

CORVEL CORP  
Form 10-Q  
November 10, 2008

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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 September 30, 2008**

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 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 October 31, 2008 was 13,419,720.

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## Part I Financial Information

## Item 1. Financial Statements

**CORVEL CORPORATION****CONSOLIDATED BALANCE SHEETS**

|   | March 31, 2008        | September 30,<br>2008<br>(Unaudited) |
|---|-----------------------|--------------------------------------|
| <b>Assets</b>   |                       |                                      |
| Current Assets  |                       |                                      |
| Cash and cash equivalents (Note A)  | \$ 17,911,000         | \$ 23,600,000                        |
| Accounts receivable, net  | 39,164,000            | 40,950,000                           |
| Prepaid taxes and expenses  | 5,242,000             | 5,648,000                            |
| Deferred income taxes   | 4,076,000             | 3,996,000                            |
| Total current assets  | 66,393,000            | 74,194,000                           |
| Property and equipment, net   | 30,569,000            | 30,209,000                           |
| Goodwill  | 31,875,000            | 33,450,000                           |
| Other intangibles, net  | 7,789,000             | 7,510,000                            |
| Other assets  | 3,949,000             | 4,203,000                            |
| <b>TOTAL ASSETS</b>   | <b>\$ 140,575,000</b> | <b>\$ 149,566,000</b>                |
| <b>Liabilities and Stockholders Equity</b>  |                       |                                      |
| Current Liabilities   |                       |                                      |
| Accounts and taxes payable  | \$ 20,475,000         | \$ 18,797,000                        |
| Accrued liabilities   | 16,473,000            | 19,030,000                           |
| Total current liabilities   | 36,948,000            | 37,827,000                           |
| Deferred income taxes   | 7,249,000             | 7,245,000                            |
| Commitments and contingencies (Note I)  |                       |                                      |
| Stockholders Equity   |                       |                                      |
| Common stock, \$.0001 par value: 60,000,000 shares authorized;<br>25,480,315 shares issued (13,792,701 shares outstanding, net of<br>Treasury shares) and 25,576,890 shares issued (13,733,939 shares<br>outstanding, net of Treasury shares) at March 31, 2008 and<br>September 30, 2008, respectively | 3,000                 | 3,000                                |
| Paid-in-capital   | 80,219,000            | 83,013,000                           |
| Treasury Stock, (11,687,614 shares at March 31, 2008 and 11,842,951<br>shares at September 30, 2008)  | (162,302,000)         | (167,511,000)                        |

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|   |                       |                       |
|---|-----------------------|-----------------------|
| Retained earnings                                 | 178,458,000           | 188,989,000           |
| Total stockholders' equity                        | 96,378,000            | 104,494,000           |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b> | <b>\$ 140,575,000</b> | <b>\$ 149,566,000</b> |

See accompanying notes to consolidated financial statements.

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**Table of Contents****CORVEL CORPORATION  
CONSOLIDATED INCOME STATEMENTS    UNAUDITED**

|  | Three Months Ended September<br>30, |               |
|--|-------------------------------------|---------------|
|  | 2007                                | 2008          |
| REVENUES   | \$ 73,510,000                       | \$ 77,855,000 |
| Cost of revenues   | 54,856,000                          | 58,996,000    |
| Gross profit   | 18,654,000                          | 18,859,000    |
| General and administrative expenses                          | 9,398,000                           | 10,722,000    |
| Income before income tax provision                           | 9,256,000                           | 8,137,000     |
| Income tax provision   | 3,624,000                           | 3,173,000     |
| NET INCOME   | \$ 5,632,000                        | \$ 4,964,000  |
| Net income per common and common equivalent share            |                                     |               |
| Basic  | \$ 0.41                             | \$ 0.36       |
| Diluted  | \$ 0.40                             | \$ 0.36       |
| Weighted average common and common equivalent                |                                     |               |
| Basic  | 13,889,000                          | 13,764,000    |
| Diluted  | 14,062,000                          | 13,960,000    |
| See accompanying notes to consolidated financial statements. |                                     |               |

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**Table of Contents****CORVEL CORPORATION  
CONSOLIDATED INCOME STATEMENTS    UNAUDITED**

|  | Six Months Ended September 30, |                |
|--|--------------------------------|----------------|
|  | 2007                           | 2008           |
| REVENUES   | \$ 147,847,000                 | \$ 156,056,000 |
| Cost of revenues   | 111,012,000                    | 117,264,000    |
| Gross profit   | 36,835,000                     | 38,792,000     |
| General and administrative expenses                          | 18,475,000                     | 21,529,000     |
| Income before income tax provision                           | 18,360,000                     | 17,263,000     |
| Income tax provision   | 7,167,000                      | 6,732,000      |
| NET INCOME   | \$ 11,193,000                  | \$ 10,531,000  |
| Net income per common and common equivalent share            |                                |                |
| Basic  | \$ 0.80                        | \$ 0.76        |
| Diluted  | \$ 0.79                        | \$ 0.75        |
| Weighted average common and common equivalent                |                                |                |
| Basic  | 13,927,000                     | 13,790,000     |
| Diluted  | 14,111,000                     | 14,003,000     |
| See accompanying notes to consolidated financial statements. |                                |                |



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CONSOLIDATED STATEMENTS OF CASH FLOWS    UNAUDITED**

|   | Six Months Ended<br>2007 | September 30,<br>2008 |
|---|--------------------------|-----------------------|
| <b><i>Cash flows from Operating Activities</i></b>                                |                          |                       |
| <b>NET INCOME</b>   | \$ 11,193,000            | \$ 10,531,000         |
| Adjustments to reconcile net income to net cash provided by operating activities: |                          |                       |
| Depreciation and amortization   | 5,645,000                | 5,909,000             |
| Loss on disposal of assets  | 108,000                  | 18,000                |
| Stock compensation expense  | 730,000                  | 513,000               |
| Write-off of uncollectible accounts   | 1,398,000                | 1,553,000             |
| Changes in operating assets and liabilities                                       |                          |                       |
| Accounts receivable   | 1,943,000                | (3,339,000)           |
| Prepaid taxes and expenses  | (402,000)                | (406,000)             |
| Accounts and taxes payable  | 396,000                  | (1,678,000)           |
| Accrued liabilities   | (2,228,000)              | 1,557,000             |
| Deferred income tax   | 128,000                  | 76,000                |
| Other assets  | (38,000)                 | (29,000)              |
| Net cash provided by operating activities   | 18,873,000               | 14,705,000            |
| <b><i>Cash Flows from Investing Activities</i></b>                                |                          |                       |
| Assets purchased in acquisition   | (12,300,000)             | (800,000)             |
| Purchase of property & equipment  | (8,712,000)              | (5,288,000)           |
| Net cash (used in) investing activities   | (21,012,000)             | (6,088,000)           |
| <b><i>Cash Flows from Financing Activities</i></b>                                |                          |                       |
| Purchase of treasury stock  | (4,121,000)              | (5,209,000)           |
| Tax effect of stock option exercises  | (285,000)                | 488,000               |
| Exercise of common stock options  | 700,000                  | 1,592,000             |
| Exercise of employee stock purchase options                                       | 172,000                  | 201,000               |
| Net cash (used in) financing activities   | (3,534,000)              | (2,928,000)           |
| <b><i>Increase/(Decrease) in cash and cash equivalents</i></b>                    | (5,673,000)              | 5,689,000             |
| Cash and cash equivalents at beginning of period                                  | 15,020,000               | 17,911,000            |
| Cash and cash equivalents at end of period  | \$ 9,347,000             | \$ 23,600,000         |

**Supplemental Cash Flow Information:**

|   |              |              |
|---|--------------|--------------|
| Income taxes paid                         | \$ 7,670,000 | \$ 6,815,000 |
| Interest paid                             |              |              |
| Accrual of earnout related to acquisition | 2,500,000    | 1,000,000    |

See accompanying notes to consolidated financial statements.

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**CORVEL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2008**

**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, 2008. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the March 31, 2008 audited financial statements have been omitted from these interim financial statements.

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 months and six months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2009. For further information, refer to the consolidated financial statements and footnotes for the fiscal year ended March 31, 2008 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 consists 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, 2008 and September 30, 2008. Cash at September 30, 2008 includes \$1.5 million of customer deposits held in bank checking accounts

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**CORVEL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2008**

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

*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. Credit is extended based on evaluation of a customer's financial condition and, generally, collateral is not required. 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, 2008 or September 30, 2008. No one customer accounted for 10% or more of revenue during either of the three and six month periods ended September 30, 2007 or 2008.

*Property and Equipment:* Additions to property and equipment are recorded at cost. Depreciation and amortization are provided using the straight-line and accelerated methods 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 Statement of Position (SOP) 98-1, *Accounting for the Costs of Computer Software Developed or Obtained 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.

*Goodwill:* The Company accounts for its business combinations in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, *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 SFAS No. 142, *Goodwill and Other Intangibles*, 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 years presented, the Company's tests indicated that no impairment existed and, accordingly, no loss has been recognized.

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**CORVEL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2008**

**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 Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109* ( FIN 48 ) on April 1, 2007, and the Company recorded a cumulative effect of a change in accounting principle in the amount of \$2,657,000. The balance of the unrecognized tax benefits as of March 31, 2008 and September 30, 2008 was \$4,480,000. There were no additions or reductions in the unrecognized tax benefit during the six months ended September 30, 2008.

*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 increased in the September 2008 quarter for diluted earnings per share due to the effect of stock options.

