METROPOLITAN HEALTH NETWORKS INC
Form 10-Q
May 15, 2003

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2003

[ ] 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 0-28456

METROPOLITAN HEALTH NETWORKS, INC.

(Exact name of registrant as specified in its charter)

Florida (State or other jurisdiction of Incorporation or organization)	65-0635748 (I.R.S. Employer Identification No.)
250 Australian Avenue/Suite 400, West Palm Beach, FL (Address of principal executive office)	33401 (Zip Code)

(561) 805-8500

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant

(1) has filed all Reports required to be filed by

section 13 or 15(d) of the Securities Exchange Act of 1934

during the preceding 12 months (or for such shorter period that the

registrant was required to file such reports), and (2) has been

subject to such filing requirements for the past 90 days.

Yes [X]

No [ ]

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding as of March 31, 2003
Common Stock par value $.001	33,249,411

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Metropolitan Health Networks, Inc.

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METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

MARCH 31, 2003 AND DECEMBER 31, 2002

ASSETS	March 31, 2003 (Unaudited)	December 31, 2002 (Audited)
CURRENT ASSETS		
Cash and equivalents	$ 439,451	$ 399,614
Accounts receivable, net of allowances	3,766,514	3,498,945
Inventory	1,146,183	1,221,592
Other current assets	722,416	535,397
TOTAL CURRENT ASSETS	6,074,564	5,655,548
CERTIFICATES OF DEPOSIT restricted	900,000	850,000
CERTIFICATES OF DEPOSIT RECEIVABLE restricted	100,000	150,000
PROPERTY AND EQUIPMENT, net	1,286,179	1,159,981
GOODWILL, net	1,992,133	1,992,133
OTHER ASSETS	332,230	351,249
TOTAL ASSETS	$ 10,685,106	$ 10,158,911
LIABILITIES AND DEFICIENCY IN ASSETS		
CURRENT LIABILITIES		
Advances from HMO	$ 877,245	$ 1,666,953
Accounts payable	5,239,377	4,299,322
Accrued expenses	1,055,374	1,651,961
Current maturities of capital lease obligations	129,246	126,220
Current maturities of long-term debt	2,113,316	2,234,521
Payroll taxes payable	4,021,670	3,805,598
TOTAL CURRENT LIABILITIES	13,436,228	13,784,575
CAPITAL LEASE OBLIGATIONS	65,525	122,416
LONG-TERM DEBT	3,002,510	3,120,213
COMMITMENTS AND CONTINGENCIES		
DEFICIENCY IN ASSETS:		
Preferred stock, par value $.001 per share; stated value $100 per share;		

10,000,000 shares authorized; 5,000 issued and outstanding		500,000		500,000
Common stock, par value $.001 per share; 80,000,000 shares authorized;				
33,249,411 and 31,376,822 issued and outstanding, respectively		33,249		31,376
Additional paid-in capital		29,978,100		29,660,886
Accumulated deficit		(35,924,389)		(36,640,086)
Securities issued for services to be rendered		(406,117)		(420,469)
TOTAL DEFICIENCY IN ASSETS		(5,819,157)		(6,868,293)
TOTAL LIABILITIES AND DEFICIENCY IN ASSETS	$	10,685,106	$	10,158,911

See accompanying notes unaudited

METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

FOR THE THREE MONTHS ENDED MARCH 31, 2003 AND 2002

		March 31, 2003 (Unaudited)		March 31, 2002 (Unaudited)
REVENUES				
Medical services	$	36,876,548	$	34,420,822
Pharmacy sales, net of intersegment sales		3,906,563		3,114,233
		40,783,111		37,535,055
EXPENSES				
Direct medical costs		31,559,691		29,447,618
Cost of sales		2,822,845		2,249,197
Payroll, payroll taxes and benefits		2,894,220		2,980,392
Medical supplies		428,586		21,889
Depreciation and amortization		188,623		193,588
Consulting expense		443,727		582,356
General and administrative		1,361,476		1,432,231

