METROPOLITAN HEALTH NETWORKS INC
Form 10-Q
November 14, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2006

OR

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

For the transition period from _____ to _____

Commission file number: 001-32361

METROPOLITAN HEALTH NETWORKS, INC.
(Exact name of registrant as specified in its charter)

Florida	65-0635748
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
250 Australian Avenue, Suite 400 West Palm Beach, FL (Address of principal executive offices)	33401 (Zip Code)

(561) 805-8500
(Registrant's telephone number, including area code)

None
(Former name, former address and former fiscal year, if changed since last report)

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

Yes [X] No [_]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [_] Accelerated filer [X] Non-accelerated filer [_]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [_] No [X]

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

Class	Outstanding at October 31, 2006
Common Stock, $.001 par value per share	50,165,426 shares

Metropolitan Health Networks, Inc.

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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

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

ASSETS	September 30, 2006 (Unaudited)
CURRENT ASSETS	
Cash and equivalents	$ 19,304,497
Short-term investments	5,769,956
Accounts receivable, net of allowance	4,273,196
Inventory	245,043
Prepaid expenses	1,049,109
Deferred income taxes	3,400,000
Other current assets	432,187
TOTAL CURRENT ASSETS	34,473,988
PROPERTY AND EQUIPMENT, net	2,070,079
INVESTMENTS	663,043
GOODWILL, net	1,992,133
DEFERRED INCOME TAXES	2,644,800
OTHER ASSETS	645,925
TOTAL ASSETS	$ 42,489,968
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES	
Accounts payable	$ 1,136,836
Advance and unearned premiums	1,298,153
Estimated medical expenses payable	4,117,183
Accrued payroll and payroll taxes	1,480,696
Accrued expenses	821,332
TOTAL CURRENT LIABILITIES	8,854,200
COMMITMENTS AND CONTINGENCIES	
STOCKHOLDERS' EQUITY	

Preferred stock, par value $.001 per share; stated value $100 per share; 10,000,000 shares authorized; 5,000 issued and outstanding	500,000
Common stock, par value $.001 per share; 80,000,000 shares authorized; 50,132,526 and 49,851,526 issued and outstanding, respectively	50,132
Additional paid-in capital	40,926,641
Accumulated deficit	(7,841,005)
TOTAL STOCKHOLDERS' EQUITY	33,635,768
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 42,489,968

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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

	For the nine months ended September 30,		For the t ended Se
	2006 (Unaudited)	2005 (Unaudited)	2006 (Unaudited)
REVENUES, net	$ 172,487,485	$ 136,688,653	$ 60,838,341
OPERATING EXPENSES			
Direct medical costs	144,945,205	114,903,124	49,647,785
Other medical costs	7,693,187	7,776,931	2,548,244
Total medical expenses	152,638,392	122,680,055	52,196,029
Administrative payroll, payroll taxes and benefits	7,529,738	4,211,494	2,526,552
Marketing and advertising	2,199,019	1,433,189	203,166
General and administrative	5,698,587	4,039,209	2,149,350
TOTAL EXPENSES	168,065,736	132,363,947	57,075,097
OPERATING INCOME	4,421,749	4,324,706	3,763,244
OTHER INCOME			
Interest income, net	717,930	263,246	305,792
Other	1,394	129,624	193
TOTAL OTHER INCOME	719,324	392,870	305,985
INCOME BEFORE INCOME TAXES	5,141,073	4,717,576	4,069,229
INCOME TAXES	(1,948,200)	(1,790,696)	(1,537,200)

NET INCOME	$ 3,192,873	$ 2,926,880	$ 2,532,029
NET EARNINGS PER SHARE:			
Basic	$ 0.06	$ 0.06	$ 0.05
Diluted	$ 0.06	$ 0.06	$ 0.05

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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

	For the nine months ended S	
	2006	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 3,192,873	$ 2
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	378,801	
Deferred income taxes	1,948,200	
Stock-based compensation expense	545,983	
Tax benefit on exercise of stock options	--	1
Loss on sale of assets	191	
Amortization of securities issued for professional services	57,300	
Changes in operating assets and liabilities:		
Accounts receivable, net	(89,222)	(1
Inventory	(43,613)	
Prepaid expenses	(575,823)	
Other current assets	115,790	
Other assets	(25,381)	
Accounts payable	167,653	
Advance and unearned premiums	1,298,153	
Estimated medical expenses payable	3,422,773	
Accrued payroll	21,598	
Accrued expenses	527,779	
Total adjustments	7,750,182	1
Net cash provided by operating activities	10,943,055	4
CASH FLOWS FROM INVESTING ACTIVITIES:		
Short-term investments	(5,769,955)	1
Investments	(35,224)	
Redemption of restricted certificates of deposit	--	1
Capital expenditures	(1,546,991)	

Net cash (used in)/provided by investing activities	(7,352,170)	1
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments on notes payable	--	(1
Repurchase of warrants	--	
Proceeds from exercise of stock options and warrants	140,750	1
Net proceeds from issuance of common stock	--	
Net cash provided by financing activities	140,750	
NET INCREASE IN CASH AND EQUIVALENTS	3,731,635	5
CASH AND EQUIVALENTS - BEGINNING	15,572,862	11
CASH AND EQUIVALENTS - ENDING	$ 19,304,497	$ 17

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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

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

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and such adjustments are of a normal recurring nature. Operating results for the three and nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

The audited financial statements at December 31, 2005, which were included in the Company's Form 10-K filed on March 16, 2006, should be read in conjunction with these condensed consolidated financial statements.

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

SEGMENT REPORTING

The Company applies Financial Accounting Standards Boards ("FASB") Statement No. 131, "Disclosure about Segments of an Enterprise and Related Information." The Company has considered its operations and has determined that, in 2005, it operated, and continues to operate in 2006, in two segments for purposes of presenting financial information and evaluating performance, a Provider Service

Network (managed care and direct medical services), operated through its wholly owned subsidiary, Metcare of Florida, Inc. (the "PSN"), and a Medicare Advantage HMO, operated through its wholly owned subsidiary Metcare Health Plans, Inc. (the "HMO").

As such, the accompanying financial statements present information in a format that is consistent with the financial information used by management for internal use. See "Note 6. Business Segment Information" for additional information regarding the Company's business segments.

CASH AND EQUIVALENTS

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. From time to time, the Company maintains cash balances with financial institutions in excess of federally insured limits.

SHORT-TERM INVESTMENTS

All investments with original maturities of greater than 90 days are accounted for in accordance with Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities." As of September 30, 2006, the Company's short-term investments consisted of commercial paper and certificates of deposit classified as available-for-sale. All income generated from these short-term investments during the three and nine months ended September 30, 2006 was recorded as interest income.

LONG-TERM INVESTMENTS

Long-term investments, which consist primarily of a non-controlling equity interest in a non-assessable reciprocal insurance organization through which the Company has renewed its malpractice insurance, are carried at cost. If an impairment occurs that is not considered temporary, the investment will be written down to net realizable value.

INCOME TAXES

The Company accounts for income taxes pursuant to Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"), which requires income taxes to be accounted for under the asset and liability method. Under this method, deferred income tax assets and liabilities are determined based upon differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment date.

SFAS No. 109 requires a valuation allowance to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. After consideration of all the evidence, both positive and negative (including, among others, projections of future taxable income, current year net operating loss carryforward utilization and the Company's profitability in recent years), the Company determined that future realization of its deferred tax assets was more

likely than not. In the event it is determined that it is more likely than not that the Company would not be able to realize all or part of its net deferred tax assets in the future, an adjustment to record a deferred tax asset valuation allowance would be charged to income in the period such determination would be made. Changes in deferred tax assets are reflected in the "Income Taxes" expense line of the Company's Condensed Consolidated Statements of Operations.

Due to the availability of deferred tax assets during the three and nine months ended September 30, 2006, the Company has not recorded any amounts payable for U.S. federal income taxes and does not expect any cash outlay to be required in connection with the income tax provisions.

REVENUE RECOGNITION

The Company's PSN is a party to two managed care contracts with Humana, Inc. (the "Humana Agreements") and provides medical care to Humana's members through wholly-owned and contracted independent medical practices and providers (collectively, the "Affiliated Providers"). The PSN receives a monthly fee for each patient that chooses one of the Affiliated Providers as his or her primary care physician in exchange for the PSN's assumption of responsibility for the provision of all necessary medical services to such patient, even those medical services not directly provided by one of the Affiliated Providers. Fees received by the PSN under these Humana Agreements are reported as revenues. The cost of both Affiliated Provider and non-Affiliated Provider services under these Humana Agreements are not included as a deduction to net revenues of the Company, but are reported as an operating expense. Changes in revenues resulting from periodic changes in risk adjustment scores are recognized when the amounts become determinable and the collectibility is reasonably assured. In connection with the Humana Agreements, the Company is exposed to losses to the extent of the PSN's share of deficits, if any, on its Affiliated Providers. The PSN's share of deficits is 100% for Medicare Part A in the Central Florida market, 50% for Medicare Part A in the South Florida market and 100% for Medicare Part B in both the Central Florida and South Florida market. Revenues generated under the Humana Agreements accounted for approximately 85% and 98% of the Company's total revenues for the quarters ended September 30, 2006 and 2005, respectively, and approximately 88% and 99% of the Company's total revenues for the nine months ended September 30, 2006 and 2005, respectively.

Humana may immediately terminate either of the Humana Agreements and/or any individual physician credentialed under the Humana Agreements, upon written notice, (i) if the PSN and/or any of its Affiliated Provider's continued participation may adversely affect the health, safety or welfare of any Humana member or bring Humana into disrepute; (ii) in the event of one of the PSN's physician's death or incompetence; (iii) if any of the PSN's physicians fail to meet Humana's credentialing criteria; (iv) in accordance with Humana's policies and procedures as specified in Humana's manual, (v) if the PSN engages in or acquiesces to any act of bankruptcy, receivership or reorganization; or (vi) if Humana loses its authority to do business in total or as to any limited segment or business (but only to that segment). The PSN and Humana may also terminate each of the Humana Agreements upon 90 days' prior written notice (with a 60 day opportunity to cure, if possible) in the event of the other's material breach of the applicable Humana Agreement.

