

U S PHYSICAL THERAPY INC /NV

Form 10-Q

May 08, 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 March 31, 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 1-11151
U.S. PHYSICAL THERAPY, INC.
(NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)**

NEVADA
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

76-0364866
(I.R.S. EMPLOYER
IDENTIFICATION NO.)

1300 WEST SAM HOUSTON PARKWAY SOUTH,
SUITE 300,
HOUSTON, TEXAS
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

77042
(ZIP CODE)

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

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

Yes 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

As of May 7, 2008, the number of shares outstanding (issued less treasury stock) of the registrant's common stock, par value \$.01 per share, was: 11,862,818.

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U.S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

| | March 31, 2008 (unaudited) | December 31, 2007 |
|--|----------------------------------|-------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 9,197 | \$ 7,976 |
| Patient accounts receivable, less allowance for doubtful accounts of \$2,142 and \$2,184, respectively | 27,581 | 25,574 |
| Accounts receivable other | 1,020 | 1,150 |
| Other current assets | 1,509 | 1,333 |
| Total current assets | 39,307 | 36,033 |
| Fixed assets: | | |
| Furniture and equipment | 29,281 | 28,782 |
| Leasehold improvements | 17,068 | 17,352 |
| | 46,349 | 46,134 |
| Less accumulated depreciation and amortization | 30,086 | 29,342 |
| | 16,263 | 16,792 |
| Goodwill | 40,631 | 37,650 |
| Other intangible assets, net | 3,981 | 3,930 |
| Other assets | 1,476 | 1,847 |
| | \$ 101,658 | \$ 96,252 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable trade | \$ 1,321 | \$ 1,555 |
| Accrued expenses | 9,065 | 9,071 |
| Current portion of notes payable | 771 | 812 |
| Total current liabilities | 11,157 | 11,438 |
| Notes payable | 886 | 959 |
| Revolving line of credit | 9,800 | 7,000 |
| Deferred rent | 1,008 | 1,104 |
| Other long-term liabilities | 689 | 696 |
| Total liabilities | 23,540 | 21,197 |

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| | | |
|---|------------|-----------|
| Minority interests in subsidiary limited partnerships | 5,847 | 5,648 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Preferred stock, \$.01 par value, 500,000 shares authorized, no shares issued and outstanding | | |
| Common stock, \$.01 par value, 20,000,000 shares authorized, 14,077,555 and 14,053,192, shares issued, respectively | 141 | 141 |
| Additional paid-in capital | 41,931 | 41,452 |
| Retained earnings | 61,827 | 59,442 |
| Treasury stock at cost, 2,214,737 shares | (31,628) | (31,628) |
| Total shareholders' equity | 72,271 | 69,407 |
| | \$ 101,658 | \$ 96,252 |

See notes to consolidated financial statements.

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U.S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF NET INCOME
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(unaudited)

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2008 | 2007 |
| Net patient revenues | \$ 44,197 | \$ 34,276 |
| Management contract and other revenues | 1,054 | 344 |
| Net revenues | 45,251 | 34,620 |
| Clinic operating costs: | | |
| Salaries and related costs | 24,101 | 17,916 |
| Rent, clinic supplies, contract labor and other | 9,603 | 7,429 |
| Provision for doubtful accounts | 748 | 631 |
| | 34,452 | 25,976 |
| Corporate office costs | 5,062 | 4,357 |
| Operating income from continuing operations | 5,737 | 4,287 |
| Interest and investment income | 25 | 66 |
| Interest expense | (149) | (25) |
| Minority interests in subsidiary limited partnerships | (1,672) | (1,315) |
| Income before income taxes from continuing operations | 3,941 | 3,013 |
| Provision for income taxes | 1,556 | 1,169 |
| Net income from continuing operations | 2,385 | 1,844 |
| Discontinued operations: | | |
| (Loss) from discontinued operations | | (24) |
| Tax benefit from discontinued operations | | 9 |
| | | (15) |
| Net income | \$ 2,385 | \$ 1,829 |
| Earnings per share: | | |
| Basic income from continuing operations | \$ 0.20 | \$ 0.16 |
| Basic loss from discontinued operations | | |
| Total basic earnings per common share | \$ 0.20 | \$ 0.16 |

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| | | |
|---|---------|---------|
| Diluted income from continuing operations | \$ 0.20 | \$ 0.16 |
| Diluted loss from discontinued operations | | |
| Total diluted earnings per common share | \$ 0.20 | \$ 0.16 |
| Shares used in computation: | | |
| Basic earnings per common share | 11,852 | 11,501 |
| Diluted earnings per common share | 11,914 | 11,589 |

See notes to consolidated financial statements.

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U.S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(unaudited)

| | Three Months Ended March | |
|---|--------------------------|----------|
| | 31, | |
| | 2008 | 2007 |
| OPERATING ACTIVITIES | | |
| Net income | \$ 2,385 | \$ 1,829 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,484 | 1,125 |
| Minority interests in earnings of subsidiary limited partnerships | 1,672 | 1,315 |
| Provision for doubtful accounts | 748 | 631 |
| Equity-based awards compensation expense | 339 | 257 |
| Loss on sale or abandonment of assets | 45 | 6 |
| Tax benefit from exercise of stock options | (75) | (9) |
| Recognition of deferred rent subsidies | (96) | (130) |
| Deferred income taxes | 343 | 81 |
| Changes in operating assets and liabilities: | | |
| Increase in patient account receivable | (2,755) | (1,001) |
| Decrease in accounts receivable other | 130 | 173 |
| Increase in other assets | (148) | (396) |
| (Decrease) increase in accounts payable and accrued expenses | (240) | 1,526 |
| (Decrease) increase in other liabilities | 68 | (7) |
| Net cash provided by operating activities | 3,900 | 5,400 |
| INVESTING ACTIVITIES | | |
| Purchase of fixed assets | (928) | (784) |
| Purchase of business | (2,831) | |
| Acquisitions of minority interest, included in goodwill | (285) | (129) |
| Purchase of marketable securities available for sale | | (1,600) |
| Proceeds on sale of marketable securities available for sale | | 640 |
| Proceeds on sale of fixed assets | 12 | 6 |
| Net cash used in investing activities | (4,032) | (1,867) |
| FINANCING ACTIVITIES | | |
| Distributions to minority investors in subsidiary limited partnerships | (1,473) | (1,463) |
| Proceeds from revolving line of credit | 2,800 | |
| Payment of notes payable | (114) | (166) |
| Excess tax benefit from stock options exercised | 75 | 9 |
| Proceeds from exercise of stock options | 65 | 228 |
| Net cash provided by (used in) financing activities | 1,353 | (1,392) |
| Net increase in cash and cash equivalents | 1,221 | 2,141 |
| Cash and cash equivalents beginning of period | 7,976 | 10,952 |

| | | | |
|---------------------------|---------------|----------|-----------|
| Cash and cash equivalents | end of period | \$ 9,197 | \$ 13,093 |
|---------------------------|---------------|----------|-----------|

