CORVEL CORP
Form 10-Q
November 10, 2008

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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, 2008

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, 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 o Accelerated filer þ Non-accelerated filer o (Do not check if a smaller reporting company) Smaller Reporting Company 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 per share, as of October 31, 2008 was 13,419,720.

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

	March 31, 2008	September 30, 2008 (Unaudited)
Assets		
Current Assets		
Cash and cash equivalents (Note A)	$ 17,911,000	$ 23,600,000
Accounts receivable, net	39,164,000	40,950,000
Prepaid taxes and expenses	5,242,000	5,648,000
Deferred income taxes	4,076,000	3,996,000
Total current assets	66,393,000	74,194,000
Property and equipment, net	30,569,000	30,209,000
Goodwill	31,875,000	33,450,000
Other intangibles, net	7,789,000	7,510,000
Other assets	3,949,000	4,203,000
TOTAL ASSETS	$ 140,575,000	$ 149,566,000
Liabilities and Stockholders Equity		
Current Liabilities		
Accounts and taxes payable	$ 20,475,000	$ 18,797,000
Accrued liabilities	16,473,000	19,030,000
Total current liabilities	36,948,000	37,827,000
Deferred income taxes	7,249,000	7,245,000
Commitments and contingencies (Note I)		
Stockholders Equity		
Common stock, $.0001 par value: 60,000,000 shares authorized; 25,480,315 shares issued (13,792,701 shares outstanding, net of Treasury shares) and 25,576,890 shares issued (13,733,939 shares outstanding, net of Treasury shares) at March 31, 2008 and September 30, 2008, respectively	3,000	3,000
Paid-in-capital	80,219,000	83,013,000
Treasury Stock, (11,687,614 shares at March 31, 2008 and 11,842,951 shares at September 30, 2008)	(162,302,000)	(167,511,000)

Retained earnings		178,458,000		188,989,000
Total stockholders equity		96,378,000		104,494,000
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	140,575,000	$	149,566,000

See accompanying notes to consolidated financial statements.

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CORVEL CORPORATION
CONSOLIDATED INCOME STATEMENTS UNAUDITED

	Three Months Ended September 30,	
	2007	2008
REVENUES	$ 73,510,000	$ 77,855,000
Cost of revenues	54,856,000	58,996,000
Gross profit	18,654,000	18,859,000
General and administrative expenses	9,398,000	10,722,000
Income before income tax provision	9,256,000	8,137,000
Income tax provision	3,624,000	3,173,000
NET INCOME	$ 5,632,000	$ 4,964,000
Net income per common and common equivalent share		
Basic	$ 0.41	$ 0.36
Diluted	$ 0.40	$ 0.36
Weighted average common and common equivalent		
Basic	13,889,000	13,764,000
Diluted	14,062,000	13,960,000

See accompanying notes to consolidated financial statements.

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CORVEL CORPORATION
CONSOLIDATED INCOME STATEMENTS UNAUDITED

	Six Months Ended September 30, 2007	2008
REVENUES	$ 147,847,000	$ 156,056,000
Cost of revenues	111,012,000	117,264,000
Gross profit	36,835,000	38,792,000
General and administrative expenses	18,475,000	21,529,000
Income before income tax provision	18,360,000	17,263,000
Income tax provision	7,167,000	6,732,000
NET INCOME	$ 11,193,000	$ 10,531,000
Net income per common and common equivalent share		
Basic	$ 0.80	$ 0.76
Diluted	$ 0.79	$ 0.75
Weighted average common and common equivalent		
Basic	13,927,000	13,790,000
Diluted	14,111,000	14,003,000

See accompanying notes to consolidated financial statements.

