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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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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, 1988

Commission file no. ~~0-3751~~ 1-9927

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)

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Bechtel Information Services
Gaithersburg, Maryland

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

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

Title of each class	Name of each exchange on which registered
Common Stock, Par Value $.10 per share	New York Stock Exchange, Inc.
Common Share Purchase Rights	New York Stock Exchange, Inc.

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

7½% Convertible Subordinated Debentures due 2019
(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 29, 1988, was $91,577,494.

At July 29, 1988, the Registrant had 10,102,295 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 6, 1988, which proxy statement will be filed no later than 120 days after the close of the Registrant's fiscal year ended May 31, 1988.

Total of sequentially numbered pages 217
Exhibit Index on sequential page number 56

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. It is the largest private provider of hospital-based chemical dependency treatment programs in the United States. The programs are provided under contractual agreements with independent general hospitals or at freestanding facilities owned and/or operated by the Registrant. During fiscal 1988, chemical dependency and psychiatric treatment programs accounted for approximately 88% of the Registrant's total revenues. A wholly owned subsidiary of the Registrant, 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. During fiscal 1983, the Registrant reorganized its operations by transferring its chemical dependency and psychiatric contract programs to CareUnit, Inc., a wholly owned subsidiary. The following table sets forth for the five years ended May 31, 1988, the contribution to operating revenues of the Registrant's freestanding operations, CareUnit, Inc. contracts, RehabCare programs, and its other activities.

	Years Ended May 31,				
	1988	1987	1986	1985	1984
Freestanding operations	61%	58%	61%	63%	60%
CareUnit, Inc.	26	32	33	34	37
RehabCare	7	5	1	—	—
Other activities	6	5	5	3	3
	100%	100%	100%	100%	100%

FREESTANDING OPERATIONS

The Registrant currently operates or participates in the operation of 23 facilities representing 2,235 available beds, including a psychiatric facility in the Sacramento area and a chemical dependency facility in Tampa both of which commenced operations in June 1988. Since 1983, the Registrant has expanded its freestanding operations through the construction of eight freestanding chemical dependency facilities and the acquisition of six chemical dependency or psychiatric facilities, representing approximately 1,412 beds. In fiscal 1988, the Registrant closed two freestanding facilities. 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 Registrant has a 50% interest in each of these joint ventures

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				
			1988	1987	1986	1985	1984
Chemical Dependency Facilities							
CareUnit Hospital of Fort Worth	1971	83	22,507	24,139	26,696	24,278	14,593
CareUnit Hospital of Orange	1976	103	32,652	29,697	33,763	33,677	31,696
CareUnit Hospital of Kirkland	1981	83	19,574	18,640	24,336	27,099	25,530
CareUnit of Jacksonville Beach	1982	84	27,613	21,065	22,818	16,539	19,355
CareUnit Hospital of Cincinnati	1982	128	29,446	25,955	29,065	29,181	26,880

(Table continued on following page)

	Year Acquired(1)	Licensed Beds	Patient Days				
			1988	1987	1986	1985	1984
CareUnit Hospital of St. Louis	1983	144	24,353	21,278	43,822	39,953	31,293
Starting Point, Oak Avenue	1983	136	27,048	21,593	22,705	21,136	13,492
Starting Point, Orange County	1983	59	19,109	19,326	17,421	15,332	4,515
Starting Point, Grand Avenue	1983	25	6,834	7,249	7,264	6,158	1,294
CareUnit Hospital of Albuquerque	1984	70	17,187	16,730	16,080	9,597	205
CareUnit Hospital of Nevada	1984	50	13,738	11,615	8,748	7,640	—
CareUnit of Coral Springs	1985	100	23,639	21,735	12,398	—	—
CareUnit of Grand Rapids	1985	76	13,483	8,595	3,386	—	—
CareUnit of DuPage	1986	120	11,969	3,916	—	—	—
CareUnit of Orlando	1987	100	15,844	106	—	—	—
CareUnit of San Diego	1988	92	2,872	—	—	—	—
CareUnit of Colorado	1988	100	4,303	—	—	—	—
Closed Facilities(2)			19,180	33,902	30,393	37,921	23,725
Psychiatric Facilities							
Brea Hospital Neuropsychiatric Center	1969	142	33,225	39,237	43,870	46,271	44,472
Crossroads Hospital	1972	43	12,281	14,148	13,657	14,503	13,266
Woodview-Calabasas Hospital	1970	117	19,143	22,473	23,104	25,531	24,375
Golden Valley Health Center	1984	377	48,877	54,970	56,453	64,007	155
Patient days served during period			445,277	416,369	435,979	418,823	274,856
Admissions			20,783	17,902	17,964	16,754	10,585
Available beds at end of period(3)			2,067	1,927	1,687	1,609	1,538
Average occupancy rate for period(4)			51%	65%	73%	72%	67%

(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 2,839 patient days in fiscal 1988. 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. On May 11, 1988, CareUnit Behavioral Center of Los Angeles was closed. The facility, licensed for 104 beds, generated 16,341 patient days in fiscal 1988. The facility was closed after it sustained operating losses in each of the last two fiscal years.

(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.

Freestanding Facility Programs

The Registrant's freestanding facilities offer a variety of behavioral medicine programs. The programs offered at a given freestanding facility are determined by the licensure of the facility, the extent and nature of competitive programs, the population base and demographics, and reimbursement considerations. A program within the facility represents a separately staffed unit dedicated to the treatment of individuals whose primary diagnosis suggests that their treatment needs will best be met within the unit. Patients whose diagnosis suggests the need for supplemental services are accommodated throughout their stay as the individual treatment plan developed for each patient requires.

Chemical Dependency. Chemical dependency programs are offered in all freestanding facilities except Woodview-Calabasas and Crossroads. These programs are delivered under the name CareUnit and include programs for adults and adolescents.

Each patient admitted to the facility 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 stay for an adult patient is approximately 18 days, which includes detoxification. The average length of stay for an adolescent patient is approximately 30 days. After discharge from the facility, the patient's recovery is monitored for a 12-week period during which the patient and family members return to the facility once a week for outpatient counseling sessions. For individuals who do not require the structure and intensity of inpatient treatment, the Registrant has developed outpatient programs which generally operate in conjunction with existing inpatient programs. At May 31, 1988, 39 such outpatient programs were in operation.

Psychiatric. Psychiatric programs are offered in certain freestanding facilities. The type of program offered at a given freestanding facility is dependent upon the extent of community need, the competitive environment, and the licensure status of the facility. In general, psychiatric hospital services are offered only in facilities which are licensed by the state in which they are located for either psychiatric or general medical/surgical services. Admission to the programs offered by the Registrant is typically voluntary although certain facilities provide emergency psychiatric services and accept involuntary patients who are suffering an acute episodic psychiatric incident.

Each patient admitted to a psychiatric program undergoes a complete assessment including an initial evaluation by a psychiatrist, a medical history, physical examination, a laboratory work-up, a nursing assessment, a psychological evaluation, and social and family assessments. The assessments are utilized to develop an individualized treatment plan for each patient.

The treatment programs are undertaken by an interdisciplinary team of professionals experienced in the treatment of psychiatric problems. The length of the treatment stay varies in accordance with the severity of the patient's condition. 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 began providing eating disorders services in 1983. This program treats those individuals 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. Eating disorders programs are offered by the Registrant only in certain freestanding facilities. Each facility offering said services is licensed as either a psychiatric or general medical/surgical hospital. The eating disorders program includes: individual and group therapy, nutritional guidance and management of attendant medical or psychological problems.

Sexual Dependency. The sexual dependency program offered at Golden Valley Health Center is the first of its kind in the United States that provides both inpatient and outpatient treatment to sexually dependent individuals. Sexual dependency is defined as engaging in obsessive/compulsive sexual behaviors which cause severe distress for the individual and/or family. The individually tailored inpatient treatment program is approximately five weeks in duration. The program is staffed by psychiatrists, chaplains, therapists and nurses experienced in treating the sexually dependent person, family and significant others. The program includes individual and group psychotherapy and educational components. Family involvement is an essential element of the treatment process.

Development of Freestanding Facilities

The development and operation of health care facilities is subject to compliance with various federal, state and local statutes and regulations. Health care facilities operated by the Registrant must comply with

the licensing requirements of 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, many states have enacted Certificate of Need ("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 in existing facilities, the Registrant must demonstrate to either state or local authorities, or both, that it is in compliance with the plan adopted by such agencies. 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. 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. The Registrant is unable to predict the outcome of these deliberations.

Factors to be considered in the development of freestanding facilities include population base and demographic characteristics, community pricing standards, state licensure and rate control issues, and CON requirements. During the past five years, the Registrant has focused its development efforts in states where the regulatory environment is relatively less restrictive so that the Registrant has been able to develop sub-acute facilities without obtaining a CON.

In general, sub-acute licensed facilities have lower operating costs than acute licensed facilities. State law governing the operation of health related facilities typically imposes a higher standard of construction, staffing and operating oversight on facilities licensed for acute treatment. The Registrant generally incurs the necessary construction cost to build its facilities to an acute psychiatric standard so that the facility may be converted to an alternative use if necessary. Although the sub-acute model facility has a lower level of operating cost, such facilities are not currently eligible for participation in the Medicare or Medicaid programs.

The Registrant selects the physical site of the proposed facility and thereafter obtains a CON, where necessary. The Registrant engages architects and engineers, construction managers and a general contractor who are responsible for the construction of the physical plant. During fiscal 1988, the Registrant employed one individual whose responsibility is the oversight of construction activities on behalf of the Registrant. The construction process normally requires from 12 to 18 months.

Source of Revenues

During fiscal 1988, approximately 93% of the Registrant's operating revenues from freestanding operations were received from private sources (private health insurers or directly from patients) 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 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.

Health Maintenance Organizations ("HMOs") and Preferred Provider Organizations ("PPOs") attempt to control the cost of health care services by directing their enrollees to participating physicians and institutions. Aggressive 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 participation in HMOs and PPOs is continuing to expand. The Registrant also believes that the development of these organizations has had a negative impact on utilization of its freestanding facilities in certain markets and 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.

Employers, union trusts and other major purchasers of health care services have become increasingly aggressive in pursuing cost containment. To the extent that the 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. In addition, many major purchasers of health care services are reconsidering the benefits that they provide and in many cases reducing the level of coverage, thereby shifting more of the burden to their employees or members. Such reductions in benefits have a negative impact on the Registrant's business.

