

METROPOLITAN HEALTH NETWORKS INC
Form 10-Q
May 10, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2004

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-28456

METROPOLITAN HEALTH NETWORKS, INC.

(Exact name of registrant as specified in its charter)

Florida

65-0635748

(State or other jurisdiction of

(I.R.S. Employer

Incorporation or organization)

Identification No.)

250 Australian Avenue, Suite 400, West Palm Beach, Fl.

33401

(Address of principal executive office)

(Zip Code)

(561) 805-8500

(Registrant's telephone number, including area code)

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

Yes [X]

No []

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

Class

Outstanding as of March 31, 2004

Common Stock par value \$.001

45,692,748

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Metropolitan Health Networks, Inc.

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METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

| <u>ASSETS</u> | March 31, 2004 (Unaudited) | December 31, 2003 (Audited) |
|--|-------------------------------|--------------------------------|
| CURRENT ASSETS | | |
| Cash and equivalents | \$ 1,366,647 | \$ 2,176,204 |
| Accounts receivable, net of allowance | 2,121,067 | 2,138,690 |
| Inventory | 256,002 | 304,248 |
| Other current assets | 810,263 | 833,112 |
| TOTAL CURRENT ASSETS | 4,553,979 | 5,452,254 |
| CERTIFICATES OF DEPOSIT - restricted | 1,000,000 | 1,000,000 |
| PROPERTY AND EQUIPMENT, net | 625,039 | 659,682 |
| GOODWILL, net | 1,992,133 | 1,992,133 |
| OTHER ASSETS | 102,699 | 119,660 |
| TOTAL ASSETS | \$ 8,273,850 | \$ 9,223,729 |
| <u>LIABILITIES AND STOCKHOLDERS'</u> <u>EQUITY/(DEFICIENCY IN ASSETS)</u> | | |
| CURRENT LIABILITIES | | |
| Advances from HMO | \$ - | \$ 164,536 |
| Accounts payable | 990,677 | 1,756,347 |
| Accrued expenses | 752,686 | 1,413,195 |
| Current maturities of capital lease obligations | 69,419 | 104,315 |
| Current maturities of long-term debt | 416,547 | 975,169 |
| Payroll taxes payable | 234,199 | 3,408,736 |
| TOTAL CURRENT LIABILITIES | 2,463,528 | 7,822,298 |
| CAPITAL LEASE OBLIGATIONS | - | 3,092 |
| LONG-TERM DEBT | 802,436 | 1,901,000 |
| TOTAL LIABILITIES | 3,265,964 | 9,726,390 |
| COMMITMENTS AND CONTINGENCIES | | |
| STOCKHOLDERS' EQUITY/(DEFICIENCY IN ASSETS) | | |
| Preferred stock, par value \$.001 per share; stated value \$100 per share; | | |
| 10,000,000 shares authorized; 5,000 issued and outstanding | 500,000 | 500,000 |

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Common stock, par value \$.001 per share; 80,000,000 shares authorized;

| | | |
|--|---------------------|---------------------|
| 45,692,748 and 38,527,699 issued and outstanding, respectively | 45,693 | 38,527 |
| Additional paid-in capital | 35,419,206 | 31,343,887 |
| Accumulated deficit | (30,793,524) | (32,238,333) |
| Common stock issued for services to be rendered | (163,489) | (146,742) |
| TOTAL STOCKHOLDERS' EQUITY/(DEFICIENCY IN ASSETS) | 5,007,886 | (502,661) |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY/(DEFICIENCY IN ASSETS) | \$ 8,273,850 | \$ 9,223,729 |

See accompanying notes - unaudited

**METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

For the three months ended March 31,

2004

2003

(Unaudited)

(Unaudited)

| | | |
|--------------------------------------|-------------------|-------------------|
| REVENUES | \$ 38,543,196 | \$ 36,876,548 |
| EXPENSES | | |
| Direct medical costs | 33,237,803 | 31,841,794 |
| Payroll, payroll taxes and benefits | 1,938,774 | 1,899,372 |
| Medical supplies | 511,379 | 428,586 |
| Depreciation and amortization | 122,523 | 167,481 |
| Rent and leases | 275,909 | 231,981 |
| Consulting expense | 142,191 | 407,275 |
| General and administrative | 702,257 | 569,011 |
| TOTAL EXPENSES | 36,930,836 | 35,545,500 |
| INCOME BEFORE OTHER INCOME (EXPENSE) | 1,612,360 | 1,331,048 |
| OTHER INCOME (EXPENSE): | | |
| Interest and penalty expense | (154,522) | (386,370) |

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| | | |
|---|---------------------|-------------------|
| Other income | 32,929 | 20,014 |
| TOTAL OTHER INCOME (EXPENSE) | (121,593) | (366,356) |
| INCOME FROM CONTINUING OPERATIONS | 1,490,767 | 964,692 |
| DISCONTINUED OPERATIONS: | | |
| Loss from operations of discontinued business segments | (45,958) | (248,995) |
| NET INCOME | \$ 1,444,809 | \$ 715,697 |
| | | |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING | 41,722,527 | 32,273,745 |
| INCOME FROM CONTINUING OPERATIONS: | | |
| Basic | \$ 0.03 | \$ 0.03 |
| Diluted | \$ 0.03 | \$ 0.03 |
| LOSS FROM DISCONTINUED OPERATIONS: | | |
| Basic | \$ - | \$ (0.01) |
| Diluted | \$ - | \$ (0.01) |
| NET EARNINGS PER SHARE: | | |
| Basic | \$ 0.03 | \$ 0.02 |
| Diluted | \$ 0.03 | \$ 0.02 |

See accompanying notes - unaudited

**METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | For the three months ended March 31, | |
|---|---|--------------------|
| | 2004 | 2003 |
| | (Unaudited) | (Unaudited) |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 1,444,809 | \$ 715,697 |
| Adjustments to reconcile net income to net cash | | |

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(used in)/provided by operating activities:

| | | |
|---|-------------|-----------|
| Depreciation and amortization | 147,156 | 167,481 |
| Amortization of discount on notes payable | 66,949 | 46,541 |
| Stock issued for interest and late fees | 578 | 80,000 |
| Stock issued for compensation and services | 36,000 | 41,500 |
| Amortization of securities issued for professional services | - | 64,352 |
| Changes in assets and liabilities: | | |
| Accounts receivable, net | 17,623 | 99,417 |
| Inventory | 48,246 | 28,377 |
| Other current assets | 22,849 | (183,527) |
| Net change in operating assets held for sale | - | (318,795) |
| Other assets | (15,000) | (22,739) |
| Accounts payable and accrued expenses | (1,426,179) | 232,605 |
| Payroll taxes payable | (3,174,537) | 216,072 |
| Total adjustments | (4,276,315) | 451,284 |
| Net cash (used in)/provided by operating activities | (2,831,506) | 1,166,981 |

CASH FLOWS FROM INVESTING ACTIVITIES:

| | | |
|--|----------|-----------|
| Purchase of restricted certificates of deposit | - | (50,000) |
| Capital expenditures | (36,632) | (73,122) |
| Net cash (used in) investing activities | (36,632) | (123,122) |

CASH FLOWS FROM FINANCING ACTIVITIES:

| | | |
|---|--------------|-------------|
| Borrowings on notes payable | - | 501,199 |
| Repayments on notes payable | (709,135) | (661,648) |
| Repayments on capital lease obligations | (37,988) | (53,865) |
| Net proceeds from issuance of common stock | 2,970,240 | - |
| Repayments to HMO | (164,536) | (789,708) |
| Net cash provided by/(used in) financing activities | 2,058,581 | (1,004,022) |
| NET INCREASE (DECREASE) IN CASH AND EQUIVALENTS | (809,557) | 39,837 |
| CASH AND EQUIVALENTS - BEGINNING | 2,176,204 | 399,614 |
| CASH AND EQUIVALENTS - ENDING | \$ 1,366,647 | \$ 439,451 |

See accompanying notes - unaudited

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METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

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

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and such adjustments are of a normal recurring nature. Operating results for the three months ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

The audited financial statements at December 31, 2003, which are included in the Company's Form 10-K, should be read in conjunction with these condensed consolidated financial statements.

Unless otherwise indicated or the context requires, all references in this Form 10-Q to the Company refers to Metropolitan Health Networks, Inc. and our consolidated subsidiaries.

SEGMENT REPORTING

The Company applies Financial Accounting Standards Boards (FASB) statement No. 131, Disclosure about Segments of an Enterprise and Related Information . The Company has considered its operations and has determined that in 2003 it operated in two segments, PSN (managed care and direct medical services) and pharmacy, and in 2004 operates only the PSN segment for purposes of presenting financial information and evaluating performance, as the pharmacy

operations were sold in November 2003.

As such, the accompanying financial statements present information in a format that is consistent with the financial information used by management for internal use.

INCOME TAXES

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

The effective tax rate for the three months ended March 31, 2004 differed from the federal statutory rate due principally to a decrease in the deferred tax asset valuation allowance.

REVENUES

Revenues are recorded when services are rendered. Revenues from one health maintenance organization (HMO) accounted for approximately 99% of the Company's total revenues for the quarters ended March 31, 2004 and 2003.

Contracts with the HMO in the South Florida and Daytona markets renew automatically unless cancelled by either party with 180-day notice. These contracts expired December 31, 2003, however the contracts were renewed for one year effective January 1, 2004. The Company expects the contracts to continue for the foreseeable future.

RECLASSIFICATION

Certain amounts reported in the comparative financial statements have been reclassified to conform to the presentation for the period ended March 31, 2004.

METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

USE OF ESTIMATES

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

ACCOUNTS RECEIVABLE

Accounts receivable at March 31, 2004 and December 31, 2003 were as follows:

| | <u>March 31, 2004</u> | <u>December 31, 2003</u> |
|----------------------------------|-----------------------|--------------------------|
| HMO accounts receivable, net | \$ 1,859,000 | \$ 1,780,000 |
| Non-HMO accounts receivable, net | 262,000 | 359,000 |
| Accounts receivable | \$ 2,121,000 | \$ 2,139,000 |

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

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

From time to time the Company is charged for certain medical expenses which, under its contracts with the HMO, the Company believes it is not liable. In connection therewith, the Company was contesting certain costs aggregating approximately \$4.2 million at March 31, 2004. Management's estimate of recovery on these contestations is determined based upon its judgment and its consideration of several factors including the nature of the contestations, historical recovery rates and other qualitative factors. Accordingly, accounts receivable due from the HMO include approximately \$835,000, which represents estimated recovery of contestations outstanding at March 31, 2004. It is possible the Company's estimate of these recoveries could change in the near term, and those changes may be material.

Non-HMO accounts receivable, aggregating approximately \$2.9 million at March 31, 2004 relate principally to medical services provided on a fee for service basis, and are reduced by amounts estimated to be uncollectible (approximately \$2.6 million). Management's estimate of uncollectible amounts is based upon its analysis of historical collections and other qualitative factors, however it is possible the Company's estimate of uncollectible amounts could change in the near term, and those changes may be material. Non-HMO accounts receivable included approximately \$2.0 million from operations discontinued in prior years, which, although the Company continues to pursue collection, is fully reserved.

METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

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

NET INCOME PER SHARE

The Company applies Statement of Financial Accounting Standards No. 128, Earnings Per Share (FAS 128) which requires dual presentation of net income per share; Basic and Diluted. Basic earnings per share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed

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using the weighted average number of common shares outstanding during the period adjusted for incremental shares attributed to outstanding options and warrants, convertible debt and preferred stock to purchase or convert into shares of common stock.

| | For the three months ended March 31, | |
|--|---|-------------|
| | 2004 | 2003 |
| Net Income from continuing operations | \$ 1,490,767 | \$ 964,692 |
| Less: Preferred stock dividend | (12,500) | (12,500) |
| | 1,478,267 | 952,192 |
| Loss from discontinued operations | (45,958) | (248,995) |
| Income available to common shareholders | \$ 1,432,309 | \$ 703,197 |
| Denominator: | | |
| Weighted average common shares outstanding | 41,722,527 | 32,273,745 |
| Basic earnings per common share | \$ 0.03 | \$ 0.02 |
| Net Income | \$ 1,444,809 | \$ 715,697 |
| Interest on convertible securities | 2,427 | 103,920 |
| | \$ 1,447,236 | \$ 819,617 |
| Denominator: | | |
| Weighted average common shares outstanding | 41,722,527 | 32,273,745 |
| Common share equivalents of outstanding stock: | | |
| Convertible preferred | 1,341,730 | 4,437,567 |
| Convertible debt | 366,323 | 6,765,116 |
| Options | 2,008,794 | -- |
| Warrants | 283,840 | -- |
| Weighted average common shares outstanding | 45,273,214 | 43,476,428 |
| Diluted earnings per common share | \$ 0.03 | \$ 0.02 |

STOCK COMPENSATION

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure-an amendment of FASB Statement No. 123. This statement provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation.

METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

SFAS No. 148 amends the disclosure requirements of SFAS 123 to require disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method on reported results.

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

Accordingly, compensation expense for options granted to employees is recorded to the extent the market value of the underlying stock exceeds the exercise price at the date of grant. For the three months ended March 31, 2004 and 2003 no compensation was recorded. If compensation cost had been determined based on the fair value at the grant date for awards in the three months ended March 31, 2004 and 2003, consistent with the provisions of SFAS 123, the Company's net income and income per share would have been reduced to the pro-forma amounts indicated below:

| | For the three months ended March 31, | |
|--|--------------------------------------|-------------|
| | <u>2004</u> | <u>2003</u> |
| Net Income | \$ 1,444,809 | \$ 715,697 |
| Less: Total stock-based employee compensation | | |
| expense determined using the fair value method, net of related tax | 17,102 | 24,149 |
| Adjusted net income | 1,427,707 | 691,548 |
| Earnings per share: | | |
| Basic, as reported | \$ 0.03 | \$ 0.02 |
| Basic, pro forma | \$ 0.03 | \$ 0.02 |
| Diluted, as reported | \$ 0.03 | \$ 0.02 |
| Diluted, pro forma | \$ 0.03 | \$ 0.02 |

NEW ACCOUNTING PRONOUNCEMENTS

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

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

METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In May 2003, the FASB issued SFAS No. 150, "Accounting For Certain Financial Instruments with Characteristics of both Liabilities and Equity". SFAS No. 150 changes the accounting for certain financial instruments with characteristics of both liabilities and equity that, under previous pronouncements, issuers could account for as equity. The new accounting guidance contained in SFAS No. 150 requires that those instruments be classified as liabilities in the balance sheet. SFAS No. 150 affects the issuer's accounting for three types of freestanding financial instruments. One type is mandatory redeemable shares, which the issuing company is obligated to buy back in exchange for cash or other assets. A second type includes put options and forward purchase contracts, which involves instruments that do or may require the issuer to buy back some of its shares in exchange for cash or other assets. The third type of instruments that are liabilities under this Statement is obligations that can be settled with shares, the monetary value of which is fixed, tied solely or predominantly to a variable such as a market index, or varies inversely with the value of the issuers' shares. SFAS No. 150 does not apply to features embedded in a financial instrument that is not a derivative in its entirety. Most of the provisions of SFAS No. 150 are consistent with the existing definition of liabilities in FASB Concepts Statement No. 6, "Elements of Financial Statements". The remaining provisions of this Statement are consistent with the FASB's proposal to revise that definition to encompass certain obligations that a reporting entity can or must settle by issuing its own shares. This Statement shall be effective for financial instruments entered into or

modified after May 31, 2003 and otherwise shall be effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatory redeemable financial instruments of a non-public entity, as to which the effective date is for fiscal periods beginning after December 15, 2003. Adoption of SFAS No. 150 did not have a material impact on the Company's financial statements.

NOTE 2. DEBT

During the first quarter of 2004, the Company repaid \$709,000 of long-term debt that was due during the quarter and restructured a \$1.2 million note due May 2004. The new terms provide for payment over twenty-four months beginning in June 2004, with interest at 12%. 100,000 shares of common stock were issued in conjunction with the restructuring.

NOTE 3. STOCKHOLDERS' EQUITY

During the first three months of 2004, the Company issued 290,980 shares of common stock for the exercise of stock options, board compensation and loan fees. In addition, the Company issued 1,869,070 shares of common stock for the conversion of \$1,015,000 of long-term debt and 5,005,000 shares, at \$0.60 per share, in a private placement related to its IRS settlement.

NOTE 4. COMMITMENTS AND CONTINGENCIES

LITIGATION

The Company is a party to certain claims arising in the ordinary course of business. Management believes that the outcome of these matters will not have a material adverse effect on the financial position or the results of operations of the Company.

PAYROLL TAXES PAYABLE

In 2000, the Company negotiated an installment plan with the Internal Revenue Service (IRS) related to unpaid payroll tax liabilities, including accrued interest and penalties. Under the plan the Company was required to make monthly installments of \$100,000 on the amount in arrears. The agreement expired and the full amount was deemed due upon demand.

In February 2004, the Company was successful in negotiating a settlement with the IRS on its outstanding payroll tax liabilities for an amount totaling approximately \$3.3 to \$3.4 million. To date, \$3.2 million of this settlement has been paid with the balance to be paid once the IRS has determined the final settlement amount.

METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 5. BUSINESS SEGMENT INFORMATION

The Company operates in one segment during 2004 for purposes of presenting financial information and evaluating performance, the PSN (managed care and direct medical services) division. During 2003, the Company also operated a second segment, a pharmacy. The Company allocated corporate overhead to the pharmacy during the period it was operational. However, the overhead allocation is not included in the loss from operations of the discontinued business segments shown in the condensed consolidated statements of operations. The PSN segment also includes all costs related to the Company's consideration and development of an HMO concept.

| <u>THREE MONTHS ENDED MARCH 31, 2004</u> | <u>PSN</u> | <u>Pharmacy</u> | <u>Total</u> |
|---|----------------|---------------------|------------------|
| Revenues from external customers | \$ 38,543,000 | \$ - | \$ 38,543,000 |
| Segment gain (loss) before allocated overhead | 2,647,000 | (46,000) | 2,601,000 |
| Allocated corporate overhead | 1,156,000 | - | 1,156,000 |
| Segment gain (loss) after allocated overhead | 1,491,000 | (46,000) | 1,445,000 |
| <u>THREE MONTHS ENDED MARCH 31, 2003</u> | <u>PSN</u> | <u>Pharmacy</u> | <u>Total</u> |
| Revenues from external customers | \$ 36,877,000 | \$ - | \$ 36,877,000 |
| Intersegment revenues from discontinued business segments | - | 317,000 | 317,000 |
| Revenues from discontinued business segments | - | 3,906,000 | 3,906,000 |
| Segment gain (loss) before allocated overhead | 2,311,000 | (249,000) | 2,062,000 |
| Allocated corporate overhead | 825,000 | 487,000 | 1,312,000 |
| Segment gain (loss) after allocated overhead | 1,486,000 | (770,000) | 716,000 |

