CORVEL CORP
Form 10-Q
August 04, 2017

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 June 30, 2017

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)

Delaware	33-0282651
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2010 Main Street, Suite 600	
Irvine, CA	92614
(Address of principal executive offices)	(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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
Emerging growth company		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 August 1, 2017, was 18,755,675.

CORVEL CORPORATION

FORM 10-Q

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Part I - Financial Information

Item 1 - Financial Statements

CORVEL CORPORATION

CONSOLIDATED BALANCE SHEETS

	March 31, 2017	June 30, 2017 (Unaudited)
Assets		
Current Assets		
Cash and cash equivalents (Note A)	$28,611,000	$35,009,000
Customer deposits	32,471,000	31,730,000
Accounts receivable, net	62,841,000	62,768,000
Prepaid taxes and expenses	4,944,000	4,906,000
Total current assets	128,867,000	134,413,000
Property and equipment, net	63,042,000	63,152,000
Goodwill	36,814,000	36,814,000
Other intangibles, net (Note F)	3,851,000	3,728,000
Other assets	2,809,000	2,352,000
TOTAL ASSETS	$235,383,000	$240,459,000
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts and taxes payable	$16,583,000	$20,679,000
Accrued liabilities	73,468,000	74,761,000
Total current liabilities	90,051,000	95,440,000
Deferred income taxes	6,686,000	6,358,000
Total liabilities	96,737,000	101,798,000
Commitments and contingencies (Notes G and H)		
Stockholders' Equity		
Common stock, $.0001 par value: 120,000,000 shares authorized at March 31, 2017 and June 30, 2017; 53,569,067 shares issued (18,937,233 shares outstanding, net of Treasury shares) and 53,619,066 shares issued (18,738,011 shares outstanding, net of Treasury shares) at March 31, 2017 and June 30, 2017, respectively	3,000	3,000
Paid-in capital	135,683,000	138,110,000
Treasury Stock (34,631,834 shares at March 31, 2017 and 34,881,055 shares at June 30, 2017)	(419,802,000)	(430,989,000)
Retained earnings	422,762,000	431,537,000
Total stockholders' equity	138,646,000	138,661,000
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$235,383,000	$240,459,000

See accompanying notes to unaudited consolidated financial statements.

CORVEL CORPORATION

CONSOLIDATED INCOME STATEMENTS – UNAUDITED

	Three Months Ended June 30,	
	2016	2017
REVENUES	$128,459,000	$137,612,000
Cost of revenues	102,877,000	108,829,000
Gross profit	25,582,000	28,783,000
General and administrative expenses	13,461,000	14,629,000
Income before income tax provision	12,121,000	14,154,000
Income tax provision	4,630,000	5,379,000
NET INCOME	$7,491,000	$8,775,000
Net income per common and common equivalent share		
Basic	$0.38	$0.47
Diluted	$0.38	$0.46
Weighted average common and common equivalent shares		
Basic	19,572,000	18,811,000
Diluted	19,754,000	19,000,000

See accompanying notes to unaudited consolidated financial statements.

CORVEL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS – UNAUDITED

	Three Months Ended June 30, 2016	2017
Cash Flows from Operating Activities		
NET INCOME	$7,491,000	$8,775,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,051,000	5,303,000
Loss on write down or disposal of property, capitalized software or investment	7,000	288,000
Stock compensation expense	516,000	922,000
Provision for doubtful accounts	386,000	276,000
Deferred income tax	(193,000)	(328,000)
Changes in operating assets and liabilities		
Accounts receivable	(1,341,000)	(203,000)
Customer deposits	1,139,000	741,000
Prepaid taxes and expenses	(1,582,000)	38,000
Other assets	71,000	178,000
Accounts and taxes payable	2,618,000	4,096,000
Accrued liabilities	(6,020,000)	1,293,000
Net cash provided by operating activities	8,143,000	21,379,000
Cash Flows from Investing Activities		
Purchase of property and equipment	(5,285,000)	(5,299,000)
Net cash (used in) investing activities	(5,285,000)	(5,299,000)
Cash Flows from Financing Activities		
Purchase of treasury stock	(1,648,000)	(11,187,000)
Tax effect of stock option exercises	743,000	768,000
Exercise of common stock options	1,502,000	737,000
Net cash provided by (used in) financing activities	597,000	(9,682,000)
Increase in cash and cash equivalents	3,455,000	6,398,000
Cash and cash equivalents at beginning of period	32,779,000	28,611,000
Cash and cash equivalents at end of period	$36,234,000	$35,009,000
Supplemental Cash Flow Information:		
Income taxes paid	$1,818,000	$152,000
Purchase of software license under finance agreement	$2,166,000	$—

