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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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AUG 27 1987
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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, 1987

Commission file no. 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.)
18551 Von Karman Avenue Irvine, California (Address of principal executive offices)	92715 (Zip code)

Registrant's telephone number, including area code (714) 851-2273

RECEIVED
AUG 31 1987
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Gaithersburg, Maryland

Securities registered pursuant to Section 12(b) of the Act: None

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

Common Stock, Par Value $.10 per share
7½% Convertible Subordinated Debentures due 2010
(Title of Class)

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

Yes X No __

The aggregate market value of voting stock held by non-affiliates of the Registrant at July 31, 1987, was $148,278,970.

At July 31, 1987, the Registrant had 11,102,295 shares of Common Stock outstanding.

Documents Incorporated by Reference

Part III incorporates information by reference from the Registrant's definitive proxy statement for the Registrant's Annual Meeting of Stockholders to be held on October 8, 1987, which proxy statement will be filed no later than 120 days after the close of the Registrant's fiscal year ended May 31, 1987.

Total of sequentially numbered pages, 78

Exhibit Index on sequential page number 47

PART I

Item 1. BUSINESS.

The Registrant, Comprehensive Care Corporation, is a Delaware corporation which was organized in January 1969. The Registrant is primarily engaged in the development, marketing and management of programs for the treatment of chemical dependency, including alcohol and drugs, and psychiatric disorders (the "Programs"). The Programs are provided under contractual agreements ("Contracts") with independent general hospitals or at freestanding facilities owned and/or operated by the Registrant. It is the largest private provider of hospital-based alcoholism treatment programs in the United States. During fiscal 1987, chemical dependency and psychiatric treatment Programs accounted for approximately 90% of the Registrant's total revenues. A wholly owned subsidiary, RehabCare Corporation ("RehabCare"), develops, markets and manages programs for the delivery of comprehensive medical rehabilitation services to functionally disabled persons in dedicated units of acute care hospitals. The following table sets forth for the five years ended May 31, 1987, the contribution to operating revenues and other income of the Registrant's freestanding and Contract operations, RehabCare programs, and its other activities.

	Years Ended May 31,				
	1987	1986	1985	1984	1983
Freestanding operations	58%	61%	63%	60%	57%
Contract operations	32	33	34	37	38
RehabCare programs	5	1	—	—	—
Other activities	5	5	3	3	5
	100%	100%	100%	100%	100%

Freestanding Operations

The Registrant currently operates or participates in the operation of 20 facilities representing 1,858 available beds. Since 1983, the Registrant has expanded its freestanding operations through the construction of five freestanding chemical dependency facilities and the acquisition of six chemical dependency or psychiatric facilities, representing approximately 1,059 beds. Freestanding facilities are either owned or leased by the Registrant or by joint ventures in which the Registrant and its partners share in the profits or losses. Two psychiatric hospitals (290 available beds) managed by the Registrant are owned or leased by such joint ventures, and one psychiatric hospital (100 available beds) is managed by the Registrant's partner in a joint venture.

The following table sets forth selected operating data regarding the Registrant's freestanding facilities. Facilities are designated either psychiatric or chemical dependency based on the predominant treatment provided. For information concerning the nature of the Registrant's interest in the facilities, see Item 2, "PROPERTIES."

	Year Acquired(1)	Licensed Beds	Patient Days				
			1987	1986	1985	1984	1983
Chemical Dependency Facilities							
CareUnit Hospital of Dallas/Ft. Worth	1971	83	24,139	26,696	24,278	14,593	12,878
CareUnit Hospital of Orange	1976	103	29,697	33,763	33,677	31,696	30,426
CareUnit Behavioral Center of Los Angeles	1978	104	16,029	19,629	23,150	20,655	17,112
CareUnit Hospital of Kirkland	1981	83	18,640	24,336	27,099	25,530	25,818
CareUnit of Jacksonville Beach	1982	84	21,065	22,818	16,539	19,355	12,416
CareUnit Hospital of Cincinnati	1982	64	25,955	29,065	29,181	26,880	27,598
CareUnit Hospital of St. Louis	1983	144	21,278	43,822	39,953	31,293	9,784
Starting Point, Oak Avenue	1983	68	21,593	22,705	21,[illegible]36	13,492	1,491
Starting Point, Orange County	1983	59	19,326	17,421	15,332	4,515	—
Starting Point, Grand Avenue	1983	25	7,249	7,264	6,158	1,294	—

(Table continued on following page)

	Year Acquired(1)	Licensed Beds	Patient Days				
			1987	1986	1985	1984	1983
CareUnit Hospital of Albuquerque	1984	70	16,730	16,080	9,597	205	—
CareUnit Hospital of Nevada	1984	50	11,615	8,748	7,640	—	—
CareUnit of Coral Springs	1985	100	21,735	12,398	—	—	—
CareUnit of Grand Rapids	1985	76	8,595	3,386	—	—	—
CareUnit of DuPage	1986	120	3,916	—	—	—	—
CareUnit of Orlando	1987	100	106	—	—	—	—
Closed Facilities(2)			17,873	10,764	14,771	3,080	—
Psychiatric Facilities							
Brea Hospital Neuropsychiatric Center	1969	142	39,237	43,870	46,271	44,472	40,100
Crossroads Hospital	1972	43	14,148	13,657	14,503	13,266	11,551
Woodview-Calabasas Hospital	1970	117	22,473	23,104	25,531	24,375	25,554
Golden Valley Health Center	1984	377	54,970	56,453	64,007	155	—
Patient days served during period			416,369	435,979	418,823	274,856	214,728
Admissions			17,902	17,954	16,754	10,585	8,074
Available beds at end of period(3)			1,927	1,687	1,609	1,538	1,015
Average occupancy rate for period(4)			64.8%	73.1%	72.0%	67.1%	70.1%

(1) Calendar year acquired or leased.

(2) On July 31, 1987 CareUnit Hospital of Portland was closed. The facility, licensed for 160 beds (69 available), generated 17,873 and 2,161 patient days in fiscal 1987 and 1986, respectively. The facility was closed because of an unfavorable regulatory and reimbursement environment for the delivery of chemical dependency treatment services in the State of Oregon which resulted in losses since the facility opened.

(3) A facility may have appropriate licensure for more beds than are in use for a number of reasons, including lack of demand, anticipation of future need, renovation and practical limitations in assigning patients to multiple-bed rooms. Available beds is defined as the number of beds which are available for use at any given time.

(4) Average occupancy rate is calculated by dividing total patient days by the number of available bed-days during the relevant period.

Contract Operations

The Registrant also develops, markets and manages behavioral medicine programs under Contracts with independent general hospitals. Under these Contracts, the hospital furnishes patients with all hospital facilities and services necessary for their generalized medical care, including nursing, dietary and housekeeping services. The Registrant provides support in the areas of Program implementation and management, staff recruiting, continuing education, nurse and hospital employee training, community education, public relations and on-going Program quality assurance. Patients are admitted to the Programs under the hospital's standard admission policies and procedures. The hospital submits to the patient, the patient's insurance company, or other responsible party a bill which covers the services of the hospital. The hospital pays the Registrant a fixed monthly management fee plus a fee for each patient day of service provided. Fees paid to the Registrant are subject to annual adjustments to reflect increases in the Consumer Price Index. The Registrant and the hospital share the risk of non-payment by patients based on a predetermined percentage participation by the Registrant in bad debts. To date, the Registrant's share of such bad debts has not exceeded 7% of Contract revenues in any one year. The Registrant may also participate with a contracting hospital in charity care and certain contractual allowances and discounts. Contracts are generally entered into for a minimum period of two years; thereafter, either party may terminate the Contract by giving 90 days notice. A significant number of the Registrant's existing Contracts are terminable on 90 days notice.

The following table sets forth selected operating data regarding Programs the Registrant manages on a Contract basis:

	Years Ended May 31,				
	1987	1986	1985	1984	1983
Number of Contracts at end of period(1):					
Adult CareUnits(2)	86	95	84	81	73
Adolescent CareUnits(2)	28	28	20	16	11
Adult CarePsychCenters(2)	20	22	17	12	9
Adolescent CarePsychCenters(2)	9	8	5	3	1
Eating disorders units	8	11	7	4	—
Total	151(3)	164	133	116	94
Available beds at end of period	3,860	3,981	3,145	2,648	2,168
Patient days served during period	845,853	803,255	697,509	588,321	494,740
Admissions	48,100	44,136	38,443	32,834	28,158
Average occupied beds per Contract	14.5	15.1	15.8	15.4	14.5
Average occupancy rate for period(4)	58.5%	62.2%	66.5%	66.9%	64.6%

(1) Excludes Contracts which have been executed but are not operational as of the end of the period.

(2) CareUnit is the service mark under which the Registrant markets chemical dependency treatment Programs. CarePsychCenter is the service mark under which the Registrant markets mental health treatment Programs.

(3) During the fiscal year ended May 31, 1987, the Registrant opened 27 new Contracts and closed 40 Contracts. Behavioral Medical Care, a 70% owned joint venture, opened nine and closed 12 of these Contracts. Of the 40 closed Contracts, 21 Contracts were terminated by the Registrant and 19 were terminated by the contracting hospitals. Twenty-eight of these hospitals have continued treatment programs, by either operating their own independent program or associating with another contract provider.

(4) Average occupancy rate is calculated by dividing total patient days by the number of available bed-days during the relevant period.

Program Descriptions

CHEMICAL DEPENDENCY. The Registrant developed and first introduced chemical dependency treatment Programs in 1973. Originally, these Programs, delivered under the name CareUnit, were directed toward the adult alcoholic but have been adapted and expanded to treat both adults and adolescents suffering from substance abuse.

The chemical dependency Program is hospital based. Each patient admitted to the hospital is subject to a full medical and social history as well as a physical examination which includes those diagnostic studies ordered by the patient's attending physician. Patients are detoxified under close medical supervision for a period averaging four days prior to entry to the rehabilitation phase of treatment.

The rehabilitation phase of treatment begins as soon as detoxification is completed. This phase of treatment includes lectures; individual, family and group counseling sessions; and such medical, psychological, and other modalities that may be necessary to meet the individual patient's needs. The average length of hospital stay for an adult patient is approximately 17 days, which includes detoxification. The average length of stay for an adolescent patient is approximately 31 days. After discharge from the hospital, the patient's recovery is monitored for a 10-week period during which the patient and family members return to the hospital once a week for outpatient counseling sessions.

For individuals who do not require the structure and intensity of inpatient hospital services, the Registrant has developed outpatient Programs which generally operate in conjunction with existing inpatient Programs. At May 31, 1987, 46 such Programs were in operation. The outpatient Programs begin with a thorough evaluation at admission. Individuals who meet the admission criteria participate in a structured 24-week Program during which they attend individual, group, and family sessions. The Program features a multi-disciplinary team approach, with involvement by a physician and chemical dependency and family therapists. Patients are urged to participate in self-help groups such as Alcoholics Anonymous and Al-Anon which supplement the treatment program as the intensity of participation in the Registrant's Program diminishes over the 24-week period.

MENTAL HEALTH. The Registrant has, since 1969, managed mental health treatment Programs for individuals suffering from acute emotional problems. These Programs, which are hospital-based, offer diagnostic and therapeutic treatment services conducted by an interdisciplinary team of professionals experienced in the treatment of mental health problems. Admission to the Program is typically voluntary and treatment is tailored to the specific needs of the patient, under the supervision of a psychiatrist.

The length of stay varies in accordance with the severity of the patient's condition but rarely exceeds 90 days. A comprehensive discharge plan is prepared for each patient which may include outpatient psychiatric or psychological treatment, or referral to an alternate treatment facility.

EATING DISORDERS. The Registrant offers a hospital-based, comprehensive eating disorders Program. The Registrant began operation of this Program in fiscal 1983. The Program treats those suffering from anorexia nervosa, bulimia and gross obesity. Each patient entering the Program is subject to a physical examination and nutritional assessment. Additional diagnostic and psychiatric evaluations are undertaken when necessary. Each patient's treatment is directed by a physician experienced in the treatment of eating disorders.

The eating disorders Program includes: individual and group therapy, nutritional guidance and management of attendant medical or psychological problems.

RehabCare Programs

The Registrant has owned 100% of RehabCare since May 1986, when it acquired the 50% interest previously held by Basic American Medical, Inc. RehabCare is currently engaged in the development, marketing and management of programs for the delivery of comprehensive medical rehabilitation services to functionally disabled persons in dedicated units of acute care hospitals. RehabCare administers all of its present programs under management contracts with hospitals. Under these contracts, the hospitals furnish patients with all hospital facilities and services necessary for their generalized medical care. RehabCare provides a multi-disciplinary treatment team, program implementation and management, treatment team training, staff recruiting, continuing education, insurance, community education, advertising, therapy equipment, public relations and on-going quality assurance.

