CORVEL CORP
Form 10-Q
August 03, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 0-19291

CORVEL CORPORATION

(Exact Name of Registrant as Specified in its Charter)

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

2010 Main Street, Suite 600	
Irvine, CA	92614
(Address of principal executive offices)	(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

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

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

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

The number of shares outstanding of the registrant's Common Stock, $0.0001 par value per share, as of July 31, 2018, was 18,880,687.

CORVEL CORPORATION

FORM 10-Q

TABLE OF CONTENTS

		Page
PART I - FINANCIAL INFORMATION		
Item 1.	Financial Statements	3
	Consolidated Balance Sheets – June 30, 2018 and March 31, 2018 (unaudited)	3
	Consolidated Income Statements (unaudited) – Three months ended June 30, 2018 and 2017	4
	Consolidated Statements of Cash Flows (unaudited) – Three months ended June 30, 2018 and 2017	5
	Notes to Consolidated Financial Statements – June 30, 2018	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	15
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	21
Item 4.	Controls and Procedures	21
PART II. OTHER INFORMATION		
Item 1.	Legal Proceedings	21
Item 1A.	Risk Factors	21
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	28
Item 3.	Defaults Upon Senior Securities	28
Item 4.	Mine Safety Disclosures	28
Item 5.	Other Information	28
Item 6.	Exhibits	29
	Signatures	30

Part I - Financial Information

Item 1 - Financial Statements

CORVEL CORPORATION

CONSOLIDATED BALANCE SHEETS

	June 30, 2018 (Unaudited)	March 31, 2018
Assets		
Current Assets		
Cash and cash equivalents (Note 1)	$73,340,000	$55,771,000
Customer deposits	35,695,000	35,496,000
Accounts receivable, net	66,124,000	64,940,000
Prepaid taxes and expenses	7,997,000	7,110,000
Total current assets	183,156,000	163,317,000
Property and equipment, net	66,849,000	69,356,000
Goodwill	36,814,000	36,814,000
Other intangibles, net (Note 7)	3,306,000	3,415,000
Other assets	1,085,000	1,102,000
TOTAL ASSETS	$291,210,000	$274,004,000
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts and taxes payable	$15,991,000	$13,453,000
Accrued liabilities	88,810,000	84,536,000
Total current liabilities	104,801,000	97,989,000
Deferred income taxes	4,544,000	4,839,000
Total liabilities	109,345,000	102,828,000
Commitments and contingencies (Notes 8 and 9)		
Stockholders' Equity		
Common stock, $.0001 par value: 120,000,000 shares authorized at June 30, 2018 and March 31, 2018; 53,839,539 shares issued (18,891,907 shares outstanding, net of Treasury shares) and 53,793,986 shares issued (18,912,907 shares outstanding, net of Treasury shares) at June 30, 2018 and March 31, 2018, respectively	3,000	3,000
Paid-in capital	146,102,000	143,705,000
Treasury Stock (34,947,632 shares at June 30, 2018 and 34,881,079 shares at March 31, 2018)	(434,475,000)	(430,989,000)
Retained earnings	470,235,000	458,457,000
Total stockholders' equity	181,865,000	171,176,000
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$291,210,000	$274,004,000

See accompanying notes to unaudited consolidated financial statements.

CORVEL CORPORATION

CONSOLIDATED INCOME STATEMENTS – UNAUDITED

	Three Months Ended June 30,	
	2018	2017
REVENUES	$150,398,000	$137,612,000
Cost of revenues	119,045,000	108,829,000
Gross profit	31,353,000	28,783,000
General and administrative expenses	15,937,000	14,629,000
Income before income tax provision	15,416,000	14,154,000
Income tax provision	3,638,000	5,379,000
NET INCOME	$11,778,000	$8,775,000
Net income per common and common equivalent share		
Basic	$0.62	$0.47
Diluted	$0.62	$0.46
Weighted average common and common equivalent shares		
Basic	18,922,000	18,811,000
Diluted	19,102,000	19,000,000

See accompanying notes to unaudited consolidated financial statements.