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**CORVEL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**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), 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. Prior to fiscal year 2007, the Company had not granted any performance-based stock options under the Plan. In May 2006, however, the Company granted performance-based stock options for 149,000 shares of common stock at the 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. Based upon the Company's results for the past three calendar quarters, the Company believes that it will not attain the earnings target for the 2008, 2009, and 2010 tranches of the performance options granted in May 2006. The Company has reversed previously recognized stock based compensation expense in the amount of \$250,000 and has now recognized no stock compensation expense for any of these performance stock options. In February 2008, the Company granted performance-based stock options for 49,000 shares of common stock at fair market value at the date of grant. Vesting of these options is tied to revenue targets for certain services by the Company in calendar years 2009, 2010, and 2011. Currently, management has determined that it is not probable that the Company will attain these targets and the Company has recognized no stock compensation expense for these options. The Company has historically issued new shares to satisfy option exercises as opposed to issuing shares from treasury stock.

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**CORVEL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2008**

**Note B Stock Based Compensation and Stock Options (continued)**

The tables below shows the amounts recognized in the financial statements for the three and six months ended September 30, 2007 and 2008, respectively.

|  | Three Months Ended    |                       |
|--|-----------------------|-----------------------|
|  | September<br>30, 2007 | September 30,<br>2008 |
| Cost of revenues   | \$ 115,000            | \$ 138,000            |
| General and administrative   | 256,000               | (9,000)               |
| <br>   |                       |                       |
| Total cost of stock-based compensation included in income, before income tax | 371,000               | 129,000               |
| Amount of income tax benefit recognized                                      | (145,000)             | (50,000)              |
| <br>   |                       |                       |
| Amount charged against income  | \$ 226,000            | \$ 79,000             |
| <br>   |                       |                       |
| Effect on diluted net income per share                                       | \$ (0.02)             | \$ (0.01)             |

|  | Six Months Ended      |                       |
|--|-----------------------|-----------------------|
|  | September<br>30, 2007 | September 30,<br>2008 |
| Cost of revenues   | \$ 226,000            | \$ 256,000            |
| General and administrative   | 504,000               | 257,000               |
| <br>   |                       |                       |
| Total cost of stock-based compensation included in income, before income tax | 730,000               | 513,000               |
| Amount of income tax benefit recognized                                      | (285,000)             | (200,000)             |
| <br>   |                       |                       |
| Amount charged against income  | \$ 445,000            | \$ 313,000            |
| <br>   |                       |                       |
| Effect on diluted net income per share                                       | \$ (0.03)             | \$ (0.02)             |

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**CORVEL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2008**

**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 6.4% and 10.75% for the three months ended September 30, 2007 and 2008, 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 September 30, 2007 and 2008 using the Black-Scholes option-pricing model:

|   | Three Months Ended September<br>30, |           |
|---|-------------------------------------|-----------|
|   | 2007                                | 2008      |
| Risk-free interest rate                           | 4.60%                               | 3.15%     |
| Expected volatility                               | 39%                                 | 40%       |
| Expected dividend yield                           | 0.00%                               | 0.00%     |
| Expected forfeiture rate                          | 6.40%                               | 10.75%    |
| Expected weighted average life of option in years | 4.8 years                           | 4.7 years |

All options granted in the six months ended September 30, 2007 and 2008 were granted at fair market value and are non-statutory stock options.



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**CORVEL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2008**

**Note B Stock Based Compensation and Stock Options (continued)**

Summarized information for all stock options for the three and six months ended September 30, 2007 and 2008 follows:

|                                | Three Months Ended<br>September 30, 2007 |                  | Three Months Ended September<br>30, 2008 |                  |
|--------------------------------|--|------------------|--|------------------|
|                                | Shares                                   | Average<br>Price | Shares                                   | Average<br>Price |
| Options outstanding, beginning | 1,027,280                                | \$ 18.08         | 991,694                                  | \$ 19.69         |
| Options granted                | 46,100                                   | 26.86            | 45,425                                   | 30.00            |
| Options exercised              | (32,027)                                 | 14.73            | (27,942)                                 | 16.18            |
| Options cancelled              | (14,887)                                 | 18.82            | (11,830)                                 | 20.18            |
| Options outstanding, ending    | 1,026,466                                | \$ 18.57         | 997,347                                  | \$ 20.26         |

  

|                                | Six Months Ended September<br>30, 2007 |                  | Six Months Ended September 30,<br>2008 |                  |
|--------------------------------|--|------------------|--|------------------|
|                                | Shares                                 | Average<br>Price | Shares                                 | Average<br>Price |
| Options outstanding, beginning | 1,021,141                              | \$ 17.84         | 1,030,558                              | \$ 19.24         |
| Options granted                | 73,800                                 | 26.97            | 75,225                                 | 30.97            |
| Options exercised              | (46,718)                               | 16.00            | (93,511)                               | 17.68            |
| Options cancelled              | (21,757)                               | 18.51            | (14,925)                               | 20.34            |
| Options outstanding, ending    | 1,026,466                              | \$ 18.57         | 997,347                                | \$ 20.26         |

The following table summarizes the status of stock options outstanding and exercisable at September 30, 2008:

| Range of Exercise Price | Number of<br>Outstanding<br>Options | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Outstanding<br>Options-<br>Weighted<br>Average<br>Exercise<br>Price | Exercisable<br>Options-<br>Number of<br>Exercisable<br>Options | Options-<br>Weighted<br>Average<br>Exercise<br>Price |
|-------------------------|-------------------------------------|---|---|--|--|
| \$8.08 to \$15.55       | 217,409                             | 2.45  | \$ 13.18  | 149,238  | \$ 13.05   |
| \$15.56 to \$17.14      | 305,148                             | 2.68  | \$ 15.94  | 115,671  | \$ 16.23   |
| \$17.15 to \$25.83      | 230,301                             | 3.99  | \$ 22.52  | 90,773   | \$ 20.76   |
| \$25.84 to \$47.70      | 244,489                             | 4.36  | \$ 29.80  | 64,340   | \$ 29.61   |
| Total                   | 997,347                             | 3.34  | \$ 20.26  | 420,022  | \$ 18.13   |



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**CORVEL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2008**

**Note B Stock Based Compensation and Stock Options (continued)**

A summary of the status for all outstanding options at September 30, 2008, and changes during the six months then ended, is presented in the table below:

|   | Number of<br>Options | Weighted<br>Average<br>Exercise Per<br>Share | Weighted<br>Average<br>Remaining<br>Contractual<br>Life (Years) | Aggregate<br>Intrinsic Value<br>as<br>of September<br>30,<br>2008 |
|---|----------------------|--|---|---|
| Options outstanding at March 31, 2008       | 1,030,558            | \$ 19.24                                     |   |   |
| Granted                                     | 75,225               | 30.97  |   |   |
| Exercised                                   | (93,511)             | 17.68  |   |   |
| Cancelled forfeited                         | (14,023)             | 20.38  |   |   |
| Cancelled expired                           | (902)                | 19.86  |   |   |
| Ending outstanding                          | 997,347              | \$ 20.26                                     | 3.34  | \$ 8,737,447  |
| Ending vested and expected to vest          | 893,656              | \$ 20.05                                     | 3.28  | \$ 8,001,874  |
| Ending exercisable at September 30,<br>2008 | 420,022              | \$ 18.13                                     | 2.82  | \$ 4,499,174  |

The weighted-average grant-date fair value of options granted during the three months ended September 30, 2007 and 2008, was \$10.90 and \$11.66, respectively.

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**CORVEL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2008**

**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 September 2008 the Board approved a 1,000,000 share expansion of the repurchase program to 13,150,000 shares. Since the commencement of the share repurchase program, the Company has spent \$168 million to repurchase 11,842,951 shares of its common stock, equal to 46% of the outstanding common stock had there been no repurchases. The average price of these repurchases is \$14.14 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 September 30, 2008, the Company repurchased 55,337 shares for \$1.5 million. The Company had 13,733,939 shares of common stock outstanding as of September 30, 2008, net of the 11,842,951 shares in treasury. During October 2008 the Company repurchased 316,122 shares of stock.

**Note D Weighted Average Shares and Net Income Per Share**

Weighted average basic common and common equivalent shares decreased from 13,889,000 for the quarter ended September 30, 2007 to 13,764,000 for the quarter ended September 30, 2008. Weighted average diluted common and common equivalent shares decreased from 14,062,000 for the quarter ended September 30, 2007 to 13,960,000 for the quarter ended September 30, 2008. The net decrease in both of these weighted share calculations is due to the repurchase of common stock as noted above, partially 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 six months ended September 30, 2007 and 2008, are as follows:

|  | Three Months Ended September<br>30, |              |
|--|-------------------------------------|--------------|
|  | 2007                                | 2008         |
| Net Income                                 | \$ 5,632,000                        | \$ 4,964,000 |
| <b>Basic:</b>                              |                                     |              |
| Weighted average common shares outstanding | 13,889,000                          | 13,764,000   |
| Net Income per share                       | \$ 0.41                             | \$ 0.36      |
| <b>Diluted:</b>                            |                                     |              |
| Weighted average common shares outstanding | 13,889,000                          | 13,764,000   |
| Treasury stock impact of stock options     | 173,000                             | 196,000      |
| Total common and common equivalent shares  | 14,062,000                          | 13,960,000   |
| Net Income per share                       | \$ 0.40                             | \$ 0.36      |

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**CORVEL CORPORATION**  
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Note D Weighted Average Shares and Net Income Per Share (Continued)

|  | Six Months Ended September 30, |               |
|--|--------------------------------|---------------|
|  | 2007                           | 2008          |
| Net Income                                 | \$ 11,193,000                  | \$ 10,531,000 |
| <b>Basic:</b>                              |                                |               |
| Weighted average common shares outstanding | 13,927,000                     | 13,790,000    |
| Net Income per share                       | \$ 0.80                        | \$ 0.76       |
| <b>Diluted:</b>                            |                                |               |
| Weighted average common shares outstanding | 13,927,000                     | 13,790,000    |
| Treasury stock impact of stock options     | 184,000                        | 213,000       |
| Total common and common equivalent shares  | 14,111,000                     | 14,003,000    |
| Net Income per share                       | \$ 0.79                        | \$ 0.75       |

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**CORVEL CORPORATION**  
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**September 30, 2008**

**Note E Shareholder Rights Plan and Subsequent Event**

During fiscal 1997, the Company's Board of Directors (the Board) approved the adoption of a Shareholder Rights Plan (the 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 Board of Directors of CorVel approved an amendment to the Company's existing shareholder rights agreement 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. The limitations under the stockholder rights agreement remain in effect for all other stockholders of the Company. 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.