When a patient is referred to one of RehabCare's programs, he or she undergoes an initial evaluation and assessment process by the entire treatment team that results in the development of a rehabilitation care plan designed specifically for the short- and long-term objectives of that patient up to the date of discharge. Depending upon the patient's disability, this evaluation process may involve the services of at least two disciplines, such as physical therapy and occupational therapy for an injury to an extremity, or of all of the disciplines, as in the case of a severe stroke patient. The following services are typically made available to patients in RehabCare's rehabilitation programs:

Inpatient rehabilitation nursing services
Physical therapy services
Speech/language pathology services
Audiological services
Orthotic/prosthetic services
Nutritional counseling services
Psychological services
Social work services
Respiratory therapy services
Occupational therapy services

In addition, educational and psychological services are provided to the families of patients as part of the program.

As of May 31, 1987 RehabCare programs were offered solely in independent general hospitals under contract. RehabCare opened its first contract program in February 1984. The following table sets forth selected operating data regarding RehabCare programs:

	Years Ended May 31,			
	1987	1986	1985	1984
Number of contracts at end of period(1)	21(2)	15	8	1
Available beds at end of period	405	310	201	20
Patient days served during period	73,027	33,036	5,680	1,035
Admissions	2,426	1,394	292	69
Average occupied beds per contract	11.9	7.6	5.4	8.1
Average occupancy rate for period(3)	59.5%	32.9%	27.3%	28.3%

(1) Excludes contracts which have been executed but are not operational as of the end of the period.

(2) During the fiscal year ended May 31, 1987, RehabCare opened eight new contracts and closed two contracts.

(3) Average occupancy rate is calculated by dividing total patient days by the number of available bed-days during the relevant period

In April 1987, the Registrant announced its intention to make a public offering of the equity securities of RehabCare. A registration statement and amendments thereto relating to these securities has been filed with the Securities and Exchange Commission but has not yet become effective. On June 5, 1987 the Registrant announced it had elected to delay the offering as a result of unfavorable market conditions.

Other Activities

LONG TERM CARE. The Registrant leases and operates a 99-bed intermediate care facility. This facility provides nursing, rehabilitative and sustaining care over extended periods of time to persons who do not require the extensive care provided in a general hospital. For the fiscal year ended May 31, 1987, the intermediate care facility accounted for less than 1% of the Registrant's total revenues.

PUBLISHING ACTIVITIES. Since 1976, the Registrant (under the name CompCare Publishers) has been engaged in the publication, distribution and sale of books, pamphlets and brochures relating to the Registrant's health care activities. The primary purpose of these activities is to support the Registrant's treatment, training and marketing programs. Literature distributed by the Registrant is sold to patients participating in a program both by contracting hospitals and facilities operated by the Registrant. Such literature is also sold to the general public and educational institutions. The Registrant does not own or operate the printing facilities used in the publication of its literature. Publishing activities accounted for approximately 2% of the Registrant's total revenues in fiscal 1987.

SMOKING CESSATION. In fiscal 1985, the Registrant entered into a license agreement with SmokEnders, Inc. The license agreement granted the Registrant the right to operate smoking cessation seminars using the name and materials of SmokEnders, Inc. The license agreement, which has an eight year life, requires the Registrant to pay a royalty to SmokEnders, Inc. based upon revenues derived from operation of the seminars. In fiscal 1986, the Registrant determined that there had been a permanent impairment in the value of the license agreement. Accordingly, the unamortized balance of license consideration of $1.4 million was charged to earnings in fiscal 1986. Smoking cessation programs accounted for less than 2% of the Registrant's total revenues in fiscal 1987 and were marginally profitable.

WEIGHT CONTROL. In fiscal 1986, the Registrant purchased the assets of a weight loss center located in Orange County, California. The Registrant subsequently began operation of a weight control program under the name CareFast.

CareFast is a protein-sparing modified fasting program directed toward individuals who exceed ideal body weight by 20% or more. Each CareFast participant is seen weekly by a physician and participates in group or individual therapy sessions directed by a trained behaviorist. Prior to admission to the program potential participants receive a physical examination including an electrocardiogram and blood tests. Repeat tests are ordered by the physician during the fast as appropriate for each individual.

The Registrant charges participants in CareFast a monthly fee. In addition, participants purchase a protein supplement which contains vitamins and minerals necessary to maintain health. Insurance coverage varies but generally excludes the cost of the protein supplement. Weight control programs accounted for less than 1% of the Registrant's total revenues in fiscal 1987.

Competition

Factors to be considered in the development of successful programs include population base and demographic characteristics, community pricing standards, state licensure and rate control issues and Certificate of Need ("CON") requirements (See "Governmental Regulation"). The Registrant either markets Contract Programs or develops freestanding Programs accordingly. The Registrant has a 15 person business development staff which identifies potential sites and develops Programs. RehabCare has a full time marketing staff of four persons.

The Registrant competes first for the development and implementation of freestanding or Contract Programs and subsequently for patients who utilize these Programs. With respect to both of these areas of competition, the Registrant's primary competitors are hospitals and hospital management companies (both not-for-profit and investor owned) which offer programs similar to that of the Registrant. The Registrant also faces competition from health maintenance organizations ("HMOs") and preferred provider organizations ("PPOs"). The Registrant has faced generally increasing competition in the last few years as a result of the increasing development of competitive programs and the growth of HMOs and PPOs.

Both HMOs and PPOs attempt to control the cost of health care services by directing their enrollees to participating physicians and institutions. Careful utilization review and limitations on access to physician specialists are used to further limit the cost of service delivery. Such organizations have typically developed on a regional basis where an appropriate enrollee population and mix of participating physicians and institutions can be developed. To the extent that these organizations are successful in a given locale, the Registrant may be faced with a decreased population base (to the extent of the enrolled population) to support its Programs. The Registrant believes that the development of these organizations has had a negative impact on utilization of its Programs in certain markets. The Registrant is unable to predict the impact of further development of such organizations. In certain instances the Registrant has elected to participate with the HMO or PPO, in which case the Registrant may discount its charges for service.

With respect to Contract Programs, the Registrant believes that experience, reputation for quality programs, the availability of program support services and price are the principal factors in a hospital's decision to utilize a contract program. While a number of competing companies offer contract programs at prices lower than those of the Registrant, the Registrant believes that its experience, reputation, and program support are superior to that of its competitors. The Registrant's experience with CON issues and program implementation often results in a reduced start-up period. Risk to the hospital is also reduced because the Registrant's compensation is based primarily on bed occupancy.

The primary competitive factors in attracting referral sources, patients and physicians are marketing, reputation, success record, quality of care and location and scope of services offered by a facility. The Registrant has an active promotional program, described below, and it is competitive in reputation and other factors necessary for patient attraction. Some of the hospitals which compete with the Registrant are either owned or supported by governmental agencies or are owned by non-profit corporations supported by endowments and charitable contributions which enable some of these hospitals to provide a wider range of services regardless of cost-effectiveness.

Promotion

The Registrant has an active public relations program designed to increase public awareness of the Programs offered by the Registrant. During fiscal 1987, the Registrant spent $16,107,000 for all forms of advertising. Media advertising (television, radio and print) was $13,730,000 in fiscal 1987 (7% of operating revenues). The Registrant's advertising program includes a series of television commercials advertising the Registrant's Programs. The forms of media used are specifically tailored to the geographic area in which the marketing efforts are directed. Accordingly, the focal point in the Registrant's public relations program is the Program Manager whose role in the local community is to identify referral sources and to carry out all marketing activities, including promotional campaigns, media coverage, conferences and distribution of literature, necessary to make the local community aware of the Program. Each Program Manager is assisted on an on-going basis by the Registrant's various support services.

Other aspects of the Registrant's public awareness program include a nationwide telephone hot line which is staffed by counselors who provide referral advice and help on a 24-hour basis; a Crisis Intervention Program which assists relatives of chemically dependent or emotionally disturbed individuals in motivating a potential patient to seek professional help through an appropriate Program; and CareInstitute conferences which are chemical dependency educational programs designed for healthcare professionals.

Joint Ventures

The Registrant has developed several joint venture partnerships for the management of behavioral medicine programs. In 1972, the Registrant entered into its first joint venture to operate two hospitals in California.

In June 1983, the Registrant entered into a joint venture with a subsidiary of Voluntary Hospitals of America, Inc. ("VHA"), one of the largest associations of not-for-profit hospitals in the United States. The Registrant has a 70% interest in the joint venture which is called Behavioral Medical Care ("BMC"). BMC markets the Registrant's Programs to the VHA network of hospitals. The Registrant manages the BMC joint venture. As of May 31, 1987, BMC was operating 47 Contracts consisting of 1,178 beds.

In May 1984, the Registrant entered into a joint venture with a subsidiary of HealthOne Corp. (formerly The Health Central System), a non-profit, multi-hospital management and service organization headquartered in Minneapolis, Minnesota. The Registrant manages the joint venture and has a 50% interest in it. As of May 31, 1987, the joint venture owned and operated a 248-bed behavioral medicine hospital.

In April 1986, the Registrant entered into a joint venture with HealthLink Behavioral Health Corp. ("HealthLink"), an Oregon corporation headquartered in Portland, Oregon. The joint venture, which is managed by the Registrant, was established to operate a 69-bed behavioral medicine hospital in Portland. The joint venture leases the hospital premises from an affiliate of HealthLink. The Registrant has a 66⅔% interest in the joint venture. On July 31, 1987, the joint venture ceased operation of the hospital because it could not operate profitably in light of an unfavorable regulatory and reimbursement environment in the State of Oregon. The Registrant is currently negotiating with HealthLink with respect to liquidation of the venture. The Registrant believes that the impact of liquidation of the venture will not have a material adverse impact on its financial condition.

Source of Revenues

During fiscal 1987, approximately 94% of the Registrant's operating revenue was received from private sources (private health insurers or directly from patients or hospitals in which the Registrant has Contracts) and the balance from Medicare, Medicaid and other governmental programs.

Private health insurers offer plans which typically include coverage for chemical dependency or psychiatric treatment. In some instances, the level of coverage for chemical dependency or psychiatric benefits is less than that provided for medical-surgical services. Lower coverage levels result in higher co-payments by the patient who is often unable to meet his or her commitment in its entirety or is unable to pay as rapidly as the insurance company. In the case of the Registrant's freestanding facilities these factors tend to increase bad debts and days outstanding in receivables.

Private insurance plans vary significantly in their methods of payment, including: cost, cost plus, prospective rate, negotiated rate, percentage of charges, and billed charges. Blue Cross and other commercial insurance plans have adopted a number of payment mechanisms for the primary purpose of decreasing the amounts paid to hospitals (including the Registrant's) for services rendered. These mechanisms include various forms of utilization review, preferred provider arrangements where use of participating hospitals is encouraged in exchange for a discount, and payment limitations or negotiated rates which are based on community standards. The Registrant is unable to predict the impact of changing payment mechanisms in the future years.

Employers, union trusts and other major purchasers of health care services have become increasingly aggressive in pursuing cost containment. To the extent that major purchasers are self-insured, they have begun actively to negotiate with hospitals, HMOs and PPOs for lower rates. Those major purchasers that are insured or use a third party administrator expect the insurer or administrator to control claims costs. The Registrant has established a nine person National Client Services division to negotiate with such major purchasers.

The Medicare program provides hospitalization, physicians, diagnostic and certain other services to eligible persons 65 years of age and over and others considered disabled. Providers of service are paid by the federal government in accordance with regulations promulgated by the United States Department of Health and Human Services ("HHS") and accept said payment, with nominal co-insurance amounts required of the service recipient, as payment in full.

Initially, Medicare provided for reimbursement of reasonable direct and indirect costs of the services furnished by hospitals to patients, plus a specified return on equity for proprietary hospitals. As a result of the Social Security Amendments Act of 1983, Congress adopted a prospective payment system ("PPS") to cover routine and ancillary operating costs of most Medicare inpatient hospital services. Under this system, the Secretary of HHS established fixed payment amounts per discharge based on diagnostic related groups ("DRG"). In general, a hospital's payment for Medicare inpatients is limited to the DRG rate, regardless of the amount of services provided to the patient or the length of the patient's hospital stay. Under PPS, a hospital may keep any difference between its prospective payment rate and its operating costs incurred in furnishing inpatient services, but is at risk for any operating costs that exceed its payment rate. Psychiatric hospitals, freestanding inpatient rehabilitation facilities and outpatient rehabilitation services are exempt from PPS. Inpatient psychiatric and rehabilitation units within acute care hospitals are eligible to obtain an exemption from PPS upon satisfaction of specified federal criteria. Qualified providers of alcohol and drug treatment services are excluded from PPS until October 1, 1987.