See accompanying notes to unaudited consolidated financial statements.

CORVEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The unaudited consolidated financial statements herein have been prepared by CorVel Corporation (“the Company”) pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”). The accompanying interim unaudited financial statements have been prepared under the presumption that users of the interim financial information have either read or have access to the audited consolidated financial statements for the latest fiscal year ended March 31, 2017. Accordingly, note disclosures which would substantially duplicate the disclosures contained in the March 31, 2017 audited consolidated financial statements have been omitted from these interim unaudited consolidated financial statements.

The Company evaluated all subsequent events and transactions through the date of filing this report.

Certain information and note disclosures normally included in financial statements prepared in accordance with United States generally accepted accounting principles (“GAAP”) 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 months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2018. For further information, refer to the audited consolidated financial statements and notes for the fiscal year ended March 31, 2017 included in the Company's Annual Report on Form 10-K filed with the SEC on June 9, 2017.

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

Use of Estimates: The preparation of financial statements in compliance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the accompanying unaudited consolidated financial statements. Actual results could differ from those estimates. Significant estimates include the values assigned to intangible assets, capitalized software development, allowance for doubtful accounts, accruals for income taxes, share-based payments related to performance-based awards, loss contingencies, estimated claims for claims administration revenue recognition, estimates used in stock option valuations, and accruals 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. Customer deposits represent cash that is expected to be returned or applied towards payment within one year through our provider reimbursement services.

Fair Value of Financial Instruments: The Company applies Financial Accounting Standards Board (the “FASB”) Accounting Standards Codification (“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 (i) 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 (ii) 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 amounts of the Company's financial instruments (i.e. cash equivalents, accounts receivable, accounts payable) are all Level 1, and the Company believes they approximate their fair values at March 31, 2017 and June 30, 2017. The Company has no Level 2 or Level 3 financial instruments.

Investment in Private Equity: The Company has made an investment of $2,250,000 into a private equity limited partnership that invests in start-up companies primarily in the data analytics industry. The Company accounts for the investment using the cost method and will periodically review the investment for possible impairment. The Company recorded an impairment to the investment of $284,000 for the year ended March 31, 2017 and an additional $283,000 for the quarter ended June 30, 2017. The investment is recorded in other assets on the accompanying consolidated balance sheets.

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Goodwill: The Company accounts for its business combinations in accordance with the FASB ASC 805-10 through ASC 805-50, “Business Combinations,” which (i) requires that the purchase method of accounting be applied to all business combinations and (ii) 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 (i) there is persuasive evidence of an arrangement, (ii) the services have been provided to the customer, (iii) the sales price is fixed or determinable, and (iv) collectability is reasonably assured. For the Company’s services, the Company’s professional staff is contractually permitted to bill (i) for fees earned for time worked in fraction of an hour increments or (ii) by units of production. The Company recognizes revenue as fees are earned 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 such multiple element arrangements in accordance with the guidance included in ASC 605-25.

The multiple element arrangements consist of bundled managed care services, which include various units of accounting such as network solutions and patient management (which includes claims administration). Such elements are considered separate units of accounting due to each element having value to the customer on a stand-alone basis. The selling price for each unit of accounting is determined using the contract price and management estimates. When the Company’s customers purchase several products, the pricing of the products sold is generally the same as if the products were sold on an individual basis. Revenue is recognized as the work is performed in accordance with the Company’s customer contracts. Based upon the nature of the Company’s products, bundled managed care elements are generally delivered in the same accounting period. The Company recognizes revenue for patient management claims administration services over the life of the customer contract. 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.

Accounts Receivable: The majority of the Company’s accounts receivable is 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, 2017 or June 30, 2017. No one customer accounted for 10% or more of revenue during the three months ended June 30, 2016 and 2017.

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 two to seven years or the life of the lease. 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 within 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 depends on 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

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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.

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 share-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 quarter ended June 30, 2017 compared to the same quarter of the prior year primarily due to repurchases of shares under the Company's share repurchase program. See also Note D.

Recent Accounting Pronouncements: On May 28, 2014, the FASB issued ASU 2014-09 regarding ASC Topic 606, "Revenue from Contracts with Customers". This standard provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services. In July 2015, the FASB approved a one-year delay of the effective date of this new revenue recognition standard. The guidance will now be effective for our fiscal year beginning April 1, 2018. We are currently evaluating the accounting, transition and disclosure requirements of the standard. Based on the analyses we have completed thus far, which includes analyzing CorVel standard contracts from which the Company derives the majority of its revenues, we anticipate that the ASU will not have a significant impact on our consolidated financial statements. However, the Company is currently reviewing its existing non-standard customer contracts, and as a result, the impact of the ASU adoption on this portion of the Company's revenues cannot yet be reasonably estimated.

In January 2016, the FASB issued ASU 2016-01 regarding Subtopic 825-10, "Financials Instruments — Overall: Recognition and Measurements of Financial Assets and Financial Liabilities". The standard addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. It requires that most equity investments be measured at fair value, with subsequent changes in fair value recognized in net income. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. We are currently evaluating the accounting, transition, and disclosure requirements of the standard and cannot currently estimate the impact of adoption on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, "Leases", which sets out the principles for the recognition, measurement, presentation, and disclosure of leases for both parties to a contract (i.e. lessees and lessors). The standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases. This classification will determine whether the lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for using an approach that is similar to the existing guidance for operating leases. The standard is effective April 1, 2019, with early adoption permitted. The standard is to be applied using a modified retrospective transition method. We are currently evaluating the impact of adoption on our consolidated financial position, results of operations, and cash flows.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows", which reduces diversity in the practice of how certain transactions are classified in the statement of cash flows. The new guidance is effective for annual reporting periods beginning after December 15, 2017, with early adoption permitted. The adoption of this guidance will not have a material impact on our consolidated financial statements.

Guidance Adopted in 2017

In March 2016, the FASB issued ASU No. 2016-09, “Improvements to Employee Share-Based Payment Accounting”, which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, statutory tax withholding requirements, as well as classification on the statement of cash flows. For public companies, the new guidance became effective for annual reporting periods, and interim periods within those periods, beginning after December 15, 2016. We have elected to early adopt this standard as of March 31, 2017.

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 June 30, 2017, options exercisable for up to 19,365,000 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 on the date of grant. Options granted under the Plan are non-statutory stock options and generally vest 25% one year from

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the date of grant with the remaining 75% vesting ratably each month for the next 36 months. The options granted to employees and the Company's Board of Directors expire at the end of five years and ten years from date of grant, respectively. All options granted in the three months ended June 30, 2016 and 2017 were granted with an exercise price equal to the fair value of the Company's common stock on the grant date and are non-statutory stock options.

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 dividend yield, the expected forfeiture rate and the expected option life. Upon adoption of ASU No. 2016-09 as of fiscal 2017, the Company will account for forfeitures as they occur, rather than estimate expected forfeitures. As a result, during the fourth quarter of fiscal 2017, we reclassified the excess tax benefit of $0.5 million from additional paid in capital into the income tax provision line. The risk-free rate is based on the interest rate paid on a U.S. Treasury issue with a term similar to the estimated life of the option. The following assumptions were used to estimate the fair value of options granted during the three months ended June 30, 2016 and 2017 using the Black-Scholes option-pricing model:

	Three Months Ended June 30,	
	2016	2017
Risk-free interest rate	1.20%	1.88%
Expected volatility	43%	41%
Expected dividend yield	0.00%	0.00%
Expected weighted average life of option in years	4.1 years	4.5 years

For the three months ended June 30, 2016 and 2017, the Company recorded share-based compensation expense of $516,000 and $922,000, respectively. The table below shows the amounts recognized in the unaudited consolidated financial statements for stock compensation expense for time-based options and performance-based options during the three months ended June 30, 2016 and 2017, respectively.

	Three Months Ended	
	June 30, 2016	June 30, 2017
Cost of revenues	$337,000	$483,000
General and administrative	179,000	439,000
Total cost of stock-based compensation included in income before income tax provision	516,000	922,000

Amount of income tax benefit recognized	(197,000)	(350,000)
Amount charged against net income	$319,000	$572,000
Effect on basic earnings per share	$(0.02)	$(0.03)
Effect on diluted earnings per share	$(0.02)	$(0.03)

The following table summarizes information for all stock options for the three months ended June 30, 2016 and 2017:

	Three Months Ended June 30, 2016		Three Months Ended June 30, 2017	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options outstanding, beginning	1,115,465	$ 30.36	1,143,928	$ 32.02
Options granted	44,900	45.74	77,400	45.93
Options exercised	(76,623)	22.11	(65,921)	26.67
Options cancelled/forfeited	(9,221)	35.43	(3,685)	39.99
Options outstanding, ending	1,074,521	$ 31.56	1,151,722	$ 33.24

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June 30, 2017

The following table summarizes the status of stock options outstanding and exercisable at June 30, 2017:

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
$12.71 to $23.10	292,576	1.94	$ 20.33	292,576	$ 20.33
$23.11 to $34.77	296,844	3.61	$ 31.75	103,778	$ 30.27
$34.78 to $43.14	316,406	3.21	$ 37.26	85,645	$ 38.93
$43.15 to $46.10	245,896	3.79	$ 45.21	76,720	$ 45.37
Total	1,151,722	3.11	$ 33.24	558,719	$ 28.46

The following table summarizes the status of all outstanding options at June 30, 2017, and changes during the three months then ended:

	Number of Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value as of June 30, 2017
Options outstanding at April 1, 2017	1,143,928	$ 32.02		
Granted	77,400	45.93		
Exercised	(65,921)	26.67		
Cancelled – forfeited	(2,062)	38.25		
Cancelled – expired	(1,623)	42.99		
Ending outstanding	1,151,722	$ 33.24	3.11	$16,370,972
Ending vested and expected to vest	1,151,722	$ 33.24	3.11	$16,370,972
Ending exercisable at June 30, 2017	558,719	$ 28.46	2.13	$10,608,043

The weighted-average grant-date fair value of options granted during the three months ended June 30, 2016 and 2017, was $15.91 and $16.57, respectively.

Included in the above-noted stock option grants and stock compensation expense are performance-based stock options which vest only upon the Company's achievement of certain earnings per share targets on a calendar year basis, as determined by the Company's Board of Directors. These options were valued in the same manner as the time-based options. However, the Company only recognizes stock compensation expense to the extent that the targets are determined to be probable of being achieved, which triggers the vesting of the performance options. The Company recognized ($31,000) and $212,000 of stock compensation expense for the three months ended June 30, 2016 and 2017, respectively, for performance-based stock options.