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid during the period for:

| | | | |
|--------------|--|----------|--------|
| Income taxes | | \$ 1,518 | \$ 109 |
| Interest | | \$ 100 | \$ 29 |

See notes to consolidated financial statements.

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U.S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY
(IN THOUSANDS)
(unaudited)

| | Common Stock | | Additional | Retained | Treasury Stock | | Total |
|--|--------------|--------|--------------------|-----------|----------------|-------------|------------------------|
| | Shares | Amount | Paid-In Capital | Earnings | Shares | Amount | Shareholders Equity |
| Balance December 31, 2007 | 14,053 | \$ 141 | \$ 41,452 | \$ 59,442 | (2,215) | \$ (31,628) | \$ 69,407 |
| Proceeds from exercise of stock options | 20 | | 65 | | | | 65 |
| Tax benefit from exercise of stock options | | | 75 | | | | 75 |
| Issuance of restricted stock | 5 | | | | | | |
| Amortization of restricted stock | | | 105 | | | | 105 |
| Equity-based compensation expense | | | 234 | | | | 234 |
| Net income | | | | 2,385 | | | 2,385 |
| Balance March 31, 2008 | 14,078 | \$ 141 | \$ 41,931 | \$ 61,827 | (2,215) | \$ (31,628) | \$ 72,271 |

See notes to consolidated financial statements.

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**U.S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2008**

(unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

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

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

During the three months ended March 31, 2008, the Company opened four new clinics, acquired one and closed three. Of the four clinics opened two were new Clinic Partnerships and two were satellites of existing partnerships. The Company ended March 2008 with 351 clinics.

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

The accompanying unaudited consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the instructions for Form 10-Q. However, the statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. For further information regarding the Company's accounting policies, please read the audited financial statements included in the Company's Form 10-K for the year ended December 31, 2007.

The Company believes, and the Chief Executive Officer, Chief Financial Officer and Corporate Controller have certified, that the financial statements included in this report contain all necessary adjustments (consisting only of normal recurring adjustments) to present fairly, in all material respects, the Company's financial position, results of operations and cash flows for the interim periods presented.

Operating results for the three months ended March 31, 2008 are not necessarily indicative of the results the Company expects for the entire year. Please also review the Risk Factors section included in our Form 10-K for the year ended December 31, 2007.

Clinic Partnerships

For Clinic Partnerships, the earnings and liabilities attributable to the minority limited partnership interest, typically owned by the managing therapist, are recorded within the balance sheets and income statements as minority interests in subsidiary limited partnerships.

Wholly-Owned Facilities

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

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Significant Accounting Policies

Cash Equivalents

The Company considers all highly liquid investments with an original maturity or remaining maturity at the time of purchase of three months or less to be cash equivalents. Based upon its investment policy, the Company invests its cash primarily in deposits with major financial institutions, in highly rated commercial paper, short-term United States treasury obligations, United States and municipal government agency securities and United States government sponsored enterprises. The Company held approximately \$4.0 million and \$4.2 million in highly liquid investments included in cash and cash equivalents at March 31, 2008 and December 31, 2007, respectively.

The Company maintains its cash and cash equivalents at financial institutions. The combined account balances at several institutions typically exceed Federal Deposit Insurance Corporation (FDIC) insurance coverage and, as a result, there is a concentration of credit risk related to amounts on deposit in excess of FDIC insurance coverage.

Management believes this risk is not significant.

Marketable Securities

Management determines the appropriate classification of its investments at the time of purchase and reevaluates such determination at each balance sheet date. Available-for-sale securities are carried at fair value, with unrealized holding gains and losses, net of tax, reported as a separate component of shareholders' equity. Since the fair value of the marketable securities available for sale equals the cost basis for such securities, there is no effect on comprehensive income for the periods reported.

Long-Lived Assets

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

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

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

Goodwill

Goodwill represents the excess of costs over the fair value of the acquired business assets. Historically, goodwill has been derived from acquisitions and from the purchase of some or all of a particular local management's equity interest in an existing clinic.

The fair value of goodwill and other intangible assets with indefinite lives are tested for impairment annually and upon the occurrence of certain events, and are written down to fair value if considered impaired. The Company evaluates goodwill for impairment on an annual basis (in its third quarter) by comparing the fair value of each reporting unit to the carrying value of the reporting unit including related goodwill. A reporting unit refers to the acquired interest of a single clinic or group of clinics. Local management typically continues to manage the acquired clinic or group of clinics. For each clinic or group of clinics, the Company maintains discrete financial information and both corporate and local management regularly review the operating results. For each purchase of the equity interest, goodwill is assigned to the respective clinic or group of clinics, if deemed appropriate.

Revenue Recognition

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

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The Company determines allowances for doubtful accounts based on the specific agings and payor classifications at each clinic. The provision for doubtful accounts is included in clinic operating costs in the statement of net income. Net accounts receivable, which are stated at the historical carrying amount net of contractual allowances, write-offs and allowance for doubtful accounts, includes only those amounts the Company estimates to be collectible. Since 1999, reimbursement for outpatient therapy services provided to Medicare beneficiaries has been made according to a fee schedule published by the Department of Health and Human Services. Under the Balanced Budget Act of 1997, the total amount paid by Medicare in any one year for outpatient physical therapy or occupational therapy (including speech-language pathology) to any one patient was initially limited to \$1,500 (the Medicare Cap or Limit), except for services provided in hospitals. After a three-year moratorium, this Medicare Limit on therapy services was implemented for services rendered on or after September 1, 2003 subject to an adjusted total of \$1,590 (the Adjusted Medicare Limit). Effective December 8, 2003, a moratorium was again placed on the Adjusted Medicare Limit for the remainder of 2003 and for years 2004 and 2005. Under the Medicare Prescription Drug, Improvement and Modernization Act of 2003, the Adjusted Medicare Limit was reinstated effective as of January 1, 2006. Outpatient therapy services rendered to Medicare beneficiaries by the Company's therapists were subject to the cap, except to the extent these services were rendered pursuant to certain management and professional services agreements with inpatient facilities, in which case the caps did not apply. The Adjusted Medicare Limit for 2006 was \$1,740.

