U S PHYSICAL THERAPY INC /NV
Form 10-Q
November 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED September 30, 2012

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 1-11151

U.S. PHYSICAL THERAPY, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

NEVADA	**76-0364866**
(STATE OR OTHER JURISDICTION OF	**(I.R.S. EMPLOYER**
INCORPORATION OR ORGANIZATION)	**IDENTIFICATION NO.)**

1300 WEST SAM HOUSTON PARKWAY SOUTH, SUITE 300,

HOUSTON, TEXAS	**77042**
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	**(ZIP CODE)**

REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE: (713) 297-7000

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 x 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of November 8, 2012, the number of shares outstanding (issued less treasury stock) of the registrant's common stock, par value $.01 per share, was: 11,867,065.

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

U. S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS, EXCEPT SHARE DATA)

	September 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Current assets:		
Cash	$ 10,683	$ 9,983
Patient accounts receivable, less allowance for doubtful accounts of $1,687 and $2,154, respectively	26,784	28,333
Accounts receivable other, less allowance for doubtful accounts of $373 and $883, respectively	1,640	1,614
Other current assets	4,956	5,737
Total current assets	44,063	45,667
Fixed assets:		
Furniture and equipment	35,853	35,103
Leasehold improvements	20,598	20,385
	56,451	55,488
Less accumulated depreciation and amortization	43,634	42,299
	12,817	13,189
Goodwill	99,716	92,750
Other intangible assets, net	12,326	9,603
Other assets	1,018	2,043
	$ 169,940	$ 163,252
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable trade	$ 1,665	$ 1,809
Accrued expenses	12,672	14,082
Current portion of notes payable	609	433
Total current liabilities	14,946	16,324
Notes payable	175	284
Revolving line of credit	16,100	23,500
Deferred rent	894	941
Other long-term liabilities	1,434	623
Total liabilities	33,549	41,672
Commitments and contingencies		
Shareholders equity:		
U. S. Physical Therapy, Inc. shareholders equity:		
Preferred stock, $.01 par value, 500,000 shares authorized, no shares issued and outstanding		
Common stock, $.01 par value, 20,000,000 shares authorized, 14,081,802 and 13,919,588 shares issued, respectively	141	139
Additional paid-in capital	37,769	36,133

Retained earnings	113,112	102,405
Treasury stock at cost, 2,214,737 shares	(31,628)	(31,628)
Total U. S. Physical Therapy, Inc. shareholders equity	119,394	107,049
Noncontrolling interests	16,997	14,531
Total equity	136,391	121,580
	$ 169,940	$ 163,252

See notes to consolidated financial statements.

U. S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF NET INCOME

(IN THOUSANDS, EXCEPT PER SHARE DATA)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net patient revenues	$ 60,782	$ 57,332	$ 183,333	$ 167,882
Other revenues	2,071	2,343	6,061	8,446
Net revenues	62,853	59,675	189,394	176,328
Clinic operating costs:				
Salaries and related costs	33,376	32,430	98,846	93,189
Rent, clinic supplies, contract labor and other	12,844	12,012	38,320	34,695
Provision for doubtful accounts	1,259	1,426	3,656	2,554
Closure costs	5	13	76	44
Total clinic operating costs	47,484	45,881	140,898	130,482
Gross margin	15,369	13,794	48,496	45,846
Corporate office costs	5,977	5,142	18,635	17,630
Operating income	9,392	8,652	29,861	28,216
Interest and other income, net	1	4	4	8
Interest expense	(142)	(149)	(449)	(331)
Income before taxes	9,251	8,507	29,416	27,893
Provision for income taxes	2,953	2,654	8,992	8,252
Net income including noncontrolling interests	6,298	5,853	20,424	19,641
Less: net income attributable to noncontrolling interests	(1,735)	(1,754)	(6,534)	(6,896)
Net income attributable to common shareholders	$ 4,563	$ 4,099	$ 13,890	$ 12,745
Earnings per share attributable to common shareholders:				
Basic	$ 0.39	$ 0.35	$ 1.18	$ 1.08
Diluted	$ 0.38	$ 0.34	$ 1.17	$ 1.06
Shares used in computation:				
Basic	11,827	11,886	11,778	11,824
Diluted	11,928	12,011	11,892	12,007
Dividends declared per common share	$ 0.09	$ 0.08	$ 0.27	$ 0.24

See notes to consolidated financial statements.