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Sections of this Quarterly Report contain statements that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act"), and we intend that such forward-looking statements be subject to the safe harbors created thereby. Statements in this Report containing the words "estimate," "project," "anticipate," "expect," "intend," "believe," "could," "should," "may," and similar expressions may be deemed to create forward-looking statements. Accordingly, such statements, including without limitation, those relating to our future business, prospects, revenues, working capital, liquidity, capital needs, interest costs and income, wherever they may appear in this document or in other statements attributable to us, involve estimates, assumptions and uncertainties which could cause actual results to differ materially from those expressed in the forward-looking statements. Specifically, this Quarterly Report contains forward-looking statements, including the following:

- our ability to service our indebtedness, make capital expenditures and respond to capital needs;

- our ability to restructure any of our debt or current liabilities;

- our ability to enhance the services we provide to our members;

- our ability to strengthen our medical management capabilities;

- our ability to improve our physician network;

- our ability to renew our managed care agreements and negotiate terms which are favorable to us and affiliated physicians;

- our ability to respond to future changes in Medicare reimbursement levels and reimbursement rates from other third parties; and

- our ability to establish relationships and expand into new geographic markets.

The forward-looking statements reflect our current view about future events and are subject to risks, uncertainties and assumptions. We wish to caution readers that certain important factors may have affected and could in the future affect our actual results and could cause actual results to differ significantly from those expressed in any forward-looking statement. The following important factors could prevent us from achieving our goals, and cause the

assumptions underlying the forward-looking statements and the actual results to differ materially from those expressed in or implied by those forward-looking statements:

pricing pressures exerted on us by managed care organizations and the level of payments we receive under governmental programs or from other payers;

future legislation and changes in governmental regulations;

the impact of Medicare Risk Adjustments on payments we receive for our managed care operations;

loss of significant contracts;

general economic and business conditions;

changes in estimates and judgments associated with our critical accounting policies;

federal and state investigations;

the enactment of unfavorable legislation by the Congress of the United States;

our ability to successfully recruit and retain medical professionals; and

impairment charges that could be required in future periods.

Additional information concerning these and other risks and uncertainties is contained in our filings with the Securities and Exchange Commission, including the section entitled "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2003.

We disclaim any intent or obligation to update forward looking statements .

OVERVIEW

Unless otherwise indicated or the context otherwise requires, all references in this Form 10-Q to the "Company" refers to Metropolitan Health Networks, Inc. and our consolidated subsidiaries.

The Company was incorporated in the State of Florida in January 1996, and began operations as a physician practice group. During the late 1990's Metcare acquired a number of physician practices and ancillary service providers. In

late 1999, the group practice strategy was abandoned in connection with a change in the senior management team.

The first managed care risk contract was secured with Humana in 1999. In 2000, an additional contract was secured to manage all of Humana's Medicare Advantage lives in the Daytona, Florida area (Flagler and Volusia Counties).

The Daytona contract currently accounts for over 19,000 lives or 77% of the Company's total Medicare Advantage lives. The balance of the Company's Humana lives reside in South Florida (Palm Beach, Broward and Miami-Dade Counties).

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company's management to make a variety of estimates and assumptions. These estimates and assumptions affect, among other things, the reported amounts of assets and liabilities, the disclosure of contingent liabilities and the reported amounts of revenues and expenses. Actual results can differ from the amounts previously estimated, which were based on the information available at the time the estimates were made.

The critical accounting policies described below are those that the Company believes are important to the portrayal of the Company's financial condition and results, and which require management to make difficult, subjective and/or complex judgments. Critical accounting policies cover accounting matters that are inherently uncertain because the future resolution of such matters is unknown. The Company believes that critical accounting policies include accounts receivable and revenue recognition, use of estimates and goodwill.

Accounts Receivable and Revenue Recognition

The Company is a party to certain managed care contracts and provides medical care to its patients through owned and non-owned medical practices. In connection with its Provider Service Network (PSN) operations, the Company is exposed to losses to the extent of its share of deficits. Accordingly, revenues under these contracts are reported as PSN revenue, and the cost of provider services under these contracts are reported as an operating expense.