Note C — Treasury Stock

The Company's Board of Directors approved the commencement of a share repurchase program in the fall of 1996. In February 2017, the Company's Board of Directors approved a 1,000,000 share expansion to the Company's existing stock repurchase program, increasing the total number of shares of the Company's common stock approved for repurchase over the life of the program to 36,000,000 shares. Since the commencement of the share repurchase program, the Company has spent $431 million on the repurchase of 34,881,055 shares of its common stock, equal to 65% of the outstanding common stock had there been no repurchases. The average price of these repurchases was $12.36 per share. These repurchases were funded primarily by the net earnings of the Company, along with proceeds from the exercise of common stock options. During the three months ended June 30, 2017, the Company repurchased 249,245 shares of its common stock for $11.2 million at an average price of $44.88 per share of stock. The Company had 18,738,011 shares of common stock outstanding as of June 30, 2017, net of the 34,881,055 shares in treasury.

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Note D — Weighted Average Shares and Net Income Per Share

Basic weighted average common shares outstanding decreased from 19,572,000 for the quarter ended June 30, 2016 to 18,811,000 for the quarter ended June 30, 2017. Diluted weighted average common and common equivalent shares outstanding decreased from 19,754,000 for the quarter ended June 30, 2016 to 19,000,000 for the quarter ended June 30, 2017. The net decrease in both of these weighted average 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 Plan.

Net income per common and common equivalent share was computed by dividing net income by the weighted average number of common and common share equivalents outstanding during the quarter. The following table sets forth the calculations of the basic and diluted weighted average shares for the three months ended June 30, 2016 and 2017:

	Three Months Ended June 30,	
	2016	2017
Net Income	$7,491,000	$8,775,000
Basic:		
Weighted average common shares outstanding	19,572,000	18,811,000
Net Income per share	$0.38	$0.47
Diluted:		
Weighted average common shares outstanding	19,572,000	18,811,000
Treasury stock impact of stock options	182,000	189,000
Total common and common equivalent shares	19,754,000	19,000,000
Net Income per share	$0.38	$0.46

Note E — Shareholder Rights Plan

During fiscal year 1997, the Company's Board of Directors approved the adoption of a shareholder rights plan (the "Shareholder Rights Plan"). The Shareholder Rights Plan provides for a dividend distribution to the Company's shareholders of one preferred stock purchase right for each outstanding share of the Company's common stock held by such shareholder (as used in this Note E, the "right" or the "rights"), only in the event of certain takeover-related events. 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 a proposed takeover of the Company, and to encourage a potential acquirer to negotiate with the Company's Board of Directors prior to attempting a takeover. The rights are not exercisable until the occurrence of certain takeover-related events, at which time they can be exercised at an exercise price of $118 per share of common stock which carries the right, subject to subsequent adjustments. The rights trade with the Company's common stock.

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 Company's Board of Directors, 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.

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June 30, 2017

Note F — Other Intangible Assets

The following table summarizes other intangible assets at March 31, 2017:

Item	Life	Cost	Fiscal 2017 Amortization Expense	Accumulated Amortization at March 31, 2017	Cost, Net of Accumulated Amortization at March 31, 2017
Covenants Not to Compete	5 Years	$775,000	$ —	$ 775,000	$ —
Customer Relationships	18-20 Years	7,922,000	423,000	4,144,000	3,778,000
TPA Licenses	15 Years	204,000	14,000	131,000	73,000
Total		$8,901,000	$ 437,000	$ 5,050,000	$ 3,851,000

The following table summarizes other intangible assets at June 30, 2017:

Item	Life	Cost	Three Months Ended June 30, 2017 Amortization Expense	Accumulated Amortization at June 30, 2017	Cost, Net of Accumulated Amortization at June 30, 2017
Covenants Not to Compete	5 Years	$775,000	$ —	$ 775,000	$ —
Customer Relationships	18-20 Years	7,922,000	118,000	4,262,000	3,660,000
TPA Licenses	15 Years	204,000	4,000	136,000	68,000
Total		$8,901,000	$ 122,000	$ 5,173,000	$ 3,728,000