Failure to maintain the Humana Agreements on favorable terms, for any reason, would adversely affect the Company's results of operations and financial condition.

The Company also recognizes non-Humana fee-for-service revenues, net of contractual allowances, as medical services are provided to patients by the Company's wholly-owned medical practices. These services are typically billed to patients, Medicare, Medicaid, health maintenance organizations and insurance companies. The Company provides an allowance for uncollectible amounts and for

contractual adjustments relating to the difference between standard charges and agreed upon rates paid by certain third party payers.

Effective July 1, 2005 the Company obtained the requisite Florida and federal licenses, approvals and contract to begin marketing, enrolling and providing services to Medicare beneficiaries through its own Medicare Advantage HMO. The contract with the Centers for Medicare and Medicaid Services ("CMS") renews on an annual basis. The HMO receives a monthly premium for each enrollee in its plan and is responsible for the provision of all covered medical services for that enrollee. Premium revenues are recognized as income in the period members are entitled to receive services, and are recorded net of retroactive membership adjustments. Retroactive membership adjustments result from enrollment changes not yet processed or not yet reported by CMS. Changes in revenues from CMS resulting from the periodic changes in risk adjustment scores for the HMO's membership are recognized when the amounts become determinable and the collectibility is reasonably assured.

MARKETING AND ADVERTISING COSTS

Marketing and advertising costs are expensed as incurred. Marketing and advertising expense was approximately $203,000 and $1.3 million for the quarters ended September 30, 2006 and 2005, respectively, and $2.2 million and $1.4 million for the nine months ended September 30, 2006 and 2005, respectively.

USE OF ESTIMATES

Revenue, Expense and Receivables

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements. The most significant area requiring estimates relates to the PSN's arrangements with Humana. Such estimates are based on knowledge of current events and anticipated future events, and accordingly, actual results may ultimately differ materially from those estimates.

With regard to virtually all of the revenues, expenses and receivables arising from the Humana Agreements, the Company estimates the amounts it believes will ultimately be realizable based in part upon estimates of claims incurred but not reported ("IBNR") and estimates of retroactive adjustments or unsettled costs to be applied by Humana. The IBNR estimates are made by Humana utilizing actuarial methods and are continually evaluated by management of the Company based upon its specific claims experience. It is reasonably possible that some or all of these estimates could change in the near term by an amount that could be material to the financial statements.

From time to time, Humana charges the PSN for certain medical expenses, which the Company believes are erroneous or are not supported by the Humana Agreements. Management's estimate of recovery on these contestations is based upon its judgment and its consideration of several factors including the nature of the contestations, historical recovery rates and other qualitative factors.

During 2005, the Company incurred approximately $4.0 million of medical costs related to the implantation of certain Implantable Automatic Defibrillators

("AICD's"). CMS directed that the costs of certain of these procedures that met 2005 eligibility requirements be paid by CMS, rather than billed to Medicare Advantage plans. The Company is working with Humana and the related providers to secure reimbursement for these amounts, and estimated a recovery of approximately $2.2 million at December 31, 2005. Approximately $379,000 of this amount was collected during the nine months ended September 30, 2006, while an additional $500,000 was written off during the second quarter of 2006 due to revised guidance issued by CMS in July 2006 regarding the costs payable by CMS in connection with these procedures. During the quarter ended September 30, 2006, the Company recorded an additional $500,000 reserve against this receivable to reflect management's concerns about the ultimate collection of these receivables. Accordingly, related accounts receivable in the accompanying consolidated balance sheets were $772,000 and $2.2 million at September 30, 2006 and December 31, 2005, respectively. It is reasonably possible that this estimate could change in the near term by an amount that could be material to the financial statements.

Included in revenues for the quarter and nine months ended September 30, 2006 were estimated amounts payable to the Company as a result of funding increases under the Medicare risk adjustment ("MRA") program. The purpose of the MRA program is to use health status indicators to improve the accuracy of payments and establish incentives for plans to enroll and treat less healthy Medicare beneficiaries. From 2000 to 2003, risk adjustment payments accounted for only 10% of the payment made by CMS to the Medicare health plans, with the remaining 90% based on demographic factors. In 2004 and 2005, the percentage of payment attributable to risk adjustment was increased to 30% and 50%, respectively. The percentage of payment attributable to risk has increased to 75% in 2006, with the 100% phase-in of risk-adjusted payment expected in 2007. We accrued approximately $5.4 million during the nine months ended September 30, 2006 related to incremental revenues anticipated to be received as a result of the MRA funding increases. $4.2 million has been received during the first nine months of 2006. Accounts receivable in the accompanying consolidated balance sheets at September 30, 2006 include $1.2 million of accrued MRA receivables that we expect to be received during the fourth quarter of 2006 and in the first quarter of 2007. It is reasonably possible that this estimate could change in the near term by an amount that could be material to the financial statements.

Non-Humana fee-for-service accounts receivable, aggregating to approximately $1,155,000 and $797,000 at September 30, 2006 and December 31, 2005, respectively, relate principally to medical services provided on a non-capitated basis, and are reduced by amounts estimated to be uncollectible (approximately $798,000 and $555,000 at September 30, 2006 and December 31, 2005, respectively). Management's estimate of uncollectible amounts is based upon its analysis of historical collections and other qualitative factors, however it is possible the Company's estimate of uncollectible amounts could change in the near term. In addition, accounts receivable at September 30, 2006 and December 31, 2005 includes approximately $519,000 and $159,000, respectively, due to the HMO from CMS and HMO enrollees, which is reduced by amounts estimated to be uncollectible at September 30, 2006 in the amount of $17,000.

With regards to the HMO, the cost of medical benefits is recognized in the period in which services are provided and includes an IBNR estimate based on management's best estimate of medical benefits payable. Included in this estimate are loss adjustment expenses of approximately 3% of the IBNR balance.

It is reasonably possible that some or all of these estimates could change in the near term by an amount that could be material to the financial statements.

The HMO memberships' average risk adjustment factor declined from December 2005 to June 2006 as a result of a large influx of new members in 2006. This decline resulted in decreased average member monthly premiums. The Company believes that the actual average risk adjustment factor for its population during this period was higher and that an increase will be reflected as claims and health data for these new members are entered into the CMS system, which is expected to result in retroactive premium adjustments. The Company has estimated the retroactive premium adjustment to be approximately $534,000 at September 30, 2006.

Accounting for Prescription Drug Benefits under Medicare Part D

On January 1, 2006, the HMO and the PSN, through the Humana Agreements, began covering prescription drug benefits in accordance with the requirements of Medicare Part D, to the HMO's and PSN's Medicare Advantage members. The benefits covered under Medicare Part D are in addition to the benefits covered by the HMO and the PSN under Medicare Parts A and B.

In general, pursuant to Medicare Part D, pharmacy benefits may vary in terms of coverage levels and out-of-pocket costs for beneficiary premiums, deductibles and co-insurance. However, all Part D plans must offer either "standard coverage" or its actuarial equivalent (with out-of-pocket threshold and deductible amounts that do not exceed those of standard coverage). These "defined standard" benefits represent the minimum level of benefits mandated by Congress. In addition to defined standard plans offered by the HMO, the PSN, through the Humana Agreements, offers certain prescription drug plans containing benefits in excess of the standard coverage limits.

The payment the Company's HMO receives monthly from CMS for coverage under Medicare Part D (the "CMS Payment") generally represents the HMO's bid amount for providing Part D insurance coverage. The Company recognizes premium revenue for the HMO's provision of this Part D insurance coverage ratably over the term of the CMS Agreement. However, the ultimate amount of the CMS Payment is subject to 1) risk corridor adjustments and 2) subsidies provided by CMS in order for the HMO and CMS to share the risk associated with financing the ultimate costs of the Medicare Part D benefit.

The CMS payment is subject to adjustment, positive or negative, based upon the application of risk corridors that compare the prescription drug benefit costs estimated by the HMO in making its bid to CMS (the "Estimated Costs") to actual incurred prescription drug benefit costs (the "Actual Costs"). For 2006 and 2007, in accordance with federal regulations, the HMO will bear all gains and losses that fall within 2.5% of its Estimated Costs. To the extent the Actual Costs exceed the Estimated Costs by more than 2.5%, CMS may make additional payments to the HMO. Conversely, to the extend the Estimated Costs exceed the Actual Costs by more than 2.5%, the HMO may be required to refund to CMS a portion of the CMS Payment. Actual Costs subject to risk sharing with CMS are limited to the costs that are, or would have been, incurred under the CMS "defined standard" benefit plan . The Company estimates and recognizes an adjustment to premium revenues from CMS related to the risk corridor payment adjustment based upon pharmacy claims experience to date as if the CMS Agreement were to end at the end of each reporting period. Accordingly, this estimate does

not take into consideration projected future pharmacy claims experience. It is reasonably possible that this estimate could change in the near term by an amount that could be material.

Certain subsidies represent reimbursements from CMS for claims the HMO paid for even though it is not ultimately required to bear the risk in connection with such claims. These include federally reinsured claims where an HMO member's actual drug spending reaches Part D's annual catastrophic threshold and certain deductible, coinsurance and co-payment amounts for low-income beneficiaries. The Company accounts for these subsidies as current liabilities in its balance sheet and as an operating activity in its statement of cash flows. The Company does not recognize premium revenue or claims expense for these subsidies.

The HMO recognizes pharmacy benefit costs as incurred. It has subcontracted the pharmacy claims administration to a third party pharmacy benefit manager.

With regards to the PSN, the Company receives Medicare Part D revenue pursuant to the applicable percent of premium provided for in the Humana Agreements. Humana does not provide the Company with a separate accounting for the incremental amount of the Part D premium and expense. As with the HMO, the Company recognizes pharmacy benefit costs as such costs are incurred by the PSN. With regards to the estimated amount of any risk corridor adjustments, the Company has relied upon estimates provided by Humana to the Company and has recorded a downward adjustment to premium revenue based on these estimates. It is reasonably possible that this estimate could change in the near term by an amount that could be material.

Deferred Tax Asset

The Company has recorded a deferred tax asset of approximately $6.0 million at September 30, 2006. Realization of the deferred tax asset is dependent on generating sufficient taxable income in the future. Management believes that it is more likely than not that it will have the ability to realize the recorded deferred tax asset. The amount of the deferred tax asset considered realizable could change in the near term if estimates of future taxable income are modified and those changes could be material.

In the future, if the Company determines that it cannot, on a more likely than not basis, realize all or part of its deferred tax assets in the future, an adjustment to establish (or record an increase in) the deferred tax asset valuation allowance would be charged to income in the period in which such determination is made.

ACCOUNTS RECEIVABLE

Accounts receivable at September 30, 2006 and December 31, 2005 were as follows:

	September 30, 2006	December 31, 2005
Humana accounts receivable, net	$ 3,414,000	$ 3,782,000
Non-Humana accounts receivable, net	859,000	402,000
Accounts receivable, net	$ 4,273,000	$ 4,184,000

EARNINGS PER SHARE

The Company applies Statement of Financial Accounting Standards No. 128, "Earnings Per Share" ("SFAS 128") which requires presentation of both basic net income per share and diluted net income per share. Basic earnings per share is computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common shares outstanding during the period adjusted for incremental shares attributed to outstanding options and warrants, convertible debt and preferred stock convertible into shares of common stock.

	For the nine months ended September 30,		For the three m September
	2006	2005	2006
Net Income	$ 3,193,000	$ 2,927,000	$ 2,532,000
Less:Preferred stock dividend	(38,000)	(38,000)	(13,000)
Income available to common shareholders	$ 3,155,000	$ 2,889,000	$ 2,519,000
Denominator:			
Weighted average common shares outstanding	49,981,000	48,716,000	50,108,000
Basic earnings per common share	$ 0.06	$ 0.06	$ 0.05
Income available to common shareholders	$ 3,155,000	$ 2,889,000	$ 2,532,000
Denominator:			
Weighted average common shares outstanding	49,981,000	48,716,000	50,108,000
Common share equivalents of outstanding stock:			
Convertible perferred stock	--	--	437,000
Options and warrants	1,402,000	2,789,000	1,494,000
Weighted average common shares outstanding	51,383,000	51,505,000	52,039,000
Diluted earnings per common share	$ 0.06	$ 0.06	$ 0.05

NEW ACCOUNTING PRONOUNCEMENTS

SFAS No. 154, Accounting Changes and Error Corrections, was issued in May 2005 and replaces APB Opinion No. 20 (Accounting Changes) and SFAS No. 3 (Reporting Accounting Changes in Interim Financial Statements). SFAS No. 154 requires retrospective application for voluntary changes in accounting principle in most instances and is required to be applied to all accounting changes made in fiscal years beginning after December 15, 2005. The Company adopted SFAS No. 154 on January 1, 2006 and it did not have a material impact on the Company's consolidated financial condition or results of operations.

In July 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement 109", or FIN 48. FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements regarding uncertain tax positions that the company has taken or expects to take on a tax return. FIN

48 also revises disclosure requirements and introduces a prescriptive, annual, tabular roll-forward of the unrecognized tax benefits. FIN 48, which will become effective for the Company beginning January 1, 2007, requires the change in net assets that results from the application of the new accounting model to be reflected as an adjustment to retained earnings. The Company currently is evaluating the impact of adopting FIN 48.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value pursuant to generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective for fiscal years beginning after November 15, 2007. We are currently assessing the potential impact that the adoption of SFAS No. 157 will have on our financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") 108, "Considering the Effects of Prior Year Misstatements when Qualifying Misstatements in Current Year Financial Statements." SAB 108 requires companies to quantify misstatements using both the balance sheet (iron curtain) and income statement (rollover) approaches and to evaluate whether either approach results in quantifying an error that is material in light of relevant and qualitative factors. The requirements are effective for annual financial statements covering the first fiscal year ending after November 15, 2006. The Company has initially determined that the potential financial impact could range between $500,000 and $525,000 upon the adoption of SAB 108.

NOTE 2. DEBT

On May 6, 2005 the Company executed an unsecured commercial line of credit agreement with a bank, which provided for borrowings and issuance of letters of credit of up to $1.0 million. The credit line expired on March 31, 2006 and was automatically renewed for an additional one-year period until March 31, 2007. The outstanding balance, if any, bears interest at the bank's prime rate. The credit facility requires the Company to comply with certain financial covenants, including a minimum liquidity requirement of $2.0 million. As of September 30, 2006, the availability under the line of credit secures a $1.0 million letter of credit that the Company has caused to be issued in favor of Humana. As of September 30, 2006, the Company has not borrowed funds under the commercial line of credit.

NOTE 3. STOCK BASED COMPENSATION

The Company has three stock option plans that are administered by the Compensation Committee of the Board of Directors. The 2001 Stock Option Plan and the Supplemental Stock Option Plan have 1,049,110 and 1,345,400 outstanding options granted under the plans, respectively, as of September 30, 2006. The Company does not intend to issue additional options from either plan in the

future. The Omnibus Equity Compensation Plan (the "Omnibus Plan") provides for the grant of non-qualified or incentive stock options and other stock based awards to directors, executives and key employees of the Company, as well as to any other persons approved by the Compensation Committee. A total of 6,000,000 shares of Metropolitan's common stock are authorized for issuance pursuant the Omnibus Plan. As of September 30, 2006, options granted pursuant to the Omnibus Plan to purchase 2,776,700 shares of the Company's common stock are currently outstanding. Under the Omnibus Plan, options are granted at the fair market value of the stock at the date of grant and expire no later than 10 years after the date of grant. Options granted under this Omnibus Plan generally vest over periods up to four years.

Prior to January 1, 2006, the Company followed Accounting Principles Board Opinion No. 25, ("APB No. 25"), "Accounting for Stock Issued to Employees," and related Interpretations in accounting for its employee stock options. Under APB No. 25, when the exercise price of the Company's employee stock options equaled or exceeded the market price of the underlying stock on the date of grant, no compensation expense was recognized. For the quarter and nine months ended September 30, 2005, no stock-based employee compensation expense was recognized in the accompanying condensed consolidated statement of income.

Effective January 1, 2006, the Company adopted SFAS No. 123(R) ("SFAS No. 123(R)"), "Share-Based Payment," which is a revision of SFAS No. 123, using the modified prospective transition method and therefore has not restated prior periods' results. Under the transition method, stock-based compensation expense for the first quarter of fiscal 2006 included compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of, January 1, 2006, based on the grant date fair value estimated in accordance with the original provision of SFAS No. 123. Stock-based compensation expense for all share-based payment awards granted after January 1, 2006 is based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). The Company recognizes these compensation costs net of an estimated forfeiture rate and recognizes the compensation costs for only those shares expected to vest. The Company calculates the fair value of employee stock options using a Black-Scholes option pricing model at the time the stock options are granted and that amount is amortized on a straight-line basis over the vesting period of the stock options, which is generally up to four years. The Company estimated the forfeiture rate based on its historical experience.

The fair value for employee stock options granted during the nine months ended September 30, 2006 was calculated based on the following assumptions: risk-free interest rate from 4.80% to 4.99%; dividend yield of 0%; volatility factor of the expected market price of the Company's common stock of 50%; and expected option lives of two years. The expected life of the options is based on the historical exercise behavior of the Company's employees. The expected volatility factor is based on the historical volatility of the market price of the Company's common stock. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

As a result of adopting SFAS No. 123(R) on January 1, 2006, for the quarter and nine month periods ended September 30, 2006, the Company's income before income taxes was approximately $182,000 and $546,000 lower, respectively, and net income was lower by approximately $113,000 and $341,000, respectively, than if

it had continued to account for share-based compensation under APB No. 25. The total income tax benefit recognized in the income statement for share-based compensation was approximately $69,000 and $205,000 for the quarter and nine month periods ended September 30, 2006.

SFAS No. 123(R) requires the tax benefits resulting from tax deductions in excess of the compensation cost recognized for options (excess tax benefits) to be classified as financing cash flows. For the quarter and nine months ended September 30, 2006, the Company had net operating loss carryforwards and did not recognize any tax benefits resulting from the exercise of stock options because the related tax deductions would not have resulted in a reduction of income taxes payable. During the quarter and nine months ended September 30, 2006, the Company issued 26,000 and 221,000 shares of common stock resulting from the exercise of stock options, respectively. Cash received from the option exercises was approximately $1,000 and $140,750 for the quarter and nine months ended September 30, 2006.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 for the quarter and nine months ended September 30, 2005. For purposes of this pro forma disclosure, the fair value of these options were estimated at the date of grant using a Black-Scholes option pricing model based on the following assumptions for the quarter and nine months ended September 30, 2005: risk-free interest rate from 2.82% to 4.24%; dividend yield of 0%; volatility factor of the expected market price of the Company's common stock of 50%; and expected option lives ranging from one to four and one-half years, depending on the vesting provisions of each option. The expected life of the options is based on the historical exercise behavior of the Company's employees. The expected volatility factor is based on the historical volatility of the market price of the Company's common stock. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The Company's pro forma information follows:

	Nine months ended September 30, 2005	Three months ended September 30, 2005
Net income, as reported	$ 2,927,000	$ 539,000
Less:Total stock-based employee compensation expense determined under SFAS No. 123 for all awards, net of related tax	(714,000)	(227,000)
Pro forma net income	$ 2,213,000	$ 312,000
Earnings per share:		
Basic, as reported	$ 0.06	$ 0.01
Basic, pro forma	$ 0.05	$ 0.01
Diluted, as reported	$ 0.06	$ 0.01
Diluted, pro forma	$ 0.04	$ 0.01

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

Stock option activity as of September 30, 2006 and changes during the nine months ended September 30, 2006 were as follows:

	Number of Options	Weighted Average Exercise Price	Aggregate Intrinsic Value
Balance, December 31, 2005	6,385,810	$ 1.63	
Granted	50,000	$ 2.08	
Exercised and returned	(221,000)	$ 0.75	
Forfeited and expired	(1,043,600)	$ 2.68	
Balance, September 30, 2006	5,171,210	$ 1.47	$4,727,303
Exercisable, September 30, 2006	3,041,537	$ 1.17	$3,918,525

The weighted-average grant-date fair value of options granted during the nine months ended September 30, 2006 and 2005 was $0.65 and $0.93, respectively. The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the Company's closing stock price on the last trading day of the first quarter of fiscal 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 30, 2006. This amount will change based on the fair market value of the Company's stock. Total intrinsic value of options exercised for the nine months ended September 30, 2006 and 2005 was approximately $414,000 and $2,866,000, respectively. Total fair value of options vested for the nine months ended September 30, 2006 and 2005 was approximately $87,000 and $101,000, respectively.

As of September 30, 2006, there was $650,965 of total unrecognized compensation cost related to non-vested stock options, which is expected to be recognized over a weighted-average period of 1.09 years.

The following table summarizes information about stock options outstanding and exercisable at September 30, 2006:

	Options Outstanding			Options Exercisable		
Exercise Price	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Number of Options	Weighted Average Exercise Price	Wei Con
$0.35 - $1.00	2,114,510	$ 0.53	2.26	2,064,510	$ 0.52	
$1.14 - $1.98	2,319,900	$ 1.81	7.86	727,452	$ 1.77	
$2.05 - $2.69	586,800	$ 2.27	8.51	99,575	$ 2.61	
$4.00 - $6.50	150,000	$ 6.17	0.60	150,000	$ 6.17	
	5,171,210	$ 1.47	5.43	3,041,537	$ 1.17	

Non-vested stock option awards as of September 30, 2006 and changes during the nine months ended September 30, 2006 were as follows:

	Number of Shares	Weighted Average Grant-Date Fair Value
Non-vested, December 31, 2005	2,337,782	$ 0.94
Granted	50,000	$ 0.65
Vested	(137,075)	$ 0.63
Forfeited and expired	(121,034)	$ 1.13
Non-vested, September 30, 2006	2,129,673	$ 0.94

Non-vested restricted stock awards as of September 30, 2006 and changes during the nine months ended September 30, 2006 were as follows:

	Restricted Shares	Weighted Average Grant-Date Fair Value
Balance, December 31, 2005	--	$ --
Granted	60,000	$ 2.08
Vested	--	$ --
Forfeited and expired	--	$ --
Balance, September 30, 2006	60,000	$ 2.08

In the quarter and nine months ended September 30, 2006, the Company recognized approximately $31,000 and $57,000, respectively, of compensation costs related to non-vested restricted stock awards. As of September 30, 2006, there was approximately $67,000 of total unrecognized compensation cost related to non-vested restricted stock awards, which is expected to be recognized over a weighted-average period of 0.56 years.

NOTE 4. STOCKHOLDERS' EQUITY

The Company issued 221,000 shares of common stock in connection with the exercise of stock options during the first nine months of 2006. In addition, an aggregate of 60,000 shares of restricted common stock were issued to two new members of the Company's Board of Directors upon their appointment to the Board of Directors in the second quarter of 2006.

NOTE 5. COMMITMENTS AND CONTINGENCIES

LITIGATION

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

NOTE 6. BUSINESS SEGMENT INFORMATION

In 2006, the Company is operating in two segments for purposes of presenting financial information and evaluating performance, the PSN and the HMO. The HMO commenced operations effective July 1, 2005.

NINE MONTHS ENDED SEPTEMBER 30, 2006	PSN	HMO
Revenues from external customers	$152,628,000	$ 19,859,00
Segment gain (loss) before allocated overhead	16,150,000	(6,218,00
Allocated corporate overhead	2,732,000	2,059,00
Segment gain (loss) after allocated overhead and before income taxes	13,418,000	(8,277,00
Segment assets	22,973,000	16,685,00
Goodwill	1,992,000	

NINE MONTHS ENDED SEPTEMBER 30, 2005	PSN	HMO
Revenues from external customers	$136,218,000	$ 471,00
Segment gain (loss) before allocated overhead	12,244,000	(4,086,00
Allocated corporate overhead	2,377,000	1,063,00
Segment gain (loss) after allocated overhead and before income taxes	9,867,000	(5,149,00
Segment assets	24,888,000	4,567,00
Goodwill	1,992,000	

THREE MONTHS ENDED SEPTEMBER 30, 2006	PSN	HMO
Revenues from external customers	$ 52,316,000	$ 8,522,00
Segment gain (loss) before allocated overhead	7,659,000	(2,049,00
Allocated corporate overhead	914,000	627,00
Segment gain (loss) after allocated overhead and before income taxes	6,745,000	(2,676,00

THREE MONTHS ENDED SEPTEMBER 30, 2005	PSN	HMO
Revenues from external customers	$ 44,529,000	$ 471,00
Segment gain (loss) before allocated overhead	4,241,000	(2,354,00
Allocated corporate overhead	558,000	446,00
Segment gain (loss) after allocated overhead and before income taxes	3,683,000	(2,800,00

NOTE 7. SUBSEQUENT EVENTS

On November 11, 2006, management and the Audit & Finance Committee of the Board of Directors of the Company concluded that the unaudited consolidated financial statements included in the Company's Quarterly Reports on Form 10-Q as of and for the quarters ended March 31, 2006 and June 30, 2006 should be restated to reflect a correction of such financial statements related to the Company's over-recording of revenues generated by the PSN during such quarters.

More specifically, the Company determined that it over-recorded revenues generated by the PSN by approximately $666,000 during each of the first quarter and second quarter of 2006. During 2005, the majority of Humana, Inc. members serviced by the PSN in the PSN's Daytona market were required to pay a monthly premium of $15 to Humana, Inc. (the "Monthly Premium"). As part of its monthly capitation payments from Humana, Inc., the Company was paid approximately $12 of the Monthly Premium per member. Commencing in January 2006, as a result of a change in health plan benefits, the Monthly Premium was eliminated in the Daytona market. However, the data the Company received from Humana, Inc. from January 2006 until July 2006 regarding the revenues the Company were entitled to receive from Humana, Inc., inadvertently continued to reflect the Monthly Premium and, accordingly, the Company was over-paid by Humana, Inc. and over-recorded its net revenues and accounts receivable by approximately $666,000 in the first quarter of 2006 and the second quarter of 2006.

Accordingly, the Company's financial statements contained within its Quarterly Report on Form 10-Q for each of the quarters ended March 31, 2006 and June 30, 2006 should not be relied upon.

On November 14, 2006, the Company:

- restated its previously issued financial statements for the first quarter of 2006 by amending its Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2006; and

- restated its previously issued financial statements for the second quarter of 2006 by amending its Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2006.

Management and the Audit & Finance Committee discussed these issues with the Company's independent registered public accounting firm, Grant Thornton, LLP.

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

THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH THE OUR ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2005, AS WELL AS THE FINANCIAL STATEMENTS AND NOTES THERETO.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

- the PSN's ability to renew the Humana Agreements and maintain the Humana Agreements on favorable terms;
- our ability to adequately predict and control medical expenses and to make reasonable estimates and maintain adequate accruals for incurred but not reported, or IBNR, claims; and
- the HMO's ability to renew, maintain or to successfully rebid for its agreement with CMS.

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

- reductions in government funding of Medicare programs;
- disruptions in the PSN's, the HMO's or Humana's healthcare provider networks;
- failure to receive claims processing, billing services, data collection and other information on a timely basis from Humana;
- future legislation and changes in governmental regulations;
- increased operating costs;
- the impact of Medicare Risk Adjustments on payments we receive for our managed care operations;

- loss of significant contracts;
- general economic and business conditions;
- increased competition;
- the relative health of our patients;
- changes in estimates and judgments associated with our critical accounting policies;

- federal and state investigations;
- our ability to successfully recruit and retain key management personnel and qualified medical professionals; and
- impairment charges that could be required in future periods.

Additional information concerning these and other risks and uncertainties is contained in our filings with the Securities and Exchange Commission (the "Commission"), including the sections entitled "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2005 and our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2006 and June 30, 2006.

Forward-looking statements should not be relied upon as a prediction of actual results. Subject to any continuing obligations under applicable law or any relevant listing rules, we expressly disclaim any obligation to disseminate, after the date of this Quarterly Report on Form 10-Q, any updates or revisions to any such forward-looking statements to reflect any change in expectations or events, conditions or circumstances on which any such statements are based.

On November 14, 2006, the Company filed amendments to its Quarterly Reports on Form 10-Q as of and for the quarters ended March 31, 2006 and June 30, 2006 to restate the financial statements included therein. See "Note 7 to the Condensed Consolidated Financial Statements" of each of the quarterly reports referenced herein for further information.

BACKGROUND

Through our provider service network ("the PSN") and our health maintenance organization ("the HMO"), we currently provide healthcare benefits to Medicare beneficiaries in Florida. As of September 30, 2006, the PSN and the HMO provided healthcare benefits to approximately 25,900 and 3,500 Medicare Advantage beneficiaries, respectively (collectively, the "Participating Members").

Substantially all of our revenues are directly or indirectly derived from reimbursements generated by Medicare Advantage health plans. As a result, our revenue and profitability are dependent on government funding levels for Medicare Advantage programs.

Provider Service Network

Pursuant to two contracts with Humana, Inc. (the "Humana Agreements"), the nation's second largest participant in the Medicare Advantage program ("Humana"), the PSN provides, on a non-exclusive basis, healthcare services to Medicare beneficiaries in Flagler and Volusia Counties ("Central Florida") and Palm Beach, Broward and Miami-Dade Counties ("South Florida") who have elected to receive benefits from Humana's Medicare Advantage Plans. As of September 30,

2006, the Humana Agreements covered approximately 19,400 Humana Plan Members (as defined below) in Central Florida and 6,500 Humana Plan Members in South Florida.

The PSN is comprised both of medical practices owned by us as well as independently owned medical practices and providers with whom it has contracted ("IPs"). We currently own and operate eight primary care physician practices and a medical oncology physician practice. We also contract with twenty-nine primary care IPs. Through the Humana Agreements, the PSN has established referral relationships with a large number of specialist physicians, ancillary service providers and hospitals throughout South Florida and Central Florida.

Humana directly contracts with the Centers for Medicare and Medicaid Services ("CMS") and is paid a monthly premium payment for each member ("Humana Plan Member") enrolled in Humana's Medicare Advantage Plan. The monthly amount varies by patient, county, age and severity of health status. Pursuant to the Humana Agreements, the PSN provides or arranges for the provision of covered medical services to each Humana Plan Member who selects one of our affiliated providers as his or her primary care physician (a "Humana Participating Member"). In return for the provision of these medical services, the PSN receives from Humana a monthly fee, also known as a "capitated fee", for each Humana Participating Member. The fee rates are established by the contracts between the PSN and Humana and comprise a vast majority of the monthly premiums received by Humana from CMS with respect to Humana Participating Members.

The PSN assumes the full financial responsibility for the provision of all Medicare-covered medical care to Humana Participating Members, including those medical services that the PSN does not itself provide. To the extent the costs of providing such medical care are less than the related premiums received from Humana, the PSN generates an operating profit. Conversely, if the medical costs exceed the fees received from Humana, the PSN experiences an operating loss.

The vast majority of the PSN's revenues come from the Humana Agreements. We do receive additional revenue for providing primary care services to non-Humana Plan Members on a fee-for-service basis in the medical practices we own and operate.

For the three and nine months ended September 30, 2006, approximately 85% and 88%, respectively, of our revenue was generated pursuant to the Humana Agreements. The Humana Agreements have one-year terms and renew automatically each December 31 for additional one-year terms unless terminated for cause or upon 180 days prior notice. Failure to maintain the Humana Agreements on favorable terms would adversely affect our results of operations and financial condition.

Health Maintenance Organization

Effective July 1, 2005, the HMO became licensed as a Medicare Advantage HMO and entered into a contract with CMS (the "CMS Agreement") to begin offering Medicare Advantage plans to Medicare beneficiaries in six Florida counties which include the cities of Fort Pierce, Port St. Lucie, Fort Myers, Port Charlotte and Sarasota. The HMO has been marketing its "AdvantageCare" branded plan since July 2005. The HMO is seeking to expand its HMO and as of September 30, 2006, the total number of enrollees in its plan was approximately 3,500.

In addition to growth within existing service areas, the HMO is expanding its business into new geographic areas. However, we do not intend to provide HMO services in the geographic markets with respect to which the PSN has a contract

with Humana. We view our HMO business as an extension of our existing core competencies.

The HMO's revenues are generated by premiums consisting of monthly payments per member that are established by the CMS Agreement. The HMO recorded its first revenues in the third quarter of fiscal 2005.

The Humana Agreements and the CMS Agreement are risk agreements under which the PSN and the HMO, respectively, receive monthly payments per Participating Member at a rate established by the agreements, also called a capitated fee. In accordance with the agreements, the total monthly payment is a function of the number of Participating Members, regardless of the actual utilization rate of covered services.

To the extent that the Participating Members require more care than is anticipated, aggregate capitation rates may be insufficient to cover the costs associated with the treatment of such members. If medical expenses exceed our estimates, except in very limited circumstances, we will be unable to increase the premiums we receive under these contracts during the then-current terms.

Relatively small changes in our ratio of medical expense to revenue can create significant changes in our financial results. Accordingly, the failure to adequately predict and control medical expenses and to make reasonable estimates and maintain adequate accruals for incurred but not reported, or IBNR, claims, may have a material adverse effect on our financial condition, results of operations and/or cash flows.

Although we have operated as a risk provider since 1997, we have only operated the HMO since July 1, 2005. While the HMO's business has continued to grow, such growth has continued to require capital. In the nine months ended September 30, 2006, the HMO's business generated a $6.2 million segment loss before allocated overhead and income taxes. We project that in fiscal 2006, the HMO's business will generate a loss of $8 million to $10 million before allocated overhead and income taxes. The amount of the loss will be determined by a number of factors including membership, medical utilization and related costs, and our decisions related to expansion and growth efforts. We are still not in a position to meaningfully estimate when, if ever, the HMO's business will become profitable and/or generate cash from operations and we may be required to fund the development and expansion of the HMO business, including any associated losses, for an extended period of time. Nonetheless, we anticipate that the on-going development efforts, reserve requirements and operating costs for our still developing HMO business can be funded by our current resources and projected cash flows from operations until at least September 30, 2007.

To successfully operate the HMO, we believe we will have to continue our development of the following capabilities, among others: sales and marketing, customer service and regulatory compliance. No assurances can be given that we will be successful in operating this segment of our business despite our allocation of a substantial amount of resources for this purpose. If the HMO does not develop as anticipated or planned, we may have to devote additional managerial and/or capital resources to the HMO, which could limit our ability to manage and/or grow the PSN. There can be no assurances that, if for any reason, we elect to discontinue the HMO business and/or seek to sell such business, we will be able to fully recoup our expenditures to date with respect to the HMO business.

CRITICAL ACCOUNTING POLICIES

Our significant accounting policies are described in Note 1 of the "Notes to Condensed Consolidated Financial Statements" included in this Form 10-Q. We believe our most critical accounting policies include the policies set forth below.

USE OF ESTIMATES

Revenue, Expense and Receivables

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements. The most significant area requiring estimates relates to the PSN's arrangements with Humana. Such estimates are based on knowledge of current events and anticipated future events, and accordingly, actual results may ultimately differ materially from those estimates.

With regard to virtually all of the revenues, expenses and receivables arising from the Humana Agreements, the Company estimates the amounts it believes will ultimately be realizable based in part upon estimates of claims incurred but not reported ("IBNR") and estimates of retroactive adjustments or unsettled costs to be applied by Humana. The IBNR estimates are made by Humana utilizing actuarial methods and are continually evaluated by management of the Company based upon its specific claims experience. It is reasonably possible that some or all of these estimates could change in the near term by an amount that could be material to the financial statements.

From time to time, Humana charges the PSN for certain medical expenses, which the Company believes are erroneous or are not supported by the Humana Agreements. Management's estimate of recovery on these contestations is based upon its judgment and its consideration of several factors including the nature of the contestations, historical recovery rates and other qualitative factors.

During 2005, the Company incurred approximately $4.0 million of medical costs related to the implantation of certain Implantable Automatic Defibrillators ("AICD's"). CMS directed that the costs of certain of these procedures that met 2005 eligibility requirements be paid by CMS, rather than billed to Medicare Advantage plans. The Company is working with Humana and the related providers to secure reimbursement for these amounts, and estimated a recovery of approximately $2.2 million at December 31, 2005. Approximately $379,000 of this amount was collected during the nine months ended September 30, 2006, while an additional $500,000 was written off in the second quarter of 2006 due to revised guidance issued by CMS in July 2006 regarding the costs payable by CMS in connection with these procedures. During the quarter ended September 30, 2006, the Company recorded an additional $500,000 reserve against this receivable to reflect management's concerns about the ultimate collection of these receivables. Accordingly, related accounts receivable in the accompanying consolidated balance sheets were $772,000 and $2.2 million at September 30, 2006 and December 31, 2005, respectively. It is reasonably possible that this estimate could change in the near term by an amount that could be material to the financial statements.

Included in revenues for the quarter and nine months ended September 30, 2006 were estimated amounts payable to the Company as a result of funding increases under the Medicare risk adjustment ("MRA") program. The purpose of the MRA program is to use health status indicators to improve the accuracy of payments and establish incentives for plans to enroll and treat less healthy Medicare beneficiaries. From 2000 to 2003, risk adjustment payments accounted for only

10% of the payment made by CMS to the Medicare health plans, with the remaining 90% based on demographic factors. In 2004 and 2005, the percentage of payment attributable to risk adjustment was increased to 30% and 50%, respectively. The percentage of payment attributable to risk has increased to 75% in 2006, with the 100% phase-in of risk-adjusted payment expected in 2007. We accrued approximately $5.4 million during the nine months ended September 30, 2006 related to incremental revenues anticipated to be received as a result of the MRA funding increases. $4.2 million has been received during the first nine months of 2006. Accounts receivable in the accompanying consolidated balance sheets at September 30, 2006 include $1.2 million of accrued MRA receivables that we expect to be received during the fourth quarter of 2006 and in the first quarter of 2007. It is reasonably possible that this estimate could change in the near term by an amount that could be material to the financial statements.

Non-Humana fee-for-service accounts receivable, aggregating to approximately $1,155,000 and $797,000 at September 30, 2006 and December 31, 2005, respectively, relate principally to medical services provided on a non-capitated basis, and are reduced by amounts estimated to be uncollectible (approximately $798,000 and $555,000 at September 30, 2006 and December 31, 2005, respectively). Management's estimate of uncollectible amounts is based upon its analysis of historical collections and other qualitative factors, however it is possible the Company's estimate of uncollectible amounts could change in the near term. In addition, accounts receivable at September 30, 2006 and December 31, 2005 includes approximately $519,000 and $159,000, respectively, due to the HMO from CMS and HMO enrollees, which is reduced by amounts estimated to be uncollectible at September 30, 2006 in the amount of $17,000.

With regards to the HMO, the cost of medical benefits is recognized in the period in which services are provided and includes an IBNR estimate based on management's best estimate of medical benefits payable. It is reasonably possible that some or all of these estimates could change in the near term by an amount that could be material to the financial statements.

The HMO memberships' average risk adjustment factor declined from December 2005 to June 2006 as a result of a large influx of new members in 2006. This decline resulted in decreased average member monthly premiums. The Company believes that the actual average risk adjustment factor for its population during this period was higher and that an increase will be reflected as claims and health data for these new members are entered into the CMS system, which is expected to result in retroactive premium adjustments. The Company has estimated the retroactive premium adjustment to be approximately $534,000 at September 30, 2006.

Accounting for Prescription Drug Benefits under Medicare Part D

On January 1, 2006, the HMO and the PSN, through the Humana Agreements, began covering prescription drug benefits in accordance with the requirements of Medicare Part D, to the HMO's and PSN's Medicare Advantage members. The benefits covered under Medicare Part D are in addition to the benefits covered by the HMO and the PSN under Medicare Parts A and B.

