

PRECIS INC
Form 10-Q
August 16, 2004

U. S. SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2004

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE
EXCHANGE ACT**

For the transition period from _____ to _____

Commission File Number: 001-15667

PRECIS, INC.

(Name of business issuer in its Charter)

OKLAHOMA
(State or other jurisdiction of
incorporation or organization)

73-1494382
(I.R.S. Employer
Identification No.)

2040 North Highway 360
Grand Prairie, Texas 75050
(Address of principal executive offices)

(972) 522-2008
(Issuer's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

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 periods that the registrant was required to file such reports), and (2) has been subject

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to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Indicate by check mark whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court. Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of issuer's classes of common equity, as of the latest practicable date: As of August 16, 2004, 11,833,280 shares of the issuer's common stock, \$0.01 par value, were outstanding.

PRECIS, INC.

FORM 10-Q

For the Quarter Ended June 30, 2004

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Our financial statements which are prepared in accordance with Regulation S-X are set forth in this report beginning on page 15.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is qualified in its entirety by the more detailed information in our Form 10-K and the financial statements contained in this report, including the notes thereto, and our other periodic reports filed with the Securities and Exchange Commission since December 31, 2003 (collectively referred to as the Disclosure Documents). Certain forward-looking statements contained herein and in such Disclosure Documents regarding our business and prospects are based upon numerous assumptions about future conditions that may ultimately prove to be inaccurate and actual events and results may materially differ from anticipated results described in such statements. Our ability to achieve such results is subject to the risks and uncertainties discussed in our Form 10-K. Any forward-looking statements contained in this report represent our judgment as of the date hereof. We disclaim, however, any intent or obligation to update these forward-looking statements. As a result, the reader is cautioned not to place undue reliance on these forward-looking statements.

Overview

Consumer Healthcare Savings Solution

We offer savings on healthcare services throughout the United States to persons who are under-insured. These savings are offered by accessing the same preferred provider organizations (PPOs) that are utilized by many insurance companies. These programs are sold primarily through a network marketing strategy under the name Care Entrée. We design these programs to benefit healthcare providers as well as the network members. Providers commonly give reduced or preferred rates to PPO networks in exchange for steering of patients. However, the providers must still file claim forms and wait 30 to 60 days to be paid for their services. Our programs utilize these same networks to obtain the same savings for the Care Entrée program members. Additionally, we collect monthly payments from program members that are held in escrow accounts and utilized to help assure prompt payment to the healthcare provider. We also provide transaction facilitation services to both the program member and the healthcare provider.

Independent Marketing Representatives (IMRs) may enroll as representatives by paying an enrollment fee and signing a standard representative agreement. We pay independent marketing representatives commissions equal to 20% of the membership fees of members they enroll for the life of that members' enrollment. Independent marketing representatives can also recruit other representatives and earn override commissions on sales made by those recruited representatives. We pay a total of 35% in override commissions down through seven levels. We have also established bonus pools that allow independent marketing representatives who have achieved certain levels to receive bonuses of up to 5% of our incremental revenues in these programs. Independent marketing representatives can also earn a commission equal to the membership fees if three or more program members are enrolled in a month. In the month of membership sales, no override commissions are paid to the

representatives upline.

Affordable Healthcare Insurance

In September 2003, we organized a new subsidiary under the name Care Financial of Texas, L.L.C. Through Care Financial, we offer our high deductible and scheduled benefit insurance policies. In addition, we have recently added a suite of products including life insurance from Lion's Share (Allianz), along with Healthcare Reimbursement Arrangements (HRAs) and medical and dependent care Flexible Spending Accounts (FSAs) offered through Care125, a division of Care Financial. The high deductible and scheduled benefit insurance policies, HRAs and medical and dependent care FSAs, when combined with the Care Entrée program, offer affordable, well-rounded solutions for individuals and employers who are no longer able to afford or obtain traditional health insurance policies. The HRAs and medical and dependent care FSAs are also sold by our independent marketing representatives who, from a regulatory standpoint, are not required to be licensed to sell these products. The life insurance products serve to complement our healthcare product offerings by addressing our members' overall financial condition. The insurance policies are sold through our independent marketing representatives who are licensed insurance agents.

Wholesale Membership Solution

Healthcare Membership Programs

We also design healthcare membership programs for employer groups, retailers and association-based organizations. Memberships in these programs are offered and sold by direct marketing through direct sales or in-bound direct marketing. We believe that our clients, their members, and the vendors of the products and services offered through the programs all benefit from our membership service programs. The products and services are bundled, priced and marketed utilizing relationship marketing strategies to target the profiled needs of the clients' particular member base. Most of our memberships are sold by third-party organizations and are generally marketed using the third-party's name or brand. We refer to these programs and membership sales as wholesale programs or private label programs. While the services offered to consumers by these private label programs are generally similar to the services we offer through Care Entrée, each of the private label programs can bundle our services to fit the needs of their consumers. For instance, some of our private label programs do not offer a self-funded escrow program to their members.

Rental Purchase and Club Membership Programs

We also design club membership programs for rental-purchase companies, financial institutions, employer groups, retailers and association-based organizations. Memberships in these programs are offered and sold as part of a point-of-sale transaction or by direct marketing through direct mail or as inserts. Program members are offered and provided our third-party vendors' products and services. The products and services are bundled, priced and marketed utilizing relationship marketing strategies to target the profiled needs of the clients' particular customer base. Most of our club membership programs are sold by third-party organizations, generally in connection with a point-of-sale transaction. We refer to these programs and membership sales as wholesale programs.