In 2006, Congress passed the Deficit Reduction Act (DRA), which allowed the Centers for Medicare & Medicaid Services (CMS) to grant exceptions to the Medicare Cap for services provided during the year, as long as those services met certain qualifications (as more fully defined in the February 15, 2006 Medicare Fact Sheet). The exception process allowed for automatic and manual exceptions to the Medicare Cap for medically necessary services. The exception process specified diagnosis that qualified for an automatic exception to the Medicare Cap if the condition or complexity had a direct and significant impact on the course of therapy being provided and the additional treatment was medically necessary. The exception process further provided that manual exceptions could be granted if the condition or complexity did not allow for an automatic exception, but was believed to require medically necessary services. The exceptions provision adopted as part of the DRA expired on December 31, 2006.

In December 2006, Congress passed and the President signed the Tax Relief and Health Care Act of 2006, which extended the Medicare Cap exceptions process for 2007. As a result, the Medicare Cap continued to apply in 2007, and the Adjusted Medicare Limit for 2007 was \$1,780. After Congress extended the exceptions for another year, CMS revised the exceptions procedures. These procedures eliminate the manual exceptions process and expand the use of automatic exceptions. Beginning January 1, 2008, all services that required exceptions to the Medicare Cap were processed as automatic exceptions. While the basic procedure for obtaining an automatic exception remained the same, CMS expanded requirements for documentation related to the medical necessity of services provided above the cap.

The Medicare Cap continues to apply in 2008, and the Adjusted Medicare Limit for 2008 is \$1,810. On December 29, 2007, the Medicare, Medicaid and SCHIP Extension Act of 2007 was signed into law. This Act extended the exceptions process for the Medicare Cap through June 30, 2008. Unless additional legislation is enacted prior to July 1, 2008, the exceptions process will expire at that time.

Since the Medicare Cap was implemented, patients who have been impacted by the cap and those who do not qualify for an exception may choose to pay for services in excess of the cap themselves; however, it is assumed that the Medicare Cap will result in some lost revenues to the Company.

Laws and regulations governing the Medicare program are complex and subject to interpretation. The Company believes that it is in compliance in all material respects with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that would have a material effect on the Company's financial statements as of March 31, 2008. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from the Medicare program.

Management contract revenues are derived from contractual arrangements whereby we manage a clinic for third party owners. The Company does not have any ownership interest in these clinics. Typically, revenues are determined based

on the number of visits conducted at the clinic and recognized when services are performed.

Contractual Allowances

Contractual allowances result from the differences between the rates charged for services performed and expected reimbursements by both insurance companies and government sponsored healthcare programs for such services. Medicare regulations and the various third party payors and managed care contracts are often complex and may include multiple reimbursement mechanisms payable for the services provided in Company clinics. The Company estimates

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contractual allowances based on its interpretation of the applicable regulations, payor contracts and historical calculations. Each month the Company estimates its contractual allowance for each clinic based on payor contracts and the historical collection experience of the clinic and applies an appropriate contractual allowance reserve percentage to the gross accounts receivable balances for each payor of the clinic. Based on the Company's historical experience, calculating the contractual allowance reserve percentage at the payor level is sufficient to allow us to provide the necessary detail and accuracy with its collectibility estimates. However, the services authorized and provided and related reimbursement are subject to interpretation that could result in payments that differ from our estimates. Payor terms are periodically revised necessitating continual review and assessment of the estimates made by management. The Company's billing systems may not capture the exact change in our contractual allowance reserve estimate from period to period in order to assess the accuracy of our revenues and hence our contractual allowance reserves. Management regularly compares its cash collections to corresponding net revenues measured both in the aggregate and on a clinic-by-clinic basis. In the aggregate, historically the difference between net revenues and corresponding cash collections has generally reflected a difference within approximately 1% of net revenues. Additionally, analysis of subsequent period's contractual write-offs on a payor basis shows a less than 1% difference between the actual aggregate contractual reserve percentage as compared to the estimated contractual allowance reserve percentage associated with the same period end balance. As a result, the Company believes that a reasonable likely change in the contractual allowance reserve estimate would not likely be more than 1% at March 31, 2008.

Income Taxes

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

In June 2006, the FASB issued FIN 48, Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109, Accounting for Income Taxes. FIN 48 prescribes a model for how a company is to recognize, measure, present and disclose in its financial statements uncertain positions that a company has taken or plans to take on a future tax return. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures. The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company did not have any unrecognized tax benefits for federal, state and local tax jurisdictions.

In May 2007, the FASB issued FASB Staff Position No. FIN 48-1, Definition of a Settlement in FASB Interpretation No. 48 (FIN 48-1). FIN 48-1 provides guidance on how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. In determining whether a tax position has been effectively settled, entities must evaluate (i) whether taxing authorities have completed their examination procedures; (ii) whether the entity intends to appeal or litigate any aspect of a tax position included in a completed evaluation; and (iii) whether it is remote that a taxing authority would examine or re-examine any aspect of a taxing position. FIN 48-1 was applied upon the initial adoption of FIN 48. There was no effect on the financial condition or results of operations due to the implementation of FIN 48 and FIN 48-1.

Estimated interest and penalties related to potential underpayment on any unrecognized tax benefits are to be classified as a component of tax expense in the Consolidated Statement of Operations. As of the date of adoption of FIN 48, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the three months ended March 31, 2008.

The Company accrued state and federal income taxes at an effective tax rate of 39.5% and 38.8% for the three months ended March 31, 2008 and 2007, respectively.

Table of Contents**Fair Values of Financial Instruments**

The carrying amounts reported in the balance sheet for cash and cash equivalents, accounts receivable, accounts payable and notes payable approximate their fair values due to the short-term maturity of these financial instruments. The carrying amount of the revolving line of credits approximates its fair value. The interest rate on the revolving line of credit is set at various short-term intervals based on current market conditions.