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U. S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

(unaudited)

	Nine Months Ended September 30, 2012	2011
OPERATING ACTIVITIES		
Net income including noncontrolling interests	$ 20,424	$ 19,641
Adjustments to reconcile net income including noncontrolling interests to net cash provided by operating activities:		
Depreciation and amortization	4,016	4,108
Provision for doubtful accounts	3,656	2,554
Equity-based awards compensation expense	1,589	1,491
Loss on sale or abandonment of assets, net	129	140
Deferred income tax	2,535	1,432
Other		(771)
Changes in operating assets and liabilities:		
Increase in patient accounts receivable	(1,298)	(3,811)
Increase in accounts receivable other	(482)	(1,277)
Decrease (increase) in other assets	471	(2,027)
Decrease in accounts payable and accrued expenses	(1,709)	(1,494)
Increase in other liabilities	19	607
Net cash provided by operating activities	29,350	20,593
INVESTING ACTIVITIES		
Purchase of fixed assets	(2,948)	(2,428)
Purchase of businesses, net of cash acquired	(7,402)	(8,149)
Acquisitions of noncontrolling interests	(1,314)	(18,935)
Sale of noncontrolling interests	239	
Net proceeds on sale of fixed assets and business	58	5
Net cash used in investing activities	(11,367)	(29,507)
FINANCING ACTIVITIES		
Distributions to noncontrolling interests	(6,850)	(7,282)
Cash dividends to shareholders	(3,183)	(2,843)
Purchase and retirement of common stock		(2,269)
Proceeds from revolving line of credit	55,900	94,000
Payments on revolving line of credit	(63,300)	(73,100)
Payment of notes payable	(284)	(100)
Excess tax benefit from stock options exercised	381	802
Other	53	2
Net cash (used in) provided by financing activities	(17,283)	9,210
Net increase in cash	700	296
Cash beginning of period	9,983	9,179
Cash end of period	$ 10,683	$ 9,475
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Income taxes	$ 5,200	$ 7,881

Interest	$	538	$	315
Non-cash investing and financing transactions during the period:				
Purchase of business seller financing portion	$	350	$	200
Acquisition of noncontrolling interest seller financing portion	$		$	367

See notes to consolidated financial statements.

U. S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY

(IN THOUSANDS)

(unaudited)

	U. S. Physical Therapy, Inc.								
	Common Stock		Additional Paid-In	Retained	Treasury Stock		Total Shareholders	Noncontrolling	
	Shares	Amount	Capital	Earnings	Shares	Amount	Equity	Interests	Total
Balance December 31, 2011	13,919	$ 139	$ 36,133	$ 102,405	(2,215)	$ (31,628)	$ 107,049	$ 14,531	$ 121,580
Issuance of restricted stock	81								
Compensation expense restricted stock			1,589				1,589		1,589
Transfer of compensation liability for certain stock issued pursuant to incentive plans			135				135		135
Proceeds from exercise of stock options	82	2	2				4		4
Excess tax benefit of equity grants			381				381		381
Purchase of business								2,892	2,892
Contribution of non controlling interests partners								49	49
Acquisition of non controlling interests			(705)				(705)	(164)	(869)
Sale of non controlling interests			234				234	5	239
Cash dividends to USPT shareholders				(3,183)			(3,183)		(3,183)
Distributions to noncontrolling interest partners								(6,850)	(6,850)
Net income				13,890			13,890	6,534	20,424
Balance September 30, 2012	14,082	$ 141	$ 37,769	$ 113,112	(2,215)	$ (31,628)	$ 119,394	$ 16,997	$ 136,391

See notes to consolidated financial statements.

