

CORVEL CORP
Form 10-Q
February 05, 2010

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**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 December 31, 2009

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)

(IRS Employer Identification No.)

2010 Main Street, Suite 600
Irvine, CA

92614

(Address of principal executive office)

(zip code)

Registrant's telephone number, including area code: (949) 851-1473

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ 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, 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 ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller Reporting
Company ☐

(Do not check if a 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 ☒

The number of shares outstanding of the registrant's Common Stock, \$0.0001 par value per share, as of January 31, 2010 was 12,088,695.

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Part I Financial Information

Item 1. Financial Statements

CORVEL CORPORATION**CONSOLIDATED BALANCE SHEETS**

	March 31, 2009	December 31, 2009 (Unaudited)
Assets		
Current Assets		
Cash and cash equivalents (Note A)	\$ 14,681,000	\$ 7,864,000
Accounts receivable, net	41,249,000	44,419,000
Prepaid taxes and expenses	4,841,000	4,641,000
Deferred income taxes	4,531,000	4,869,000
Total current assets	65,302,000	61,793,000
Property and equipment, net	29,790,000	29,873,000
Goodwill	34,852,000	36,010,000
Other intangibles, net	7,495,000	7,055,000
Other assets	3,770,000	3,835,000
TOTAL ASSETS	\$ 141,209,000	\$ 138,566,000
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts and taxes payable	\$ 18,553,000	\$ 16,931,000
Accrued liabilities	18,653,000	20,956,000
Total current liabilities	37,206,000	37,887,000
Deferred income taxes	7,706,000	7,673,000
Commitments and contingencies (Note G and H)		
Stockholders' Equity		
Common stock, \$.0001 par value: 60,000,000 shares authorized; 25,600,022 shares issued (12,917,279 shares outstanding, net of Treasury shares) and 25,747,156 shares issued (12,140,156 shares outstanding, net of Treasury shares) at March 31, 2009 and December 31, 2009, respectively	3,000	3,000
Paid-in capital	84,321,000	88,538,000
	(185,762,000)	(212,749,000)

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Treasury Stock (12,682,743 shares at March 31, 2009 and 13,607,000 shares at December 31, 2009)

Retained earnings	197,735,000	217,214,000
Total stockholders' equity	96,297,000	93,006,000
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 141,209,000	\$ 138,566,000

See accompanying notes to consolidated financial statements.

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CONSOLIDATED INCOME STATEMENTS UNAUDITED**

	Three Months Ended December 31,	
	2008	2009
REVENUES	\$ 76,962,000	\$ 86,629,000
Cost of revenues	59,300,000	64,823,000
Gross profit	17,662,000	21,806,000
General and administrative expenses	10,296,000	10,713,000
Income before income tax provision	7,366,000	11,093,000
Income tax provision	2,862,000	4,418,000
NET INCOME	\$ 4,504,000	\$ 6,675,000
Net income per common and common equivalent share		
Basic	\$ 0.34	\$ 0.55
Diluted	\$ 0.34	\$ 0.54
Weighted average common and common equivalent		
Basic	13,316,000	12,237,000
Diluted	13,439,000	12,426,000
See accompanying notes to consolidated financial statements.		

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CONSOLIDATED INCOME STATEMENTS UNAUDITED**

	Nine Months Ended December 31,	
	2008	2009
REVENUES	\$ 233,018,000	\$ 250,357,000
Cost of revenues	176,564,000	186,602,000
Gross profit	56,454,000	63,755,000
General and administrative expenses	31,825,000	31,369,000
Income before income tax provision	24,629,000	32,386,000
Income tax provision	9,594,000	12,907,000
NET INCOME	\$ 15,035,000	\$ 19,479,000
Net income per common and common equivalent share		
Basic	\$ 1.10	\$ 1.54
Diluted	\$ 1.09	\$ 1.52
Weighted average common and common equivalent		
Basic	13,632,000	12,640,000
Diluted	13,815,000	12,801,000
See accompanying notes to consolidated financial statements.		

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CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED**

	Nine Months Ended December 31,	
	2008	2009
<i>Cash flows from Operating Activities</i>		
NET INCOME	\$ 15,035,000	\$ 19,479,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,852,000	8,771,000
Loss on disposal of assets	14,000	48,000
Stock compensation expense	915,000	1,560,000
Write-off of uncollectible accounts	1,878,000	2,277,000
Changes in operating assets and liabilities		
Accounts receivable	(538,000)	(5,447,000)
Prepaid taxes and expenses	(906,000)	200,000
Other assets	174,000	96,000
Accounts and taxes payable	(2,811,000)	(1,622,000)
Accrued liabilities	1,059,000	1,203,000
Deferred income tax	(58,000)	(371,000)
Net cash provided by operating activities	23,614,000	26,194,000
<i>Cash Flows from Investing Activities</i>		
Acquisition earn out payment	(1,800,000)	
Purchase of property and equipment	(7,714,000)	(8,681,000)
Net cash (used in) investing activities	(9,514,000)	(8,681,000)
<i>Cash Flows from Financing Activities</i>		
Purchase of treasury stock	(22,195,000)	(26,987,000)
Tax effect of stock option exercises	426,000	740,000
Exercise of common stock options	1,693,000	1,753,000
Exercise of employee stock purchase options	201,000	164,000
Net cash (used in) financing activities	(19,875,000)	(24,330,000)
<i>Decrease in cash and cash equivalents</i>	(5,775,000)	(6,817,000)
Cash and cash equivalents at beginning of period	17,911,000	14,681,000
Cash and cash equivalents at end of period	\$ 12,136,000	\$ 7,864,000

Supplemental Cash Flow Information:

Income taxes paid	\$ 10,879,000	\$ 11,830,000
Accrual of earn-out related to acquisition	\$ 800,000	\$ 1,100,000
Accrual of software license	\$ 864,000	\$ 0

See accompanying notes to consolidated financial statements.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2009

Note A Basis of Presentation and Summary of Significant Accounting Policies

The unaudited financial statements herein have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. The accompanying interim financial statements have been prepared under the presumption that users of the interim financial information have either read or have access to the audited financial statements for the latest fiscal year ended March 31, 2009. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the March 31, 2009 audited financial statements have been omitted from these interim financial statements.

Beginning in the quarter ended June 30, 2009, the Company implemented Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 855-10-05 through 885-10-55, *Subsequent Events*. This standard establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. In accordance with FASB ASC 855-10-05 through ASC 855-10-55, the Company evaluated all events or transactions that occurred after December 31, 2009 up through the date the Company issued these consolidated financial statements. During this period, the Company did not have any material subsequent events other than the repurchase of approximately 55,000 shares for \$1.7 million or \$31.38 per share. These shares were repurchased under the Company's ongoing share repurchase program described in Note C.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended December 31, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2010. For further information, refer to the consolidated financial statements and footnotes for the fiscal year ended March 31, 2009 included in the Company's Annual Report on Form 10-K.

