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DISCLOSURE INCORPORATED

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-K

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

For the fiscal year ended May 31, 1978 Commission file number 0-5751

COMPREHENSIVE CARE CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Delaware
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)

95-2594724
(I.R.S. EMPLOYER IDENTIFICATION NO.)

660 Newport Center Drive, 4th Flr.
Newport Beach, California
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

92660
(ZIP CODE)

Registrant's telephone number, including area code (714) 640-8950

Securities registered pursuant to Section 12(b) of the Act:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, Par Value $.10 per share
(TITLE OF CLASS)

(TITLE OF CLASS)

1,297,432 shares of Common Stock outstanding as of the close of the period covered by this 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 period that the registrant was required to file such reports), (2) has been subject to such filing requirements for the past 90 days. Yes x No__.

Item 1. Business.

(a) Registrant, who was incorporated in January, 1969, specializes in the management and operation of health care facilities, particularly in the acute psychiatric and alcoholic rehabilitation fields. At May 31, 1978, Registrant was operating (or participating in the operation of) five acute hospitals (three of which are dedicated to the treatment of alcoholism), one extended care facility, one intermediate care facility and two board and care facilities. In addition, Registrant was managing CAREUNITS (Comprehensive Alcoholic Rehabilitation Environment Units) in twenty-eight general hospitals and two HOPEUNIT (HOspital Psychiatric Environment) programs in general hospitals. Registrant also operates CompCare Publications, a literature publishing and distribution center specializing in items related to the Company's health care services.

The five acute hospitals are Brea Hospital Neuropsychiatric Center (Brea); Trinity Oaks Hospital (Trinity Oaks); Woodview Calabasas Hospital (Calabasas); Crossroads Hospital (Crossroads); and CareManor Hospital (CareManor).

Brea is a 142-bed facility located in Brea, California; Trinity Oaks is a 26-bed facility located in Fort Worth, Texas; Calabasas is a 117-bed facility located in Calabasas, California; Crossroads is a 33-bed facility located in Van Nuys, California; and CareManor is a 94-bed facility located in Orange, California. These hospitals provide treatment for a wide range of psychiatric patients except that Trinity Oaks, Crossroads and CareManor are dedicated to the treatment of alcoholism. Calabasas and Crossroads are jointly managed by Registrant and American Psychiatric Hospitals of California, Inc. ("APHI"), a Tennessee corporation, under a joint venture agreement entered into as of November 1, 1972. Under such agreement primary management responsibility for Calabasas is in APHI and primary management responsibility for Crossroads is in Registrant.

Registrant operates one extended care facility, namely, Bay View Convalescent Hospital (Bay View). Bay View is a 59-bed facility located in Costa Mesa, California. Registrant operates one intermediate care and two board and care facilities, namely, Tustin Manor, Gilmar Manor and Bayview Manor. Tustin Manor is a 99-bed facility located in Tustin, California; Gilmar Manor is a 78-bed facility located in Van Nuys, California; and Bayview Manor is a 70-bed facility located in Costa Mesa, California.

At May 31, 1978 Registrant was managing 28 CAREUNITS located in 16 states, including 11 in California. Pursuant to contracts with such hospitals, Registrant, on a fee per patient per day basis provides treatment for alcoholic patients. Under such contracts, the hospitals provide routine hospital services such as room, meals and nursing care, and Registrant provides the doctor and therapy team.

The HOPEUNIT programs which Registrant managed at May 31, 1978 are located in California and Montana. Under a contractual arrangement similar to that of the CAREUNIT program, the HOPEUNIT program delivers mental health services through a general hospital.

(b) (1) There are hospitals, extended care facilities and board and care facilities in the areas served by Registrant's facilities, some of which are much larger and have greater financial resources than those operated by Registrant. In addition, some of them are owned by governmental agencies and others by non-profit corporations which may be supported by endowments and charitable contributions not available to Registrant.

(2) Not applicable.

(3) Not applicable.

(4) Not applicable.

(5) Not applicable.

(6) Not applicable.

(7) Not applicable.

(8) As of May 31, 1978, Registrant employed approximately 750 persons.

(9) Not applicable.

(c) (1) Registrant operates only one line of business, namely, the management and operation of health care facilities, as described above.

(2) Not applicable.

Comprehensive Care Corporation and Subsidiaries

Consolidated Summary of Operations

	Year ended May 31 1978	1977	1976	1975	1974
Revenues:					
Operating (Note B)	$ 18,417,000	$ 13,981,000	$ 10,632,000	$ 7,956,000	$ 5,959,000
Other	143,000	149,000	142,000	120,000	85,000
	18,560,000	14,130,000	10,774,000	8,076,000	6,044,000
Costs and expenses:					
Operating	11,739,000	8,935,000	6,542,000	5,434,000	4,122,000
General, administrative and marketing	4,511,000	3,772,000	2,919,000	1,793,000	1,294,000
Depreciation and amortization	317,000	257,000	171,000	135,000	110,000
Interest	150,000	97,000	80,000	91,000	153,000
	16,717,000	13,061,000	9,712,000	7,453,000	5,679,000
Earnings from continuing operations before taxes on income	1,843,000	1,069,000	1,062,000	623,000	365,000
Taxes on income (Note D)	902,000	471,000	545,000	317,000	186,000
Earnings from continuing operations	941,000	598,000	517,000	306,000	179,000
Losses from discontinued operations, net of income tax credits (Note D)	-	-	-	-	(9,000)
Earnings before extraordinary items	941,000	598,000	517,000	306,000	170,000
Extraordinary items					
Income tax reduction from utilization of net operating loss carryforward (Note D)	-	-	451,000	264,000	200,000
	-	-	451,000	264,000	200,000
Net earnings	$ 941,000	$ 598,000	$ 968,000	$ 570,000	$ 370,000

See notes to summary of operations

Comprehensive Care Corporation and Subsidiaries

Consolidated Summary of Operations (Continued)

	1978	1977	1976	1975	1974
Earnings Per Common and Common Equivalent Share (Note E)					
Primary					
Earnings from continuing operations	$ .73	$ .55	$ .52	$ .30	$ .19
Losses from discontinued operations, net of income tax credits	-	-	-	-	(.01)
Extraordinary items	-	-	.48	.28	.22
Net earnings	$ .73	$ .55	$ 1.00	$ .58	$ .40
Fully diluted					
Earnings from continuing operations	$ .73	$ .47	$ .42	$ .25	$ .19
Losses from discontinued operations, net of income tax credits	-	-	-	-	(.01)
Extraordinary items	-	-	.36	.21	.21
	$ .73	$ .47	$ .78	$ .46	$ .39

See notes to summary of operations

Item 2. Summary of Operations (continued):

Notes to Summary of Operations

Note A - Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries (all wholly-owned) and the Company's 50% interest in the accounts of a joint venture partnership. All significant intercompany accounts and transactions have been eliminated in consolidation.

The losses from discontinued operations, net of income tax credits have been segregated in the consolidated summary of operations. For the year ended May 31, 1974, revenues from these operations were $577,000, while losses, net of income tax credits, were $9,000.

Note B - Operating Revenues

Operating revenue includes amounts from third-party programs under cost reimbursement principles. Management believes that these principles have been properly applied in the determination of revenues from these programs. Final determination of revenues is subject to audit by intermediaries administering these programs. Differences between final settlement and estimated provisions are reflected in operating revenue in the year finalized.

Adjustments related to prior years increased revenue in 1974 by $146,000. Adjustments in 1975, 1976, 1977 and 1978 were not significant.

Note C - Accounting for 50% Interest in a Joint Venture

The Company consolidates its 50% interest in a joint venture partnership. The assets and liabilities of the joint venture partnership included in the consolidated balance sheet are as follows:

	Company's 50% Share				
	1978	1977	1976	1975	1974
Assets					
Current assets	$731,000	$567,000	$324,000	$301,000	$353,000
Property and equipment (net)	88,000	100,000	95,000	91,000	96,000
Other assets	4,000	1,000	3,000	7,000	8,000
	$823,000	$668,000	$422,000	$399,000	$457,000
Liabilities and partner's equity					
Current liabilities	$226,000	$191,000	$156,000	$135,000	$333,000
Long-term debt due after one year	-	-	-	-	14,000
Partner's equity	597,000	477,000	266,000	264,000	110,000
	$823,000	$668,000	$422,000	$399,000	$457,000

The operating results of the joint venture partnership included in the consolidated statement of earnings are as follows:

	Company's 50% Share				
	1978	1977	1976	1975	1974
Revenues					
Operating	$2,521,000	$2,187,000	$1,703,000	$1,273,000	$1,031,000
Other	17,000	20,000	30,000	18,000	11,000
	2,538,000	2,207,000	1,733,000	1,291,000	1,042,000
Costs and expenses					
Operating	1,286,000	1,150,000	914,000	877,000	744,000

Notes to Summary of Operations

	Company's 50% Share				
	1978	1977	1976	1975	1974
General, administrative and marketing	693,000	544,000	$458,000	230,000	174,000
Depreciation and amortization	19,000	21,000	19,000	15,000	12,000
Interest	-	-	11,000	14,000	34,000
	1,998,000	1,715,000	1,402,000	1,136,000	964,000
Earnings before taxes on income	$ 540,000	$ 492,000	$ 331,000	$ 155,000	$ 78,000

Note D - Taxes on Income:

The Company and its subsidiaries file consolidated corporate income tax returns. Prior to May 31, 1973, separate corporate income tax returns were filed.

Taxes based on earnings from continuing operations consist of the following:

	Year ended May 31				
	1978	1977	1976	1975	1974
Federal income taxes	$ 753,000	$ 385,000	$ 450,000	$ 264,000	$ 154,000
State income taxes	149,000	86,000	95,000	53,000	32,000
	$ 902,000	$ 471,000	$ 545,000	$ 317,000	$ 186,000

Income tax credits applicable to losses from discontinued operations for the year ended May 31, 1974 were $10,000.

As of May 31, 1976, the Company had fully utilized federal income tax carryforwards for financial and income tax reporting.

Investment tax credits are applied as a reduction of the tax provision in the year utilized.

A reconciliation between total income taxes and the amount computed by applying the statutory federal income tax rate of 48% to earnings from continuing operations before taxes on income follows:

	Year ended May 31				
	1978	1977	1976	1975	1974
Statutory tax rate applied to pre-tax earnings	$ 885,000	$ 513,000	$ 510,000	$ 299,000	$ 175,000
Add (deduct)					
State income taxes net of federal tax benefit	91,000	53,000	49,000	28,000	15,000
Investment tax credit	(26,000)	(93,000)	-	-	-
New jobs credit	(52,000)	-	-	-	-
Other	4,000	(2,000)	(14,000)	(10,000)	(4,000)
	$ 902,000	$ 471,000	$ 545,000	$ 317,000	$ 186,000

Note E - Earnings Per Share:

Primary earnings per common and common equivalent share have been computed by dividing earnings net of cash dividends on the 8% new preferred shares by the weighted average number of shares of common stock and convertible preferred stock outstanding during the year as follows:

Notes to [illegible]mary of Operations

	1978	1977	1976	1975	1974
Common stock	1,297,370	1,090,940	939,001	938,682	916.599
Convertible preferred stock	-	-	3,255	7,813	7,813
	1,297,370	1,090,940	942,256	946,495	924.412
8% cash dividends	$ -	$ -	$ 24,000	$ 24,000	$ 2,000

Fully diluted earnings per common and common equivalent share have been computed by dividing earnings by the weighted average number of shares of common stock, convertible preferred stock and 8% new preferred stock outstanding during the year as follows:

	1978	1977	1976	1975	1974
Common stock	1,297,370	1,090,940	939,001	938,682	916,599
Convertible preferred stock	-	-	3,255	7,813	7,813
8% new preferred stock	-	177,917	305,000	305,000	33,098
	1,297,370	1,268,857	1,247,256	1,251,495	957,510

The dilutive effect of outstanding stock options and warrants was not significant in 1974, 1975, 1976, 1977 or 1978.