U.S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2012

(unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements include the accounts of U.S. Physical Therapy, Inc. and its subsidiaries (the Company). All significant intercompany transactions and balances have been eliminated. The Company primarily operates through subsidiary clinic partnerships, in which the Company generally owns a 1% general partnership interest and a 64% limited partnership interest. The managing therapist of each clinic owns, directly or indirectly, the remaining limited partnership interest in the majority of the clinics (hereinafter referred to as Clinic Partnership). To a lesser extent, the Company operates some clinics, through wholly-owned subsidiaries, under profit sharing arrangements with therapists (hereinafter referred to as Wholly-Owned Facilities).

The Company continues to seek to attract physical and occupational therapists who have established relationships with patients and physicians by offering therapists a competitive salary and a share of the profits of the clinic(s) operated by that therapist. The Company has developed satellite clinic facilities of existing clinics, with the result that many Clinic Partnerships and Wholly-Owned Facilities operate more than one clinic location. In addition, the Company has acquired a majority interest in a number of clinics through acquisitions.

During the nine months ended September 30, 2012, the Company acquired 10 clinics as follows:

Acquisition	Date	% Interest Acquired	Number of Clinics
January 2012 Acquisition	January 3	100%	1
March 2012 Acquisition	March 31	65%	1
May 2012 Acquisition	May 22	70%	7
August 2012 Acquisition	August 1	65%	1

As of September 30, 2012, the Company operated 423 clinics in 42 states.

The results of operations of the acquired clinics have been included in the Company s consolidated financial statements since the dates of their respective acquisition.

The Company intends to continue to focus on developing new clinics and on opening satellite clinics where deemed appropriate. The Company will also continue to evaluate acquisition opportunities.

The accompanying unaudited consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the instructions for Form 10-Q. However, the statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Management believes this report contains all necessary adjustments (consisting only of normal recurring adjustments) to present fairly, in all material respects, the Company s financial position, results of operations and cash flows for the interim periods presented. For further information regarding the Company s accounting policies, please read the audited financial statements included in the Company s Form 10-K for the year ended December 31, 2011.

The Company believes, and the Chief Executive Officer, Chief Financial Officer and Corporate Controller have certified, that the financial statements included in this report present fairly, in all material respects, the Company s financial position, results of operations and cash flows for the interim periods presented.

Operating results for the three months and nine months ended September 30, 2012 are not necessarily indicative of the results the Company expects for the entire year. Please also review the Risk Factors section included in our Form 10-K for the year ended December 31, 2011.

Clinic Partnerships

For Clinic Partnerships, the earnings and liabilities attributable to the non-controlling interests, typically owned by the managing therapist, directly or indirectly, are recorded within the balance sheets and income statements as non-controlling interests.

Wholly-Owned Facilities

For Wholly-Owned Facilities with profit sharing arrangements, an appropriate accrual is recorded for the amount of profit sharing due to the profit sharing therapists. The amount is expensed as compensation and included in clinic operating costs salaries and related costs. The respective liability is included in current liabilities accrued expenses on the balance sheet.

Significant Accounting Policies

Long-Lived Assets

Fixed assets are stated at cost. Depreciation is computed on the straight-line method over the estimated useful lives of the related assets. Estimated useful lives for furniture and equipment range from three to eight years and for software purchased from three to seven years. Leasehold improvements are amortized over the shorter of the related lease term or estimated useful lives of the assets, which is generally three to five years.

Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

The Company reviews property and equipment and intangible assets with finite lives for impairment upon the occurrence of certain events or circumstances which indicate that the related amounts may be impaired. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Goodwill

Goodwill represents the excess of the amount paid and fair value of the non-controlling interests over the fair value of the acquired business assets, which include certain intangible assets. Historically, goodwill has been derived from acquisitions and, prior to 2009, from the purchase of some or all of a particular local management s equity interest in an existing clinic. Effective January 1, 2009, if the purchase price of a non-controlling interest by the Company exceeds or is less than the book value at the time of purchase, any excess or shortfall is recognized as an adjustment to additional paid-in capital.

The fair value of goodwill and other intangible assets with indefinite lives are tested for impairment annually and upon the occurrence of certain events, and are written down to fair value if considered impaired. The Company evaluates goodwill for impairment on at least an annual basis (in its third quarter) by comparing the fair value of its reporting unit to the carrying value of each reporting unit including related goodwill. The Company operates a one segment business which is made up of various clinics within partnerships. The partnerships are components of regions and are aggregated to the operating segment level for the purpose of determining our reporting units when performing our annual goodwill impairment test.

An impairment loss generally would be recognized when the carrying amount of the net assets of a reporting unit, inclusive of goodwill and other intangible assets, exceeds the estimated fair value of the reporting unit. The estimated fair value of a reporting unit is determined using two factors: (i) earnings prior to taxes, depreciation and amortization for the reporting unit multiplied by a price/earnings ratio used in the industry and (ii) a discounted cash flow analysis. A weight is assigned to each factor and the sum of each weight times the factor is considered the estimated fair value. For 2012, the factors (ie., price/earnings ratio, discount rate and residual capitalization rate) were updated to reflect current market conditions. The evaluation in the third quarter of 2012, did not yield any impairment charge.

Non-controlling interests

The Company recognizes non-controlling interests as equity in the consolidated financial statements separate from the parent entity s equity. The amount of net income attributable to non-controlling interests is included in consolidated net income on the face of the income statement. Changes in a parent entity s ownership interest in a subsidiary that do not result in deconsolidation are treated as equity transactions if the parent entity retains its controlling financial interest. The Company recognizes a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss is measured using the fair value of the non-controlling equity investment on the deconsolidation date.

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When the purchase price of a non-controlling interest by the Company exceeds or is less than the book value at the time of purchase, any excess or shortfall is recognized as an adjustment to additional paid-in capital. Additionally, operating losses are allocated to non-controlling interests even when such allocation creates a deficit balance for the non-controlling interest partner.

Revenue Recognition

Revenues are recognized in the period in which services are rendered. Net patient revenues (patient revenues less estimated contractual adjustments) are reported at the estimated net realizable amounts from third-party payors, patients and others for services rendered. The Company has agreements with third-party payors that provide for payments to the Company at amounts different from its established rates. The allowance for estimated contractual adjustments is based on terms of payor contracts and historical collection and write-off experience.

The Company determines allowances for doubtful accounts based on the specific agings and payor classifications at each clinic. The provision for doubtful accounts is included in clinic operating costs in the statement of net income. Net accounts receivable, which are stated at the historical carrying amount net of contractual allowances, write-offs and allowance for doubtful accounts, includes only those amounts the Company estimates to be collectible.

Medicare Reimbursement

The Medicare program reimburses outpatient rehabilitation providers based on the Medicare Physician Fee Schedule (MPFS). The MPFS rates are automatically updated annually based on a formula, called the sustainable growth rate (SGR) formula. The use of the SGR formula has resulted in calculated automatic reductions in rates in every year since 2002; however, for each year through 2012, Centers for Medicare & Medicaid Services (CMS) or Congress has taken action to prevent the implementation of SGR formula reductions. The Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2011 provided a 2.2% increase to MPFS payment rates, retroactive from June 1, 2011 through November 30, 2011, suspending a 21.3% reduction that briefly became effective on June 1, 2011. The Medicare and Medicaid Extenders Act of 2011 (MMEA) prevented a 25.5% reduction in the MPFS payment rates that would have taken effect on January 1, 2011. The Temporary Payroll Tax Cut Continuation Act of 2011 (TPTC) delayed application of the SGR for two additional months, through February 29, 2012. The Middle Class Tax Relief and Job Creation Act of 2012 (MCTRA) included a measure freezing payment rates at their current level through December 31, 2012.