In October 2008, the Board of the Corporation approved amendments to the Shareholder Rights Plan to, among other things, (i) amend the supplements and amendments provision and other related provisions to remove certain restrictions on the Board of Directors, (ii) substitute Computershare Trust Company, N.A. as the Rights Agent and (iii) extend the term of the Rights from the existing Final Expiration Date of February 10, 2012, to February 10, 2022, (iv) modify the definition of Acquiring Person and (v) effect certain technical changes to the Rights Plan.

**Note F Acquisitions**

In December 2006, the Company's wholly-owned subsidiary, CorVel Enterprise Comp, Inc., entered into an Asset Purchase Agreement with Hazelrigg Risk Management Services, Inc. and its affiliated companies (Hazelrigg) to acquire certain assets and liabilities of Hazelrigg, for an initial cash payment of \$12 million. The Company completed the acquisition on January 31, 2007 and paid the initial cash payment on that date. Hazelrigg is a California based provider of integrated medical management, claims processing and technology services for workers' compensation clients. The acquisition represented an expansion of CorVel's Enterprise Comp service offering in the Southern California marketplace. The sellers of Hazelrigg also had the potential to receive up to an additional \$2.5 million in a cash earn-out based upon the revenue earned by the business during the one-year period after consummation of the acquisition, which earnout could have been accelerated based upon the occurrence of

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**CORVEL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2008**

**Note F Acquisitions (continued)**

certain post-acquisition events. The Company accrued the earn-out during the quarter ended September 30, 2007. The Company paid out \$2 million during the March 31, 2008 quarter and \$214,000 during the June 2008 quarter. The sellers agreed to reduce the remaining earn-out by an additional \$242,000 for obligations the sellers had to the Company.

The following table summarizes the recorded value of the Hazelrigg assets acquired and liabilities assumed:

|   | <b>Life</b> | <b>Amount</b> |
|---|-------------|---------------|
| Accounts receivable, net                    |             | \$ 1,100,000  |
| Property and equipment, net                 |             | 321,000       |
| Covenant not to compete                     | 5 Years     | 250,000       |
|   | 18          |               |
| Customer relationships                      | Years       | 4,446,000     |
|   | 15          |               |
| TPA license                                 | Years       | 26,000        |
| Goodwill                                    |             | 9,451,000     |
| Subtotal                                    |             | 15,594,000    |
| Less : Accounts payable and deferred income |             | 1,348,000     |
| Total                                       |             | \$ 14,246,000 |

In June 2007, the Company's wholly-owned subsidiary, CorVel Enterprise Comp, Inc., acquired 100% of the stock of The Schaffer Companies Ltd. ( Schaffer ) for \$12.3 million in cash. Schaffer is a third-party administrator headquartered in Maryland. The acquisition is expected to allow the Company to expand its service capabilities as a third-party administrator and provide claims processing services along with patient management services and network solutions services to an increased customer base. The sellers of Schaffer had the potential to receive up to an additional \$3 million in a cash earn-out based upon the revenue earned by the business during the one-year period after completion of the acquisition. The Company believes the amount of the earn-out to be \$1,800,000 which resulted in an increase in goodwill and accrued liabilities. The Company's calculation is subject to review by the sellers in accordance with the terms of the acquisition agreement and there can be no assurance that an adjustment to the Company's calculation will not be required. If an adjustment to the earn-out is required under terms of the acquisition agreement, it would result in a change to goodwill and accrued liabilities.

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**CORVEL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2008**

**Note F Acquisitions (Continued)**

The following table summarizes the fair value of the Schaffer assets acquired and liabilities assumed:

|  | <b>Life</b> | <b>Amount</b> |
|--|-------------|---------------|
| Accounts receivable, net                   |             | \$ 1,362,000  |
| Property and equipment, net                |             | 586,000       |
| Other assets                               |             | 104,000       |
|  | 5           |               |
| Covenant not to compete                    | Years       | 500,000       |
|  | 20          |               |
| Custmer relationships                      | Years       | 2,962,000     |
|  | 15          |               |
| TPA licenses                               | Years       | 152,000       |
|  | 5           |               |
| Software                                   | Years       | 50,000        |
| Goodwill                                   |             | 11,306,000    |
| Subtotal                                   |             | 17,022,000    |
| Less: Accounts payable and deferred income |             | 2,636,000     |
| Total                                      |             | \$ 14,386,000 |

The following supplemental unaudited pro forma information presents the combined operating results of the Company and Schaffer during the six months ended September 30, 2007 and 2008, as if the acquisition had occurred at the beginning of each of the periods presented. The pro forma information is based on the historical financial statements of the Company and that of Schaffer. Amounts are not necessarily indicative of the results that may have been attained had the combinations been in effect at the beginning of the periods presented or that may be achieved in the future.

|                                      | Six Months Ended<br>September 30<br>2007 |
|--------------------------------------|--|
| Pro forma revenue                    | \$ 149,784,000                           |
| Pro forma income before income taxes | \$ 18,385,000                            |
| Pro forma net income                 | \$ 11,215,000                            |
| Pro forma basic earnings per share   | \$ 0.81                                  |
| Pro forma diluted earnings per share | \$ 0.80                                  |



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**CORVEL CORPORATION**  
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**September 30, 2008**

**Note G Other Intangible Assets**

Other intangible assets consist of the following at September 30, 2008:

| Item                     | Life                | Cost        | Six Months<br>Ended<br>September 30,<br>2008<br>Amortization<br>Expense | Accumulated<br>Amortization<br>at<br>September 30,<br>2008 | Cost, Net of<br>Accumulated<br>Amortization at<br>September 30,<br>2008 |
|--------------------------|---------------------|-------------|---|--|---|
| Covenants Not to Compete | 5<br>Years<br>18-20 | \$ 750,000  | \$ 80,000   | \$ 217,000   | \$ 533,000  |
| Customer Relationships   | Years               | 7,408,000   | 194,000   | 593,000  | 6,815,000   |
| TPA Licenses             | 15<br>Years         | 178,000     | 6,000   | 16,000   | 162,000   |
| Total                    |                     | \$8,336,000 | \$ 280,000  | \$ 826,000   | \$ 7,510,000  |

**Note H Line of Credit**

In August 2007, the Company, upon authorization by its Board of Directors, entered into a credit agreement with a financial institution to provide a revolving credit facility with borrowing capacity of up to \$10 million. This agreement expired in September 2008. Borrowings under this agreement would bear interest, at the Company's option, at a fixed LIBOR-based rate plus 1.25% or at the financial institution's fluctuating prime lending rate. The loan covenants would require the Company to maintain a current ratio of at least 1.25:1, debt to tangible net worth not greater than 1:1 and have positive net income. There were no borrowings under the line of credit during the six months ended September 30, 2007 and 2008. The Company chose not to renew the line of credit during the quarter ended September 30, 2008 due to its current cash balance and expected cash flow from operations.

**Note I Contingencies**

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 steer 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 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 vigorously defend this case.

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; cost of capital and capital requirements; 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; possible litigation and legal liability in the course of operations; 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, third-party administrators (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, MRI examinations, and inpatient bill review.

**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

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the assets of Hazelrigg Risk Management Services and the June 2007 acquisition of the outstanding capital stock of The Schaffer Companies, Ltd.

**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**

We operate 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. Statement of Financial Accounting Standards, or SFAS, No. 131, "Disclosures about Segments of an Enterprise and Related Information," 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 SFAS 131, 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 of SFAS 131, 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. We believe each of the Company's regions meet these criteria as they provide similar services to similar customers using similar methods of productions and similar methods to distribute their services.

**Summary of Quarterly Results**

The Company generated revenues of \$77.9 million for the quarter ended September 30, 2008, an increase of \$4.3 million or 5.9%, compared to revenues of \$73.5 million for the quarter ended September 30, 2007. The increase in revenues was due to an increase in volume across all lines of service.

The continued decrease in the number of jobs in the manufacturing sector and its corresponding effect on the number of workplace injuries that have become longer-term disability cases, the considerable price competition given the flat-to-declining overall workers compensation market, the increase in competition from local and regional companies, changes and the potential changes in state workers' compensation and auto managed care laws, which can reduce demand for the Company's services, have created an environment where revenue and margin growth is more difficult to attain and where revenue growth is uncertain. Additionally, the Company's technology and preferred provider network competes against other companies, some of which have more resources available. Also, some customers may handle their managed care services in-house and may reduce the amount of services which are outsourced to managed care companies such as CorVel Corporation. These factors are expected to continue to limit our revenue growth in the near future.

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The Company's cost of revenues increased by \$4.1 million, from \$54.9 million in the September 2007 quarter to \$59.0 million in the September 2008 quarter, an increase of 7.5%. This increase was primarily due to the increase in revenues across the Company's services, especially increases in the lower margin Patient Management services.

The Company's general and administrative costs increased by \$1.3 million, from \$9.4 million in the September 2007 quarter to \$10.7 million in the September 2008 quarter, an increase of 14.1%. This increase is primarily due to the increase in the Company's systems and data interface costs and capabilities including storage, area networks, customer help desk, electronic data interface (EDI), data co-location center, software programmers, and wide area network (WAN).

The Company's income tax expense decreased by \$0.4 million, or 12.4%, from \$3.6 million, in the September 2007 quarter to \$3.2 million in the September 2008 quarter. The decrease in income before income taxes was primarily due to the aforementioned increase in both cost of revenues and general and administrative expenses which resulted in a decrease in income before income taxes. The effective income tax rate was 39.0% in each of the September 2007 and September 2008 quarters.