Cash dividends of $156,000, $63,000 and $48,000 have been paid on common shares in 1978, 1977 and 1976, respectively. Shareholders of the convertible preferred stock were not entitled to cash dividends.

Note F - Pending Litigation and Claims:

A lawsuit initiated in August, 1976, has resulted in a $122,700 judgment against the Company's Texas subsidiary entered May 26, 1978 The suit alleged breach of an oral lease agreement which was claimed to exist both prior to and subsequent to the Company's acquisition of the subsidiary even though not disclosed by the acquisition documents as an obligation to be assumed. A new trial has been requested and if that motion is denied, an appeal will be filed. Management believes, based upon the opinion of Texas counsel for the subsidiary, that the judgment will be reversed upon the retrial or appeal. If not reversed, it is anticipated that any loss incurred by the Company will be fully recovered from the seller of the subsidiary under an indemnification provision contained in the acquisition agreement.

MANAGEMENTS' DISCUSSION AND ANALYSIS OF

THE SUMMARY OF OPERATIONS

1978

An increase in revenues of $4,430,000 or 31% was recorded in 1978. New units accounted for approximately 20% of the increase, increased utilization accounted for approximately 40%, and price increases accounted for the remainder.

The increase in operating and general administrative and marketing expenses of $3,543,000 (28%) can be attributed to several factors. New operating units generated 20% of the increase, while increased labor, advertising and other costs accounted for the remainder.

Depreciation and amortization increased approximately $60,000. The refurbishment of two free-standing facilities in 1977 and 1978 coupled with other capital expenditures were the causing factors.

Interest was higher due to increased short-term borrowings necessary to meet working capital requirements.

As a result of the above factors, pre-tax earnings in 1978 increased by $774,000 (72%) more than 1977 pre-tax earnings.

Payroll taxes increased approximately 22% as a result of new units and generally higher tax rates.

Real and personal property taxes increased approximately 20% due to tax rate increases.

Rents increased approximately $187,000. A full year's rent was paid for the corporate offices, accounting for approximately $80,000 of the increase. Increases in facility rents due to escalation clauses accounted for approximately $100,000, with increased equipment rental charges the remainder.

Advertising increased $407,000. The Company employed the services of an agency through March, 1978. Their fees accounted for approximately $85,000 of the increase. Expenditures for media advertising increased approximately $260,000. Productions and other costs made up the remainder of the increase.

1977

Revenues of the Company in 1977 increased by $3,356,000 or 32% more than 1976 revenues. Increased patient census resulting from new units and increased utilization generated approximately 55% of the total increase in revenues. Rate increases accounted for the balance of the increase in revenue.

1977 (Continued)

New operating units combined with increasing salaries and wages and other rising costs resulted in increased costs and expenses of $3,349,000.

As a result of the above factors, pre-tax earnings rose $7,000 to $1,069,000. This moderate increase reflects approximately $260,000 in losses incurred during the startup of CareManor and CompCare Publications.

Payroll taxes increased approximately 34% over the prior year primarily as a result of hiring new employees in new operating units.

The addition of a new operating facility plus increasing tax rates lead to an increase of $31,000 in real and personal property taxes.

Rent expense increased by $169,000 as a result of the acquisition of CareManor, increased equipment rental usage and rises in other facility rents due to escalation clauses.

The increase in advertising expenditures resulted from the addition of new operating units and the increased use of various advertising media.

1976

The Company's revenues increased significantly in 1976, rising $2,698,000 or 33% over 1975 revenues. Approximately two-thirds of the revenue increase was attributable to increased patient census which resulted from opening new alcoholic rehabilitation and psychiatric care units and increased utilization in all operating units. The remainder of the revenue increase resulted from rate increases which were effected to absorb higher costs and expenses, primarily salaries and wage increases.

Costs and expenses related to new operating units opened during the year in addition to the rising costs and expenses noted above resulted in costs and expenses increasing $2,259,000 in 1976.

All operating divisions contributed to the increase in earnings in 1976.

Payroll taxes were increased substantially in 1976 primarily due to the hiring of employees for the new operating units.

The increase in rent expense in 1976 was due to rises in facilities rent under provisions in leases containing escalations based on the Consumers Price Index, additional facility space and increased equipment rental usage.

The increase in advertising is attributable to expanded use of newspaper, television and other media to inform the public of health care services available from the Company.

1975

Revenues of the Company in 1975 increased by $2,032,000 or 34% more than 1974 revenues. Increased patient census resulting from opening new alcoholic rehabilitation units and increased utilization in all operating units; alcoholic rehabilitation, psychiatric care (restated to include the Company's 50% interest in joint venture operation) and long-term care accounted for approximately 62% of the total increase in revenue.

Costs and expenses related to new operating units opened in addition to rising costs and expenses resulted in 1975 costs and expenses increasing by $1,774,000.

Earnings from operations reflected increases from all operating divisions.

Payroll taxes were up in 1975 due to the hiring of new employees, especially in the expanding alcoholic rehabilitation division, higher salary and wage levels for withholding of taxes and higher tax rates.

Rent expense was up from 1974, primarily because a full year of the corporate office rent is included in 1975. Larger facilities were required in October, 1973.

The increase in advertising is attributable to managements' decision to utilize newspaper and other media to inform the public of health care services available from the Company.

1974

Revenues increased in 1974 as the result of higher census levels, especially in the psychiatric division (restated to include the Company's 50% interest in joint venture operations) rate increases and retroactive Medicare and Blue Cross adjustments.

After giving effect to increased costs and expenses attributable to increased volume and inflation, earnings from continuing operations before taxes on income increased by $270,000. Retroactive Medicare and Blue Cross adjustments accounted for $146,000 of this increase.

Start-up costs relative to the alcoholic rehabilitation division reduced earnings from operations.

Payroll taxes were up from 1974 due to the hiring of new employees, higher salary and wage levels for withholding of taxes and higher tax rates.

Rent expense was up in 1974 primarily due to higher corporate office rent resulting from moving to a larger building in October, 1973.

Item 3. Properties.

Registrant's executive offices are located on the fourth floor of an office building at 660 Newport Center Drive, Newport Beach, California. This facility consists of approximately 14,896 square feet and is leased for $8,557 per month under a lease which expires in 1986. Registrant owns Bay View Convalescent Hospital and Gilmar Manor. All of Registrant's other health care facilities are operated under leases. The following table sets forth by facility the addresses of the facilities, the dates the leases expire and the monthly rental payable thereunder.

Facility and Address	Lease Expires	Monthly Rental
Brea Hospital Neuro-psychiatric Center 875 North Brea Blvd. Brea, California 92621	1986	$15,965*
Trinity Oaks Hospital, Inc. 1066 West Magnolia Fort Worth, Texas 76104	1996	5,353*
Calabasas Hospital - Neuro-psychiatric Center 25100 Calabasas Road Calabasas, California 92373	1996	16,200*(1)
Crossroads Hospital 6305 Woodman Avenue Van Nuys, California 91401	1987	5,577
CareManor Hospital 401 South Tustin Avenue Orange, California 92666	1994	10,418
Tustin Manor 1051 Bryan Tustin, California 92680	1995	7,754*
Bayview Manor 350 Bay Street Costa Mesa, California 92627	1996	6,105*

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* Subject to increase every five years based upon increases in the Consumer Price Index published by the U. S. Department of Labor, Bureau of Labor Statistics.

(1) This amount is reimbursable to the Registrant under provisions of a joint venture agreement (See Item 1).

Item 4. Parents and Subsidiaries.

Registrant has no parents. The following is a list of all subsidiaries of Registrant setting forth as to each subsidiary the percentage of voting securities owned, or other basis of control, by its parent:

Company	State of Incorporation	Percentage of Voting Securities Owned
NPHS, Inc. *	California	100%
Trinity Oaks Hospital, Inc.*	Texas	100%
CAREUNIT, Inc. *	California	100%
Terracina Convalescent Hospital **	California	100%

* Subsidiaries included in consolidated financial statements.

** Inactive.

Item 5. Legal Proceedings.

Registrant was not engaged in any material legal proceedings as of May 31, 1978.

Item 6. Increases and Decreases in Outstanding Securities and Indebtedness.

(a) Title of Class

(1) New Preferred Stock, $50 par value: Outstanding at June 1, 1977 and May 31, 1978	-0-

Title of Class

(1) Common Stock, $.10 par value: Outstanding at June 1, 1977	1,287,182
(2) Issued for cash upon exercise of qualified stock options	10,250
Outstanding at May 1, 1978	1,297,432

(b) (1) The transaction referred to in item (2) above involved the sale and issuance by Registrant of shares of its Common Stock to its employees for an aggregate cash consideration of $17,938, as follows:

Date	Employee	No. of Shares	Price	Price in the over-the-counter-market Bid	Asked
6-9-77	A. Joel Klein	10,000	$1.75	4-1/2	5
9-20-77	B. Porchia	250	1.75	3-1/4	3-3/4

No broker, underwriters or finders were involved in any of these transactions. Registrant obtained such evidence (including written representations of the issuees) as it deemed necessary to assure itself that these securities were purchased for investment and not with a view to distribution; and therefore determined that the offer and sale of these securities was exempt from the registration and prospectus delivery requirements of the Act pursuant to Section 4(2) thereof as transactions not involving any public offering.

The certificates evidencing the securities issued in such transaction were endorsed with the following legend:

> "No sale, offer to sell or transfer of the shares represented by this certificate shall be made unless a registration statement under the Federal Securities Act of 1933, as amended, with respect to such shares is then in effect or an exemption from the registration requirements of such act is then in fact applicable to such shares."

In addition, stop transfer instructions were given to Registrant's Transfer Agent with respect to such securities.

Title of Class

(1) Qualified Stock Options: Outstanding at June 1, 1977	10,250
(2) Exercised during 1977	(10,250)
Outstanding at May 31, 1978	-0-

Item 7. Changes in Securities and Changes in Security for Registered Securities.

None.

Item 8. Defaults Upon Senior Securities.

None.

Item 9. Approximate Number of Equity Security Holders.

Title of Class	Number of Record Holders as of May 31, 1978
Common Stock, par value $.10 per share	789

Item 10. Submission of Matters to a Vote of Security Holders.

None.

Item 11. Executive Officers of the Registrant.

Name	Office	Age
B. Lee Karns	President	48
A. Joel Klein	Vice President - Development	38
William James Nicol	Vice President - Finance and Administration, Secretary and Treasurer	34
Edward A. Johnson	Vice President - Acute Hospital Division	33
Robert L. Kasselmann	Vice President - Contract Division	42
Marjorie McAdam	Vice President Communications	43
Allen G. Herkimer, Jr.	Vice President - Management Services	53

No family relations exist between any of the above-named officers of the Registrant and none of them has an employment contract with Registrant.

Mr. Karns has been the President of Registrant since May 1972.

Mr. Klein has been a Vice President of Registrant since November, 1972.

Mr. Nicol has been employed by Registrant since June, 1973. He has been its Secretary since December, 1973 and a Vice President and Treasurer of Registrant since April, 1974.

Mr. Johnson has been a Vice President of Registrant since May, 1974. For more than five years prior thereto, he was Administrator and Executive Director of Registrant's Brea Hospital Neuro-Psychiatric Center.

Mr. Kasselmann has been a Vice President of Registrant since May, 1975. He was a consultant with the Health Care Management Services Division of Laventhol & Horwath from January, 1974 to August, 1974 and for approximately five years prior thereto he was a project manager and director of operations of S.D.S. Management Services.

Ms. McAdam has been employed by Registrant since April 1972 except during a leave of absence from July 1976 to March 1978 during which time she provided consulting services to the Company. Ms. McAdam was Vice President - Public Relations prior to her leave of absence and she returned to the Company as Vice President - Communications.

Mr. Herkimer has been a Vice President of Registrant since March 1977. He was employed by Laventhol & Horwath, certified public accountants from May 1973 to March 1977 and was a Principal at the time he terminated his employment with that firm.

Item 12. Indemnification of Directors and Officers.

Section 145 of the General Corporation Law of the State of Delaware, Registrant's State of incorporation, provides, among other things, that a corporation may indemnify an officer or director against expenses, fees (including attorneys' fees), judgments, and amounts paid in settlement, actually and reasonably incurred by such officer or director in connection with any civil, criminal, administrative or investigative action, suit or proceeding (other than an action brought by or in the right of the corporation) if such officer or director was named in such action, suit or proceeding by reason of the fact that he was such a director or officer of the corporation and if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, he had no reasonable cause to believe his conduct was unlawful.

A corporation may also indemnify an officer or director against expenses (including attorneys' fees) reasonably incurred in connection with the defense or settlement of any action or suit brought by or in the right of the corporation, except that no indemnification may be made in respect to any claim, issue or matter as to which such person shall have been adjudged to be liable for negligence or misconduct in performance of his duty to the corporation unless the court shall determine that such person is fairly and reasonably entitled to indemnity for such expenses.

In addition to the foregoing, to the extent that a director or officer is successful on the merits or otherwise in the defense of any action, suit or proceeding referred to above, or in defense of any claim, issue or matter therein he may be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him in connection therewith.

Except in the case where an officer or director has been successful in his defense of an action or any claim, issue or matter therein, the determination as to whether any such officer of director shall be indemnified shall be made (1) by the Board of Directors by a majority vote of a quorum consisting of directors who are not parties to such action, suit or proceeding, or (2) if such a quorum is not obtainable, or, even if obtainable, a quorum of disinterested directors so directs, by independent legal counsel in a written opinion, or (3) by the stockholders.

Other provisions of Section 145 provide that, upon the meeting of certain conditions, expenses of an officer or director may be paid prior to final disposition of the action; that indemnification provided by the statute shall not be deemed the exclusive of any other rights which said officer or director may have; that the corporation may purchase and maintain insurance on behalf of any such officer or director; and that the provisions of said section apply to constituent corporations.

Item 13. Financial Statements, Exhibits Filed and Reports on Form 8-K.

(a) The Index to Financial Statements and Schedules appearing on page S-1 hereof contains a list of all financial statements filed as a part of this report.

Exhibits:

Loan Agreement dated March 20, 1978 between Union Bank and Registrant.

(b) Reports on Form 8-K. None filed during the quarter ended May 31, 1978.

PART II

Omitted. Registrant has filed with the Securities and Exchange Commission, proxy material with respect to its Annual Meeting to be held on September 29, 1978 covering its fiscal year ended May 31, 1978.

Pursuant to the requirements of Section 13 or 15(d) 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.

COMPREHENSIVE CARE CORPORATION

William James Nicol,
Vice President - Finance and Administration,
Secretary and Treasurer

DATED: August 16, 1978.

Comprehensive Care Corporation and Subsidiaries

Financial Statements and Schedules Comprising Item 10 (a)

of Annual Report on Form 10-K

To Securities and Exchange Commission

Years Ended May 31, 1978 and 1977

Financial Statements and Schedules

Years Ended May 31, 1978 and 1977

Index

All other schedules are omitted because they are inapplicable, not required under the instructions or the information is included in the financial statements or notes thereto.

(A) Including Comprehensive Care Corporation (parent only) financial statements - years ended May 31, 1978 and 1977, in Note 10.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Stockholders and Board of Directors of
Comprehensive Care Corporation

We have examined the consolidated balance sheet of Comprehensive Care Corporation and subsidiaries as of May 31, 1978 and 1977 and the related consolidated statements of earnings, stockholders' equity and changes in financial position for the years then ended and the additional notes and schedules listed in the accompanying index. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements identified above present fairly the financial position of Comprehensive Care Corporation and subsidiaries at May 31, 1978 and 1977, the results of their operations and the changes in their financial position for the years then ended, and the additional notes and schedules present fairly the information required to be set forth therein, all in conformity with generally accepted accounting principles applied on a consistent basis.

Baron, Lesley, Thomas, Schwarz & Postma

BARON, LESLEY, THOMAS, SCHWARZ & POSTMA

Newport Beach, California
July 19, 1978

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Partners of
Neuro Affiliates Company (A Joint Venture)

We have examined the balance sheet of Neuro Affiliates Company (A Joint Venture) as of May 31, 1978 and 1977, and the related statements of income and partners' capital, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements identified above present fairly the financial position of Neuro Affiliates Company at May 31, 1978 and 1977, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Baron, Lesley, Thomas, Schwarz + Postma

BARON, LESLEY, THOMAS, SCHWARZ & POSTMA

Newport Beach, California
July 17, 1978

Comprehensive Care Corporation and Subsidiaries

Consolidated Balance Sheet

	May 31 1978	May 31 1977
Assets		
Current assets:		
Cash (Note 3)	$ 910,000	$ 518,000
Accounts receivable, less allowance for doubtful accounts of $348,000, 1978 and $240,000, 1977 (Schedule XII)	3,403,000	2,567,000
Prepaid expenses	668,000	683,000
Total current assets	4,981,000	3,768,000
Property and equipment, at cost (Notes 1 and 3 and Schedules V and VI):		
Land and improvements	473,000	326,000
Buildings and improvements	861,000	763,000
Furniture and improvements	1,714,000	1,549,000
Leasehold improvements	847,000	515,000
	3,895,000	3,153,000
Less accumulated depreciation and amortization	1,148,000	843,000
	2,747,000	2,310,000
Other assets:		
Lease acquisition costs (Note 1 and Schedule VII)	248,000	276,000
Cost in excess of net assets of businesses purchased (Note 1 and Schedule VII)	517,000	517,000
Other	189,000	137,000
	954,000	930,000
	$ 8,682,000	$ 7,008,000
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities (Note 9)	$ 1,580,000	$ 1,237,000
Payable to third party payors within one year	550,000	607,000
Long-term debt payable within one year (Note 3)	337,000	524,000
Income taxes payable	484,000	317,000
Deferred income taxes	180,000	140,000
Total current liabilities	3,131,000	2,825,000
Deferred gain on sale and leaseback of property (Note 1)	131,000	138,000
Long-term debt due after one year (Note 3)	1,661,000	1,089,000
Commitments and contingent liabilities (Note 5)		
Stockholders' equity (Note 4):		
Common stock, $.10 par value; authorized 2,000,000 shares; issued and outstanding 1,297,432 shares, 1978 and 1,287,182 shares 1977	130,000	129,000
Additional paid-in capital	1,836,000	1,819,000
Retained earnings	1,793,000	1,008,000
	3,759,000	2,956,000
	$ 8,682,000	$ 7,008,000

See notes to consolidated financial statements.

Comprehensive Care Corporation and Subsidiaries

Consolidated Statement of Earnings

	Year ended May 31	
	1978	1977*
Revenues:		
Operating (Note 1)	$ 18,417,000	$ 13,981,000
Other	143,000	149,000
	18,560,000	14,130,000
Costs and expenses:		
Operating	11,739,000	8,935,000
General, administrative and marketing	4,511,000	3,772,000
Depreciation and amortization (Note 1 and Schedule VI)	317,000	257,000
Interest	150,000	97,000
	16,717,000	13,061,000
Earnings before taxes on income	1,843,000	1,069,000
Taxes on income (Note 6)	902,000	471,000
Net Earnings	$ 941,000	$ 598,000
Earnings per common and common equivalent share: (Note 1)	$ .73	$ .47

*Restated to conform to current presentation

See notes to consolidated financial statements.

Comprehensive Care Corporation and Subsidiaries

Consolidated Statement of Stockholders' Equity

	New Preferred Stock 8% Convertible		Common Stock		Additional Paid-in Capital	Retained Earnings
	Shares	Amount	Shares	Amount		
Balances, May 31, 1976	6,100	$305,000	947,682	$ 95,000	$1,459,000	$461,000
Net earnings						598,000
Exercise of employee stock options			34,500	4,000	85,000	
Dividends declared on common stock						(63,000)
Restoration of dividends declared on 8% new preferred stock resulting from conversion of shares to common stock						12,000
Conversion of preferred stock to common stock	(6,100)	(305,000)	305,000	30,000	275,000	
Balances, May 31, 1977	-	-	1,287,182	129,000	1,819,000	1,008,000
Net earnings						941,000
Exercise of employee stock options			10,250	1,000	17,000	
Dividends declared on common stock						(156,000)
	-	$ -	1,297,432	$130,000	$1,836,000	$1,793,000

See notes to consolidated financial statements.

Comprehensive Care Corporation and Subsidiaries

Consolidated Statement of Changes in Financial Position

	Year ended May 31 1978	Year ended May 31 1977
Financial Resources Provided by:		
Operations		
Net earnings	$ 941,000	$ 598,000
Items not requiring outlay of working capital:		
Depreciation and amortization of property and equipment	317,000	257,000
Amortization of leasehold costs and other deferred charges	21,000	24,000
Working capital provided by operations	1,279,000	879,000
Disposal of property and equipment	25,000	61,000
Additional long-term debt due after one year	1,118,000	653,000
Issuance of common stock	18,000	89,000
	2,440,000	1,682,000
Financial Resources Used for:		
Purchases of property and equipment	779,000	1,100,000
Reduction of long-term debt	546,000	539,000
Dividends	156,000	51,000
Other applications	52,000	16,000
	1,533,000	1,706,000
Increase (Decrease) in Working Capital	$ 907,000	$ (24,000)
Summary of Changes in Components of Working Capital:		
Increase (decrease) in current assets:		
Cash	$ 392,000	$ (215,000)
Accounts receivable	836,000	948,000
Prepaid expenses	(15,000)	199,000
	1,213,000	932,000
Increase (decrease) in current liabilities:		
Accounts payable and accrued liabilities	343,000	224,000
Payable to third party payors within one year	(57,000)	39,000
Long-term debt payable within one year	(187,000)	373,000
Income taxes payable	207,000	392,000
Cash dividends payable	-	(72,000)
	306,000	956,000
Increase (Decrease) in Working Capital	$ 907,000	$ (24,000)

See notes to consolidated financial statements.

Comprehensive Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements

May 31, 1978 and 1977

Note 1 Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries (all wholly-owned) and the Company's 50% interest in the accounts of a joint venture partnership. All significant intercompany accounts and transactions have been eliminated in consolidation.

Operating Revenues

Operating revenue includes amounts from third-party programs under cost reimbursement principles. Management believes that these principles have been properly applied in the determination of revenues from these programs. Final determination of revenues is subject to audit by intermediaries administering these programs. Differences between final settlement and estimated provisions are reflected in operating revenue in the year finalized.

Property and Equipment

Depreciation and amortization of property and equipment is computed on the straight-line method over the estimated useful lives of the related assets; principally: buildings and improvements - 5 to 40 years; furniture and equipment - 3 to 12 years; leasehold improvements - life of lease or life of asset whichever is less. Expenditures for maintenance, repairs and minor renewals are charged to expense as incurred and major betterments are capitalized. Cost of property disposed of and related accumulated depreciation are removed from the accounts and gains or losses are reflected in earnings.

Intangible Assets

Costs in excess of net assets of businesses purchased are not being amortized since, in the opinion of management, there has been no reduction in value

Lease acquisition costs are being amortized on the straight-line method over the term of the leases, which expire in 1986 and 1997. The unamortized balances at May 31, 1978 are $230,000 and $18,000 respectively.

Project Development and Preopening Costs

Expenditures for project development and preopening costs are expensed as incurred.

Investment Tax Credits

Investment tax credits are applied as a reduction to the tax provision in the year utilized.

Deferred Gain on Sale and Leaseback of Property

The gain realized on the sale and leaseback of a hospital facility is taken into income by straight-line amortization over the term of the lease which expires in 1996.

Comprehensive Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements

May 31, 1978 and 1977

(Continued)

Earnings Per Share

Earnings per share have been computed by using the weighted average number of common shares outstanding; 1,297,370 in 1978 and 1,268,857 in 1977.

Stock options, warrants and rights were not dilutive in 1978 or in 1977.

Note 2 Accounting for 50% Interest in a Joint Venture

The Company consolidates its 50% interest in a joint venture partnership. The assets and liabilities of the joint venture partnership included in the consolidated balance sheet are as follows:

	Company's 50% Share	
	1978	1977
Assets		
Current assets	$ 731,000	$ 567,000
Property and equipment (net)	88,000	100,000
Other assets	4,000	1,000
	$ 823,000	$ 668,000
Liabilities and partner's equity		
Current liabilities	$ 226,000	$ 191,000
Partner's equity	597,000	477,000
	$ 823,000	$ 668,000

The operating results of the joint venture partnership included in the consolidated statement of earnings are as follows:

	Company's 50% Share	
	1978	1977
Revenues		
Operating	$ 2,521,000	$ 2,187,000
Other	17,000	20,000
	2,538,000	2,207,000
Costs and expenses		
Operating	1,286,000	1,150,000
General, administrative and marketing	693,000	544,000
Depreciation and amortization	19,000	21,000
	1,998,000	1,715,000
Earnings before taxes on income	$ 540,000	$ 492,000

Comprehensive Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements

May 31, 1978 and 1977

(Continued)

Note 3 Long-Term Debt

Long-term debt consists of the following:

	1978	1977
6½ to 10% notes collateralized by trust deeds, payable in monthly installments with maturity dates from 1980 through 1993	$ 531,000	$ 476,000
Note payable to Small Business Administration, uncollateralized, bearing interest at 3% with maturity in 2002	347,000	347,000
7% to 8½% unsecured notes payable in quarterly installments with maturity dates through 1983	90,000	123,000
Unsecured demand notes payable bearing interest at 1% to 1½% over the prime rate	-	300,000
Notes payable, secured by equipment bearing interest at 1% to 2% over the prime interest rate payable in monthly installments maturing in 1983	967,000	252,000
Equipment contracts	42,000	92,000
Other	21,000	23,000
	1,998,000	1,613,000
Less amounts due within one year	337,000	524,000
	$ 1,661,000	$ 1,089,000

Annual maturities of long-term debt for the next five years amount to $337,000 in 1979, $292,000 in 1980, $255,000 in 1981, $254,000 in 1982 and $226,000 in 1983.

In April, 1978, the Company secured a five-year term loan for $1,000,000, with a bank, bearing interest at one and seven-eighths percent over the bank's prime rate. The terms of this loan call for a compensating amount of 20% of the outstanding loan balance, the maintenance of consolidated working capital of at least $1,500,000, a current ratio of 1.6 to 1, tangible net worth of $2,600,000 plus 70% of net earnings generated subsequent to November 30, 1977, and a debt to net worth ratio of 1.5 to 1. Monthly payments on this loan are $17,000 plus interest. The balance outstanding at May 31, 1978, was $967,000.

The Company also has a working capital loan agreement with the same bank whereby the Company may borrow, from time to time, certain amounts, evidenced by promissory notes, the aggregate of which cannot exceed $300,000. The notes bear interest at the rate of one and seven-eighths percent over the bank's prime rate. The Company had no amounts outstanding under this line of credit at May 31, 1978.

Comprehensive Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements

May 31, 1978 and 1977

(Continued)

Note 4 Stockholders' Equity

New Preferred Stock

The Company is authorized to issue 60,000 shares of new preferred stock, par value $50 a share, issuable in one or more series. The Board of Directors of the Company is authorized to fix the number of shares constituting each series and to establish rights and preferences.

The rights and preferences of the series of new preferred stock issued provide for an 8% dividend ($4.00 a share) each year; convertibility into common stock at $1.00 per share; preference over the holders of common stock in the event the Company is liquidated; and voting rights, with the number of votes being based upon the number of shares of common stock that the new preferred stock may be converted. During December, 1976 and January 1977, all 6,100 shares of the stock were converted into common shares.

Accounting for Stock Options

When stock options are exercised, the excess of the proceeds received over the par value of the shares of stock issued is credited to additional paid-in capital.

Stock Options

Under the Company's qualified stock option plan, options have been granted to key employees to purchase common stock of the Company at prices of not less than 100% of the fair market value at date of grant. During fiscal 1978, options to purchase 10,250 shares at $1.75 each were exercised. No options were outstanding at May 31, 1978.

Comprehensive Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements

May 31, 1978 and 1977

(Continued)

Note 5 Lease Commitments

The Company and the joint venture partnership leases facilities, furniture and equipment. The facility leases contain clauses for escalations based on the Consumers Price Index, payment of real estate taxes, insurance, maintenance and repair expenses. Generally, the furniture and equipment leases provide purchase options and accordingly, these leases have been capitalized. Equipment leases that do not have purchase options are not significant and are not included herein. Rent expense of facilities included in costs and expenses was as follows:

	1978	1977
Company's operations	$ 722,000	$ 535,000
50% of Joint Venture operations	131,000	131,000
	$ 853,000	$ 666,000

In addition, amortization of leasehold costs of $28,000 less amortization of deferred gain on sale and leaseback of property of $7,000 was charged to the Company's operations in 1978 and 1977. Minimum annual facility rental commitments under non-cancellable leases as of May 31, 1978 are summarized as follows:

	Company	Joint Venture	Total
1979	$ 1,082,000	$ 67,000	$ 1,149,000
1980	1,077,000	67,000	1,144,000
1981	1,066,000	67,000	1,133,000
1982	1,039,000	67,000	1,106,000
1983	1,033,000	67,000	1,100,000
1984-1988	4,808,000	290,000	5,098,000
1989-1993	3,686,000	-	3,686,000
1994-1998	1,998,000	-	1,998,000
After 1998	-	-	-
	$15,789,000	$ 625,000	$16,414,000

Included in the Company's commitments is $194,000 annual rent payable through 1996, which is reimbursed to the Company by the Joint Venture.

The present value of minimum lease commitments applicable to all noncancellable financing leases at May 31, 1978 and 1977 is $ 3,681,000 and $ 3,819,000 respectively. The weighted average interest rate (based on present value) and range of interest for 1978 and 1977 are 8.4% and 6.5% - 9.25%.

If the leases were capitalized and the related property rights were amortized on a straight-line basis and interest was accrued on the basis of present value, earnings before extraordinary item would have been reduced by $ 78,000 in 1978 and $ 82,000 in 1977. Net earnings would have been reduced by $40,000 in 1978 and $ 46,000 in 1977.

Amortization in the above computations was $ 216,000 and $206,000 for 1978 and 1977, respectively. Interest amounted to $ 319,000 and $313,000 for 1978 and 1977 respectively.

Note 6 Taxes on Income

Federal and state taxes on income consist of the following:

	1978	1977
Currently payable		
Federal income taxes	$ 721,000	$ 298,000
State income taxes	141,000	69,000
	862,000	367,000
Deferred		
Federal income taxes	32,000	87,000
State income taxes	8,000	17,000
	40,000	104,000
	$ 902,000	$ 471,000

A reconciliation between total income taxes and the amount computed by applying the statutory federal income tax rate (48%) to earnings before taxes on income is as follows:

	1978	1977
Statutory tax rate applied to pre-tax earnings	$ 885,000	$ 513,000
Add state income taxes net of federal tax benefit	91,000	53,000
Deduct investment tax credit	(26,000)	(93,000)
New jobs credit	(52,000)	-
Other	4,000	(2,000)
	$ 902,000	$ 471,000

As of May 31, 1976, the Company had fully utilized federal income tax carry-forwards to offset taxable income for financial and income tax reporting.

Deferred tax expense results from timing differences in the recognition of revenue and expenses for tax and financial statement purposes. The sources of these differences and the tax effect of each were as follows:

	1978	1977
Excess tax over book depreciation	$ 22,000	$ 36,000
Cash basis accounting and different reporting period for tax purposes by joint venture	33,000	57,000
State income taxes not currently deductible	(31,000)	(8,000)
Other, net	16,000	19,000
	$ 40,000	$ 104,000

Comprehensive Care Corporation and Subsidiaries

Notes to Consolidated Financial Statements

May 31, 1978 and 1977

(Continued)

Note 7 Quarterly Results (Unaudited) Years Ended May 31, 1978 and 1977

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1978				
Revenues	$4,101,000	$4,437,000	$4,549,000	$5,473,000
Earnings before income taxes	$ 108,000	$ 474,000	$ 444,000	$ 817,000
Federal and state income taxes	52,000	226,000	194,000	430,000
Net earnings	$ 56,000	$ 248,000	$ 250,000	$ 387,000
Per share	$ .04	$ .19	$ .20	$ .30
1977				
Revenues	$3,143,000	$3,521,000	$3,468,000	$3,998,000
Earnings before income taxes	$ 300,000	$ 348,000	$ 155,000	$ 266,000
Federal and state income taxes	133,000	162,000	56,000	120,000
Net earnings	$ 167,000	$ 186,000	$ 99,000	$ 146,000
Per share	$ .13	$ .15	$ .08	$ .11

Note 8 Supplementary Income Statement Information

The following amounts were charged to costs and expenses:

	Company		Consolidated	
	1978	1977	1978	1977
Depreciation and amortization of property, plant and equipment	$ 183,000	$ 150,000	$ 317,000	$ 257,000
Amortization of intangible assets	$ -	$ -	$ 28,000	$ 31,000
Taxes other than income taxes:				
Payroll	$ 172,000	$ 129,000	$ 565,000	$ 462,000
Real and personal property	$ 84,000	$ 63,000	$ 179,000	$ 151,000
Other	$ -	$ -	$ 19,000	$ 15,000
Rents	$ 412,000	$ 263,000	$ 959,000	$ 772,000
Advertising	$ 329,000	$ 120,000	$ 815,000	$ 408,000

There were no royalties or research and development costs paid during the above years.

Note 9 Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities include salaries and wages in the following amounts:

Company		Consolidated	
1978	1977	1978	1977
$ 20,000	$ 32,000	$ 192,000	$ 159,000

Note 10 - Financial Statements of Parent Company:

Financial statements of the parent company, Comprehensive Care Corporation, are as follows:

Comprehensive Care Corporation

Balance Sheet

	May 31 1978	May 31 1977
Assets		
Current assets		
Cash (Note 3)	$ 707,000	$ 348,000
Accounts receivable, less allowance for doubtful accounts of $134,000, 1978 and $ 81,000, 1977 (Schedule XII)	810,000	471,000
Prepaid expenses	386,000	343,000
Total current assets	1,903,000	1,162,000
Investment in Wholly-Owned Subsidiaries, Equity Method (Schedule III)	7,797,000	4,459,000
Property and Equipment, at Cost (Notes 1 and 3 and Schedules V and VI)		
Land	210,000	210,000
Buildings and improvements	729,000	699,000
Furniture and equipment	1,021,000	991,000
Leasehold improvements	394,000	231,000
	2,354,000	2,131,000
Less accumulated depreciation and amortization	641,000	469,000
	1,713,000	1,662,000
Other assets		
Cost in excess of net assets of businesses purchases (Note 1 and Schedule VII)	517,000	517,000
Other	126,000	106,000
	643,000	623,000
	$12,056,000	$ 7,906,000
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable and accrued liabilities (Note 9)	$ 950,000	$ 577,000
Payable to third party payors within one year	58,000	18,000
Long-term debt payable within one year (Note 3)	332,000	524,000
Income taxes payable	484,000	317,000
Deferred income taxes	180,000	140,000
Total current liabilities	2,004,000	1,576,000
Payable to Wholly-Owned Subsidiaries (Schedule IV)	5,084,000	2,617,000
Long-Term Debt Due After One Year (Note 3)	1,209,000	757,000
Commitments (Note 5)		
Stockholders' Equity (Note 4)		
Common stock, $ .10 par value; Authorized 2,000,000 shares; Issued and outstanding 1,297,432 shares, 1978 and 1,289,182 shares, 1977	130,000	129,000
Additional paid-in capital	1,836,000	1,819,000
Retained earnings	1,793,000	1,008,000
	3,759,000	2,956,000
	$12,056,000	$ 7,906,000

See notes to consolidated financial statements

Note 10 - Financial Statements of Parent Company (Continued):

Comprehensive Care Corporation

Statement of Earnings

	Year Ended May 31 1978	Year Ended May 31 1977
Revenue		
Operating (Note 1)	$ 4,266,000	$ 2,564,000
Other	88,000	236,000
	4,354,000	2,800,000
Costs and Expenses		
Operating	3,122,000	2,126,000
General, administrative and marketing	2,408,000	1,536,000
Depreciation and amortization (Note 1 & Schedule VI)	183,000	150,000
Interest	135,000	83,000
	5,848,000	3,895,000
Loss before income tax credit and equity in net earnings of subsidiaries	(1,494,000)	(1,095,000)
Income tax credit	730,000	615,000
Loss before equity in net earnings of subsidiaries	(764,000)	(480,000)
Equity in net earnings of subsidiaries	1,705,000	1,078,000
Net Earnings	$ 941,000	$ 598,000

See notes to consolidated financial statements

Note 10 - Financial Statements of Parent Company (Continued):

Comprehensive Care Corporation

Statement of Changes in Financial Position

	Year Ended May 31	
	1978	1977
Financial Resources Provided by		
Operations		
Net earnings	$ 941,000	$ 598,000
Items not requiring (providing) outlay of working capital		
Depreciation and amortization of property and equipment	183,000	150,000
Equity in earnings of subsidiaries	(3,337,000)	(2,164,000)
Working capital provided from (required for) operations	(2,213,000)	(1,416,000)
Disposal of property and equipment	23,000	-
Increase in amounts due to subsidiaries	2,467,000	1,344,000
Issuance of common stock	18,000	89,000
Additional long-term debt due after one year	1,008,000	653,000
	1,303,000	670,000
Financial Resources Used For		
Purchase of property and equipment	259,000	748,000
Reduction of long-term debt due after one year	546,000	534,000
Dividends	156,000	51,000
Other applications	29,000	69,000
	990,000	1,402,000
Increase((Decrease) in Current Assets	$ 313,000	$ (732,000)

Summary of Changes in Components of Working Capital

Increase (Decrease) in Current Assets		
Cash	$ 359,000	$ (307,000)
Accounts receivable	339,000	381,000
Prepaid expenses	43,000	169,000
	741,000	243,000
Increase (Decrease) in Current Liabilities		
Accounts payable and accrued liabilities	373,000	245,000
Payable to third party payors within one year	40,000	10,000
Long-term debt payable within one year	(192,000)	391,000
Income taxes payable	207,000	392,000
Cash dividends payable	-	(72,000)
	428,000	975,000
Increase (Decrease) in Working Capital	$ 313,000	$ (732,000)

See notes to consolidated financial statements

NEURO AFFILIATES COMPANY

(A Joint Venture)

BALANCE SHEET

ASSETS

	May 31 1978	May 31 1977
CURRENT ASSETS		
Cash	$ 384,000	$ 199,000
Accounts receivable, less allowance for doubtful accounts of $79,000 and $52,000	1,001,000	817,000
Prepaid expenses, supplies and other assets	76,000	123,000
Total current assets	1,461,000	1,139,000
EQUIPMENT AND IMPROVEMENTS, at cost (Note 1)		
Furniture and equipment	237,000	231,000
Leasehold improvements	115,000	109,000
	352,000	340,000
Less accumulated depreciation and amortization	(176,000)	140,000
	176,000	200,000
OTHER ASSETS	7,000	1,000
	$ 1,644,000	$ 1,340,000

LIABILITIES AND PARTNERS' CAPITAL

	1978	1977
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 209,000	$ 232,000
Estimated amounts due under insurance programs (Note 2)	208,000	150,000
Amounts due (from) to affiliated companies, net (Note 3)	32,000	5,000
Total current liabilities	449,000	387,000
PARTNERS' CAPITAL	1,195,000	953,000
	$ 1,644,000	$ 1.340,000

See notes to financial statements

NEURO AFFILIATES COMPANY
(A Joint Venture)

STATEMENT OF INCOME AND PARTNERS' CAPITAL

	YEAR ENDED MAY 31 1978	1977
REVENUES		
Patient care	$ 5,043,000	$ 4,374,000
Other	35,000	40,000
	5,078,000	4,414,000
COSTS AND EXPENSES (Note 3)		
Operating	2,610,000	2,300,000
General and administrative	1,386,000	1,131,000
	3,996,000	3,431,000
NET INCOME	1,082,000	983,000
PARTNERS' CAPITAL, at beginning of year	953,000	532,000
PAYMENTS TO PARTNERS	(840,000)	(562,000)
PARTNERS' CAPITAL, at end of year	$ 1,195,000	$ 953,000

See notes to financial statements

NEURO AFFILIATES COMPANY
(A Joint Venture)

Statement of Changes in Financial Position

	YEAR ENDED MAY 31 1978	1977
FINANCIAL RESOURCES WERE PROVIDED BY		
Operations		
Net income	$ 1,082,000	$ 983,000
Charges to income not requiring an outlay of working capital		
Depreciation of equipment and improvements	36,000	37,000
Amortization of deferred costs	-	6,000
Working capital provided by operations	1,118,000	1,026,000
FINANCIAL RESOURCES WERE USED FOR		
Purchase of equipment and improvements	12,000	46,000
Payments to partners	840,000	562,000
	852,000	608,000
INCREASE IN WORKING CAPITAL	$ 266,000	$ 418,000

	1978	1977
CHANGES IN COMPONENTS OF WORKING CAPITAL		
Increase (decrease) in current assets		
Cash	$ 185,000	$ 146,000
Accounts receivable - net	184,000	294,000
Prepaid expenses, supplies and other assets	(41,000)	31,000
	328,000	471,000
Increase (decrease) in current liabilities		
Accounts payable and accrued expenses	(23,000)	63,000
Estimated amounts due under insurance programs	58,000	(7,000)
Amounts due (from) to affiliates companies - net	27,000	(3,000)
	62,000	53,000
INCREASE IN WORKING CAPITAL	$ 266,000	$ 418,000

See notes to financial statements

NEURO AFFILIATES COMPANY
(A Joint Venture)

NOTES TO FINANCIAL STATEMENTS

May 31, 1978 and 1977

NOTE 1 - THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company - In November, 1972, Hospital Affiliates International, Inc., (HAII), of Nashville, Tennessee, and Comprehensive Care Corporation (CompCare) of Newport Beach, California, entered into an agreement to form a joint venture, Neuro Affiliates Company (NAC). NAC operates two psychiatric hospitals in California. Each partner manages one of the hospitals. The Woodview-Calabasas facility is managed by HAII and the Crossroads facility is managed by CompCare. The two partners share equally in the results of the joint venture operations.

Basis of presentation - The financial statements include only those assets, liabilities and results of operations of the partners which relate to the business of Neuro Affiliates Company. No provision has been made for Federal and state income taxes since these taxes are the responsibility of the partners.

Depreciation - The cost of equipment and leasehold improvements is depreciated or amortized over the estimated useful lives of the assets (five to twelve years) using the straight-line method of depreciation.

NOTE 2 - ESTIMATED AMOUNTS DUE UNDER INSURANCE PROGRAMS

A substantial amount of the revenue of the Company is provided under Federal, state and Blue Cross insurance programs. Allowable revenue under the programs is determined annually by fiscal intermediaries administering the programs based on cost reports filed by the Company. The Company is current with the filing of such cost reports; however, certain cost reports have not been audited by the intermediaries. The Company believes that adequate reserves have been provided in the financial statements for these contingencies.

NOTE 3 - TRANSACTIONS WITH PARTNERS

Rentals - The Company reimburses annual rentals of $194,000 to Comprehensive Care Corporation and $67,000 to Woodview Hospital, a subsidiary of Hospital Affiliates International, Inc., for the use of hospital facilities.

Management fees - Costs and expenses for 1978 and 1977 include $36,000 paid to Comprehensive Care Corporation and $80,000 to Hospital Affiliates International, Inc., for administrative and other services.

Management is of the opinion that these transactions were executed for a consideration substantially equivalent to that which would have been obtained between wholly unrelated interests.