In general, pursuant to Medicare Part D, pharmacy benefits may vary in terms of coverage levels and out-of-pocket costs for beneficiary premiums, deductibles and co-insurance. However, all Part D plans must offer either "standard coverage" or its actuarial equivalent (with out-of-pocket threshold and deductible amounts that do not exceed those of standard coverage). These "defined standard" benefits represent the minimum level of benefits mandated by Congress. In addition to defined standard plans offered by the HMO, the PSN, through the Humana Agreements, offers certain prescription drug plans containing benefits in excess of the standard coverage limits.

The payment the Company's HMO receives monthly from CMS for coverage under Medicare Part D (the "CMS Payment") generally represents the HMO's bid amount

for providing Part D insurance coverage. The Company recognizes premium revenue for the HMO's provision of this Part D insurance coverage ratably over the term of the CMS Agreement. However, the ultimate amount of the CMS Payment is subject to 1) risk corridor adjustments and 2) subsidies provided by CMS in order for the HMO and CMS to share the risk associated with financing the ultimate costs of the Medicare Part D benefit.

The CMS payment is subject to adjustment, positive or negative, based upon the application of risk corridors that compare the prescription drug benefit costs estimated by the HMO in making its bid to CMS (the "Estimated Costs") to actual incurred prescription drug benefit costs (the "Actual Costs"). For 2006 and 2007, in accordance with federal regulations, the HMO will bear all gains and losses that fall within 2.5% of its Estimated Costs. To the extent the Actual Costs exceed the Estimated Costs by more than 2.5%, CMS may make additional payments to the HMO. Conversely, to the extend the Estimated Costs exceed the Actual Costs by more than 2.5%, the HMO may be required to refund to CMS a portion of the CMS Payment. Actual Costs subject to risk sharing with CMS are limited to the costs that are, or would have been, incurred under the CMS "defined standard" benefit plan. The Company estimates and recognizes an adjustment to premium revenues from CMS related to the risk corridor payment adjustment based upon pharmacy claims experience to date as if the CMS Agreement were to end at the end of each reporting period. Accordingly, this estimate does not take into consideration projected future pharmacy claims experience. It is reasonably possible that this estimate could change in the near term by an amount that could be material.

Certain subsidies represent reimbursements from CMS for claims the HMO paid for even though it is not ultimately required to bear the risk in connection with such claims. These include federally reinsured claims where a MetHMO member's actual drug spending reaches Part D's annual catastrophic threshold and certain deductible, coinsurance and co-payment amounts for low-income beneficiaries. The Company accounts for these subsidies as current liabilities in its balance sheet and as an operating activity in its statement of cash flows. The Company does not recognize premium revenue or claims expense for these subsidies.

The HMO recognizes pharmacy benefit costs as incurred. It has subcontracted the pharmacy claims administration to a third party pharmacy benefit manager.

With regards to the PSN, the Company receives Medicare Part D revenue pursuant to the applicable percent of premium provided for in the Humana Agreements. Humana does not provide the Company with a separate accounting for the incremental amount of the Part D premium and expense. As with the HMO, the Company recognizes pharmacy benefit costs as such costs are incurred by the PSN. With regards to the estimated amount of any risk corridor adjustments, the Company has relied upon estimates provided by Humana to the Company and has recorded a downward adjustment to premium revenue based on these estimates. It is reasonably possible that this estimate could change in the near term by an amount that could be material.

Deferred Tax Asset

The Company has recorded a deferred tax asset of approximately $6.0 million at September 30, 2006. Realization of the deferred tax asset is dependent on generating sufficient taxable income in the future. The amount of the deferred tax asset considered realizable could change in the near term if estimates of future taxable income are modified and those changes could be material.

In the future, if the Company determines that it cannot, on a more likely than

not basis, realize all or part of its deferred tax assets in the future, an adjustment to establish (or record an increase in) the deferred tax asset valuation allowance would be charged to income in the period in which such determination is made.

Stock-Based Compensation Expense

Effective January 1, 2006, the Company adopted SFAS 123(R) using the modified prospective transition method. SFAS 123(R) requires the Company to recognize compensation costs related to share-based payment transactions with employees in its financial statements. SFAS 123(R) requires the Company to calculate this cost based on the grant date fair value of the equity instrument. Consistent with its prior disclosures under SFAS 123, the Company elected to calculate the fair value of its employee stock options using the Black-Scholes option pricing model. Based on the Black-Scholes model and its assumptions, the Company recognized stock-based employee compensation expense of approximately $182,000 and $546,000 for the quarter and nine months ended September 30, 2006, respectively (See "Notes to Condensed Consolidated Financial Statements," Note 3.").

SFAS 123(R) does not require the use of any particular option valuation model. Because the Company's stock options have characteristics significantly different from traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, it is possible that existing models may not necessarily provide a reliable measure of the fair value of the Company's employee stock options. It selected the Black-Scholes model based on prior experience with it, its wide use by issuers comparable to the Company, and the Company's review of alternate option valuation models. Based on these factors, the Company believes that the Black-Scholes model and the assumptions it made in applying it provide a reasonable estimate of the fair value of its employee stock options.

The effect of applying the fair value method of accounting for stock options on reported net income for any period might not be representative of the effects for future periods because outstanding options typically vest over a period of several years and additional awards may be made in future periods.

RESULTS OF OPERATIONS

We recognized Revenues, net of $60.8 million for the quarter ended September 30, 2006 compared to $45 million in quarter ended September 30, 2005, an increase of $15.8 million, or 35.2%. Net income for the quarter ended September 30, 2006 was $2.5 million compared to $539,000 for the quarter ended September 30, 2005.

For the nine months ended September 30, 2006, we recognized Revenues, net of $172.5 million compared to $136.7 million for the nine months ended September 30, 2005, an increase of $35.8million, or 26.2%. Net income for the nine months ended September 30, 2006 was $3.2 million compared to $2.9 million for the nine months ended September 30, 2005.

Net Earnings Per Share, Basic was $.05 and $.01 for the quarters ended September 30, 2006 and 2005, respectively. The weighted average shares outstanding for the quarter increased from 49,269,000 at September 30, 2005 to 50,108,000 at September 30, 2006.

For the nine months ended September 30, 2006 and 2005, Net Earnings Per Share, Basic was $.06 and $.06, respectively. The weighted average shares outstanding for the nine-month period increased from 48,716,000 at September 30, 2005 to

49,981,000 at September 30, 2006.

In both 2005 and 2006, we operated in two financial reporting segments, the PSN business and the Medicare Advantage HMO business, which began enrolling members effective July 1, 2005. The PSN reported a Segment gain (loss) before allocated overhead of $7.7 million and $16.1 million for the quarter and nine months ended September 30, 2006, respectively, compared to $4.2 million and $12.2 million for the quarter and nine months ended September 30, 2005, respectively. The HMO incurred a Segment loss before allocated overhead of $2.0 million and $6.2 million for the quarter and nine months ended September 30, 2006, compared to $2.4 million and $4.1 million for the quarter and nine months ended September 30, 2005, respectively.

MEMBERSHIP

The PSN

As of September 2006, the PSN was providing healthcare services to approximately 25,900 Humana Participating Members as compared to approximately 26,700 Humana Participating Members in September 2005, a decrease of 800 members or 3%. Effective October 1, 2005, we discontinued our contractual obligation with a number of our South Florida physician practices due to non-compliance with our policies and procedures. These centers accounted for approximately 700 members.

Humana Participating Member months, which is defined as the aggregate of the PSN's Humana Plan membership for each month during the fiscal quarter, decreased to approximately 77,500 for third quarter 2006 from approximately 79,900 for third quarter 2005. Humana Participating Member months for the nine months ended September 30, 2006 were approximately 232,500 as compared to 239,200 for the nine months ended September 30, 2005, a decrease of 6,700 member months. As discussed above, we discontinued our contractual obligation with a number of our South Florida physician practices due to non-compliance with our policies and procedures in 2005. These centers accounted for approximately 6,500 member months for the nine months ended September 30, 2005.

The HMO

The HMO commenced operations in July 2005. As of September 2006, there were approximately 3,500 Participating Members enrolled in the HMO, compared to 500 in September 2005. The HMO's Participating Member months was approximately 10,300 and 24,700 for the quarter and nine months ended September 30, 2006. The HMO's marketing efforts during the first nine months of 2006 have generated approximately 2,100 net additional members.

COMPARISON OF THE QUARTERS ENDED SEPTEMBER 30, 2006 AND SEPTEMBER 30, 2005

REVENUES

Revenues, net for the quarter ended September 30, 2006 increased $15.8 million, or 35.2%, over the quarter ended September 30, 2005, from $45.0 million to $60.8 million.

The PSN

Our most significant revenue component during both the third quarter of 2005 and the third quarter of 2006 was the premium revenue generated pursuant to the Humana Agreements (the "Humana Related Revenue"). The Humana Related Revenue increased from $44.3 million in the third quarter of 2005 to $52.0 million in

the third quarter of 2006, an increase of approximately $7.7 million or 17.3%. Included in revenue during this period was $763,000 of MRA retroactive adjustments related to prior years. Average per member per month revenue increased approximately $671 in the third quarter of 2006 compared to $554 in the third quarter of 2005. The increased per member per month premium accounted for a total revenue increase of approximately $9.3 million which was partially offset by the 2,400 decrease in Humana Participating Member months or $1.6 million.

The HMO

Revenues for the HMO, which began enrolling members in July 2005, amounted to $8.5 million for the third quarter of 2006 as compared to $471,000 for the third quarter of 2005. Average per member per month premiums amounted to approximately $825 in the third quarter of 2006.

OPERATING EXPENSES

Total Medical Expenses

Total medical expenses represent the total costs of providing patient care and are comprised of two components, direct medical costs and other medical costs.

Direct medical costs include the costs of medical services provided to Participating Members by providers other than our affiliated providers ("Non-Affiliated Providers"). Approximately 95% of our Total medical expenses are attributable to the costs of medical services provided by Non-Affiliated Providers. Other medical costs include costs associated with the operations of our wholly owned physician practices and oncology center including salaries and benefits, supplies, malpractice insurance and office related expenses.