Exempt hospitals and exempt units within acute care hospitals are subject to limitations on the level of cost or the permissible increase in cost subject to reimbursement under the Medicare program, including those limitations imposed under the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"). No assurance can be given that psychiatric or rehabilitation services will in the future continue to be eligible for exemption from PPS or that other regulatory or legislative changes will not adversely affect the Registrant's business.

Ten of the Registrant's hospitals participate in the Medicare program. Of these, nine are currently excluded from PPS (TEFRA limits are applicable to these facilities). Medicare utilization at those facilities participating in the program averaged approximately 6% in fiscal 1987. The Registrant does not believe that the imposition of TEFRA limits or PPS have had a material adverse impact on its business at freestanding facilities. Loss of exclusion at freestanding facilities would also not materially impact the Registrant's business. Substantially all of the hospitals contracting with the Registrant for programs participate in the Medicare program. The Registrant is unable to predict the impact of PPS, TEFRA, or other reimbursement changes on its Contract operations.

Hospitals participating in the Medicare program are required to retain the services of a peer review organization ("PRO"). The PRO is responsible for determining the medical necessity, appropriateness and quality of care given program patients. In instances where the medical necessity of an admission or procedure is challenged by the PRO, payment may be delayed, reduced or denied in its entirety. Amounts denied because of medical review may not be charged to the service recipient, they are absorbed by the hospital. In non-emergency admissions (which encompass most of the Registrant's admissions) review is performed prior to the patient's arrival at the hospital. In the event that the PRO does not approve the admission, the patient is referred to an alternative treatment provider such as an outpatient program or sent home. The Registrant believes that the existence of PROs has had a negative impact on census growth in certain freestanding and Contract units, but is unable to measure the magnitude because the primary impact is in lost admissions.

The Medicaid program is a combined federal and state program providing coverage for low income persons. The specific services offered and reimbursement methods vary from state to state. In the majority of states Medicaid reimbursement is patterned after the Medicare program. Less than 2% of the Registrant's operating revenues is derived from the Medicaid program. Accordingly, changes in reimbursement are not expected to have a material adverse impact on the Registrant.

Governmental Regulation

The development and operation of health care facilities is subject to compliance with various federal, state and local statutes and regulations. Hospitals and other health care facilities operated by the Registrant as well as hospitals under contract for Programs must comply with the licensing requirements of the federal, state and local health agencies, with state mandated rate control initiatives and with the requirements of municipal building codes, health codes and local fire departments. State licensing of facilities is a prerequisite to participation in the Medicare and Medicaid programs.

Pursuant to the requirements of federal law, most states have enacted CON laws to curtail the proliferation of unnecessary health care services. Thus, prior to the construction of new facilities, the expansion of old facilities or the introduction of major new services (such as the Registrant's Contract Programs) in existing facilities, the Registrant (in the case of its own facilities), or the contracting hospital for a Contract Program, must demonstrate to either state or local authorities, or both, that it is in compliance with the plan adopted by such agencies. The Registrant, because of its experience in the processing of the CON documentation required for such Programs, usually prepares such documentation on behalf of the contracting hospital, with the assistance of the hospital. The CON application process ordinarily takes from six to 18 months, and may in some instances take two years or more, depending upon the state involved and whether the application is contested by a competitor or the health agency. As of May 31, 1987, the Registrant had entered into, but not yet opened five CareUnit Contracts, two CarePsychCenter Contracts, and five RehabCare Contracts with general hospitals, four of which are awaiting governmental approval. Certain states, including California and Texas, have enacted legislation repealing CON requirements for the construction of new health care facilities or the expansion of existing facilities. CON legislation is also being challenged as anti-competitive in certain states as it protects existing providers from new competition, and has been repealed in certain states. The Registrant is unable to predict the outcome of these deliberations.

The Joint Commission on the Accreditation of Hospitals ("JCAH"), at a facility's request, will participate in the periodic surveys which are conducted by state and local health agencies to insure continuous compliance with all licensing requirements by health care facilities. JCAH accreditation satisfies certain of the certification requirements for participation in Medicare and Medicaid programs. A facility found substantially to comply with JCAH standards receives accreditation. A patient's choice of a treatment facility may be affected by JCAH accreditation considerations because most major third party payors limit coverage to services provided by an accredited facility. The Registrant believes that all of the facilities operated by it and hospitals under Contract have received or, in the case of new facilities, applied for, such accreditation.

The laws of various states in which the Registrant operates generally prevent corporations from engaging in the practice of medicine or other professions. Although the Registrant believes that its operations do not violate these prohibitions, recent legal precedents in this area are unclear and there can be no assurance that state authorities or courts will not determine that the Registrant is engaged in unauthorized professional practice. In the event of an unfavorable determination, the Registrant could be required to modify its method of operation or could be restrained from the continuation of certain of its operations, the result of which could be materially adverse to the Registrant.

Insurance codes of certain states specify the extent of coverage required on group insurance contracts with respect to chemical dependency and psychiatric services. The impact of these requirements varies from state to state. To the extent that coverage for chemical dependency or psychiatric services is expanded, the Registrant's business is positively impacted. Such requirements have a negative impact when coverage is reduced or restricted. The Registrant is unable to measure the impact of insurance industry regulation on its business.

Both Medicare and Medicaid programs contain specific physical plant, safety, patient care and other requirements which must be satisfied by health care facilities in order to qualify under said programs. The Registrant believes that the facilities it owns or leases are in substantial compliance with the various Medicare and Medicaid regulatory requirements applicable to them.

Administration and Employees

The Registrant's executive and administrative offices are located in Irvine, California, where management controls operations, business development, accounting, medical insurance claims, governmental and statistical reporting, advertising and public relations, research and treatment program evaluation.

At May 31, 1987, the Registrant employed approximately 250 persons in its corporate and administrative offices, 3,180 persons in the hospital and long-term health care facilities operated by it, 930 persons assigned to its Contract units and 200 persons assigned to its RehabCare subsidiary. The physicians and psychiatrists who are the medical directors of the Registrant's Contract units, the psychologists serving on treatment teams, and the doctors utilizing the facilities operated by the Registrant are not employed by the Registrant.

The Registrant has not encountered any work stoppages due to labor disputes with its employees. Although the Registrant has expanded rapidly in the last five years, it has not experienced any significant difficulty in attracting competent employees.

Item 2. PROPERTIES.

The following table sets forth certain information regarding the properties owned or leased by the Registrant at May 31, 1987:

Name and Location	Owned or Leased	Lease Expires (1)	Monthly Rental (2)
Chemical Dependency Treatment Facilities			
CareUnit Hospital, Fort Worth, Texas	Owned(3)	—	—
CareUnit Hospital, Orange, California	Owned(3)	—	—
CareUnit Behavioral Center, Los Angeles, California	Owned(3)	—	—
CareUnit Hospital, Kirkland, Washington	Leased	2035	$12,000(5)
CareUnit Facility, Jacksonville Beach, Florida	Owned(3)	—	—
CareUnit Hospital, Cincinnati, Ohio	Owned	—	—
CareUnit Hospital, St. Louis, Missouri	Owned	—	—
Starting Point, Oak Avenue, Orangevale, California	Owned	—	—
Starting Point, Orange County, Costa Mesa, California	Owned(3)	—	—
Starting Point, Grand Avenue, Sacramento, California	Owned(3)	—	—
CareUnit Hospital, Albuquerque, New Mexico	Leased(6)	2012	4,049
CareUnit Hospital, Las Vegas, Nevada	Owned	—	—
CareUnit Facility, Coral Springs, Florida	Owned(3)	—	—
CareUnit Facility, Grand Rapids, Michigan	Leased	1990	12,417
CareUnit Hospital(4)(11), Portland, Oregon	Leased	1989	35,000
CareUnit Facility, DuPage County, Illinois	Owned	—	—
CareUnit Facility, Orlando, Florida	Owned	—	—

(Table continued on following page)

Name and Location	Owned or Leased	Lease Expires (1)	Monthly Rental (2)
Psychiatric Treatment Facilities			
Brea Hospital Neuropsychiatric Center Brea, California	Owned	—	—
Crossroads Hospital(4) Van Nuys, California	Leased	1997	5,577
Woodview-Calabasas Hospital(7) Calabasas, California	Leased	1996	19,227(8)
Golden Valley Health Center(9) Golden Valley, Minnesota	Owned	—	—
Other Operating Facilities			
Tustin Manor Tustin, California (Intermediate Care Facility)	Leased	1995	7,754(8)
CompCare Publishers Minneapolis, Minnesota	Leased	1990	7,092
Administrative Facilities			
Corporate Headquarters(10) Irvine, California	Owned	—	—
RehabCare Headquarters Chesterfield, Missouri	Leased	1994	11,080
Regional Headquarters Tampa, Florida	Leased	1989	8,623

(1) Assumes all options to renew will be exercised.

(2) All leases, other than those relating to the Registrant's administrative facilities, are triple net leases under which the Registrant bears all costs of operations, including insurance, taxes and utilities. The Registrant is responsible for specified increases in taxes, assessments and operating costs relating to its administrative facilities.

(3) Subject to encumbrances. For information concerning the Registrant's long-term debt, see Note 6 to the Registrant's Consolidated Financial Statements contained in this report.

(4) Leased by a joint venture and managed by the Registrant.

(5) Subject to increase every three years based upon increases in the Consumer Price Index, not to exceed 10%.

(6) The Registrant has a 30 year land lease for the facility which includes 182,200 square feet of land.

(7) Leased by the Registrant and managed by the Registrant's partner in a joint venture.

(8) Subject to increase every five years based upon increases in the Consumer Price Index.

(9) Owned by a joint venture and managed by the Registrant.

(10) Purchased by the Registrant in May 1985.

(11) Operations at this facility ceased on July 31, 1987. Negotiations are in progress with respect to termination of the lease.

Item 3. LEGAL PROCEEDINGS.

The Registrant is routinely engaged in the defense of lawsuits arising out of the ordinary course and conduct of its business and has insurance policies covering such potential insurable losses where such coverage is cost effective. Management believes that the outcome of such lawsuits will not have a material adverse impact on the Registrant's business.

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

Inapplicable.

EXECUTIVE OFFICERS OF THE REGISTRANT

Executive

B. LEE KARNS, age 57. Mr. Karns has been a director of the Registrant since 1972 and served as President of the Registrant from 1972 until 1985. Mr. Karns presently serves as Chairman of the Board and Chief Executive Officer of the Registrant and in July 1986 he was reappointed President.

Operations

ROBERT L. KASSELMANN, age 51. Mr. Kasselmann has been employed by the Registrant since 1974. He was President of RehabCare Corporation, a wholly owned subsidiary of the Registrant, from 1984 until 1985. He became Executive Vice President—Special Services of the Registrant in 1985, and Executive Vice President—Operations in July 1986.

JAMES P. CARMANY, age 48. Mr. Carmany has been employed by the Registrant since 1978 and was a Vice President of the Registrant from 1982 until 1985. He was Senior Vice President—National Client Services from 1985 until July 1986 when he became Senior Vice President—Operations.

DAVID G. COMERZAN, age 43. Mr Comerzan has been employed by the Registrant since 1975 and was a Vice President—Operations of the Registrant from 1984 until 1985 when he became Senior Vice President—Operations.

DONALD G. SIMPSON, age 34. Mr. Simpson has been employed by the Registrant since 1980 and was Vice President—Operations of the Registrant from 1985 until July 1986 when he became Senior Vice President—Operations.

LAURENCE J. STEUDLE, age 40. Mr. Steudle has been employed by the Registrant since 1970. He was Vice President—BMC Operations of the Registrant from 1984 until he became Senior Vice President—Operations in 1985.

EARL E. WILLIAMS, age 52. Mr. Williams has been employed by the Registrant since 1984. He was Vice President—Marketing from June 1985 until November 1985 when he became Senior Vice President—Operations. Prior to his employment with the Registrant, Mr. Williams was a health care consultant from 1982 to 1984.