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

Use of Estimates: The preparation of financial statements conforming with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements. Actual results could differ from those estimates. Significant estimates include the allowance for doubtful accounts, accrual for bonuses, earn-out accruals, accruals for self-insurance reserves, share-based payments related to performance based awards, and estimates used in stock option valuations.

Cash and Cash Equivalents: Cash and cash equivalents consist of short-term highly-liquid investment-grade interest-bearing securities with maturities of 90 days or less when purchased. The carrying amounts of the Company's financial instruments approximate their fair values at March 31, 2009 and December 31, 2009. Cash at December 31, 2009 included \$1.5 million of customer deposits held in bank checking accounts.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2009

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

Goodwill: The Company accounts for its business combinations in accordance with FASB ASC 805-10 through ASC 805-50 *Business Combinations* which requires that the purchase method of accounting be applied to all business combinations and addresses the criteria for initial recognition of intangible assets and goodwill. In accordance with 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. The Company's goodwill impairment test is conducted company-wide and the fair value is compared to its carrying value. The measurement of fair value is based on an evaluation of market capitalization and is further tested using a multiple of earnings approach. For all periods presented, no impairment existed and, accordingly, no loss was recognized.

Revenue Recognition: The Company's revenues are recognized primarily as services are rendered based on time and expenses incurred. A certain portion of the Company's revenues are derived from fee schedule auditing which is based on the number of provider charges audited and on a percentage of savings achieved for the Company's customers. The Company generally recognizes revenue when there is persuasive evidence of an arrangement, the services have been provided to the customer, the sales price is fixed or determinable, and collectability is reasonably assured. The Company reduces revenue for estimated contractual allowances and records any amounts invoiced to the customer in advance of service performance as deferred revenue.

Accounts Receivable: The majority of the Company's accounts receivable are due from companies in the property and casualty insurance industries, self-insured employers, and government entities. Accounts receivable are due within 30 days and are stated as amounts due from customers net of an allowance for doubtful accounts. Accounts outstanding longer than the contractual payment terms are considered past due. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company and the condition of the general economy and the industry as a whole. No one customer accounted for 10% or more of accounts receivable at either March 31, 2009 or December 31, 2009. No one customer accounted for 10% or more of revenue during either of the three and nine month periods ended December 31, 2008 or 2009.

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 three to seven years. The Company capitalizes software development costs intended for internal use. The Company accounts for internally developed software costs in accordance with 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 in computer software in property and equipment and are amortized over a period of five years.

Long-Lived Assets: The carrying amount of all long-lived assets is evaluated periodically to determine if adjustment to the depreciation and amortization period or to the unamortized balance is warranted. Such evaluation is based principally on the expected utilization of the long-lived assets and the projected, undiscounted cash flows of the operations in which the long-lived assets are deployed.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2009

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

Income Taxes: The Company provides for income taxes under the liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities as measured by the enacted tax rates which are expected to be in effect when these differences reverse. Income tax expense is the tax payable for the period and the change during the period in net deferred tax assets and liabilities. The Company adopted the provisions of FASB ASC 740-10-05 through ASC 740-10-55, *Accounting for Uncertainty in Income Taxes*, on April 1, 2007. As a result of the implementation, the Company recognized no material change in the liability for unrecognized income tax benefits during the December 2009 quarter. The balance of the unrecognized tax benefits as of March 31, 2009 and December 31, 2009 was \$3,681,000. There were no additions or reductions in the unrecognized tax benefit during the quarter ended December 31, 2009.

Earnings Per Share: Earnings per common share-basic is based on the weighted average number of common shares outstanding during the period. Earnings per common shares-diluted is based on the weighted average number of common shares and common share equivalents outstanding during the period. In calculating earnings per share, earnings are the same for the basic and diluted calculations. Weighted average shares outstanding decreased in the December 2009 quarter compared to the same quarter of the prior year for diluted earnings per share due to shares repurchased under the Company's share repurchase program.

Recent Accounting Standards Updates

The FASB issued ASC 105-10-05, *Generally Accepted Accounting Principles*, which establishes the Accounting Standards Codification (Codification or ASC) as the single source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of GAAP for SEC registrants. The Codification supersedes all existing non-SEC accounting and reporting standards.

GAAP is not intended to be changed as a result of the Codification, but the ASC does change the way the guidance is organized and presented. As a result, these changes have a significant impact on how companies reference GAAP in their financial statements and in their accounting policies for financial statements issued for interim and annual periods ending after September 15, 2009. The Company has included the references to the Codification, as appropriate, in these consolidated financial statements.

In September 2006, FASB issued ASC 820-10-20, *Fair Value Measurements and Disclosures* (ASC 820-10-20), which defines fair value to be the price that would be received when an asset is sold or paid when a liability is transferred in an orderly transaction between market participants at the measurement date and emphasizes that fair value is a market-based measurement, not an entity-specific measurement. It establishes a fair value hierarchy and expands disclosures about fair value measurements in both interim and annual periods. On April 1, 2008, the Company adopted ASC 820-10-20 for its financial assets and financial liabilities. The adoption of ASC 820-10-20 did not have a material impact on the Company's financial position or results of operations.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Note A Basis of Presentation and Summary of Significant Accounting Policies (continued)

In April 2009, FASB issued ASC 825-10-65, *Transition Related to FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments* (ASC 825-10-65), which requires disclosures about fair value of financial instruments for interim reporting periods as well as in interim financial statements ending after June 15, 2009. The Company adopted ASC 825-10-65 on June 30, 2009, and the adoption did not have a material impact on the Company's financial position or results of operations.

In May 2009, FASB issued ASC 855-10-05 through ASC 855-10-55, *Subsequent Events* (ASC 855-10), which establishes principles and standards related to the accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued. ASC 855-10-25, *Recognition*, requires an entity to recognize, in the financial statements, subsequent events that provide additional information regarding conditions that existed at the balance sheet date. Subsequent events that provide information about conditions that did not exist at the balance sheet date shall not be recognized in the financial statements under ASC 855-10. ASC 855-10 was effective for interim and annual reporting periods on or after June 15, 2009. The Company adopted ASC 855-10 on June 30, 2009, and the adoption did not have a material impact on the Company's financial position or results of operations.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2009

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 December 31, 2009, options for up to 9,682,500 shares of the Company's common stock may be granted over the life of the Plan to employees, non-employee directors and consultants at exercise prices not less than the fair market value of the stock at the date of grant. Options granted under the Plan are non-statutory stock options and generally vest 25% one year from date of grant with the remaining 75% vesting ratably each month for the next 36 months thereafter. The options granted to employees generally expire at the end of five years from the date of grant and the options granted to non-employee members of the board of directors generally expire at the end of ten years from the date of grant.