TOTAL EXPENSES		39,699,168		36,907,271
INCOME BEFORE OTHER INCOME (EXPENSE)		1,083,943		627,784
OTHER INCOME (EXPENSE):				
Interest and penalty expense		(388,204)		(158,744)
Other income		19,958		24,626
TOTAL OTHER INCOME (EXPENSE)		(368,246)		(134,118)
INCOME FROM CONTINUING OPERATIONS		715,697		493,666
DISCONTINUED OPERATIONS:				
Loss from operations of discontinued operations		-		(41,803)
NET INCOME	$	715,697	$	451,863
Weighted average number of common shares outstanding		32,273,745		28,656,864
Income from continuing operations	$	0.02	$	0.02
Loss from discontinued operations	$	-	$	-
Net earnings per share basic	$	0.02	$	0.02
Net earnings per share diluted	$	0.02	$	0.01

See accompanying notes - unaudited

METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31, 2003 AND 2002

	March 31, 2003 (Unaudited)	March 31, 2002 (Unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:		

Net income	$ 715,697	$ 451,863
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	188,623	198,591
Provision for bad debt	100,000	-
Amortization of discount on notes payable	46,541	-
Stock issued for interest payment	80,000	-
Stock issued for compensation and services	41,500	106,119
Amortization of securities issued for professional services	64,352	45,366
Changes in assets and liabilities:		
Accounts receivable, net	(367,572)	(2,999,293)
Inventory	75,409	(49,495)
Other current assets	(187,019)	(50,209)
Other assets	(16,374)	(217,247)
Accounts payable and accrued expenses	391,058	(87,581)
Payroll taxes payable	216,072	297,713
Total adjustments	632,590	(2,756,036)
Net cash provided by/used in operating activities	1,348,287	(2,304,173)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of restricted CDs	(50,000)	-
Capital expenditures	(254,428)	(122,695)
Net cash used in investing activities	(304,428)	(122,695)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings on notes payable	501,199	2,325,357
Repayments on notes payable	(661,648)	(174,065)
Repayments on capital leases	(53,865)	(32,528)
Proceeds from issuance of stock	-	535,705
Proceeds from exercise of options	-	67
Cash paid for stock price guarantee	-	(122,893)
Net repayments on advances from HMO	(789,708)	(135,010)

Net cash used in/provided by financing activities		(1,004,022)		2,396,633
NET INCREASE (DECREASE) IN CASH AND EQUIVALENTS		39,837		(30,235)
CASH AND EQUIVALENTS - BEGINNING		399,614		393,968
CASH AND EQUIVALENTS - ENDING	$	439,451	$	363,733

See accompanying notes - unaudited

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METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and such adjustments are of a normal recurring nature. Operating results for the three months ended March 31, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003.

The audited financial statements at December 31, 2002, which are included in the Company s Form 10-K, should be read in conjunction with these condensed consolidated financial statements.

SEGMENT REPORTING

The Company applies Financial Accounting Standards Boards (FASB) statement No. 131, Disclosure about Segments of an Enterprise and Related Information . The Company has considered its operations and has determined that in 2002 it operated in three segments and in 2003 operates in two segments for purposes of presenting financial information and evaluating performance, PSN (managed care and direct medical services) and pharmacy. As such, the accompanying financial statements present information in a format that is consistent with the financial information used by management for internal use.

INCOME TAXES

The Company accounts for income taxes according to Statement of Financial Accounting Standards No. 109, which requires a liability approach to calculating deferred income taxes. Under this method, the Company records deferred taxes based on temporary differences between the tax bases of the Company s assets and liabilities and their financial reporting bases. A valuation allowance is established when it is more likely than not that some or all of the deferred tax assets will not be realized.

The effective tax rate for the three months ended March 31, 2003 differed from the federal statutory rate due principally to a de crease in the deferred tax asset valuation allowance.

REVENUES

Revenues are recorded when services are rendered or pharmacy products are sold. Revenues from one health maintenance organization (HMO) accounted for approximately 89 % and 91 % of the Company s total revenues for the quarters ended March 31 , 200 3 and 200 2, respectively.

Contracts with the HMO in the South Florida and Daytona markets renew automatically unless cancelled by either party with 120-day notice. These contracts expired December 31, 2002, however the contracts were renewed for one year effective January 1, 2003. The Company expects the contracts to continue for the foreseeable future.