The Medicare program provides hospitalization, physician, 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 were excluded from PPS until October 1, 1987. Such providers are no longer eligible for exclusion from PPS effective with the beginning of their Medicare fiscal year on or after October 1, 1987 and will be paid under PPS. Three of the Registrant's freestanding facilities became subject to payment under PPS effective June 1, 1988.

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 continue to be eligible for exemption from PPS or that other regulatory or legislative changes will not adversely affect the Registrant's business.

Nine of the Registrant's facilities participate in the Medicare program. Of these, six 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 1988. The Registrant does not believe that the imposition of TEFRA limits or PPS have had a material adverse impact on its business at its freestanding facilities. Loss of exclusion at freestanding facilities would also not materially impact the Registrant's business.

Hospitals participating in the Medicare program are required to retain the the services of a peer review organization ("PRO"). The PRO is responsible for determining the medical necessity, appropriateness and quality of care given Medicare 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 facilities, 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 freestanding facility revenue is derived from the Medicaid program. Accordingly, changes in Medicaid program reimbursement are not expected to have a material adverse impact on the Registrant's business.

Competition and Promotion

The Registrant competes first for the development and implementation of freestanding facilities and subsequently for patients who utilize those facilities. 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 has faced generally increasing competition in the last few years as a result of the increasing development of competitive programs. 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.

The Registrant and its competitors compete to attract patients to utilize their programs. In many instances the patient may be directed to a specific facility by his or her employer (or their agent), by a physician, by a social services agency, or by another health care provider. The Registrant markets its services by attracting these referral sources to its programs. The primary competitive factors in attracting referral sources, patients and physicians are marketing, reputation, success record, cost and quality of care, and location and scope of services offered by a facility. The Registrant has an active promotional program, described below, and believes it is competitive in reputation and other factors necessary for patient attraction. In addition, the Registrant and its competitors compete to attract qualified physicians and psychiatrists.

The Registrant has an active public relations program designed to increase public awareness of the programs offered by the Registrant. During fiscal 1988, the Registrant spent $9,553,000 for all forms of advertising in support of its freestanding operations. Media advertising (television, radio and print) was $7,886,000 in fiscal 1988. 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.

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 and 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.

CONTRACT OPERATIONS

Behavioral Medicine

As a result of the reorganization of the Registrant's operations in fiscal 1988, CareUnit, Inc. is currently engaged in the development, marketing, and management of programs for the delivery of behavioral medicine services to patients requiring such services in dedicated units of hospitals. The programs offered are similar to the behavioral medicine programs offered in the Registrant's freestanding facilities except that sexual dependency programs are not offered on a contract basis.

In June 1983, the Registrant entered into a joint venture with an affiliate of Voluntary Hospital 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 programs to the VHA network of hospitals. As a part of its internal reorganization, the Registrant assigned its interest in BMC to CareUnit, Inc. which manages the BMC joint venture. As of May 31, 1988, BMC was operating 49 contracts consisting of 1,254 beds. Unless otherwise specified, the following discussion and tables relating to CareUnit, Inc. include BMC contracts.

Under a contract, the hospital furnishes patients with all hospital facilities and services necessary for their generalized medical care, including, nursing, dietary, and housekeeping services. CareUnit, Inc. typically provides support in the areas of program implementation and management, staff recruiting, continuing education, treatment team training, community education, advertising, public relations, insurance, and on-going program quality assurance. CareUnit, Inc. is obligated to provide a multi-disciplinary team generally consisting of a physician (who serves as medical director for the program), a program manager, a social worker, a therapist and other appropriate supporting personnel. As a result of reimbursement changes and competitive pressures, the contractual obligations of CareUnit, Inc. have been subject to more intense evaluation during the past year. In general, some prospective client hospitals are expressing a desire for more control over the services provided by CareUnit, Inc. and in response CareUnit, Inc. is providing a more flexible approach to contract management.

In response to changes in reimbursement and competitive environment, CareUnit, Inc. began offering franchises to hospitals and related health care providers in December 1987. At present, franchises are offered for adult and adolescent chemical dependency and adult psychiatric programs. Under a CareUnit, Inc. franchise, the franchisee receives a license to use the CareUnit name, certain program and promotional materials, and training necessary to operate a program in exchange for initial and on-going fees. The franchisee provides and compensates all members of the treatment team and is responsible for all costs of operating the treatment program. CareUnit, Inc. also provides on-going operational, promotional, and quality assurance support. As of July 31, 1988, one franchise has been sold and is scheduled to begin operations in October 1988.

The following table sets forth selected operating data regarding behavioral mecicine programs managed under contract:

	Years Ended May 31,				
	1988	1987	1986	1985	1984
Number of contracts at end of period(1):					
Adult CareUnits(2)	82	86	95	84	81
Adolescent CareUnits(2)	22	28	28	20	16
Adult CarePsychCenters(2)	21	20	22	17	12
Adolescent CarePsychCenters(2)	6	9	8	5	3
Eating disorders units	4	8	11	7	4
Total	135(3)	151	164	133	116
Available beds at end of period	3,446	3,860	3,981	3,145	2,648
Patient days served during period	769,255	845,853	803,255	697,509	588,321
Admissions	45,171	48,100	44,136	38,443	32,834
Average occupied beds per contract	14.2	14.5	15.1	15.8	15.4
Average occupancy rate for period(4)	57%	58%	62%	66%	67%

(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 psychiatric treatment programs.

(3) During the fiscal year ended May 31, 1988, CareUnit, Inc. opened 17 new contracts and closed 33 contracts. BMC opened six and closed six of these contracts. Of the 33 closed contracts, 15 contracts were terminated by CareUnit, Inc. and 18 were terminated by the contracting hospitals. Twenty 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.

Sources of Revenue

Patients are admitted to a behavioral medicine program under the contracting 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 CareUnit, Inc. a fixed monthly management fee plus a fee for each patient day of service provided. Fees paid by the hospital are subject to annual adjustments to reflect changes in the Consumer Price Index. CareUnit, Inc. and the hospital share the risk of non-payment by patients based on a predetermined percentage participation by CareUnit, Inc. in bad debts. CareUnit, Inc. may also participate with a contracting hospital in charity care and certain contractual allowances and discounts. Hospitals contracting for programs generally suffer from the same reimbursement pressures as the Registrant's freestanding facilities. In some instances, contracting hospitals have instituted admissions policies which restrict the ability of CareUnit, Inc. to promote utilization of the programs. Such policies have a negative impact on contract revenues.

Generally, management contracts are entered into for a period of two to five years and thereafter are automatically renewed for successive one year periods unless either party gives notice of termination at least 90 days prior to the end of such periods. Contracts are also terminable for material defaults. A significant number of contracts are terminable by either party on their anniversary dates.

Development, Competition and Promotion

CareUnit, Inc. directs its development activities toward increasing the number of management contracts with hospitals. The primary competitors of CareUnit, Inc. are hospitals and hospital management companies which offer programs similar to those offered by CareUnit, Inc.

The significant factors in a hospital's decision to utilize a contract manager include the degree of sophistication of hospital management, financial resources of the hospital, and perceived value of the services to be rendered under contract. Individual contract managers are selected based on experience, reputation for quality programs, availability of program support services and price. While a number of competing companies offer contract programs at prices lower than CareUnit, Inc., it believes that its experience, reputation, and program support are superior to that of its competitors. CareUnit, Inc. also believes that its experience with CON issues and program implementation often results in a reduced start-up period. Risk to the hospital is also reduced because the fees paid by the hospital to CareUnit, Inc. are primarily based on bed occupancy.

Programs managed by CareUnit, Inc. must meet minimum occupancy levels to be profitable for both the hospital and CareUnit, Inc. The program manager of each unit is responsible for local promotion of the unit. The program manager is responsible for identifying and contacting referral sources, instituting promotional campaigns, obtaining local media coverage relating to behavioral medicine problems and otherwise promoting the unit. Each program manager is assisted by the corporate-based communications department. In addition, the program manager is supported by media advertising including television, radio, and print. CareUnit, Inc. spent $5,362,000 on media advertising for the year ended May 31, 1988. Most of these expenditures were for the promotion of chemical dependency services rather than psychiatric services which are driven more by professional referrals.

Comprehensive Medical Rehabilitation

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. Comprehensive medical rehabilitation is a health treatment program offered to disabled or impaired persons with the objective of making such persons as functionally independent and self sufficient as possible. Rehabilitation programs are used to treat disabilities or impairments resulting from medical problems such as traumatic brain injuries, strokes, spinal cord injuries, severe fractures, back disorders, arthritis, neurological disorders and amputations. Rehabilitative care emphasizes the treatment of functional limitations and disability in order to maximize the patient's ability to function independently. Although the transition from acute to rehabilitative care is not always precisely demarcated, patients do not enter a rehabilitation program until they no longer require acute medical care.

RehabCare's responsibility under its contracts is to provide a multi-disciplinary team generally consisting of a physician (who serves as the medical director for the rehabilitation program), a program manager, a psychologist, physical and occupational therapists, a speech pathologist, a social worker and other appropriate supporting personnel. In addition, RehabCare provides program implementation and management, treatment team training, staff recruiting, continuing education, insurance, community education, promotion, 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 the rehabilitation programs:

Inpatient rehabilitation nursing services	Nutritional counseling services
Physical therapy services	Psychological services
Speech/language pathology services	Social work services
Audiological services	Respiratory therapy services
Orthotic/prosthetic 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, 1988, RehabCare programs were offered solely in acute care 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,				
	1988	1987	1986	1985	1984
Number of contracts at end of period(1)..	33(2)	21	15	8	1
Available beds at end of period	682	405	310	201	20
Patient days served during period.....	109,940	72,027	33,036	5,680	1,035
Admissions.....	3,932	2,426	1,394	292	69
Average occupied beds per contract	11.1	11.9	7.6	5.4	8.1
Average occupancy rate for period(3)	54%	59%	33%	27%	28%

(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, 1988, RehabCare opened 16 new contracts and closed four 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 and a registration statement and amendments thereto relating to these securities were filed with the Securities and Exchange Commission. In June 1987, the Registrant announced it had elected to delay the offering as a result of unfavorable market conditions. On February 29, 1988, RehabCare withdrew its registration statement.

Sources of Revenue

RehabCare's contracts are similar to those of CareUnit, Inc. RehabCare receives a fixed monthly management fee plus a fee for each patient day of service rendered. Fees paid to RehabCare are subject to annual adjustments to reflect changes in the Consumer Price Index. RehabCare also participates with its hospital clients in the risk of non-payment by patients by sharing in bad debts, contractual adjustments and charity allowances.