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CORVEL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED

	Six Months Ended September 30, 2007	2008
Cash flows from Operating Activities		
NET INCOME	$ 11,193,000	$ 10,531,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,645,000	5,909,000
Loss on disposal of assets	108,000	18,000
Stock compensation expense	730,000	513,000
Write-off of uncollectible accounts	1,398,000	1,553,000
Changes in operating assets and liabilities		
Accounts receivable	1,943,000	(3,339,000)
Prepaid taxes and expenses	(402,000)	(406,000)
Accounts and taxes payable	396,000	(1,678,000)
Accrued liabilities	(2,228,000)	1,557,000
Deferred income tax	128,000	76,000
Other assets	(38,000)	(29,000)
Net cash provided by operating activities	18,873,000	14,705,000
Cash Flows from Investing Activities		
Assets purchased in acquisition	(12,300,000)	(800,000)
Purchase of property & equipment	(8,712,000)	(5,288,000)
Net cash (used in) investing activities	(21,012,000)	(6,088,000)
Cash Flows from Financing Activities		
Purchase of treasury stock	(4,121,000)	(5,209,000)
Tax effect of stock option exercises	(285,000)	488,000
Exercise of common stock options	700,000	1,592,000
Exercise of employee stock purchase options	172,000	201,000
Net cash (used in) financing activities	(3,534,000)	(2,928,000)
Increase/(Decrease) in cash and cash equivalents	(5,673,000)	5,689,000
Cash and cash equivalents at beginning of period	15,020,000	17,911,000
Cash and cash equivalents at end of period	$ 9,347,000	$ 23,600,000

Supplemental Cash Flow Information:		
Income taxes paid	$ 7,670,000	$ 6,815,000
Interest paid		
Accrual of earnout related to acquisition	2,500,000	1,000,000

See accompanying notes to consolidated financial statements.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008

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, 2008. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the March 31, 2008 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 months and six months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2009. For further information, refer to the consolidated financial statements and footnotes for the fiscal year ended March 31, 2008 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 conforming 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, earn-out accruals, accruals for self-insurance reserves, share based payments related to performance based awards, and estimates used in stock option valuations.

Cash and Cash Equivalents: Cash and cash equivalents consists 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, 2008 and September 30, 2008. Cash at September 30, 2008 includes $1.5 million of customer deposits held in bank checking accounts

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008

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. The Company generally 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. The Company reduces revenue for estimated contractual allowances and records 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 as 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, 2008 or September 30, 2008. No one customer accounted for 10% or more of revenue during either of the three and six month periods ended September 30, 2007 or 2008.

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 Statement of Position (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: The Company accounts for its business combinations in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, 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 SFAS No. 142, Goodwill and Other Intangibles , 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. The Company s goodwill impairment test is conducted company-wide and the fair value is compared to its carrying value. The measurement of fair value is based on an evaluation of market capitalization and is further tested using a multiple of earnings approach. For all years presented, the Company s tests indicated that no impairment existed and, accordingly, no loss has been recognized.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008

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 Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* (FIN 48) on April 1, 2007, and the Company recorded a cumulative effect of a change in accounting principle in the amount of $2,657,000. The balance of the unrecognized tax benefits as of March 31, 2008 and September 30, 2008 was $4,480,000. There were no additions or reductions in the unrecognized tax benefit during the six months ended September 30, 2008.

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 in the September 2008 quarter for diluted earnings per share due to the effect of stock options.

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CORVEL CORPORATION
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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), options for up to 9,682,500 shares of the Company s common stock may be granted over the life of the Plan 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 with the remaining 75% vesting ratably each month for the next 36 months thereafter. The options granted to employees generally expire at the end of five years from the date of grant and the options granted to non-employee members of the board of directors generally expire at the end of ten years from the date of grant. 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 performance-based stock options for 149,000 shares of common stock at the 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. Based upon the Company s results for the past three calendar quarters, the Company believes that it will not attain the earnings target for the 2008, 2009, and 2010 tranches of the performance options granted in May 2006. The Company has reversed previously recognized stock based compensation expense in the amount of $250,000 and has now recognized no stock compensation expense for any of these performance stock options. In February 2008, the Company granted performance-based stock options for 49,000 shares of common stock at fair market value at the date of grant. Vesting of these options is tied to revenue targets for certain services by the Company in calendar years 2009, 2010, and 2011. Currently, management has determined that it is not probable that the Company will attain these targets and the Company has recognized no stock compensation expense for these options. The Company has historically issued new shares to satisfy option exercises as opposed to issuing shares from treasury stock.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008