On November 1, 2012, CMS released the 2013 Medicare Physician Fee Schedule final rule. Under the 2013 Medicare Physician Fee Schedule, CMS has estimated a 26.5% reduction in the outpatient physical therapy payment rates beginning on January 1, 2013, unless Congress again takes legislative action to prevent the SGR formula reductions from going into effect. This reduction would be in addition to any automatic spending reductions being enacted as a result of the Budget Control Act of 2011, which would cut Medicare spending by 2%. If the 26.5% SGR reduction and the 2% cut in Medicare spending are averted by Congress, the projected impact of other changes in the rule on outpatient physical therapy service payments in aggregate is expected to be a 4.0% increase in 2013, primarily due to the continued phase in of new practice expense survey data derived from the Physician Practice Information Survey (PPIS). In 2013, when the use of the PPIS data is fully phased in, the impact is expected to be a 6.0% increase for outpatient physical therapy payments. In the final 2012 Medicare Physician Fee Schedule rule, CMS indicated that over the next year it will continue to review whether specific Current Procedural Terminology (CPT) codes billed under the fee schedule are overvalued or undervalued, including certain specific CPT codes used by physical therapists.

In the 2013 Medicare Physician Fee Schedule rule, CMS indicated that it will implement a claims-based data collection process to gather additional data on patient function during the course of therapy in order to better understand patient conditions and outcomes. All practice settings that provide outpatient therapy services would be required to include this data on the claim form. Beginning on July 1, 2013, therapists will be required to report new codes and modifiers on the claim form that reflect a patient s functional limitations and goals at initial evaluation, periodically throughout care, and at discharge. For claims submitted after July 1, 2013, CMS proposes to return claims as unpaid if the required data is not included in the claim.

As a result of the Balanced Budget Act of 1997, the formula for determining the total amount paid by Medicare in any one year for outpatient physical therapy, occupational therapy, and/or speech-language pathology services provided to any Medicare beneficiary (*i.e.*, the Therapy Cap or Limit) was established. Based on the statutory definitions which constrained how the Therapy Cap would be applied, there is one Limit for Physical Therapy and Speech Language Pathology Services combined, and one Limit for Occupational Therapy. Effective January 1, 2012, the annual Limit on outpatient therapy services is $1,880 for physical therapy and speech language pathology services combined and $1,880 for occupational therapy services. Pursuant to the final MPFS rule for 2013, effective January 1, 2013 the annual Limit on outpatient therapy services is $1,900 for physical therapy and speech language pathology services combined and $1,900 for occupational therapy services. These Therapy Caps are applicable to outpatient therapy services provided in all settings, except for services provided in departments of hospitals. However, pursuant to the MCTRA, beginning no later than October 1, 2012 and expiring on December 31, 2012, these Limits will temporarily apply to therapy services performed in hospital outpatient departments.

In the Deficit Reduction Act of 2005, Congress implemented an exceptions process to the annual Limit for therapy expenses. Under this process, a Medicare enrollee (or person acting on behalf of the Medicare enrollee) is able to request an exception from the therapy caps if the provision of therapy services was deemed to be medically necessary. Therapy cap exceptions have been available automatically for certain conditions and on a case-by-case basis upon submission of documentation of medical necessity. The MCTRA extended the exceptions process for outpatient therapy caps through December 31, 2012. Unless Congress extends the exceptions process, the therapy caps will apply to all outpatient therapy services beginning January 1, 2013, except those services furnished and billed by outpatient hospital departments.

