ENSIGN GROUP, INC
Form 10-Q
October 30, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
For the quarterly period ended September 30, 2008.

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: 001-33757
THE ENSIGN GROUP, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**33-0861263**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

27101 Puerta Real, Suite 450
Mission Viejo, CA 92691
(Address of Principal Executive Offices and Zip Code)
(949) 487-9500
(Registrants Telephone Number, Including Area Code)
N/A
(Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report)

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. þ Yes o 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 o Accelerated filer o Non-accelerated filer þ (Do not check if a smaller reporting company) Smaller reporting company o

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

As of October 24, 2008, 20,552,880 shares of the registrant s common stock were outstanding.

THE ENSIGN GROUP, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008
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Part I. Financial Information

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Part I. Financial Information

Item 1. ***Financial Statements***

THE ENSIGN GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)
(Unaudited)

	September 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 56,407	$ 51,732
Accounts receivable less allowance for doubtful accounts of $8,325 and $7,454 at September 30, 2008 and December 31, 2007, respectively	44,597	50,615
Prepaid income taxes	2,177	5,835
Prepaid expenses and other current assets	4,750	5,319
Deferred tax asset current	6,663	6,862
Total current assets	114,594	120,363
Property and equipment, net	141,893	124,861
Insurance subsidiary deposits	11,035	8,810
Deferred tax asset	4,119	4,865
Restricted and other assets	3,586	3,273
Intangible assets, net	4,502	2,335
Goodwill	2,882	2,882
Total assets	$ 282,611	$ 267,389
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 12,267	$ 14,699
Accrued wages and related liabilities	21,897	21,141
Accrued self-insurance liabilities current	6,997	7,424
Other accrued liabilities	10,869	11,137
Current maturities of long-term debt	1,089	2,993
Total current liabilities	53,119	57,394
Long-term debt less current maturities	59,735	60,577
Accrued self-insurance liability	19,214	17,236
Deferred rent and other long-term liabilities	1,887	2,505
Commitments and contingencies (Note 13)		
Stockholders equity:		
Common stock; $0.001 par value; 75,000 shares authorized; 21,225 and 20,553 issued and outstanding at September 30, 2008, respectively, and 21,196 and 20,480 shares issued and outstanding at December 31, 2007, respectively	21	21
Additional paid-in capital	63,681	62,142
Retained earnings	89,304	72,119

Common stock in treasury, at cost, 672 and 716 shares at September 30, 2008 and December 31, 2007, respectively		(4,350)		(4,605)
Total stockholders equity		148,656		129,677
Total liabilities and stockholders equity	$	282,611	$	267,389

See accompanying notes to condensed consolidated financial statements.

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THE ENSIGN GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	**2007**	**2008**	**2007**
Revenue	$ 116,328	$ 104,092	$ 345,425	$ 302,339
Expense:				
Cost of services (exclusive of facility rent and depreciation and amortization shown separately below)	94,297	86,176	278,364	247,177
Facility rent cost of services	3,282	4,177	11,229	12,511
General and administrative expense	4,565	3,995	14,628	11,638
Depreciation and amortization	2,350	1,818	6,513	5,004
Total expenses	104,494	96,166	310,734	276,330
Income from operations	11,834	7,926	34,691	26,009
Other income (expense):				
Interest expense	(1,183)	(1,288)	(3,553)	(3,637)
Interest income	239	275	1,094	973
Other expense, net	(944)	(1,013)	(2,459)	(2,664)
Income before provision for income taxes	10,890	6,913	32,232	23,345
Provision for income taxes	4,093	2,447	12,582	9,047
Net income	$ 6,797	$ 4,466	$ 19,650	$ 14,298
Net income per share:				
Basic	$ 0.33	$ 0.32	$ 0.96	$ 1.04
Diluted	$ 0.33	$ 0.26	$ 0.95	$ 0.85
Weighted average common shares outstanding:				
Basic	20,525	13,506	20,512	13,463
Diluted	20,777	16,878	20,667	16,887

See accompanying notes to condensed consolidated financial statements.