Generally, RehabCare's contracts are entered into for a three year period and thereafter are automatically renewed for successive one year periods unless either party gives notice of termination at least 90 days prior to the end of such periods. Contracts are also terminable for material defaults.

Development, Competition and Promotion

RehabCare's development efforts are directed toward increasing the number of management contracts with acute care hospitals. Site selection for such contract units emphasizes communities where there is a demonstrated need for inpatient rehabilitation programs in quality community hospitals located in

moderate to high growth population areas; community pricing standards; and state licensure and CON requirements. Some of these contract units may serve as the hub of regional integrated delivery systems envisioned by RehabCare. Furthermore, RehabCare intends to expand the scope of its activities in the field of rehabilitation services beyond its standard contractual relationship for inpatient programs in acute care hospitals. RehabCare also intends to explore joint venture opportunities in selected markets with these same acute care hospitals and/or local physician groups to acquire or develop freestanding rehabilitation hospitals (some of which may specialize in traumatic head injury or spinal cord injury), skilled nursing and custodial care facilities dedicated to physical rehabilitation programs and outpatient facilities.

RehabCare competes with other health care management companies for contracts with acute care hospitals and RehabCare's programs compete for patients with the programs of other acute care hospitals and rehabilitation facilities. The success of RehabCare is dependent on its ability to establish relationships with sources of patient referrals. RehabCare believes that the principal competitive factors in each case are reputation for quality of programs, the effectiveness of program support services and price.

RehabCare believes that hospital discharge planners, physicians, other health care professionals, insurance claims adjusters and case managers representing various other payors are its principal sources of patient referral. Accordingly, RehabCare directs its marketing efforts toward these sources rather than directly to prospective patients. RehabCare relies principally upon aggressive local public relations and marketing activities conducted by its program managers followed by direct mail campaigns to deliver brochures, newsletters and other promotional materials to referral sources. RehabCare also maintains active community relations programs designed to increase local community awareness of the availability of RehabCare's rehabilitation programs.

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, 1988, the intermediate care facility accounted for less than 1% of the Registrant's operating 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 operating revenues in fiscal 1988.

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 operating revenues in fiscal 1988 and were marginally profitable.

WEIGHT CONTROL. In fiscal 1986, the Registrant purchased the assets of a weight loss center and subsequently began operation of a weight control program under the name CareFast. The weight control clinic business has not grown to the extent originally envisioned and there are no current plans to further expand this aspect of the business. In conjunction with the acquisition of the weight control clinic, the

Registrant also acquired the rights to market and distribute a protein supplement which contains vitamins and minerals necessary to maintain the health of individuals during the course of a weight reduction program. The Registrant plans to expand its marketing of the supplement. Sales of the supplement will be directed toward organizations operating weight control programs and not to individual users. Weight control activities accounted for less than 1% of the Registrant's operating revenues in fiscal 1988.

GOVERNMENTAL REGULATION

The development and operation of health care facilities is subject to compliance with various federal, state and local statutes and regulations. Health care facilities operated by the Registrant as well as hospitals under contract with CareUnit, Inc. or RehabCare must comply with the licensing requirements of 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.

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.

Section 1128(B) of the Social Security Act, as amended, prohibits the payment or receipt of any remuneration in return for referring an individual to a person who furnishes items or services covered by the Medicare program. At present, HHS has not promulgated detailed regulations pursuant to this section, although it is required to do so not later than August 18, 1989. The Registrant believes that the content and scope of these regulations, once implemented, could lead to significant changes in business relationships within the health care industry. The Registrant is unable to predict the impact of such regulations.

The Registrant and CareUnit, Inc. are subject to federal and state regulation governing the sale and operation of franchises. These regulations include the Federal Trade Commission's "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures" and similar regulations adopted by certain states. Generally, these regulations require disclosure of specific information to a prospective franchisee and prohibit certain sales and operating activities. In addition, some states require registration. The Registrant believes that its franchise related activities comply with these regulations, as applicable.

Insurance codes of certain states specify the extent of coverage required in 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.

ACCREDITATION

The Joint Commission on Accreditation of Healthcare Organizations ("JCAHO") is an independent commission which conducts voluntary accreditation programs with the goal of improving the quality of care provided in health care facilities. Generally, hospitals including dedicated units, long-term care facilities and certain other health care facilities may apply for JCAHO accreditation. If a hospital under contract with CareUnit, Inc. requests a JCAHO survey of its entire facility, the contract program, if a chemical dependency program, will be separately surveyed. After conducting on-site surveys, JCAHO awards accreditation for up to three years to facilities found to be in substantial compliance with JCAHO standards. Accredited facilities are periodically resurveyed. Loss of JCAHO accreditation could adversely affect the hospital's reputation and its ability to obtain third party reimbursement. The Registrant believes that all of its freestanding facilities and the hospitals under contract with CareUnit, Inc. have received or, in the case of new facilities, have applied for such accreditation.

RehabCare's programs are or will be reviewed by the Commission on Accreditation of Rehabilitation Facilities ("CARF"), an independent commission which surveys and accredits rehabilitation programs. RehabCare voluntarily seeks accreditation of each of its programs by CARF as soon as feasible (generally after two to three years of operation).

ADMINISTRATION AND EMPLOYEES

The Registrant's executive and administrative offices are located in Irvine, California, where management controls operations, business development, legal and accounting, medical insurance claims, governmental and statistical reporting, advertising and public relations, research and treatment program evaluation. The Registrant intends to relocate its CareUnit, Inc. administrative offices to Chesterfield, Missouri, where RehabCare currently maintains its administrative offices.

At May 31, 1988, the Registrant employed approximately 240 persons in its corporate and administrative offices, 3,360 persons in the hospital and long-term health care facilities operated by it, 800 persons assigned to CareUnit, Inc., and 300 persons assigned to RehabCare. The physicians and psychiatrists who are the medical directors of the Registrant's contract units, the psychologists serving on treatment teams, and the physicians 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, 1988:

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(4) Los Angeles, California	Owned	—	—
CareUnit Hospital Kirkland, Washington	Leased	2035	$14,520(5)
CareUnit Facility Jacksonville Beach, Florida	Owned(3)	—	—
CareUnit Hospital Cincinnati, Ohio	Owned(3)	—	—
CareUnit Hospital St. Louis, Missouri	Owned	—	—
Starting Point, Oak Avenue Orangevale, California	Owned(3)	—	—
Starting Point, Orange County Costa Mesa, California	Owned(3)	—	—
Starting Point, Grand Avenue Sacramento, California	Owned(3)	—	—
CareUnit Hospital Albuquerque, New Mexico	Leased	2012	12,965
CareUnit Hospital Las Vegas, Nevada	Owned	—	—
CareUnit Facility Coral Springs, Florida	Owned(3)	—	—
CareUnit Facility Grand Rapids, Michigan	Leased	1990	12,417
CareUnit Facility DuPage County, Illinois	Owned	—	—
CareUnit Facility Orlando, Florida	Owned(3)	—	—
CareUnit Facility Aurora, Colorado	Owned	—	—
CareUnit Facility San Diego, California	Owned	—	—
CareUnit Facility(6) Tampa, Florida	Owned	—	—
Psychiatric Treatment Facilities			
Brea Hospital Neuropsychiatric Center Brea, California	Owned	—	—
Crossroads Hospital(9) Van Nuys, California	Leased	1997	5,577
Woodview-Calabasas Hospital(7) Calabasas, California	Leased	1996	21,401(8)
Golden Valley Health Center(9) Golden Valley, Minnesota	Owned	—	—
Sutter Center for Psychiatry(10) Sacramento, California	Owned	—	—

(Table continued on following page)

Name and Location	Owned or Leased	Lease Expires (1)	Monthly Rental (2)
Other Operating Facilities			
Tustin Manor ..... Tustin, California (Intermediate Care Facility)	Leased	1995	16,093(8)
CompCare Publishers..... Minneapolis, Minnesota	Leased	1990	7,192
Administrative Facilities			
Corporate Headquarters..... Irvine, California	Owned	—	—
RehabCare Headquarters ..... Chesterfield, Missouri	Leased	1994	12,281
Regional Headquarters ..... Tampa, Florida	Leased	1989	11,415

(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) Closed on May 11, 1988. The Registrant is currently negotiating a sale of the property.

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

(6) Commenced operations on June 1, 1988.

(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 or leased by a joint venture and managed by the Registrant.

(10) BMC owns a 49% interest in the property. Commenced operations on June 28, 1988.

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 58. 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 1986 he was reappointed President.

JAMES P. CARMANY, age 49. 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 1986 when he became Senior Vice President—Operations. In October 1987, he became Executive Vice President—Hospital Operations.

ROBERT L. KASSELMANN, age 52. Mr. Kasselmann has been employed by the Registrant since 1974. He was President of RehabCare from 1982 until February 1987. He became Executive Vice President—Special Services of the Registrant in 1985, and was Executive Vice President—Operations from 1986 until October 1987 when he became Executive Vice President—Contract Operations and President of CareUnit, Inc. On July 18, 1988, he became Executive Vice President—Corporate Administrative Services.

W. JAMES NICOL, age 44. Mr. Nicol has been employed by the Registrant since 1973. Mr. Nicol was the Registrant's Corporate Secretary from 1973 to 1987; he was a Vice President and the Treasurer from 1974 through 1983; he was a Senior or Executive Vice President from 1983 to 1985; and in 1985 he became the Vice Chairman and was elected to the Registrant's Board of Directors. Mr. Nicol resigned as an officer and director of the Registrant in February 1987 and June 1987, respectively, to become President and Chief Executive Officer of RehabCare. On February 3, 1988, Mr. Nicol was reelected to the Registrant's Board of Directors and effective July 18, 1988, Mr. Nicol became Executive Vice President —Contract Operations of the Registrant and President and Chief Executive Officer of CareUnit, Inc. Mr. Nicol remains President and Chief Executive Officer of RehabCare.

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. In October 1987, he became Senior Vice President—Hospital Operations.

ESTILL D. MITTS, age 44. Mr. Mitts has been employed by the Registrant since 1984. He was the Administrator of CareUnit of Jacksonville Beach from 1984 to 1986. He was the Administrator of CareUnit Hospital of Orange from 1986 until October 1987, when he became Senior Vice President —Hospital Operations. Prior to his employment with the Registrant, Mr. Mitts was Executive Director of Goodman Hill Hospital, Paducah, Kentucky from 1983 to 1984.

MARY LEE POTTER, age 62. 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 1986 when she was reappointed Vice President—Professional Services. She became Senior Vice President—Professional Services in June 1987. On July 18, 1988, she became Senior Vice President —Quality Assurance.