Furthermore, under the MCTRA, starting on October 1, 2012, patients who meet or exceed $3,700 in therapy expenditures will be subject to a manual medical review. The MCTRA designates that this medical review will be similar to the process used following Deficit Reduction Act implementation in 2006. The $3,700 threshold will be applied to the combined physical therapy/speech language pathology cap; a separate $3,700 threshold will be applied to the occupational therapy cap.

CMS adopted a multiple procedure payment reduction (MPPR) for therapy services in the final update to the MPFS for calendar year 2011. Under MPPR, the Medicare program pays 100% of the practice expense component of the Relative Value Unit (RVU) for the therapy procedure with the highest Practive Expense RVU, then reduces the payment for the practice expense component of the RVU for additional procedures. The reduction for these subsequent procedures varies based on the setting, with a 20% reduction for services in an office or other non-institutional setting and 25% in institutional settings. The reduction applies to most therapy services furnished during the same day for the same patient, whether or not the therapy services are furnished in separate sessions. The MPPR was continued in calendar year 2012 and for 2013.

Statutes, regulations, and payment rules governing the delivery of therapy services to Medicare beneficiaries are complex and subject to interpretation. The Company believes that it is in compliance in all material respects with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that would have a material effect on the Company s financial statements as of September 30, 2012. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from the Medicare program.

Physician Services Revenues

Revenues from physician services are generated by franchisee arrangements with third parties, pursuant to which there are multiple deliverables training and ongoing services as well as through the two physician services facilities. Each component can be purchased separately. Revenue is recognized over the period the respective services are provided. Physician service revenues are included in other revenues in the accompanying Consolidated Statements of Net Income.

Management Contract Revenues

Management contract revenues are derived from contractual arrangements whereby the Company manages a clinic for third party owners. The Company does not have any ownership interest in these clinics. Typically, revenues are determined based on the number of visits conducted at the clinic and recognized when services are performed. Costs, typically salaries for the Company s employees, are recorded when incurred. Management contract revenues are included in other revenues in the accompanying Consolidated Statements of Net Income.

Contractual Allowances

Contractual allowances result from the differences between the rates charged for services performed and expected reimbursements for such services by both insurance companies and government sponsored healthcare programs. Medicare regulations and the various third party payors and managed care contracts are often complex and may include multiple reimbursement mechanisms payable for the services provided in Company clinics. The Company estimates contractual allowances based on its interpretation of the applicable regulations, payor contracts and historical calculations. Each month the Company estimates its contractual allowance for each clinic based on payor contracts and the historical collection experience of the clinic and applies an appropriate contractual allowance reserve percentage to the gross accounts receivable balances for each payor of the clinic. Based on the Company s historical experience, calculating the contractual allowance reserve percentage at the payor level is sufficient to allow it to provide the necessary detail and accuracy with its collectibility estimates. However, the services authorized and provided and related reimbursement are subject to interpretation that could result in payments that differ from the Company s estimates. Payor terms are periodically revised necessitating continual review and assessment of the estimates made by management. The Company s billing systems may not capture the exact change in its contractual allowance reserve estimate from period to period in order to assess the accuracy of its revenues, and hence, its contractual allowance reserves. Management regularly compares its cash collections to corresponding net revenues measured both in the aggregate and on a clinic-by-clinic basis. In the aggregate, historically the difference between net revenues and corresponding cash collections has generally reflected a difference within approximately 1% of net revenues. Additionally, analysis of subsequent period s contractual write-offs on a payor basis shows a less than 1% difference between the actual aggregate contractual reserve percentage as compared to the estimated contractual allowance reserve percentage associated with the same period end balance. As a result, the Company believes that a change in the contractual allowance reserve estimate would not likely be more than 1% at September 30, 2012.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount to be recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority.

The Company recognizes accrued interest expense and penalties associated with unrecognized tax benefits as income tax expense. The Company did not have any accrued interest or penalties associated with any unrecognized tax benefits nor was any interest expense recognized during the three months and nine months ended September 30, 2012.