Professional Services

MARY LEE POTTER, age 61. Ms. Potter has been employed by the Registrant since 1977. She was Director, Human Resources from 1979 until 1984. She was Vice President—Professional Services from 1984 until 1985 when she became Vice President—Operations. She was Vice President—Operations from 1985 until October 1986 when she became Vice President—Professional Services. She became Senior Vice President—Professional Services on June 16, 1987.

Business Development

JAMES E. PARKHURST, age 47. Mr. Parkhurst has been employed by the Registrant since 1985. He was Vice President—Marketing until he became Senior Vice President—Business Development in

1985. Prior to his employment with the Registrant, Mr. Parkhurst was Vice President—Acquisitions for Medical Care International (a health care management company) from 1983 to 1985. He served as Vice President—Corporate Development for LifeMark Corporation (a health care management company) from 1978 to 1983.

National Client Services

EDWARD A. CARELS, Ph.D., age 44. Dr. Carels has been employed by the Registrant since 1979. He was a Vice President of the Registrant from 1980 until he became an Executive Vice President—Communications in 1983. He became Senior Vice President—National Client Services in July 1986.

Finance

STEPHEN R. MUNROE, age 42. Mr. Munroe has been employed by the Registrant since 1977 and was a Vice President from 1983 until 1984 when he became Chief Financial Officer. He became a Senior Vice President in 1985.

MARK A. EDWARDS, age 33. Mr. Edwards has been employed by the Registrant since 1977. He has been Corporate Controller of the Registrant since 198[illegible]. He became a Vice President of the Registrant in 1985.

BRUCE K. NELSON, age 33. Mr. Nelson has been employed by the Registrant since 1985. He was Finance Manager from 1985 until June 1986 when he became Assistant Treasurer. He was appointed Treasurer of the Registrant on March 19, 1987. Prior to his employment with the Registrant he was a Corporate Banking Officer with California First Bank from 1982 to 1985.

Law

MARILYN U. MacNIVEN-YOUNG, age 36. Ms. MacNiven-Young was employed by the Registrant in 1985 as Vice President, General Counsel and Assistant Secretary. She was appointed Corporate Secretary of the Registrant on March 19, 1987. Prior to her employment with the Registrant, Ms. MacNiven-Young served as Senior Counsel for Fluor Corporation, an engineering and construction and natural resources company from 1978 through 1985.

All executive officers serve at the discretion of the Board of Directors of the Registrant.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

(a) The Registrant's Common Stock is traded on the national over-the-counter market and is quoted on the NASDAQ National Market System under the symbol CMPH. The following table sets forth the range of high and low bid prices for the Common Stock for the fiscal quarters indicated. All prices have been adjusted to give effect to a 33⅓% stock dividend (which had the effect of a four-for-three stock split) effected on July 16, 1985 and are rounded to the nearest one-eighth. Such prices represent inter-dealer prices, without retail markup, markdown or commission and do not necessarily represent actual transactions.

Fiscal Year	Bid Price	
	High	Low
1987:		
First Quarter	$16¼	$12
Second Quarter	16⅜	10½
Third Quarter	13⅝	10⅛
Fourth Quarter	14¾	11⅝
1986:		
First Quarter	$25⅞	$17⅞
Second Quarter	18⅝	14¾
Third Quarter	23¼	17
Fourth Quarter	19¼	13⅛

(b) As of July 31, 1987, the Registrant had 3,130 stockholders of record.

(c) The Registrant paid $.09 and $.08 per share cash dividends on a quarterly basis during the fiscal years ended May 31, 1987 and May 31, 1986, respectively, or an aggregate of $.36 and $.32 per share for those years. The Registrant intends to continue to pay regular cash dividends in the future, although the payment of such dividends will be dependent upon the earnings, financial position and cash requirements of the Registrant and other relevant factors existing at the time. See Item 7, "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS—LIQUIDITY AND CAPITAL RESOURCES" for a description of restrictions on the payment of dividends contained in the Registrant's loan agreement. On June 25, 1987, the Registrant's Board of Directors declared a quarterly dividend of $.10 per share payable on August 20, 1987, to stockholders of record on July 31, 1987.

Item 6. SELECTED FINANCIAL DATA.

The following tables summarize selected consolidated financial data and should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this report.

	Years Ended May 31,				
	1987	1986	1985	1984	1983
	(Amounts in thousands, except per share data)				
Statement of Earnings Data					
Revenues:					
Operating	$190,675	$187,022	$153,035	$107,913	$86,126
Interest	2,458	4,812	4,637	5,416	2,845
Other	1,757	1,102	864	353	412
	$194,890	$192,936	$158,536	$113,682	$89,383
Costs and Expenses:					
Operating	116,255	108,894	84,912	58,817	46,619
General and administrative	43,896	43,012	32,926	22,742	18,574
Depreciation and amortization	6,628	5,775	4,240	2,781	1,952
Interest	5,433	4,135	1,577	783	660
Loss on write-down of assets	—	5,701	—	—	—
	$172,212	$167,517	$123,655	$ 85,123	$67,805
Earnings before taxes on income	$ 22,678	$ 25,419	$ 34,881	$ 28,559	$21,578
Net earnings	$ 12,088	$ 13,102	$ 17,226	$ 14,058	$10,767
Earnings per common and common equivalent share(1):					
Primary and fully diluted	$ .90	$ .87	$ 1.13	$ .93	$ .81
Cash dividends per share	$ .36	$ .32	$ .30	$ .24	$ .18
Weighted average common and common equivalent shares outstanding	15,360	16,987	15,315	15,160	13,367

(1) Amounts per share have been adjusted to effect a four-for-three stock split effected July 16, 1985.

	May 31,				
	1987	1986	1985	1984	1983
	(Dollars in thousands)				
Balance Sheet Data					
Working capital	$ 40,232	$ 79,145	$ 92,852	$ 55,481	$ 59,691
Total assets	215,839	220,469	216,397	144,290	119,491
Long-term debt	100,828	59,377	64,522	15,493	6,446
Stockholders' equity	85,369	132,180	123,745	110,910	100,489

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following table sets forth for the periods indicated (i) percentages which certain items reflected in the financial data bear to total revenues and (ii) the percentage change of such items as compared to the indicated prior period:

	Relationships to Total Revenues			Period-to-Period Change	
	Years Ended May 31,			Years Ended	
	1987	1986	1985	1986-87	1985-86
Revenues:					
Operating	97.8%	96.9%	96.6%	2.0 %	22.2 %
Interest	1.3	2.5	2.9	(48.9)	3.8
Other	.9	.6	.5	59.4	27.5
	100.0	100.0	100.0	1.0	21.7
Costs and Expenses:					
Operating	59.7	56.4	53.5	6.8	28.2
General and administrative	22.5	22.3	20.8	2.1	30.6
Depreciation and amortization	3.4	3.0	2.7	14.8	36.2
Interest	2.8	2.1	1.0	31.4	162.2
Loss on write-down of assets	—	3.0	—	—	—
Earnings before taxes on income	11.6	13.2	22.0	(10.8)	(27.1)
Taxes on income	5.4	6.4	11.1	(14.0)	(30.2)
Net earnings	6.2%	6.8%	10.9%	(7.7)%	(23.9)%

Results of Operations

The Registrant's total revenues have increased from approximately $159,000,000 in fiscal 1985 to $195,000,000 in fiscal 1987. These gains are the result of changes in the utilization of the Registrant's existing Programs, the addition of new Programs and services, and price increases. Changes in utilization at the Registrant's freestanding chemical dependency or psychiatric facilities have a proportionately greater effect on revenues than do changes in utilization at Contract units. The difference is attributable to the higher fees charged for each day of service rendered in freestanding facilities where a broader range of services are provided. Changes in utilization in the Registrant's freestanding facilities include: (i) gross changes in the number of patient days served; (ii) shifts in utilization of a facility's Programs, for example adult versus adolescent treatment; and (iii) changes in the patient's source of payment, i.e., Medicare, Medicaid, Blue Cross, HMO, commercial insurance or self-payment. With the exception of commercial insurance and self-pay accounts, services are provided under arrangements which generally provide for discounts. Thus, an increase in utilization of services by patients served under such an arrangement would typically result in a lower net revenue to the provider. Commercial insurers and self-insured groups are increasingly pursuing discounts from providers of health care services, including the Registrant. Providers of service often grant such discounts when incremental volume increases can be achieved.

Fiscal 1987

Operating and other revenues increased approximately 2% over fiscal 1986 as the Registrant incurred a decrease in utilization of its freestanding facilities and only a modest increase in utilization in its Contract units.

Patient days of service rendered in mature freestanding facilities declined by 11% in fiscal 1987 as a result of a decrease in both admissions and average length of stay. Patient days of service rendered in facilities opened in fiscal 1987 and 1986 had the effect of reducing the overall decline in freestanding facility patient days of service to 4%. The majority of the decline in utilization and resulting decline in pretax earnings occurred at the Registrant's mature freestanding facilities. In general, these declines in utilization occurred in the Registrant's higher margin facilities and, in particular, at the CareUnit Hospital of St. Louis. This facility suffered from ineffective administration, and in the first quarter was subject to unfavorable publicity as a result of the loss of its Medicare certification. The facility lost its Medicare certification due to poor documentation of treatment and inadequate quality control. These factors, combined with increased competition in the St. Louis area resulted in a severe decline in census such that the facility was not profitable in fiscal 1987. Nearly one-half the decline in aggregate pretax earnings from freestanding facilities was attributable to this facility Changes have been made which the Registrant believes will lead to improved utilization of this facility in fiscal 1988. In addition, the Registrant anticipates it will be recertified by Medicare in the second quarter of fiscal 1988. The CareUnit Hospital of Portland, which opened in April 1986, has not been profitable since it opened. The reimbursement of chemical dependency services in the State of Oregon is highly regulated and very unfavorable and the CareUnit Hospital of Portland was closed on July 31, 1987.

Revenues of freestanding facilities were also adversely affected by an increase in deductions from revenues, which, as a percentage of gross revenues, increased 5% in 1987. Approximately one-half of this increase arose from contractual allowances to third party payors. The balance was attributable to increased bad debt allowances and other forms of uncompensated care. Although the Registrant believes it will face continuing rate pressures from payors, it believes it has taken appropriate measures to reduce its deductions for bad debts and uncompensated care. Price increases in fiscal 1987 were sufficient to offset the increase in deductions from revenues.

Contract revenues declined slightly even though patient days increased by approximately 5%. Changes in program utilization accounted for part of this decline. Utilization improved in the Contracts operated by the BMC joint venture and declined in Contracts operated by the Registrant. However, BMC Contracts have a discounted price structure which contributed to the decline in Contract revenues. These discounts are based on volume by virtue of the contracting hospital's affiliation with the VHA.

The decline in revenues from the Registrant's chemical dependency and psychiatric operations has been offset by an increase in revenues from the Registrant's other operations including its RehabCare subsidiary, CompCare Publishers division, and outpatient Programs.

Interest income declined from approximately $4.8 million in fiscal 1986 to $2.5 million in fiscal 1987 as the Registrant used its excess cash to fund a self tender offer in January 1987. The Registrant expects to have a negligible amount of interest income during fiscal 1988.

Operating and general and administrative expenses rose approximately 5%. Expenses of the Registrant's RehabCare subsidiary were a significant factor in the increase. Expenses of freestanding facilities rose as new facilities opened and general inflationary increases offset expense decreases attributable to the declines in utilization. Contract expenses and corporate overhead expenses declined slightly.

Depreciation and amortization increased approximately 15% or $853,000 principally as a result of the additional freestanding facilities opened during fiscal 1987 and 1986, remodeling and refurbishment completed at certain of the Registrant's other facilities, and occupancy of the Registrant's new corporate headquarters building in December 1985. Amortization of goodwill incurred in the purchase of the Registrant's RehabCare subsidiary in May 1986 also contributed to the increase.

The increase in interest expense of approximately $1.3 million resulted primarily from borrowings by the Registrant in 1987 under its revolving line of credit. The Registrant's borrowings under the line of credit were $41 million at May 31, 1987.

The above factors, without considering the write-down of assets of $5.7 million in fiscal 1986, resulted in a decline in pretax earnings of approximately $8.4 million.

The Registrant's effective tax rate declined from approximately 48.5% in fiscal 1986 to 46.7% in fiscal 1987 as a result of a rehabilitation tax credit of approximately $900,000 related to the refurbishment of the Registrant's CareUnit Hospital of St. Louis. As a result of the changes in the rates under the Tax Reform Act of 1986, the Registrant anticipates that its effective tax rate will be approximately 41% in fiscal 1988. Certain provisions of the Act, particularly the repeal of the cash basis method of accounting, will require the Registrant to reduce its deferred taxes for these items by the payment of higher taxes. These taxes will be payable over the required period provided for under the Act and should not have a material effect on the Registrant's cash flow.