DONALD G. SIMPSON, age 36. Mr. Simpson has been employed by the Registrant since 1980 and was a Vice President—Operations of the Registrant from 1985 until 1986 when he became Senior Vice President—Operations. In October 1987, he became Senior Vice President—Contract Operations.

LAURENCE J. STEUDLE, age 41. Mr. Steudle has been employed by the Registrant since 1970. He was Vice President—BMC Operations of the Registrant from 1984 until 1985 when he became Senior Vice President—Operations. In October 1987, he became Senior Vice President—Contract Operations.

STEPHEN J. TOTH, age 39. Mr. Toth has been employed by the Registrant since 1974. He was Vice President—Employee Services from 1984 until 1986 when he became Vice President—Outpatient Services. In November 1987, he became Senior Vice President—Quality Assurance. On July 18, 1988, he became Senior Vice President—Professional Services.

EARL E. WILLIAMS, age 54. 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. In October 1987, he became Senior Vice President—Contract Operations. Prior to his employment with the Registrant, Mr. Williams was a health care consultant from 1982 to 1984.

Business Development

K. JOHN HARRISON, age 40. Mr. Harrison has been employed by the Registrant since 1985. He was Director of Business Development until June 15, 1988 when he became Senior Vice President —Business Development. On July 18, 1988, he became Senior Vice President—CareFast. Prior to his employment with the Registrant, Mr. Harrison was Chairman and Chief Executive Officer of JCH Communications, a telecommunications, military early warning systems and security systems company located in Johannesburg, South Africa from 1981 to 1985.

Finance

STEPHEN R. MUNROE, age 43. 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 1983. He was a Vice President of the Registrant from 1985 until November 1987, when he became a Senior Vice President.

BRUCE K. NELSON, age 34. Mr. Nelson has been employed by the Registrant since 1985. He was Finance Manager from 1985 until 1986 when he became Assistant Treasurer. He was appointed Treasurer of the Registrant in March 1987. Prior to his employment with the Registrant, Mr. Nelson was a Corporate Banking Officer with California First Bank from 1982 to 1985.

Law

MARILYN U. MacNIVEN-YOUNG, age 37. 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 in March 1987. Prior to her employment with the Registrant, Ms. MacNiven-Young was 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 was traded on the national over-the-counter market and quoted on the NASDAQ National Market System under the symbol CMPH until July 18, 1988 when trading commenced on the New York Stock Exchange under the symbol CMP. The following table sets forth the range of high and low bid prices for the Common Stock for the fiscal quarters indicated. Such prices represent inter-dealer prices, without retail markup, markdown or commission and do not necessarily represent actual transactions.

	Bid Price	
Fiscal Year	High	Low
1988:		
First Quarter	$15⅝	$12½
Second Quarter	14½	6⅜
Third Quarter	9¼	5½
Fourth Quarter	9¾	8⅜
1987:		
First Quarter	$16¼	$12
Second Quarter	16⅜	10½
Third Quarter	13⅜	10⅛
Fourth Quarter	14¾	11⅜

(b) As of July 29, 1988, the Registrant had 2,784 stockholders of record.

(c) The Registrant paid $.10 and $.09 per share cash dividends on a quarterly basis during the fiscal years ended May 31, 1988 and May 31, 1987, respectively, or an aggregate of $.40 and $.36 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 agreements. On June 23, 1988, the Registrant's Board of Directors declared a quarterly dividend of $.10 per share payable on August 18, 1988, to stockholders of record on July 29, 1988.

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,				
	1988	1987	1986	1985	1984
	(Amounts in thousands, except per share data)				
Statement of Earnings Data					
Operating revenues	$211,236	$192,432	$188,124	$153,899	$108,266
Costs and expenses:					
Operating, general and administrative	181,534	160,151	151,906	117,838	81,559
Depreciation and amortization	8,405	6,628	5,775	4,240	2,781
Loss on write-down of assets	—	—	5,701	—	—
	189,939	166,779	163,382	122,078	84,340
Operating earnings	21,297	25,653	24,742	31,821	23,926
Interest income	805	2,458	4,812	4,637	5,416
Interest expense	7,202	5,433	4,135	1,577	783
Earnings before taxes on income	14,900	22,678	25,419	34,881	28,559
Net earnings	$ 8,970	$ 12,088	$ 13,102	$ 17,226	$ 14,058
Earnings per common and common equivalent share (1):					
Primary and fully diluted	$ .88	$ .90	$ .87	$ 1.13	$ .93
Cash dividends per share	$ .40	$ .36	$ .32	$ .30	$ .24
Weighted average common and common equivalent shares outstanding	12,522	15,360	16,987	15,315	15,160

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

	May 31,				
	1988	1987	1986	1985	1984
	(Dollars in thousands)				
Balance Sheet Data					
Working capital	$ 34,964	$ 40,232	$ 79,145	$ 92,852	$ 55,481
Total assets	229,893	215,839	220,469	216,397	144,290
Long-term obligations	111,376	100,828	59,377	64,522	15,493
Stockholders' equity	81,470	85,369	132,180	123,745	110,910

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 operating revenues and (ii) the percentage change of such items as compared to the indicated prior period:

	Relationship to Operating Revenues			Period-to-Period Change	
	Years Ended May 31,			Years Ended	
	1988	1987	1986	1987-88	1986-87
Operating revenues	100.0%	100.0%	100.0%	9.8%	2.3%
Costs and expenses:					
Operating, general and administrative	85.9	83.2	80.7	13.4	5.4
Depreciation and amortization	4.0	3.4	3.1	26.8	14.8
Loss on write-down of assets	—	—	3.0	—	—
Operating earnings	10.0	13.3	13.2	(17.0)	3.7
Interest income	.4	1.3	2.6	(67.2)	(48.9)
Interest expense	3.4	2.8	2.2	32.6	31.4
Earnings before taxes on income	7.0	11.8	13.5	(34.3)	(10.8)
Taxes on income	2.8	5.5	6.5	(44.0)	(14.0)
Net earnings	4.2%	6.3%	7.0%	(25.8)%	(7.7)%

Results of Operations

The Registrant's operating revenues have increased from approximately $188 million in fiscal 1986 to $211 million in fiscal 1988. This increase is 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, including the Registrant, often grant such discounts when incremental volume increases can be achieved.

Fiscal 1988

Operating revenues increased approximately 10% over fiscal 1987. Overall utilization of the Registrant's freestanding facilities increased by approximately 7% while utilization of behavioral medicine contract units declined by 9%. Patient days of service rendered by RehabCare increased by approximately 51%.

Patient days of service rendered in mature freestanding facilities (excluding closed facilities) increased by approximately 5% in fiscal 1988 as a result of an increase in the number of admissions. The Registrant's freestanding psychiatric facilities suffered a decline in patient days of service rendered of approximately 13%. Two chemical dependency facilities were expanded during fiscal 1988 (CareUnit Hospital of Cincinnati and Starting Point, Oak Avenue) and each of these facilities recorded significantly higher census levels. Patient days of service rendered in facilities opened in fiscal 1988 and late fiscal 1987 contributed substantially to the overall 7% increase in freestanding facility census.

Operating revenues from freestanding facilities increased by approximately 15% in fiscal 1988. Approximately 35% of the increase is attributable to new freestanding units, 20% to improved census in mature units, and the balance to rate increases and changes in patient mix. Revenues of freestanding facilities were adversely affected by an increase in deductions from revenue, which, as a percentage of gross revenues, increased by approximately 2% in fiscal 1988. Management expects that deductions from revenues, as a percentage of gross revenues, will continue to increase as a result of the opening of new facilities and continuing pressure from third party payors. A majority of the Registrant's freestanding facilities achieved increased earnings in fiscal 1988 over the prior year.

The Registrant incurred significant losses in the operation and subsequent closure of two freestanding facilities. On July 31, 1987, the Registrant closed CareUnit Hospital of Portland which had not been profitable since it opened in April 1986. On May 11, 1988, the Registrant closed CareUnit Behavioral Center of Los Angeles, a 104-bed psychiatric and chemical dependency treatment facility, because it had sustained operating losses in each of the last two fiscal years and was in need of substantial renovation. The Registrant's losses on facilities closed during fiscal 1988 totalled approximately $2.4 million.

The performance of CareUnit Hospital of St. Louis has improved gradually throughout fiscal 1988 and the facility posted a modest profit in the fourth quarter. CareUnit of DuPage continues to be a disappointment, operating at a loss in fiscal 1988. The Registrant's outpatient programs have failed to perform as expected and unprofitable outpatient programs are being closed.

Behavioral medicine contract revenues decreased by approximately 11% as a result of a decline in the number of patient days of service rendered in managed units. The number of units and number of beds under contract also declined in fiscal 1988 by 11%. Management believes that the decline in the number of contracts and beds under contract is a result of increased competitive pressure and changes in reimbursement, which have had the effect of making the Registrant's contracts less profitable to hospitals. The Registrant has adopted a more flexible approach to contract development and shifted its focus from chemical dependency to psychiatric. Management has reorganized its internal structure and believes this reorganization will allow it to compete more effectively on price and service. The Registrant expects the number of contracts and the number of beds under contract to decrease further in fiscal 1989, and as a result contract earnings will continue to decline. However, management believes that there is continued demand for the contract business.

Revenues from RehabCare increased by approximately 61% as a result of an increase in the number of units in operation at year end from 21 to 33 and an increase in the number of patient days of service of approximately 51%. Earnings from RehabCare decreased substantially due to the start-up costs of the large number of units opened in fiscal 1988.

Operating, general and administrative expenses increased by approximately 13%. The opening of freestanding facilities and increase in the number of operating RehabCare units were the principal factors for the increase. Corporate overhead expenses increased slightly as a result of general inflationary pressures.

Depreciation and amortization increased approximately 27% or $1.8 million principally as a result of the opening of new freestanding facilities in fiscal 1987 and fiscal 1988.

Interest income declined from approximately $2.5 million in fiscal 1987 to $.8 million in fiscal 1988 as the Registrant decreased the balances of cash on hand.

Interest expense increased by approximately 33% as a result of increased borrowings. Capitalized interest on construction projects, which offsets interest expense, increased from $.5 million to $1.2 million. The Registrant's bank borrowings were $56 million at May 31, 1988 compared to $41 million at May 31, 1987.

Operating earnings and earnings before taxes on income declined by $4.4 million and $7.8 million, respectively.

The Registrant's effective tax rate declined from approximately 47% in fiscal 1987 to 40% in fiscal 1988, principally as a result of the changes in rates under the Tax Reform Act of 1986. In December 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes" ("SFAS 96"). This accounting standard significantly changes the methodology used to calculate and report income taxes for financial statement purposes. The Registrant is required to adopt SFAS 96 in fiscal 1990, although earlier adoption is optional.