CORVEL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS – UNAUDITED

	Three Months Ended June 30, 2018	2017
Cash Flows from Operating Activities		
NET INCOME	$11,778,000	$8,775,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,633,000	5,303,000
(Gain) loss on write down or disposal of property, capitalized software or investment	(49,000)	288,000
Stock compensation expense	1,179,000	922,000
Provision for doubtful accounts	1,313,000	276,000
Deferred income tax	(294,000)	(328,000)
Changes in operating assets and liabilities		
Accounts receivable	(2,497,000)	(203,000)
Customer deposits	(199,000)	741,000
Prepaid taxes and expenses	(887,000)	38,000
Other assets	16,000	178,000
Accounts and taxes payable	2,538,000	4,096,000
Accrued liabilities	4,274,000	1,293,000
Net cash provided by operating activities	22,805,000	21,379,000
Cash Flows from Investing Activities		
Purchase of property and equipment	(2,969,000)	(5,299,000)
Net cash (used in) investing activities	(2,969,000)	(5,299,000)
Cash Flows from Financing Activities		
Purchase of treasury stock	(3,486,000)	(11,187,000)
Tax effect of stock option exercises	—	768,000
Exercise of common stock options	1,219,000	737,000
Net cash (used in) financing activities	(2,267,000)	(9,682,000)
Increase in cash and cash equivalents	17,569,000	6,398,000
Cash and cash equivalents at beginning of period	55,771,000	28,611,000
Cash and cash equivalents at end of period	$73,340,000	$35,009,000
Supplemental Cash Flow Information:		
Income taxes paid	$56,000	$152,000

See accompanying notes to unaudited consolidated financial statements.

CORVEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

Note 1 — Summary of Significant Accounting Policies

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

The unaudited consolidated financial statements herein have been prepared by CorVel Corporation (“the Company”) pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”). The accompanying interim unaudited financial statements have been prepared under the presumption that users of the interim financial information have either read or have access to the audited consolidated financial statements for the latest fiscal year ended March 31, 2018. Accordingly, note disclosures which would substantially duplicate the disclosures contained in the March 31, 2018 audited consolidated financial statements have been omitted from these interim unaudited consolidated financial statements.

The Company evaluated all subsequent events and transactions through the date of filing this report. During the period subsequent to the quarter ended June 30, 2018, the Company repurchased 24,001 shares of common stock for $1,334,000 at an average of $55.60 per share of common stock. These shares of common stock were repurchased under the Company’s share repurchase program described in Note 4.

Certain information and note disclosures normally included in financial statements prepared in accordance with United States generally accepted accounting principles (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2019. For further information, refer to the audited consolidated financial statements and notes for the fiscal year ended March 31, 2018 included in the Company's Annual Report on Form 10-K filed with the SEC on June 8, 2018.

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

Guidance Adopted: On May 28, 2014, the FASB issued ASU 2014-09 regarding ASC Topic 606, “Revenue from Contracts with Customers”. This standard provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services. In July 2015, the FASB approved a one-year delay of the effective date of this new revenue recognition standard. The guidance will now be effective for the Company’s fiscal year beginning April 1, 2018. The Company has adopted this standard as of April 1, 2018. Refer to Note 2 of the accompanying consolidated financial statements for a description of the impact of the adopted guidance.

In January 2016, the FASB issued ASU 2016-01 regarding Subtopic 825-10, "Financials Instruments — Overall: Recognition and Measurements of Financial Assets and Financial Liabilities". The standard addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. It requires that most equity investments be measured at fair value, with subsequent changes in fair value recognized in net income. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company adopted this guidance prospectively on April 1, 2018. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows", which reduces diversity in the practice of how certain transactions are classified in the statement of cash flows. The new guidance is effective for annual reporting periods beginning after December 15, 2017, with early adoption permitted. The Company adopted this guidance prospectively on April 1, 2018. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

CORVEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

Note 2 – Revenue Recognition

The Company adopted ASC 606 using the modified retrospective method for those contracts which were not substantially completed as of the transition date. The reported results for the three months ended June 30, 2018 reflect the application of the guidance of ASC 606 while the reported results for the three months ended June 30, 2017 were prepared under the guidance of ASC 605.