Note B Stock Based Compensation and Stock Options (continued)

The tables below shows the amounts recognized in the financial statements for the three and six months ended September 30, 2007 and 2008, respectively.

	Three Months Ended	
	September 30, 2007	September 30, 2008
Cost of revenues	$ 115,000	$ 138,000
General and administrative	256,000	(9,000)
Total cost of stock-based compensation included in income, before income tax	371,000	129,000
Amount of income tax benefit recognized	(145,000)	(50,000)
Amount charged against income	$ 226,000	$ 79,000
Effect on diluted net income per share	$ (0.02)	$ (0.01)

	Six Months Ended	
	September 30, 2007	September 30, 2008
Cost of revenues	$ 226,000	$ 256,000
General and administrative	504,000	257,000
Total cost of stock-based compensation included in income, before income tax	730,000	513,000
Amount of income tax benefit recognized	(285,000)	(200,000)
Amount charged against income	$ 445,000	$ 313,000
Effect on diluted net income per share	$ (0.03)	$ (0.02)

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CORVEL CORPORATION
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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 6.4% and 10.75% for the three months ended September 30, 2007 and 2008, 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, 2007 and 2008 using the Black-Scholes option-pricing model:

	Three Months Ended September 30,	
	2007	2008
Risk-free interest rate	4.60%	3.15%
Expected volatility	39%	40%
Expected dividend yield	0.00%	0.00%
Expected forfeiture rate	6.40%	10.75%
Expected weighted average life of option in years	4.8 years	4.7 years

All options granted in the six months ended September 30, 2007 and 2008 were granted at fair market value and are non-statutory stock options.

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Note B Stock Based Compensation and Stock Options (continued)

Summarized information for all stock options for the three and six months ended September 30, 2007 and 2008 follows:

	Three Months Ended September 30, 2007		Three Months Ended September 30, 2008	
	Shares	Average Price	Shares	Average Price
Options outstanding, beginning	1,027,280	$ 18.08	991,694	$ 19.69
Options granted	46,100	26.86	45,425	30.00
Options exercised	(32,027)	14.73	(27,942)	16.18
Options cancelled	(14,887)	18.82	(11,830)	20.18
Options outstanding, ending	1,026,466	$ 18.57	997,347	$ 20.26

	Six Months Ended September 30, 2007		Six Months Ended September 30, 2008	
	Shares	Average Price	Shares	Average Price
Options outstanding, beginning	1,021,141	$ 17.84	1,030,558	$ 19.24
Options granted	73,800	26.97	75,225	30.97
Options exercised	(46,718)	16.00	(93,511)	17.68
Options cancelled	(21,757)	18.51	(14,925)	20.34
Options outstanding, ending	1,026,466	$ 18.57	997,347	$ 20.26

The following table summarizes the status of stock options outstanding and exercisable at September 30, 2008:

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	Options-Weighted Average Exercise Price
$8.08 to $15.55	217,409	2.45	$ 13.18	149,238	$ 13.05
$15.56 to $17.14	305,148	2.68	$ 15.94	115,671	$ 16.23
$17.15 to $25.83	230,301	3.99	$ 22.52	90,773	$ 20.76
$25.84 to $47.70	244,489	4.36	$ 29.80	64,340	$ 29.61
Total	997,347	3.34	$ 20.26	420,022	$ 18.13

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note B Stock Based Compensation and Stock Options (continued)

A summary of the status for all outstanding options at September 30, 2008, and changes during the six months then ended, is presented in the table below: