

## SELECTED CONSOLIDATED FINANCIAL DATA

The following selected financial data for the five years ended March 31, 2002, have been derived from the Company's audited consolidated financial statements. The following data should be read in conjunction with the Company's Consolidated Financial Statements, the related notes thereto, and "Management's Discussion and Analysis of Financial Condition and Results of Operations." The following amounts are in thousands, except per share data. Historical common share amounts and earnings per share data for all periods presented have been restated to reflect a three-for-two stock dividend in the form of a 50% dividend in August 2001.

|  | <b>Year Ended March 31,</b> |                    |                    |                    |                    |
|--|-----------------------------|--------------------|--------------------|--------------------|--------------------|
|  | <b><u>1998</u></b>          | <b><u>1999</u></b> | <b><u>2000</u></b> | <b><u>2001</u></b> | <b><u>2002</u></b> |
| <b>Statement of Income Data:</b>               |                             |                    |                    |                    |                    |
| Revenues                                       | \$141,709                   | \$165,457          | \$186,765          | \$209,554          | \$235,912          |
| Costs and Expenses:                            |                             |                    |                    |                    |                    |
| Cost of revenues                               | 115,553                     | 136,082            | 152,710            | 172,010            | 193,225            |
| General and administrative                     | 11,029                      | 12,596             | 14,752             | 16,389             | 18,783             |
|  | <u>126,582</u>              | <u>148,678</u>     | <u>167,462</u>     | <u>188,399</u>     | <u>212,008</u>     |
| Income before income taxes                     | 15,127                      | 16,779             | 19,303             | 21,155             | 23,904             |
| Income tax provision                           | <u>5,670</u>                | <u>6,376</u>       | <u>7,336</u>       | <u>7,933</u>       | <u>9,083</u>       |
| Net income                                     | <u>\$ 9,457</u>             | <u>\$10,403</u>    | <u>\$ 11,967</u>   | <u>\$ 13,222</u>   | <u>\$ 14,821</u>   |
| Net income per share:                          |                             |                    |                    |                    |                    |
| Basic  | \$ .75                      | \$ .85             | \$ .99             | \$ 1.16            | \$ 1.34            |
| Diluted  | <u>\$ .74</u>               | <u>\$ .84</u>      | <u>\$ .98</u>      | <u>\$ 1.13</u>     | <u>\$ 1.30</u>     |
| Shares used in computing net income per share: |                             |                    |                    |                    |                    |
| Basic  |                             |                    |                    |                    |                    |
| Diluted  | 12,579                      | 12,233             | 12,032             | 11,399             | 11,043             |
|  | 12,858                      | 12,392             | 12,227             | 11,672             | 11,367             |
| Return on beginning of year equity             |                             |                    |                    |                    |                    |
| Return on beginning of year assets             | 20.5%                       | 22.7%              | 22.5%              | 23.9%              | 25.2%              |
|  | 16.1%                       | 17.2%              | 17.4%              | 18.6%              | 19.1%              |
| <b>Balance Sheet Data as of March 31,</b>      |                             |                    |                    |                    |                    |
|  | <b><u>1998</u></b>          | <b><u>1999</u></b> | <b><u>2000</u></b> | <b><u>2001</u></b> | <b><u>2002</u></b> |
| Cash and cash equivalents                      |                             |                    |                    |                    |                    |
| Accounts receivable, net                       | \$ 8,430                    | \$ 9,052           | \$ 5,643           | \$ 9,457           | \$ 12,601          |
| Working capital                                | 25,633                      | 31,562             | 35,874             | 34,316             | 33,040             |
| Total assets                                   | 24,726                      | 31,700             | 34,396             | 35,130             | 35,539             |
| Retained earnings                              | 60,491                      | 68,737             | 71,187             | 77,565             | 80,295             |
| Treasury stock                                 | 36,883                      | 47,286             | 59,253             | 72,475             | 87,296             |
| Total stockholders' equity                     | 21,727                      | 26,990             | 39,956             | 53,903             | 69,140             |
|  | 45,771                      | 53,214             | 55,293             | 58,718             | 60,983             |

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This Management's Discussion and Analysis of Financial Condition and Results of Operations may include certain forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including (without limitation) statements with respect to anticipated future operating and financial performance, growth and acquisition opportunities and other similar forecasts and statements of expectation. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates" and "should" and variations of these words and similar expressions, are intended to identify these forward- looking statements. Forward-looking statements made by the Company and its management are based on estimates, projections, beliefs and assumptions of management at the time of such statements and are not guarantees of future performance.

The Company disclaims any obligations to update or revise any forward-looking statement based on the occurrence of future events, the receipt of new information or otherwise. Actual future performance, outcomes and results may differ materially from those expressed in forward-looking statements made by the Company and its management as a result of a number of risks, uncertainties and assumptions. Representative examples of these factors include (without limitation) general industry and economic conditions; cost of capital and capital requirements; competition from other managed care companies; the ability to expand certain areas of the Company's business; shifts in customer demands; the ability of the Company to produce market-competitive software; changes in operating expenses including employee wages, benefits and medical inflation; governmental and public policy changes; dependence on key personnel; possible litigation and legal liability in the course of operations; and the continued availability of financing in the amounts and at the terms necessary to support the Company's future business.

The Company derives the majority of its revenues from providing patient management and provider program services to payors of workers' compensation benefits and health insurance benefits. Patient management services include early intervention, utilization review, medical case management, vocational rehabilitation, and independent medical examinations. Provider program revenues include fee schedule auditing, hospital bill auditing, and preferred provider referral services. The percentages of revenues attributable to patient management and provider program services for the fiscal years ended March 31, 2000, 2001, and 2002 are as follows:

|                             | <u>2000</u>   | <u>2001</u>   | <u>2002</u>   |
|-----------------------------|---------------|---------------|---------------|
| Patient management services | 59.9%         | 59.3%         | 54.7%         |
| Provider program services   | 40.1%         | 40.7%         | 45.3%         |
|                             | <u>100.0%</u> | <u>100.0%</u> | <u>100.0%</u> |

**Results of Operations**

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

|                            | <u>Year Ended March 31,</u> |             |             |
|----------------------------|-----------------------------|-------------|-------------|
|                            | <u>2000</u>                 | <u>2001</u> | <u>2002</u> |
| Revenues                   | 100.0%                      | 100.0%      | 100.0%      |
| Cost of revenues           | 81.8                        | 82.1        | 81.9        |
| Gross profit               | 18.2                        | 17.9        | 18.1        |
| General and administrative | 7.9                         | 7.8         | 8.0         |
| Income before income taxes | 10.3                        | 10.1        | 10.1        |
| Net income                 | 6.4                         | 6.3         | 6.3         |

*Years Ended March 31, 2000, 2001 and 2002*

Revenues for fiscal 2001 increased by 12% to \$210 million from \$187 million in fiscal 2000, an increase of \$23 million. The majority of this growth came from patient management services, which grew 11% from \$112 million in fiscal year 2000 to \$124 million in fiscal 2001, primarily due to an increase in referrals from existing customers. Provider program services increased 13%, by \$10 million from \$75 million in fiscal 2000 to \$85 million in fiscal 2001. This increase is primarily due to the increased volume of bills processed along with continued growth in the Company's provider network.

Revenues for fiscal 2002 increased by 13% to \$236 million from \$210 million in fiscal 2001, an increase of \$26 million. The majority of this growth came from provider program services, which grew 26% from \$85 million in fiscal year 2001 to \$107 million in fiscal 2002, primarily due to an increase in the number of bills reviewed along with an increase in the number of providers included in the Company's PPO network. Patient management services increased 4%, by \$5 million from \$124 million in fiscal 2001 to \$129 million in fiscal 2002.

The Company's cost of revenues consists primarily of salaries, salary related taxes and benefits, rent, telephone, and costs related to the Company's computer operations, including depreciation and amortization. Costs of revenues increased from \$153 million in fiscal 2000 and \$172 million in fiscal 2001, to \$193 million in fiscal 2002, primarily due to the increases in revenues as noted above.

Cost of services as a percentage of revenues was 81.8% during fiscal 2000 and 82.1% in fiscal 2001, and decreased to 81.9% in fiscal 2002. During fiscal 2002, the cost of revenue percentage decreased primarily due to the growth rate in the program services compared to the patient management services. Provider program services have a lower cost of services percentage than that of patient management services. There is no guarantee the cost of service percentage will remain constant or decrease, should the Company pursue a strategy of reducing price in order to obtain greater market share or if competition causes pricing pressure in the industry.

General and administrative expense increased from \$14.8 million in fiscal 2000 and \$16.4 million in fiscal 2001 to \$18.8 million in fiscal 2002. This increase was primarily due to increased MIS staff to support the Company's implementation of Care<sup>MC</sup> and further electronic data interface capabilities as required by customer needs. General and administrative expenses were 7.9%, 7.8%, and 8.0% for the years ended March 31, 2000, 2001 and 2002, respectively.

### **Liquidity and Capital Resources**

The Company has funded its operations and capital expenditures primarily from cash flow from operations. Net working capital remained unchanged at \$35 million at both March 31, 2001 and March 31, 2002. The increase in cash flow due to the net income of \$15 million was offset by \$15 million in repurchases of the Company's common stock in the open market. As of March 31, 2002, the Company had \$12 million in cash and cash equivalents, invested primarily in short-term, highly liquid investments with maturities of 90 days or less. The Company has no interest-bearing short-term debt.

The Company has historically required substantial capital to fund the growth of its operations, particularly working capital to fund the growth in accounts receivable and capital expenditures. The Company believes, however, that the cash balance at March 31, 2002 along with anticipated internally generated funds will be sufficient to meet the Company's expected cash requirements for at least the next twelve months.



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|  | <u>Year Ended March 31,</u> |                 |                  |                  |                  |
|--|-----------------------------|-----------------|------------------|------------------|------------------|
|  | <u>1998</u>                 | <u>1999</u>     | <u>2000</u>      | <u>2001</u>      | <u>2002</u>      |
| <b>Statement of Income Data:</b>               |                             |                 |                  |                  |                  |
| Revenues                                       | \$141,709                   | \$165,457       | \$186,765        | \$209,554        | \$235,912        |
| Costs and Expenses:                            |                             |                 |                  |                  |                  |
| Cost of revenues                               | 115,553                     | 136,082         | 152,710          | 172,010          | 193,225          |
| General and administrative                     | 11,029                      | 12,596          | 14,752           | 16,389           | 18,783           |
|  | <u>126,582</u>              | <u>148,678</u>  | <u>167,462</u>   | <u>188,399</u>   | <u>212,008</u>   |
| Income before income taxes                     | 15,127                      | 16,779          | 19,303           | 21,155           | 23,904           |
| Income tax provision                           | <u>5,670</u>                | <u>6,376</u>    | <u>7,336</u>     | <u>7,933</u>     | <u>9,083</u>     |
| Net income                                     | <u>\$ 9,457</u>             | <u>\$10,403</u> | <u>\$ 11,967</u> | <u>\$ 13,222</u> | <u>\$ 14,821</u> |
| Net income per share:                          |                             |                 |                  |                  |                  |
| Basic  | \$ .75                      | \$ .85          | \$ .99           | \$ 1.16          |                  |
| Diluted  | <u>\$ .74</u>               | <u>\$ .84</u>   | <u>\$ .98</u>    | <u>\$ 1.13</u>   | <u>\$ 1.34</u>   |
| Shares used in computing net income per share: |                             |                 |                  |                  | <u>\$ 1.30</u>   |
| Basic  |                             |                 |                  |                  |                  |
| Diluted  | 12,579                      | 12,233          | 12,032           | 11,399           | 11,043           |
|  | 12,858                      | 12,392          | 12,227           | 11,672           | 11,367           |
| Return on beginning of year equity             |                             |                 |                  |                  |                  |
| Return on beginning of year assets             | 20.5%                       | 22.7%           | 22.5%            | 23.9%            | 25.2%            |
|  | 16.1%                       | 17.2%           | 17.4%            | 18.6%            | 19.1%            |
| <b>Balance Sheet Data as of March 31,</b>      |                             |                 |                  |                  |                  |
|  | <u>1998</u>                 | <u>1999</u>     | <u>2000</u>      | <u>2001</u>      | <u>2002</u>      |
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The Company has historically required substantial capital to fund the growth of its operations, particularly working capital to fund the growth in accounts receivable and capital expenditures. The Company believes, however, that the cash balance at March 31, 2002 along with anticipated internally generated funds will be sufficient to meet the Company's expected cash requirements for at least the next twelve months.

## REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Stockholders and Board of Directors  
CorVel Corporation

We have audited the accompanying consolidated balance sheets of CorVel Corporation as of March 31, 2001 and 2002, and the related consolidated statements of income, stockholders' equity, and cash flows for the each of the two years in the period ended March 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of CorVel Corporation at March 31, 2001 and 2002, and the consolidated results of its operations and its cash flows for each of the two years in the period ended March 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

We have also audited Schedule II for each of the two years in the period ended March 31, 2002. In our opinion, this schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information therein.

/s/ Grant Thornton LLP

Portland, Oregon  
May 16, 2002

## **Report of Independent Auditors**

Stockholders and Board of Directors  
CorVel Corporation

We have audited the consolidated balance sheet of CorVel Corporation as of March 31, 2000 (not presented separately herein), and the related consolidated statement of income, stockholders' equity, and cash flows for the year ended March 31, 2000. Our audit also included the financial statement schedule listed in the Index at Item 14(a) for the year ended March 31, 2000. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of CorVel Corporation at March 31, 2000, and the consolidated results of its operations and its cash flows for the year ended March 31, 2000, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ ERNST & YOUNG LLP

Orange County, California  
May 9, 2000

**CORVEL CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME**

|  | <u>Years Ended March 31,</u> |                      |                      |
|--|------------------------------|----------------------|----------------------|
|  | <u>2000</u>                  | <u>2001</u>          | <u>2002</u>          |
| REVENUES                                       | \$186,765,000                | \$209,554,000        | \$235,912,000        |
|  |                              |                      |                      |
| COSTS AND EXPENSES                             |                              |                      |                      |
| Cost of revenues                               | 152,710,000                  | 172,010,000          | 193,225,000          |
| General and administrative                     | <u>14,752,000</u>            | <u>16,389,000</u>    | <u>18,783,000</u>    |
|  | <u>167,462,000</u>           | <u>188,399,000</u>   | <u>212,008,000</u>   |
| Income before income taxes                     | 19,303,000                   | 21,155,000           | 23,904,000           |
| Income tax provision                           | <u>7,336,000</u>             | <u>7,933,000</u>     | <u>9,083,000</u>     |
| NET INCOME                                     | <u>\$ 11,967,000</u>         | <u>\$ 13,222,000</u> | <u>\$ 14,821,000</u> |
|  |                              |                      |                      |
| Net income per share:                          |                              |                      |                      |
| Basic  | <u>\$ .99</u>                | <u>\$ 1.16</u>       | <u>\$ 1.34</u>       |
| Diluted  | <u>\$ .98</u>                | <u>\$ 1.13</u>       | <u>\$ 1.30</u>       |
|  |                              |                      |                      |
| Shares used in computing net income per share: |                              |                      |                      |
| Basic  | 12,032,000                   | 11,399,000           | 11,043,000           |
| Diluted  | 12,227,000                   | 11,672,000           | 11,367,000           |

See accompanying notes to consolidated financial statements.

**CORVEL CORPORATION  
CONSOLIDATED BALANCE SHEETS**

|   | <u>2001</u>          | <u>March 31,</u><br><u>2002</u> |
|---|----------------------|---------------------------------|
| <b>ASSETS</b>   |                      |                                 |
| Current Assets  |                      |                                 |
| Cash and cash equivalents   | \$ 9,457,000         | \$ 12,601,000                   |
| Accounts receivable (less allowance for doubtful accounts<br>of \$3,387,000 in 2001 and \$3,635,000 in 2002)  | 34,316,000           | 33,040,000                      |
| Prepaid expenses and taxes  | 2,465,000            | 1,299,000                       |
| Deferred income taxes   | <u>4,130,000</u>     | <u>4,236,000</u>                |
| Total current assets  | <u>50,368,000</u>    | <u>51,176,000</u>               |
| Property and equipment, net   | 20,071,000           | 22,481,000                      |
| Other assets  | <u>7,126,000</u>     | <u>6,638,000</u>                |
|   | <u>\$ 77,565,000</u> | <u>\$ 80,295,000</u>            |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                      |                                 |
| Current Liabilities   |                      |                                 |
| Accounts and taxes payable  | \$ 3,006,000         | \$ 3,432,000                    |
| Accrued liabilities   | <u>12,232,000</u>    | <u>12,205,000</u>               |
| Total current liabilities   | <u>15,238,000</u>    | <u>15,637,000</u>               |
| Deferred income taxes   | 3,609,000            | 3,675,000                       |
| Commitments and Contingencies (Note H)  |                      |                                 |
| Stockholders' Equity  |                      |                                 |
| Common Stock, \$.0001 par value: 20,000,000 shares authorized;<br>15,444,704 and 15,617,381 shares issued and outstanding in 2001<br>and 2002, respectively | 2,000                | 2,000                           |
| Paid-in Capital   | 40,144,000           | 42,825,000                      |
| Treasury Stock, at cost (4,211,910 shares in 2001 and 4,769,780<br>shares in 2002)  | (53,903,000)         | (69,140,000)                    |
| Retained Earnings   |                      |                                 |
| Total stockholders' equity  | <u>72,475,000</u>    | <u>87,296,000</u>               |
|   | <u>\$ 77,565,000</u> | <u>\$ 80,295,000</u>            |

See accompanying notes to consolidated financial statements.

**CORVEL CORPORATION**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY - Continued**  
**Years Ended March 31, 2000, 2001, and 2002**

|   | <b>Common<br/>stock- shares</b> | <b>Common stock<br/>- amount</b> | <b>Common stock<br/>and paid in<br/>capital</b> | <b>Treasury<br/>Shares</b> |
|---|---------------------------------|----------------------------------|---|----------------------------|
| Balance - March 31, 1999  | 14,828,364                      | \$2,000                          | \$ 32,916,000                                   | (2,620,920)                |
| Stock issued under employee<br>stock purchase plan  | 52,200                          | -                                | 588,000   | -                          |
| Stock issued and income tax<br>benefits under stock option plan,<br>net of shares repurchased | 237,938                         | -                                | 2,490,000                                       | -                          |
| Purchase of common stock  | -                               | -                                | -   | (879,090)                  |
| Net income  | -                               | -                                | -   | -                          |
| Balance - March 31, 2000  | 15,118,502                      | 2,000                            | 35,994,000                                      | (3,500,010)                |
| Stock issued under employee<br>stock purchase plan  | 45,108                          | -                                | 687,000   | -                          |
| Stock issued and income tax<br>benefits under stock option plan,<br>net of shares repurchased | 281,094                         | -                                | 3,463,000                                       | -                          |
| Purchase of common stock  | -                               | -                                | -   | (711,900)                  |
| Net income  | -                               | -                                | -   | -                          |
| Balance - March 31, 2001  | 15,444,704                      | 2,000                            | 40,144,000                                      | (4,211,910)                |
| Stock issued under employee<br>stock purchase plan  | 36,951                          | -                                | 788,000   | -                          |
| Stock issued and income tax<br>benefits under stock option plan,<br>net of shares repurchased | 135,726                         | -                                | 1,893,000                                       | -                          |
| Purchase of common stock  | -                               | -                                | -   | (557,870)                  |
| Net income  | -                               | -                                | -   | -                          |
| Balance - March 31, 2002  | 15,617,381                      | \$2,000                          | \$42,825,000                                    | (4,769,780)                |

See accompanying notes to consolidated financial statements.

**CORVEL CORPORATION**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY - Continued**  
**Years Ended March 31, 2000, 2001, and 2002**

|   | <b>Treasury shares<br/>– cost</b> | <b>Retained<br/>Earnings</b> | <b>Total<br/>shareholders'<br/>equity</b> |
|---|-----------------------------------|------------------------------|---|
| Balance - March 31, 1999  | \$ (26,990,000)                   | \$ 47,286,000                | \$53,214,000                              |
| Stock issued under employee stock purchase plan   | -                                 | -                            | 588,000                                   |
| Stock issued and income tax benefits under stock option plan, net of shares repurchased | -                                 | -                            | 2,490,000                                 |
| Purchase of common stock  | (12,966,000)                      | -                            | (12,966,000)                              |
| Net income  | -                                 | 11,967,000                   | 11,967,000                                |
| Balance - March 31, 2000  | (39,956,000)                      | 59,253,000                   | 55,293,000                                |
| Stock issued under employee stock purchase plan   | -                                 | -                            | 687,000                                   |
| Stock issued and income tax benefits under stock option plan                            | -                                 | -                            | 3,463,000                                 |
| Purchase of common stock  | (13,947,000)                      | -                            | (13,947,000)                              |
| Net income  | -                                 | 13,222,000                   | 13,222,000                                |
| Balance - March 31, 2001  | (53,903,000)                      | 72,475,000                   | 58,718,000                                |
| Stock issued under employee stock purchase plan   | -                                 | -                            | 788,000                                   |
| Stock issued and income tax benefits under stock option plan, net of shares repurchased | -                                 | -                            | 1,893,000                                 |
| Purchase of common stock  | (15,237,000)                      | -                            | (15,237,000)                              |
| Net income  | -                                 | 14,821,000                   | 14,821,000                                |
| Balance - March 31, 2002  | \$(69,140,000)                    | \$87,296,000                 | \$60,983,000                              |

See accompanying notes to consolidated financial statements.

**CORVEL CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

|  | <u>Years Ended March 31,</u> |                            |                             |
|--|------------------------------|----------------------------|-----------------------------|
|  | <u>2000</u>                  | <u>2001</u>                | <u>2002</u>                 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |                              |                            |                             |
| Net income   | \$ 11,967,000                | \$ 13,222,000              | \$ 14,821,000               |
| Adjustments to reconcile net income<br>to net cash provided by operating activities: |                              |                            |                             |
| Depreciation   | 6,965,000                    | 6,759,000                  | 8,414,000                   |
| Deferred income taxes  | (131,000)                    | 303,000                    | (40,000)                    |
| Loss and (gain) on disposal of property and<br>equipment                             | 192,000                      | (45,000)                   | 52,000                      |
| Changes in operating assets and liabilities:   |                              |                            |                             |
| Accounts receivable  | (4,312,000)                  | 1,558,000                  | 1,276,000                   |
| Prepaid expenses and taxes   | (1,075,000)                  | (534,000)                  | 1,166,000                   |
| Accounts and taxes payable   | (1,158,000)                  | (2,304,000)                | 426,000                     |
| Accrued liabilities  | 1,050,000                    | 4,657,000                  | (27,000)                    |
| Other assets   | (779,000)                    | 149,000                    | 488,000                     |
| Net cash provided by operating activities  | <u>12,719,000</u>            | <u>23,765,000</u>          | <u>26,576,000</u>           |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |                              |                            |                             |
| Purchases of property and equipment  | (6,240,000)                  | (10,154,000)               | (10,876,000)                |
| Net cash used in investing activities  | <u>(6,240,000)</u>           | <u>(10,154,000)</u>        | <u>(10,876,000)</u>         |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |                              |                            |                             |
| Proceeds and tax benefits from exercise of stock options                             | 3,078,000                    | 4,150,000                  | 2,681,000                   |
| Purchase of common stock   | (12,966,000)                 | (13,947,000)               | (15,237,000)                |
| Net cash used in financing activities  | <u>(9,888,000)</u>           | <u>(9,797,000)</u>         | <u>(12,556,000)</u>         |
| Net increase (decrease) in cash and cash equivalents                                 | (3,409,000)                  | 3,814,000                  | 3,144,000                   |
| Cash and cash equivalents at beginning of year                                       | 9,052,000                    | 5,643,000                  | 9,457,000                   |
| <b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>                                      | <u><u>\$ 5,643,000</u></u>   | <u><u>\$ 9,457,000</u></u> | <u><u>\$ 12,601,000</u></u> |

See accompanying notes to consolidated financial statements.

**CorVel Corporation**  
**Notes to Consolidated Financial Statements**  
**March 31, 2002**

**Note A – Summary of Significant Accounting Policies**

Organization: CorVel Corporation (CorVel or the Company) provides services and programs nationwide that are designed to enable insurance carriers, third party administrators and self-insured employers with self-insured programs to administer, manage and control the cost of workers' compensation and other healthcare benefits.

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

Use of Estimates: The preparation of financial statements in conforming with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements. Actual results could differ from those estimates.

Cash and Cash Equivalents: Cash and cash equivalents consists of short-term highly-liquid investments with maturities of 90 days or less when purchased. The carrying amounts of the Company's financial instruments approximate their relative fair values at March 31, 2001 and 2002.

Revenue Recognition: The Company's revenues are recognized primarily as services are rendered based on time and expenses incurred. A certain portion of the Company's revenues are derived from fee schedule auditing which is based on the number of provider charges audited and, to a limited extent, on a percentage of savings achieved for the Company's clients. Accounts receivable includes \$3,749,000 and \$3,267,000 of unbilled receivables at March 31, 2001 and 2002, respectively. No one customer accounted for more than 10% of consolidated revenues during the years ended March 31, 2000, 2001 and 2002.

Property and Equipment: Additions to property and equipment are recorded at cost. Depreciation and amortization are provided using the straight-line and accelerated methods over the estimated useful lives of the related assets which range from three to seven years.

The Company capitalized software development costs, intended for internal use, totaling \$3,250,000 and \$4,704,000 for the years ended March 31, 2001 and 2002, respectively. These costs are included in computer software in property and equipment and are amortized over a period of five years.

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

Other Assets: Other assets consists primarily of the excess of the purchase price over the estimated fair value of the net assets of businesses acquired (goodwill) and is being amortized using the straight-line method over periods not exceeding 40 years. Goodwill amounted to \$5,978,000 (net of accumulated amortization of \$1,672,000) at March 31, 2001 and \$5,775,000 (net of accumulated amortization of \$2,047,000) at March 31, 2002.

Concentrations of Credit Risk: The Company performs periodic credit evaluations of its customers' financial condition and does not require collateral. No single customer accounted for 10% of accounts receivable in 2001 or 2002. Receivables are generally due within 60 days. Credit losses relating to customers in the workers' compensation insurance industry consistently have been within management's expectations.

**CorVel Corporation**  
**Notes to Consolidated Financial Statements**  
**March 31, 2002**

Income Taxes: The Company provides for income taxes under the liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities as measured by the enacted tax rates which are expected to be in effect when these differences reverse. Income tax expense is the tax payable for the period and the change during the period in net deferred tax assets and liabilities.

Earnings Per Share: Earnings per common share-basic is based on the weighted average number of common shares outstanding during the period. Earnings per common shares-diluted is based on the weighted average number of common shares and common share equivalents outstanding during the period. In calculating earnings per share, earnings are the same for the basic and diluted calculations. Weighted average shares outstanding are increased for diluted earnings calculations to reflect the effect of stock options.

All common shares outstanding and earnings per shares have been adjusted to reflect the three-for-two stock split in the form of a 50% dividend paid in August 2001.

Stock Option Plans: The Company applies the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123) and accordingly, is continuing to account for its stock-based compensation plans under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations.

Recent Pronouncements: In July, 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." These statements make significant changes to the accounting for business combinations, goodwill, and intangible assets. SFAS No. 141 establishes new standards for accounting and reporting requirements for business combinations and will require that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method will be prohibited.

SFAS No. 142 establishes new standards for goodwill acquired in a business combination and eliminates amortization of goodwill and instead sets forth methods to periodically evaluate goodwill for impairment. Intangible assets with a determinable useful life will be continue to be amortized over that period. The Company expects to adopt SFAS 142 during the first quarter of fiscal 2003. Management is in the process of evaluating the requirements of this statement. The final determination of the impact of these statements has not been completed.

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 143, "Accounting for Asset Retirement Obligations." This statement addresses the financial accounting and reporting for the retirement of tangible long-lived assets and the associated asset retirement costs. The Company believes the adoption of SFAS 143 will have no significant impact on its financial statements.

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This statement addresses the financial accounting and reporting for the impairment or disposal of long-lived assets. The Company believes the adoption of SFAS 144 will have no significant impact on its financial statements.

**Notes to Consolidated Financial Statements**  
**March 31, 2002**

**Note B – Property and Equipment**

Property and equipment consists of the following at March 31:

|   | <u>2001</u>          | <u>2002</u>          |
|---|----------------------|----------------------|
| Office equipment and computers                  | \$ 27,560,000        | \$ 31,775,000        |
| Computer software                               | 14,201,000           | 20,019,000           |
| Leasehold improvements                          | 1,731,000            | 2,004,000            |
|   | <hr/>                | <hr/>                |
|   | 43,492,000           | 53,798,000           |
| Less: accumulated depreciation and amortization | 23,421,000           | 31,317,000           |
|   | <hr/>                | <hr/>                |
|   | <u>\$ 20,071,000</u> | <u>\$ 22,481,000</u> |

**Note C – Accrued Liabilities**

Accrued liabilities consists of the following at March 31:

|                              | <u>2001</u>          | <u>2002</u>          |
|------------------------------|----------------------|----------------------|
| Payroll and related benefits | \$ 9,401,000         | \$ 8,623,000         |
| Self-insurance accruals      | 2,131,000            | 3,029,000            |
| Other                        | 700,000              | 553,000              |
|                              | <hr/>                | <hr/>                |
|                              | <u>\$ 12,232,000</u> | <u>\$ 12,205,000</u> |

**Note D - Income Taxes**

The income tax provision consists of the following for the three years ended March 31:

|                    | <u>2000</u>         | <u>2001</u>         | <u>2002</u>         |
|--------------------|---------------------|---------------------|---------------------|
| Current – Federal  | \$ 6,745,000        | \$ 7,010,000        | \$ 8,226,000        |
| Current – State    | 722,000             | 620,000             | 897,000             |
|                    | <hr/>               | <hr/>               | <hr/>               |
| Subtotal           | 7,467,000           | 7,630,000           | 9,123,000           |
|                    | <hr/>               | <hr/>               | <hr/>               |
| Deferred – Federal | (118,000)           | 277,000             | (36,000)            |
| Deferred – State   | (13,000)            | 26,000              | (4,000)             |
|                    | <hr/>               | <hr/>               | <hr/>               |
| Subtotal           | (131,000)           | 303,000             | (40,000)            |
|                    | <hr/>               | <hr/>               | <hr/>               |
|                    | <u>\$ 7,336,000</u> | <u>\$ 7,933,000</u> | <u>\$ 9,083,000</u> |

## March 31, 2002

### Note D - Income Taxes (continued)

Income tax benefits associated with the exercise of stock options were \$577,000, \$673,000 and \$606,000 for fiscal 2000, 2001, and 2002, respectively.

The following is a reconciliation of the income tax provision from the statutory federal income tax rate to the effective rate for the three years ended March 31:

|  | <u>2000</u>         | <u>2001</u>        | <u>2002</u>         |
|--|---------------------|--------------------|---------------------|
| Income taxes at federal statutory rate     | \$ 6,756,000        | \$7,404,000        | \$ 8,336,000        |
| State income taxes, net of federal benefit | 465,000             | 646,000            | 893,000             |
| Goodwill amortization                      | 115,000             | 47,000             | 40,000              |
| Other                                      | -                   | (164,000)          | (186,000)           |
|  | <u>\$ 7,336,000</u> | <u>\$7,933,000</u> | <u>\$ 9,083,000</u> |

Income taxes paid totaled \$9,307,000, \$7,570,000 and \$7,910,000 for the years ended March 31, 2000, 2001, and 2002, respectively.

Deferred taxes at March 31, 2001 and 2002 are:

|  | <u>2001</u>        | <u>2002</u>        |
|--|--------------------|--------------------|
| <i>Deferred tax assets:</i>                    |                    |                    |
| Accrued liabilities not currently deductible   | \$ 2,806,000       | \$ 2,849,000       |
| Allowance for doubtful accounts                | 1,321,000          | 1,385,000          |
| Other  | <u>3,000</u>       | <u>2,000</u>       |
| Deferred assets                                | 4,130,000          | 4,236,000          |
| <i>Deferred tax liabilities:</i>               |                    |                    |
| Excess of tax under book basis of fixed assets | (3,067,000)        | (3,205,000)        |
| Other  | <u>(542,000)</u>   | <u>(470,000)</u>   |
| Deferred liability                             | <u>(3,609,000)</u> | <u>(3,675,000)</u> |
| Net deferred tax asset                         | <u>\$ 521,000</u>  | <u>\$ 561,000</u>  |

### Note E - Stock Option Plans

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB No. 25) and related interpretations in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under SFAS No. 123 requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB No. 25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Under the Company's Restated 1988 Executive Stock Option Plan, ("the Plan") as amended, options for up to 5,955,000 shares (adjusted for the three-for-two stock split in the form of a 50% stock dividend in August 2001) of the Company's common stock may be granted to key employees, non employee directors and consultants at prices not less than 85% of the fair value of the stock at the date of grant as determined by the Board. Options granted under the Plan may be either incentive stock options or non-statutory stock options and are generally exercisable beginning one year from the date of grant and vest monthly thereafter for three years.

**March 31, 2002**

**Note E - Stock Option Plans (continued)**

Summarized information for all stock options for the past three fiscal year follows:

|  | <u>2000</u>      | <u>2001</u>      | <u>2002</u>      |
|--|------------------|------------------|------------------|
| Options outstanding at beginning of year | 1,194,609        | 1,184,014        | 1,104,994        |
| Options granted                          | 263,250          | 290,550          | 278,702          |
| Options exercised                        | (246,470)        | (281,094)        | (146,988)        |
| Options cancelled                        | (27,375)         | (88,476)         | (18,620)         |
| Options outstanding at end of year       | <u>1,184,014</u> | <u>1,104,994</u> | <u>1,218,088</u> |

|   | <u>2000</u> | <u>2001</u> | <u>2002</u> |
|---|-------------|-------------|-------------|
| During the year, weighted average price of: |             |             |             |
| Options granted                             | \$14.09     | \$19.03     | \$26.82     |
| Options exercised                           | 8.27        | 10.05       | 10.88       |
| Options cancelled                           | 11.68       | 13.03       | 16.23       |

|                                     |                |                |                |
|-------------------------------------|----------------|----------------|----------------|
| At the end of the year:             |                |                |                |
| Price range of outstanding options  | \$5.67-\$15.75 | \$5.67-\$23.17 | \$5.67-\$30.55 |
| Weighted average price of options   | \$11.33        | \$13.53        | \$16.86        |
| Options available for future grants | 702,522        | 501,869        | 990,317        |
| Exercisable options                 | 509,834        | 482,441        | 587,803        |

The following table summarizes the status of stock options outstanding and exercisable at March 31, 2002:

| Range of<br>Exercise Prices | Number of<br>Outstanding<br>Options | Weighted<br>Average<br>Remaining<br>Contractual<br>Life | Outstanding<br>Options -<br>Weighted<br>Average<br>Exercise Price | Exercisable<br>Options -<br>Number of<br>Exercisable<br>Options | Exercisable<br>Options -<br>Weighted<br>Average<br>Exercise Price |
|-----------------------------|-------------------------------------|---|---|---|---|
| \$ 5.67 - \$12.00           | 371,248                             | 2.14 years  | \$10.48   | 290,305   | \$10.68   |
| 12.01 - 16.00               | 301,697                             | 2.65 years  | 13.57   | 204,481   | 13.31   |
| 16.01 - 24.00               | 267,641                             | 3.80 years  | 19.07   | 93,017  | 18.75   |
| 24.01 - 30.55               | 277,502                             | 4.78 years  | 26.83   | -   | -   |
| Total                       | <u>1,218,088</u>                    | <u>3.23 years</u>                                       | <u>\$16.86</u>  | <u>587,803</u>  | <u>\$12.87</u>  |

The Company has adopted the disclosure-only provisions of SFAS No. 123. Had compensation cost for the Company's stock option and stock purchase plans been recorded consistent with the provisions of SFAS No. 123, net income, net income per share-basic and net income per common share-diluted would have been as follows for the three fiscal years ending March 31:

|                                | <u>2000</u>  | <u>2001</u>  | <u>2002</u>  |
|--------------------------------|--------------|--------------|--------------|
| Net income – adjusted          | \$11,406,000 | \$12,584,000 | \$14,016,000 |
| Net income per share – basic   | \$0.95       | \$1.11       | \$1.27       |
| Net income per share – diluted | \$0.93       | \$1.08       | \$1.23       |

The weighted average fair values at date of grant for options during fiscal 2000, 2001, and 2002, were \$4.37, \$6.39, and \$6.38, respectively.

**Note E - Stock Option Plans (continued)**

The fair value of each option is estimated on the date of grant using the Black-Scholes option-pricing model. The following weighted average assumptions were used for fiscal years ending March 31:

|                         | <u>2000</u> | <u>2001</u> | <u>2002</u> |
|-------------------------|-------------|-------------|-------------|
| Expected volatility     | .37         | .41         | .28         |
| Risk free interest rate | 6.6%        | 4.8%        | 4.3%        |

The assumptions for all three years reflect no dividend yield and a weighted average option life of 4.7 years for fiscal 2000 and 2001, and 4.6 years for fiscal 2002.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

The number of shares to be issued, the weighted average exercise price of outstanding options, and the number of securities remaining available for future issuance under all stock option plans, including the 1991 Employee Stock Purchase Plan described in Note F below are as follows:

| <u>Plan category</u>                                       | <u>Number of securities to be issued upon exercised of outstanding options, warrants and rights</u> | <u>Weighted -average exercise price of outstanding options, warrants and rights</u> | <u>Number of securities remaining available for future issuance under equity compensation plans</u> |
|--|---|---|---|
| Equity compensation plans approved by security holders     | 1,218,088   | \$16.86   | 1,149,910   |
| Equity compensation plans not approved by security holders | -   | -   | -   |
| Total  | <u>1,218,088</u>  | <u>\$16.86</u>  | <u>1,149,910</u>  |

**CorVel Corporation**  
**Notes to Consolidated Financial Statements**  
**March 31, 2002**

#### **Note F - Employee Stock Purchase Plan**

The Company maintains an Employee Stock Purchase Plan which allows employees of the Company and its subsidiaries to purchase shares of common stock on the last day of two six-month purchase periods (i.e. March 31 and September 30) at a purchase price which is 85% of the closing sale price of shares as quoted on NASDAQ on the first or last day of such purchase period, whichever is lower. Employees are allowed to participate up to 20% of their gross pay. A maximum of 750,000 shares has been authorized for issuance under the plan, as amended. As of March 31, 2002, 590,407 shares had been issued pursuant to the plan. Summarized plan information is as follows:

|                        | <u>2000</u> | <u>2001</u> | <u>2002</u> |
|------------------------|-------------|-------------|-------------|
| Employee contributions | \$588,000   | \$687,000   | \$788,000   |
| Shares acquired        | 52,200      | 45,108      | 36,951      |
| Average purchase price | \$11.26     | \$15.23     | \$21.32     |

#### **Note G - Treasury Stock**

The Company's Board of Directors has approved a plan to repurchase up to 5,100,000 shares of the Company's outstanding common stock. Purchases may be made from time to time depending on market conditions and other relevant factors. The share repurchases for fiscal years ending March 31, 2000, 2001 and 2002 are as follows:

|                    | <u>2000</u>  | <u>2001</u>  | <u>2002</u>  | <u>Cumulative</u> |
|--------------------|--------------|--------------|--------------|-------------------|
| Shares repurchased | 879,090      | 711,900      | 557,870      | 4,769,780         |
| Cost               | \$12,966,000 | \$13,947,000 | \$15,237,000 | \$69,140,000      |
| Average price      | \$14.75      | \$19.59      | \$27.31      | \$14.50           |

The repurchased shares were recorded as treasury stock, at cost, and are available for general corporate purposes. The repurchases were financed from cash generated from operations.

#### **Note H - Commitments and Contingencies**

The Company leases office facilities under non cancelable operating leases. Future minimum rental commitments under operating leases at March 31, 2002 are \$7,134,000 in fiscal 2003, \$6,273,000 in fiscal 2004, \$5,189,000 in fiscal 2005, \$4,070,000 in fiscal 2006, \$2,715,000 in fiscal 2007, and \$992,000 thereafter. Total rental expense of \$7,100,000, \$8,685,000, and \$9,926,000 was charged to operations for the years ended March 31, 2000, 2001, and 2002, respectively.

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

## Note I - Savings Plan

The Company maintains a retirement savings plan for its employees, which is a qualified plan under Section 401(k) of the Internal Revenue Code. Full-time employees that meet certain requirements are eligible to participate in the plan. Company contributions are made annually primarily at the discretion of the Company's Board of Directors. Contributions of \$199,000, \$224,000, and \$247,000, were charged to operations for the years ended March 31, 2000, 2001 and 2002, respectively.

## Note J – Subsequent Events – Acquisition and Shareholder Rights Plan

On May 16, 2002, the Company acquired Ancicare, PPO, Inc., a Florida-based national provider of diagnostic imaging services. The down payment for the acquisition was paid from the Company's existing cash on hand. If the results of the Ancicare operations attain certain levels, the Company will pay an additional amount for the purchase which is expected to be funded from future earnings of the Company.

During fiscal 1997, the Company's Board of Directors approved the adoption of a Shareholder Rights Plan. The Rights Plan, which is similar to rights plans adopted by numerous other public companies, provides for a dividend distribution to CorVel stockholders of one preferred stock purchase "Right" for each outstanding share of CorVel's common stock. The Rights are designed to assure that all stockholders receive fair and equal treatment in the event of any proposed takeover of the company and to encourage a potential acquirer to negotiate with the Board of Directors prior to attempting a takeover. In April, 2002, the Board of Directors of the Company approved an amendment to the Company's existing stockholder rights agreement to extend the expiration date of the rights to February 10, 2012, increase the initial exercise price of each right to \$118. The Rights will not be exercisable until the occurrence of certain takeover-related events. The issuance of the Rights has no dilutive effect on the Company's earnings per share.

## Note K - Quarterly Results

The following is a summary of unaudited results of operations for the two years ended March 31, 2001 and 2002:

| <b>Fiscal Year Ended</b> |                 |                     |                   | Net income<br>per basic<br><u>common share</u> | Net income<br>per diluted<br><u>common share</u> |
|--------------------------|-----------------|---------------------|-------------------|--|--|
| <b>March 31, 2001:</b>   | <u>Revenues</u> | <u>Gross Margin</u> | <u>Net Income</u> |  |  |
| First Quarter            | \$50,557,000    | \$9,328,000         | \$3,227,000       | \$.28  | \$.27  |
| Second Quarter           | 51,658,000      | 9,347,000           | 3,272,000         | .29  | .28  |
| Third Quarter            | 52,241,000      | 9,059,000           | 3,328,000         | .29  | .29  |
| Fourth Quarter           | 55,098,000      | 9,810,000           | 3,395,000         | .30  | .29  |
| <b>Fiscal Year Ended</b> |                 |                     |                   |  |  |
| <b>March 31, 2002:</b>   |                 |                     |                   |  |  |
| First Quarter            | \$58,001,000    | \$10,364,000        | \$3,593,000       | \$.32  | \$.31  |
| Second Quarter           | 58,411,000      | 10,482,000          | 3,640,000         | .33  | .32  |
| Third Quarter            | 58,724,000      | 10,701,000          | 3,755,000         | .34  | .33  |
| Fourth Quarter           | 60,776,000      | 11,140,000          | 3,833,000         | .35  | .34  |

## EXHIBIT INDEX

| <b><u>Exhibit<br/>No.</u></b> | <b><u>Title - - Method of Filing</u></b>   | <b><u>Page</u></b> |
|-------------------------------|--|--------------------|
| 3.1                           | Certificate of Incorporation of the Company - - Incorporated herein by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1 Registration No. 33-40629.   |                    |
| 3.2                           | Bylaws of the Company - - Incorporated herein by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 Registration No. 33-40629.   |                    |
| 10.1                          | Nonqualified Stock Option Agreement between V. Gordon Clemons, the Company and North Star together with all amendments and addendums thereto - - Incorporated herein by reference to Exhibit 10.6 to the Company's Registration Statement on Form S-1 Registration No. 33-40629. |                    |
| 10.2                          | Supplementary Agreement between V. Gordon Clemons, the Company and North Star - - Incorporated herein by reference to Exhibit 10.7 to the Company's Registration Statement on Form S-1 Registration No. 33-40629.  |                    |
| 10.3                          | Amendment to Supplementary Agreement between Mr. Clemons, the Company and North Star - - Incorporated herein by reference to Exhibit 10.5 to the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 1992.  |                    |
| 10.4                          | Restated 1988 Executive Stock Option Plan, as amended - - Incorporated herein by reference to Exhibit 10.5 to the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 1995.   |                    |
| 10.5                          | Form of Notice of Grant of Stock Option Under the Restated 1988 Executive Stock Option Plan - - Incorporated herein by reference to the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 1994.   |                    |
| 10.6                          | Form of Stock Option Agreement under the Restated 1988 Executive Stock Option Plan - - Incorporated herein by reference to the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 1994.  |                    |

## **EXHIBIT INDEX (continued)**

| <b>Exhibit<br/>No.</b> | <b><u>Title - - Method of Filing</u></b>   | <b><u>Page</u></b> |
|------------------------|--|--------------------|
| 10.7                   | Form of Notice of Exercise under the Restated 1988 Executive Stock Option Plan - - Incorporated herein by reference to the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 1994.        |                    |
| 10.8                   | Employment Agreement of V. Gordon Clemons - - Incorporated herein by reference to Exhibit 10.12 to the Company's Registration Statement on Form S-1 Registration No. 33-40629.                                   |                    |
| 10.9                   | Restated 1991 Employee Stock Purchase Plan, as amended - - Incorporated herein by reference to Exhibit 10.11 in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 1995.               |                    |
| 10.10                  | Fidelity Master Plan for Savings and Investments, and amendments - - Incorporated herein by reference to Exhibit 10.16 and 10.16A to the Company's Registration Statement on Form S-1 Registration No. 33-40629. |                    |
| 10.11                  | Shareholder Rights Plan - - Incorporated herein by reference to the Company's 8-K filed on February 28, 1997.  |                    |
| 10.12                  | Amended Shareholder Rights Plan - - Incorporated herein by reference to the Company's 8-K filed on May 24, 2002.   |                    |
| 21.1                   | Subsidiaries of the Company - - Attached.  |                    |
| 23.1                   | Consent of Independent Certified Public Accountants - - Attached.  |                    |
| 23.2                   | Consent of Independent Certified Public Accountants - - Attached.  |                    |

**EXHIBIT 21.1 - - SUBSIDIARIES OF THE REGISTRANT**

| <u>Name of Subsidiary</u>      | <u>State of Incorporation</u> | <u>Relationship to Registrant</u> |
|--------------------------------|-------------------------------|-----------------------------------|
| CorVel Healthcare Organization | California                    | wholly-owned subsidiary           |
| CorVel Health Care Corporation | California                    | wholly-owned subsidiary           |

**EXHIBIT 23.1 - - CONSENT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS**

We have issued our report dated May 16, 2002, accompanying the consolidated financial statements and financial statement schedule in the Annual Report of CorVel Corporation on Form 10-K for the year ended March 31, 2002. We hereby consent to the incorporation by reference of said report in the Registration Statements of CorVel Corporation on Form S-8 (File Nos. 33-42554, 33-48186, and 33-42424).

/s/ GRANT THORNTON LLP

Portland, Oregon  
June 26, 2002

## EXHIBIT 23.2 - - CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in the Registration Statements (Form S-8 Nos. 33-42554, 33-48186, and 33-42424) pertaining to the Employee Stock Option and Employee Stock Purchase Plans of CorVel Corporation of our report dated May 9, 2000, included in the Annual Report (Form 10-K) for the year ended March 31, 2002, with respect to the consolidated balance sheet of CorVel Corporation as of March 31, 2000 (not presented separately therein), and the related consolidated statements of income, stockholders' equity, and cash flows and related financial statement schedule for the year ended March 31, 2000.