In May 2006, the Company's Board of Directors granted performance-based stock options for 149,000 shares of common stock at fair market value at the date of grant, which will only vest if the Company attains certain earnings per share targets, as established by the Company's Board of Directors, for calendar years 2008, 2009, and 2010. Net of cancelations due to employee terminations, options for 136,050 shares remain outstanding under these performance-based stock options as of December 31, 2009. These options were granted with an exercise price of \$15.76 per share, which was the fair market value at the date of grant, and have a valuation of \$6.75 per share. The Company did not attain the targets for calendar years 2008 and 2009. Currently, management has determined that it is not probable that the Company will attain the earnings per share target for calendar year 2010 under these options and, accordingly, the Company has recognized no stock compensation expense for these options.

In February 2008, the Company's Board of Directors granted performance-based stock options for 42,000 shares of common stock at fair market value at the date of grant, which will only vest if the Company attains certain revenue targets for TPA revenues and out-of-network bill review revenues, as established by the Company's Board of Directors, for calendar years 2009, 2010, and 2011. The targets for the various options varied by the regions managed by these optionees and each region has different targets. Net of cancelations due to employee terminations, options for 38,000 shares remain outstanding under these performance-based stock options as of December 31, 2009. These options were granted with an exercise price of \$25.10 per share, which was the fair market value at the date of grant, and have a valuation of \$9.81 per share. Currently, management has determined that the optionees with 12,000 shares attained these the revenue targets for calendar year 2009, and, accordingly, the Company has recognized \$25,000 during the December 2009 quarter and \$39,000, cumulatively, since the date of the option grant. Currently, management has determined that it is not probable that the revenue targets for the remaining optionees will be attained and, accordingly, the Company has recognized no stock compensation expense for those options.

In February 2009, the Company's Board of Directors granted performance-based stock options for 100,000 shares of common stock at fair market value at the date of grant, which will only vest if the Company attains certain earnings per share targets, as established by the Company's Board of Directors, for calendar years 2009, 2010, and 2011. Net of cancelations due to employee terminations, options for 95,000 shares remain outstanding under these performance-based stock options as of December 31, 2009. These options were granted with an exercise price of \$19.79 per share, which was the fair market value at the date of grant, and have a valuation of \$8.21 per share. The Company attained these revenue targets for calendar 2009, and, accordingly, the Company has recognized stock compensation expense of \$65,000 during the December 2009 quarter and \$260,000, cumulatively, since the date of the option grants.

In February 2009, the Company's Board of Directors granted performance-based stock options for 10,000 shares of common stock at fair market value at the date of grant to an employee, which will only vest if the Company attains certain revenue targets for third party administration (TPA) revenues and out-of-network bill review revenues, as established by the Company's Board of Directors, for calendar years 2009, 2010, and 2011. These options were granted with an exercise price of \$19.79 per share, which was the fair market value at the date of grant, and have a valuation of \$8.45 per share. Currently, management has determined that it is not probable that the

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2009

Note B Stock Based Compensation and Stock Options (continued)

Company will attain the revenue targets and, accordingly, the Company has recognized no stock compensation expense for this stock option grant.

Additionally, in November 2009, the Company's Board of Directors granted performance-based stock options for 110,000 shares of common stock at fair market value at the date of grant to an employee, which will only vest if the Company attains certain earnings per share targets, as established by the Company's Board of Directors, for calendar years 2010, 2011, and 2012. These options were granted with an exercise price of \$28.92 per share, which was the fair market value at the date of grant, and have a valuation of \$12.57 per share. Currently, management has determined that it is probable that the Company will attain the earnings per share targets for calendar year 2010 and, accordingly, the Company has recognized \$73,000 of stock compensation expense for this stock option grant during the December 2009 quarter.

The tables below shows the amounts recognized in the financial statements for the three and nine months ended December 31, 2008 and 2009, respectively.

	Three Months Ended	
	December 31, 2008	December 31, 2009
Cost of revenues	\$ 138,000	\$ 227,000
General and administrative	263,000	345,000
 Total cost of stock-based compensation included in income before income tax provision	 401,000	 572,000
Amount of income tax benefit recognized	(156,000)	(210,000)
Amount charged against income	\$ 245,000	\$ 362,000
Effect on diluted income per share	\$ (0.02)	\$ (0.03)

	Nine Months Ended	
	December 31, 2008	December 31, 2009
Cost of revenues	\$ 394,000	\$ 516,000
General and administrative	521,000	1,044,000
 Total cost of stock-based compensation included in income before income tax provision	 915,000	 1,560,000
Amount of income tax benefit recognized	(357,000)	(605,000)
Amount charged against income	\$ 558,000	\$ 955,000
Effect on diluted income per share	\$ (0.04)	\$ (0.07)

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2009

Note B Stock Based Compensation and Stock Options (continued)

The Company records compensation expense for employee stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes option-pricing model with the assumptions included in the table below. The Company uses historical data among other factors to estimate the expected volatility, the expected option life, and the expected forfeiture rate. The risk-free rate is based on the interest rate paid on a U.S. Treasury issue with a term similar to the estimated life of the option. Based upon the historical experience of options cancellations, the Company has estimated an annualized forfeiture rate of 10.56% and 9.81% for the three months ended December 31, 2008 and 2009, respectively. Forfeiture rates will be adjusted over the requisite service period when actual forfeitures differ, or are expected to differ, from the estimate. The following assumptions were used to estimate the fair value of options granted during the three months ended December 31, 2008 and 2009 using the Black-Scholes option-pricing model:

	Three Months Ended December 31,	
	2008	2009
Risk-free interest rate	2.71%	2.34%
Expected volatility	43%	47%
Expected dividend yield	0.00%	0.00%
Expected forfeiture rate	10.56%	9.81%
Expected weighted average life of option in years	4.8 years	4.8 years

All options granted in the nine months ended December 31, 2008 and 2009 were granted at fair market value and are non-statutory stock options.

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CORVEL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2009

Note B Stock Based Compensation and Stock Options (continued)

Summarized information for all stock options for the three and nine months ended December 31, 2008 and 2009 follows:

	Three Months Ended December 31, 2008		Three Months Ended December 31, 2009	
	Shares	Average Price	Shares	Average Price
Options outstanding, beginning	997,247	\$20.26	1,036,528	\$21.01
Options granted	26,150	25.82	122,500	29.13
Options exercised	(5,888)	14.34	(52,682)	14.76
Options cancelled	(3,868)	24.94	(940)	28.89
Options outstanding, ending	1,013,641	\$20.42	1,105,406	\$22.20

	Nine Months Ended December 31, 2008		Nine Months Ended December 31, 2009	
	Shares	Average Price	Shares	Average Price
Options outstanding, beginning	1,030,458	\$19.24	1,115,171	\$20.31
Options granted	101,375	29.64	171,900	27.83
Options exercised	(99,399)	17.48	(150,958)	14.74
Options cancelled	(18,793)	21.29	(30,707)	21.81
Options outstanding, ending	1,013,641	\$20.42	1,105,406	\$22.20

The following table summarizes the status of stock options outstanding and exercisable at December 31, 2009:

Range of Exercise Price	Number of Outstanding Options	Weighted Average Remaining Contractual Life	Outstanding Options- Weighted Average Exercise Price	Exercisable Options- Number of Exercisable Options	Options- Weighted Average Exercise Price
\$11.00 to \$15.76	315,383	1.55	\$14.91	165,779	\$14.20
\$15.79 to \$23.55	271,071	3.51	\$19.20	125,227	\$18.35
\$23.56 to \$27.15	230,290	3.98	\$25.75	74,592	\$26.11
\$27.16 to \$47.70	288,662	3.81	\$30.15	95,634	\$30.89
Total	1,105,406	3.13	\$22.20	461,232	\$20.71

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CORVEL CORPORATION
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Note B Stock Based Compensation and Stock Options (continued)

A summary of the status for all outstanding options at December 31, 2009, and changes during the three months then ended, is presented in the table below:

	Number of Options	Weighted Average Exercise Per Share	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value as of December 31, 2009
Options outstanding at October 1, 2009	1,036,528	\$ 21.01		
Granted	122,500	29.13		
Exercised	(52,682)	14.76		
Cancelled forfeited				
Cancelled expired	(940.00)	28.89		
Ending outstanding	1,105,406	\$ 22.20	3.13	\$12,558,198
Ending vested and expected to vest	975,360	\$ 21.99	3.01	\$11,289,544
Ending exercisable at December 31, 2009	461,232	\$ 20.71	2.43	\$ 5,931,896

The weighted-average grant-date fair value of options granted during the three months ended December 31, 2008 and 2009, was \$11.66 and \$12.64, respectively.

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Note C Treasury Stock and Subsequent Event

The Company's Board of Directors initially approved the commencement of a share repurchase program in the fall of 1996. In August 2009, the Board approved a 1,000,000 share expansion of the repurchase program to 14,150,000 shares over the life of the share repurchase program. Since the commencement of the share repurchase program, the Company has spent \$213 million to repurchase 13,607,000 shares of its common stock, equal to 53% of the outstanding common stock had there been no repurchases. The average price of these repurchases is \$15.64 per share. These purchases have been funded primarily from the net earnings of the Company, along with the proceeds from the exercise of common stock options. During the three months ended December 31, 2009, the Company repurchased 313,250 shares for \$9.5 million. During the nine months ended December 31, 2009, the Company repurchased 924,257 shares for \$27.0 million. The Company had 12,140,156 shares of common stock outstanding as of December 31, 2009, net of the 13,607,000 shares in treasury. Subsequent to the end of the quarter, through January 31, 2010, the Company repurchased 54,706 shares of common stock for \$1.7 million or \$31.38 a share.

Note D Weighted Average Shares and Net Income Per Share

Weighted average basic common and common equivalent shares decreased from 13,316,000 for the quarter ended December 31, 2008 to 12,237,000 for the quarter ended December 31, 2009. Weighted average diluted common and common equivalent shares decreased from 13,439,000 for the quarter ended December 31, 2008 to 12,426,000 for the quarter ended December 31, 2009. The net decrease in both of these weighted 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 Company's employee stock option plan.

Net income per common and common equivalent shares was computed by dividing net income by the weighted average number of common and common stock equivalents outstanding during the quarter. The calculations of the basic and diluted weighted shares for the three months and nine months ended December 31, 2008 and 2009, are as follows:

	Three Months Ended December 31,	
	2008	2009
Net Income	\$ 4,504,000	\$ 6,675,000
Basic:		
Weighted average common shares outstanding	13,316,000	12,237,000
Net Income per share	\$ 0.34	\$ 0.55
Diluted:		
Weighted average common shares outstanding	13,316,000	12,237,000
Treasury stock impact of stock options	123,000	189,000
Total common and common equivalent shares	13,439,000	12,426,000
Net Income per share	\$ 0.34	\$ 0.54

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Note D Weighted Average Shares and Net Income Per Share (continued)

	Nine Months Ended December 31,	
	2008	2009
Net Income	\$ 15,035,000	\$ 19,479,000
Basic:		
Weighted average common shares outstanding	13,632,000	12,640,000
Net Income per share	\$ 1.10	\$ 1.54
Diluted:		
Weighted average common shares outstanding	13,632,000	12,640,000
Treasury stock impact of stock options	183,000	161,000
Total common and common equivalent shares	13,815,000	12,801,000
Net Income per share	\$ 1.09	\$ 1.52

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Note E Shareholder Rights Plan

During fiscal 1997, the Company's Board of Directors approved the adoption of a Shareholder Rights Plan. The Shareholder Rights Plan provides for a dividend distribution to CorVel stockholders of one preferred stock purchase right for each outstanding share of CorVel's common stock under certain circumstances. In April 2002, 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, 2012, set the exercise price of each right at \$118 and enable Fidelity Management & Research Company and its affiliates to purchase up to 18% of the shares of common stock of the Company without triggering the stockholder rights, with the limitations under the Shareholder Rights Plan remaining in effect for all other stockholders of the Company. 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, remove the ability of Fidelity Management & Research Company and its affiliates to purchase up to 18% of the shares of common stock of the Company without triggering the stockholder rights, substitute Computershare Trust Company, N.A. as the rights agent and effect certain technical changes to the Shareholder Rights Plan.

The rights are designed to assure that all shareholders receive fair and equal treatment in the event of any proposed takeover of the Company and to encourage a potential acquirer to negotiate with the Board of Directors prior to attempting a takeover. The rights have an exercise price of \$118 per right, subject to subsequent adjustment. The rights trade with the Company's common stock and will not be exercisable until the occurrence of certain takeover-related events.

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 Board, 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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Note F Other Intangible Assets

Other intangible assets consist of the following at December 31, 2009:

Item	Life	Cost	Nine Months Ended December 31, 2009 Amortization Expense	Accumulated Amortization at December 31, 2009	Cost, Net of Accumulated Amortization at December 31, 2009
Covenants Not to Compete	5 Years	\$ 950,000	\$ 124,000	\$ 541,000	\$ 409,000
Customer Relationships	18-20 Years	7,571,000	304,000	1,096,000	6,475,000
TPA Licenses	15 Years	204,000	10,000	33,000	171,000
Total		\$8,725,000	\$ 438,000	\$ 1,670,000	\$ 7,055,000

Note G Line of Credit

In May 2009, the Company entered into a credit agreement with a financial institution to provide a revolving credit facility with borrowing capacity of up to \$10 million. Borrowings under this agreement bear interest, at the Company's option, at a fixed LIBOR-based rate plus 1.50% or at a fluctuating rate determined by the financial institution to be 1.50% above the daily one-month LIBOR rate. The loan covenants require the Company to maintain the current assets to liabilities ratio of at least 1.25:1, debt to tangible net worth not greater than 1:1 and have positive net income. The Company is not authorized to use this line for stock repurchases. There are no outstanding revolving loans as of the date hereof, but letters of credit in the aggregate amount of \$6.3 million have been issued under a letter of credit sub-limit that does not reduce the amount of borrowings available under the revolving credit facility. The credit agreement expires in May 2010.

