.33	$ 19.53	202,544	$20.12