/s/ ERNST & YOUNG LLP

Orange County, California  
June 26, 2002

**CORVEL CORPORATION  
CONSOLIDATED BALANCE SHEETS**

|   | <u>2001</u>          | <u>March 31,</u><br><u>2002</u> |
|---|----------------------|---------------------------------|
| <b>ASSETS</b>   |                      |                                 |
| Current Assets  |                      |                                 |
| Cash and cash equivalents   | \$ 9,457,000         | \$ 12,601,000                   |
| Accounts receivable (less allowance for doubtful accounts<br>of \$3,387,000 in 2001 and \$3,635,000 in 2002)  | 34,316,000           | 33,040,000                      |
| Prepaid expenses and taxes  | 2,465,000            | 1,299,000                       |
| Deferred income taxes   | <u>4,130,000</u>     | <u>4,236,000</u>                |
| Total current assets  | <u>50,368,000</u>    | <u>51,176,000</u>               |
| Property and equipment, net   | 20,071,000           | 22,481,000                      |
| Other assets  | <u>7,126,000</u>     | <u>6,638,000</u>                |
|   | <u>\$ 77,565,000</u> | <u>\$ 80,295,000</u>            |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                      |                                 |
| Current Liabilities   |                      |                                 |
| Accounts and taxes payable  | \$ 3,006,000         | \$ 3,432,000                    |
| Accrued liabilities   | <u>12,232,000</u>    | <u>12,205,000</u>               |
| Total current liabilities   | <u>15,238,000</u>    | <u>15,637,000</u>               |
| Deferred income taxes   | 3,609,000            | 3,675,000                       |
| Commitments and Contingencies (Note H)  |                      |                                 |
| Stockholders' Equity  |                      |                                 |
| Common Stock, \$.0001 par value: 20,000,000 shares authorized;<br>15,444,704 and 15,617,381 shares issued and outstanding in 2001<br>and 2002, respectively | 2,000                | 2,000                           |
| Paid-in Capital   | 40,144,000           | 42,825,000                      |
| Treasury Stock, at cost (4,211,910 shares in 2001 and 4,769,780<br>shares in 2002)  | (53,903,000)         | (69,140,000)                    |
| Retained Earnings   |                      |                                 |
| Total stockholders' equity  | <u>72,475,000</u>    | <u>87,296,000</u>               |
|   | <u>58,718,000</u>    | <u>60,983,000</u>               |
|   | <u>\$ 77,565,000</u> | <u>\$ 80,295,000</u>            |

**CORVEL CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

|  | <u>Years Ended March 31,</u> |                            |                             |
|--|------------------------------|----------------------------|-----------------------------|
|  | <u>2000</u>                  | <u>2001</u>                | <u>2002</u>                 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |                              |                            |                             |
| Net income   | \$ 11,967,000                | \$ 13,222,000              | \$ 14,821,000               |
| Adjustments to reconcile net income<br>to net cash provided by operating activities: |                              |                            |                             |
| Depreciation   | 6,965,000                    | 6,759,000                  | 8,414,000                   |
| Deferred income taxes  | (131,000)                    | 303,000                    | (40,000)                    |
| Loss and (gain) on disposal of property and<br>equipment                             | 192,000                      | (45,000)                   | 52,000                      |
| Changes in operating assets and liabilities:   |                              |                            |                             |
| Accounts receivable  | (4,312,000)                  | 1,558,000                  | 1,276,000                   |
| Prepaid expenses and taxes   | (1,075,000)                  | (534,000)                  | 1,166,000                   |
| Accounts and taxes payable   | (1,158,000)                  | (2,304,000)                | 426,000                     |
| Accrued liabilities  | 1,050,000                    | 4,657,000                  | (27,000)                    |
| Other assets   | (779,000)                    | 149,000                    | 488,000                     |
| Net cash provided by operating activities  | <u>12,719,000</u>            | <u>23,765,000</u>          | <u>26,576,000</u>           |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |                              |                            |                             |
| Purchases of property and equipment  | (6,240,000)                  | (10,154,000)               | (10,876,000)                |
| Net cash used in investing activities  | <u>(6,240,000)</u>           | <u>(10,154,000)</u>        | <u>(10,876,000)</u>         |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |                              |                            |                             |
| Proceeds and tax benefits from exercise of stock options                             | 3,078,000                    | 4,150,000                  | 2,681,000                   |
| Purchase of common stock   | (12,966,000)                 | (13,947,000)               | (15,237,000)                |
| Net cash used in financing activities  | <u>(9,888,000)</u>           | <u>(9,797,000)</u>         | <u>(12,556,000)</u>         |
| Net increase (decrease) in cash and cash equivalents                                 | (3,409,000)                  | 3,814,000                  | 3,144,000                   |
| Cash and cash equivalents at beginning of year                                       | 9,052,000                    | 5,643,000                  | 9,457,000                   |
| <b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>                                      | <u><u>\$ 5,643,000</u></u>   | <u><u>\$ 9,457,000</u></u> | <u><u>\$ 12,601,000</u></u> |

**CORVEL CORPORATION**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**Years Ended March 31, 2000, 2001, and 2002**

|   | <b>Common<br/>stock- shares</b> | <b>Common stock<br/>- amount</b> | <b>Common stock<br/>and paid in<br/>capital</b> | <b>Treasury<br/>Shares</b> |
|---|---------------------------------|----------------------------------|---|----------------------------|
| Balance - March 31, 1999  | 14,828,364                      | \$2,000                          | \$ 32,916,000                                   | (2,620,920)                |
| Stock issued under employee<br>stock purchase plan  | 52,200                          | -                                | 588,000   | -                          |
| Stock issued and income tax<br>benefits under stock option plan,<br>net of shares repurchased | 237,938                         | -                                | 2,490,000                                       | -                          |
| Purchase of common stock  | -                               | -                                | -   | (879,090)                  |
| Net income  | -                               | -                                | -   | -                          |
| Balance - March 31, 2000  | 15,118,502                      | 2,000                            | 35,994,000                                      | (3,500,010)                |
| Stock issued under employee<br>stock purchase plan  | 45,108                          | -                                | 687,000   | -                          |
| Stock issued and income tax<br>benefits under stock option plan,<br>net of shares repurchased | 281,094                         | -                                | 3,463,000                                       | -                          |
| Purchase of common stock  | -                               | -                                | -   | (711,900)                  |
| Net income  | -                               | -                                | -   | -                          |
| Balance - March 31, 2001  | 15,444,704                      | 2,000                            | 40,144,000                                      | (4,211,910)                |
| Stock issued under employee<br>stock purchase plan  | 36,951                          | -                                | 788,000   | -                          |
| Stock issued and income tax<br>benefits under stock option plan,<br>net of shares repurchased | 135,726                         | -                                | 1,893,000                                       | -                          |
| Purchase of common stock  | -                               | -                                | -   | (557,870)                  |
| Net income  | -                               | -                                | -   | -                          |
| Balance - March 31, 2002  | 15,617,381                      | \$2,000                          | \$42,825,000                                    | (4,769,780)                |

**CORVEL CORPORATION**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY - Continued**  
**Years Ended March 31, 2000, 2001, and 2002**

|   | <b>Treasury shares<br/>– cost</b> | <b>Retained<br/>Earnings</b> | <b>Total<br/>shareholders'<br/>equity</b> |
|---|-----------------------------------|------------------------------|---|
| Balance - March 31, 1999  | \$ (26,990,000)                   | \$ 47,286,000                | \$53,214,000                              |
| Stock issued under employee stock purchase plan   | -                                 | -                            | 588,000                                   |
| Stock issued and income tax benefits under stock option plan, net of shares repurchased | -                                 | -                            | 2,490,000                                 |
| Purchase of common stock  | (12,966,000)                      | -                            | (12,966,000)                              |
| Net income  | -                                 | 11,967,000                   | 11,967,000                                |
| Balance - March 31, 2000  | (39,956,000)                      | 59,253,000                   | 55,293,000                                |
| Stock issued under employee stock purchase plan   | -                                 | -                            | 687,000                                   |
| Stock issued and income tax benefits under stock option plan                            | -                                 | -                            | 3,463,000                                 |
| Purchase of common stock  | (13,947,000)                      | -                            | (13,947,000)                              |
| Net income  | -                                 | 13,222,000                   | 13,222,000                                |
| Balance - March 31, 2001  | (53,903,000)                      | 72,475,000                   | 58,718,000                                |
| Stock issued under employee stock purchase plan   | -                                 | -                            | 788,000                                   |
| Stock issued and income tax benefits under stock option plan, net of shares repurchased | -                                 | -                            | 1,893,000                                 |
| Purchase of common stock  | (15,237,000)                      | -                            | (15,237,000)                              |
| Net income  | -                                 | 14,821,000                   | 14,821,000                                |
| Balance - March 31, 2002  | \$(69,140,000)                    | \$87,296,000                 | \$60,983,000                              |

## **Note A – Summary of Significant Accounting Policies**

Organization: CorVel Corporation (CorVel or the Company) provides services and programs nationwide that are designed to enable insurance carriers, third party administrators and self-insured employers with self-insured programs to administer, manage and control the cost of workers' compensation and other healthcare benefits.

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

Use of Estimates: The preparation of financial statements in conforming with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements. Actual results could differ from those estimates.

Cash and Cash Equivalents: Cash and cash equivalents consists of short-term highly-liquid investments with maturities of 90 days or less when purchased. The carrying amounts of the Company's financial instruments approximate their relative fair values at March 31, 2001 and 2002.

Revenue Recognition: The Company's revenues are recognized primarily as services are rendered based on time and expenses incurred. A certain portion of the Company's revenues are derived from fee schedule auditing which is based on the number of provider charges audited and, to a limited extent, on a percentage of savings achieved for the Company's clients. Accounts receivable includes \$3,749,000 and \$3,267,000 of unbilled receivables at March 31, 2001 and 2002, respectively. No one customer accounted for more than 10% of consolidated revenues during the years ended March 31, 2000, 2001 and 2002.

Property and Equipment: Additions to property and equipment are recorded at cost. Depreciation and amortization are provided using the straight-line and accelerated methods over the estimated useful lives of the related assets which range from three to seven years.

The Company capitalized software development costs, intended for internal use, totaling \$3,250,000 and \$4,704,000 for the years ended March 31, 2001 and 2002, respectively. These costs are included in computer software in property and equipment and are amortized over a period of five years.