There was no material impact to any of the line items within the Company's Consolidated Statements of Income or Consolidated Balance Sheets as a result of applying ASC 606 for the three months ended June 30, 2018.

Revenue from Contracts with Customers

Revenue is recognized when control of the promised services are transferred to the Company's customers in an amount that reflects the consideration expected to be entitled to in exchange for those services. As the Company completes its performance obligations which are identified below, it has an unconditional right to consideration as outlined in the Company's contracts. Generally the Company's accounts receivable are expected to be collected in 30 days, in accordance with the underlying payment terms.

The Company generates revenue through its patient management and network solutions service lines. The Company operates in one reportable operating segment, managed care.

Patient Management Service Line

The patient management service line provides services primarily related to Workers' Compensation claims management and case management. This service line also includes additional services such as accident and health claims programs. Each claim referred by the customer is considered an additional optional purchase of claims management services under the agreement with the customer. The transaction price is readily available from the contract and is fixed for each service. Revenue is recognized over time as services are provided as the performance obligations are satisfied through the effort expended to research, investigate, evaluate, document, and report the claim and control of these services are transferred to the customer. Revenue is recognized based on historical claim closure rates and claim type applied utilizing a portfolio approach based on time elapsed for these claims, generally between three and 15 months. The Company believes this approach reasonably reflects the transfer of the claims management services to its customer.

The Company's obligation to manage claims and cases under the patient management service line can range from less than one year to multi-year contracts. They are generally one year under the terms of the contract; however, many of these contracts contain auto-renewal provisions and the Company's customer relationships can span multiple years. Under certain claims management agreements, the Company receives consideration from a customer at contract inception prior to transferring services to the customer, however, it would begin performing services immediately. The period between a customer's payment of consideration and the completion of the promised services is generally less than one year. There is no difference between the amount of promised consideration and the cash selling price of the promised services. The fee is billed upfront by the Company in order to provide customers with simplified and predictable ways of purchasing its services. The Company considered whether a significant financing component exists and determined that there is not a significant financing component at the contract level.

The patient management service line also offers case managers who provide administration services by proactively managing medical treatment for claimants while facilitating an understanding of and participation in their rehabilitation process. Revenue for case management services are recognized over time as the performance obligations are satisfied through the effort expended to manage the medical treatment for claimants and control of these services are transferred to the customer. Case management services are generally billed based on time incurred, are considered variable consideration, and revenue is recognized at the amount in which the Company has the right to invoice for services performed. The Company believes this approach reasonably reflects the transfer of the case management service to the customer.

Network Solutions Service Line

Network solutions services consist primarily of medical bill review and third-party services. Medical bill review services provide an analysis of medical charges for customers' claims to identify opportunities for savings. Medical bill review services revenues are recognized at a point in time when control of the service is transferred to the customer. Revenue is recognized based upon the transfer of the results of the medical bill review service to the customer as this is the most accurate depiction of the transfer of the service to the customer. Medical bill review revenues are variable, generally based on performance metrics set forth in the underlying contracts. Each period, the Company bases its estimates on a contract-by-contract basis. The Company must make its best estimate of amounts the Company has earned and expects to be collected using historical averages and other factors to project such revenues. Variable consideration is recognized when the Company concludes that it is probable that a significant revenue reversal will not occur in future periods.

Third-party services revenue includes pharmacy, directed care services and other services, and includes amounts received from customers reimbursing the Company for certain third-party costs associated with providing its integrated network solutions services. The Company is considered the principal in these transactions as it directs the third party, controls the specified service, performs program utilization review, directs payment to the provider, accepts the financial risk of loss associated with services rendered and combines the services provided into an integrated solution, as specified within the Company's client contracts. The Company has the ability to influence contractual fees with clients and possess the financial risk of loss in certain contractual obligations. These factors indicate the Company is the principal and, as such, it is required to recognize revenue gross and service partner vendor fees in the operating expense in the Company's Consolidated Income Statements.