The Company recognizes non-Humana revenues, net of contractual allowances, as medical services are provided. These services are typically billed to patients, Medicare, Medicaid, health maintenance organizations, insurance companies and other third parties. The Company provides an allowance for uncollectible amounts and for contractual adjustments relating to the difference between standard charges and agreed upon rates paid by certain third party payers.

Use of Estimates-PSN

In HMO-PSN arrangements, accounts receivable estimates often change as a result of one or more future confirming events. With regard to revenues, expenses and resulting accounts receivable arising from agreements with Humana, the Company estimates amounts it believes will ultimately be realizable through the use of judgments and assumptions. Contractual terms with an HMO are sometimes complex and at times subject to different interpretation by the Company and Humana. As a result, certain revenue, expense and accounts receivable estimates may change from amounts previously recorded in the financial statements and may require subsequent adjustments. To assist in estimating and collecting amounts due from Humana, the Company has contracted with several outside consultants that have worked closely with Humana or other HMOs for extended periods of time. These consultants provide numerous services including, but not limited to, revenue, expense and accounts receivable analysis, and monthly claims and contestation analysis. However, it is possible that actual results may differ from the estimates.

Direct medical expenses include costs incurred directly by the Company and costs paid by the HMO on the Company's behalf. These costs also include estimates of claims incurred but not reported (IBNR), estimates of retroactive adjustments to be applied by Humana and adjustments for charges which the Company believes it is not liable (contestations). The IBNR estimates are made by Humana utilizing actuarial methods and are continually evaluated and adjusted by management of the Company, based upon its specific claims experience and input from outside consultants. The Company bases its estimates of retroactive adjustments on agreements with the HMO to modify previous charges. Some of these adjustments have been quantified while others involve situations where Humana has agreed the charges were processed at incorrect rates, but the amount of the correction has not yet been quantified. Contestations involve charges where the Company, with the assistance of its consultants, contest certain expenses charged by the HMO. The estimate of direct medical expense includes an estimated recovery of 20% of outstanding contestations with Humana. It is possible that estimates of such recoveries could change and the effect of the change could be material.

Accounts receivable from Humana represents the combined effect of the Company's interpretation of the contract with Humana and its payment patterns. Collection times on these accounts typically exceed normal collection periods reflecting the need to reconcile the different interpretations and the HMO's cash management practices.

Goodwill

The Company has made several acquisitions in the past that included a significant amount of goodwill. Under accounting principles generally accepted in the United States of America in effect through December 31, 2001, these assets were amortized over their useful lives and tested periodically to determine if they were recoverable from operating earnings on a discounted basis over their useful lives.

Effective January 1, 2002, goodwill is accounted for under SFAS No. 142, *Goodwill and Other Intangible Assets*. The new rules eliminate amortization of goodwill but subject these assets to impairment tests. Management is

required to make assumptions and estimates, such as the discount factor, in determining fair value. Such estimated fair values might produce significantly different results if other reasonable assumptions and estimates were to be used.

RESULTS OF OPERATIONS

The Company generated revenues of \$38.5 million for the quarter ended March 31, 2004 compared to \$36.9 million in the prior year quarter, an increase of \$1.7 million (4.5%). Net income for the 2004 quarter was \$1.4 million, compared to net income of \$716,000 for the quarter ended March 31, 2003, an improvement of \$729,000 or 101.9%.

The 2003 quarter included approximately \$249,000 in losses related to its discontinued pharmacy operations, compared to \$46,000 in the current year quarter. On a basic per share basis, net income was \$0.03 for the quarter ended March 31, 2004, compared to per share net income of \$0.02 in the prior year quarter.

The Company operated two business segments in 2003, managed care and direct medical services (PSN) and pharmacy. The Company disposed of its pharmacy division in November 2003 and, accordingly, the operations of the pharmacy division are shown as losses from discontinued operations. The remaining PSN segment, prior to allocation of corporate overhead, reported an increase in its income as a percentage of revenue, from 6.3% in the first quarter of 2003 to 6.9% in the current year period.

Quarter ended March 31, 2004

REVENUES

Revenues for the quarter ended March 31, 2004 increased \$1.7 million (4.5%) over the prior year, from \$36.9 million to \$38.3 million. PSN revenues from Humana increased 4.8%, from \$36.5 million to \$38.2 million. Approximately \$3.4 million in incremental revenues were generated by governmental funding increases ranging from an estimated 9.8% in Daytona and 15% in Palm Beach County. These increases were partially offset by declines in the number of patients in our Daytona and South Florida networks, resulting in approximately \$942,000 in reduced funding. In addition, effective August 1, 2003 the Company cancelled its risk arrangement with one of its South Florida centers due to noncompliance with the Company's policies and procedures, resulting in a funding decrease of \$710,000.