The Registrant anticipates that it will implement SFAS 96 in fiscal 1990 and that the treatment of deferred taxes in the Registrant's financial statements will be significantly affected. Based upon the Registrant's current estimates, this change is expected to increase deferred taxes and decrease stockholders' equity and, if the Registrant chooses not to restate prior years, decrease net earnings in the year of adoption. In the years after implementation the Registrant expects that its effective tax rate will be subject to greater fluctuations.

Fiscal 1987

Operating 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 operating earnings occurred at the Registrant's mature freestanding facilities. In general, these declines in utilization occurred in the Registrant's higher margin facilities. Nearly one-half of the decline in aggregate operating earnings from freestanding facilities was attributable to CareUnit Hospital of St. Louis which temporarily lost its Medicare certification.

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 fiscal 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. 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 RehabCare, publishing, 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.

Operating expenses rose approximately 5%. Expenses of RehabCare's expansion 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 remaining 50% of RehabCare 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 CareUnit Hospital of St. Louis.

Liquidity and Capital Resources

The Registrant's current ratio decreased from approximately 2.4:1 at May 31, 1987 to 1.9:1 at May 31, 1988. This decrease is principally attributable to the use of short-term bank borrowings for the construction of freestanding facilities. Accounts receivable days outstanding increased from 80 days at May 31, 1987 to 86 days at May 31, 1988. The Registrant believes that accounts receivable days outstanding will increase as patients are forced to assume greater responsibility for copayments.

In December 1986, the Registrant announced an offer to purchase up to four 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 costs. Between December 1987 and March 1988, the Registrant repurchased one million shares of Common Stock at an aggregate cost of approximately $8.6 million pursuant to an open market stock repurchase program.

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. All borrowings under the revolving loan were converted into a term loan during fiscal 1988 under applicable provisions of the loan agreement.

As long as any amount is outstanding under the term loan, the Registrant is required to maintain cash flow equal to at least 170% of debt service; maintain a minimum tangible net worth equal to the prior year's minimum tangible net worth plus the sum of (i) 25% of net after tax profits and (ii) 50% of any equity infusion; limit dividends to not more than 50% of net earnings; and limit capital expenditures to an amount not to exceed certain planned expenditures plus $2 million. Until May 31, 1987, the Registrant was required to maintain a minimum tangible net worth of at least $58,828,000. The Registrant was in compliance with its loan covenants at May 31, 1988. Interest payable under the term loan is the lending bank's reference rate announced from time-to-time, plus .375%. Interest is payable on the outstanding principal amount of the loan on a quarterly basis.

The Registrant has a revolving loan agreement with a bank pursuant to which the bank has agreed to loan the Registrant up to $10 million. The terms of the loan require that it be repaid on or before September 13, 1988. Interest on the loan is payable quarterly at .25% above the lending bank's reference rate announced from time-to-time. The cash flow, net worth, dividend, and capital expenditure covenants of the revolving loan are the same as those contained in the Registrant's $50 million term loan.

In July 1988, the Registrant and two subsidiaries of the Registrant issued $20 million in senior secured notes to a group of insurance companies. The notes are secured by three of the Registrant's freestanding facilities. Performance of the subsidiaries' obligations under the notes is guaranteed by the Registrant. The notes provide for the payment of interest at a fixed rate of 10.5% per annum. The notes require principal payment in five equal annual installments beginning on August 1, 1991. Interest on the unpaid balance is payable semi-annually commencing February 1, 1989.

Under the terms of the notes, the Registrant is required to maintain a current ratio of at least 1.8:1 at all times prior to November 30, 1988 and 2.0:1 thereafter; maintain consolidated funded debt at less than 66.66% of net tangible assets; maintain consolidated senior funded debt at less than 50% of net tangible assets; and maintain a fixed charges ratio of at least 2.0:1. The Registrant may not pay, in the aggregate, dividends which exceed $5 million plus 50% of net income accrued after February 29, 1988. The Registrant utilized the net proceeds of $19.5 million to reduce the balance on its $50 million term loan.

The Registrant has committed or plans to commit approximately $16 million for replacement of its psychiatric facility in Brea, California, and the 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, sale of certain underproductive assets and, as necessary, additional borrowings. The Registrant believes it can obtain separate construction financing of approximately $12 million for replacement of its Brea facility. In addition, the Registrant is currently renegotiating its term and revolving loan agreements.

Impact of Inflation

Although inflation has become a less 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 in 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, 1988, 1987 and 1986

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Stockholders and Board of Directors
Comprehensive Care Corporation:

We have audited the accompanying consolidated balance sheets of Comprehensive Care Corporation and subsidiaries as of May 31, 1988 and 1987, 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, 1988. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Comprehensive Care Corporation and subsidiaries at May 31, 1988 and 1987, 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, 1988, in conformity with generally accepted accounting principles.

Peat Marwick Main & Co.

Orange County, California
July 22, 1988

COMFREHENSIVE CARE CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS	May 31, 1988	1987
	(Dollars in thousands)	
Current assets:		
Cash, including short-term investments of $3,518 and $3,250	$ 9,819	$ 10,159
Accounts and notes receivable, less allowance for doubtful accounts of $15,217 and $10,791 (Note 3)	56,925	50,157
Prepaid income taxes (Note 7)	—	2,845
Other current assets	5,267	6,713
Total current assets	72,011	69,874
Property and equipment, at cost (Notes 4, 6 and 8)	159,371	139,895
Less accumulated depreciation and amortization	(27,533)	(20,904)
Total property and equipment	131,838	118,991
Other assets:		
Intangible assets	7,426	7,906
Notes receivable	857	2,084
Investments	6,221	7,899
Deferred contract costs	2,776	3,061
Other	8,764	6,024
Total other assets	26,044	26,974
	$229,893	$215,839

LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities (Note 5)	$ 22,033	$ 20,786
Note payable (Note 6)	6,000	—
Long-term debt payable within one year (Note 6)	2,401	1,129
Deferred income taxes (Note 7)	4,424	7,710
Income taxes payable (Note 7)	2,189	17
Total current liabilities	37,047	29,642
Long-term debt due after one year (Note 6)	102,408	95,609
Other liabilities (Note 9)	8,968	5,219
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 15,182,295 shares	1,518	1,518
Additional paid-in capital	75,885	75,885
Retained earnings	66,903	62,190
Less treasury stock; at cost, 5,080,000 and 4,080,000 shares	(62,836)	(54,224)
Total stockholders' equity	81,470	85,369
	$229,893	$215,839

See notes to consolidated financial statements.

COMPREHENSIVE CARE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS

	Years Ended May 31,		
	1988	1987	1986
	(Dollars in thousands, except per share amounts)		
Operating revenues (Note 3)	$211,236	$192,432	$188,124
Costs and expenses:			
Operating	129,993	116,255	108,894
General and administrative	51,541	43,896	43,012
Depreciation and amortization	8,405	6,628	5,775
Loss on write-down of assets (Note 14)	—	—	5,701
	189,939	166,779	163,382
Operating earnings	21,297	25,653	24,742
Interest income	805	2,458	4,812
Interest expense	7,202	5,433	4,135
Earnings before taxes on income	14,900	22,678	25,419
Taxes on income (Note 7)	5,930	10,590	12,317
Net earnings	$ 8,970	$ 12,088	$ 13,102
Earnings per common and common equivalent share (Note 1):			
Primary and fully diluted	$ .88	$ .90	$ .87
Dividends per common share	$ .40	$ .36	$ .32

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, 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)
Net earnings	—	—	—	8,970	—	—
Cash dividends	—	—	—	(4,257)	—	—
Purchase of treasury stock (Note 11)	—	—	—	—	(1,000)	(8,612)
Balances, May 31, 1988	15,182	$1,518	$75,885	$66,903	(5,080)	$(62,836)

See notes to consolidated financial statements.

COMPREHENSIVE CARE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Years Ended May 31,		
	1988	1987	1986
	(Dollars in thousands)		
Financial resources provided by			
Operations:			
Net earnings	$ 8,970	$ 12,088	$ 13,102
Items not requiring outlay of working capital:			
Depreciation and amortization of property and equipment	7,244	5,525	4,501
Deferred income taxes	—	—	(3,608)
Interest income on annuity contracts	(178)	(401)	(315)
Amortization of intangible and other assets	1,161	1,102	1,274
Loss on write-down of assets	—	—	5,701
Working capital provided by operations	17,197	18,314	20,655
Disposal of property and equipment	203	104	2,050
Additional long-term debt	9,004	41,016	3,152
Decrease in notes receivable	1,664	376	361
Decrease in other assets	—	2,743	1,732
Sale of annuity	3,326	—	—
Other sources	3,843	2,609	189
	35,237	65,162	28,139
Financial resources used for			
Purchase of treasury stock	8,612	54,224	—
Acquisition of property and equipment	20,294	39,475	23,492
Reduction of long-term debt	2,205	1,118	6,674
Increase in notes receivable	437	1,148	515
Cash dividends	4,257	4,730	4,856
Increase in intangible assets	—	—	4,853
Investments	1,470	2,635	—
Other applications	3,230	745	1,456
	40,505	104,075	41,846
Decrease in working capital	$(5,268)	$(38,913)	$(13,707)
Summary of changes in components of working capital			
Increase (decrease) in current assets:			
Cash	$ (340)	$(32,675)	$(19,394)
Accounts and notes receivable	6,768	(5,766)	8,020
Prepaid income taxes	(2,845)	(141)	(1,545)
Other current assets	(1,446)	399	(6)
	2,137	(38,183)	(12,925)
Increase (decrease) in current liabilities:			
Accounts payable and accrued liabilities	1,247	1,992	(817)
Note payable	6,000	—	—
Long-term debt payable within one year	1,272	38	(92)
Deferred income taxes	(3,286)	(918)	1,627
Income taxes payable	2,172	(382)	64
	7,405	730	782
Decrease in working capital	$(5,268)	$(38,913)	$(13,707)

See notes to consolidated financial statements.

COMPREHENSIVE CARE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

May 31, 1988, 1987 and 1986

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 97% of the Registrant's operating revenues are 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 than 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 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 $1,386,000 and $1,016,000 at May 31, 1988 and 1987, 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 $1,202,000, $474,000 and $654,000 in fiscal 1988, 1987 and 1986, 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 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.