Note H Contingencies and Litigation

In February 2005, Kathleen Roche, D.C., as plaintiff, filed a putative class action in Circuit Court for the 20th Judicial District, St. Clair County, Illinois, against the Company. The case seeks unspecified damages based on the Company's alleged failure to direct patients to medical providers who are members of the CorVel CorCare PPO network and also alleges that the Company used biased and arbitrary computer software to review medical providers bills. In December 2007, the trial court certified a class in this case of all Illinois health care providers with CorVel PPO agreements, excluding hospitals. In January 2008, CorVel filed with the Illinois Appellate Court a petition for interlocutory appeal of the trial court's class certification order which was denied in April 2008. In May 2008, the Company appealed the appellate court's denial of its petition for interlocutory appeal which appeal was also denied by the Illinois Supreme Court in September 2008. The Company intends to pursue all available legal remedies including vigorously defending this case. The Company is not able to estimate the amount of possible loss, if any, at this time.

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

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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, believes, seeks, estimates and should, and 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 decreasing number of injured workers; cost of capital and capital requirements; possible litigation and legal liability in the course of operations; 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; dependence on key personnel; and the continued availability of financing in the amounts and at the terms necessary to support the Company's future business.

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 and auto policies. The Company's services are provided to insurance companies, TPAs, and self-administered employers to assist them in managing the medical costs and monitoring the quality of care associated with healthcare claims.

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, auto policies and, to a lesser extent, group health policies. The network solutions offered by the Company include automated medical fee auditing, preferred provider services, retrospective utilization review, independent medical examinations, and inpatient bill review. Network solutions services also includes revenue from the Company's directed care network (CareIQ), including imaging and physical therapy.

Patient Management Services

In addition to its network solutions services, the Company offers a range of patient management services, which involve working on a one-on-one basis with injured employees and their various healthcare professionals, employers and insurance company adjusters. 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. The Company expanded its patient management services to include the processing of claims for self-insured payors to property and casualty insurance with the January 2007 acquisition of the assets of Hazelrigg Risk Management Services, the June 2007 acquisition of the outstanding capital stock of The Schaffer Companies, Ltd. and the February 2009 acquisition of the outstanding capital stock of Eagle Claim Services, Inc.

Table of Contents**Organizational Structure**

The Company's management is structured geographically with regional vice-presidents who report to the 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. FASB ASC 280-10 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: 1) the nature of products and services; 2) the nature of the production processes; 3) the type or class of customer for their products and services; and 4) 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.

Summary of Quarterly Results

The Company generated revenues of \$86.6 million for the quarter ended December 31, 2009, an increase of \$9.7 million or 12.6% compared to revenues of \$77.0 million for the quarter ended December 31, 2008. The increase in revenues was primarily due to an increase in patient management business. An improvement in customer utilization of the Company's TPA services was the primary reason for the increase in patient management revenues. An increase in revenues from CareIQ services, which contributed to the increase in network solutions review. As the Company expands the TPA offering we have found the CareIQ services and our TPA offering to be synergistic.

The Company's cost of revenues increased by \$5.5 million, from \$59.3 million in the December 2008 quarter to \$64.8 million in the December 2009 quarter, an increase of 9.3%. This increase was primarily due to the costs associated with the increase in demand for the Company's TPA services, and to a lesser extent, the CareIQ services, which are high-cost services.

The Company's general and administrative expense increased by \$0.4 million, from \$10.3 million in the December 2008 quarter to \$10.7 million in the December 2009 quarter, an increase of 4.1%. This increase is primarily due to an increase in the Company's systems and data interface costs. Systems cost increased from \$5.9 million to \$6.2 million as the Company increased the number of employees and consultants in systems.

The Company's income tax expense increased by \$1.6 million, or 54.4%, from \$2.9 million, in the December 2008 quarter to \$4.4 million in the December 2009 quarter. The increase in income tax expense before income taxes was primarily due to the aforementioned increase in revenues. The effective income tax rate was 38.9% in the December 2008 quarter and 39.8% in the December 2009 quarter.

Weighted diluted shares decreased from 13.4 million shares in the December 2008 quarter to 12.4 million shares in the December 2009 quarter, a decrease of 1.0 million shares, or 7.5%. This decrease was due primarily to the repurchase of 581,000 shares of common stock during the September 2009 quarter and an additional 313,000 shares of common stock during the December 2009 quarter. The decrease was offset by the exercise of stock options during the December 2009 quarter.

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Diluted earnings per share increased from \$0.34 in the December 2008 quarter to \$0.54 in the December 2009 quarter, an increase of \$0.20 per share, or 58.8%. The increase in diluted earnings per share was due to the increase in income before income taxes along with the reduction in the number of shares outstanding due to the shares repurchased.

Results of Operations for the three months ended December 31, 2008 and 2009

The Company derives its revenues from providing patient management and network solutions services to payors of workers' compensation benefits, auto insurance claims and health insurance benefits. Patient management services include utilization review, medical case management, vocational rehabilitation, and claims processing. Network solutions revenues include fee schedule auditing, hospital bill auditing, independent medical examinations, diagnostic imaging review services and preferred provider referral services. The percentage of total revenues attributable to patient management and network solutions services for the quarters ended December 31, 2008 and December 31, 2009 are as follows:

	December 31, 2008	December 31, 2009
Patient management services	43.2%	47.4%
Network solutions services	56.8%	52.6%

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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 items reflected in the Company's consolidated income statements for the quarters ended December 31, 2008 and December 31, 2009. The Company's past operating results are not necessarily indicative of future operating results.

	Three Months Ended December 31, 2008	Three Months Ended December 31, 2009	Change	Percentage Change
Revenue	\$76,962,000	\$ 86,629,000	\$ 9,667,000	12.6%
Cost of revenues	59,300,000	64,823,000	5,523,000	9.3%
Gross profit	17,662,000	21,806,000	4,144,000	23.5%
Gross profit as percentage of revenue	22.9%	25.2%		
General and administrative	10,296,000	10,713,000	417,000	4.1%
General and administrative as percentage of revenue	13.4%	12.4%		
Income before income tax provision	7,366,000	11,093,000	3,727,000	50.6%
Income before income tax provision as percentage of revenue	9.6%	12.8%		
Income tax provision	2,862,000	4,418,000	1,556,000	54.4%
Net income	\$ 4,504,000	\$ 6,675,000	\$ 2,171,000	48.2%
Weighted Shares				
Basic	13,316,000	12,237,000	(1,079,000)	(8.1%)
Diluted	13,439,000	12,426,000	(1,013,000)	(7.5%)
Earnings Per Share				
Basic	\$ 0.34	\$ 0.55	\$ 0.21	61.8%
Diluted	\$ 0.34	\$ 0.54	\$ 0.20	58.8%

Revenues**Change in revenue from the quarter ended December 2008 to the quarter ended December 2009**

Revenues increased from \$77.0 million for the three months ended December 31, 2008 to \$86.6 million for the three months ended December 31, 2009, an increase of \$9.7 million or 12.6%. The increase was primarily due to an increase in the Company's patient management revenues of \$7.8 million or 22.7% from \$33.3 million in the December 2008 quarter to \$41.1 million in the December 2009 quarter. Improvements in customer utilization of the Company's TPA services were the primary reason for the increase in patient management service revenues. This was complimented by an increase in network solutions revenue of \$1.9 million or 4.3%, from \$43.7 million in the December 2008 quarter to \$45.6 million in the December 2009 quarter. This increase was primarily due to an increase in revenues from CareIQ services.