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THE ENSIGN GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Cash flows from operating activities:		
Net income	$ 19,650	$ 14,298
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,524	5,013
Amortization of deferred financing fees	51	
Deferred income taxes	945	(3,497)
Provision for doubtful accounts	3,050	2,139
Stock-based compensation	1,329	1,207
Excess tax benefit from share based compensation	(128)	
Loss on disposition of property and equipment	212	14
Change in operating assets and liabilities		
Accounts receivable	2,968	(4,493)
Prepaid income taxes	3,747	
Prepaid expenses and other current assets	569	(1,648)
Insurance subsidiary deposits	(2,225)	(1,179)
Accounts payable	(2,432)	(520)
Accrued wages and related liabilities	756	(2,935)
Other accrued liabilities	(340)	(905)
Accrued self-insurance	1,551	3,459
Deferred rent liability	(628)	36
Net cash provided by operating activities	35,599	10,989
Cash flows from investing activities:		
Purchase of property and equipment	(23,511)	(15,785)
Cash payment for business acquisitions	(2,005)	(9,452)
Restricted assets	(468)	(510)
Other assets	155	44
Net cash used in investing activities	(25,829)	(25,703)
Cash flows from financing activities:		
Payments on long term debt	(2,746)	(700)
Issuance of treasury stock upon exercise of options	255	57
Issuance of common stock upon exercise of options	121	32
Dividends paid	(2,468)	(1,973)
Payments of deferred offering costs		(1,690)
Excess tax benefit from share based compensation	128	

Payments of deferred financing costs		(385)		(84)
Purchase of treasury stock				(1)
Net cash used in financing activities		(5,095)		(4,359)
Net increase (decrease) in cash and cash equivalents		4,675		(19,073)
Cash and cash equivalents beginning of period		51,732		25,491
Cash and cash equivalents end of period	$	56,407	$	6,418
Supplemental disclosures of cash flow information:				
Cash paid during the period for:				
Interest	$	3,526	$	3,225
Income taxes	$	8,224	$	14,617
Non-cash investing and financing activities:				
Conditional asset retirement obligations under FIN 47	$		$	113

See accompanying notes to condensed consolidated financial statements.

THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars and shares in thousands, except per share data)
(Unaudited)

1. DESCRIPTION OF BUSINESS

The Company The Ensign Group, Inc., through its subsidiaries (collectively, Ensign or the Company), provides skilled nursing and rehabilitative care services through the operation of 62 facilities as of September 30, 2008, located in California, Arizona, Texas, Washington, Utah and Idaho. All of these facilities are skilled nursing facilities, other than three stand-alone assisted living facilities in Arizona and Texas and four campuses that offer both skilled nursing and assisted living services located in California, Arizona and Utah. The Company s facilities, each of which strives to be the facility of choice in the community it serves, provide a broad spectrum of skilled nursing and assisted living services, physical, occupational and speech therapies, and other rehabilitative and healthcare services, for both long-term residents and short-stay rehabilitation patients. The Company s facilities have a collective licensed capacity of over 7,500 skilled nursing, assisted living and independent living beds. As of September 30, 2008 the Company owned 28 of its 62 facilities, operated an additional 34 facilities through long-term lease arrangements, and had options to purchase 8 of those 34 facilities.

The Ensign Group, Inc. is a holding company with no direct operating assets, employees or revenue. All of the Company s facilities are operated by separate, wholly-owned, independent subsidiaries, each of which has its own management, employees and assets. One of the Company s wholly-owned subsidiaries, referred to as the Service Center, provides centralized accounting, payroll, human resources, information technology, legal, risk management and other centralized services to the other operating subsidiaries through contractual relationships with such subsidiaries. The Company also has a wholly-owned captive insurance subsidiary (the Captive) that provides some claims-made coverage to the Company s operating subsidiaries for general and professional liability, as well as coverage for certain workers compensation insurance liabilities.

Like the Company s facilities, the Service Center and the Captive are operated by separate, wholly-owned, independent subsidiaries that have their own management, employees and assets. References herein to the consolidated Company and its assets and activities, as well as the use of the terms we, us, our and similar verbia this quarterly report is not meant to imply that The Ensign Group, Inc. has direct operating assets, employees or revenue, or that any of the facilities, the Service Center or the Captive are operated by the same entity.

Other Information The accompanying condensed consolidated financial statements as of September 30, 2008 and for the three and nine month periods ended September 30, 2008 and 2007 (collectively, the Interim Financial Statements), are unaudited. Certain information and footnote disclosures normally included in annual consolidated financial statements have been condensed or omitted, as permitted under applicable rules and regulations. Readers of the Interim Financial Statements should refer to the Company s audited consolidated statements and notes thereto for the year ended December 31, 2007 which are included in the Company s annual report on Form 10-K, File No. 001-33757 (the Annual Report) filed with the Securities and Exchange Commission (the SEC). Management believes that the Interim Financial Statements reflect all adjustments which are of a normal and recurring nature necessary to present fairly the Company s financial position and results of operations in all material respects. The results of operations presented in the Interim Financial Statements are not necessarily representative of operations for the entire year.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The Company is the sole member or shareholder of various consolidated limited liability companies and corporations; each established to operate various acquired skilled nursing and assisted living facilities. All intercompany transactions and balances have been eliminated in consolidation.