Segment Reporting

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

Use of Estimates

In preparing the Company's consolidated financial statements, management makes certain estimates and assumptions that affect the amounts reported in the consolidated financial statements and related disclosures. Actual results may differ from these estimates.

Self-Insurance Program

The Company utilizes a self-insurance plan for its employee group health insurance coverage administered by a third party. Predetermined loss limits have been arranged with the insurance company to limit the Company's maximum liability and cash outlay. Accrued expenses include the estimated incurred but unreported costs to settle unpaid claims and estimated future claims. Management believes that the current accrued amounts are sufficient to pay claims arising from self insurance incurred during the three months ended March 31, 2008.

Stock Options

Effective January 1, 2006, the Company adopted Statement No. 123R, Shared-Based Payment (SFAS 123R), which requires companies to measure and recognize compensation expense for all stock-based payments at fair value. SFAS 123R was applied on the modified prospective basis. Under the modified prospective basis, SFAS 123R applies to new awards and to awards that were outstanding on January 1, 2006 that are subsequently modified, repurchased or cancelled. Under the modified prospective basis, compensation cost recognized includes compensation for all stock-based payments granted prior to, but not yet vested on January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123, and compensation cost for the stock-based payments granted subsequent to January 1, 2006, based on the grant-date fair value with the provisions of SFAS 123R. No stock options were granted during the three months ended March 31, 2008.

The impact of adopting SFAS 123R on January 1, 2006 resulted in lowering net income and net income per diluted share for the three months ended March 31, 2008 and 2007 as follows (in thousands, except per share data):

| | Three Months Ended March 31, | |
|---|---------------------------------|--------|
| | 2008 | 2007 |
| After tax effect of stock option compensation expense | \$ 141 | \$ 145 |
| Effect on diluted earnings per share | \$0.01 | \$0.01 |

As of March 31, 2008, the future pre-tax expense of nonvested stock options is \$1.3 million to be recognized through 2010.

Table of Contents**Restricted Stock**

Restricted stock issued to employees is subject to continued employment and typically the transfer restrictions lapse in equal installments on the following five anniversaries of the date of grant. Compensation expense for grants of restricted stock is recognized based on the fair value per share on the date of grant amortized over the vesting period. For the quarters ended March 31, 2008 and 2007, compensation expense for restricted stock grants was \$105,000 and \$21,000, respectively. The Compensation Committee of the Board of Directors, which administers the Company's employee benefit programs, granted 5,000 shares of restricted stock to one employee in the three months ended March 31, 2008.

Recently Adopted Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, (SFAS 157) which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles (GAAP). As a result of SFAS 157, there is now a common definition of fair value to be used throughout GAAP. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The adoption of SFAS 157 did not have a material impact on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (SFAS 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value and is effective for fiscal years beginning after November 15, 2007 or January 1, 2008 for the Company. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to adopt the provisions of SFAS No. 157. The adoption of SFAS 159 did not have a material impact on our consolidated financial statements.

Recently Promulgated Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS No. 141R). SFAS No. 141R replaces SFAS No. 141, *Business Combinations*, and applies to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS No. 141R requires an acquirer, upon initially obtaining control of another entity, to recognize the assets, liabilities and any non-controlling interest in the acquiree at fair value as of the acquisition date. Contingent consideration is required to be recognized and measured at fair value on the date of acquisition rather than at a later date when the amount of that consideration may be determinable beyond a reasonable doubt. This fair value approach replaces the cost-allocation process required under SFAS No. 141 whereby the cost of an acquisition was allocated to the individual assets acquired and liabilities assumed based on their estimated fair value. SFAS No. 141R requires acquirers to expense acquisition-related costs as incurred rather than allocating such costs to the assets acquired and liabilities assumed, as was previously the case under SFAS No. 141. Under SFAS No. 141R, the requirements of SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* would have to be met in order to accrue for a restructuring plan in purchase accounting. Pre-acquisition contingencies are to be recognized at fair value, unless it is a non-contractual contingency that is not likely to materialize, in which case, nothing should be recognized in purchase accounting and, instead, that contingency would be subject to the probable and estimable recognition criteria of SFAS No. 5, *Accounting for Contingencies*. SFAS No. 141R may have a significant impact on our accounting for business combinations closing on or after January 1, 2009. In December 2007 the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements: an amendment of ARB No. 51* (SFAS 160). SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest (formerly referred to as minority interests) in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to a noncontrolling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, SFAS 160 requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gains or loss will be measured using

the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS 160 is effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008, with early adoption prohibited. The Company is in the process of determining the impact of the adoption of this standard on the Company's financial position, results of operations, and cash flows.

Table of Contents**2. EARNINGS PER SHARE**

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

| | Three Months Ended March 31, | |
|---|---------------------------------|----------|
| | 2008 | 2007 |
| Numerator: | | |
| Net income from continuing operations | \$ 2,385 | \$ 1,844 |
| Net loss from discontinued operations | | (15) |
| Net income | \$ 2,385 | \$ 1,829 |
| Denominator: | | |
| Denominator for basic earnings per share weighted-average shares | 11,852 | 11,501 |
| Effect of dilutive securities: | | |
| Stock options | 62 | 88 |
| Denominator for diluted earnings per share adjusted weighted-average shares and assumed conversions | 11,914 | 11,589 |
| Earnings per share: | | |
| Basic income from continuing operations | \$ 0.20 | \$ 0.16 |
| Basic loss from discontinued operations | | |
| Total basic earnings per share | \$ 0.20 | \$ 0.16 |
| Diluted income from continuing operations | \$ 0.20 | \$ 0.16 |
| Diluted loss from discontinued operations | | |
| Total diluted earnings per share | \$ 0.20 | \$ 0.16 |

Options to purchase 423,000 and 456,000 shares for the three months ended March 31, 2008 and 2007, respectively, were excluded from the diluted earnings per share calculations for the respective periods because the options exercise prices were greater than the average market price of the common shares during the periods.