Weighted diluted shares decreased from 14.1 million shares in the September 2007 quarter to 14.0 million shares in the September 2008 quarter, a decrease of 100,000 shares, or 0.7%. This decrease was due to the repurchase of 155,000 shares of common stock during the September 2008 quarter. The decrease was offset by the exercise of stock options during the quarter.

Diluted earnings per share decreased from \$0.40 in the September 2007 quarter to \$0.36 in the September 2008 quarter, a decrease of \$0.04 per share, or 10.0%. The decrease in diluted earnings per share was due to the decrease in income before income taxes.

**Results of Operations for the three months ended September 30, 2007 and 2008**

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, and vocational rehabilitation. Network solutions revenues include fee schedule auditing, hospital bill auditing, independent medical examinations, diagnostic imaging review services and preferred provider referral services. The percentages of total revenues attributable to patient management and network solutions services for the quarters ended September 30, 2007 and September 30, 2008 are as follows:

|                             | September 30,<br>2007 | September 30,<br>2008 |
|-----------------------------|-----------------------|-----------------------|
| Patient management services | 42.9%                 | 44.2%                 |
| Network solutions services  | 57.1%                 | 55.8%                 |

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The following table sets forth, for the periods indicated, the dollars and the percentage of revenues represented by certain items reflected in the Company's consolidated income statements for the quarters ended September 30, 2007 and September 30, 2008. The Company's past operating results are not necessarily indicative of future operating results.

|   | Three Months<br>Ended<br>September 30,<br>2007 | Three Months<br>Ended<br>September 30,<br>2008 | Change       | Percentage<br>Change |
|---|--|--|--------------|----------------------|
| Revenue   | \$73,510,000                                   | \$ 77,855,000                                  | \$ 4,345,000 | 5.9%                 |
| Cost of revenues  | 54,856,000                                     | 58,996,000                                     | 4,140,000    | 7.5%                 |
| Gross profit  | 18,654,000                                     | 18,859,000                                     | 205,000      | 1.1%                 |
| Gross profit as percentage of revenue                       | 25.4%  | 24.2%  |              |                      |
| General and administrative                                  | 9,398,000                                      | 10,722,000                                     | 1,324,000    | 14.1%                |
| General and administrative as percentage of revenue         | 12.8%  | 13.8%  |              |                      |
| Income before income tax provision                          | 9,256,000                                      | 8,137,000                                      | (1,119,000)  | -12.1%               |
| Income before income tax provision as percentage of revenue | 12.6%  | 10.5%  |              |                      |
| Income tax provision  | 3,624,000                                      | 3,173,000                                      | (451,000)    | -12.4%               |
| Net income  | \$ 5,632,000                                   | \$ 4,964,000                                   | \$ (668,000) | -11.9%               |
| Weighted Shares   |  |  |              |                      |
| Basic   | 13,889,000                                     | 13,764,000                                     | (125,000)    | -0.9%                |
| Diluted   | 14,062,000                                     | 13,960,000                                     | (102,000)    | -0.7%                |
| Earnings Per Share  |  |  |              |                      |
| Basic   | \$ 0.41  | \$ 0.36  | \$ (0.05)    | -12.2%               |
| Diluted   | \$ 0.40  | \$ 0.36  | \$ (0.04)    | -10.0%               |

**Revenues****Change in revenue from the quarter ended September 2007 to the quarter ended September 2008**

Revenues increased from \$73.5 million for the three months ended September 30, 2007 to \$77.9 million for the three months ended September 30, 2008, an increase of \$4.3 million or 5.9%. The increase was primarily due to an increase in the Company's patient management revenues of \$2.9 million or 9.0% from \$31.5 million in the September 2007 quarter to \$34.4 million in the September 2008 quarter and an increase in the Company's network solutions revenues from \$42.0 million in the September 2007 quarter to \$43.5 million in the September 2008 quarter, an increase of \$1.5 million or 3.6%. This increase in revenues is due to an increase in TPA customers and services rendered to existing TPA customer.

The decrease in the nation's manufacturing employment levels, which has helped lead to a decline in national workers' compensation claims, considerable price competition in a flat-to-declining overall market, an increase in

competition from both larger and smaller competitors, changes and the potential changes in state workers compensation and auto managed care laws which can reduce demand for the Company's services, have created an environment where revenue and margin growth is more difficult to attain and where revenue growth is less certain than historically experienced. Additionally, the Company's technology and preferred provider network

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competes against other companies, some of which have more resources available. Also, some customers may handle their managed care services in-house and may reduce the amount of services which are outsourced to managed care companies such as CorVel Corporation. These factors are expected to continue to limit our revenue growth in the near future.

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.

**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 48% 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 operations, such as district managers, account executives, rent, and telephone.

**Change in cost of revenue from the quarter ended September 2007 to the quarter ended September 2008**

The Company's costs of revenues increased from \$54.9 million in the quarter ended September 30, 2007 to \$59.0 million in the quarter ended September 30, 2008, an increase of \$4.1 million or 7.5%. The increase in cost of revenues was primarily due to the increase in the labor intensive Patient Management revenues and the costs associated with operating the businesses, including labor, rent, telephone, and office supplies.

**General and Administrative Costs****Change in cost of general and administrative expense from the quarter ended September 2007 to the quarter ended September 2008**

For the quarter ended September 30, 2008, general and administrative costs consisted of approximately 61% 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 39% of the general and administrative costs consisted of national marketing, national sales support, corporate legal, corporate insurance, human resources, accounting, product management, new business development and other general corporate matters. The largest portion of the non-systems portion of general and administrative costs during the September 2008 quarter pertained to accounting, financial reporting and corporate governance.

General and administrative costs increased from \$9.4 million in the quarter ended September 30, 2007 to \$10.7 million in the quarter ended September 30, 2008, an increase of \$1.3 million, or 14.1%. This increase is primarily due to the increase in the Company's systems and data interface costs and capabilities including storage area networks, customer help desk, electronic data interface (EDI), data co-location center, software programmers, and wide area network (WAN). The largest portion of the cost increase was due to the new co-location center.

**Table of Contents****Income Tax Provision**

The Company's income tax expense decreased by \$0.5 million, or 12.4%, from \$3.6 million for the quarter ended September 30, 2007 to \$3.2 million for the quarter ended September 30, 2008 due to the decrease in income before income taxes from \$9.3 million to \$8.1 million. The income tax expense as a percentage of income before income taxes (i.e. effective tax rate) was 39.0% for each of the three months ended September 30, 2007 and 2008. 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 Six Months Ended September 30, 2007 and 2008**

The following table sets forth, for the periods indicated, the dollars and the percentage of revenues represented by certain items reflected in the Company's consolidated income statements for the six months ended September 30, 2007 and September 30, 2008. The Company's past operating results are not necessarily indicative of future operating results.

|  | Six Months<br>Ended<br>September 30,<br>2007 | Six Months Ended<br>September 30,<br>2008 | Change       | Percentage<br>Change |
|--|--|---|--------------|----------------------|
| Revenue  | \$ 147,847,000                               | \$ 156,056,000                            | \$ 8,209,000 | 5.6%                 |
| Cost of revenues   | 111,012,000                                  | 117,264,000                               | 6,252,000    | 5.6%                 |
| Gross profit   | 36,835,000                                   | 38,792,000                                | 1,957,000    | 5.3%                 |
| Gross profit as percentage of revenue                          | 24.9%  | 24.9%                                     |              |                      |
| General and administrative                                     | 18,475,000                                   | 21,529,000                                | 3,054,000    | 16.5%                |
| General and administrative as percentage<br>of revenue         | 12.5%  | 13.8%                                     |              |                      |
| Income before income tax provision                             | 18,360,000                                   | 17,263,000                                | (1,097,000)  | (6.0%)               |
| Income before income tax provision as<br>percentage of revenue | 12.4%  | 11.1%                                     |              |                      |
| Income tax provision   | 7,167,000                                    | 6,732,000                                 | (435,000)    | (6.1%)               |
| Net income   | \$ 11,193,000                                | \$ 10,531,000                             | \$ (662,000) | (5.9%)               |
| Weighted Shares  |  |   |              |                      |
| Basic  | 13,927,000                                   | 13,790,000                                | (137,000)    | (1.0%)               |
| Diluted  | 14,111,000                                   | 14,003,000                                | (108,000)    | (0.8%)               |
| Earnings Per Share   |  |   |              |                      |
| Basic  | \$ 0.80                                      | \$ 0.76                                   | \$ (0.04)    | (5.0%)               |
| Diluted  | \$ 0.79                                      | \$ 0.75                                   | \$ (0.04)    | (5.1%)               |

**Revenues****Change in revenue from the six months ended September 2007 to the six months ended September 2008**



Revenues increased from \$147.8 million for the six months ended September 30, 2007 to \$156.1 million for the six months ended September 30, 2008, an increase of \$8.2 million or 5.6%. The Company's patient management revenues increased \$6.0 million or 9.6% from \$61.8 million in the six months ended September 2007 to \$67.8 million in the six months ended September 2008. This increase was partially due to the acquisition of Schaffer in June 2007 as noted above. The Company's network solutions revenues increased from \$86.0 million in the six months ended September 2007 to \$88.3 million in the six months ended September 2008, an increase of \$2.3

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million or 2.6%. This increase was primarily due an increase in the Company's bill review volume over the six months ended September 30, 2007.

The Company's limited revenue increase excluding the aforementioned acquisition of Schaffer reflects the challenging market conditions the Company has experienced during the past few years. The decrease in the nation's manufacturing employment levels, which has helped lead to a decline in national workers' compensation claims, considerable price competition in a flat-to-declining overall market, an increase in competition from both larger and smaller competitors, changes and the potential changes in state workers' compensation and auto managed care laws which can reduce demand for the Company's services, have created an environment where revenue and margin growth is more difficult to attain and where revenue growth is less certain than historically experienced. Additionally, the Company's technology and preferred provider network competes against other companies, some of which have more resources available. Also, some customers may handle their managed care services in-house and may reduce the amount of services which are outsourced to managed care companies such as CorVel Corporation.