Schedule III

Comprehensive Care Corporation and Subsidiaries

Investments In, Equity In earnings of And Dividends Received From Affiliates

Year Ended May 31, 1978 and 1977

Name of issuer and description of investment	Balance at beginning of period		Additions			Deductions			Balance at end of period		Dividends received during the period from investments not accounted for by the equity method
	Percent of ownership	Amount	Equity taken up in earnings (loss) of affiliates for the period	Other: Percent of ownership	Other: Amount	Distribution of earnings (loss) by affiliates in which earnings (loss) were taken up	Other: Percent of ownership	Other: Amount	Percent of ownership	Amount	
Year Ended May 31, 1978											
NPHS, Inc. investment in joint venture in Neuro Affiliates Company, a partnership	50%	$477,000	$541,000	-	$ -	$420,000	-	$ -	50%	$598,000	$ -
Year Ended May 31, 1977											
NPHS, Inc. investment in joint venture in Neuro Affiliates Company, a partnership	50%	$266,000	$492,000	-	$ -	$281,000	-	$ -	50%	$477,000	$ -

Comprehensive Care Corporation

Investments In, Equity In Earnings Of, And Dividends Received From Affiliates

Year Ended May 31, 1978

Name of issuer and description of investment	Balance beginning of period: Number of Shares	Balance beginning of period: Amount	Additions: Equity taken up in earnings (loss) of affiliates for the period	Additions: Number of shares	Additions: Amount	Deductions: Distribution of earnings (loss) by affiliates in which earnings (loss) were taken up	Deductions: Other: Number of shares	Deductions: Other: Amount	Balance at end of period: Number of shares	Balance at end of period: Amount	Dividends received during the period from investments not accounted for by the equity method
Consolidated Subsidiaries											
NPHS, Inc. common stock par value $10 a share	320	$2,917,000	$1,789,000(a)	-	$ -	$ -	-	$ -	320	$4,706,000	$ -
Terracina Convalescent Hospital & Home, Inc. common stock, par value $100 a share	50	58,000							50	58,000	
Trinity Oaks Hospital, Inc. common stock, par value $1 a share	10,002	205,000	(203,000)						10,002	2,000	
CAREUNIT, Inc. common stock, par value $1 a share	500	1,279,000	1,751,000	500	1,000				1,000	3,031,000	
		$4,459,000	$3,337,000		$ 1,000	$ -		$ -		$7,797,000	$ -

(a) Includes joint venture earnings before taxes on income of $ 541,000

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Schedule III (Continued)

Comprehensive Care Corporation

Investments In, Equity In Earnings Of, And Dividends Received From Affiliates

Year Ended May 31, 1977

Name of issuer and description of investment	Balance at beginning of period: Number of shares	Balance at beginning of period: Amount	Additions: Equity taken up in earnings (loss) of affiliates for the period	Additions: Other: Number of shares	Additions: Other: Amount	Deductions: Distribution of earnings (loss) by affiliates in which earnings (loss) were taken up	Deductions: Other: Number of shares	Deductions: Other: Amount	Balance at end of period: Number of shares	Balance at end of period: Amount	Dividends received during the period from investments not accounted for by the equity method
Consolidated Subsidiaries											
NPHS, Inc. common stock par value $10 a share	320	$1,566,000	$1,351,000 (a)	-	$ -	$ -	-	$ -	320	$2,917,000	$ -
Terracina Convalescent Hospital & Home, Inc. common stock, par value $100 a share	50	67,000	(9,000)						50	58,000	
Fort Worth Neuro-psychiatric Hospital, Inc. common stock, par value $1 a share	10,002	207,000	(2,000)						10,002	205,000	
CAREUNIT, Inc. common stock, par value $1 a share	500	455,000	824,000						500	1,279,000	
		$2,295,000	$2,164,000		$ -	$ -		$ -		$4,459,000	$ -

(a) Includes joint venture earnings before taxes on income of $492,000.

Comprehensive Care Corporation

Indebtedness of and to Affiliates

Year Ended May 31, 1978 and 1977

Name of Affiliate	Balance receivable (payable) at beginning of period	Balance receivable (payable) at end of period
Year ended May 31, 1978:		
Amounts eliminated in consolidation:		
Wholly-owned subsidiaries:		
NPHS, Inc.	$ (1,913,000)	$ (3,183,000)
Terracina Convalescent Hospital & Home, Inc.	(53,000)	(64,000)
Trinity Oaks Hospital, Inc.	(147,000)	50,000
CAREUNIT, Inc.	(504,000)	(1,887,000)
	(2,617,000)	(5,084,000)
Neuro Affiliates Company (50% interest)	(10,000) (c)	9,000 (a)
Total eliminated in consolidation	(2,627,000)	(5,075,000)
Amount not eliminated in consolidation Neuro Affiliates Company	(10,000) (d)	(8,000) (b)
Total indebtedness of and to Affiliates	$ (2,637,000)	$ (5,083,000)
Year Ended May 31, 1977:		
Amounts eliminated in consolidation:		
Wholly-owned subsidiaries:		
NPHS, Inc.	$ (1,106,000)	$ (1,913,000)
Terracina Convalescent Hospital & Home, Inc.	29,000	(53,000)
Trinity Oaks Hospital, Inc.	(182,000)	(147,000)
CAREUNIT, Inc.	(14,000)	(504,000)
	(1,273,000)	(2,617,000)
Neuro Affiliates Company (50% interest)	11,000 (a)	(10,000) (c)
Total eliminated in consolidation	(1,262,000)	(2,627,000)
Amount not eliminated in consolidation Neuro Affiliates Company	11,000 (b)	(10,000) (d)
Total indebtedness of and to Affiliates	$ (1,251,000)	$ (2,637,000)

(a) Included in accounts receivable on balance sheet of Comprehensive Care Corporation.

(b) Included in accounts receivable on balance sheet of Comprehensive Care Corporation and on balance sheet of Comprehensive Care Corporation and Subsidiaries.

(c) Included in accounts payable on balance sheet of Comprehensive Care Corporation.

(d) Included in accounts payable on balance sheet of Comprehensive Care Corporation and on balance sheet of Comprehensive Care Corporation and Subsidiaries.

Comprehensive Care Corporation and Subsidiaries

Property, Plant and Equipment

Year Ended May 31, 1978 and 1977

Classification	Balance at beginning of period	Additions at cost	Sales, retirements and abandonments	Other changes	Balance at end of period
Company:					
Year Ended May 31, 1978:					
Land	$ 210,000	$ -	$ -	$ -	$ 210,000
Buildings and improvements	699,000	45,000	13,000	-	729,000
Furniture and equipment	991,000	158,000	2,000	(126,000)(b)	1,021,000
Leasehold improvements	231,000	56,000	19,000	126,000 (b)	394,000
	$ 2,131,000	$ 259,000	$ 34,000	$ -	$2,354,000
Year Ended May 31, 1977:					
Land	$ 210,000	$ -	$ -	$ -	$ 210,000
Buildings and improvements	676,000	23,000	-	-	699,000
Furniture and equipment	451,000	542,000	6,000	4,000(a)	991,000
Leasehold improvements	58,000	183,000	10,000	-	231,000
	$ 1,395,000	$ 748,000	$ 16,000	$ 4,000	$2,131,000
Consolidated:					
Year Ended May 31, 1978:					
Land and improvements	$ 326,000	$ 147,000	$ -	$ -	$ 473,000
Buildings and improvements	763,000	177,000	14,000	(65,000)(b)	861,000
Furniture and equipment	1,549,000	295,000	4,000	(126,000)(b)	1,714,000
Leasehold improvements	515,000	160,000	19,000	191,000 (b)	847,000
	$ 3,153,000	$ 779,000	$ 37,000	$ -	$3,895,000
Year Ended May 31, 1977:					
Land	$ 216,000	$ 110,000	$ -	$ -	$ 326,000
Buildings and improvements	676,000	87,000	-	-	763,000
Furniture and equipment	954,000	670,000	123,000	48,000(b)	1,549,000
Leasehold improvements	411,000	233,000	81,000	(48,000)(b)	515,000
	$ 2,257,000	$1,100,000	$ 204,000	$ -	$3,153,000

(a) Net transfers from wholly-owned subsidiaries
(b) Reclassifications

Comprehensive Care Corporation and Subsidiaries

Accumulated Depreciation of Property, Plant and Equipment

Year Ended May 31, 1978 and 1977

Classification	Balance at beginning period	Additions charged to costs and expenses	Sales, retirements and abandonments	Other changes	Balance at end of period
Company:					
Year Ended May 31, 1978					
Buildings and improvements	$ 136,000	$ 21,000	$ -	$ -	$ 157,000
Furniture and equipment	289,000	127,000	4,000	(2,000) (a)	410,000
Leasehold improvements	44,000	35,000	7,000	2,000 (a)	74,000
	$ 469,000	$ 183,000	$ 11,000	$ -	$ 641,000
Year Ended May 31, 1977:					
Buildings and improvements	$ 117,000	$ 19,000	$ -	$ -	$ 136,000
Furniture and equipment	189,000	105,000	5,000	-	289,000
Leasehold improvements	28,000	26,000	10,000	-	44,000
	$ 334,000	$ 130,000	$ 15,000	$ -	$ 469,000
Consolidated:					
Year Ended May 31, 1978:					
Buildings and improvements	$ 136,000	$ 23,000	$ -	$ -	$ 159,000
Furniture and equipment	579,000	217,000	6,000	(2,000) (a)	789,000
Leasehold improvements	128,000	77,000	7,000	2,000 (a)	200,000
	$ 843,000	$ 317,000	$ 13,000	$ -	$1,148,000
Year Ended May 31, 1977:					
Buildings and improvements	$ 117,000	$ 19,000	$ -	$ -	$ 136,000
Furniture and equipment	499,000	184,000	104,000	-	579,000
Leasehold improvements	113,000	54,000	39,000	-	128,000
	$ 729,000	$ 257,000	$143,000	$ -	$ 843,000

(a) Reclassifications

Comprehensive Care Corporation and Subsidiaries

Intangible Assets, Deferred Research and Development Expenses, Preoperating Expenses and Similar Deferrals

Year Ended May 31, 1978 and 1977

Classification	Balance at beginning of period	Additions at cost	Deductions: Charged to costs and expenses	Deductions: Charged to other accounts	Balance at end of period
Company:					
Year ended May 31, 1978					
Cost in excess of net assets of purchased businesses	$ 517,000	$ -	$ -	$ -	$ 517,000
Year ended May 31, 1977					
Cost in excess of net assets of purchased businesses	$ 517,000	$ -	$ -	$ -	$ 517,000
Consolidated:					
Year ended May 31, 1978					
Cost in excess of net assets of purchased businesses	$ 517,000	$ -	$ -	$ -	$ 517,000
Lease acquisition costs	$ 276,000	$ -	$ 28,000	$ -	$ 248,000
Year ended May 31, 1977					
Cost in excess of net assets of purchased businesses	$ 517,000	$ -	$ -	$ -	$ 517,000
Lease acquisition costs	$ 304,000	$ -	$ 28,000	$ -	$ 276,000
Preopening costs (a)	$ 3,000	$ -	$ 3,000	$ -	$ -

(a) Represents 50% of joint venture's preopening costs.

Comprehensive Care Corporation and Subsidiaries

Valuation and Qualifying Accounts and Reserves

Year Ended May 31, 1978 and 1977

Description	Balance at beginning of period	Additions: Charged to revenue	Additions: Charged to other accounts (a)	Deductions: Write-off of accounts	Deductions: Other	Balance at end of period
Allowance for doubtful accounts (deducted from accounts receivable in the balance sheet):						
Company:						
Year ended May 31, 1978	$ 81,000	$ 213,000	$ 14,000	$ 174,000	$ -	$ 134,000
Year ended May 31, 1977	$ 10,000	$ 114,000	$ 3,000	$ 46,000	$ -	$ 81,000
Consolidated:						
Year ended May 31, 1978	$ 240,000	$ 517,000	$ 62,000	$ 471,000	$ -	$ 348,000
Year ended May 31, 1977	$ 209,000	$ 308,000	$ 54,000	$ 297,000	$ 34,000 (b)	$ 240,000

(a) Amounts included in this column are recoveries on accounts previously charged to this reserve.

(b) Amount represents adjustments of amounts previously credited to this reserve and charged to revenue.

Schedule XII

LOAN AGREEMENT

THIS AGREEMENT is made and entered into on March 20, 1978 by and between COMPREHENSIVE CARE CORPORATION a Delaware corporation ("Borrower"), and UNION BANK, a California banking corporation ("Bank").

Section 1. THE LOAN

1.1 The Loan. Bank will lend to Borrower the sum of One Million Dollars ($1,000,000.) (the "Loan") at Borrower's request in one disbursement on or before March 31, 1978. The Loan shall be evidenced by a promissory note (the "Note") on the standard form used by Bank for commercial loans.

1.2 Interest. The unpaid principal balance of the Loan shall bear interest at the rate of one and seven-eighths percent (1 7/8%) per year in excess of the Prime Rate of interest which Bank charges corporate borrowers of the highest credit standing for short-term unsecured commercial loans, which shall vary concurrently with any change in such Prime Rate. Interest shall be computed on the basis of the actual number of days during which the principal is outstanding divided by 360 which shall, for the purposes of interest computation, be considered one year. Interest shall be payable monthly within ten (10) days after receipt of notice from Bank of the amount owing.

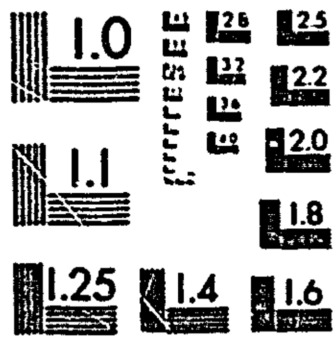
1.3 Payment. The principal of the Loan shall be payable in equal monthly installments of Sixteen Thousand Six Hundred Sixty-Six Dollars and Sixty-Seven Cents ($16,666.67) on the twentieth day of each month commencing April 20, 1978, and continuing until March 20, 1983, at which time all the unpaid principal and accrued interest shall be due and payable.

1.4 Prepayment of Loan. Borrower may prepay the Loan in whole or in part without premium or penalty. In the event of prepayment, the prepayment shall be applied on the principal payments of latest maturity.

1.5 Security. Prior to any disbursement of the Loan, Borrower shall execute a security agreement, on Bank's standard form therefor, and a financing statement, suitable for filing in the office of the Secretary of State of the State of California and any other appropriate state, granting and does hereby grant to Bank a first priority security interest in all of its furniture and fixtures now or hereafter owned or acquired located at Corporate Headquarters: 660 Newport Center Drive, 4th floor, Newport Beach, California Brea Hospital: Neuro-Psychiatric Center, 875 N. Brea Boulevard, Brea, California and all proceeds, guaranties and other security therefor, and all of Borrower's books and records relating thereto.

Section 2. CONDITIONS PRECEDENT TO THE LOAN

Bank shall not be obligated to disburse all or any portion of the proceeds



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NATIONAL BUREAU OF STANDARDS 1963-A

of the Loan unless at or prior to the time for the making of such disbursement, the following conditions have been fulfilled:

2.1 Borrower shall have performed and complied with all agreements and conditions required by this Agreement to be performed or complied with by it prior to or at the date of the making of any disbursement and shall have executed and delivered to Bank the Note.

2.2 CAREUNIT, Inc.; Fort Worth Neuropsychiatric Hospital, Inc.; NPHS, Inc.; and Terracina Convalescent Hospital and Home, Inc. (hereinafter individually and collectively referred to as "Guarantors") shall have executed with respect to the Loan and delivered to Bank their continuing guaranties on the standard form for continuing guaranties used by Bank, for the sum of at least One Million Dollars ($1,000,000.) each.

2.3 Borrower shall have provided Bank with a certified copy of Borrowing Resolution on Bank's form duly adopted by the Board of Directors of Borrower.

2.4 With respect to this Agreement, Bank has received opinion of counsel satisfactory to it to the effect that:

(i) Borrower and Guarantors are duly organized and existing under the laws of their states of incorporation, without limitation to their existence, and have the power and authority to carry on the business in which they are engaged;

(ii) Borrower has the power and authority to enter into this Agreement and to execute and deliver the Note and all of the documents required by this Agreement and Guarantors have the power and authority to enter into their guaranties;

(iii) This Agreement and all things required by this Agreement have been duly authorized by all requisite corporate action of Borrower or Guarantors as applicable;

(iv) The making of this Agreement and the compliance with its terms, and the terms of all documents required by this Agreement are not in variance with or in contravention of any provision of the Articles of Incorporation of Borrower or Guarantors, or to the best knowledge of such counsel, of any applicable provision of law or any indenture, contract or agreement to which Borrower or Guarantors are a party or by which Borrower or Guarantors are bound;

(v) Borrower and Guarantors are duly qualified in good standing as a foreign corporation wherever such qualification is required.

In giving such opinion, counsel shall be entitled to rely upon certificates of officers of Borrower, of Guarantors, of public officials, or of such other persons which counsel shall consider an appropriate and reliable source of the information on which counsel's opinion is requested.

Counsel shall also deliver to Bank copies of attorney's summaries on all non-insured cases where Borrower is defendant which were reported to Borrower's auditors during the last audit.

2.5 At the time the requested disbursement is to be made, there shall not exist no event, condition or act which constitutes an event of default as defined in Section 6 hereof and any condition, event or act which with notice, lapse of time or both would constitute such event of default. There would not exist any event, condition, or act immediately after the disbursement were it to be made.

Section 3. REPRESENTATIONS AND WARRANTIES

Borrower represents and warrants that:

3.1 The business of Borrower is health care and related services.

3.2 The execution, performance and delivery of this Agreement, the Note and all other agreements and instruments required by Bank in connection with the Loan are not in contravention of any of the terms of any indenture, agreement or undertaking to which Borrower or Guarantors are a party or by which their or any of their property is bound or affected.

3.3 A consolidated statement of financial condition of Borrower at November 30, 1977, together with supporting schedules and a consolidated statement of income and expense of Borrower for the six months ended November 30, 1977, (Borrower's Form 10-Q as submitted to the Securities Exchange Commission) have heretofore been furnished to Bank, and ~~are true and complete and~~ fairly represent the financial conditions during the periods covered thereby. Since November 30, 1977, there has been no material adverse change in the financial position or operations of Borrower or Guarantors.

3.4 Except for assets which may have been disposed of in the ordinary course of business, Borrower and Guarantors have good and marketable title, free and clear of all liens, encumbrances, security interests and adverse claims except those specifically set forth to all of the property reflected in Borrower's consolidated statement of financial condition at November 30, 1977, and to all property acquired by Borrower or Guarantors since that date.

3.5 There is no litigation or proceeding pending or to the best of borrower's threatened against Borrower or Guarantors or any of their property, the results of which, if decided adversely, might substantially affect the financial condition, property or business of Borrower or Guarantors in an adverse manner or result in liability in excess of Borrower's or Guarantors' insurance coverage.

3.6 Neither Borrower nor Guarantors are now in default in the payment of any of their material obligations except for SBA Loan #DC 887012-00-01LA entered into by NPHS, Inc.

3.7 There exists no event, condition or act which constitutes an event of default as defined in Section 6 hereof and no condition, event or act which with notice or lapse of time would constitute such event of default.

3.8 Borrower and Guarantors are duly organized and existing under the laws of their state of incorporation, without limitation to its existence, and have the power and authority to carry on the business in which they are engaged.

3.9 Borrower has the power and authority to enter into this Agreement and to execute and deliver the Note and all of the documents required by this Agreement. Guarantors have the power and authority to execute their guaranties.

3.10 This Agreement and all things required by this Agreement have been duly authorized by all requisite corporate action of Borrower or Guarantors as appropriate.

3.11 Borrower and Guarantors are duly qualified and in good standing as a foreign corporation wherever such qualification is required.

3.12 These representations shall be considered to have been made again at and as of the date of each disbursement of the Loan and shall be true and correct as of that date.

3.13 Borrower's and Guarantors' pension plans for retired employees have been funded in accordance with principles that are actuarially sound and no reportable event has occurred and is continuing with respect to any such plan. No fact exists in connection with any of Borrower's and Guarantors' pension plans for retired employees which constitutes grounds under the Employee Retirement Income Security Act of 1974, as presently in effect, for the termination of any such plan by the Pension Benefit Guaranty Corporation or for the appointment by any United States district court of a trustee to administer any such plan.

3.14 No action has been taken or is currently planned by the Borrower or Guarantors, or any agent acting on its behalf, which would cause this Agreement or the Note to violate Regulation U or any other regulation of the Board of Governors of the Federal Reserve System, ~~or to violate the Securities and Exchange Act of 1934~~, in each case as in effect now or as the same may hereafter be in effect. Borrower is not engaged in the business of extending credit for the purpose of purchasing or carrying margin stocks as one of its important activities.

3.15 Guarantors are the only subsidiaries of Borrower and Borrower owns one hundred percent (100%) of the stock of Guarantors. When consolidated statements are required or referred to in this Agreement, Guarantors shall be all the consolidated subsidiaries.

Section 4. AFFIRMATIVE COVENANTS OF BORROWER

Until the Note and all other sums payable pursuant to this Agreement or any other agreement or instrument required by Bank in connection with the Loan have been paid in full, unless Bank waives compliance in writing, Borrower agrees that:

4.1. Use of Proceeds. Borrower will use the net proceeds of the Loan only for general corporate purposes in the conduct of the business in which it and its Guarantors are presently engaged.

4.2 Payment of Obligations. Borrower will and will cause Guarantors to pay and discharge promptly all taxes, assessments and other governmental charges and claims levied or imposed upon them or upon their property, or any part thereof, provided, however, that Borrower or Guarantors shall have the right in good faith to contest any such taxes, assessments, charges or claims and, pending the outcome of such contest, to delay or refuse payment thereof provided that adequate ~~funded~~ reserves are established by Borrower on its consolidated balance sheet to pay and discharge any such taxes, assessments, charges and claims.

4.3 Maintenance of Corporate Existence. Borrower will and will cause Guarantors to maintain and preserve their existence and assets and all rights, franchises and other authority necessary for the conduct of their businesses and will maintain and preserve their property, equipment and facilities in good order, condition and repair. Bank may, at reasonable times, visit and inspect any of the properties of Borrower or Guarantors.

4.4 Records. Borrower will keep and maintain full and accurate accounts and records of its and Guarantors' operations according to generally accepted accounting principles and practices and will permit Bank to have access thereto, to make examination thereof, and to make audits during regular business hours.

4.5 Information Furnished. Borrower will furnish to Bank:

(i) Within forty-five (45) days after the close of each fiscal quarter, except for the last quarter of each fiscal year, ~~its unaudited consolidated balance sheet as of the close of such quarter, its unaudited consolidated income and [illegible] statement with supportive schedules and statement of retained earnings for that quarter~~, prepared in accordance with generally accepted accounting principles and practices and examined and certified as correct to the best of the knowledge and belief of its chief financial officer.

its Form 10Q as submitted to the SEC for that quarter

(ii) Within ninety (90) days after the close of each fiscal year, ~~a copy of its consolidated statement of financial condition including at least its consolidated balance sheet as of the close of such fiscal~~

its Annual Report to Shareholders and Annual Form 10K

is really ok as it is - doesn't call for anything [illegible]

As submitted to the SE:

~~year its consolidated income and expense statement and consolidated retained earnings statement for such fiscal year,~~ by independent certified public accountants, selected by Borrower and reasonably satisfactory to Bank, in accordance with generally accepted accounting principles applied on a basis consistent with that of the previous year. Bank has no current objection to Borrower's existing accountants.