3. ACQUISITIONS**Acquisition of Businesses**

Effective January 1, 2008, the Company acquired a physical therapy practice located in Oakland County, Michigan (Oakland County Michigan Acquisition). The purchase price was \$2,800,000 in cash. In addition, the Company incurred \$30,000 of acquisition costs. The acquisition yielded \$2.7 million of tax deductible goodwill. In addition, the Company acquired assets of \$29,000 and entered into non competition agreements valued at \$106,000. The results of operations of this clinic are included in the results of the Company for the quarter ended March 31, 2008. Unaudited proforma consolidated financial information for the Oakland County Michigan Acquisition has not been included as the results were not material to current operations.

The STAR Acquisition closed on September 6, 2007. The Company acquired a 70% interest with the existing partners retaining a 30% interest. The Company paid \$23.3 million (inclusive of certain capitalized acquisition costs) including

\$19.2 million in cash, promissory notes aggregating \$1.0 million and 227,618 in restricted shares of the Company's common stock representing an aggregate of \$3.1 million based on the market price of \$13.72 per share. The amount of the consideration was derived through arm's length negotiations. Funding for the cash portion of the STAR Acquisition was derived from \$9.2 million of existing cash and \$10.0 million of the proceeds from the Company's credit agreement, dated as of August 27, 2007 among the Company, as the Borrower, Bank of America, N. A., as Administrative Agent, Swing Line Lender and L/C Issuer ("Credit Agreement").

The Company is permitted to make, and has occasionally made, changes to preliminary purchase price allocations during the first year after completing an acquisition.

Table of Contents**Acquisitions of Minority Interests**

During the first quarter of 2008, the Company purchased the minority interest in a limited partnership for an aggregate purchase price of \$259,000. The purchase yielded \$235,000 of goodwill. The remaining \$24,000 represented payments of undistributed earnings to the minority limited partners. In addition, during the first quarter of 2008, the Company paid \$50,000 for a contingent payment due on the purchase of a minority interest in 2006. The \$50,000 was recognized as goodwill.

During 2007, the Company purchased the minority interest in several limited partnerships in separate transactions for an aggregate purchase price of \$731,000. The purchases yielded \$512,000 of goodwill related to two of the partnerships and the remaining \$219,000 represented payment of undistributed earnings to the minority limited partners.

For all minority interest purchases noted above, the Company paid or has agreed to pay to the minority limited partner any pro rata undistributed earnings earned through an agreed date prior to the purchase date.

The Company's minority interest purchases were accounted for as purchases and accordingly, the results of operations of the acquired minority interest are included in the accompanying financial statements from the dates of purchase. In addition, the Company is permitted to make, and has occasionally made, changes to preliminary purchase price allocations during the first year after completing the purchase.

The changes in the carrying amount of goodwill consisted of the following (in thousands):

| | Quarter Ended March 31, 2008 |
|-------------------------------------|---------------------------------------|
| Beginning balance | \$ 37,650 |
| Goodwill acquired during the period | 2,981 |
| Ending balance | \$ 40,631 |

4. NOTES PAYABLE

Notes payable as of March 31, 2008 and December 31, 2007 consist of the following (in thousands):

| | 2008 | 2007 |
|---|-----------|----------|
| Revolving credit agreement, average interest rate of 3.85% | \$ 9,800 | \$ 7,000 |
| Various promissory notes payable in annual installments of an aggregate of \$333 plus accrued interest through September 6, 2010, interest accrues at 8.25% per annum | 1,000 | 1,000 |
| Promissory note payable in quarterly installments of \$73 plus accrued interest through November 17, 2009, interest accrues at 7.5% per annum | 512 | 585 |
| Promissory note payable in quarterly installments of \$42 plus accrued interest through May 18, 2008, interest accrues at 6% per annum | 42 | 83 |
| Promissory note payable in quarterly installments of \$26 plus accrued interest through December 19, 2008, interest accrues at 5.75% per annum | 103 | 103 |
| | 11,457 | 8,771 |
| Less current portion | (771) | (812) |
| | \$ 10,686 | \$ 7,959 |

Effective August 27, 2007, the Company entered into the Credit Agreement with a commitment for a \$30,000,000 revolving credit facility. The Credit Agreement can be increased to \$50,000,000 subject to certain terms and conditions. The Credit Agreement has a four year term, is unsecured and includes standard financial covenants.

Proceeds from the Credit Agreement may be used to finance acquisitions, working capital, capital expenditures and for other corporate purposes. Interest expense on borrowings is based on a pricing grid tied to the Company's overall financial leverage with the applicable spread over LIBOR ranging from .5% to 1.5%. There are fees under the Credit Agreement including a closing fee of .25% and an unused commitment fee ranging from .1% to .35% depending on financial leverage and the amount of funds outstanding under the agreement.

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In connection with the STAR Acquisition in September 2007, the Company incurred notes payable in the aggregate totaling \$1,000,000 payable in equal annual installments of \$333,333 beginning September 6, 2008 plus any accrued and unpaid interest. Interest accrues at a fixed rate of 8.25% per annum. The final principal payment and any accrued and unpaid interest then outstanding is due and payable on September 6, 2010.

In connection with the acquisition of an eight-clinic practice in Arizona in December 2006, the Company incurred a note payable in the amount of \$877,500, payable in equal quarterly principal installments of \$73,125 beginning March 1, 2007 plus any accrued and unpaid interest. Interest accrues at a fixed rate of 7.5% per annum. The final principal payment and any accrued and unpaid interest then outstanding is due and payable on November 17, 2009.

In connection with the acquisition of two physical therapy clinics located in Alaska on December 19, 2005, the Company incurred a note payable in the amount of \$309,710, payable in equal quarterly principal installments of \$25,809 beginning April 1, 2006 plus any accrued and unpaid interest. Interest accrues at a fixed rate of 5.75% per annum. The final principal payment and any accrued and unpaid interest then outstanding is due and payable on December 19, 2008.

In connection with the acquisition of three physical and occupational therapy clinics located in New Jersey on May 18, 2005, the Company incurred a note payable in the amount of \$500,000, payable in equal quarterly principal installments of \$41,667 beginning September 1, 2005 plus any accrued and unpaid interest. Interest accrues at a fixed rate of 6% per annum. The final principal payment and any accrued and unpaid interest then outstanding is due and payable on May 18, 2008.