Fiscal 1986

Operating and other revenues for fiscal 1986 increased by 23% over fiscal 1985. New freestanding facilities and new Contracts net of units closed, accounted for approximately 15% of the increase. Other operations, principally RehabCare, outpatient Programs and SmokEnders, accounted for approximately 15% with price increases accounting for approximately 30% and improved utilization of existing freestanding facilities and Contracts accounting for approximately 30%. A decline in average length of stay was a factor moderating utilization gains. A change in ownership interest in certain joint venture facilities accounted for the remaining 10% of the increase.

Cost and expenses increased approximately 35% over fiscal 1985. Major factors in the increase were the write-down of the value of the Registrant's Brea, California psychiatric facility of $4.3 million and the write-off of the license agreement the Registrant has with SmokEnders, Inc. of $1.4 million. Without these two items costs and expenses would have increased approximately 31%. Media advertising expenditures rose approximately $4.7 million in fiscal 1986 (from 6% of operating revenues in fiscal 1985 to 7% in fiscal 1986).

During fiscal 1986, in addition to the increase in operating and general and administrative expenses caused by the addition of new freestanding facilities, new Contracts, and general inflationary pressures, the Registrant added several new services including departments to provide in-house legal services, to package the Registrant's services for national organizations, to provide construction management and other systems support. In fiscal 1986, there was also a marked increase in expenditures for the development of new Programs and facilities which was generally offset by a decrease in the Registrant's executive bonus plan expense. The Registrant accrued approximately $1.2 million for this plan in fiscal 1985. Nothing was accrued in fiscal 1986 since the Registrant did not meet its internal operating goals.

Depreciation and amortization expenses increased in fiscal 1986 as a result of the Registrant's acquisition of interests in certain joint venture facilities, the opening of freestanding facilities and its new corporate headquarters, and additional amortization of deferred contract costs.

The increase in interest expense in fiscal 1986 was due primarily to interest associated with the convertible debentures the Registrant issued in April 1985. This was partially offset by capitalized interest associated with the Registrant's new corporate headquarters building of approximately $610,000.

As a result of the above factors, pretax earnings for fiscal 1986 decreased by approximately $9.5 million when compared to fiscal 1985. Earnings from operations, without considering write-downs, interest income and interest expense, decreased approximately $1.4 million or 4%. Operating margins declined from 21% to 16%. In addition to increased media costs, this decline was also influenced by declining occupancy trends in the third and fourth quarter that were not offset by decreased costs. Much of the revenue gain can also be attributed to lower margin operating units and programs such as SmokEnders, RehabCare and outpatient services.

Liquidity and Capital Resources

The Registrant's current ratio decreased from approximately 3.7:1 at May 31, 1986 to 2.4:1 at May 31, 1987. Accounts receivable days outstanding increased from 79 days at May 31, 1986 to 80 days at May 31, 1987.

In December 1986, the Registrant announced an offer to purchase up to 4 million shares of its Common Stock at $13 net per share in cash. Approximately 4,587,166 shares were tendered and the

Registrant accepted for payment 4,080,000 validly tendered shares, including 80,000 additional shares, the maximum amount permitted to be purchased under the terms of the offer. The Registrant utilized existing cash balances of approximately $26 million and borrowed $28 million to provide funding for the repurchase of shares and related expenses. The Registrant has a loan agreement pursuant to which it may borrow up to $50 million. The terms of the loan agreement provide for a revolving loan, a term loan and a revolving capital loan. Under the revolving loan, the Registrant may borrow, repay and reborrow an amount not to exceed $50 million. All borrowings under the revolving loan must be made before January 25, 1988, at which time all unpaid principal and accrued interest, if any, will be converted into the term loan. Commencing upon the maturity of the revolving loan, the Registrant is entitled, under the capital loan, to borrow the lesser of (i) $10 million and (ii) the difference between $50 million and the original principal balance of the term loan. The Registrant may borrow, repay and reborrow amounts available under the capital loan until January 25, 1989, at which time all unpaid principal and accrued interest under the capital loan will be due and payable. For a period of 30 consecutive days during each 12-month period during the term of the capital loan (and any renewal term), there can be no outstanding balance under the capital loan. As long as any amount is outstanding under the revolving loan the Registrant is required to maintain cash flow equal to at least 150% of debt service: maintain a minimum tangible net worth of at least $58,828,000 until May 31, 1987; maintain a minimum tangible net worth thereafter equal to the prior years minimum tangible net worth plus the sum of (i) 25% of net after tax profits and (ii) 50% of any equity infusion· and limit capital expenditures to an amount not to exceed certain planned expenditures plus $2 million.

The Registrant will be subject to additional restrictive covenants under terms of the term loan and capital loan in the event that those loans are utilized, including a limitation on dividends, which may not exceed 40% of net earnings, during the period of the term loan. At May 31, 1987, $41 million was outstanding under the revolving loan.

The Registrant has committed or plans to commit approximately $33 million for purchase or construction or refurbishment of new freestanding facilities in San Diego, California, Denver, Colorado and Tampa, Florida, replacement of the existing facility in Brea, California, and the expansion and renovation of existing facilities. The Registrant intends to fulfill these commitments and its other obligations with present cash on hand, expected cash flow from operations and its unused line of credit. In addition, management believes it will be necessary to increase its line of credit in fiscal 1988. The Registrant is currently negotiating for such an increase in its line of credit.

Impact of Inflation

Although inflation has become less of a significant factor in the nation's economy, to cope with its effect of increasing expenses, the Registrant regularly raises prices charged at its freestanding facilities. The Registrant's Contracts provide for annual price increases to reflect increases the Consumer Price Index. To date, these price increases have been adequate to offset the Registrant's increases in costs due to inflation.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

COMPREHENSIVE CARE CORPORATION

Index to Consolidated Financial Statements

Years Ended May 31, 1987, 1986 and 1985

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Stockholders and Board of Directors
Comprehensive Care Corporation:

We have examined the consolidated balance sheets of Comprehensive Care Corporation and subsidiaries as of May 31, 1987 and 1986 and the related consolidated statements of earnings, stockholders' equity and changes in financial position for each of the years in the three-year period ended May 31, 1987. 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 accompanying consolidated financial statements present fairly the financial position of Comprehensive Care Corporation and subsidiaries at May 31, 1987 and 1986 and the results of their operations and the changes in their financial position for each of the years in the three-year period ended May 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat Marwick Main & Co.

Orange County, California
July 17, 1987

COMPREHENSIVE CARE CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS

	May 31, 1987	May 31, 1986
	(Dollars in thousands)	
Current assets:		
Cash, including short-term investments of $3,250 and $31,332	$ 10,159	$ 42,834
Accounts and notes receivable, less allowance for doubtful accounts of $10,791 and $7,553 (Note 3)	50,157	55,923
Prepaid income taxes (Note 7)	2,845	2,986
Other current assets	6,713	6,314
Total current assets	69,874	108,057
Property and equipment, at cost (Notes 4, 6, 8 and 14):	139,895	100,574
Less accumulated depreciation and amortization	(20,904)	(15,429)
Total property and equipment	118,991	85,145
Other assets, net:		
Intangible assets (Note 2)	7,906	9,308
Notes receivable	2,084	1,312
Investments	7,899	4,863
Deferred contract costs	3,061	3,284
Other	6,024	8,500
Total other assets	26,974	27,267
	$215,839	$220,469

LIABILITIES AND STOCKHOLDERS' EQUITY

	1987	1986
Current liabilities:		
Accounts payable and accrued liabilities (Note 5)	$ 20,786	$ 18,794
Long-term debt payable within one year (Note 6)	1,129	1,091
Deferred income taxes (Note 7)	7,710	8,628
Income taxes payable (Note 7)	17	399
Total current liabilities	29,642	28,912
Long-term debt due after one year (Note 6)	95,609	55,711
Other liabilities (Note 9)	5,219	3,666
Commitments and contingencies (Notes 8 and 13)		
Stockholders' equity (Notes 6, 10 and 11):		
Common stock, $.10 par value; authorized 30,000,000 shares; issued 15,18[illegible],295 and 15,178,668 shares	1,518	1,518
Additional paid-in capital	75,885	75,830
Retained earnings	62,190	54,832
Less treasury stock; at cost, 4,080,000 shares	(54,224)	—
Total stockholders' equity	85,369	132,180
	$215,839	$220,469

See notes to consolidated financial statements.

COMPREHENSIVE CARE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS

	Years Ended May 31,		
	1987	1986	1985
	(Dollars in thousands, except per share amounts)		
Revenues:			
Operating (Note 3)	$190,675	$187,022	$153,035
Interest	2,458	4,812	4,637
Other	1,757	1,102	864
	194,890	192,936	158,536
Costs and Expenses:			
Operating	116,255	108,894	84,912
General and administrative	43,896	43,012	32,926
Depreciation and amortization	6,628	5,775	4,240
Interest	5,433	4,135	1,577
Loss on write-down of assets (Note 14)	—	5,701	—
	172,212	167,517	123,655
Earnings before taxes on income	22,678	25,419	34,881
Taxes on income (Note 7)	10,590	12,317	17,655
Net earnings	$ 12,088	$ 13,102	$ 17,226
Earnings per common and common equivalent share (Note 1). Primary and fully diluted	$ .90	$ .87	$ 1.13
Dividends per common share	$ .36	$ .32	$ .30

See notes to consolidated financial statements.

COMPREHENSIVE CARE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock	
	Shares	Amount			Shares	Amount
			(Amounts in thousands)			
Balances, May 31, 1984	15,160	$1,137	$75,862	$33,911	—	$ —
Net earnings	—	—	—	17,226	—	—
Exercise of stock options (Note 10)	9	1	159	—	—	—
Cash dividends	—	—	—	(4,551)	—	—
Balances, May 31, 1985	15,169	1,138	76,021	46,586	—	—
Stock split effected July 16, 1985	(1)	379	(379)	—	—	—
Net earnings	—	—	—	13,102	—	—
Exercise of stock options (Note 10)	11	1	188	—	—	—
Cash dividends	—	—	—	(4,856)	—	—
Balances, May 31, 1986	15,179	1,518	75,830	54,832	—	—
Net earnings	—	—	—	12,088	—	—
Exercise of stock options (Note 10)	3	—	55	—	—	—
Cash dividends	—	—	—	(4,730)	—	—
Purchase of treasury stock (Note 11)	—	—	—	—	(4,080)	(54,224)
Balances, May 31, 1987	15,182	$1,518	$75,885	$62,190	(4,080)	$(54,224)

See notes to consolidated financial statements.

COMPREHENSIVE CARE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Years Ended May 31,		
	1987	1986	1985
	(Dollars in thousands)		
Financial resources provided by			
Operations:			
Net earnings	$ 12,088	$ 13,102	$17,226
Items not requiring outlay of working capital:			
Depreciation and amortization of property and equipment	5,525	4,501	3,878
Deferred income taxes	—	(3,608)	2,378
Interest income on annuity contracts	(401)	(315)	(347)
Amortization of intangible and other assets	1,102	1,274	362
Loss on write-down of assets	—	5,701	—
Working capital provided by operations	18,314	20,655	23,497
Disposal of property and equipment	104	2,050	299
Additional long-term debt	41,016	3,152	48,076
Decrease in notes receivable	376	361	3,518
Issuance of common stock	55	189	160
Decrease in other assets	2,743	1,732	—
Other sources	2,554	—	—
	65,162	28,139	75,550
Financial resources used for			
Purchase of treasury stock	54,224	—	—
Acquisition of property and equipment	39,475	23,492	21,196
Reduction of long-term debt	1,118	6,674	1,425
Increase in notes receivable	1,148	515	84
Cash dividends	4,730	4,856	4,551
Deferred contract costs	145	593	2,599
Increase in intangible assets	—	4,853	—
Investments	2,635	—	1,250
Other applications	600	863	7,074
	104,075	41,846	38,179
Increase (decrease) in working capital	$(38,913)	$(13,707)	$37,371
Summary of changes in components of working capital			
Increase (decrease) in current assets:			
Cash	$(32,675)	$(19,394)	$20,467
Accounts and notes receivable	(5,766)	8,020	20,633
Prepaid income taxes	(141)	(1,545)	4,531
Other current assets	399	(6)	1,983
	(38,183)	(12,925)	47,614
Increase (decrease) in current liabilities:			
Accounts payable and accrued liabilities	1,992	(817)	7,286
Long-term debt payable within one year	38	(92)	20
Deferred income taxes	(918)	1,627	3,701
Income taxes payable	(382)	64	(764)
	730	782	10,243
Increase (decrease) in working capital	$(38,913)	$(13,707)	$37,371

See notes to consolidated financial statements.