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

Other Assets: Other assets consists primarily of the excess of the purchase price over the estimated fair value of the net assets of businesses acquired (goodwill) and is being amortized using the straight-line method over periods not exceeding 40 years. Goodwill amounted to \$5,978,000 (net of accumulated amortization of \$1,672,000) at March 31, 2001 and \$5,775,000 (net of accumulated amortization of \$2,047,000) at March 31, 2002.

Concentrations of Credit Risk: The Company performs periodic credit evaluations of its customers' financial condition and does not require collateral. No single customer accounted for 10% of accounts receivable in 2001 or 2002. Receivables are generally due within 60 days. Credit losses relating to customers in the workers' compensation insurance industry consistently have been within management's expectations.

Income Taxes: The Company provides for income taxes under the liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities as measured by the enacted tax rates which are expected to be in effect when these differences reverse. Income tax expense is the tax payable for the period and the change during the period in net deferred tax assets and liabilities.

Earnings Per Share: Earnings per common share-basic is based on the weighted average number of common shares outstanding during the period. Earnings per common shares-diluted is based on the weighted average number of common shares and common share equivalents outstanding during the period. In calculating earnings per share, earnings are the same for the basic and diluted calculations. Weighted average shares outstanding are increased for diluted earnings calculations to reflect the effect of stock options.

All common shares outstanding and earnings per shares have been adjusted to reflect the three-for-two stock split in the form of a 50% dividend paid in August 2001.

Stock Option Plans: The Company applies the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123) and accordingly, is continuing to account for its stock-based compensation plans under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations.

Recent Pronouncements: In July, 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." These statements make significant changes to the accounting for business combinations, goodwill, and intangible assets. SFAS No. 141 establishes new standards for accounting and reporting requirements for business combinations and will require that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method will be prohibited.

SFAS No. 142 establishes new standards for goodwill acquired in a business combination and eliminates amortization of goodwill and instead sets forth methods to periodically evaluate goodwill for impairment. Intangible assets with a determinable useful life will be continue to be amortized over that period. The Company expects to adopt SFAS 142 during the first quarter of fiscal 2003. Management is in the process of evaluating the requirements of this statement. The final determination of the impact of these statements has not been completed.

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 143, "Accounting for Asset Retirement Obligations." This statement addresses the financial accounting and reporting for the retirement of tangible long-lived assets and the associated asset retirement costs. The Company believes the adoption of SFAS 143 will have no significant impact on its financial statements.

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This statement addresses the financial accounting and reporting for the impairment or disposal of long-lived assets. The Company believes the adoption of SFAS 144 will have no significant impact on its financial statements.

**Note B – Property and Equipment**

Property and equipment consists of the following at March 31:

|                                | <u>2001</u>   | <u>2002</u>   |
|--------------------------------|---------------|---------------|
| Office equipment and computers | \$ 27,560,000 | \$ 31,775,000 |
| Computer software              | 14,201,000    | 20,019,000    |

|   |               |               |
|---|---------------|---------------|
| Leasehold improvements                          | 1,731,000     | 2,004,000     |
|   | <hr/>         | <hr/>         |
|   | 43,492,000    | 53,798,000    |
| Less: accumulated depreciation and amortization | 23,421,000    | 31,317,000    |
|   | <hr/>         | <hr/>         |
|   | \$ 20,071,000 | \$ 22,481,000 |
|   | <hr/> <hr/>   | <hr/> <hr/>   |

#### Note C – Accrued Liabilities

Accrued liabilities consists of the following at March 31:

|                              |                    |                    |
|------------------------------|--------------------|--------------------|
|                              | <b><u>2001</u></b> | <b><u>2002</u></b> |
| Payroll and related benefits | \$ 9,401,000       | \$ 8,623,000       |
| Self-insurance accruals      | 2,131,000          | 3,029,000          |
| Other                        | 700,000            | 553,000            |
|                              | <hr/>              | <hr/>              |
|                              | \$ 12,232,000      | \$ 12,205,000      |
|                              | <hr/> <hr/>        | <hr/> <hr/>        |

#### Note D - Income Taxes

The income tax provision consists of the following for the three years ended March 31:

|                    |                    |                    |                    |
|--------------------|--------------------|--------------------|--------------------|
|                    | <b><u>2000</u></b> | <b><u>2001</u></b> | <b><u>2002</u></b> |
| Current – Federal  | \$ 6,745,000       | \$ 7,010,000       | \$ 8,226,000       |
| Current – State    | 722,000            | 620,000            | 897,000            |
|                    | <hr/>              | <hr/>              | <hr/>              |
| Subtotal           | 7,467,000          | 7,630,000          | 9,123,000          |
|                    | <hr/>              | <hr/>              | <hr/>              |
| Deferred – Federal | (118,000)          | 277,000            | (36,000)           |
| Deferred – State   | (13,000)           | 26,000             | (4,000)            |
|                    | <hr/>              | <hr/>              | <hr/>              |
| Subtotal           | (131,000)          | 303,000            | (40,000)           |
|                    | <hr/>              | <hr/>              | <hr/>              |
|                    | \$ 7,336,000       | \$ 7,933,000       | \$ 9,083,000       |
|                    | <hr/> <hr/>        | <hr/> <hr/>        | <hr/> <hr/>        |

Income tax benefits associated with the exercise of stock options were \$577,000, \$673,000 and \$606,000 for fiscal 2000, 2001, and 2002, respectively.

The following is a reconciliation of the income tax provision from the statutory federal income tax rate to the effective rate for the three years ended March 31:

|  |                    |                    |                    |
|--|--------------------|--------------------|--------------------|
|  | <b><u>2000</u></b> | <b><u>2001</u></b> | <b><u>2002</u></b> |
| Income taxes at federal statutory rate     | \$ 6,756,000       | \$ 7,404,000       | \$ 8,336,000       |
| State income taxes, net of federal benefit | 465,000            | 646,000            | 893,000            |
| Goodwill amortization                      | 115,000            | 47,000             | 40,000             |
| Other                                      | -                  | (164,000)          | (186,000)          |

|              |             |              |
|--------------|-------------|--------------|
| \$ 7,336,000 | \$7,933,000 | \$ 9,083,000 |
|--------------|-------------|--------------|

Income taxes paid totaled \$9,307,000, \$7,570,000 and \$7,910,000 for the years ended March 31, 2000, 2001, and 2002, respectively.

Deferred taxes at March 31, 2001 and 2002 are:

|  | <u>2001</u>        | <u>2002</u>        |
|--|--------------------|--------------------|
| <i>Deferred tax assets:</i>                    |                    |                    |
| Accrued liabilities not currently deductible   | \$ 2,806,000       | \$ 2,849,000       |
| Allowance for doubtful accounts                | 1,321,000          | 1,385,000          |
| Other  | <u>3,000</u>       | <u>2,000</u>       |
| Deferred assets                                | 4,130,000          | 4,236,000          |
| <i>Deferred tax liabilities:</i>               |                    |                    |
| Excess of tax under book basis of fixed assets | (3,067,000)        | (3,205,000)        |
| Other  | <u>(542,000)</u>   | <u>(470,000)</u>   |
| Deferred liability                             | <u>(3,609,000)</u> | <u>(3,675,000)</u> |
| Net deferred tax asset                         | <u>\$ 521,000</u>  | <u>\$ 561,000</u>  |

#### Note E - Stock Option Plans

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB No. 25) and related interpretations in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under SFAS No. 123 requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB No. 25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Under the Company's Restated 1988 Executive Stock Option Plan, ("the Plan") as amended, options for up to 5,955,000 shares (adjusted for the three-for-two stock split in the form of a 50% stock dividend in August 2001) of the Company's common stock may be granted to key employees, non employee directors and consultants at prices not less than 85% of the fair value of the stock at the date of grant as determined by the Board. Options granted under the Plan may be either incentive stock options or non-statutory stock options and are generally exercisable beginning one year from the date of grant and vest monthly thereafter for three years.

Summarized information for all stock options for the past three fiscal year follows:

|  | <u>2000</u>      | <u>2001</u>      | <u>2002</u>      |
|--|------------------|------------------|------------------|
| Options outstanding at beginning of year | 1,194,609        | 1,184,014        | 1,104,994        |
| Options granted                          | 263,250          | 290,550          | 278,702          |
| Options exercised                        | (246,470)        | (281,094)        | (146,988)        |
| Options cancelled                        | (27,375)         | (88,476)         | (18,620)         |
| Options outstanding at end of year       | <u>1,184,014</u> | <u>1,104,994</u> | <u>1,218,088</u> |

|   | <u>2000</u> | <u>2001</u> | <u>2002</u> |
|---|-------------|-------------|-------------|
| During the year, weighted average price of: |             |             |             |
| Options granted                             | \$14.09     | \$19.03     | \$26.82     |
| Options exercised                           | 8.27        | 10.05       | 10.88       |
| Options cancelled                           | 11.68       | 13.03       | 16.23       |

|                                    |                |                |                |
|------------------------------------|----------------|----------------|----------------|
| At the end of the year:            |                |                |                |
| Price range of outstanding options | \$5.67-\$15.75 | \$5.67-\$23.17 | \$5.67-\$30.55 |

|                                     |         |         |         |
|-------------------------------------|---------|---------|---------|
| Weighted average price of options   | \$11.33 | \$13.53 | \$16.86 |
| Options available for future grants | 702,522 | 501,869 | 990,317 |
| Exercisable options                 | 509,834 | 482,441 | 587,803 |