The following table presents revenues disaggregated by service line for the three months ended June 30, 2018:

	June 30, 2018
Patient management services	$87,891,000
Network solutions services	62,507,000
Total services	$150,398,000

Arrangements with Multiple Performance Obligations

For many of the Company's services, the Company typically has one performance obligation; however, it also provides the customer with an option to acquire additional services. The Company offers multiple services under its patient management and network solutions service lines. The Company typically provides a menu of offerings from which the customer chooses to purchase at their option. The price of each service is separate and distinct and provides a separate and distinct value to the customer. Pricing is generally consistent for each service irrespective of the other services or quantities requested by the customer.

Contract Balances

The timing of revenue recognition, billings and cash collections results in billed accounts receivables, contract assets (reported as unbilled revenues at estimated billable amounts) and contract liabilities (reported as deferred revenues) on the Company’s Consolidated Balance Sheets. Unbilled revenues is a contract asset for revenue that has been recognized in advance of billing the customer, resulting from professional services delivered that the Company expects and is entitled to receive as consideration under certain contracts. Billing requirements vary by contract but substantially all unbilled revenues are billed within one year.

	June 30, 2018
Billed receivables	$56,687,000
Allowance for doubtful accounts	$(5,625,000)
Contract assets	15,062,000
Accounts receivable, net	$66,124,000

When the Company receives consideration from a customer prior to transferring services to the customer under the terms of certain claims management agreements, it records deferred revenues on the Company’s Consolidated Balance Sheets, which represents a contract liability.

CORVEL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

Certain services, such as claims management, are provided under fixed-fee service agreements and require the Company to manage claims over a contract period, typically for one year with the option for auto renewal, which the fixed fee will renew on the anniversary date of such contracts. The Company recognizes deferred revenues as revenues as it performs services and transfers control of the services to the customer and satisfies the performance obligation which it determines utilizing a portfolio approach. For all fixed fee service agreements, revenues are recognized over the expected service periods, by type of claim.

The table below presents the deferred revenues balance as of the transition date and the significant activity affecting deferred revenues during the three months ended June 30, 2018:

	June 30, 2018
Beginning balance at April 1, 2018	$ 15,316,000
Additions	7,780,000
Revenue recognized from beginning of period	(3,826,000)
Revenue recognized from additions	(2,788,000)
Ending balance at June 30, 2018	$ 16,482,000

Remaining Performance Obligations

As of June 30, 2018, the Company had $47.4 million of remaining performance obligations related to claims and non-claims services in which the price is fixed. Remaining performance obligations consist of deferred revenues as well as certain unbilled receivables that are considered contract assets. The Company expects to recognize approximately 82% of its remaining performance obligations as revenues within one year and the remaining balance thereafter. See the discussion below regarding the practical expedients elected for the disclosure of remaining performance obligations.

Costs to Obtain a Contract

The Company has an internal sales force compensation program where remuneration is based solely on the revenues recognized in the period and does not represent an incremental cost to the Company which provides a future benefit expected to be longer than one year and would meet the criteria to be capitalized and presented as a contract asset on the Company's Consolidated Balance Sheets.

Practical Expedients Elected

As a practical expedient, the Company does not adjust the consideration in a contract for the effects of a significant financing component it expects, at contract inception, that the period between a customer's payment of consideration and the transfer of promised services to the customer will be one year or less.

For patient management services that are billed on a time and expense incurred or per unit basis and revenue is recognized over time, the Company recognizes revenue at the amount to which it has the right to invoice for services performed.

The Company does not disclose the value of remaining performance obligations for (i) contracts for which it recognizes revenue at the amount to which it has the right to invoice for services performed, and (ii) contracts with variable consideration allocated entirely to