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

**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 47% 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 operations, such as district managers, account executives, rent, and telephone.

**Change in cost of revenue from the six months ended September 2007 to the six months ended September 2008**

The Company's costs of revenues increased from \$111.0 million in the six months ended September 30, 2007 to \$117.3 million in the six months ended September 30, 2008, an increase of \$6.3 million or 5.6%. The increase in cost of revenues was primarily due to the acquisition of Schaffer and the costs associated with operating the business. This was partially offset by the Company improving its field operating productivity in both its patient management and network solutions lines of business.

**General and Administrative Costs****Change in cost of general and administrative expense from the six months ended September 2007 to the six months ended September 2008**

For the six months ended September 30, 2008, general and administrative costs consisted of approximately 62% 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 38% of the general and administrative costs consisted of national marketing, national sales support, corporate legal, corporate insurance, human resources, accounting, product management, new business development and other general corporate matters.

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The largest portion of the non-systems portion of general and administrative costs during the six months ended September 30, 2008 pertained to accounting, financial reporting and corporate governance.

General and administrative costs increased from \$18.5 million in the six months ended September 30, 2007 to \$21.5 million in the six months ended September 30, 2008, an increase of \$3.0 million, or 16.5%. This increase is primarily due to the increase in the Company's systems and data interface costs and capabilities including storage area networks, customer help desk, electronic data interface (EDI), data co-location center, software programmers, and wide area network (WAN).

**Table of Contents****Income Tax Provision**

The Company's income tax expense decreased by \$0.5 million, or 6.0%, from \$7.2 million for the six months ended September 30, 2007 to \$6.7 million for the six months ended September 30, 2008 due to the decrease in income before income taxes from \$18.4 million to \$17.3 million. The income tax expense as a percentage of income before income taxes (i.e. effective tax rate) was 39.0% for each of the six months ended September 30, 2007 and 2008. 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. Net working capital increased \$7 million, or 22%, from \$29 million as of March 31, 2008 to \$36 million as of September 30, 2008, primarily due to an increase in cash from \$18 million as of March 31, 2008 to \$24 million as of September 30, 2008.

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 when needed, financing 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 September 30, 2008, excluding \$1.5 million of customer deposits held in bank checking accounts, the Company had \$22.1 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 a federally regulated bank.

In August 2007, 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. This agreement expired in September 2008 with no borrowings against the line of credit at any time during the last two fiscal years. Management decided not to renew this line of credit due to the current cash balance in excess of \$23 million and expected cash flow from operations.

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 September 30, 2008 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*****Six months ended September 30, 2007 compared to six months ended September 30, 2008***

Net cash provided by operating activities decreased from \$18.9 million in the six months ended September 30, 2007 compared to \$14.7 million in the six months ended September 30, 2008. The decrease in the cash flow from operating activities was primarily due to an increase in accounts receivable for the six months ended September 30, 2008 compared to the six months ended September 30, 2007.

**Table of Contents****Investing Activities****Six months ended September 30, 2007 compared to six months ended September 30, 2008**

Net cash flow used in investing activities decreased from \$21.0 million in the six months ended September 30, 2007 to \$6.1 million in the six months ended September 30, 2008, a decrease of \$14.9 million. The decrease in net cash used in investing activities is primarily due to the Company's acquisition of The Schaffer Companies, Ltd. during the six months ended September 30, 2007. The Company had no acquisitions in the six months ended September 30, 2008.

**Financing Activities****Six months ended September 30, 2007 compared to six months ended September 30, 2008**

Net cash flow used in financing activities decreased from \$3.5 million for the six months ended September 30, 2007 to \$2.9 million for the six months ended September 30, 2008, a decrease of \$0.6 million. The decrease 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 six months ended September 30, 2008, the Company spent \$5.2 million to repurchase 155,337 shares of its common stock. During the six months ended September 30, 2007, the Company spent \$4.1 million to repurchase 152,927. 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 \$24 million of cash on its balance sheet at September 30, 2008 to repurchase additional shares of stock.

**Contractual Obligations**

The following table summarizes the Company's contractual obligations outstanding as of September 30, 2008.

|                     | Total        | Payments Due by Period |                                   |                                   | More than<br>Five Years |
|---------------------|--------------|------------------------|-----------------------------------|-----------------------------------|-------------------------|
|                     |              | Within One<br>Year     | Between Two<br>and<br>Three Years | Between Four<br>and<br>Five Years |                         |
| Operating leases    | \$46,257,000 | \$11,804,000           | \$18,314,000                      | \$10,161,000                      | \$5,978,000             |
| Software license    | 864,000      | 864,000                |                                   |                                   |                         |
| Earn-out obligation | 1,000,000    | 1,000,000              |                                   |                                   |                         |
| Total               | \$48,121,000 | \$13,668,000           | \$18,314,000                      | \$10,161,000                      | \$5,978,000             |

**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 to recover based on the Company's alleged failure to steer 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 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 we appealed the appellate court's denial of our petition for interlocutory appeal which appeal was also denied by the Illinois Supreme Court in September 2008. We intend to vigorously defend this case. A possible range of loss cannot be estimated 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.

**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.



**Table of Contents****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 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.

We have identified the following accounting policies as critical to us: 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. We 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. We reduce revenue for estimated contractual allowances and record 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.

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We must make significant management judgments and estimates in determining contractual and bad debt allowances in any accounting period. One significant uncertainty inherent in our analysis is whether our past experience will be indicative of future periods. Although we consider future projections when estimating contractual and bad debt allowances, we ultimately make our decisions based on the best information available to us at that time. Adverse changes in general economic conditions or trends in reimbursement amounts for our services could affect our 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, 2008, or at September 30, 2008.

*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 SFAS No. 142,

Goodwill and Other Intangible Assets, goodwill is tested annually for impairment or more frequently if circumstances 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 its tests and reviews, no impairment of its goodwill, intangible assets or other long-lived assets existed at March 31, 2008 or at September 30, 2008. 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 SFAS No. 109, Accounting for Income Taxes. Accordingly, deferred income tax assets and liabilities are computed for differences between the financial statement and tax bases of assets and liabilities. These differences will result in taxable or deductible amounts in the future, based on tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. The ultimate realization of deferred tax assets 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 SFAS No. 123R, Share-Based Payment, which establishes accounting for equity instruments exchanged for employee services. Under the provisions of SFAS No. 123R, 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). The Company granted performance stock options in May 2006 and February 2008. These options vest only upon the attainment of certain board determined targets. The Company reviews the actual performance against these targets to determine if stock compensation expense should be recorded.

For the six months ended September 30, 2008, the Company recorded share-based compensation expense of \$513,000. Share-based compensation expense recognized in fiscal 2009 is based on awards ultimately expected to vest; therefore, it has been reduced for estimated forfeitures. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates





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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 2008. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards.

The key input assumptions that were utilized in the valuation of the stock options granted during the quarter end September 30, 2008 are summarized in the table below.

|                                |           |
|--------------------------------|-----------|
| Expected option term (1)       | 4.7 years |
| Expected volatility (2)        | 40%       |
| Risk-free interest rate (3)    | 3.15%     |
| Expected forfeiture rate       | 10.75%    |
| Expected annual dividend yield | 0%        |

- (1) The expected option term is based on historical exercise and post-vesting termination patterns.
- (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.

**Recently Issued Accounting Standards**

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, or SFAS No. 159. SFAS No. 159 expands opportunities to use fair value measurement in financial reporting and permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. This pronouncement has no material impact on the Company's financial statements.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations. SFAS No. 141(R) replaces SFAS No. 141, Business Combinations. SFAS No. 141(R) retains the fundamental requirements in SFAS No. 141 that the acquisition method of accounting be used for all business combinations and for an acquirer to be identified for each business combination. SFAS No. 141(R) amends the recognition provisions for assets and liabilities acquired in a business combination, including those arising from contractual and noncontractual contingencies. SFAS No. 141(R) also amends the recognition criteria for contingent consideration. In addition, under SFAS No. 141(R), changes in an acquired entity's deferred tax assets and uncertain tax positions after the measurement period will impact income tax expense. SFAS No. 141(R) is effective for fiscal years beginning on or after December 15, 2008. Early adoption is not permitted. Management expects the potential impact of adopting SFAS No. 141(R) on our consolidated financial statements to be immaterial.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51. SFAS No. 160 establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for fiscal years beginning on or after December 15, 2008. Management does not currently expect the adoption of SFAS No. 160 to have a material impact on our consolidated financial statements.

FASB Staff Position No. FAS 157-2 ( FSP 157-2 ), Effective Date of FASB Statement No. 157, was issued in February 2008. FSP 157-2 delays the effective date of SFAS No. 157, for nonfinancial assets and

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nonfinancial liabilities, except for items that are recognized or disclosed at fair value at least once a year, to fiscal years beginning after November 15, 2008, and for interim periods within those fiscal years.

**Item 3 Quantitative and Qualitative Disclosures About Market Risk**

As of September 30, 2008, the Company held no market risk sensitive instruments for trading purposes, and the Company did not employ any derivative financial instruments, other financial instruments, or derivative commodity instruments to hedge any market risk. The Company had no debt outstanding as of September 30, 2008.

**Item 4 Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report pursuant to Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act ). Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were not effective due to the material weaknesses in our internal control over financial reporting as of March 31, 2008, that have not been remediated described below.

**Management's Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control system is designed to provide reasonable assurance to our management, the Board of Directors and investors regarding reliable preparation and presentation of published financial statements. Nonetheless, all internal control systems, no matter how well designed, have inherent limitations. Even systems determined to be effective as of a particular date can only provide reasonable assurance with respect to reliable financial statement preparation and presentation.