Note G — Line of Credit

In September 2016, the Company renewed its line of credit agreement with a financial institution, which provides a revolving credit facility with borrowing capacity of up to $10 million. Borrowings under the credit agreement, as amended, bear interest, at the Company’s option, at a fixed LIBOR-based rate plus 1.00% or at a fluctuating rate determined by the financial institution to be 1.00% above the daily one-month LIBOR rate. The loan covenants require the Company to (i) maintain a current assets to liabilities ratio of at least 1.25:1, (ii) maintain a current debt to tangible net worth ratio of not greater than 1.25:1 and (iii) have positive net income. The Company is in compliance with all these covenants. There were no outstanding revolving loans as of June 30, 2017, but letters of credit in the aggregate amount of $4.5 million have been issued separately 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 2017. The Company expects to renew the line of credit for another year.

Note H — Contingencies and Legal Proceedings

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

Note I — Accounts and Taxes Payable and Accrued Liabilities

The following table sets forth accounts payable, income taxes payable, and accrued liabilities at March 31, 2017 and June 30, 2017:

	March 31, 2017	June 30, 2017
Accounts payable	$13,869,000	$12,588,000
Income taxes payable and uncertain tax positions	2,714,000	8,091,000
Total accounts and taxes payable	$16,583,000	$20,679,000

CORVEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

	March 31, 2017	June 30, 2017
Payroll, payroll taxes and employee benefits	$14,465,000	$15,999,000
Customer deposits	32,471,000	31,730,000
Accrued professional service fees	4,551,000	4,408,000
Self-insurance accruals	2,835,000	2,896,000
Deferred revenue	10,096,000	10,904,000
Accrued rent	5,774,000	5,607,000
Other	3,276,000	3,217,000
Total accrued liabilities	$73,468,000	$74,761,000

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,” “will,” “would,” “co variations of these words and similar expressions, are intended to identify these forward-looking statements. Forward-looking statements made by the Company and its management are based on estimates, projections, beliefs and assumptions of management at the time of such statements and are not guarantees of future performance.

The Company disclaims any obligations to update or revise any forward-looking statement based on the occurrence of future events, the receipt of new information or otherwise. Actual future performance, outcomes, and results may differ materially from those expressed in forward-looking statements made by the Company and its management as a result of a number of risks, uncertainties and assumptions. Representative examples of these factors include (without limitation) general industry and economic conditions, including a decreasing number of national claims due to a 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, including but not limited to legislative and administrative law and rule implementation or change; dependence on key personnel; the impact of recently issued accounting standards on the Company’s consolidated financial statements; the continued growth in the Company’s sale of TPA services and the other risks identified in Part II, Item 1A of this report.

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 benefits, mobile insurance claims, and group health insurance benefits. The Company’s services are provided to insurance companies, third party administrators, or TPA’s, governmental entities, and self-administered employers to assist them in managing the medical costs and monitoring the quality of care associated with healthcare claims. There is a decrease in the occupational injury and illness incidence rates as released from the United States Department of Labor in October 2016. This is a continuance of a long term trend of a decrease in the injury rates in the United States, therefore, fewer claims could lead to fewer medical dollars to be reviewed.

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, automobile insurance policies, and group health insurance policies. The network solutions services offered by the Company include automated medical fee auditing, preferred provider management and reimbursement services, retrospective utilization review, facility claim review, professional review, pharmacy services, directed care services, Medicare solutions, clearinghouse services, independent medical examinations, and inpatient medical bill review. Network solutions services also includes revenue from the Company’s directed care network (known as CareIQ), which includes imaging, physical therapy and durable medical equipment.

Patient Management Services

In addition to its network solutions services, the Company offers a range of patient management services, which involve working one-on-one with injured employees and their various healthcare professionals, employers and insurance company adjusters. Patient management services include claims management and all services sold to claims management customers, case management, 24/7 nurse triage, utilization management, vocational rehabilitation, and life care planning. 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. Patient management services include the processing of claims for self-insured payors with respect to property and casualty insurance.