Aggregate annual payments of principal pursuant to the above notes payable required subsequent to March 31, 2008 are as follows (in thousands):

| | |
|---|-----------|
| During the twelve months ended March 31, 2009 | \$ 771 |
| During the twelve months ended March 31, 2010 | 553 |
| During the twelve months ended March 31, 2011 | 333 |
| During the twelve months ended March 31, 2012 | 9,800 |
| | \$ 11,457 |

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.****EXECUTIVE SUMMARY****Our Business**

We operate outpatient physical and/or occupational therapy clinics that provide preventive and post-operative care for a variety of orthopedic-related disorders and sports-related injuries, treatment for neurologically-related injuries and rehabilitation of injured workers. At March 31, 2008, we operated 351 outpatient physical and occupational therapy clinics in 42 states. Of these operating clinics, we have developed 280 and acquired 71. During the first quarter of 2008, we added four new clinics that we developed, acquired one clinic and closed three. The average age of our clinics at March 31, 2008 was 5.8 years.

Effective September 1, 2007, the Company acquired a majority interest in STAR, a multi partner outpatient rehabilitation practice with operations in the southeast United States. STAR owns and operates 51 outpatient physical and occupational therapy clinics and manages eight other facilities for third parties. The results of operations of the acquired clinics have been included in our consolidated financial statements since the effective date of their acquisition.

In addition to our owned clinics, we also manage physical therapy facilities for third parties, primarily physicians, with 11 third-party facilities under management as of March 31, 2008.

Selected Operating and Financial Data

The following table presents selected operating and financial data that we believe are key indicators of our operating performance.

| | For the Three Months Ended March 31, | |
|---|---|----------|
| | 2008 | 2007 |
| Number of clinics, at the end of period | 351 | 293 |
| Working Days | 64 | 64 |
| Average visits per day per clinic | 20.3 | 19.1 |
| Total patient visits | 454,482 | 359,032 |
| Net patient revenue per visit | \$ 97.25 | \$ 95.47 |
| Statement of operations per visit: | | |
| Net revenues | \$ 99.57 | \$ 96.43 |
| Salaries and related costs | 53.03 | 49.90 |
| Rent, clinic supplies, contract labor and other | 21.13 | 20.69 |
| Provision for doubtful accounts | 1.65 | 1.76 |
| Contribution from clinics | 23.76 | 24.08 |
| Corporate office costs | 11.14 | 12.14 |
| Operating income from continuing operations | \$ 12.62 | \$ 11.94 |

RESULTS OF OPERATIONS**Three Months Ended March 31, 2008 Compared to the Three Months Ended March 31, 2007**

Net revenues increased to \$45.3 million for the three months ended March 31, 2008 (2008 First Quarter) from \$34.6 million for the three months ended March 31, 2007 (2007 First Quarter) due to a 26.6% increase in patient visits from 359,000 to 454,500 and a \$1.78 increase from \$95.47 to \$97.25 in net patient revenue per visit. The 2008 figures include the results for the STAR clinics and the Oakland County Michigan clinic acquired in September 2007 and January 2008, respectively.

Net income for the 2008 First Quarter was \$2.4 million versus \$1.8 million for the same period last year. Net income was \$0.20 per diluted share for the 2008 First Quarter as compared to \$0.16 per diluted share for the 2007 First Quarter. Total diluted shares were 11.9 million for the 2008 First Quarter and 11.6 million for the 2007 First Quarter.

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Net Patient Revenues

Net patient revenues increased to \$44.2 million for the 2008 First Quarter from \$34.3 million for the 2007 First Quarter, an increase of \$9.9 million, or 28.9%, due to a 26.6% increase in patient visits to 454,500 and an increase of \$1.78 in net patient revenues per visit to \$97.25 from \$95.47.

Total patient visits increased 95,500, or 26.6%, to 454,500 for the 2008 First Quarter from 359,000 for the 2007 First Quarter. The growth in visits was attributable to an increase of approximately 91,600 visits in clinics opened or acquired between April 1, 2007 and March 31, 2008 (New Clinics) and by an increase of 3,900 for clinics opened or acquired prior to April 1, 2007 (Mature Clinics).

The \$9.9 million net patient revenues increase for the 2008 First Quarter included approximately \$8.6 million from New Clinics and an increase of \$1.3 million from Mature Clinics. The \$1.3 million increase from Mature Clinics included a \$0.7 million increase for clinics opened or acquired in 2006 and in the 2007 First Quarter.

Net patient revenues are based on established billing rates less allowances and discounts for patients covered by contractual programs and workers compensation. Net patient revenues are after contractual and other adjustments relating to patient discounts from certain payors. Payments received under these programs are based on predetermined rates and are generally less than the established billing rates of the clinics.

Management Contract and Other Revenues

Management contract and other revenues increased by approximately \$710,000 from \$344,000 to \$1,054,000 due to inclusion of revenues from the STAR management contracts and clinics.

Clinic Operating Costs

Clinic operating costs as a percentage of net revenues were 76.1% for the 2008 First Quarter and 75.0% for the 2007 First Quarter.

Clinic Operating Costs Salaries and Related Costs

Salaries and related costs increased to \$24.1 million for the 2008 First Quarter from \$17.9 million for the 2007 First Quarter, an increase of \$6.2 million, or 34.5%. Of the \$6.2 million increase, costs of \$5.9 million were incurred at the New Clinics and \$0.3 million at the Mature Clinics. Salaries and related costs as a percentage of net revenues were at 53.3% for the 2008 First Quarter and 51.8% for the 2007 First Quarter.

Clinic Operating Costs Rent, Clinic Supplies, Contract Labor and Other

Rent, clinic supplies, contract labor and other increased to \$9.6 million for the 2008 First Quarter from \$7.4 million for the 2007 First Quarter, an increase of \$2.2 million, or 29.3%. The \$2.2 million increase was incurred at the New Clinics. Rent, clinic supplies, contract labor and other remained the same during the periods for the Mature Clinics. Rent, clinic supplies, contract labor and other as a percentage of net revenues was 21.2% for the 2008 First Quarter and 21.5% for the 2007 First Quarter.

Clinic Operating Costs Provision for Doubtful Accounts

The provision for doubtful accounts was \$0.7 million for the 2008 First Quarter and \$0.6 million for the 2007 First Quarter. The provision for doubtful accounts as a percentage of net patient revenues was 1.7% for the 2008 First Quarter and 1.8% for the 2007 First Quarter. Our allowance for bad debts as a percent of total patient accounts receivable was 7.2% at March 31, 2008, as compared to 7.9% at December 31, 2007. Our days sales outstanding was 57 days at March 31, 2008 and 55 days at December 31, 2007.