Estimates and Assumptions The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. The most significant estimates in the Company s condensed consolidated financial statements relate to revenue, allowance for doubtful accounts, intangible assets and goodwill, impairment of long-lived assets, patient liability, general and professional liability, worker s compensation, and healthcare claims included in accrued self-insurance liabilities, stock-based compensation and income taxes. Actual results could differ from those estimates.

Business Segments The Company has a single reporting segment long-term care services, which includes the operation of skilled nursing and assisted living facilities, and related ancillary services at the facilities. The Company s single reporting segment is made up of several individual operating segments grouped together principally based on their geographical locations within the United States. Based on the similar economic and other characteristics of each of the operating segments, management believes the Company meets the criteria for aggregating its operating segments into a single reporting segment.

Fair Value of Financial Instruments The Company s financial instruments consist principally of cash and cash equivalents, accounts receivable, insurance subsidiary deposits, accounts payable and borrowings. The Company believes all of the financial instruments recorded values approximate fair values because of their nature and respective durations. The Company s fixed-rate debt instruments do not actively trade in an established market. The fair values of this debt are estimated by discounting the principal and interest payments at rates available to the Company for debt with similar terms and maturities.

Revenue Recognition The Company follows the provisions of Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition in Financial Statements* (SAB 104), for revenue recognition. Under SAB 104, four conditions must be met before revenue can be recognized: (i) there is persuasive evidence that an arrangement exists; (ii) delivery has occurred or service has been rendered; (iii) the price is fixed or determinable; and (iv) collection is reasonably assured. The Company s revenue is derived primarily from providing long-term healthcare services to residents and is recognized on the date services are provided at amounts billable to individual residents. For residents under reimbursement arrangements with third-party payors, including Medicaid, Medicare and private insurers, revenue is recorded based on contractually agreed-upon amounts on a per patient, daily basis.

Revenue from the Medicare and Medicaid programs accounted for approximately 74% and 75% of the Company s revenue for the three and nine months ended September 30, 2008 and 74% of the Company s revenue for both periods during the three and nine months ended September 30, 2007, respectively. The Company records revenue from these governmental and managed care programs as services are performed at their expected net realizable amounts under these programs. The Company s revenue from governmental and managed care programs is subject to audit and retroactive adjustment by governmental and third-party agencies. Consistent with healthcare industry accounting practices, any changes to these governmental revenue estimates are recorded in the period the change or adjustment becomes known based on final settlements. The Company recorded retroactive adjustments that increased revenue by $60 and $460, for the three and nine months ended September 30, 2008 and $80 and $848 for the three and nine months ended September 30, 2007, respectively. The Company also records revenue from private pay patients as services are performed.

Accounts Receivable Accounts receivable consist primarily of amounts due from Medicare and Medicaid programs, other government programs, managed care health plans and private payor sources. Estimated provisions for doubtful accounts are recorded to the extent it is probable that a portion or all of a particular account will not be collected.

In evaluating the collectibility of accounts receivable, the Company considers a number of factors, including the age of the accounts, changes in collection patterns, the composition of patient accounts by payor type and the status of ongoing disputes with third-party payors. The percentages applied to the aged receivable balances are based on the Company s historical experience and time limits, if any, for managed care, Medicare and Medicaid. The Company periodically refines its procedures for estimating the allowance for doubtful accounts based on experience with the estimation process and changes in circumstances.

Cash and Cash Equivalents Cash and cash equivalents consist of cash and short-term investments in bank term deposits, money market funds, and treasury bill related investments with original maturities of three months or less at time of purchase and therefore approximate fair value. The Company places its cash and short-term investments with high credit quality financial institutions.