Fair Value of Financial Instruments

The carrying amounts reported in the balance sheet for cash and cash equivalents, accounts receivable, accounts payable and notes payable approximate their fair values due to the short-term maturity of these financial instruments. The carrying amount of the Company s revolving line of credit approximates its fair value. The interest rate on the revolving line of credit, which is tied to the Eurodollar Rate, is set at various short-term intervals as detailed in the credit agreement.

Segment Reporting

Operating segments are components of an enterprise for which separate financial information is available that is evaluated regularly by chief operating decision makers in deciding how to allocate resources and in assessing performance. The Company identifies operating segments based on management responsibility and believes it meets the criteria for aggregating its operating segments into a single reporting segment.

Use of Estimates

In preparing the Company's consolidated financial statements, management makes certain estimates and assumptions, especially in relation to, but not limited to, purchase accounting, goodwill impairment, allowance for receivables, tax provision and contractual allowances, that affect the amounts reported in the consolidated financial statements and related disclosures. Actual results may differ from these estimates.

Self-Insurance Program

The Company utilizes a self-insurance plan for its employee group health insurance coverage administered by a third party. Predetermined loss limits have been arranged with the insurance company to minimize the Company s maximum liability and cash outlay. Accrued expenses include the estimated incurred but unreported costs to settle unpaid claims and estimated future claims. Management believes that the current accrued amounts are sufficient to pay claims arising from self insurance claims incurred through September 30, 2012.

Restricted Stock

Restricted stock issued to employees and directors is subject to certain conditions, including continued employment or continued service on the board, respectively. The transfer restrictions for shares granted to employees lapse in equal installments on the following four or five annual anniversaries of the date of grant. Compensation expense for grants of restricted stock is recognized based on the fair value per share on the date of grant amortized over the service period. The restricted stock issued is included in basic and diluted shares for the earnings per share computation.

Recent Accounting Pronouncements

In July 2011, the Financial Accounting Standards Board (FASB) issued ASU 2011-07, Health Care Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts and the Allowance for Doubtful Accounts for Certain Health Care Entities (ASU 2011-07). ASU 2011-07 requires certain health care entities to change the presentation in their statement of operations by reclassifying the provision for bad debts associated with patient service revenue that is not subject to an assessment as to the patient s ability to pay from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, those health care entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts. ASU 2011-07 also requires disclosure of patient service revenue (net of contractual allowances and discounts) as well as qualitative and quantitative information about changes in the allowance for doubtful accounts. The Company has evaluated ASU 2011-07 and concluded that it is not required to change its presentation and disclosure. Substantially all of the Company s patient revenue is subject to an assessment as to the patient s ability to pay at the time the related service is provided.

In September 2011, the FASB issued ASU 2011-08, Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment (ASU 2011-08), which modifies the impairment test for goodwill intangibles. ASU 2011-08 provides an entity the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not (more than 50%) that the fair value of a reporting unit is less than its carrying amount. Such qualitative factors may include the following: macroeconomic conditions; industry and market considerations; cost factors; overall financial performance; and other relevant entity-specific events. If an entity elects to perform a qualitative assessment and determines that an impairment is more likely than not, the entity is then required to perform the existing two-step quantitative impairment test, otherwise no further analysis is required. An entity also may elect not to perform the qualitative assessment and, instead, go directly to the two-step quantitative impairment test. These changes are effective for any goodwill impairment test performed on January 1, 2012 or later, although early adoption was permitted. These changes should not affect the outcome of the impairment analysis of a reporting unit. The Company performs a review of the Company s goodwill in the third quarter of each fiscal year. The adoption of ASU 2011-08 in 2012 did not have an impact on the Company as it performed its goodwill impairment test using a quantitative approach.

2. EARNINGS PER SHARE

The computations of basic and diluted earnings per share for the Company are as follows (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Numerator:				
Net income attributable to common shareholders	$ 4,563	$ 4,099		