Note 1—Summary of Significant Accounting Policies (continued)

Investment Tax Credits

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

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 used to calculate earnings per share was 12,522,000, 15,360,000, and 16,987,000 in 1988, 1987 and 1986, 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 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, Minnesota. 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:

	1988	1987
	(Dollars in thousands)	
Assets		
Current assets	$ 6,546	$ 6,730
Property and equipment (net)	10,133	9,721
Other assets	55	110
	$16,784	$16,561
Liabilities and partner's equity		
Total liabilities	$ 1,800	$ 1,228
Partner's equity	14,984	15,333
	$16,784	$16,561

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,		
	1988	1987	1986
	(Dollars in thousands)		
Revenues	$17,811	$19,187	$23,407
Costs and expenses:			
Operating, general and administrative	15,026	14,262	16,931
Depreciation and amortization	648	585	743
Interest	—	—	215
	15,674	14,847	17,889
Earnings before taxes on income	$ 2,137	$ 4,340	$ 5,518

Note 3—Accounts and Notes Receivable

Accounts and notes receivable include current notes receivable of $572,000 and $90,000 at May 31, 1988 and 1987, respectively.

The following table summarizes changes in the Registrant's allowance for doubtful accounts for the fiscal years ended May 31, 1988, 1987 and 1986:

	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, 1988	$10,791	$23,677	$4,101	$23,352	$15,217
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

Note 4—Property and Equipment

Property and equipment consists of the following:

	May 31,	
	1988	1987
	(Dollars in thousands)	
Land and improvements	$ 24,869	$ 27,863
Buildings and improvements	106,008	87,292
Furniture and equipment	25,616	21,823
Leasehold improvements	174	213
Capitalized leases	2,704	2,704
	$159,371	$139,895

Note 5—Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consist of the following:

	May 31,	
	1988	1987
	(Dollars in thousands)	
Accounts payable and accrued liabilities	$15,187	$14,973
Accrued salaries and wages	2,074	1,534
Accrued vacation	3,531	2,562
Payable to third party intermediaries	1,241	1,717
	$22,033	$20,786

Note 6—Note Payable and Long-Term Debt

The Registrant has a note payable pursuant to a revolving loan agreement with a bank under which the bank has agreed to loan the Registrant up to $10 million of which $6 million was outstanding at May 31, 1988. The terms of the loan require that it be repaid on or before September 13, 1988. Interest on the loan is payable quarterly at .25% above the lending bank's reference rate announced from time-to-time. The cash flow, net worth, dividend, and capital expenditure covenants of this loan are the same as those contained in the Registrant's $50 million term loan.

Long-term debt consists of the following:

	May 31,	
	1988	1987
	(Dollars in thousands)	
7% to 10% notes, payable in monthly installments with maturity dates through 1995; collateralized by real and personal property having a net book value of $8,692	$ 1,565	$ 1,845
Note payable bearing interest at 88% of prime, payable quarterly, maturing in 1995; collateralized by real and personal property having a net book value of $6,613	3,875	4,250
Term loan, unsecured, converted from a revolving loan during fiscal 1988, maturing in 1994	50,000	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 $2,889	1,364	1,487
7½% convertible subordinated debentures due 2010	46,000	46,000
Capital lease obligations (Note 8)	1,684	1,766
Other	321	390
	104,809	96,738
Less amounts due within one year	2,401	1,129
	$102,408	$95,609

As of May 31, 1988, the annual maturities of long-term debt for the next five years amounted to $2,401 in 1989, $6,701 in 1990, $8,346 in 1991, $8,207 in 1992, and $8,287 in 1993.

Note 6—Note Payable and Long-Term Debt (continued)

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. All borrowings under the revolving loan were converted into a term loan during fiscal 1988 under applicable provisions of the loan agreement.

As long as any amount is outstanding under the term loan the Registrant is required to maintain cash flow equal to at least 170% of debt service; maintain a minimum tangible net worth equal to the prior year's minimum tangible net worth plus the sum of (i) 25% of net after tax profits and (ii) 50% of any equity infusion; limit dividends to not more than 50% of net earnings; and limit capital expenditures to an amount not to exceed certain planned expenditures plus $2 million. Until May 31, 1987, the Registrant was required to maintain a minimum tangible net worth of at least $58,828,000. Interest payable under the term loan is the lending bank's reference rate announced from time-to-time, plus .375%. Interest is payable on the outstanding principal amount of the loan on a quarterly basis. The Registrant was in compliance with its loan covenants at May 31, 1988.

In July 1988, the Registrant and two subsidiaries of the Registrant issued $20 million in senior secured notes to a group of insurance companies. The notes are secured by three of the Registrant's freestanding facilities. Performance of the subsidiaries' obligations under the notes is guaranteed by the Registrant. The notes provide for the payment of interest at a fixed rate of 10.5% per annum. The notes require principal payment in five equal annual installments beginning on August 1, 1991. Interest on the unpaid balance is payable semi-annually commencing February 1, 1989. The Registrant utilized the net proceeds of $19.5 million to reduce the balance on its $50 million term loan.

Note 7—Taxes on Income

In December 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes" ("SFAS 96"). This accounting standard significantly changes the methodology used to calculate and report income taxes for financial statement purposes. The Registrant is required to adopt SFAS 96 in fiscal 1990, however, earlier adoption is optional.

It is anticipated that the Registrant will implement these new rules in fiscal 1990 and that the treatment of deferred taxes in the Registrant's financial statements will be significantly affected. Based upon the Registrant's current estimates, this change is expected to increase deferred taxes and decrease stockholders' equity and, if the Registrant chooses not to restate prior years, decrease net earnings in the year of adoption. In the years after implementation the Registrant expects that its effective tax rate will be subject to greater fluctuations.

Note 7—Taxes on Income (continued)

Taxes on income consist of the following:

	Years Ended May 31,		
	1988	1987	1986
	(Dollars in thousands)		
Currently payable:			
Federal income taxes	$ 8,512	$ 9,108	$12,303
State income taxes	1,980	1,839	2,584
	10,492	10,947	14,887
Deferred:			
Federal income taxes	(3,625)	(186)	(1,946)
State income taxes	(937)	(171)	(624)
	(4,562)	(357)	(2,570)
	$ 5,930	$10,590	$12,317

A reconciliation between taxes on income and the amount computed by applying the statutory federal income tax rate (35% in 1988, and 46% in 1987 and 1986) to earnings before taxes on income is as follows:

	Years Ended May 31,		
	1988	1987	1986
	(Dollars in thousands)		
Income taxes at the statutory tax rate	$5,215	$10,432	$11,692
State income taxes net of federal tax benefit	678	895	1,058
Investment tax credit	8	(900)	(517)
Loss from unconsolidated subsidiary	—	—	144
Amortization of intangible assets	95	124	127
Other	(66)	39	(187)
	$5,930	$10,590	$12,317

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,		
	1988	1987	1986
	(Dollars in thousands)		
Excess tax over book depreciation	$ 1,251	$ 1,268	$ 969
Cash basis accounting and different reporting period by joint ventures	(1,337)	1,219	272
State income taxes deductible on a cash basis	304	236	124
Deferred compensation expense not currently deductible	(578)	(612)	(768)
Cash basis accounting by subsidiaries	(401)	(335)	1,173
Employee benefit expenses not currently deductible	(1,069)	(1,373)	(1,509)
Write-down of Brea facility not currently deductible	—	—	(2,307)
Partnership exchange recognized as income	—	—	(863)
Bad debt expense not currently deductible	(2,516)	(685)	415
Other	(216)	(75)	(76)
	$(4,562)	$ (357)	$(2,570)

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 are as follows:

	Years Ended May 31,		
	1988	1987	1986
	(Dollars in thousands)		
Minimum rentals	$1,891	$1,634	$ 935
Contingent rentals	344	144	126
Total rentals	$2,235	$1,778	$1,061

Assets under capital leases are capitalized using interest rates appropriate at the inception of each lease; contingent rents associated with capital leases in fiscal 1988, 1987 and 1986 were $188,000, $148,000 and $129,000, respectively. The net book value of capital leases at May 31, 1988 and 1987 was $1,084,000 and $1,181,000, 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 consist of the following at May 31, 1988:

	Capital Leases			
	Registrant	Joint Venture	Total	Operating Leases
	(Dollars in thousands)			
1989	$ 204	$ 89	$ 293	$1,862
1990	204	89	293	1,340
1991	204	89	293	851
1992	204	89	293	459
1993	204	89	293	159
Later years	1,868	266	2,134	108
Total minimum lease payments	$2,888	$711	3,599	$4,779
Less amounts representing interest			1,915	
Present value of net minimum lease payments			$1,684	

Note 9—Deferred Compensation Plans

The Registrant has a deferred compensation agreement for its Chairman and President. The vested unfunded benefits at May 31, 1988 and 1987 ($1,446,000 and $1,386,000), 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 Registrant has deferred compensation plans (the Financial Security Plan) for its key executives and medical directors. Under provisions of these plans, participants may elect to defer receipt of a portion of their current compensation to future periods.

Note 10—Stock Option and Rights Plans

In 1983, the Registrant adopted a stock option plan which is intended to qualify as an incentive stock option plan under Section 422A of the Internal Revenue Code of 1986, as amended ("IRC").

The following table sets forth the incentive stock options granted under the 1983 plan:

		Option Price	
	Number of Shares	Per Share	Aggregate
	(Dollars in thousands, except share amounts)		
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
Options forfeited in fiscal 1988	(4,626)	13.78	(64)
Options cancelled in fiscal 1988	(144,322)	13.78-18.38	(2,283)
Balances, May 31, 1988	2,176	$ 13.78	$ 30

In fiscal 1988, the Registrant's Board of Directors adopted a 1988 Incentive Stock Option Plan and 1988 Nonstatutory Stock Option Plan to replace the plan adopted in 1983. At May 31, 1988, an option to purchase 2,176 shares was outstanding under the 1983 plan. All other options outstanding under the 1983 plan were cancelled subject to stockholder approval of the 1988 plans.

Options granted under the 1988 Incentive Stock Option Plan are intended to qualify as incentive stock options ("ISOs") under Section 422A of the IRC. Options granted under the 1988 Nonstatutory Stock Option Plan do not qualify as ISOs. The maximum number of shares subject to option are 750,000 and 200,000 for the ISOs and nonstatutory options, respectively. During fiscal 1988, incentive stock options for 654,728 shares were granted under the 1988 plan at an exercise price of $8.125 per share, none of which are exercisable at May 31, 1988.