Impairment of Long-Lived Assets The Company reviews the carrying value of long-lived assets that are held and used in the Company s operations for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of these assets is determined based upon expected undiscounted future net cash flows from the operations to which the assets relate, utilizing management s best estimate, appropriate assumptions, and projections at the time. If the carrying value is determined to be unrecoverable from future operating cash flows, the asset is deemed impaired and an impairment loss would be recognized to the extent the carrying value exceeded the estimated fair value of the asset. The Company estimates the fair value of assets based on the estimated future discounted cash flows of the asset. Management has evaluated its long-lived assets and has not identified any impairment as of September 30, 2008 and December 31, 2007.

Intangible Assets and Goodwill Intangible assets consist primarily of deferred financing costs, favorable lease, lease acquisition costs and trade names. Deferred financing costs are amortized over the term of the related debt, ranging from five to 26 years. Favorable leases and lease acquisition costs are amortized over the life of the lease of the facility, ranging from ten to 20 years. Trade names are amortized over 30 years.

Goodwill is accounted for under Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations* (SFAS 141) and represents the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142), goodwill is subject to annual testing for impairment. In addition, goodwill is tested for impairment if events occur or circumstances change that would reduce the fair value of a reporting unit below its carrying amount. The Company defines reporting units as the individual facilities. The Company performs its annual test for impairment during the fourth quarter of each year. The Company did not record any impairment charges during the nine months ended September 30, 2008 or in 2007.

Self-Insurance The Company is partially self-insured for general and professional liability up to a base amount per claim (the self-insured retention) with an aggregate, one time deductible above this limit. Losses beyond these amounts are insured through third-party policies with coverage limits per occurrence, per location and on an aggregate basis for the Company. For claims made in 2008, the self-insured retention was $350 per claim with a $900 deductible. As of September 30, 2008, the third-party coverage above these limits was $1,000 per occurrence, $3,000 per facility with a $6,000 blanket aggregate.

The self-insured retention and deductible limits for general and professional liability and worker s compensation are self-insured through the Captive, the related assets and liabilities of which are included in the accompanying consolidated financial statements. The Captive is subject to certain statutory requirements as an insurance provider. These requirements include, but are not limited to, maintaining statutory capital. The Company s policy is to accrue amounts equal to the actuarially estimated costs to settle open claims of insureds, as well as an estimate of the cost of insured claims that have been incurred but not reported. The Company develops information about the size of the ultimate claims based on historical experience, current industry information and actuarial analysis, and evaluates the estimates for claim loss exposure on a quarterly basis. Accrued general liability and professional malpractice liabilities recorded on an undiscounted basis in the accompanying condensed consolidated balance sheets were $18,700 and $18,596 as of September 30, 2008 and December 31, 2007, respectively.

The Company s operating subsidiaries are self-insured for workers compensation liability in California. To protect itself against loss exposure in California, with this policy, the Company has purchased individual stop-loss insurance coverage that insures individual claims that exceed $600 for each claim. In Texas, the operating subsidiaries have elected non-subscriber status for workers compensation claims. The Company s operating subsidiaries in other states have third party guaranteed cost coverage. In California and Texas, the Company accrues amounts equal to the estimated costs to settle open claims, as well as an estimate of the cost of claims that have been incurred but not reported. The Company uses actuarial valuations to estimate the liability based on historical experience and industry information. Accrued workers compensation liabilities are recorded on an undiscounted basis in the accompanying condensed consolidated balance sheets and were $5,606 and $4,145 as of September 30, 2008 and December 31, 2007, respectively.

During 2003 and 2004, the Company s California and Arizona operating subsidiaries were insured for workers compensation liability by a third-party carrier under a policy where the retrospective premium was adjusted annually based on incurred developed losses and allocated expenses. Based on a comparison of the computed retrospective premium to the actual payments funded, amounts will be due to the insurer or insured. The term for this policy expired and all remaining balances were settled with the insurance carrier during the quarter ended September 30, 2008. The funded accrual in excess of the estimated liabilities is included in prepaid expenses and other current assets in the accompanying condensed consolidated balance sheets and was $0 and $431 as of September 30, 2008 and December 31, 2007, respectively.

The Company provides self-insured medical (including prescription drugs) and dental healthcare benefits to the majority of its employees. The Company is fully liable for all financial and legal aspects of these benefit plans. To protect itself against loss exposure with this policy, the Company has purchased individual stop-loss insurance coverage that insures individual claims that exceed $200 for each covered person, which resets every plan year or a lifetime maximum of $5,000 per each covered person s lifetime on the PPO plan and unlimited on the HMO plan. The Company has also purchased aggregate stop-loss coverage that reimburses the plan up to $5,000 to the extent that paid claims exceed $7,225. The aforementioned coverage only applies to claims paid during the plan year. The Company s accrued liability under these plans recorded on an undiscounted basis in the accompanying condensed consolidated balance sheets was $1,905 and $1,919 at September 30, 2008 and December 31, 2007, respectively.