COMPREHENSIVE CARE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 1987, 1986 and 1985

Note 1—Summary of Significant Accounting Policies

The consolidated financial statements include the accounts of Comprehensive Care Corporation (the "Registrant"), its subsidiaries and the Registrant's interest in the accounts of joint venture partnerships (see Note 2). All intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications of prior year amounts have been made to conform with current year classifications.

Revenue Recognition

Approximately 94% of the Registrant's operating revenues is received from private sources; the remainder from Medicare, Medicaid and other governmental programs. The latter are programs which provide for payments at rates generally less then the established billing rates. Payments are subject to audit by intermediaries administering these programs. Revenues from these programs are recorded under reimbursement principles applicable under the circumstances. Although management believes estimated provisions currently recorded properly reflect these revenues, any differences between final settlement and these estimated provisions are reflected in operating revenues in the year finalized.

Property and Equipment

Depreciation and amortization of property and equipment are 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.

Intangible Assets

Intangible assets include costs in excess of the fair value of net assets of businesses purchased (goodwill), licenses, and similar rights. Costs in excess of net assets purchased are amortized over 25 to 40 years. The costs of other intangible assets are amortized over the period of benefit. The amounts on the consolidated balance sheets are net of accumulated amortization of $1,016,000 and $703,000 at May 31, 1987 and 1986, respectively.

Capitalized Interest

Interest incurred during the construction of freestanding facilities is capitalized and subsequently charged to depreciation expense over the life of the related asset. The interest rate utilized is either the rate of the specific borrowing associated with the project or the Registrant's average interest rate on borrowings where there is no specific borrowing associated with the project. The amount of interest capitalized was $474,000, $654,000 and $161,000 in fiscal 1987, 1986 and 1985, respectively.

Deferred Contract Costs

The Registrant has entered into a limited number of contracts with independent general hospitals whereby it will provide services over a period in excess of the standard two year agreement. In recognition of the hospital's long-term commitment, the Registrant has paid certain amounts to them. These amounts may be used by the hospital for capital improvements or as otherwise determined by the hospital. The Registrant is entitled to a pro rata refund in the event that the hospital terminates the contract before its scheduled termination date; accordingly, these amounts are charged to expense over the life of the contract.

Investment Tax Credits

Investment tax credits are accounted for under the "flow through" method.

COMPREHENSIVE CARE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

May 31, 1987, 1986 and 1985

Note 1—Summary of Significant Accounting Policies (continued)

Earnings Per Share

Primary and fully diluted earnings per common and common equivalent share have been computed by dividing net earnings, after giving effect to the elimination of interest expense applicable to the convertible debentures less income tax effect, by the weighted average number of common and common equivalent shares outstanding during the period. The convertible debentures issued in April 1985 are considered to be common stock equivalents from the time of issuance. The weighted average of the number of shares issuable on conversion of the convertible debentures and exercise of stock options was added to the weighted average number of common shares outstanding.

The weighted average number of shares outstanding used to compute primary and fully diluted earnings per share has been restated to reflect a four-for-three stock split effected July 16, 1985, as has all share and per share information. The weighted average number of shares used to calculate earnings per share was 15,360,000, 16,987,000, and 15,315,000, in 1987, 1986 and 1985, respectively.

Note 2—Accounting for Interests in Joint Venture Partnerships

In 1972, the Registrant entered into a joint venture partnership with another corporation for the purpose of operating two hospitals. Under the terms of the joint venture agreement, the Registrant manages one of the hospitals and its partner manages the other. Each of the partners in the joint venture receives a management fee for the hospital it manages, and they share equally in the profits or losses.

In May 1984, the Registrant entered into a joint venture agreement with a subsidiary of HealthOne Corp. (formerly The Health Central System). The joint venture owns and operates Golden Valley Health Center, a 248-bed behavioral medicine hospital located in a suburb of Minneapolis. The Registrant serves as managing partner of the joint venture for which it earns a fee based on profitability. The Registrant has a 50% interest in the joint venture.

The Registrant consolidates its interest in the assets, liabilities, income and expenses of these joint ventures on a proportionate basis. The assets and liabilities of the joint ventures included in the consolidated balance sheets are as follows:

	May 31, 1987	May 31, 1986
	(Dollars in thousands)	
Assets		
Current assets	$ 6,730	$ 6,589
Property and equipment (net)	9,721	9,863
Other assets	110	113
	$16,561	$16,965
Liabilities and partners' equity		
Current liabilities	$ 1,228	$ 1,699
Partners' equity	15,333	15,266
	$16,561	$16,965

Note 2—Accounting for Interests in Joint Venture Partnerships (continued)

In fiscal 1986, the Registrant purchased its partner's interests in three joint ventures and sold its interest in one joint venture. Results of operations below include results of the joint ventures for the periods prior to the purchase and sale transactions.

The Registrant's proportionate share of the operating results of the joint ventures included in the consolidated statements of earnings is as follows:

	Years Ended May 31,		
	1987	1986	1985
	(Dollars in thousands)		
Revenues	$19,187	$23,407	$25,354
Costs and expenses			
Operating, general and administrative	14,262	16,931	18,135
Depreciation and amortization	585	743	841
Interest	—	215	608
	14,847	17,889	19,584
Earnings before taxes on income	$ 4,340	$ 5,518	$ 5,770

Note 3—Accounts and Notes Receivable

Accounts and notes receivable include current notes receivable of $90,000 and $8,062,000 at May 31, 1987 and 1986, respectively.

The following table summarizes changes in the Registrant's allowance for doubtful accounts for the fiscal years ended May 31, 1987, 1986 and 1985:

	Balance at Beginning of Period	Additions: Charged to Revenue	Additions: Recoveries	Deductions: Write-off of Accounts	Balance at End of Period
	(Dollars in thousands)				
Year ended May 31, 1987	$7,553	$16,706	$3,773	$17,241	$10,791
Year ended May 31, 1986	$6,674	$14,959	$4.057	$18,137	$7,553
Year ended May 31, 1985	$3,513	$12,398	$1,930	$11,167	$6,674

Note 4—Property and Equipment

Property and equipment consists of the following:

	May 31, 1987	May 31, 1986
	(Dollars in thousands)	
Land and improvements	$ 27,863	$ 15,464
Buildings and improvements	87,292	64,063
Furniture and equipment	21,823	18,139
Leasehold improvements	213	204
Capitalized leases	2,704	2,704
	$139,895	$100,574

Note 5—Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consist of the following:

	May 31, 1987	May 31, 1985
	(Dollars in thousands)	
Accounts payable and accrued liabilities	$14,973	$12,311
Accrued salaries and wages	1,534	2,080
Accrued vacation	2,562	2,355
Payable to third party intermediaries	1,717	2,048
	$20,786	$18,794

Note 6—Long-Term Debt

Long-term debt consists of the following:

	May 31, 1987	May 31, 1986
	(Dollars in thousands)	
7% to 10% notes, payable in monthly installments with maturity dates through 1996; collateralized by real and personal property having a net book value of $8,042	$ 1,845	$ 2,115
Note payable bearing interest at 72% of prime through 1988, and at 74% of prime for years 1989 through 1994, payable quarterly maturing in 1994; collateralized by real and personal property having a net book value of $6,628	4,250	4,750
Revolving loan, unsecured, convertible into a term loan	41,000	—
Note payable bearing interest at 65% of prime, payable monthly maturing in 1994; collateralized by real property having a net book value of $2,649	1,487	1,619
7½% convertible subordinated debentures due 2010	46,000	46,000
Capital lease obligations (Note 8)	1,766	1,890
Other	390	428
	96,738	56,802
Less amounts due within one year	1,129	1,091
	$95,609	$55,711

As of May 31, 1987, the annual maturities of long-term debt for the next five years amounted to $1,129 in 1988, $2,361 in 1989, $6,714 in 1990, $8,403 in 1991, and $8,264 in 1992.

In April 1985, the Registrant issued $46 million in convertible subordinated debentures. These debentures require that the Registrant make semi-annual interest payments in April and October at an interest rate of 7½%. The debentures are due in 2010 but may be converted to Common Stock of the Registrant at the option of the holder at a conversion price of $25.97 per share, subject to adjustment in certain events. The debentures are also redeemable, at the option of the Registrant, in certain circumstances. Mandatory annual sinking fund payments sufficient to retire 5% of the aggregate principal amount of the debentures are required to be made on each April 15 commencing in April 1996 to and including April 15, 2009.

The Registrant has a loan agreement with banks pursuant to which the banks have agreed to loan the Registrant up to $50 million. The terms of the loan agreement provide for a revolving loan, a term loan and a revolving capital loan. Under the revolving loan the Registrant may borrow, repay and reborrow an amount not to exceed $50 million. All borrowings under the revolving loan must be made within 12 months of the date of the first borrowings, at which time all unpaid principal and accrued interest, if any, will be converted into a term loan. At maturity of the revolving loan, the Registrant is entitled under the capital loan to borrow the lesser of (i) $10 million and (ii) the difference between $50 million and the original principal balance of the term loan.

As long as any amount is outstanding under the revolving loan the Registrant is required to maintain cash flow equal to at least 150% of debt service; maintain a minimum tangible net worth of at least $58,828,000 until May 31, 1987; maintain a minimum tangible net worth thereafter equal to the prior years

Note 6—Long-Term Debt (continued)

minimum tangible net worth plus the sum of (i) 25% of net after tax profits and (ii) 50% of any equity infusion; and limit capital expenditures to an amount not to exceed certain planned expenditures plus $2 million. The Registrant was in compliance with its loan covenants at May 31, 1987.

The Registrant will be subject to additional restrictive covenants under terms of the term loan and capital loan in the event that those loans are utilized, including a limitation on dividends, which may not exceed 40% of net earnings, during the period of the term loan. At May 31, 1987, $41 million was outstanding under the revolving loan. Interest payable under the revolving loan and the term loan are calculated on the basis of rates selected by the Registrant equal to either (i) the lending bank's cost of funds CD rate, plus 1.5% or (ii) the lending bank's cost of funds LIBOR rate, plus 1.5% or (iii) the lending bank's reference rate announced from time-to-time, plus .375%. Interest payable for borrowings under the capital loan will be calculated at the lending bank's reference rate. Interest is payable on the outstanding principal amount of any of the loans on a monthly basis.

Note 7—Taxes on Income

Taxes on income consist of the following:

	Years Ended May 31,		
	1987	1986	1985
	(Dollars in thousands)		
Currently payable:			
Federal income taxes	$ 9,108	$12,303	$10,264
State income taxes	1,839	2,584	1,974
	10,947	14,887	12,238
Deferred:			
Federal income taxes	(186)	(1,946)	4,518
State income taxes	(171)	(624)	899
	(357)	(2,570)	5,417
	$10,590	$12,317	$17,655

A reconciliation between taxes on income and the amount computed by applying the statutory federal income tax rate (46%) to earnings before taxes on income is as follows:

	Years Ended May 31,		
	1987	1986	1985
	(Dollars in thousands)		
Income taxes at the statutory tax rate	$10,432	$11,692	$16,045
State income taxes net of federal tax benefit	895	1,058	1,540
Investment tax credit	(900)	(517)	(303)
Loss from unconsolidated subsidiary	—	144	312
Amortization of intangible assets	124	127	65
Other	39	(137)	(4)
	$10,590	$12,317	$17,655

Note 7—Taxes on Income (continued)

Total taxes on income differ from taxes currently payable as a result of differences in the recognition of revenue and expense for tax and financial statement purposes. The sources of these differences and the tax effect of each are as follows:

	Years Ended May 31,		
	1987	1986	1985
	(Dollars in thousands)		
Excess tax over book depreciation	$1,268	$ 969	$ 572
Cash basis accounting and different reporting period for tax purposes by joint ventures	1,219	272	2,312
State income taxes deductible on a cash basis	236	124	(462)
Deferred compensation expense not currently deductible	(612)	(768)	(351)
Cash basis accounting by subsidiaries	(335)	1,173	1,363
Employee benefit expenses not currently recorded for book purposes	(1,373)	(1,509)	2,405
Write-down of Brea Hospital facility not currently deductible	—	(2,307)	—
Partnership exchange recognized as income for tax purposes	—	(863)	—
Bad debt expense not currently deductible for tax purposes	(685)	415	(633)
Other	(75)	(76)	211
	$ (357)	$(2,570)	$5,417

Note 8—Lease Commitments

The Registrant and its joint venture partnerships lease certain facilities, furniture and equipment. The facility leases contain escalation clauses based on the Consumer Price Index and provisions for payment of real estate taxes, insurance, maintenance and repair expenses.