Total Medicare Advantage lives declined approximately 1,600 members from March 31, 2003 to a membership of approximately 25,200 at March 31, 2004. Approximately 500 of the decline resulted from the terminated Broward County center, with the other 1,100 attributable to attrition. However, as a result of the increased funding provided by

the Medicare Modernization Act, or MMA, which was signed into law in December 2003, the Company believes this trend will reverse and enrollment in its network will increase over the balance of 2004. The funding increases are intended to both offset medical cost inflation and to allow enhanced plan benefit design to encourage increased participation in Medicare Advantage plans.

Non-Humana revenue for Metcare's wholly owned physician practices in the first quarter of 2004 declined \$97,000 over the same period in 2003, to a total of \$308,000. The Company operated six physician practices and an oncology center in both quarters.

EXPENSES

Operating expenses for the quarter ended March 31, 2004 increased \$1.4 million (3.9%) over the prior year quarter, from \$35.5 million to \$36.9 million. Operating expenses other than direct medical costs and medical supplies, which correlate to revenue, decreased 2.9% over the prior year quarter.

Direct medical costs, the largest component of expense, represents costs associated with providing services of the PSN operation including direct medical payments to physician providers, hospitals and ancillaries on a capitated or fee for service basis. Direct medical costs for the first quarter of 2004 were \$33.2 million compared to \$31.9 million for 2003, an increase of 4.4%. The increase reflects the results of a flu season that was the severest in four years, resulting in increased hospital admissions and lengths of stay, combined with overall increases in health care costs over the past year.

Salaries and benefits for the quarter was virtually the same as the prior year's total of \$1.9 million. An increase of approximately \$102,000 resulted from the hire of an oncologist in late 2004, whereas in 2003 a consultant was utilized. Additionally, savings of approximately \$168,000 were realized through the closure of the Company's hospitalist program in early 2003. Salary increases combined with increased benefit costs accounted for the balance of the incremental expense.

Medical supplies were \$511,000 for the 2004 quarter, compared to \$429,000 in 2003. Medical supply costs are incurred in all the Company's medical offices, but most prominently in the Company's Daytona oncology offices, accounting for 91.2% of the 2004 expense. The 2004 quarter included \$31,000 of incremental expense relating to the purchase of flu vaccine for its Daytona network.

Depreciation and amortization for the quarter ended March 31, 2004 totaled \$123,000, a 26.8% decrease over the prior year total of \$167,000, as many of the Company's fixed assets are fully depreciated.

Rents and leases for the quarter ended March 31, 2004 increased \$44,000 over the prior year quarter. When the Company negotiated the lease for its new corporate office effective January 2003, it received certain rent concessions in the first quarter of 2003.

Consulting expense for the quarter decreased approximately \$265,000 (65.1%), from \$407,000 in 2003 to \$142,000 in 2004. Of the reduction, \$103,000 resulted from the hiring of an oncologist, whereas in the prior year a consultant was utilized. In addition, approximately \$114,000 in savings was realized through a reduction in marketing and administrative consultants and the closure of the Company's hospitalist program in early 2003.

General and administrative expenses for the 2004 quarter amounted to \$702,000, an increase of \$133,000 over the prior year quarter. Legal and accounting expenses increased \$168,000 primarily related to the Company's restructuring activities. Insurance costs increased \$87,000 reflective of increased insurance costs for policies renewed mid-2003. Savings in other areas partially offset these increases.

Other income and expenses for the quarter included a decrease in interest expense of \$232,000 from the prior year due to the decreased average amount of debt and IRS obligations carried by the Company in the 2004 quarter as compared to the prior year.

Losses from the discontinued pharmacy operations for the quarter, was \$46,000 in 2004 as compared to \$249,000 in 2003. The pharmacy operations were sold in November 2003.

LIQUIDITY AND CAPITAL RESOURCES

During the quarter, the Company reduced its current liabilities from \$7.8 million to \$2.5 million and its total liabilities from \$9.7 million to \$3.3 million. Most significantly, the Company settled its longstanding payroll tax obligation. The Company's net worth totaled \$5.0 million at March 31, 2004 compared to a deficit of \$503,000 a year earlier. Additionally, working capital improved from a deficit of \$2.4 million at year-end 2003 to a surplus of \$2.1 million at March 31, 2004.

Also during the quarter, the Company issued 290,980 shares of common stock for the exercise of stock options, board compensation and loan fees. In addition, the Company issued 1,869,070 shares of common stock for the conversion of \$1,015,000 of long-term debt and 5,005,000 shares in a private placement related to its IRS settlement, as discussed below. The shares were sold at \$0.60 per share and these issuances were completed pursuant to exception

from registration under the Securities Act of 1933.