The following table summarizes the status of stock options outstanding and exercisable at March 31, 2002:

| <u>Range of Exercise Prices</u> | <u>Number of Outstanding Options</u> | <u>Weighted Average Remaining Contractual Life</u> | <u>Outstanding Options- Weighted Average Exercise Price</u> | <u>Exercisable Options - Number of Exercisable Options</u> | <u>Exercisable Options - Weighted Average Exercise Price</u> |
|---------------------------------|--------------------------------------|--|---|--|--|
| \$ 5.67 - \$12.00               | 371,248                              | 2.14 years   | \$10.48   | 290,305  | \$10.68  |
| 12.01 - 16.00                   | 301,697                              | 2.65 years   | 13.57   | 204,481  | 13.31  |
| 16.01 - 24.00                   | 267,641                              | 3.80 years   | 19.07   | 93,017   | 18.75  |
| 24.01 - 30.55                   | 277,502                              | 4.78 years   | 26.83   | -  | -  |
| <b>Total</b>                    | <b>1,218,088</b>                     | <b>3.23 years</b>                                  | <b>\$16.86</b>  | <b>587,803</b>   | <b>\$12.87</b>   |

The Company has adopted the disclosure-only provisions of SFAS No. 123. Had compensation cost for the Company's stock option and stock purchase plans been recorded consistent with the provisions of SFAS No. 123, net income, net income per share-basic and net income per common share-diluted would have been as follows for the three fiscal years ending March 31:

|                                | <u>2000</u>  | <u>2001</u>  | <u>2002</u>  |
|--------------------------------|--------------|--------------|--------------|
| Net income – adjusted          | \$11,406,000 | \$12,584,000 | \$14,016,000 |
| Net income per share – basic   | \$0.95       | \$1.11       | \$1.27       |
| Net income per share – diluted | \$0.93       | \$1.08       | \$1.23       |

The weighted average fair values at date of grant for options during fiscal 2000, 2001, and 2002, were \$4.37, \$6.39, and \$6.38, respectively.

The fair value of each option is estimated on the date of grant using the Black-Scholes option-pricing model. The following weighted average assumptions were used for fiscal years ending March 31:

|                         | <u>2000</u> | <u>2001</u> | <u>2002</u> |
|-------------------------|-------------|-------------|-------------|
| Expected volatility     | .37         | .41         | .28         |
| Risk free interest rate | 6.6%        | 4.8%        | 4.3%        |

The assumptions for all three years reflect no dividend yield and a weighted average option life of 4.7 years for fiscal 2000 and 2001, and 4.6 years for fiscal 2002.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

The number of shares to be issued, the weighted average exercise price of outstanding options, and the number of securities remaining available for future issuance under all stock option plans, including the 1991 Employee Stock Purchase Plan described in Note F below are as follows:

|                      |                   |                      |
|----------------------|-------------------|----------------------|
| Number of securities | Weighted –average | Number of securities |
|----------------------|-------------------|----------------------|

| <u>Plan category</u>                                       | <u>to be issued upon<br/>exercised of<br/>outstanding options,<br/>warrants and rights</u> | <u>exercise price of<br/>outstanding<br/>options, warrants<br/>and rights</u> | <u>remaining available for<br/>future issuance under<br/>equity compensation<br/>plans</u> |
|--|--|---|--|
| Equity compensation plans approved by security holders     | 1,218,088  | \$16.86   | 1,149,910  |
| Equity compensation plans not approved by security holders | -  | -   | -  |
| <b>Total</b>   | <b>1,218,088</b>   | <b>\$16.86</b>  | <b>1,149,910</b>   |

#### **Note F - Employee Stock Purchase Plan**

The Company maintains an Employee Stock Purchase Plan which allows employees of the Company and its subsidiaries to purchase shares of common stock on the last day of two six-month purchase periods (i.e. March 31 and September 30) at a purchase price which is 85% of the closing sale price of shares as quoted on NASDAQ on the first or last day of such purchase period, whichever is lower. Employees are allowed to participate up to 20% of their gross pay. A maximum of 750,000 shares has been authorized for issuance under the plan, as amended. As of March 31, 2002, 590,407 shares had been issued pursuant to the plan. Summarized plan information is as follows:

|                        | <u>2000</u> | <u>2001</u> | <u>2002</u> |
|------------------------|-------------|-------------|-------------|
| Employee contributions | \$588,000   | \$687,000   | \$788,000   |
| Shares acquired        | 52,200      | 45,108      | 36,951      |
| Average purchase price | \$11.26     | \$15.23     | \$21.32     |

#### **Note G - Treasury Stock**

The Company's Board of Directors has approved a plan to repurchase up to 5,100,000 shares of the Company's outstanding common stock. Purchases may be made from time to time depending on market conditions and other relevant factors. The share repurchases for fiscal years ending March 31, 2000, 2001 and 2002 are as follows:

|                    | <u>2000</u>  | <u>2001</u>  | <u>2002</u>  | <u>Cumulative</u> |
|--------------------|--------------|--------------|--------------|-------------------|
| Shares repurchased | 879,090      | 711,900      | 557,870      | 4,769,780         |
| Cost               | \$12,966,000 | \$13,947,000 | \$15,237,000 | \$69,140,000      |
| Average price      | \$14.75      | \$19.59      | \$27.31      | \$14.50           |

The repurchased shares were recorded as treasury stock, at cost, and are available for general corporate purposes. The repurchases were financed from cash generated from operations.

#### **Note H - Commitments and Contingencies**

The Company leases office facilities under non cancelable operating leases. Future minimum rental commitments under operating leases at March 31, 2002 are \$7,134,000 in fiscal 2003, \$6,273,000 in fiscal 2004, \$5,189,000 in fiscal 2005, \$4,070,000 in fiscal 2006, \$2,715,000 in fiscal 2007, and \$992,000 thereafter. Total rental expense of \$7,100,000, \$8,685,000, and \$9,926,000 was charged to operations for the years ended March 31, 2000, 2001, and 2002, respectively.

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

#### **Note I - Savings Plan**

The Company maintains a retirement savings plan for its employees, which is a qualified plan under Section 401(k) of the Internal Revenue Code. Full-time employees that meet certain requirements are eligible to participate in the plan. Company contributions are made annually primarily at the discretion of the Company's Board of Directors. Contributions of \$199,000, \$224,000, and \$247,000, were charged to operations for the years ended March 31, 2000, 2001 and 2002, respectively.

#### **Note J – Subsequent Events – Acquisition and Shareholder Rights Plan**

On May 16, 2002, the Company acquired AnciCare, PPO, Inc., a Florida-based national provider of diagnostic imaging services. The down payment for the acquisition was paid from the Company's existing cash on hand. If the results of the Ancicare operations attain certain levels, the Company will pay an additional amount for the purchase which is expected to be funded from future earnings of the Company.

During fiscal 1997, the Company's Board of Directors approved the adoption of a Shareholder Rights Plan. The Rights Plan, which is similar to rights plans adopted by numerous other public companies, provides for a dividend distribution to CorVel stockholders of one preferred stock purchase "Right" for each outstanding share of CorVel's common stock. The Rights are designed to assure that all stockholders receive fair and equal treatment in the event of any proposed takeover of the company and to encourage a potential acquirer to negotiate with the Board of Directors prior to attempting a takeover. In April, 2002, the Board of Directors of the Company approved an amendment to the Company's existing stockholder rights agreement to extend the expiration date of the rights to February 10, 2012, increase the initial exercise price of each right to \$118. The Rights will not be exercisable until the occurrence of certain takeover-related events. The issuance of the Rights has no dilutive effect on the Company's earnings per share.

#### **Note K - Quarterly Results**

The following is a summary of unaudited results of operations for the two years ended March 31, 2001 and 2002:

| <b>Fiscal Year Ended</b> |                 |                     |                   | Net income<br>per basic<br><u>common share</u> | Net income<br>per diluted<br><u>common share</u> |
|--------------------------|-----------------|---------------------|-------------------|--|--|
| <b>March 31, 2001:</b>   | <u>Revenues</u> | <u>Gross Margin</u> | <u>Net Income</u> |  |  |
| First Quarter            | \$50,557,000    | \$9,328,000         | \$3,227,000       | \$.28  | \$.27  |
| Second Quarter           | 51,658,000      | 9,347,000           | 3,272,000         | .29  | .28  |
| Third Quarter            | 52,241,000      | 9,059,000           | 3,328,000         | .29  | .29  |
| Fourth Quarter           | 55,098,000      | 9,810,000           | 3,395,000         | .30  | .29  |
| <b>Fiscal Year Ended</b> |                 |                     |                   |  |  |
| <b>March 31, 2002:</b>   |                 |                     |                   |  |  |
| First Quarter            | \$58,001,000    | \$10,364,000        | \$3,593,000       | \$.32  | \$.31  |
| Second Quarter           | 58,411,000      | 10,482,000          | 3,640,000         | .33  | .32  |
| Third Quarter            | 58,724,000      | 10,701,000          | 3,755,000         | .34  | .33  |
| Fourth Quarter           | 60,776,000      | 11,140,000          | 3,833,000         | .35  | .34  |

## REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Stockholders and Board of Directors  
CorVel Corporation

We have audited the accompanying consolidated balance sheets of CorVel Corporation as of March 31, 2001 and 2002, and the related consolidated statements of income, stockholders' equity, and cash flows for the each of the two years in the period ended March 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of CorVel Corporation at March 31, 2001 and 2002, and the consolidated results of its operations and its cash flows for each of the two years in the period ended March 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

We have also audited Schedule II for each of the two years in the period ended March 31, 2002. In our opinion, this schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information therein.

/s/ Grant Thornton LLP

Portland, Oregon  
May 16, 2002

## **Report of Independent Auditors**

Stockholders and Board of Directors  
CorVel Corporation

We have audited the consolidated balance sheet of CorVel Corporation as of March 31, 2000 (not presented separately herein), and the related consolidated statement of income, stockholders' equity, and cash flows for the year ended March 31, 2000. Our audit also included the financial statement schedule listed in the Index at Item 14(a) for the year ended March 31, 2000. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of CorVel Corporation at March 31, 2000, and the consolidated results of its operations and its cash flows for the year ended March 31, 2000, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ ERNST & YOUNG LLP

Orange County, California  
May 9, 2000