Total rental expenses for all operating leases were as follows:

	Years Ended May 31,		
	1987	1986	1985
	(Dollars in thousands)		
Minimum rentals	$1,634	$ 935	$603
Contingent rentals	144	126	71
Total rentals	$1,778	$1,061	$674

Assets under capital leases are capitalized using interest rates appropriate at the inception of each lease; contingent rents associated with capital leases in fiscal 1987, 1986 and 1985 were $148,000, $129,000 and $123,000, respectively. The net book value of capital leases at May 31, 1987 and 1986, was $1,181,000 and $1,300,000, respectively.

Note 8—Lease Commitments (continued)

Future minimum payments, by year and in the aggregate, under capital leases and non-cancellable operating leases with initial or remaining terms of one year or more consisted of the following at May 31, 1987:

	Capital Leases			
	Registrant	Joint Venture	Total	Operating Leases
	(Dollars in thousands)			
1988	$ 204	$100	$ 304	$1,983
1989	204	89	293	1,655
1990	204	89	293	784
1991	204	89	293	408
1992	204	89	293	146
Later years	2,072	354	2,426	1,145
Total minimum lease payments	$3,092	$810	3,902	$6,121
Less amounts representing interest			2,136	
Present value of net minimum lease payments			$1,766	

Note 9—Deferred Compensation Plans

The Registrant has a deferred compensation agreement for its Chairman and President. The vested unfunded benefits at May 31, 1987 and 1986 ($1,386,000 and $1,374,000), have been accrued by the Registrant. The Registrant utilized an 8% discount rate in determining the present value of vested unfunded past service cost. The total charges to earnings for fiscal 1987, 1986 and 1985 amounted to $12,000, $463,000 and $136,000, respectively.

The Registrant has deferred compensation plans for its key executives and medical directors. Under provisions of these plans, participants may elect to defer a portion of their current compensation to future periods.

Note 10—Stock Options Plans

In fiscal 1984, the Registrant adopted a stock option plan which is intended to qualify as an Incentive Stock Option Plan. The total number of shares of Common Stock which may be granted under this Plan cannot exceed 333,333 shares. At the time of granting an option under the Plan, "stock appreciation rights" and "cash appreciation rights" may be concurrently granted. Options granted under the Plan are granted at the market price at the date of the grant. The Plan provides that options must be exercised within 10 years of the date of grant and that no options may be granted under the Plan subsequent to May 31, 1993.

Note 10—Stock Options Plans (continued)

The following table sets forth the options granted under this Plan:

	Number of Shares	Option Price	
		Per Share	Aggregate
	(Dollars in thousands, except share amounts)		
Options granted in fiscal 1985	140,345	$13.78-18.38	$1,959
Options forfeited in fiscal 1985	(5,802)	13.78	(80)
Balances, May 31, 1985	134,543	13.78-18.38	1,879
Options granted in fiscal 1986	74,000	18.00	1,332
Options forfeited in fiscal 1986	(14,418)	13.78	(199)
Options exercised in fiscal 1986	(1,088)	13.78	(15)
Balances, May 31, 1986	193,037	13.78-18.38	2,997
Options forfeited in fiscal 1987	(38,286)	13.78	(570)
Options exercised in fiscal 1987	(3,627)	13.78	(50)
Balances, May 31, 1987	151,124	$13.78-18.38	$2,377

During fiscal 1984, the Registrant authorized the issuance of non-statutory options for 33,333 common shares at $15.56–16.88 per share. The non-statutory options become exercisable at the rate of 25% per year following the date of grant and must be exercised within five years after the date of grant. At May 31, 1987, options for 25,000 shares are exercisable.

In July 1986, the Registrant authorized the issuance of non-statutory options for 30,908 common shares at $12.94 per share. The non-statutory options become exercisable one year after the date of grant. At May 31, 1987 none of these options were exercisable.

Note 11—Purchase of Treasury Stock

In December 1986, the Registrant announced an offer to purchase up to 4 million shares of its Common Stock at $13 net per share in cash. Approximately 4,587,166 shares were tendered and the Registrant accepted for payment 4,080,000 validly tendered shares including 80,000 additional shares permitted to be purchased under the terms of the offer. The Registrant utilized existing cash balances of approximately $26 million and borrowed $28 million to provide funding for the repurchase of shares and related expenses. See Note 6 for a description of the Registrant's loan agreement.

Note 12—Acquisitions and Dispositions

In May 1986, the Registrant purchased the remaining 50% of its partially owned subsidiary, RehabCare Corporation. The purchase price of $3.6 million exceeded the fair market value of net assets purchased by $3.1 million. In 1987, the benefit of RehabCare's net operating loss carryforward (approximately $1.1 million) was used to reduce intangible assets included in the consolidated balance sheets.

In July 1986, the Registrant purchased the assets of a hospital in San Diego, California. Consideration for purchase of the assets was $4 million. Upon completion of regulatory proceedings and renovation, the Registrant intends to operate the hospital as a 92-bed chemical dependency treatment center.

In November 1986, the Registrant opened a 120-bed chemical dependency treatment center in DuPage County in the Chicago metropolitan area. Purchase of the facility, which was built to the Registrant's specifications, was effected through the use of available cash of approximately $7.3 million.

Note 12—Acquisitions and Dispositions (continued)

In May 1987, the Registrant opened a 100-bed chemical dependency treatment center in Orlando, Florida. The facility was constructed at a cost of approximately $6.7 million. The cost of the construction was paid through internally generated funds and proceeds of the Registrant's revolving loan.

The Registrant has acquired land in Miami and Tampa, Florida and Denver, Colorado where it intends to develop freestanding chemical dependency treatment centers of 100-bed capacity each. Behavioral Medical Care, a 70% owned joint venture (managed by the Registrant) is a 49% owner of a joint venture which has acquired land in Sacramento, California where it intends to develop a 69-bed psychiatric facility.

Note 13—Contingencies

The Registrant is routinely engaged in the defense of lawsuits arising out of the ordinary course and conduct of its business and has insurance policies covering such potential insurable losses where such coverage is cost effective. Management believes that the outcome of such lawsuits will not have a material adverse effect on the consolidated financial statements.

Note 14—Loss on Write-Down of Assets

In May 1986, the Registrant determined that its psychiatric hospital in Brea, California required physical plant replacement. The Registrant has begun development of a replacement facility to be constructed at the same site. Upon completion of the new structure, the existing facilities will be razed. The Registrant incurred in fiscal 1986 a charge to earnings of $4.3 million related to the write-down of the facilities.

In fiscal 1985, the Registrant entered into a license agreement with SmokEnders, Inc. The license agreement granted the Registrant the right to operate smoking cessation seminars using the name and materials of SmokEnders, Inc. In fiscal 1986, the Registrant determined that there had been a permanent impairment in the value of the license agreement, and accordingly, the unamortized balance of license consideration of $1.4 million was charged to earnings in fiscal 1986.

COMPREHENSIVE CARE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

May 31, 1987, 1986 and 1985

Note 15—Unaudited Quarterly Results

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(Dollars in thousands, except per share amounts)			
1987				
Revenues	$50,615	$45,488	$46,635	$52,152
Earnings before taxes on income	$ 9,701	$ 4,743	$ 3,850	$ 4,384
Taxes on income	4,918	2,277	1,809	1,586
Net earnings	$ 4,783	$ 2,466	$ 2,041	$ 2,798
Per share:				
Earnings—primary and fully diluted	$ .31	$ .17	$ .17	$ .25
Dividend declared	$ .09	$ .09	$ .09	$ .09
1986				
Revenues	$44,207	$46,697	$48,914	$53,118
Earnings before taxes on income	$ 9,304	$ 9,399	$ 6,634	$ 82(1)
Taxes on income	4,643	4,671	3,305	(302)
Net earnings	$ 4,661	$ 4,728	$ 3,329	$ 384
Per share:				
Earnings—primary and fully diluted	$ .30	$ .30	$ .22	$ .05
Dividend declared	$ .08	$ .08	$ .08	$ .08

(1) See Note 14 for information regarding the loss on write-down of assets recorded in the fourth quarter of fiscal 1986.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

There is hereby incorporated by reference the information which will appear under the caption "Election of Directors" in a proxy statement to be filed with the Securities and Exchange Commission relating to the Registrant's Annual Meeting of Stockholders to be held on October 8, 1987.

Item 11. EXECUTIVE COMPENSATION.

There is hereby incorporated by reference the information which will appear under the caption "Executive Compensation and Other Information" in a proxy statement to be filed with the Securities and Exchange Commission relating to the Registrant's Annual Meeting of Stockholders to be held on October 8, 1987.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

There is hereby incorporated by reference the information which will appear under the captions "Principal Stockholders" and "Election of Directors" in a proxy statement to be filed with the Securities and Exchange Commission relating to the Registrant's Annual Meeting of Stockholders to be held on October 8, 1987.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

There is hereby incorporated by reference the information which will appear under the caption "Executive Compensation and Other Information" in a proxy statement to be filed with the Securities and Exchange Commission relating to the Registrant's Annual Meeting of Stockholders to be held on October 8, 1987.

PART IV

Item 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.

(a) 1. **Financial Statements**

Included in Part II of this report:

Report of Independent Certified Public Accountants
Consolidated Balance Sheets as of May 31, 1987 and 1986
Consolidated Statements of Earnings for years ended May 31, 1987, 1986 and 1985
Consolidated Statements of Stockholders' Equity for years ended May 31, 1987, 1986 and 1985
Consolidated Statements of Changes in Financial Position for years ended May 31, 1987, 1986 and 1985
Notes to Consolidated Financial Statements

2. **Financial Statement Schedules**

V. Property and Equipment
VI. Accumulated Depreciation and Amortization of Property and Equipment
X. Supplementary Statement of Earnings Information

Other schedules are omitted, as the required information is inapplicable or the information is presented in the consolidated financial statements or related notes.

3. Exhibits

Exhibit Number	Description and Reference
3.1	Restated Certificate of Incorporation(11)
3.2	Restated Bylaws as amended July 14, 1986(10)
4.1	Indenture dated April 25, 1985, between the Registrant and Bank of America, NT&SA relating to Convertible Subordinated Debentures(7)
4.2	Amended and Restated Loan Agreement among the Registrant, Union Bank, Centerre Bank, National Association and Southeast Bank, N.A. (filed herewith)
10.1	Standard form of CareUnit Contract(1)
10.2	Standard form of CarePsychCenter Contract(1)
10.3	The Registrant's Employee Savings Plan(9)
10.4	Deferred Compensation Agreement dated April 6, 1982, between the Registrant and B. Lee Karns(3)
10.5	Amendment No. 1 to Deferred Compensation Agreement between the Registrant and B. Lee Karns(6)
10.6	Amendment No. 2 to Deferred Compensation Agreement between the Registrant and B. Lee Karns(10)
10.7	The Registrant's Amended and Restated 1983 Incentive Stock Option Plan(8)
10.8	Form of Individual Death Benefit Agreement(6)
10.9	Deferred Compensation Plan for executive management(8)
10.10	Form of Non-Statutory Stock Option Agreement(8)
10.11	Form of Incentive Stock Option Agreement(10)
10.12	Description of Executive Bonus Plan(8)
10.13	Guarantee Agreement dated March 30, 1981, among the Registrant, Caremanor Hospital of Washington, Inc., Alcoholism Center Associates, Inc., James R. Milam and Doris M. Hutchinson(2)
10.14	Guaranty Agreement dated June 1, 1982, among CareManor of Northeast Florida, the Registrant, Womlar, Inc., Burch Williams, Arthur Lucas, Fred Ahern, Sr., and Algie Outlaw and Southeast Bank, N.A.(4)
10.15	Group Annuity Contract between the Registrant and Manufacturers Life Insurance Company dated April 18, 1983(5)
10.16	Annuity Contract between the Registrant and New York Life Insurance and Annuity Corporation dated November 2, 1982(5)
10.17	Joint Venture Agreement dated June 17, 1983, between the Registrant and Voluntary Health Enterprises, Inc.(6)
10.18	Agreements between the Registrant and SmokEnders, Inc.(8)
10.19	City of Coral Springs, Florida Industrial Development Revenue Bonds (CareUnit of Coral Springs Project) dated September 19, 1983, in the amount of $6,000,000(6)
11	Computation of Earnings per Share (filed herewith)
15	Acknowledgement of Peat Marwick Main & Co. regarding use of unaudited interim financial information (filed herewith)
22	List of the Registrant's subsidiaries (filed herewith)
24.1	Report and consent of Peat Marwick Main & Co. (filed herewith)

(1) Filed as an exhibit to the Registrant's Form S-1 Registration Statement No. 2-69263.