Total medical expenses totaled $52.2 million and $40.1 million for the quarters ended September 30, 2006 and 2005, respectively. The ratio of the Company's Total medical expense as a percentage of Revenue, ("MER"), improved to 85.8% in the third quarter of 2006 from 89.2% in the third quarter of 2005.

The PSN's MER improved to 83.8% in the quarter ended September 30, 2006 compared to 89.3% in the year earlier period. A number of factors contributed to this improvement, including, but not limited to, improved utilization trends, prior year MRA adjustments included in revenues during the period and the termination of certain South Florida medical practices in October 2005, which practices generated an average MER of greater than 100%.

The HMO's MER was 98.3% for the third quarter of 2006. Due to its relatively small membership, our HMO's operations are volatile from a medical utilization standpoint. We expect that the volatility will decline as membership grows and anticipate that the HMO's MER will decrease in future periods.

Administrative Payroll, Payroll Taxes and Benefits

Administrative payroll, payroll taxes and benefits include salaries and related costs for our executive and administrative staff. For the quarter ended September 30, 2006, administrative payroll, payroll taxes and benefits were $2.5 million, compared to $1.5 million for the quarter ended September 30, 2005. Costs associated with the HMO accounted for the $300,000 of the incremental increases in expenses. In addition, we incurred $200,000 of stock option related non-cash expenses and $130,000 in incremental bonus and 401(k) contribution accruals. The HMO had 55 employees at September 30, 2006 compared in 26 a September 30, 2005. The PSN's and corporate administrative headcount totaled 131 employees at September 30, 2006, an increase of 9 as compared to September 30, 2005.

Marketing and Advertising

Marketing and advertising expense for the third quarter of 2006 was $203,000, compared to expenses of $1.3 million in the third quarter of 2005. During the third quarter of 2005, we were conducting an open enrollment and launching our HMO . The Medicare industry entered its first lock-in period effective May 15, 2006. During this lock-in period, which continues until November 15, 2006, most people are not eligible to join or switch Medicare Advantage plans. The next open enrollment period begins November 15, 2006 and will extend until March 30, 2006. Based on the limited ability to enroll members, our marketing and sales efforts and expenditures decreased in the quarter ended September 30, 2006.

General and Administrative

General and administrative expenses for the third quarter of 2006 amounted to $2.1 million, an increase of $849,000 over the third quarter of 2005. Approximately $500,000 of the increase is attributable to expenses incurred in connection with the HMO, including $250,000 for claims processing, $100,000 of incremental stoploss insurance premiums, and $100,000 in legal and accounting fees.

OTHER INCOME AND EXPENSE

Total other income for the third quarter of 2006 totaled $305,000 as compared to $126,000 in the third quarter of 2005, primarily the result of increased cash balances and higher interest rates.

COMPARISON OF THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND SEPTEMBER 30, 2005

REVENUES

Revenues, net for the nine months ended September 30, 2006 increased $35.8 million, or 26.2%, over the nine months ended September 30, 2005, from $136.7 million to $172.5 million.

The PSN

Our most significant revenue component during both the nine months ending September 30, 2005 and the nine months ending September 30, 2006 was the Humana Related Revenue. The Humana Related Revenue increased from $135.1 million in the nine months ended September 30, 2005 to $151.6 million in the nine months ended September 30, 2006, an increase of approximately $16.5 million or 12.2%. Included in revenue during this period was $4.2 million of MRA retroactive adjustments related to prior years. Average per member per month revenue was approximately $652 in the nine months ended September 30, 2006 compared to $565 in the nine months ended September 30, 2005. The increased per member per month premium accounted for a total revenue increase of approximately $20.8 million which was partially offset by the 6,700 decrease in Humana Participating Member months or $4.3 million.

The HMO

Revenues for the HMO, which began enrolling members in July 2005, amounted to $19.9 million for the nine months ending September 30, 2006 as compared to $471,000 for the nine months ended September 30, 2005. Average per member per month premiums amounted to approximately $806 in the nine months ended September 30, 2006.

OPERATING EXPENSES

Total Medical Expenses

Total medical expenses represent the total costs of providing patient care and are comprised of two components, direct medical costs and other medical costs.

Direct medical costs include the costs of medical services provided to Participating Members by providers other than our affiliated providers ("Non-Affiliated Providers"). Approximately 95% of total medical expenses are attributable to the costs of medical services provided by Non-Affiliated Providers. Other medical costs include costs associated with the operations of our wholly owned physician practices and oncology center including salaries and benefits, supplies, malpractice insurance and office related expenses.

Total medical expenses totaled $152.6 million and $122.7 million for the nine months ended September 30, 2006 and 2005, respectively. Our MER improved to 88.5% in the nine months ended September 30, 2006 compared to 89.8% in the nine months ending September 30, 2005.

The PSN's MER improved to 87.8% in the nine months ended September 30, 2006 compared to 89.8% in the nine months ended September 30, 2005. A number of factors contributed to the decrease including, among other things, improved utilization trends, prior year MRA adjustments included in revenues during the period and the termination of certain South Florida medical practices in October 2005, which practices generated an average MER of greater than 100%.

The HMO's MER was 94.1% for the nine months ended September 30, 2006. Due to its relatively small membership, our HMO's operations are volatile from a medical utilization standpoint. We expect that the volatility will decline as membership grows and anticipate that the HMO's MER will decrease in future periods.

Administrative Payroll, Payroll Taxes and Benefits

Administrative payroll, payroll taxes and benefits include salaries and related costs for our executive and administrative staff. For the nine months ended September 30, 2006, administrative payroll, payroll taxes and benefits were $7.5 million, compared to $4.2 million for the nine months ended September 30, 2005. Costs associated with the HMO accounted for the $1.4 million of the incremental increases in expenses. In addition, we incurred $546,000 of stock option related non-cash expenses and $390,000 in incremental bonus and 401(k) contribution accruals. The HMO had 55 employees at September 30, 2006 compared to 26 September 30, 2005. The PSN's and corporate administrative headcount totaled 131 employees at September 30, 2006, an increase of 9 since September 30, 2005.

Marketing and Advertising

Marketing and advertising expense for the nine months ended September 30, 2006 was $2.2 million, compared to expenses of $1.4 million in the nine months ended September 30, 2005. We operated our HMO for the full first nine months of 2006 during which time we incurred marketing and advertising expenses. The HMO commenced operations in July 2005 and we incurred significant marketing and advertising expenses only in the third quarter of the year.

The Medicare industry entered its first lock-in period effective May 15, 2006 that extends to November 15, 2006 during which period most people with Medicare cannot join or switch Medicare Advantage plans. The next open enrollment period begins November 15, 2006 and will extend to March 30, 2007. Based on the limited

ability to enroll members, our marketing and sales efforts and expenditures decreased in the quarter ended September 30, 2006.

General and Administrative

General and administrative expenses for the nine months ended September 30, 2006 amounted to $5.7 million, an increase of $1.7 million over the third quarter of 2005. Approximately $1.1 million of the increase is attributable to the expenses incurred in connection with the HMO, including $560,000 for claims processing, $175,000 of incremental stoploss insurance premiums, and $100,000 in legal and accounting fees.

OTHER INCOME AND EXPENSE

Total other income in the nine months ended September 30, 2006 totaled $719,000 as compared to $393,000 in the nine months ended September 30, 2005, primarily the result of increased cash balances and higher interest rates.

LIQUIDITY AND CAPITAL RESOURCES

Total Cash and equivalents and Short-term investments at September 30, 2006 totaled approximately $25.1 million compared to approximately $15.6 million at December 31, 2005. As of September 30, 2006, $9.6 million of our Cash and equivalents and Short-term investments were in accounts established for the HMO. While available to fund ongoing operations for the HMO, these balances are not otherwise available for non-HMO operations or other general corporate uses. As of September 30, 2006, we had a working capital surplus of approximately $25.6 million, compared to a surplus of approximately $21.1 million as of December 31, 2005, an increase of $4.5 million.

Our Total stockholder equity increased approximately $3.9 million, from approximately $29.7 million at December 31, 2005 to approximately $33.6 million at September 30, 2006.

At September 30, 2006, we had no outstanding debt.

Net cash provided by operating activities for the nine months ended September 30, 2006 was approximately $10.9 million. The largest sources of cash from operating activities were:

- $3.4 million in cash generated from an increase in estimated medical expenses payable;
- $3.2 million of cash generated from net income;
- $1.9 million in cash generated from a decrease in deferred income taxed;
- $1.3 million of cash generated by an increase in advance and unearned premiums;
- $546,000 of cash generated from an increase in stock based compensation expense;
- $527,000 of cash generated from an increase in accrued expenses;
- $379,000 of cash generated from depreciation and amortization;

- $168,000 of cash generated by an increase in accounts payable; and
- $116,000 of cash generated by a decrease in other current assets.

These sources of cash were partially offset by the following uses of cash:

- $576,000 increase in prepaid expenses; and
- $89,000 increase in accounts receivable.

Net cash used in investing activities for the nine months ended September 30, 2006 was approximately $7.3 million. The Company purchased $5.8 million of short-term investments and incurred $1.6 million in capital expenditures during the first nine months of 2006.

The Company's financing activities for the nine months ended September 30, 2006 provided approximately $141,000 of cash in connection with the issuance of common stock upon the exercise of outstanding options.

During 2005, we incurred approximately $4.0 million of medical costs related to the implantation of certain Implantable Automatic Defibrillators ("AICD's"). CMS directed that the costs of certain of these procedures that met 2005 eligibility requirements be paid by CMS, rather than billed to Medicare Advantage plans. We are working with Humana and the related providers to secure reimbursement for these amounts, and estimated a recovery of approximately $2.2 million at December 31, 2005. Approximately $379,000 of this amount was collected during the nine months ended September 30, 2006, while an additional $500,000 was written off in the second quarter of 2006 due to revised guidance issued by CMS regarding the costs payable by CMS in connection with these procedures. An additional reserve of $500,000 was recorded during the quarter ending September 30, 2006 reflecting our concerns regarding the ultimate collection of these recoveries and the timing of the collections.