The Company believes that adequate provision has been made in the consolidated financial statements for liabilities that may arise out of patient care, workers compensation, healthcare benefits and related services provided to date. The amount of the Company s reserves was determined based on an estimation process that uses information obtained from both company-specific and industry data. This estimation process requires the Company to continuously monitor and evaluate the life cycle of the claims. Using data obtained from this monitoring and the Company s assumptions about emerging trends, the Company, with the assistance of an independent actuary, develops information about the size of ultimate claims based on the Company s historical experience and other available industry information. The most significant assumptions used in the estimation process include determining the trend in costs, the expected cost of claims incurred but not reported and the expected costs to settle or pay damage awards with respect to unpaid claims. It is possible, however, that the actual liabilities may exceed the Company s estimate of loss.

The self-insured liabilities are based upon estimates, and while management believes that the estimates of loss are reasonable, the ultimate liability may be in excess of or less than the recorded amounts. Due to the inherent volatility of actuarially determined loss estimates, it is reasonably possible that the Company could experience changes in estimated losses that could be material to net income. If the Company s actual liability exceeds its estimate of loss, its future earnings and financial condition would be adversely affected.

Income Taxes Income taxes are accounted for in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS 109). Under this method, deferred tax assets and liabilities are established for temporary differences between the financial reporting basis and the tax basis of the Company s assets and liabilities at tax rates expected to be in effect when such temporary differences are expected to reverse. The temporary differences are primarily attributable to compensation accruals, straight line rent adjustments and reserves for doubtful accounts and insurance liabilities. When necessary, the Company records a valuation allowance to reduce its net deferred tax assets to the amount that is more likely than not to be realized. In considering the need for a valuation allowance against some portion or all of its deferred tax assets, the Company must make certain estimates and assumptions regarding future taxable income, the feasibility of tax planning strategies and other factors.

Estimates and judgments regarding deferred tax assets and the associated valuation allowance, if any, are based on, among other things, knowledge of operations, markets, historical trends and likely future changes and, when appropriate, the opinions of advisors with knowledge and expertise in certain fields. However, due to the nature of certain assets and liabilities, there are risks and uncertainties associated with some of the Company s estimates and judgments. Actual results could differ from these estimates under different assumptions or conditions. The net deferred tax assets as of September 30, 2008 and December 31, 2007 were $10,782 and $11,727, respectively. The Company expects to fully utilize these deferred tax assets; however, their ultimate realization is dependent upon the amount of future taxable income during the periods in which the temporary differences become deductible.

As of January 1, 2007, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 requires the Company to maintain a liability for underpayment of income taxes and related interest and penalties, if any, for uncertain income tax positions. In considering the need for and magnitude of a liability for uncertain income tax positions, the Company must make certain estimates and assumptions regarding the amount of income tax benefit that will ultimately be realized. The ultimate resolution of an uncertain tax position may not be known for a number of years, during which time the Company may be required to adjust these reserves, in light of changing facts and circumstances.

The Company used an estimate of its annual income tax rate to recognize a provision for income taxes in financial statements for interim periods. However, changes in facts and circumstances could result in adjustments to the Company s effective tax rate in future quarterly or annual periods.

Stock-Based Compensation As of January 1, 2006, the Company adopted SFAS No. 123(R), *Share-Based Payment* (SFAS 123(R)), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including employee stock options based on estimated fair values, ratably over the requisite service period of the award. Net income has been reduced as a result of the recognition of the fair value of all stock options issued on and subsequent to January 1, 2006, the amount of which is contingent upon the number of future options granted and other variables. Prior to the adoption of SFAS 123(R), the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) as allowed under SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123).