A material weakness is a deficiency (within the meaning of the United States Public Company Accounting Oversight Board Auditing Standard No. 5), or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

Our management assessed the effectiveness of our internal control over financial reporting as of March 31, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework (COSO). Based on our assessment, we believe that, as of March 31, 2008, our internal control over financial reporting was ineffective based on those criteria, in consideration of the material weaknesses described below.

*Accounts Payable.* We did not maintain adequate controls to ensure the proper inclusion or exclusion of expenditures within the reporting period and, therefore, the accuracy and completeness of our accounts payable.

*Financial close and reporting.* We did not maintain adequate controls to support: (i) effective and timely analysis and correction of errors noted when reconciling significant accounts, (ii) complete and accurate financial statement disclosures, and (iii) restricted access to certain financial systems and files necessary to maintain the integrity of journal entry reviews, account reconciliations, and financial reports. Furthermore, the indirect lines of responsibilities within our accounting and reporting function do not provide direct oversight and accountability to allow for timely and accurate financial reporting.

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**Remediation Activities**

Management is working to implement new and enhanced controls over the financial close and reporting process. Many of these controls will be enabled by the implementation of upgraded financial accounting software. In addition to the automated controls just noted, management is adding additional review and approval processes that will enhance internal controls over financial reporting. This effort is ongoing. Management expects to complete the effort before the end of the fourth quarter.

During the quarter, the Company worked to implement new accounts payable software. The rollout of the new A/P software has occurred for 75% of the organization. The new accounts payable software has functionality not available in the Company's previous accounts payable application. The new functionality will enable management to implement additional automated controls over the accounts payable process. Through the use of automated controls, management expects to improve controls over the accounts payable process. Automation of manual controls will also help the Company improve segregation of duties in the disbursements cycle. Management expects the implementation of the additional automated controls to take place throughout the rest of the fiscal year. Management expects 100% of the company will be using the new software at the close of the third fiscal quarter.

Management continues to evaluate various controls and procedures that would enable the Company to remediate the material weaknesses previously noted.

***Changes In Internal Control Over Financial Reporting.***

Other than as discussed in the preceding paragraphs, there have been no changes in our internal control over financial reporting that occurred during our last fiscal quarter that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1 Legal Proceedings**

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 to recover based on the Company's alleged failure to steer 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 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 we appealed the appellate court's denial of our petition for interlocutory appeal which appeal was also denied by the Illinois Supreme Court in September 2008. We intend to vigorously defend this case. A possible range of loss cannot be estimated 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.

**Table of Contents****Item 1A. Risk Factors**

A restated description of the risk factors associated with our business is set forth below. This description includes any and all changes (whether or not material) to, and supercedes, the description of the risk factors associated with our business previously disclosed in Part 1, Item 1A of our Annual Report on Form 10-K for the fiscal year ended March 31, 2008.

Past financial performance is not necessarily a reliable indicator of future performance, and investors in our common stock should not use historical performance to anticipate results or future period trends. Investing in our common stock involves a high degree of risk. Investors should consider carefully the following risk factors, as well as the other information in this report and our other filings with the Securities and Exchange Commission, including our consolidated financial statements and the related notes, before deciding whether to invest or maintain an investment in shares of our common stock. If any of the following risks actually occurs, our business, financial condition and results of operations would suffer. In this case, the trading price of our common stock would likely decline. The risks described below are not the only ones we face. Additional risks that we currently do not know about or that we currently believe to be immaterial also may impair our business operations.

**Changes in government regulations could increase our costs of operations and/or reduce the demand for our services.**

Many states, including a number of those in which we transact business, have licensing and other regulatory requirements applicable to our business. Approximately half of the states have enacted laws that require licensing of businesses which provide medical review services such as ours. Some of these laws apply to medical review of care covered by workers' compensation. These laws typically establish minimum standards for qualifications of personnel, confidentiality, internal quality control and dispute resolution procedures. These regulatory programs may result in increased costs of operation for us, which may have an adverse impact upon our ability to compete with other available alternatives for healthcare cost control. In addition, new laws regulating the operation of managed care provider networks have been adopted by a number of states. These laws may apply to managed care provider networks having contracts with us or to provider networks which we may organize. To the extent we are governed by these regulations, we may be subject to additional licensing requirements, financial and operational oversight and procedural standards for beneficiaries and providers.

Regulation in the healthcare and workers' compensation fields is constantly evolving. We are unable to predict what additional government initiatives, if any, affecting our business may be promulgated in the future. Our business may be adversely affected by failure to comply with existing laws and regulations, failure to obtain necessary licenses and government approvals or failure to adapt to new or modified regulatory requirements. Proposals for healthcare legislative reforms are regularly considered at the federal and state levels. To the extent that such proposals affect workers' compensation, such proposals may adversely affect our business, financial condition and results of operations.

In addition, changes in workers' compensation, auto and managed health care laws or regulations may reduce demand for our services, require us to develop new or modified services to meet the demands of the marketplace or reduce the fees that we may charge for our services. One proposal which had been considered in the past, but not enacted by Congress or certain state legislatures, is 24-hour health coverage, in which the coverage of traditional employer-sponsored health plans is combined with workers' compensation coverage to provide a single insurance plan for work-related and non-work-related health problems. Incorporating workers' compensation coverage into conventional health plans may adversely affect the market for our services because some employers would purchase 24-hour coverage from group health plans, which would reduce the demand for CorVel's workers' compensation customers.

**Our quarterly sequential revenue may not increase and may decline. As a result, we may fail to meet or exceed the expectations of investors or analysts which could cause our common stock price to decline.**

Our quarterly sequential revenue growth may not increase and may decline in the future as a result of a variety of factors, many of which are outside of our control. If changes in our quarterly sequential revenue fall below the expectations of investors or analysts, the price of our common stock could decline substantially. Fluctuations or declines in quarterly sequential revenue growth may be due to a number of factors, including, but not limited to, those

listed below and identified throughout this Risk Factors section: the decline in manufacturing employment,  
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the decline in workers' compensation claims, the decline in healthcare expenditures, the considerable price competition in a flat-to-declining workers' compensation market, the increase in competition, and the changes and the potential changes in state workers' compensation and automobile managed care laws which can reduce demand for our services. These factors create an environment where revenue and margin growth is more difficult to attain and where revenue growth is less certain than historically experienced. Additionally, our technology and preferred provider network face competition from companies that have more resources available to them than we do. Also, some customers may handle their managed care services in-house and may reduce the amount of services which are outsourced to managed care companies such as CorVel. These factors could cause the market price of our common stock to fluctuate substantially. There can be no assurance that our growth rate in the future, if any, will be at or near historical levels.

In addition, the stock market has in the past experienced price and volume fluctuations that have particularly affected companies in the healthcare and managed care markets resulting in changes in the market price of the stock of many companies, which may not have been directly related to the operating performance of those companies.

Due to the foregoing factors, and the other risks discussed in this report, investors should not rely on quarter-to-quarter comparisons of our results of operations as an indication of our future performance.

**Exposure to possible litigation and legal liability may adversely affect our business, financial condition and results of operations.**

We, through our utilization management services, make recommendations concerning the appropriateness of providers' medical treatment plans of patients throughout the country, and as a result, could be exposed to claims for adverse medical consequences. We do not grant or deny claims for payment of benefits and we do not believe that we engage in the practice of medicine or the delivery of medical services. There can be no assurance, however, that we will not be subject to claims or litigation related to the authorization or denial of claims for payment of benefits or allegations that we engage in the practice of medicine or the delivery of medical services.

In addition, there can be no assurance that we will not be subject to other litigation that may adversely affect our business, financial condition or results of operations, including but not limited to being joined in litigation brought against our customers in the managed care industry. We maintain professional liability insurance and such other coverages as we believe are reasonable in light of our experience to date. If such insurance is insufficient or unavailable in the future at reasonable cost to protect us from liability, our business, financial condition or results of operations could be adversely affected.

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 to recover based on the Company's alleged failure to steer patients to medical providers who are members of the CorVel CorCare PPO network and also alleges that we used biased and arbitrary computer software to review medical providers' bills. In December 2007, the 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 we appealed the appellate court's denial of our petition for interlocutory appeal which appeal was also denied by the Illinois Supreme Court in September 2008. We intend to vigorously defend this case.



**Table of Contents****If lawsuits against us are successful, we may incur significant liabilities.**

We provide to insurers and other payors of health care costs managed care programs that utilize preferred provider organizations and computerized bill review programs. Health care providers have brought against us and our customers individual and class action lawsuits challenging such programs. If such lawsuits are successful, we may incur significant liabilities.

We make recommendations about the appropriateness of providers' proposed medical treatment plans for patients throughout the country. As a result, we could be subject to claims arising from any adverse medical consequences. Although plaintiffs have not to date subjected us to any claims or litigation relating to the grant or denial of claims for payment of benefits or allegations that we engage in the practice of medicine or the delivery of medical services, we cannot assure you that plaintiffs will not make such claims in future litigation. We also cannot assure you that our insurance will provide sufficient coverage or that insurance companies will make insurance available at a reasonable cost to protect us from significant future liability.

**Our failure to compete successfully could make it difficult for us to add and retain customers and could reduce or impede the growth of our business.**

We face competition from PPOs, TPAs and other managed healthcare companies. We believe that as managed care techniques continue to gain acceptance in the workers' compensation marketplace, our competitors will increasingly consist of nationally-focused workers' compensation managed care service companies, insurance companies, HMOs and other significant providers of managed care products. Legislative reform in some states has been considered, but not enacted to permit employers to designate health plans such as HMOs and PPOs to cover workers' compensation claimants. Because many health plans have the ability to manage medical costs for workers' compensation claimants, such legislation may intensify competition in the markets served by us. Many of our current and potential competitors are significantly larger and have greater financial and marketing resources than we do, and there can be no assurance that we will continue to maintain our existing customers, our past level of operating performance or be successful with any new products or in any new geographical markets we may enter.