Corporate Office Costs

Corporate office costs, consisting primarily of salaries and benefits of corporate office personnel, rent, insurance costs, depreciation and amortization, travel, legal, professional, and recruiting fees, were \$5.1 million, or 11.2% of net revenues, for the 2008 First Quarter and \$4.4 million, or 12.6% of net revenues for the 2007 First Quarter.

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Interest and investment income

Interest and investment income decreased to \$25,000 for the 2008 First Quarter from \$66,000 for the 2007 First Quarter primarily attributable to funds being used to fund the STAR Acquisition.

Interest expense

Interest expense increased to \$149,000 for the 2008 First Quarter from \$25,000 for the 2007 First Quarter primarily due to the borrowings in conjunction with the acquisitions on our revolving credit facility. At March 31, 2008, there was \$9.8 million outstanding on the revolving credit facility. See Liquidity and Capital Resources section below for a discussion of the terms of the Credit Agreement.

Minority Interests in Earnings of Subsidiary Limited Partnerships

Minority interests in earnings of subsidiary limited partnerships was \$1.7 million for the 2008 First Quarter and \$1.3 million for the 2007 First Quarter. Minority interest as a percentage of operating income before corporate office costs increased to 15.5% for the 2008 First Quarter as compared to 15.2% for the 2007 First Quarter.

Provision for Income Taxes

The provision for income taxes increased to \$1.6 million for the 2008 First Quarter from \$1.2 million for the 2007 First Quarter. During the 2008 First Quarter, the Company accrued state and federal income taxes at an effective tax rate of 39.5% versus 38.8% for the 2007 First Quarter.

LIQUIDITY AND CAPITAL RESOURCES

We believe that our business is generating sufficient cash flow from operating activities to allow us to meet our short-term and long-term cash requirements, other than with respect to future acquisitions. At March 31, 2008, we had \$9.2 million in cash and cash equivalents compared to \$8.0 million in cash and cash equivalents at December 31, 2007. Although the start-up costs associated with opening new clinics, and our planned capital expenditures are significant, we believe that our cash and cash equivalents and availability under our revolving credit agreement are sufficient to fund the working capital needs of our operating subsidiaries, payment of clinic closure costs accrued, future clinic development and investments through at least March 2009. Significant acquisitions would require financing. Included in cash and cash equivalents at March 31, 2008 were \$4.5 million in a money market fund. Cash, cash equivalents and marketable securities increased \$1.2 million from December 31, 2007 to March 31, 2008 due primarily to cash provided by operations of \$3.9 million and proceeds on the revolving credit facility of \$2.8 million. The major uses of cash included: purchase of business (\$2.8 million), purchase of fixed assets (\$0.9 million), purchase of intangibles limited partner interests (\$0.3 million), distributions to limited partners (\$1.5 million) and payment on notes payable (\$0.1 million).

Effective August 27, 2007, we entered into the Credit Agreement with a commitment for a \$30.0 million revolving credit facility. The Credit Agreement can be increased to \$50.0 million subject to certain terms and conditions. The Credit Agreement has a four year term, is unsecured and includes standard financial covenants. Proceeds from the Credit Agreement may be used to finance acquisitions, working capital, capital expenditures and for other corporate purposes. Interest expense on borrowings is based on a pricing grid tied to our overall financial leverage with the applicable spread over LIBOR ranging from .5% to 1.5%. There are fees under the Credit Agreement including a closing fee of .25% and an unused commitment fee ranging from .1% to .35% depending on financial leverage and the amount of funds outstanding under the agreement. On March 31, 2008, the outstanding balance on the revolving credit facility was \$9.8 million leaving \$20.2 million in availability.

Historically, we have generated sufficient cash from operations to fund our development activities and cover operational needs. We plan to continue developing new clinics and make additional acquisitions in select markets. We have from time to time purchased the minority interests of limited partners in our clinic partnerships. We may purchase additional minority interests in the future. Generally, any acquisition or purchase of minority interests is expected to be accomplished using a combination of cash and financing. Any large acquisition would likely require financing.

We make reasonable and appropriate efforts to collect accounts receivable, including applicable deductible and co-payment amounts, in a consistent manner for all payor types. Claims are submitted to payors daily, weekly or monthly in accordance with our policy or payor's requirements. When possible, we submit our claims electronically. The collection process is time consuming and typically involves the submission of claims to multiple payors whose

payment of claims may be dependent upon the payment of another payor. Claims under litigation and vehicular incidents can take a year or

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longer to collect. Medicare and other payor claims relating to new clinics awaiting Medicare Rehab Agency status approval initially may not be submitted for six months or more. When all reasonable internal collection efforts have been exhausted, accounts are written off prior to sending them to outside collection firms. With managed care, commercial health plans and self-pay payor type receivables, the write-off generally occurs after the account receivable has been outstanding for 120 days.

In connection with the STAR Acquisition, we incurred notes payable in the aggregate totaling \$1,000,000 payable in equal annual installments totaling \$333,333 beginning September 6, 2008 plus any accrued and unpaid interest. Interest accrues at a fixed rate of 8.25% per annum. The final principal payment and any accrued and unpaid interest then outstanding is due and payable on September 6, 2010. In addition, we assumed leases with remaining terms ranging from two months to six years for the operating facilities.

In conjunction with the acquisition of an eight-clinic practice in Arizona in November 2006, we entered into a note payable with the sellers in the amount of \$877,500 payable in equal quarterly principal installments of \$73,125, beginning March 1, 2007, plus any accrued and unpaid interest. Interest accrues at a fixed rate of 7.5% per annum. The final principal payment and any accrued and unpaid interest then outstanding is due and payable on the third anniversary of the note, November 17, 2009. The purchase agreement also provides for possible contingent consideration of up to \$1,500,000 based on the achievement of a certain designated level of operating results within a three-year period following the acquisition. In addition, we assumed leases with remaining terms ranging from one to five years for six of the eight operating facilities. With respect to the two remaining leased facilities, one is being leased on a month-to-month basis and the other was renewed for three years effective February 1, 2007.