Repricing for Governments and Third Party Administration Services

For governments and other large, self-funded employers seeking to reduce the cost of offering healthcare benefits to their employees, we can also offer a more streamlined version of our product. In these cases, we offer access to healthcare through our network of providers and the efficient repricing of bills through our proprietary systems. We can offer these services on a price based on either the number of participants per month or as a percentage of savings on healthcare costs actually realized.

On June 18, 2004, we acquired Access Healthsource, Inc. (Access), a full-service third party administrator, for a purchase price of \$3.4 million (consisting of \$2,000,000 of cash at closing and \$1,400,000 of the Company's stock that has been placed in escrow pending the renewal of one of Access' public sector contracts). Through the acquisition of Access, we now provide a wide range of healthcare claims administration services and other cost containment procedures that are frequently required by governments and other employers who have chosen to self fund their healthcare benefits requirements. Access helps us offer a more complete suite of healthcare services. We are now able to provide individuals and employee groups access to preferred provider networks, medical escrow accounts and full third party administration capabilities to adjudicate and pay medical claims. From a sales distribution standpoint, we have the ability to grow Access' regional business through our numerous independent marketing representatives who sell both to individuals and employer groups throughout the United States. Our acquisition of Access serves to complement our most recent entry into the public sector market through our agreement with the State of Louisiana. Access' primary area of expertise is in the public sector market.

Benefits to Members of Our Programs

We believe that our programs offer members an economical, efficient and convenient method for the selection of health-related products and services. Members are entitled to savings for products and services that may not otherwise be available to them at the price levels available under our healthcare savings programs. Vendors of products and services offered and sold through the programs to members are benefited. Vendors are provided the opportunity to reach a large number of demographically targeted customers with minimal incremental marketing cost.

Critical Accounting Policies

Revenue Recognition

Healthcare Membership Revenues

We recognize membership revenues in the month the member joins the program. Membership revenues are reduced by the amount of refunds estimated to be incurred. Subsequent to the initial membership month, membership revenues are recognized on each monthly anniversary date.

Member program enrollment fees, net of direct costs, are deferred and amortized over the estimated membership period, which averages seven to eight months. Independent marketing representative enrollment fees, net of direct costs, are deferred and amortized over the term of the contract.

Rental Purchase and Club Membership Revenues

Rental purchase and club membership revenues are recognized in the month that our products and services are delivered to our clients. We sell our rental purchase and club membership programs on a wholesale basis to our clients. The wholesale client remits a portion of the rental purchase and club membership revenues to us and retains the balance as compensation for having made the sale.

Commission Expense

Commissions are accrued when earned and paid to our independent marketing representatives in the month following the month in which a member enrolls in our Care Entrée program. Commissions are paid in the month following the month in which the related monthly membership fees are received. We do not pay advanced commissions on membership sales.

Goodwill

As of December 31, 2003 and June 30, 2004, our goodwill of \$21,077,284 and \$22,873,310, respectively, represented the excess of acquisition costs over the fair value of net assets acquired. Goodwill is not amortized. As of December 31, 2003, no impairment had been indicated. On June 18, 2004, we recorded additional goodwill of \$1,796,026 attributable to our acquisition of Access.

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As of June 30, 2004, our goodwill represented approximately 53.2% of our total assets. The goodwill balance of \$22,873,310 as of June 30, 2004 consisted of \$19,077,284 that arose from the merger-acquisition of The Capella Group, Inc., \$2,000,000 from the acquisition of Foresight, Inc., and \$1,796,026 which arose from the acquisition of Access. Our goodwill valuation is dependent primarily on the projected revenue and net earnings of our Care Entrée healthcare, Foresight, Inc.'s club membership business, and Access third party administration services. The procedures surrounding goodwill valuation are very subjective and difficult to quantify given that the projected revenue and net earnings associated with our Care Entrée healthcare membership business is based on a business strategy that is fairly new, innovative and evolutionary in nature. In the case of our club membership business, this business is considered relatively mature and generally has a lower expected growth rate compared to our Care Entrée business. Our recent acquisition of Access serves to complement our Precis healthcare membership business particularly in the self-funded government and employer markets and forms part of our Precis business strategy.

Results of Operations

Current and Comparative Prior Period Historical Information. The following table sets forth selected results of operations for the three and six months ended June 30, 2004 and 2003.

| | For the Three Months Ended June 30, Unaudited | | For the Six Months Ended June 30, Unaudited | |
|----------------------------------|---|---------------|---|---------------|
| | 2004 | 2003 | 2004 | 2003 |
| Product and service revenues | \$ 9,403,212 | \$ 10,963,994 | \$ 19,349,343 | \$ 21,726,303 |
| Operating expenses: | | | | |
| Cost of operations | 3,286,918 | 3,407,147 | 6,588,035 | 6,571,932 |
| Sales and marketing | 2,813,330 | 4,069,180 | 6,011,277 | 8,283,434 |
| General and administrative | 2,701,267 | 1,495,075 | 5,030,548 | 3,091,886 |
| Total operating expenses | 8,801,515 | 8,971,402 | 17,629,860 | 17,947,252 |
| Operating income | 601,697 | 1,992,592 | 1,719,483 | 3,779,051 |
| Other expenses: | | | | |
| Interest income and expense, net | 21,489 | 44,927 | 50,495 | 73,908 |
| Total other expenses | 21,489 | 44,927 | 50,495 | 73,908 |
| Earnings before income taxes | 580,208 | 1,947,665 | 1,668,988 | 3,705,143 |
| Provision for income taxes | 292,327 | 681,285 | 775,185 | 1,252,003 |
| Net earnings | \$ 287,881 | \$ 1,266,380 | \$ 893,803 | \$ 2,453,140 |
| Earnings per common share | | | | |
| Basic | \$ 0.02 | \$ 0.11 | \$ 0.08 | \$ 0.21 |
| Diluted | \$ 0.02 | | | |