New Accounting Pronouncements In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS 141(R)), which replaces SFAS 141. The provisions of SFAS 141(R) are similar to those of SFAS 141; however, SFAS 141(R) requires companies to record most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination at full fair value. SFAS 141(R) also requires companies to record fair value estimates of contingent consideration and certain other potential liabilities during the original purchase price allocation and to expense acquisition costs as incurred. This statement applies to all business combinations, including combinations by contract alone. Further, under SFAS 141(R), all business combinations will be accounted for by applying the acquisition method. SFAS 141(R) is effective for fiscal years beginning on or after December 15, 2008. Accordingly, any business combinations the Company engages in will be recorded and disclosed according to SFAS 141, until January 1, 2009. The Company expects SFAS 141(R) will have an impact on its consolidated financial statements when effective, but the nature and magnitude of the specific effects will depend upon the nature, terms and size of the acquisitions, if any, that the Company consummates after the effective date.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS 160), which will require noncontrolling interests (previously referred to as minority interests) to be treated as a separate component of equity, not as a liability or other item outside of permanent equity. This Statement applies to the accounting for noncontrolling interests and transactions with non-controlling interest holders in consolidated financial statements. SFAS 160 will be applied prospectively to all noncontrolling interests, including any that arose before the effective date except that comparative period information must be recast to classify noncontrolling interests in equity, attribute net income and other comprehensive income to noncontrolling interests, and provide other disclosures required by SFAS 160. SFAS 160 is effective for periods beginning on or after December 15, 2008. The adoption of SFAS 160 is not expected to have a material impact on the Company s financial position, results of operations or liquidity.

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In September 2008, the FASB finalized Staff Position (FSP) No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP 03-6-1). The FSP affects entities that accrue cash dividends on share-based payment awards during the awards service period when the dividends do not need to be returned if the employees forfeit the awards. The FASB concluded that all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends participate in undistributed earnings with common shareholders and therefore the issuing entity is required to apply the two-class method of computing basic and diluted earnings per share. The FSP is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The Company is currently evaluating the impact that FSP 03-6-1 will have on its consolidated financial statements.

Adoption of New Accounting Pronouncements In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157) which defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and requires enhanced disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. In February 2008 the FASB issued FSP 157-2, *Effective Date of FASB Statement No. 157* , which delays the effective date of SFAS 157 for non-financial assets and liabilities, other than those that are recognized or disclosed at fair value on a recurring basis, to fiscal years beginning after November 15, 2008. The adoption of SFAS 157 related to financial assets and liabilities had no impact on the Company s consolidated financial statements. The Company is currently evaluating the impact, if any, that SFAS 157 may have on its future consolidated financial statements related to non-financial assets and liabilities.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 permits all entities to choose, at specified election dates, to measure certain financial instruments and other items at fair value (fair value option). A business entity must report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. SFAS 159 is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. The Company s adoption of SFAS 159 at the beginning of fiscal 2008 had no impact on its consolidated financial position or results of operations.

In September 2007, the FASB ratified EITF Issue No. 06-11, *Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards* (EITF 06-11). This EITF prescribes that the tax benefit received on dividends associated with non-vested share-based awards that are charged to retained earnings should be recorded in additional paid-in capital and included in the pool of excess tax benefits available to absorb potential future tax deficiencies of share based payment awards. EITF 06-11 is effective for the tax benefits of dividends declared in fiscal years beginning after December 15, 2007. The Company s adoption of EITF 06-11 at the beginning of fiscal 2008 did not have a material impact on its consolidated financial position or results of operations.

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3. COMPUTATION OF NET INCOME PER COMMON SHARE

Basic net income per share is computed by dividing net income attributable to common shares by the weighted average number of outstanding common shares for the period. The computation of diluted net income per share is similar to the computation of basic net income per share except that the denominator is increased to include contingently returnable shares and the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. In addition, in computing the dilutive effect of convertible securities, the numerator is adjusted to add back (a) any convertible preferred dividends and (b) the after-tax amount of interest, if any, recognized in the period associated with any convertible debt.

A reconciliation of the numerator and denominator used in the calculation of basic net income per common share follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	**2007**	**2008**	**2007**
Numerator:				
Net income	$ 6,797	$ 4,466	$ 19,650	$ 14,298
Preferred stock dividends		(110)		(329)
Net income available to common stockholders for basic net income per share	$ 6,797	$ 4,356	$ 19,650	$ 13,969
Denominator:				
Weighted average shares outstanding for basic net income per share(1)	20,525	13,506	20,512	13,463
Basic net income per common share	$ 0.33	$ 0.32	$ 0.96	$ 1.04

(1) Basic share amounts are shown net of unvested shares subject to the Company s repurchase right, which total 50 and 160 shares at September 30, 2008 and 2007, respectively.

A reconciliation of the numerator and denominator used in the calculation of diluted net income per common share follows:

	Three Months Ended September 30,	Nine Months Ended September 30,
	2008	