In conjunction with the acquisition of the two-clinic practice in Alaska in December 2005, we entered into a note payable with the sellers in the amount of \$309,710 payable in equal quarterly principal installments of \$25,809, beginning April 1, 2006, plus any accrued and unpaid interest. Interest accrues at a fixed rate of 5.75% per annum. The final principal payment and any accrued and unpaid interest then outstanding is due and payable on the third anniversary of the note, December 19, 2008. The purchase agreement also provides for possible contingent consideration of up to \$325,000 based on the achievement of a certain designated level of operating results within a three-year period following the acquisition. In addition, we entered into a five-year lease for one of the facilities and assumed a lease expiring September 30, 2009 on the other facility.

In conjunction with the acquisition of the three-clinic practice in New Jersey in May 2005, we entered into a note payable with the sellers in the amount of \$500,000 payable in equal quarterly principal installments of \$41,667, beginning September 1, 2005, plus any accrued and unpaid interest. Interest accrues at a fixed rate of 6% per annum. The final principal payment and any accrued and unpaid interest then outstanding is due and payable on the third anniversary of the note, May 18, 2008. The purchase agreement also provides for possible contingent consideration of up to \$650,000 based on the achievement of a certain designated level of operating results within a three-year period following the acquisition. In addition, we entered into a five-year lease for each of the three facilities. In July 2006, we paid \$90,000 additional consideration related to this acquisition upon achievement of the predefined operating results for the first year, and such amount was added to goodwill.

Since September 2001, the Board of Directors (Board) has authorized us to purchase, in the open market or in privately negotiated transactions, up to 2,250,000 shares of its common stock. As of March 31, 2008, there were approximately 50,000 shares remaining that could be purchased under these programs. Since there is no expiration date for these share repurchase programs, additional shares may be purchased from time to time in the open market or private transactions depending on price, availability and our cash position. Shares purchased are held as treasury shares and may be used for such valid corporate purposes or retired as the Board considers advisable. We did not purchase any shares of our common stock during the 2008 First Quarter.

FACTORS AFFECTING FUTURE RESULTS*Clinic Development*

As of March 31, 2008, we had 351 clinics in operation, four of which were opened in the 2008 First Quarter and one of which was acquired in the 2008 First Quarter. During 2008, we expect to incur initial operating losses from new clinics opened in late 2007 and during 2008. Generally, we experience losses during the initial period of a new clinic's operation. Operating margins for newly opened clinics tend to be lower than for more seasoned clinics because of

start-up costs and lower patient visits and revenues. Generally, patient visits and revenues gradually increase in the first year of operation, as patients and referral sources become aware of the new clinic. Revenues typically continue to increase during the two to three years following the first anniversary of a clinic opening. Based on the historical performance of our new clinics, generally the clinics opened in the second half of 2007 would begin to favorably impact our results of operations beginning in late 2008.

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FORWARD LOOKING STATEMENTS

We make statements in this report that are considered to be forward-looking statements within the meaning under Section 21E of the Securities Exchange Act of 1934. These statements contain forward-looking information relating to the financial condition, results of operations, plans, objectives, future performance and business of our Company. These statements (often using words such as believes, expects, intends, plans, appear, should and similar words) involve risks and uncertainties that could cause actual results to differ materially from those we project. Included among such statements are those relating to opening new clinics, availability of personnel and the reimbursement environment. The forward-looking statements are based on our current views and assumptions and actual results could differ materially from those anticipated in such forward-looking statements as a result of certain risks, uncertainties, and factors, which include, but are not limited to:

revenue and earnings expectations;

general economic, business, and regulatory conditions including federal and state regulations;

availability and cost of qualified physical and occupational therapists;

personnel productivity;

changes in Medicare guidelines and reimbursement or failure of our clinics to maintain their Medicare certification status;

competitive and/or economic conditions in our markets which may require us to close certain clinics and thereby incur closure costs and losses including the possible write-down or write-off of goodwill;

changes in reimbursement rates or payment methods from third party payors including governmental agencies and deductibles and co-pays owed by patients;

maintaining adequate internal controls;

availability, terms, and use of capital;

acquisitions and the successful integration of the operations of the acquired businesses; and

weather and other seasonal factors.

Many factors are beyond our control.

Given these uncertainties, you should not place undue reliance on our forward-looking statements. Please see our other periodic reports filed with the Securities and Exchange Commission (the SEC) for more information on these factors. Our forward-looking statements represent our estimates and assumptions only as of the date of this report. Except as required by law, we are under no obligation to update any forward-looking statement, regardless of the reason the statement is no longer accurate.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We do not maintain any derivative instruments, interest rate swap arrangements, hedging contracts, futures contracts or the like. The Company's primary market risk exposure is the changes in interest rates obtainable on our revolving credit agreement. The interest on our revolving credit agreement is based on a variable rate. Based on the balance of the revolving credit facility at March 31, 2008, any change in the interest rate of 1% would yield a decrease or increase in annual interest expense of \$98,000.

ITEM 4. CONTROLS AND PROCEDURES.

(a) Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, the Company's Management completed an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded (i) that our disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure (ii) that our disclosure controls and procedures are effective.

(b) Changes in Internal Control

There have been no changes in our internal control over financial reporting during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION
ITEM 6. EXHIBITS.

EXHIBIT

| NO. | DESCRIPTION |
|-------|---|
| 31.1* | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 31.2* | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer |
| 31.3* | Rule 13a-14(a)/15d-14(a) Certification of Corporate Controller |
| 32* | Certification Pursuant to 18 U.S.C 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

* Filed herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on our behalf by the undersigned thereunto duly authorized.

U.S. PHYSICAL THERAPY, INC.

Date: May 8, 2008

By: /s/ LAWRANCE W. MCAFEE
Lawrance W. McAfee
Chief Financial Officer
(duly authorized officer and principal
financial
and accounting officer)

By: /s/ JON C. BATES
Jon C. Bates
Vice President/Corporate Controller

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| EXHIBIT NO. | DESCRIPTION |
|----------------|---|
| 31.1* | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer |
| 31.2* | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer |
| 31.3* | Rule 13a-14(a)/15d-14(a) Certification of Corporate Controller |
| 32* | Certification Pursuant to 18 U.S.C 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

* Filed herewith