In addition, the Company repaid \$709,000 of long-term debt that was due in the quarter and finalized an extension, for payment over twenty-four months, of approximately \$1.2 million in additional debt due May 2004.

In 2000, the Company negotiated an installment plan with the Internal Revenue Service (IRS) related to unpaid payroll tax liabilities, including accrued interest and penalties. Under the plan the Company was required to make monthly installments of \$100,000 on the amount in arrears. The agreement expired and the full amount was deemed due upon demand.

In February 2004, the Company was successful in negotiating a settlement with the IRS on its outstanding payroll tax liabilities for an amount totaling approximately \$3.3 to \$3.4 million. To date, \$3.2 million of this settlement has been paid with the balance to be paid once the IRS has determined the final settlement amount.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk generally represents the risk of loss that may result from the potential change in value of a financial instrument as a result of fluctuations in interest rates and market prices. We do not currently have any trading derivatives nor do we expect to have any in the future. We have established policies and internal processes related to the management of market risks, which we use in the normal course of our business operations.

Interest Rate Risk

The fair market value of long-term debt is subject to interest rate risk. While changes in market interest rates may affect the fair value of our fixed-rate long-term debt, we believe a change in interest rates would not have a material impact on our financial condition, future results of operations or cash flows.

Intangible Asset Risk

We have a substantial amount of intangible assets. Although at March 31, 2004, we believe our intangible assets are recoverable, changes in the economy, the business in which we operate and our own relative performance could change the assumptions used to evaluate intangible asset recoverability. We continue to monitor those assumptions and their consequent effect on the estimated recoverability of our intangible assets.

ITEM 4. CONTROLS AND PROCEDURES

Our Management, which includes our CEO and our CFO, have conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of the end of the fiscal quarter covered by this report. Based upon that evaluation, our management has concluded that our disclosure controls and procedures are effective for timely gathering, analyzing and disclosing the information we are required to disclose in our reports filed under the Securities Exchange Act of 1934, as amended. There have been no significant changes made in our internal controls or in other factors that could significantly affect our internal controls during the fiscal quarter covered by this report.

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PART II OTHER INFORMATION

ITEM 1. SUMMARY OF LEGAL PROCEEDINGS

NONE

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

NONE

ITEM 3. DEFAULT UPON SENIOR SECURITIES

NONE

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

NONE

ITEM 5. OTHER INFORMATION

NONE

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

EXHIBITS

No. 31 Section 302 Certifications

No. 32 Section 906 Certifications

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SIGNATURES

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

METROPOLITAN HEALTH NETWORKS, INC.

Registrant

Date: May 10, 2004

/s/ Michael M. Earley

Michael M. Earley

President and

Chief Executive Officer

Date: May 10, 2004

/s/ David S. Gartner

David S. Gartner

Chief Financial Officer

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Exhibit 31.1

CHIEF EXECUTIVE OFFICER CERTIFICATION

I, Michael M. Earley, Chief Executive Officer of Metropolitan Health Networks, Inc., certify that:

1.

I have reviewed this Quarterly Report on Form 10-Q of Metropolitan Health Networks, Inc. (the Registrant);

2.

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3.

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4.

The registrant s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a)

Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b)

Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c)

Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5.

The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditor and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a)

All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b)

Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2004

/s/ Michael M. Earley

Michael M. Earley

President and Chief Executive Officer

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Exhibit 31.2

CHIEF FINANCIAL OFFICER CERTIFICATION

I, David S. Gartner, Chief Financial Officer of Metropolitan Health Networks, Inc., certify that:

1.

I have reviewed this Quarterly Report on Form 10-Q of Metropolitan Health Networks, Inc. (the Registrant);

2.

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3.

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4.

The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a)

Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b)

Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c)

Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5.

The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditor and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a)

All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b)

Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2004

/s/ David S. Gartner

David S. Gartner

Chief Financial Officer

Exhibit 32.1

SECTION 1350 CERTIFICATIONS

CERTIFICATION PURSUANT TO\

18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

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In connection with the Quarterly Report of Metropolitan Health Networks, Inc. (the Company) on Form 10-Q for the period ended March 31, 2004, as filed with the Securities and Exchange Commission on the date hereof (the Report), I, Michael M. Earley, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that based on my knowledge:

1.

The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2.

The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 10, 2004

/s/ Michael M. Earley

Michael M. Earley

President and Chief Executive Officer

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Exhibit 32.2

SECTION 1350 CERTIFICATIONS

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Metropolitan Health Networks, Inc. (the Company) on Form 10-Q for the period ended March 31, 2004, as filed with the Securities and Exchange Commission on the date hereof (the Report), I, David S. Gartner, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that based on my knowledge:

1.

The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2.

The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 10, 2004

/s/ David S. Gartner

David S. Gartner

Chief Financial Officer

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