The Company believes that referral volume in patient management services and bill review volume in network solutions services may decrease or reflect nominal growth until there is growth in the number of work related injuries and workers compensation related claims.

Table of Contents**Cost of Revenues**

The Company's cost of revenues consist of direct expenses, costs directly attributable to the generation of revenue, and field indirect costs which are incurred in the field offices of the Company. Direct costs are primarily case manager salaries, bill review analysts, related payroll taxes and fringe benefits, and costs for independent medical examination (IME) and MRI providers. Most of the Company's revenues are generated in offices which provide both patient management services and network solutions services. The largest of the field indirect costs are manager salaries and bonus, account executive base pay and commissions, administrative and clerical support, field systems personnel, PPO network developers, related payroll taxes and fringe benefits, office rent, and telephone expense. Approximately 42% of the costs incurred in the field are costs which support both the patient management services and network solutions operations of the Company's field offices, such as district managers, account executives, rent, and telephone.

Change in cost of revenue from the quarter ended December 2008 to the quarter ended December 2009

The Company's costs of revenues increased from \$59.3 million in the quarter ended December 31, 2008 to \$64.8 million in the quarter ended December 31, 2009, an increase of \$5.5 million or 9.3%. This increase was primarily due to the costs associated with the increase in demand for the Company's TPA services, and to a lesser extent, the CareIQ services, which are high-cost services. During the December 2009 quarter, software enhancements increased the Company's gross margin in these services.

General and Administrative Expense

For the quarter ended December 31, 2009, general and administrative expense consisted of approximately 58% of corporate systems costs which include the corporate systems support, implementation and training, amortization of software development costs, depreciation of the hardware costs in the Company's national systems, the Company's national wide area network and other systems related costs. The remaining 42% of the general and administrative expense consisted of national marketing, national sales support, corporate legal, corporate insurance, human resources, accounting, product management, new business development and other general corporate matters.

Change in general and administrative expense from the quarter ended December 2008 to the quarter ended December 2009

General and administrative expense increased from \$10.3 million in the quarter ended December 31, 2008 to \$10.7 million in the quarter ended December 31, 2009, an increase of \$0.4 million, or 4.1%. This increase is primarily due to an increase in the Company's systems and data interface costs. Systems cost increased from \$5.9 million to \$6.2 million due to an increase in the number of employees and consultants.

Income Tax Provision

The Company's income tax expense increased by \$1.6 million, or 54.4%, from \$2.9 million for the quarter ended December 31, 2008 to \$4.4 million for the quarter ended December 31, 2009 due to the increase in income before income taxes from \$7.4 million to \$11.1 million. The income tax expense as a percentage of income before income taxes (i.e. effective tax rate) was 38.9% for the three months ended December 31, 2008 and 39.8% for the three months ended December 31, 2009. The income tax provision rates were based upon management's review of the Company's estimated annual income tax rate, including state taxes. This effective tax rate differed from the statutory federal tax rate of 35.0% primarily due to state income taxes and certain non-deductible expenses.

Results of Operations for the nine months ended December 2008 and the nine months ended December 2009

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 consolidated income statements for the nine months ended December 31, 2008 and December 31, 2009. The Company's past operating results are not necessarily indicative of future operating results.

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	Nine Months Ended December 31, 2008	Nine Months Ended December 31, 2009	Change	Percentage Change
Revenue	\$233,018,000	\$250,357,000	\$17,339,000	7.4%
Cost of revenues	176,564,000	186,602,000	10,038,000	5.7%
Gross profit	56,454,000	63,755,000	7,301,000	12.9%
Gross profit as percentage of revenue	24.2%	25.5%		
General and administrative	31,825,000	31,369,000	(456,000)	(1.4%)
General and administrative as percentage of revenue	13.7%	12.5%		
Income before income tax provision	24,629,000	32,386,000	7,757,000	31.5%
Income before income tax provision as percentage of revenue	10.6%	12.9%		
Income tax provision	9,594,000	12,907,000	3,313,000	34.5%
Net income	\$ 15,035,000	\$ 19,479,000	\$ 4,444,000	29.6%
Weighted Shares				
Basic	13,632,000	12,640,000	(992,000)	(7.3%)
Diluted	13,815,000	12,801,000	(1,014,000)	(7.3%)
Earnings Per Share				
Basic	\$ 1.10	\$ 1.54	\$ 0.44	40.0%
Diluted	\$ 1.09	\$ 1.52	\$ 0.43	39.4%

Revenues**Change in revenue from the nine months ended December 2008 to the nine months ended December 2009**

Revenues increased from \$233.0 million for the nine months ended December 31, 2008 to \$250.4 million for the nine months ended December 31, 2009, an increase of \$17.3 million or 7.4%. The Company's patient management revenues increased \$11.5 million or 11.5% from \$101.1 million in the nine months ended December 2008 to \$112.6 million in the nine months ended December 2009. This increase was primarily due to improvements in customer utilization of the Company's TPA services. The Company's network solutions revenues increased from \$132.0 million in the nine months ended December 2008 to \$137.8 million in the nine months ended December 2009, an increase of \$5.8 million or 4.4%. This increase was primarily due to an increase in customer utilization of the Company's CorCareRx and CareIQ services.

Table of Contents**Cost of Revenues****Change in cost of revenue from the nine months ended December 2008 to the nine months ended December 2009**

The Company's costs of revenues increased from \$176.6 million in the nine months ended December 31, 2008 to \$186.6 million in the nine months ended December 31, 2009, an increase of \$10.0 million or 5.7%. This increase was primarily due to the costs associated with the increase in demand for the Company's TPA services, CareIQ and CorCareRx services, which are high-cost services. CorVel TPA service costs increased \$9.7 million from the previous nine month period. CorCareRX cost of goods sold increased \$2.3 million from the previous nine month period. Similarly, CareIQ costs increased \$3.1 million from the previous nine month period.