**Declines in workers' compensation claims may harm our results of operations.**

Within the past few years, several states have experienced a decline in the number of workers' compensation claims and the average cost per claim which have been reflected in workers' compensation insurance premium rate reductions in those states. We believe that declines in workers' compensation costs in these states are due principally to intensified efforts by payors to manage and control claim costs, and to a lesser extent, to improved risk management by employers and to legislative reforms. If declines in workers' compensation costs occur in many states and persist over the long-term, it would have an adverse impact on our business, financial condition and results of operations.

We provide an outsource service to payors of workers' compensation and auto healthcare benefits. These payors include insurance companies, TPAs, municipalities, state funds, and self-insured, self-administered employers. If these payors reduce the amount of work they outsource, our results of operations would be adversely affected.

**If the average annual growth in nationwide employment does not offset declines in the frequency of workplace injuries and illnesses, then the size of our market may decline, which may adversely affect our ability to grow.**

The rate of injuries that occur in the workplace has decreased over time. Although the overall number of people employed in the workplace has generally increased over time, this increase has only partially offset the declining rate of injuries and illnesses. Our business model is based, in part, on our ability to expand our relative share of the market for the treatment and review of claims for workplace injuries and illnesses. If nationwide employment does not increase or experiences periods of decline, or if workplace injuries and illnesses continue to decline at a greater rate than the increase in total employment, our ability to increase our revenue and earnings could be adversely impacted.

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**If the utilization by healthcare payors of early intervention services continues to increase, the revenue from our later-stage network and healthcare management services could be negatively affected.**

The performance of early intervention services, including injury occupational healthcare, first notice of loss, and telephonic case management services, often result in a decrease in the average length of, and the total costs associated with, a healthcare claim. By successfully intervening at an early stage in a claim, the need for additional cost containment services for that claim often can be reduced or even eliminated. As healthcare payors continue to increase their utilization of early intervention services, the revenue from our later stage network and healthcare management services will decrease.

**We face competition for staffing, which may increase our labor costs and reduce profitability.**

We compete with other health-care providers in recruiting qualified management and staff personnel for the day-to-day operations of our business, including nurses and other case management professionals. In some markets, the scarcity of nurses and other medical support personnel has become a significant operating issue to health-care providers. This shortage may require us to enhance wages to recruit and retain qualified nurses and other health-care professionals. Our failure to recruit and retain qualified management, nurses and other health-care professionals, or to control labor costs could have a material adverse effect on profitability.

**If competition increases, our growth and profits may decline.**

The markets for our Network Services and Care Management Services segments are also fragmented and competitive. Our competitors include national managed care providers, preferred provider networks, smaller independent providers and insurance companies. Companies that offer one or more workers' compensation managed care services on a national basis are our primary competitors. We also compete with many smaller vendors who generally provide unbundled services on a local level, particularly companies with an established relationship with a local insurance company adjuster. In addition, several large workers' compensation insurance carriers offer managed care services for their customers, either by performance of the services in-house or by outsourcing to organizations like ours. If these carriers increase their performance of these services in-house, our business may be adversely affected. In addition, consolidation in the industry may result in carriers performing more of such services in-house.

**The failure to attract and retain qualified or key personnel may prevent us from effectively developing, marketing, selling, integrating and supporting our services.**

We are dependent, to a substantial extent, upon the continuing efforts and abilities of certain key management personnel. In addition, we face competition for experienced employees with professional expertise in the workers' compensation managed care area. The loss of key employees, especially V. Gordon Clemons, Chairman, and Dan Starck, President, Chief Executive Officer, and Chief Operating Officer, or the inability to attract, qualified employees, could have a material unfavorable effect on our business and results of operations.

**If we fail to grow our business internally or through strategic acquisitions we may be unable to execute our business plan, maintain high levels of service or adequately address competitive challenges.**

Our strategy is to continue internal growth and, as strategic opportunities arise in the workers' compensation managed care industry, to consider acquisitions of, or relationships with, other companies in related lines of business. As a result, we are subject to certain growth-related risks, including the risk that we will be unable to retain personnel or acquire other resources necessary to service such growth adequately. Expenses arising from our efforts to increase our market penetration may have a negative impact on operating results. In addition, there can be no assurance that any suitable opportunities for strategic acquisitions or relationships will arise or, if they do arise, that the transactions contemplated could be completed. If such a transaction does occur, there can be no assurance that we will be able to integrate effectively any acquired business. In addition, any such transaction would be subject to various risks associated with the acquisition of businesses, including, but not limited to, the following:

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an acquisition may negatively impact our results of operations because it may require incurring large one-time charges, substantial debt or liabilities; it may require the amortization or write down of amounts related to deferred compensation, goodwill and other intangible assets; or it may cause adverse tax consequences, substantial depreciation or deferred compensation charges;

we may encounter difficulties in assimilating and integrating the business, technologies, products, services, personnel or operations of companies that are acquired, particularly if key personnel of the acquired company decide not to work for us;

an acquisition may disrupt ongoing business, divert resources, increase expenses and distract management; the acquired businesses, products, services or technologies may not generate sufficient revenue to offset acquisition costs;

we may have to issue equity or debt securities to complete an acquisition, which would dilute stockholders and could adversely affect the market price of our common stock; and

acquisitions may involve the entry into a geographic or business market in which we have little or no prior experience.

There can be no assurance that we will be able to identify or consummate any future acquisitions or other strategic relationships on favorable terms, or at all, or that any future acquisition or other strategic relationship will not have an adverse impact on our business or results of operations. If suitable opportunities arise, we may finance such transactions, as well as internal growth, through debt or equity financing. There can be no assurance, however, that such debt or equity financing would be available to us on acceptable terms when, and if, suitable strategic opportunities arise.

**Our Internet-based services are dependent on the development and maintenance of the Internet infrastructure.**

We deploy our CareMC and, to a lesser extent, MedCheck services over the Internet. Our ability to deliver our Internet-based services is dependent on the development and maintenance of the infrastructure of the Internet by third parties. This includes maintenance of a reliable network backbone with the necessary speed, data capacity and security, as well as timely development of complementary products, such as high-speed modems, for providing reliable Internet access and services. The Internet has experienced, and is likely to continue to experience, significant growth in the number of users and the amount of traffic. If the Internet continues to experience increased usage, the Internet infrastructure may be unable to support the demands placed on it. In addition, the performance of the Internet may be harmed by increased usage.

The Internet has experienced a variety of outages and other delays as a result of damages to portions of its infrastructure, and it could face outages and delays in the future. These outages and delays could reduce the level of Internet usage, as well as the availability of the Internet to us for delivery of our Internet-based services. In addition, our customers who use our Web-based services depend on Internet service providers, online service providers and other Web site operators for access to our Web site. All of these providers have experienced significant outages in the past and could experience outages, delays and other difficulties in the future due to system failures unrelated to our systems. Any significant interruptions in our services or increases in response time could result in a loss of potential or existing users, and, if sustained or repeated, could reduce the attractiveness of our services.

**Demand for our services could be adversely affected if our prospective customers are unable to implement the transaction and security standards required under HIPAA.**

For some of our network services, we routinely implement Electronic Data Interfaces (EDIs) to our customers locations that enable the exchange of information on a computerized basis. To the extent that our customers do not have sufficient personnel to implement the transactions and security standards required by HIPAA

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or to work with our information technology personnel in the implementation of our electronic interfaces, the demand for our network services could decline.

**An interruption in our ability to access critical data may cause customers to cancel their service and/or may reduce our ability to effectively compete.**

Certain aspects of our business are dependent upon our ability to store, retrieve, process and manage data and to maintain and upgrade our data processing capabilities. Interruption of data processing capabilities for any extended length of time, loss of stored data, programming errors or other system failures could cause customers to cancel their service and could have a material adverse effect on our business and results of operations.

In addition, we expect that a considerable amount of our future growth will depend on our ability to process and manage claims data more efficiently and to provide more meaningful healthcare information to customers and payors of healthcare. There can be no assurance that our current data processing capabilities will be adequate for our future growth, that we will be able to efficiently upgrade our systems to meet future demands, or that we will be able to develop, license or otherwise acquire software to address these market demands as well or as timely as our competitors.

**The introduction of software products incorporating new technologies and the emergence of new industry standards could render our existing software products less competitive, obsolete or unmarketable.**

There can be no assurance that we will be successful in developing and marketing new software products that respond to technological changes or evolving industry standards. If we are unable, for technological or other reasons, to develop and introduce new software products cost-effectively, in a timely manner and in response to changing market conditions or customer requirements, our business, results of operations and financial condition may be adversely affected.

Developing or implementing new or updated software products and services may take longer and cost more than expected. We rely on a combination of internal development, strategic relationships, licensing and acquisitions to develop our software products and services. The cost of developing new healthcare information services and technology solutions is inherently difficult to estimate. Our development and implementation of proposed software products and services may take longer than originally expected, require more testing than originally anticipated and require the acquisition of additional personnel and other resources. If we are unable to develop new or updated software products and services cost-effectively on a timely basis and implement them without significant disruptions to the existing systems and processes of our customers, we may lose potential sales and harm our relationships with current or potential customers.

**A breach of security may cause our customers to curtail or stop using our services.**

We rely largely on our own security systems, confidentiality procedures and employee nondisclosure agreements to maintain the privacy and security of our and our customers proprietary information. Accidental or willful security breaches or other unauthorized access by third parties to our information systems, the existence of computer viruses in our data or software and misappropriation of our proprietary information could expose us to a risk of information loss, litigation and other possible liabilities which may have a material adverse effect on our business, financial condition and results of operations. If security measures are breached because of third-party action, employee error, malfeasance or otherwise, or if design flaws in our software are exposed and exploited, and, as a result, a third party obtains unauthorized access to any customer data, our relationships with our customers and our reputation will be damaged, our business may suffer and we could incur significant liability. Because techniques used to obtain unauthorized access or to sabotage systems change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures.