(iii) Such other financial statements and information as Bank may reasonably request from time to time including consolidating worksheets for the statements required by subparts (i) and (ii) hereof.

4.6 Working Capital. On a consolidated basis, Borrower will at all times maintain a net working capital equal to at least One Million Five Hundred Thousand Dollars ($1,500,000.) and a ratio of current assets over current liabilities of at least 1.6 to 1.0. Net working capital for the purpose of this subsection shall mean the excess of current assets over current liabilities of Borrower. Current assets and current liabilities are those assets and liabilities which normally turn over during a twelve (12) month cycle including the current portion of long term liabilities.

4.7 Tangible Net Worth. On a consolidated basis, Borrower will at all times maintain a minimum tangible net worth of Two Million Six Hundred Thousand Dollars ($2,600,000.) which shall increase as of fiscal year end by seventy percent (70%) of net profit after taxes, if any, for the previous fiscal year beginning with the fiscal year to end May 31, 1978. Tangible net worth for the purpose of this subsection shall mean net worth after deducting patents, trade marks, goodwill and other similar intangible assets.

4.8 Debt to Net Worth. On a consolidated basis, Borrower will at all times maintain a ratio of total debt to tangible net worth of not greater than 1.5 to 1.0.

4.9 Insurance. Borrower will keep all of its insurable property, real, personal or mixed, insured by good and responsible companies against fire and such other risks as are customarily insured against by companies conducting similar businesses with respect to like properties. Borrower, will maintain adequate workmen's compensation insurance and adequate insurance against liability for damages to persons and property.

4.10 Notice of Default. Borrower will give prompt written notice to Bank of all events of default under any of the terms or provisions of this Agreement or of any other agreement, contract, document or instrument entered, or to be entered into by it or Guarantors, changes in management, litigation, and of any other matter which has resulted in, or might result in, a materially adverse change in financial condition or operation of of Borrower or Guarantors.

4.11 Execution of Other Documents. Borrower will promptly, upon demand by Bank, execute or cause Guarantors to execute all such additional agreements, contracts, indentures, documents and instruments in connection with this Agreement as Bank, in its sole discretion may consider necessary.

4.12 Compensating Balances. Borrower will maintain or cause to be maintained on deposit with Bank average daily collected demand deposit balances equal to at least twenty percent (20%) of the average daily outstanding balance of the Loan. Balances shall be calculated after reduction for reserve requirements of the Federal Reserve Board, balances compensating Bank for all services provided by Bank without charge, uncollected funds and account activity charges. These balances shall be computed quarterly as of the last day of each March, June, September and December for the preceding quarter and any deficiency shall be charged a fee equal to the rate of interest on the Loan as of the last day of the quarter times the deficiency divided by four. This fee shall be due and payable ten (10) days after Bank sends Borrower notice of the amount due and owing. Failure to maintain required balances shall not be a default unless and until Borrower shall fail to pay the fee when due.

4.13 Litigation and Attorneys' Fees. Borrower will pay promptly to Bank without demand, reasonable attorneys' fees and all costs and other expenses paid or incurred by Bank in collecting or compromising the Loan or in enforcing or exercising its rights or remedies created by, connected with or provided in this Agreement or any other agreement or instrument required by Bank in connection with the Loan, whether or not suit is filed. If suit is filed only the prevailing party shall be entitled to attorneys' fees and court costs.

4.14 Reports Under Pension Plans. Borrower will and will cause Guarantors to at all times make, prompt payments of contributions required to meet the minimum funding standard set forth in Section 302 through 305 of the Employee Retirement Income Security Act of 1974, as from time to time amended, with respect to each of its and their pension plans for retired employees; promptly after the filing thereof, furnish to Bank copies of each annual report required to be filed by it or them pursuant to Section 103 of such Act in connection with such plan for each plan year, including any certified financial statements or actuarial statements required pursuant to said Section 103; notify Bank immediately of any fact, including, but not limited to, any "Reportable Event" as that term is defined in Section 4043 of such Act, arising in connection with any such plan which might constitute grounds for the termination thereof by the Pension Benefit Guaranty Corporation or for the appointment by the appropriate United States district court of a trustee to administer the plan; and furnish to Bank, promptly upon its request therefor, such additional information concerning any such plan as may be reasonably requested.

Section 5. NEGATIVE COVENANTS OF BORROWER

Until the Note and all other sums payable pursuant to this Agreement or any other agreement or instrument required by Bank in connection with the Loan have been paid in full, unless Bank waives compliance in writing, Borrower agrees that:

5.1 Encumbrances and Liens. Borrower will not and will cause Guarantors not to create, assume or suffer to exist, any mortgage, pledge, security interest, encumbrance or lien (other than for taxes not delinquent, ~~and~~ for taxes and other items being contested in good faith) on property of any kind, real, personal or mixed, now owned or hereafter acquired, or upon the income or profits thereof, except to Bank and except for minor encumbrances and easements on real property which do not effect its market value.

and/or other liens encumbrances or security interests [illegible] undischarged incurred/in the ordinary course of Borrower's business discharged

5.2 Borrowings. Borrower will not and will cause Guarantors not to sell or discount any receivables or evidence of indebtedness, except to Bank, nor borrow any money, nor incur, directly or indirectly, any liabilities for borrowed money.

5.3 Liquidation or Merger. Borrower will not and will cause Guarantors not to liquidate nor dissolve nor enter into any consolidation, merger, partnership, or other combination, nor convey, nor sell, nor lease all or the greater part of their assets or business, nor purchase or lease all or the greater part of the assets or business of another.

5.4 Loans, Advances and Guaranties. Except to Borrower or Guarantors, Borrower will not and will cause Guarantors not to, except in the ordinary course of business as currently conducted, make any loans or advances, nor become a guarantor or surety, nor pledge its credit or properties in any manner, nor extend credit.

Borrower will not and will cause Guarantors not to purchase the debt or equity of another person or entity except for savings accounts and certificates of deposit of Bank, direct U. S. Government obligations and commercial paper issued by corporations with the top ratings of Moody's or Standard & Poor's, provided all such permitted investments shall mature within one year of purchase.

5.5 Fixed Assets. Without Bank's prior written approval, Borrower will not and will cause Guarantors not to spend in excess of Two Two Hundred Fifty Thousand Dollars ($250,000.) annually in the aggregate on a consolidated basis for capital equipment, whether real, personal or mixed. Each said expenditure shall be needed by Borrower or Guarantors in their ordinary course of business. Expenditures as used in this section shall include the capitalized portion of leases.

Section 6. EVENT OF DEFAULT

6.1 Event of Default. If one or more of the following described events of default shall occur:

(A) Borrower shall default in the due and punctual payment of the principal of or the interest on any note issued hereunder and such default shall not be cured within ten (10) business days after the occurrence thereof; or

(B) Any representation or warranty made by Borrower herein or in any certificate or financial or other statement heretofore or hereafter furnished by Borrower or its officers or any Guarantor shall prove to be in any material respect false and misleading; or

(C) Default shall be made by Borrower or Guarantors in the due performance or observance of any covenant or condition of this Agreement and such default shall not, within ~~ten (10)~~ thirty (30) days after Borrower has knowledge thereof, have been cured; or

(D) The filing by Borrower or Guarantors of any petition under the bankruptcy, reorganization, arrangement, insolvency or other debtors relief laws, or the filing against Borrower or Guarantors of any such petition if the filing against Borrower is not dismissed within thirty (30) days thereafter; or

(E) The making by Borrower or Guarantors of an assignment for the benefit of creditors; or

(F) The levy of any attachment, execution or other like process in an amount in excess of Ten Thousand Dollars ($10,000.) against any of Borrower's or Guarantors' property, if such attachment, execution or process is not released within thirty (30) days thereafter; or

(G) The voluntary suspension of business by Borrower or Guarantor; or

(H) The entry of any decree or order of a court having jurisdiction in the premises appointing a receiver of all or any substantial part of Borrower's or Guarantors' property, if such order or decree is not reversed or vacated within thirty (30) days thereafter; or

(I) If, in the opinion of Bank, there is a materially adverse change in the financial condition of Borrower or Guarantors or if for any reason Bank believes that the prospect of payment or performance pursuant to the Note, any other indebtedness of Borrower to Bank, this Agreement or any other agreement or instrument required by Bank in connection with the Loan has been impaired; or

(J) Borrower or Guarantors shall commit or do, or fail to commit or do, any act or thing which would constitute an event of default under any of the terms of any other agreement, document or instrument executed, or to be executed by it and concerning the obligation to pay money.

THEN, or at any time thereafter, and in each and every case, unless such default shall have been remedied, or waived in writing by Bank, at the option of Bank, the Loans outstanding under this Agreement shall thereupon, without presentment, demand, protest, or notice of any kind, all of which are hereby expressly waived be forthwith due and payable, if not otherwise then due and payable, anything herein or in any note or other agreement, contract, document or instrument contained to the contrary notwithstanding, and Bank may immediately, and without expiration of any period of grace, enforce payment of all liabilities of Borrower under this Agreement.

Section 7. MISCELLANEOUS PROVISIONS

7.1 Additional Remedies. The rights, powers and remedies given to Bank hereunder shall be cumulative and not alternative and shall be in addition to all rights, powers and remedies given to Bank by law against Borrower or any other person, including but not limited to Bank's rights of setoff or Banker's lien.

7.2 Non-Waiver. Any forbearance or failure or delay by Bank in exercising any right, power or remedy hereunder shall not be deemed a waiver thereof and any single or partial exercise of any right, power or remedy shall not preclude the further exercise thereof. No waiver shall be effective unless it is in writing.

7.3 Inurement. The benefits of this Agreement shall inure to the successors and assigns of Bank and the permitted successors and assignees of Borrower.

7.4 Applicable Law. This Agreement and all other agreements and instruments required by Bank in connection therewith shall be governed by and construed according to the laws of the State of California, to the jurisdiction of whose courts the parties hereby agree to submit.

7.5 Severability. Should any one or more provisions of this Agreement be determined to be illegal or unenforceable, all other provisions nevertheless shall be effective.

7.6 Time of the Essence. Time is hereby declared to be of the essence of this Agreement and of every part hereof.

7.7 Integration Clause. Except for documents and instruments specifically referenced herein, this Agreement constitutes the entire agreement between Bank and Borrower regarding the Loan and all prior communications verbal or written between Borrower and Bank shall be of no further effect or evidentiary value.

7.8 Amendments. This Agreement may be amended only in writing signed by all parties herein.

Section 8. SERVICE OF NOTICE

8.1 Any notices or other communications provided for or allowed hereunder shall be considered to have been validly given if delivered personally or 48 hours after being deposited in the United States mail, postage prepaid and addressed:

If to Borrower:

Attention:

If to Bank:

UNION BANK
610 Newport Center Drive
Newport Beach, CA 92660
Attention: Commercial Loan Department

8.2 The addresses to which notices or demands are to be given may be changed from time to time by notice served as provided above.

This Agreement is executed on behalf of the parties by duly authorized officers as of the date first above written.

UNION BANK

By_______________________________

Title_____________________________

By_______________________________

Title_____________________________

COMPREHENSIVE CARE CORPORATION

By_______________________________

Title_____________________________

By_______________________________

Title_____________________________

END