The per share exercise price of shares to be issued under the plans shall be determined by the Board of Directors, but in no event shall the option exercise price be less than the Fair Market Value (as defined in the plans) of the shares. In the case of an ISO, if on the date of the grant of such option the optionee is a Restricted Stockholder (as defined in the plans), the option exercise price shall not be less than 110% of the Fair Market Value of the shares on the date of the grant.

Options shall vest and become exercisable at such times and in such installments as the Board of Directors shall provide in the individual option agreement, except that an option granted to a director may not be exercised until the expiration of one year from the date such option is granted. Subject to the limitation with respect to the vesting of options granted to directors, the Board may in its sole discretion accelerate the time at which an option or installment thereof may be exercised.

Note 10—Stock Option and Rights Plans (continued)

In fiscal 1987, the Registrant granted nonstatutory options for 30,908 common shares at an exercise price of $12.94 per share. During fiscal 1988, the Registrant granted nonstatutory options for 28,316 common shares at an exercise price of $14.13 per share. All outstanding nonstatutory options were cancelled subject to stockholder approval of the 1988 plans. During fiscal 1988, nonstatutory options for 92,557 shares were granted under the 1988 plans at exercise prices ranging from $8.125 to $14.13 per share in replacement of the cancelled options. The nonstatutory options become exercisable one year after the date of grant.

On April 19, 1988, the Registrant declared a dividend of one Common Share Purchase Right ("Right") for each share of Common Stock outstanding at May 6, 1988. Each Right entitles the holder to purchase one share of Common Stock at a price of $30 per share, subject to certain antidilution adjustments. The Rights are not exercisable and are transferable only with the Common Stock until the earlier of ten days following a public announcement that a person has acquired ownership of 25% or more of the Registrant's Common Stock or the commencement or announcement of a tender or exchange offer, the consummation of which would result in the ownership by a person of 30% or more of the Registrant's Common Stock. In the event that a person acquires 25% or more of the Registrant's Common Stock or if the Registrant is the surviving corporation in a merger and its Common Stock is not changed or exchanged, each holder of a Right, other than the 25% stockholder (whose Rights will be void), will thereafter have the right to receive on exercise that number of shares of Common Stock having a market value of two times the exercise price of the Right. If the Registrant is acquired in a merger or more than 50% of its assets are sold, proper provision shall be made so that each Right holder shall have the right to receive or exercise, at the then-current exercise price of the Right, that number of shares of common stock of the acquiring company that at the time of the transaction would have a market value of two times the exercise price of the Right. The Rights are redeemable at a price of $.02 per Right at any time prior to ten days after a person has acquired 25% or more of the Registrant's Common Stock.

Note 11—Purchase of Treasury Stock

In December 1986, the Registrant announced an offer to purchase up to four 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 costs.

Between December 21, 1987 and March 24, 1988, the Registrant repurchased one million shares of its Common Stock at an aggregate cost of approximately $8.6 million pursuant to an open market stock repurchase program.

Note 12—Acquisitions and Dispositions

On February 1, 1988, the Registrant opened a 100-bed chemical dependency treatment facility in Aurora (a suburb of Denver), Colorado. On February 28, 1988, the Registrant opened a 92-bed chemical dependency treatment facility in San Diego, California. The facility was purchased by the Registrant in July 1986 for $4 million. Opening of the facility was delayed due to regulatory proceedings and renovation. On June 1, 1988, the Registrant opened a 100-bed chemical dependency treatment center in Tampa, Florida. The Registrant has financed the acquisition and construction of these facilities through the use of available cash and borrowings under its lines of credit.

Note 12—Acquisitions and Dispositions (continued)

On June 28, 1988, the Sutter Center for Psychiatry, a 69-bed psychiatric hospital, opened in Sacramento, California. The facility is owned by a joint venture between Behavioral Medical Care ("BMC") and Sutter Community Hospitals. BMC has a 49% interest in the joint venture. The Registrant has a 70% interest in BMC.

On July 31, 1987, CareUnit Hospital of Portland was closed. The facility, which was leased by a joint venture in which the Registrant had a 66⅔% interest, was closed because an unfavorable reimbursement and regulatory environment in the state of Oregon resulted in continued losses on operation of the facility.

On May 11, 1988, CareUnit Behavioral Center of Los Angeles was closed. The facility was closed because it had sustained operating losses in each of the last two fiscal years and was in need of substantial renovation.

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 Registrant's consolidated financial statements.

The Registrant is currently undergoing a payroll tax audit by the Internal Revenue Service ("IRS") for calendar years 1983 and 1984. The IRS agent conducting the audit has verbally asserted that certain physicians and psychologists engaged as independent contractors by the Registrant should have been treated as employees for payroll tax purposes. The Registrant has not received an assessment related to this assertion. Management believes that its treatment of the independent contractors is consistent with IRS guidelines and established industry practice. Management intends to defend vigorously any claims made by the IRS related to this issue. Although the final outcome of the IRS audit is not presently determinable, management believes that the ultimate resolution of this matter will not have a material adverse effect on the Registrant's consolidated financial statements.

Note 14—Loss on Write-Down of Assets

In fiscal 1986, the Registrant determined that its psychiatric facility 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 facility will be razed. The Registrant incurred in fiscal 1986 a charge to earnings of $4.3 million related to the write-down of the facility.

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.

Note 15—Unaudited Quarterly Results

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(Dollars in thousands, except per share amounts)			
1988				
Operating revenues	$50,152	$50,029	$52,394	$58,661
Costs and expenses	44,014	44,727	47,172	54,026 (1)
Operating earnings	6,138	5,302	5,222	4,635
Interest expense, net of interest income	(1,925)	(1,601)	(1,870)	(1,001)(1)
Earnings before taxes on income	4,213	3,701	3,352	3,634
Taxes on income	1,706	1,562	1,407	1,255
Net earnings	$ 2,507	$ 2,139	$ 1,945	$ 2,379
Per share:				
Earnings—primary and fully diluted	$ .23	$ .21	$ .20	$ .24
Dividend declared	$ .10	$ .10	$ .10	$ .10
1987				
Operating revenues	$49,750	$44,890	$46,115	$51,677
Costs and expenses	39,746	39,723	41,480	45,830
Operating earnings	10,004	5,167	4,635	5,847
Interest expense, net of interest income	(303)	(424)	(785)	(1,463)
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

(1) An adjustment of $610,000 was recorded during the fourth quarter to reduce interest expense and increase capitalized interest on the Registrant's new facilities. The impact of this adjustment was offset by additional fourth quarter adjustments which increased operating costs and depreciation.

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 6, 1988.

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 6, 1988.

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 6, 1988.

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 6, 1988.

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 at May 31, 1988 and 1987

Consolidated Statements of Earnings for years ended May 31, 1988, 1987 and 1986

Consolidated Statements of Stockholders' Equity for years ended May 31, 1988, 1987 and 1986

Consolidated Statements of Changes in Financial Position for years ended May 31, 1988, 1987 and 1986

Notes to Consolidated Financial Statements

2. **Financial Statement Schedules**

V. Property and Equipment

VI. Accumulated Depreciation and Amortization of Property and Equipment

X. Supplementary Statements 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. Exhibi.

Exhibit Number	Description and Reference
3.1	Restated Certificate of Incorporation(6)
3.2	Restated Bylaws as amended July 14, 1986(5)
4.1	Indenture dated April 25, 1985 between the Registrant and Bank of America, NT&SA relating to Convertible Subordinated Debentures(3)
4.2	Amended and Restated Loan Agreement dated as of July 20, 1987 among the Registrant, Union Bank, Centerre Bank, National Association and Southeast Bank, N.A.(7)
4.3	First Amendment to Amended and Restated Loan Agreement dated as of January 25, 1988 among the Registrant, Union Bank, Centerre Bank, N.A. and Southeast Bank, N.A.(8)
4.4	Second Amendment to Amended and Restated Loan Agreement dated as of March 17, 1988 among the Registrant, Union Bank, Centerre Bank, N.A. and Southeast Bank, N.A.(8)
4.5	Letter Agreement dated as of March 17, 1988 between the Registrant and Union Bank (filed herewith)
4.6	Trust Indenture dated as of July 1, 1988 among the Registrant, Starting Point Incorporated, CareUnit Hospital of Ohio, Inc. and Security Pacific National Bank, relating to Senior Secured Notes (filed herewith)
4.7	Rights Agreement dated as of April 19, 1988 between the Registrant as Security Pacific National Bank(9)
10.1	Standard form of CareUnit Contract (filed herewith)
10.2	Standard form of CarePsychCenter Contract (filed herewith)
10.3	The Registrant's Employee Savings Plan, as amended and restated(10)
10.4	Deferred Compensation Agreement dated April 6, 1982 between the Registrant and B. Lee Karns (filed herewith)
10.5	Amendment No. 1 to Deferred Compensation Agreement dated September 20, 1983 between the Registrant and B. Lee Karns(2)
10.6	Amendment No. 2 to Deferred Compensation Agreement dated April 21, 1986 between the Registrant and B. Lee Karns(5)
10.7	The Registrant's Amended and Restated 1983 Incentive Stock Option Plan(4)
10.8	Form of Individual Death Benefit Agreement(2)
10.9	Financial Security Plan for executive management(4)
10.10	The Registrant's 1988 Incentive Stock Option and 1988 Nonstatutory Stock Option Plans(10)
10.11	Form of Stock Option Agreement (filed herewith)
10.12	Form of Indemnity Agreement (filed herewith)
10.13	Description of Executive Bonus Plan(4)
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. (filed herewith)
10.15	Annuity Contract dated November 2, 1982 between the Registrant and New York Life Insurance and Annuity Corporation(1)
10.16	Joint Venture Agreement dated June 17, 1983 between the Registrant and Voluntary Health Enterprises, Inc.(2)
10.17	Agreements between the Registrant and SmokEnders, Inc.(4)
10.18	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(2)
11	Computation of Earnings per Share (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 10-K for the fiscal year ended May 31, 1983.

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

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

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

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

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

(7) Filed as an exhibit to the Registrant's Form 10-K for the fiscal year ended May 31, 1987.

(8) Filed as an exhibit to the Registrant's Form 10-Q for the quarter ended February 29, 1988.

(9) Filed as an exhibit to the Registrant's Form 8-K dated May 4, 1988.

(10) Filed as an exhibit to the Registrant's Post-Effective Amendment No. 1 to Form S-8 Registration Statement No. 33-6520.

(b) Reports on Form 8-K

During the quarter ended May 31, 1988, the Registrant filed a report on Form 8-K, dated May 4, 1988, reporting Item 5.

SIGNATURES

Pursuant to the requirements of Sections 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 16, 1988.

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 so indicated.