General and Administrative Costs**Change in cost of general and administrative expense from the nine months ended December 2008 to the nine months ended December 2009**

General and administrative expense decreased from \$31.8 million in the nine months ended December 31, 2008 to \$31.4 million in the nine months ended December 31, 2009, a decrease of \$0.5 million, or 1.4%. This decrease is primarily due to a decrease in the Company's systems and data interface costs. Systems cost decreased from \$19.1 million to \$18.0 million due to a reduction in employee headcount and consultants, offset by increases in other general and administrative costs. During the December 2009 quarter, software enhancements increased the Company's gross margin in these services. Additionally, during the December 2009 quarter, the Company began increasing software development expenditures to further our TPA product. The Company expects to grow software development expenditures. Additionally, the Company's legal expenses decreased in the nine months ended December 31, 2009 compared to the nine months ended December 31, 2008, due to a reduction in settlements and outside attorney expenses. This decrease was offset by an increase in sales and marketing primarily due to an increase in customer meetings and product management personnel.

Income Tax Provision

The Company's income tax expense increased by \$3.3 million, or 34.5%, from \$9.6 million for the nine months ended December 31, 2008 to \$12.9 million for the nine months ended December 31, 2009 due to the increase in income before income taxes from \$24.6 million to \$32.4 million. The income tax expense as a percentage of income before income taxes, also known as the effective tax rate, was 39.0% for the nine months ended December 31, 2008 and 39.9% for the nine months ended December 31, 2009. The income tax provision rates were based upon management's review of the Company's estimated annual income tax rate, including state taxes. This effective tax rate differed from the statutory federal tax rate of 35.0% primarily due to state income taxes and certain non-deductible expenses.

Liquidity and Capital Resources

The Company has historically funded its operations and capital expenditures primarily from cash flow from operations, and to a lesser extent, stock option exercises. Working capital decreased \$4.2 million, or 15%, from \$28.1 million as of March 31, 2009 to \$23.9 million as of December 31, 2009, primarily due to a decrease in cash from \$14.7 million as of March 31, 2009 to \$7.9 million as of December 31, 2009. The decrease in cash was primarily due to the \$27 million in share repurchases.

The Company believes that cash from operations and funds from exercises of stock options granted to employees are adequate to fund existing obligations, repurchase shares of the Company's common stock under its current share repurchase program, introduce new services, and continue to develop healthcare related businesses for at least the next twelve months. The Company regularly evaluates cash requirements for current operations and commitments, and for capital acquisitions and other strategic transactions. The Company may elect to raise additional funds for these purposes, through debt or equity financings or otherwise, as appropriate. Additional equity or debt financing may not be available when needed, on terms favorable to us or at all.

As of December 31, 2009, excluding \$1.5 million of customer deposits held in bank checking accounts, the Company had \$6.4 million in cash and cash equivalents, invested primarily in short-term, interest-bearing, highly liquid investment-grade securities with maturities of 90 days or less in federally regulated banks.

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In May 2009, the Company entered into a credit agreement with a financial institution to provide a revolving credit facility with borrowing capacity of up to \$10 million. Borrowings under this agreement bear interest, at the Company's option, at a fixed LIBOR-based rate plus 1.50% or at a fluctuating rate determined by the financial institution to be 1.50% above the daily one-month LIBOR rate. The loan covenants require the Company to maintain the current assets to liabilities ratio of at least 1.25:1, debt to tangible net worth not greater than 1:1 and have positive net income. The Company is not authorized to use this line for stock repurchases. There are no outstanding revolving loans as of the date hereof, but letters of credit in the aggregate amount of \$6.3 million have been issued under a letter of credit sub-limit that does not reduce the amount of borrowings available under the revolving credit facility. The credit agreement expires in May 2010.

The Company has historically required substantial capital to fund the growth of its operations, particularly working capital to fund the growth in accounts receivable and capital expenditures. The Company believes, however, that the cash balance at December 31, 2009 along with anticipated internally generated funds, will be sufficient to meet the Company's expected cash requirements for at least the next twelve months.

Operating Cash Flows***Nine months ended December 31, 2008 compared to nine months ended December 31, 2009***

Net cash provided by operating activities increased from \$23.6 million in the nine months ended December 31, 2008 to \$26.2 million in the nine months ended December 31, 2009. The increase in cash flow from operating activities was primarily due to the increase in net income to \$19.5 million for the nine months ended December 31, 2009 from \$15.0 million for the nine months ended December 31, 2008, an increase of \$4.5 million.

Investing Activities***Nine months ended December 31, 2008 compared to nine months ended December 31, 2009***

Net cash flow used in investing activities decreased from \$9.5 million in the nine months ended December 31, 2008 to \$8.7 million in the nine months ended December 31, 2009, a decrease of \$0.8 million. The decrease in net cash used in investing activities is primarily due to payments during the nine months ended December 31, 2008 related to the Company's acquisition of The Schaffer Companies, Ltd. in June 2007. The Company had no acquisitions or acquisition related disbursements in the nine months ended December 31, 2009. Property additions increased from \$7.7 million in the nine months ended December 31, 2008 to \$8.7 million in the nine months ended December 31, 2009.

Financing Activities***Nine months ended December 31, 2008 compared to nine months ended December 31, 2009***

Net cash flow used in financing activities increased from \$19.9 million for the nine months ended December 31, 2008 to \$24.3 million for the nine months ended December 31, 2009, an increase of \$4.5 million. The increase in cash flow used in financing activities was primarily due to an increase in purchases under the Company's share repurchase program, partially offset by an increase in the number of options exercised. During the nine months ended December 31, 2009, the Company spent \$27.0 million to repurchase 924,000 shares of its common stock, including 200,000 shares which were repurchased from the Company's Chairman of the Board in September 2009 for an average price of \$30.00 per share. During the nine months ended December 31, 2008, the Company spent \$22.2 million to repurchase 923,000 shares of its common stock. The Company has historically used cash provided by operating activities and from the exercise of stock options to repurchase stock. The Company expects it may use some of the \$7.9 million of cash on its balance sheet at December 31, 2009 to repurchase additional shares of stock.

Table of Contents**Contractual Obligations**

The following table summarizes the Company's contractual obligations outstanding as of December 31, 2009.

	Total	Payments Due by Period			
		Within One Year	Between Two and Three Years	Between Four and Five Years	More than Five Years
Operating leases	\$48,903,000	\$13,746,000	\$19,985,000	\$10,443,000	\$4,729,000
Total	\$48,903,000	\$13,746,000	\$19,985,000	\$10,443,000	\$4,729,000

Operating leases are rents paid for the Company's physical locations.

Litigation

In February 2005, Kathleen Roche, D.C., as plaintiff, filed a putative class action in Circuit Court for the 20th Judicial District, St. Clair County, Illinois, against the Company. The case seeks unspecified damages based on the Company's alleged failure to direct patients to medical providers who are members of the CorVel CorCare PPO network and also alleges that the Company used biased and arbitrary computer software to review medical providers bills. In December 2007, the trial court certified a class in this case of all Illinois health care providers with CorVel PPO agreements, excluding hospitals. In January 2008, CorVel filed with the Illinois Appellate Court a petition for interlocutory appeal of the trial court's class certification order which was denied in April 2008. In May 2008, the Company appealed the appellate court's denial of its petition for interlocutory appeal which appeal was also denied by the Illinois Supreme Court in September 2008. The Company intends to pursue all available legal remedies including vigorously defending this case. The Company is not able to estimate the amount of possible loss, if any, at this time.