RECLASSIFICATION

Certain amounts reported in the comparative financial statements have been reclassified to conform with the presentation for the period ended March 31, 2003.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

ACCOUNTS RECEIVABLE

Accounts receivable at March 31, 2003 and December 31, 2002 were as follows:

		March 31, 2003		December 31, 2002
HMO accounts receivable, net	$	1,064,000	$	1,063,000
Non HMO accounts receivable, net		2,703,000		2,436,000
Accounts receivable	$	3,767,000	$	3,499,000

In the health care environment, estimates often change as a result of one or more future confirming events . With regard to revenues, expenses and receivable s arising from agreements with the HMO, the Company estimates amounts it believes will ultimately be realizable through the use of judgments and assumptions about future decisions. It is reasonably possible that some or all of these estimates could change in the near term by an amount that could be material to the financial statements.

Direct medical cost s are based in part upon estimates of claims incurred but not reported (IBNR) and estimates of retroactive adjustments or unsettled costs to be applied by the HMO. The IBNR estimates are made by the HMO utilizing actuarial methods and are continually evaluated by management of the Company, based upon its specific claims experience. The estimates of retroactive adjustments or unsettled costs to be applied by the HMO are based upon current agreements and understandings with the HMO to modify certain amounts previously charged to the Company s fund balances. Management believes its estimates of IBNR claims and estimates of retroactive adjustments are reasonable, however, it is reasonably possible the Company's estimate of these costs could change in the near term, and those changes may be material.

F rom time to time the Company is charged for certain medical expenses which, under its contracts with the HMO, the Company believes it is not liable. In connection therewith, the Company was contesting certain costs aggregating approximately $ 1.8 million at March 31, 2003 . Management s estimate of recovery on these contestations is determined based upon its judgment and its consideration of several factors including the nature of the contestations, historical recovery rates and other qualitative factors. Accordingly, accounts receivable due from the HMO includes approximately $ 370,000 , which represents estimated recovery of contestations outstanding at March 31, 2003 . It is reasonably possible the Company s estimate of these recoveries could change in the near term, and those changes may be material.

Non-HMO accounts receivable, aggregating approximately $ 7.1 million at March 31, 2003 relate principally to prescription sales and medical services provided on a fee for service basis, and are reduced by amounts estimated to be uncollectible (approximately $ 4.4 million). Management s estimate of uncollectible amounts is based upon its analysis of historical collections and other qualitative factors, however it is reasonabl y possible the Company s estimate of uncollectible amounts could change in the near term, and those changes may be material. Non-HMO accounts receivable included approximately $3.5 million from discontinued operations, which amount is fully reserved.

Non-HMO accounts receivable are typically uncollateralized customer obligations due under normal trade terms requiring payment within 30-90 days from the invoice date. The Company does not charge late fees or penalties on delinquent invoices, however it continually evaluates the need for a valuation allowance (Allowance). The Allowance reflects management s best estimate of the amounts that will not be collected. Management reviews all non-current accounts receivable balances on an ongoing basis and , based on this assessment of current creditworthiness, estimates the portion, if any, that will not be collected. It is reasonably possible that some or all of these estimates could change in the near term by an amount that could be material to the financial statements.

NET INCOME PER SHARE

The Company applies Statement of Financial Accounting Standards No. 128, Earnings Per Share (FAS 128) which requires dual presentation of net income per share; Basic and Diluted. Basic earnings per share is computed using the weighted average number of common shares outstanding during the period .. Diluted earnings per share is computed using the weighted average number of common shares outstanding during the period adjusted for incremental shares attributed to outstanding options and warrants, convertible debt and preferred stock to purchase or convert into shares of common stock ..

	Three Months Ended			
	March 31, 2003		March 31, 2002	
Net Income	$	715,697	$	451,863
Less: Preferred stock dividend		(12,500)		(12,500)
Income available to common shareholders	$	703,197	$	439,363
Denominator:				
Weighted average common shares outstanding		32,273,745		28,656,864
Basic earnings per common share	$	0.02	$	0.02
Net Income	$	715,697	$	451,863
Interest on convertible securities		103,920		4,274
	$	819,617	$	456,137
Denominator:				
Weighted average common shares outstanding		32,273,745		28,656,864
Common share equivalents of outstanding stock:				
Convertible preferred		4,437,567		1,103,583
Convertible debt		6,765,116		1,596,999
Weighted average common shares outstanding		43,476,428		31,357,446
Diluted earnings per common share	$	0.02	$	0.01

NEW ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 143 which requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. Subsequently, the asset retirement cost should be allocated to expense using a systematic and rational method over its useful life. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. Adoption of SFAS No. 143 did not have a material impact on the Company s financial statements.