Signature	Title	Date
_____ B. Lee Karns	Director, Chairman of the Board, and President (Chief Executive Officer)	August 16, 1988
_____ Stephen R. Munroe	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	August 16, 1988
_____ Mark A. Edwards	Senior Vice President and Corporate Controller (Principal Accounting Officer)	August 16, 1988
_____ Warren G. Elliott, Esq.	Director	August , 1988
_____ Robert B. Hunter, M.D.	Director	August , 1988
_____ Robert L. Kasselmann	Director	August 16, 1988

SIGNATURES

Pursuant to the requirements of Sections 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 , 1988.

COMPREHENSIVE CARE CORPORATION

By _____
B. Lee Karns
Chairman of the Board and President

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Signature	Title	Date
_____ B. Lee Karns	Director, Chairman of the Board, and President (Chief Executive Officer)	August , 1988
_____ Stephen R. Munroe	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	August , 1988
_____ Mark A. Edwards	Senior Vice President and Corporate Controller (Principal Accounting Officer)	August , 1988
Warren G. Elliott Warren G. Elliott, Esq.	Director	August 16, 1988
_____ Robert B. Hunter, M.D.	Director	August , 1988
_____ Robert L. Kasselmann	Director	August , 1988

SIGNATURES

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COMPREHENSIVE CARE CORPORATION

By _____
B. Lee Karns
Chairman of the Board and President

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_____ Stephen R. Munroe	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	August , 1988
_____ Mark A. Edwards	Senior Vice President and Corporate Controller (Principal Accounting Officer)	August , 1988
_____ Warren G. Elliott, Esq.	Director	August , 1988
Robert B. Hunter M.D. Robert B. Hunter, M.D.	Director	August 16, 1988
_____ Robert L. Kasselmann	Director	August , 1988

Signature	Title	Date
Stanley R. Nelson	Director	August , 1988
Tom E. Nesbitt, Sr., M.D.	Director	August 16, 1988
W. James Nicol	Director	August , 1988

Signature	Title	Date
_____ Stanley R. Nelson	Director	August , 1988
_____ Tom E. Nesbitt, Sr., M.D.	Director	August , 1988
_____ W. James Nicol	Director	August 16, 1988

SCHEDULE V

COMPREHENSIVE CARE CORPORATION

Schedule V—Property and Equipment

For the Years Ended May 31, 1988, 1987 and 1986

	Balance at Beginning of Period	Additions at Cost	Retirements	Reclassifications	Balance at End of Period
			(Dollars in thousands)		
Year ended May 31, 1988					
Land and improvements	$ 27,863	$ 41	$ —	$(3,035)	$ 24,869
Buildings and improvements	87,292	15,735	54	3,035	106,008
Furniture and equipment	21,823	4,499	706	—	25,616
Leasehold improvements	213	19	58	—	174
Capitalized building leases	2,704	—	—	—	2,704
	$139,895	$20,294	$ 818	$ —	$159,371
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

COMPREHENSIVE CARE CORPORATION

Schedule VI—Accumulated Depreciation and Amortization of Property and Equipment

For the Years Ended May 31, 1988, 1987 and 1986

	Balance at Beginning of Period	Additions Charged to Expense	Retirements	Reclassifications	Balance at End of Period
			(Dollars in thousands)		
Year ended May 31, 1988					
Buildings and improvements	$10,161	$3,918	$ 17	$ —	$14,062
Furniture and equipment	9,121	3,208	571	—	11,758
Leasehold improvements	99	21	27	—	93
Capitalized building leases	1,523	97	—	—	1,620
	$20,904	$7,244	$615	$ —	$27,533
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

SCHEDULE X

COMPREHENSIVE CARE CORPORATION

Schedule X—Supplementary Statements of Earnings Information

For the Years Ended May 31, 1988, 1987 and 1986

	May 31,		
	1988	1987	1986
	(Dollars in thousands)		
Advertising costs	$15,860	$16,107	$15,232

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

RECD S.E.C.
AUG 17 1988
FEE 99

EXHIBITS

to

FORM 10-K

For the fiscal year ended May 31, 1988

COMPREHENSIVE CARE CORPORATION

(Exact name of Registrant as specified in its charter)

EXHIBIT INDEX

Exhibit No.	Description	Sequentially Numbered Page
3.1	Restated Certificate of Incorporation(6)	
3.2	Restated Bylaws as amended July 14, 1986(5)	
4.1	Indenture dated April 25, 1985 between the Registrant and Bank of America, NT&SA relating to Convertible Subordinated Debentures(3)	
4.2	Amended and Restated Loan Agreement dated as of July 20, 1987 among the Registrant, Union Bank, Centerre Bank, National Association and Southeast Bank, N.A.(7)	
4.3	First Amendment to Amended and Restated Loan Agreement dated as of January 25, 1988 among the Registrant, Union Bank, Centerre Bank, N.A. and Southeast Bank, N.A.(8)	
4.4	Second Amendment to Amended and Restated Loan Agreement dated as of March 17, 1988 among the Registrant, Union Bank, Centerre Bank, N.A. and Southeast Bank, N.A.(8)	
4.5	Letter Agreement dated as of March 17, 1988 between the Registrant and Union Bank (filed herewith)	58
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10.3	The Registrant's Employee Savings Plan, as amended and restated(10)	
10.4	Deferred Compensation Agreement dated April 6, 1982 between the Registrant and B. Lee Karns (filed herewith)	183
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10.6	Amendment No. 2 to Deferred Compensation Agreement dated April 21, 1986 between the Registrant and B. Lee Karns(5)	
10.7	The Registrant's Amended and Restated 1983 Incentive Stock Option Plan(4)	
10.8	Form of Individual Death Benefit Agreement(2)	
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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. (filed herewith)	196
10.15	Annuity Contract dated November 2, 1982 between the Registrant and New York Life Insurance and Annuity Corporation(1)	
10.16	Joint Venture Agreement dated June 17, 1983 between the Registrant and Voluntary Health Enterprises, Inc.(2)	
10.17	Agreements between the Registrant and SmokEnders, Inc.(4)	
10.18	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(2)	

Exhibit No.	Description	Sequentially Numbered Page
11	Computation of Earnings per Share (filed herewith)	215
22	List of the Registrant's subsidiaries (filed herewith)	216
24.1	Report and consent of Peat Marwick Main & Co. (filed herewith)	217

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

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

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

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

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

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

(7) Filed as an exhibit to the Registrant's Form 10-K for the fiscal year ended May 31, 1987.

(8) Filed as an exhibit to the Registrant's Form 10-Q for the quarter ended February 29, 1988.

(9) Filed as an exhibit to the Registrant's Form 8-K dated May 4, 1988.

(10) Filed as an exhibit to the Registrant's Post-Effective Amendment No. 1 to Form S-8 Registration Statement No. 33-6520.

COMPREHENSIVE CARE CORPORATION AND SUBSIDIARIES
CALCULATION OF EARNINGS PER SHARE

	YEAR ENDED MAY 31,				
PRIMARY AND FULLY DILUTED	1988	1987	1986	1985	1984
	(AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)				
NET EARNINGS APPLICABLE TO COMMON STOCK(a)	$11,040	$13,888	$14,817	$17,361	$14,058
AVERAGE NUMBER OF SHARES OF COMMON STOCK AND COMMON STOCK EQUIVALENTS OUTSTANDING(c):					
SHARES OF COMMON STOCK	10,733	13,583	15,173	15,169	15,160
ADDITIONAL AVERAGE NUMBER OF SHARES OUTSTANDING ASSUMING CONVERSION OF 7.5% CONVERTIBLE DEBENTURES	1,771	1,771	1,771	146	-
DILUTIVE EFFECT OF STOCK OPTIONS AFTER APPLICATION OF TREASURY STOCK METHOD(b)	18	6	43	-	-
AVERAGE NUMBER OF SHARES OF COMMON STOCK AND COMMON STOCK EQUIVALENTS	12,522	15,360	16,987	15,315	15,160
EARNINGS PER SHARE	$.88	$0.90	$0.87	$1.13	$0.93

	YEAR ENDED MAY 31,				
	1988	1987	1986	1985	1984
	(DOLLARS IN THOUSANDS)				
NET EARNINGS PER SELECTED FINANCIAL DATA	8,970	$12,088	$13,102	$17,226	$14,058
ADD INTEREST EXPENSE ATTRIBUTABLE TO 7.5% CONVERTIBLE SUBORDINATED DEBENTURES	2,070	1,800	1,715	135	-
(a) NET EARNINGS APPLICABLE TO COMMON STOCK	$11,040	$13,888	$14,817	$17,361	$14,058

(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 1984 AND 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.

COMPREHENSIVE CARE CORPORATION
SCHEDULE OF SUBSIDIARIES

SUBSIDIARY NAME	STATE OF INCORPORATION
NPHS, 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 INCORPORATED	California
CAREUNIT HOSPITAL OF ALBUQUERQUE, INC.	New Mexico
COMPREHENSIVE CARE CORPORATION	Nevada
CAREUNIT HOSPITAL OF NEVADA, INC.	Nevada
CAREINSTITUTE	California
CAREUNIT CLINIC OF WASHINGTON, INC.	Washington
CAREUNIT REDEVELOPMENT CORPORATION	Missouri
CAREUNIT HOSPITAL OF OHIO, INC.	Ohio
CAREUNIT OF FLORIDA, INC.	Florida
COMPREHENSIVE CARE CORPORATION (CANADA) LTD.	Canada
REHABCARE CORPORATION	Delaware
TWELVE POINT RIDGE, INC.	Oklahoma
CAREUNIT OF CHICAGO, INC.	Illinois
VIDEOHEALTH, INC.	California
CAREUNIT, INC.	Delaware

EXHIBIT 22

To the Stockholders and Board of Directors
Comprehensive Care Corporation:

The audits referred to in our report dated July 22, 1988 included the related financial statement schedules as of May 31, 1988 and for each of the years in the three-year period ended May 31, 1988 included in Form 10-K. These financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statement schedules, based on our audits. 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 the incorporation by reference in the Registration Statements (Nos. 33-6520 and 33-3091) on Form S-8 of Comprehensive Care Corporation of our report dated July 22, 1988, relating to the consolidated balance sheets of Comprehensive Care Corporation and subsidiaries as of May 31, 1988 and 1987 and the related consolidated statements of earnings, stockholders' equity, and changes in financial position for the years then ended which report appears in the May 31, 1988 annual report on Form 10-K of Comprehensive Care Corporation.

Peat Marwick Main & Co.

Orange County, California
August 16, 1988

EXHIBIT 24.1

FILMED
AUGUST 1988

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