(2) Filed as an exhibit to the Registrant's Form 10-K for the fiscal year ended May 31, 1981.

(3) Filed as an exhibit to the Registrant's Form 10-K for the fiscal year ended May 31, 1982.

(4) Filed as an exhibit to the Registrant's Form 10-Q for the quarter ended February 28, 1983.

(5) Filed as an exhibit to the Registrant's Form 10-K for the fiscal year ended May 31, 1983.

(6) Filed as an exhibit to the Registrant's Form 10-K for the fiscal year ended May 31, 1984.

(7) Filed as an exhibit to the Registrant's Form S-3 Registration Statement No. 2-97160.

(8) Filed as an exhibit to the Registrant's Form 10-K for the fiscal year ended May 31, 1985.

(9) Filed as an exhibit to the Registrant's Form S-8 Registration Statement No. 33-6520.

(10) Filed as an exhibit to the Registrant's Form 10-K for the fiscal year ended May 31, 1986.

(11) Filed as an exhibit to the Registrant's Form 10-Q for the quarter ended August 31, 1986.

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the last quarter of the period covered by this report.

SIGNATURES

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, August 25 1987.

COMPREHENSIVE CARE CORPORATION

By ______________________

B. Lee Karns
Chairman of the Board and President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
B. Lee Karns	Director, Chairman of the Board, and President (Chief Executive Officer)	August 25 1987
Stephen R. Munroe	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	August 25 1987
Mark A. Edwards	Vice President and Controller (Principal Accounting Officer)	August 25 1987
Robert B. Hunter, M.D.	Director	August 25 1987
Robert L. Kasselmann	Director	August 25 1987
Jack A. McLeod	Director	August 25 1987

COMPREHENSIVE CARE CORPORATION

Schedule V—Property and Equipment

For the Years Ended May 31, 1987, 1986 and 1985

	Balance at Beginning of Period	Additions at Cost	Retirements	Reclassifications	Balance at End of Period
	(Dollars in thousands)				
Year ended May 31, 1987					
Land and improvements	$ 15,464	$12,399	$ —	$ —	$ 27,863
Buildings and improvements	64,063	23,294	38	(27)	87,292
Furniture and equipment	18,139	3,773	116	27	21,823
Leasehold improvements	204	9	—	—	213
Capitalized building leases	2,704	—	—	—	2,704
	$100,574	$39,475	$ 154	$ —	$139,895
Year ended May 31, 1986					
Land and improvements	$ 14,267	$ 1,348	$ 151	$ —	$ 15,464
Buildings and improvements	53,819	15,742	5,938	440	64,063
Furniture and equipment	12,912	6,328	666	(435)	18,139
Leasehold improvements	514	74	379	(5)	204
Capitalized building leases	2,704	—	—	—	2,704
	$ 84,216	$23,492	$7,134	$ —	$100,574
Year ended May 31, 1985					
Land and improvements	$ 7,476	$ 6,957	$ 147	$ (19)	$ 14,267
Buildings and improvements	42,607	11,359	18	(129)	53,819
Furniture and equipment	10,144	2,850	237	155	12,912
Leasehold improvements	501	30	10	(7)	514
Capitalized building leases	2,704	—	—	—	2,704
	$ 63,432	$21,196	$ 412	$ —	$ 84,216

COMPREHENSIVE CARE CORPORATION

Schedule VI—Accumulated Depreciation and Amortization of Property and Equipment

For the Years Ended May 31, 1987, 1986 and 1985

	Balance at Beginning of Period	Additions Charged to Expense	Retirements	Reclassifications	Balance at End of Period
	(Dollars in thousands)				
Year ended May 31, 1987					
Buildings and improvements	$ 7,501	$2,932	$ —	$(272)	$10,161
Furniture and equipment	6,455	2,444	50	272	9,121
Leasehold improvements	69	30	—	—	99
Capitalized building leases	1,404	119	—	—	1,523
	$15,429	$5,525	$ 50	$ —	$20,904
Year ended May 31, 1986					
Buildings and improvements	$ 5,027	$2,570	$118	$ 22	$ 7,501
Furniture and equipment	4,959	1,798	280	(22)	6,455
Leasehold improvements	436	17	384	—	69
Capitalized building leases	1,289	116	1	—	1,404
	$11,711	$4,501	$783	$ —	$15,429
Year ended May 31, 1985					
Buildings and improvements	$ 3,147	$1,882	$ 2	$ —	$ 5,027
Furniture and equipment	3,345	1,703	111	22	4,959
Leasehold improvements	281	177	—	(22)	436
Capitalized building leases	1,173	116	—	—	1,289
	$ 7,946	$3,878	$113	$ —	$11,711

SCHEDULE X

COMPREHENSIVE CARE CORPORATION

Schedule X—Supplementary Statement of Earnings Information

For the Years Ended May 31, 1987, 1986 and 1985

	May 31,		
	1987	1986	1985
	(Dollars in thousands)		
Advertising costs	$16,107	$15,232	$10,075

RECD S.E.C.

AUG 27 1987

COMPREHENSIVE CARE CORPORATION

Form 10-K

EXHIBIT VOLUME

For the fiscal year ended May 31, 1987

EXHIBIT INDEX

Exhibit No.	Description	Sequentially Numbered Page
4.2	Amended and Restated Loan Agreement among the Registrant, Union Bank, Centerre Bank, National Association and Southeast Bank, N.A.	47
11	Computation of Earnings per Share	74
15	Acknowledgement of Peat Marwick Main & Co. regarding use of unaudited interim financial information	75
22	List of the Registrant's subsidiaries	76
24.1	Report and consent of Peat Marwick Main & Co.	78

COMPREHENSIVE CARE CORPORATION AND SUBSIDIARIES
CALCULATION OF EARNINGS PER SHARE

PRIMARY AND FULLY DILUTED	1987	1986	1985	1984	1983
	YEAR ENDED MAY 31, (AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)				
NET EARNINGS APPLICABLE TO COMMON STOCK(a)	$13,888	$14,817	$17,361	$14,058	$10,767
AVERAGE NUMBER OF SHARES OF COMMON STOCK AND COMMON STOCK EQUIVALENTS OUTSTANDING(c):					
SHARES OF COMMON STOCK	13,583	15,173	15,169	15,160	13,367
ADDITIONAL AVERAGE NUMBER OF SHARES OUTSTANDING ASSUMING CONVERSION OF 7.5% CONVERTIBLE DEBENTURES	1,771	1,771	146	-	-
DILUTIVE EFFECT OF STOCK OPTIONS AFTER APPLICATION OF TREASURY STOCK METHOD(b)	6	43	-	-	-
AVERAGE NUMBER OF SHARES OF COMMON STOCK AND COMMON STOCK EQUIVALENTS	15,360	16,987	15,315	15,160	13,367
EARNINGS PER SHARE	$0.90	$0.87	$1.13	$0.93	$0.81

	1987	1986	1985	1984	1983
	YEAR ENDED MAY 31, (DOLLARS IN THOUSANDS)				
NET EARNINGS PER SELECTED FINANCIAL DATA	$12,088	$13,102	$17,226	$14,058	$10,767
ADD INTEREST EXPENSE ATTRIBUTABLE TO 7.5% CONVERTIBLE SUBORDINATED DEBENTURES	1,800	1,715	135	-	-
(a) NET EARNINGS APPLICABLE TO COMMON STOCK	$13,888	$14,817	$17,361	$14,058	$10,767

(b) STOCK OPTIONS GRANTED DID NOT HAVE A SIGNIFICANT DILUTIVE EFFECT AND WERE NOT INCLUDED IN THE COMPUTATION OF EARNINGS PER SHARE FOR THE YEARS 1983 THROUGH 1985.

(c) THE WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING USED TO COMPUTE EARNINGS PER SHARE HAS BEEN ADJUSTED TO REFLECT A FOUR-FOR-THREE STOCK SPLIT EFFECTED JULY 16, 1985.

EXHIBIT 11

KPMG Peat Marwick

Certified Public Accountants

Peat Marwick Main & Co.
Orange County Office
Center Tower
650 Town Center Drive
Costa Mesa, CA 92626

Telephone 714 850 4300
Telex 683481

Telecopier 714 850 4488

Comprehensive Care Corporation
18551 Von Karman Avenue
Irvine, California 92714

Gentlemen:

Re: Registration Statements No. 2-62410, 2-75129, 33-6520 and 33-3091

With respect to the subject Registration Statements, we acknowledge our awareness of the use therein of our SAS No. 36 reports dated September 24, 1986, December 17, 1986 and April 8, 1987 related to our reviews of interim financial information.

Pursuant to Rule 436(c) under the Securities Act, such reports are not considered a part of a Registration Statement prepared or certified by an accountant or a report prepared or certified by an accountant within the meaning of Sections 7 and 11 of the Act.

Very truly yours,

Peat Marwick Main & Co.

Orange County, California
August 21, 1987

EXHIBIT 15

COMPREHENSIVE CARE CORPORATION
SCHEDULE OF SUBSIDIARIES

SUBSIDIARY NAME	STATE OF INCORPORATION
COMPREHENSIVE CARE CORPORATION (PARENT)	Delaware
N.P.H.S., INC.	California
CAREMANOR HOSPITAL OF WASHINGTON, INC.	Washington
TRINITY OAKS HOSPITAL, INC.	Texas
CAREMANOR HOSPITAL OF VIRGINIA, INC.	California
TERRACINA CONVALESCENT HOSPITAL & HOME, INC.	California
CAREUNIT, INC.	California
CAREUNIT HOSPITAL OF ST. LOUIS, INC.	Missouri
STARTING POINT, INC.	California
CAREUNIT HOSPITAL OF ALBUQUERQUE, INC.	New Mexico
CAREUNIT HOSPITAL OF NEVADA, INC.	Nevada
CAREINSTITUTE	California
CAREUNIT CLINIC OF WASHINGTON, INC.	Washington
CAREUNIT REDEVELOPMENT CORP.	Missouri
CAREUNIT HOSPITAL OF OHIO, INC.	Ohio
CAREUNIT OF FLORIDA, INC.	Florida
COMPREHENSIVE CARE CORPORATION (CANADA) LIMITED	Canada
REHABCARE CORPORATION	Delaware
TWELVE POINT RIDGE, INC.	Oklahoma
CAREUNIT OF CHICAGO, INC.	Illinois
VIDEOHEALTH, INC.	California

EXHIBIT 22

COMPREHENSIVE CARE CORPORATION
SCHEDULE OF JOINT VENTURES

<u>JOINT VENTURES</u> (CompCare is the Partner in all except as noted)

NEUROAFFILIATES
(N.P.H.S., INC. IS THE PARTNER)

BEHAVIORAL MEDICAL CARE ("BMC")

SUTTER-BMC JOINT VENTURE
(BMC IS THE PARTNER)

GOLDEN VALLEY HEALTH CENTER

CAREUNIT HEALTHLINK

CARETECH

Peat Marwick

Certified Public Accountants

Peat Marwick Main & Co.
Orange County Office
Center Tower
650 Town Center Drive
Costa Mesa, CA 92626

Telephone 714 850 4300
Telex 683481

Telecopier 714 850 4488

To the Stockholders and Board of Directors
Comprehensive Care Corporation:

The examinations referred to in our report dated July 17, 1987 included the related financial statement schedules as of May 31, 1987 and for each of the years in the three-year period ended May 31, 1987 included in Form 10-K. In our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

We consent to incorporation by reference in the Registration Statements (No. 2-62410a, 2-75129, 336520a and 33-3091) on Form S-8 of Comprehensive Care Corporation of our reports dated July 17, 1987, relating to the consolidated balance sheets of Comprehensive Care Corporation and subsidiaries as of May 31, 1987 and 1986 and the related consolidated statements of earnings, stockholders' equity, and changes in financial position and related schedules for each of the years in the three-year period ended May 31, 1987 which report appears in the May 31, 1987 annual report on Form 10-K of Comprehensive Care Corporation.

Peat Marwick Main & Co.

Orange County, California
August 21, 1987

EXHIBIT 24.1

END

FILMED

SEPTEMBER 1987

BECHTEL

Information Services