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. This statement addresses accounting and reporting for costs associated with exit or disposal activities and nullifies emerging issues Task Force Issue No. 94-3. The statement is effective for exit or disposal costs initiated after December 31, 2002, with early application encouraged. The Company adopted SFAS No. 146 effective January 1, 2003, which did not have a material impact on the Company s financial statements.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure-an amendment of FASB Statement No. 123. This statement provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. Adoption of SFAS No. 14 8 did not have a material impact on the Company s financial statements.

On January 17, 2003, FIN 46, Consolidation of Variable Interest Entities, an interpretation of ARB 51, was issued. The primary objective of FIN 46 is to provide guidance on the identification and consolidation of variable interest entities, or VIEs, which are entities for which control is achieved through means other than through voting rights. The provision of FIN 46 is required to be adopted by the Company in fiscal 2003. The Company adopted FIN 46 effective January 1, 2003, with no material impact on its financial position, results of operations or cash flows.

In April 2003, the FASB issued SFAS No. 149, which amends SFAS 133, Accounting for Derivative Instruments and Hedging Activities . The primary focus of this Statement is to amend and clarify financial accounting and reporting for derivative instruments. This Statement is effective for contracts entered into or modified after June 30, 2003. The Company is currently assessing the impact of SFAS No. 149, which is not expected to have a material impact on the Company s financial statements.

NOTE 2. LIQUIDITY AND CAPITAL RESOURCES

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplates continuation of the Company as a going concern. However, the Company has incurred negative cash flows from operations, partly as a result of the Company s diversification of its revenue base, including the pharmacy and clinical laboratory operations. Although the Company expects its cash flow from operations to continue to improve, there can be no assurance that this will occur. In the absence of achieving continuing positive cash flows from operations or obtaining additional debt or equity financing, the Company may have difficulty meeting current and long-term obligations, and may be forced to discontinue a material business segment or overall operations.

To address these concerns, management has taken measures to continue to reduce overhead and is reviewing its operations for further reductions as well as potential sources of increased revenue in order to accomplish its long-term goals. The Company has agreed in principle to sell the assets and certain liabilities of its pharmacy division for a purchase price of $5.0 million, consisting of cash and a promissory note, and 17.5% of the new entity (see Note 8). The Company believes that this sale will result in both improved profitability and cash flows.

During the first quarter of 2003, the Company borrowed $500,000 on a short-term note that is due August 21, 2003. The proceeds from this transaction were used for working capital. Such offering was to an accredited investor pursuant to Section 4(2) of the Securities and Exchange Act of 1934. Also during the first quarter, the Company borrowed $1.1 million from the HMO, of which $489,000 was repaid in the quarter, with the balance payable over the remainder of the year.

In view of these matters, realization of a major portion of the assets in the accompanying balance sheet is dependent upon continued operations of the Company, which in turn is dependent upon the Company s ability to meet its financial obligations. Management believes that actions presently being taken, as described in the preceding paragraph s , provide the opportunity for the Company to continue as a going concern, however, there is no assurance this will occur.

NOTE 3. SHORT-TERM DEBT

During the first quarter of 2003, the Company borrowed $500,000 on a short-term note that is due August 21, 2003. This note bears interest at 24% and is collateralized by shares of common stock of the Company. The proceeds from this transaction were used for working capital. Also during the first quarter, the Company borrowed $1.1 million from the HMO, of which $489,000 was repaid in the quarter, with the balance payable over the remainder of the year.

NOTE 4. DEFICIENCY IN ASSETS

During the first quarter of 2003, the Company issued 1,872,589 shares of common stock to accredited investors. The shares were issued for services, compensation, debt obligations, settlements and extinguishment of accounts payable. In addition, the Company issued shares of common stock to convert approximately $75,000 of long-term debt to equity.

NOTE 5. STOCK OPTIONS

The Company adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, (SFAS 123). The Company has elected to continue using Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees in accounting for employee stock options.