On May 6, 2005 the Company executed an unsecured commercial line of credit agreement with a bank, which provided for borrowings and issuance of letters of credit of up to $1.0 million. The credit line expired on March 31, 2006 and was automatically renewed for a one-year period until March 31, 2007. The outstanding balance, if any, bears interest at the bank's prime rate. The credit facility requires the Company to comply with certain financial covenants, including a minimum liquidity requirement of $2.0 million. As of September 30, 2006, the availability under the line of credit secures a $1.0 million letter of credit that the Company has caused to be issued in favor of Humana. As of September 30, 2006, the Company has not borrowed funds under this commercial line of credit.

Although we have operated as a risk provider since 1997, we have only operated the HMO since July 1, 2005. While the HMO's business has continued to grow, such growth has continued to require capital. In the nine months ended September 30, 2006, The HMO's business generated a $6.2 million segment loss before allocated overhead and income taxes. We project that in fiscal 2006, the HMO's business will generate a loss of $8 million to $10 million before allocated overhead and income taxes. The amount of the loss will be determined by a number of factors including membership, medical utilization and related costs, and our decisions related to expansion and growth efforts. We are still not in a position to meaningfully estimate when, if ever, the HMO's business will become profitable and/or generate cash from operations and may be required to fund the development and expansion of the HMO business, including any associated losses, for an extended period of time. Nonetheless, we anticipate that the on-going development efforts, reserve requirements and operating costs for our still developing HMO business can be funded by our current resources and projected cash flows from operations until at least September 30, 2007.

To successfully operate the HMO, we believe we will have to continue our development of the following capabilities, among others: sales and marketing, customer service and regulatory compliance. No assurances can be given that we will be successful in operating this segment of our business despite our allocation of a substantial amount of resources for this purpose. If The HMO does not develop as anticipated or planned, we may have to devote additional managerial and/or capital resources to the HMO, which could limit our ability to manage and/or grow The PSN. There can be no assurances that, if for any reason, we elect to discontinue the HMO business and/or seek to sell such business, we will be able to fully recoup our expenditures to date with respect to the HMO business.

In 2004, we adopted an investment policy with respect to the investment of our Cash and equivalents. The investment policy goal is to obtain the highest yield possible while investing only in highly rated instruments or investments with nominal risk of loss of principal. The investment policy sets forth a list of "Permitted Investments" and provides that the Chief Financial Officer or the Chief Executive Officer must approve any exceptions to the policy. We had approximately $5.8 million of short-term investments as of September 30, 2006 compared to none at December 31, 2005.

OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any Off-Balance Sheet Arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk

Market risk generally represents the risk of loss that may result from the potential change in value of a financial instrument as a result of fluctuations in interest rates and market prices. At September 30, 2006, the Company had only commercial paper, certificates of deposit and cash equivalents invested in high grade, short-term and long-term securities, which are not typically subject to material market risk. The Company has established policies and internal processes related to the management of market risks, which it uses in the normal course of its business operations.

Interest Rate Risk

The Company believes a change in interest rates would not have a material impact on its financial condition, future results of operations or cash flows.

Intangible Asset Risk

The Company has a substantial amount of intangible assets. It is required to perform goodwill impairment tests whenever events or circumstances indicate that the carrying value may not be recoverable from estimated future cash flows. As a result of its periodic evaluations, the Company may determine that the intangible asset values need to be written down to their fair values, which could result in material charges that could be adverse to its operating results and financial position. Although at September 30, 2006 the Company believes its intangible assets were recoverable, changes in the economy, the business in which it operates and its own relative performance could change the assumptions

used to evaluate intangible asset recoverability. The Company continues to monitor those assumptions and their effect on the estimated recoverability of its intangible assets.

Equity Price Risk

The Company does not own any equity investments, other than in its subsidiaries. As a result, it does not currently have any direct equity price risk.

Commodity Price Risk

The Company does not enter into contracts for the purchase or sale of commodities. As a result, it does not currently have any direct commodity price risk.

ITEM 4. CONTROLS AND PROCEDURES

Our Chief Executive Officer, who is also serving as Interim Chief Financial Officer, participated in an evaluation by our management of the effectiveness of our disclosure controls and procedures as of the end of our fiscal quarter that ended on September 30, 2006. Based on his participation in that evaluation, our CEO concluded that our disclosure controls and procedures were effective as of September 30, 2006 to ensure that the information included in the reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer, as appropriate, to allow timely decisions regarding required disclosure. As described in detail in Note 7 to our condensed consolidated financial statements, we have amended our Form 10-Qs as of and for the quarterly periods ended March 30, 2006 and June 30, 2006. Our management, including our CEO, has re-evaluated our disclosure controls and procedures as of the end of the period covered by this Report to determine whether such restatement changes their prior conclusion, and has determined that it does not change their conclusion that as of September 30, 2006, our disclosure controls and procedures were effective to ensure that the information included in the reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Our CEO has concluded that he does not believe that the internal control deficiency constitutes a material weakness due to, among other things:

- The remote likelihood that the significant deficiency will result in a material misstatement not being prevented or detected in the future. (Humana, Inc.'s member premium revenue program in the Daytona market was discontinued in 2006); and

- Various qualitative factors, including Humana, Inc.'s vested interest in not paying us premiums that Humana, Inc. has not received from its members.

During the third quarter of 2006, we announced the departure of our Chief Financial Officer. The Chief Financial Officer is an integral part of our internal control structure over financial reporting. During the third quarter financial reporting process, our CEO was appointed Interim CFO and assumed the responsibilities of the CFO related to the internal controls over financial reporting. We have appointed a new CFO and anticipate that he will commence his employment in November 2006. Other than the departure of the former CFO, there have been no significant changes made in our internal controls over financial

reporting that occurred during the last fiscal quarter that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. SUMMARY OF LEGAL PROCEEDINGS

The Company is a party to various legal proceedings which are either immaterial in amount to the Company and its subsidiaries or involve ordinary routine litigation incidental to the business of the Company and its subsidiaries. There are no material pending legal proceedings, other than routine litigation incidental to the business of the Company and its subsidiaries, to which the Company or any of its subsidiaries is a party of or which any property of the Company or its subsidiaries is the subject.

ITEM 1A. RISK FACTORS

There have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005 other than as set forth below:

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

NONE

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

NONE

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

NONE

ITEM 5. OTHER INFORMATION

NONE

ITEM 6. EXHIBITS

3.1 Articles of Incorporation, as amended (1)

3.2 Amended and Restated Bylaws (2)

10.1 Physician Practice Management Participation Agreement, dated August 2, 2001, between Metropolitan of Florida, Inc. and Humana, Inc. (3)

10.2 Letter of Agreement, dated February 2003, between Metropolitan of Florida, Inc. and Humana, Inc. (4)

10.3 Physician Practice Management Participation Agreement, dated December 1,1998, between Metcare of Florida, Inc. and Humana, Inc. (9)

10.4 Supplemental Stock Option Plan (5)

10.5 Omnibus Equity Compensation Plan (6)

10.6 Amended and Restated Employment Agreement between Metropolitan and Michael M. Earley dated January 3, 2005 (8)

10.7 Amended and Restated Employment Agreement between Metropolitan and David S. Gartner dated January 3, 2005 (8)

10.8 Amended and Restated Employment Agreement between Metropolitan and Roberto L. Palenzuela dated January 3, 2005 (8)

10.9 Amended and Restated Employment Agreement between Metropolitan and Debra A. Finnel dated January 3, 2005 (8)

10.10 Employment Agreement between Metcare of Florida, Inc. and Jose A. Guethon, M.D. (9)

10.11 Form of Option Award Agreement for Option Grants to Directors pursuant to the Omnibus Compensation Plan (9)

10.12 Form of Option Award Agreement for Option Grants to Key Employees pursuant to the Omnibus Compensation Plan (9)

10.13 Form of Option Award Agreement for Option Grants to Employees pursuant to the Omnibus Compensation Plan (9)

10.14 Agreement between Metcare of Florida, Inc. and the Centers for Medicare and Medicaid Services (10)

10.15 Code of Business Conduct and Ethics (9)

10.16 Employment Agreement between Metropolitan and Robert J. Sabo (11)

31.1 Certification of the Chief Executive Officer and Interim Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*

32.1 Certification of the Chief Executive Officer and Interim Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

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* filed herewith
**furnished herewith

(1) Incorporated by reference to Metropolitan's Registration Statement on Form 8-A12B filed with the Commission on November 19, 2004 (No. 001-32361).

(2) Incorporated by reference to Metropolitan's Current Report on Form 8-K filed with the Commission on September 30, 2004.

(3) Incorporated by reference to Metropolitan's Amendment to Registration Statement on Form SB-2/A filed with the Commission on August 2, 2001 (No. 333-61566). Portions of this document were omitted and were filed separately with the SEC on or about August 2, 2001 pursuant to a request for confidential treatment.

(4) Incorporated by reference to Metropolitan's Amendment to Annual Report for the fiscal year ended December 31, 2003 on Form 10-K/A filed with the Commission on July 28, 2004. Portions of this document have been omitted and were filed separately with the SEC on July 28, 2004 pursuant to a request for confidential treatment.

(5) Incorporated by reference to Metropolitan's Amendment to Annual Report for the fiscal year ended December 31, 2003 on Form 10-K/A filed with the Commission on July 28, 2004.

(6) Incorporated by reference to Metropolitan's Registration Statement on Form S-8 filed with the Commission on February 24, 2005 (No. 333-122976).

(7) Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003, as filed with the Commission on March 22, 2004.

(8) Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004, as filed with the Commission on March 22, 2005.

(9) Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005, as filed with the Commission on March 16, 2006.

(10) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2006, as filed with the Commission on May 15, 2006.

(11) Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on October 20, 2006.

SIGNATURES

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

METROPOLITAN HEALTH NETWORKS, INC.

Registrant

Date: November 14, 2006

/s/ Michael M. Earley

Michael M. Earley
Chairman, Chief Executive Officer and
Interim Chief Financial Officer