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

Inflation

The Company experiences pricing pressures in the form of competitive prices. The Company is also impacted by rising costs for certain inflation-sensitive operating expenses such as labor and employee benefits, and facility leases. However, the Company generally does not believe these impacts are material to its revenues or net income.

Off-Balance Sheet Arrangements

The Company is not a party to off-balance sheet arrangements as defined by the rules of the Securities and Exchange Commission. However, from time to time the Company enters into certain types of contracts that contingently require the Company to indemnify parties against third-party claims. The contracts primarily relate to: (i) certain contracts to perform services, under which the Company may provide customary indemnification to the purchasers of such services; (ii) certain real estate leases, under which the Company may be required to indemnify property owners for environmental and other liabilities, and other claims arising from the Company's use of the applicable premises; and (iii) certain agreements with the Company's officers, directors and employees, under which the Company may be required to indemnify such persons for liabilities arising out of their relationship with the Company.

The terms of such obligations vary by contract and in most instances a specific or maximum dollar amount is not explicitly stated therein. Generally, amounts under these contracts cannot be reasonably estimated until a

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specific claim is asserted. Consequently, no liabilities have been recorded for these obligations on the Company's balance sheets for any of the periods presented.

Critical Accounting Policies

The rules of the Securities and Exchange Commission define critical accounting policies as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

The following is not intended to be a comprehensive list of our accounting policies, but supplements the accounting policies described in Note A to the Consolidated Financial Statements. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States of America, with no need for management's judgment in their application. There are also areas in which management's judgment in selecting an available alternative would not produce a materially different result.

The Company has identified the following accounting policies as critical to it: 1) revenue recognition, 2) cost of revenues, 3) allowance for uncollectible accounts, 4) goodwill and long-lived assets, 5) accrual for self-insured costs, 6) accounting for income taxes, and 7) share-based compensation.

Revenue Recognition: The Company's revenues are recognized primarily as services are rendered based on time and expenses incurred. A certain portion of the Company's revenues are derived from fee schedule auditing which is based on the number of provider charges audited and, to a lesser extent, on a percentage of savings achieved for the Company's customers. The Company has generally recognize revenue when there is persuasive evidence of an arrangement, the services have been provided to the customer, the sales price is fixed or determinable, and collectability is reasonably assured. The Company reduces revenue for estimated contractual allowances and records any amounts invoiced to the customer in advance of service performance as deferred revenue.

Cost of revenues: Cost of services consists primarily of the compensation and fringe benefits of field personnel, including managers, medical bill analysts, field case managers, telephonic case managers, systems support, administrative support and account managers and account executives and related facility costs including rent, telephone and office supplies. Historically, the costs associated with these additional personnel and facilities have been the most significant factor driving increases in the Company's cost of services. Locally managed and incurred IT costs are charged to cost of revenues whereas the costs incurred and managed at the corporate offices are charged to general and administrative expense.

Allowance for Uncollectible Accounts: 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 customers current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes off accounts receivable when they become uncollectible.

The Company must make significant management judgments and estimates in determining contractual and bad debt allowances in any accounting period. One significant uncertainty inherent in the Company's analysis is whether its past experience will be indicative of future periods. Although the Company considers future projections when estimating contractual and bad debt allowances, the Company ultimately makes its decisions based on the best information available to it at that time. Adverse changes in general economic conditions or trends in reimbursement amounts for the Company's services could affect the Company's contractual and bad debt allowance estimates, collection of accounts receivable, cash flows, and results of operations.

There has been no material change in the net reserve balance during the past three fiscal years. No one customer accounted for 10% or more of accounts receivable at March 31, 2009 or at December 31, 2009.

Goodwill and Long-Lived Assets: Goodwill arising from business combinations represents the excess of the purchase price over the estimated fair value of the net assets of the acquired business. Pursuant to FASB ASC 350-10 through ASC 350-30 goodwill is tested annually for impairment or more frequently if circumstances

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indicate the potential for impairment. Also, management tests for impairment of its intangible assets and long-lived assets on an ongoing basis and whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company's impairment is conducted at a company-wide level. The measurement of fair value is based on an evaluation of market capitalization and is further tested using a multiple of earnings approach. In projecting the Company's cash flows, management considers industry growth rates and trends and cost structure changes. Based on the Company's tests and reviews, no impairment of its goodwill, intangible assets or other long-lived assets existed at March 31, 2009 or at December 31, 2009. However, future events or changes in current circumstances could affect the recoverability of the carrying value of goodwill and long-lived assets. Should an asset be deemed impaired, an impairment loss would be recognized to the extent the carrying value of the asset exceeded its estimated fair market value.

Accrual for Self-insurance Costs: The Company self-insures for the group medical costs and workers compensation costs of its employees. The Company purchases stop loss insurance for large claims. Management believes that the self-insurance reserves are appropriate; however, actual claims costs may differ from the original estimates requiring adjustments to the reserves. The Company determines its estimated self-insurance reserves based upon historical trends along with outstanding claims information provided by its claims paying agents.

Accounting for Income Taxes: The Company provides for income taxes in accordance with provisions specified in FASB ASC 740-10-05 through ASC 740-10-55, Accounting for Uncertainty in 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 is dependent upon 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 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.

Share-Based Compensation: Effective April 1, 2006, the Company adopted the provisions of FASB ASC 718, on which establishes accounting for equity instruments exchanged for employee services. Under the provisions of FASB ASC 718, share-based compensation cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity grant).

For the nine months ended December 31, 2009, the Company recorded share-based compensation expense of \$1,560,000. Share-based compensation expense recognized in fiscal 2010 is based on awards ultimately expected to vest; therefore, it has been reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The Company estimates the fair value of stock options using the Black-Scholes valuation model. Key input assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected option term, the expected volatility of the Company's stock over the option's expected term, the risk-free interest rate over the option's term, and the Company's expected annual dividend yield. The Company's management believes that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of the Company's stock options granted in fiscal 2010. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards.

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The key input assumptions that were utilized in the valuation of the stock options granted during the quarter ended December 31, 2009 are summarized in the table below.

Expected option term (1)	4.8 years
Expected volatility (2)	47%
Risk-free interest rate (3)	2.34%
Expected forfeiture rate	9.81%
Expected annual dividend yield	0%

(1) The expected option term is based on historical exercise and post-vesting termination patterns, as well as our expectations regarding future trends.

(2) Expected volatility represents a combination of historical stock price volatility and estimated future volatility.

(3) The risk-free interest rate is based on the implied yield on five year United States Treasury Bill on the date of grant.

Recent Accounting Standards Update