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 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 to customers. Financial Accounting Standards Board, or FASB, Accounting Standard Codification, or ASC, 280- 10, "Segment Reporting", 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: (i) the nature of products and services; (ii) the nature of the production processes; (iii) the type or class of customer for their products and services; and (iv) 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.

Seasonality

While we are not directly impacted by seasonal shifts, we are affected by the change in working days in a given quarter. There are generally fewer working days for our employees to generate revenue in the third fiscal quarter due to employee vacations, inclement weather, and holidays.

Summary of Quarterly Results

The Company's revenues increased by $9.2 million, or 7.1%, from $128.5 million in the quarter ended June 30, 2016 to $137.6 million in the quarter ended June 30, 2017. This increase was due to an increase in patient management services, which was due to an increase in TPA services partially offset by a decrease in case management services.

Cost of revenues increased by $6.0 million, or 5.8%, from $102.9 million in the quarter ended June 30, 2016 to $108.8 million in the quarter ended June 30, 2017. This increase was primarily due to an increase of 7% in revenue mentioned above. Additionally, there was an increase in salaries, due to an increase in headcount in field operations.

General and administrative expense increased by $1.2 million, or 8.7%, from $13.5 million in the quarter ended June 30, 2016 to $14.6 million in the quarter ended June 30, 2017. This increase was primarily due to an increase in legal, marketing and stock compensation expenses and the impairment in our investment in private equity.

Income tax expense increased by $0.7 million, or 16.2%, from $4.6 million in the quarter ended June 30, 2016 to $5.4 million in the quarter ended June 30, 2017. This increase was primarily due to an increase in pretax income.

Weighted diluted shares decreased by 754,000 shares, or 3.8%, from 19.8 million shares in the quarter ended June 30, 2016 to 19 million shares in the quarter ended June 30, 2017. This decrease was primarily due to the repurchase of 956,636 shares of common stock in the twelve months ended June 30, 2017 under our stock repurchase program.

Diluted earnings per share increased $0.08 per share, or 21.1%, from $0.38 per share in the quarter ended June 30, 2016 to $0.46 per share in the quarter ended June 30, 2017. The increase in diluted earnings per share was primarily due to an increase in net income and a decrease in weighted diluted shares.

Results of Operations for the three months ended June 30, 2016 and 2017

The Company derives its revenues from providing patient management and network solutions services to payors of workers' compensation benefits, automobile insurance claims, and group health insurance benefits. The percentages of total revenues attributable to patient management and network solutions services for the quarters ended June 30, 2016 and June 30, 2017 are as follows:

	June 30, 2016		June 30, 2017	
Patient management services	55.5	%	55.5	%
Network solutions services	44.5	%	44.5	%

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 unaudited consolidated income statements for the three months ended June 30, 2016 and June 30, 2017. The Company's past operating results are not necessarily indicative of future operating results.

	Three Months Ended June 30, 2016		Three Months Ended June 30, 2017		Change		Percentage Change	
Revenue	$128,459,000		$137,612,000		$9,153,000		7.1	%
Cost of revenues	102,877,000		108,829,000		5,952,000		5.8	%
Gross profit	25,582,000		28,783,000		3,201,000		12.5	%
Gross profit as percentage of revenue	19.9	%	20.9	%				
General and administrative	13,461,000		14,629,000		1,168,000		8.7	%
General and administrative as percentage of revenue	10.5	%	10.6	%				
Income before income tax provision	12,121,000		14,154,000		2,033,000		16.8	%
Income before income tax provision as percentage of revenue	9.4	%	10.3	%				
Income tax provision	4,630,000		5,379,000		749,000		16.2	%
Net income	$7,491,000		$8,775,000		$1,284,000		17.1	%
Weighted Shares								
Basic	19,572,000		18,811,000		(761,000	)	(3.9	%)
Diluted	19,754,000		19,000,000		(754,000	)	(3.8	%)
Earnings Per Share								