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**If we are unable to increase our market share among national and regional insurance carriers and large, self-funded employers, our results may be adversely affected.**

Our business strategy and future success depend in part on our ability to capture market share with our cost containment services as national and regional insurance carriers and large, self-funded employers look for ways to achieve cost savings. We cannot assure you that we will successfully market our services to these insurance carriers and employers or that they will not resort to other means to achieve cost savings. Additionally, our ability to capture additional market share may be adversely affected by the decision of potential customers to perform services internally instead of outsourcing the provision of such services to us. Furthermore, we may not be able to demonstrate sufficient cost savings to potential or current customers to induce them not to provide comparable services internally or to accelerate efforts to provide such services internally.

**If we lose several customers in a short period, our results may be adversely affected.**

Our results may decline if we lose several customers during a short period. Most of our customer contracts permit either party to terminate without cause. If several customers terminate, or do not renew or extend their contracts with us, our results could be adversely affected. Many organizations in the insurance industry have consolidated and this could result in the loss of one or more of our customers through a merger or acquisition. Additionally, we could lose customers due to competitive pricing pressures or other reasons.

**We are subject to risks associated with acquisitions of intangible assets.**

Our acquisition of other businesses may result in significant increases in our intangible assets and goodwill. We regularly evaluate whether events and circumstances have occurred indicating that any portion of our intangible assets and goodwill may not be recoverable. When factors indicate that intangible assets and goodwill should be evaluated for possible impairment, we may be required to reduce the carrying value of these assets. We cannot currently estimate the timing and amount of any such charges.

**If we are unable to leverage our information systems to enhance our outcome-driven service model, our results may be adversely affected.**

To leverage our knowledge of workplace injuries, treatment protocols, outcomes data, and complex regulatory provisions related to the workers' compensation market, we must continue to implement and enhance information systems that can analyze our data related to the workers' compensation industry. We frequently upgrade existing operating systems and are updating other information systems that we rely upon in providing our services and financial reporting. We have detailed implementation schedules for these projects that require extensive involvement from our operational, technological and financial personnel. Delays or other problems we might encounter in implementing these projects could adversely affect our ability to deliver streamlined patient care and outcome reporting to our customers.

**The increased costs of professional and general liability insurance may have an adverse effect on our profitability.**

The cost of commercial professional and general liability insurance coverage has risen significantly in the past several years, and this trend may continue. In addition, if we were to suffer a material loss, our costs may increase over and above the general increases in the industry. If the costs associated with insuring our business continue to increase, it may adversely affect our business. We believe our current level of insurance coverage is adequate for a company of our size engaged in our business.

**The impact of seasonality has a negative effect on our revenue.**

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

**Table of Contents****If the referrals for our patient management services continue to decline, our business, financial condition and results of operations would be materially adversely affected.**

We have experienced a general decline in the revenue and operating performance of patient management services. We believe that the performance decline has been due to the following factors: the decrease of the number of workplace injuries that have become longer-term disability cases; increased regional and local competition from providers of managed care services; a possible reduction by insurers on the types of services provided by our patient management business; the closure of offices and continuing consolidation of our patient management operations; and employee turnover, including management personnel, in our patient management business. In the past, these factors have all contributed to the lowering of our long-term outlook for our patient management services. If some or all of these conditions continue, we believe that the performance of our patient management revenues could decrease.

**Healthcare providers are becoming increasingly resistant to the application of certain healthcare cost containment techniques; this may cause revenue from our cost containment operations to decrease.**

Healthcare providers have become more active in their efforts to minimize the use of certain cost containment techniques and are engaging in litigation to avoid application of certain cost containment practices. Recent litigation between healthcare providers and insurers has challenged certain insurers' claims adjudication and reimbursement decisions. Although these lawsuits do not directly involve us or any services we provide, these cases may affect the use by insurers of certain cost containment services that we provide and may result in a decrease in revenue from our cost containment business.

**Failure to achieve and maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act of 2002, and any delays in completing our internal controls and financial audits, could have a material adverse effect on our business and stock price.**

Our fiscal 2008 management assessment revealed material weaknesses in our internal controls over accounts payable and financial close and reporting processes. We are attempting to cure these material weaknesses, but we have not yet completed remediation and there can be no assurance that such remediation will be successful. During the course of our continued testing, we also may identify other significant deficiencies or material weaknesses, in addition to the ones already identified, which we may not be able to remediate in a timely manner or at all. If we continue to fail to achieve and maintain effective internal controls, we will not be able to conclude that we have effective internal controls over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002. Failure to achieve and maintain an effective internal control environment, and delays in completing our internal controls and financial audits, could cause investors to lose confidence in our reported financial information and us, which could result in a decline in the market price of our common stock, and cause us to fail to meet our reporting obligations in the future, which in turn could impact our ability to raise equity financing if needed in the future.

**Item 2 Unregistered Sales of Equity Securities and Use of Proceeds**

There were no sales of unregistered securities during the period covered by this report. The following table shows the repurchases of the Company's common stock made by or on behalf of the Company for the quarter ended September 30, 2008 pursuant to a publicly announced plan.

| Period                  | Total<br>Number of<br>Shares<br>Purchased | Average Price<br>Paid<br>Per Share | Total Number<br>of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Program | Maximum<br>Number<br>of Shares that<br>may<br>yet be<br>Purchased<br>Under the<br>Program |
|-------------------------|---|------------------------------------|---|---|
| July 1 to July 31, 2008 |   |                                    | 11,787,614  | 1,362,386   |

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|                                   |        |          |            |           |
|-----------------------------------|--------|----------|------------|-----------|
| August 1 to August 31, 2008       |        |          | 11,787,614 | 1,362,386 |
| September 1 to September 30, 2008 | 55,337 | \$ 27.15 | 11,842,951 | 1,307,049 |
| Total                             | 55,337 | \$ 27.15 | 11,842,951 | 1,307,049 |

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In 1996, the Company's Board of Directors authorized a stock repurchase program for up to 100,000 shares of the Company's common stock. The Company's Board of Directors has periodically increased the number of shares authorized for repurchase under the repurchase program. The most recent increase occurred in September 2008 and brought the number of shares authorized for repurchase to 13,150,000 shares. There is no expiration date for the repurchase program.

**Item 3 Defaults Upon Senior Securities** None.

**Item 4 Submission of Matters to a Vote of Security Holders**

The Annual Meeting of Stockholders was held on August 14, 2008 to act on the following matters, all of which were approved:

1. To elect five directors, each to serve until the 2009 annual meeting of stockholders or until his or her successor has been duly elected and qualified. The following directors were elected at the 2008 Annual Meeting: V. Gordon Clemons, Steven J. Hamerslag, Alan R. Hoops, R. Judd Jessup, Jean H. Macino, and Jeffery J. Michael. The votes cast for Mr. Clemons were 12,108,925 shares, with 1,506,816 votes withheld. The votes cast for Mr. Hamerslag were 12,129,868 shares, with 1,485,873 votes withheld. The votes cast for Mr. Hoops were 12,130,023 shares, with 1,485,718 votes withheld. The votes cast for Mr. Jessup were 11,708,015 shares, with 1,907,726 votes withheld. The votes cast for Mrs. Macino were 13,312,692 shares, with 303,049 votes withheld. The votes cast for Mr. Michael were 11,679,936 shares, with 1,935,805 votes withheld.
2. To approve an amendment to the CorVel Corporation Restated Omnibus Incentive Plan (Formerly The Restated 1988 Executive Stock Option Plan) to reduce the number of shares of common stock underlying options to be granted under the automatic option grant program from 11,250 to 7,500 shares for initial automatic option grants to be awarded to a director upon first joining the Board and from 4,500 to 3,000 shares for annual automatic option grants to be awarded to directors on the date of each annual meeting of stockholders. The appointment was ratified with a total of 10,690,796 shares voting for, 455,366 shares voting against, 216,942 shares abstaining, and 2,252,637 broker non votes;
3. To ratify the appointment of Haskell & White LLP as our independent auditors for the fiscal year ending March 31, 2009. The appointment was ratified with a total of 13,612,313 shares voting for, 3,139 shares voting against, and 289 shares abstaining.
4. To transact such other business as may properly come before the Annual Meeting or any adjournment or postponement thereof.

**Item 5 Other Information** None.

**Item 6 Exhibits**

2.2 Stock Purchase Agreement dated May 31, 2007 by and among the Company's subsidiary, CorVel Enterprise Comp, Inc., The Schaffer Companies, Ltd., and Dawn Colwell, Christopher Schaffer, John Colwell and Kelly Ribeiro de Sa. Incorporated herein by reference to Exhibit 2.1 to the Company's Form 8-K filed on June 6, 2007.

3.1 Amended and Restated Certificate of Incorporation of the Company. Incorporated herein by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2007 filed on August 9, 2007.

3.2 Amended and Restated Bylaws of the Company. Incorporated herein by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006 filed on August 14, 2006.

31.1 Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002



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32.1 Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)

32.2 Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)

Confidential treatment was requested for certain confidential portions of this exhibit pursuant to Rule 24b-2 under the Securities Exchange Act of 1934. In accordance with Rule 24b-2, these confidential portions were omitted from this exhibit and filed separately with the Securities and Exchange Commission.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

CORVEL CORPORATION

By: Daniel J. Starck  
Daniel J. Starck, President,  
Chief Executive Officer, and Chief Operating  
Officer

By: Scott R. McCloud  
Scott R. McCloud,  
Chief Financial Officer

November 7, 2008

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**INDEX TO EXHIBITS**

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32.2 Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith)

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