METROPOLITAN HEALTH NETWORKS INC
Form 10-Q
November 09, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2004

[ ] 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 0-28456

METROPOLITAN HEALTH NETWORKS, INC.

(Exact name of registrant as specified in its charter)

Florida

65-0635748

(State or other jurisdiction of

(I.R.S. Employer

Incorporation or organization)

Identification No.)

250 Australian Avenue, Suite 400, West Palm Beach, FL

33401

(Address of principal executive office)

(Zip Code)

(561) 805-8500

(Registrant s telephone number, including area code)

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 an accelerated filer (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 as of October 31, 2004

Common Stock par value $.001

46,857,505

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Metropolitan Health Networks, Inc.

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

ASSETS		**September 30, 2004 (Unaudited)**		**December 31, 2003 (Audited)**
CURRENT ASSETS				
Cash and equivalents	$	8,554,541	$	2,176,204
Accounts receivable, net of allowance		2,795,243		2,138,690
Inventory		285,709		304,248
Other current assets		819,759		833,112
TOTAL CURRENT ASSETS		12,455,252		5,452,254
CERTIFICATES OF DEPOSIT - restricted		1,000,000		1,000,000
PROPERTY AND EQUIPMENT, net		699,172		659,682
GOODWILL, net		1,992,133		1,992,133
OTHER ASSETS		127,685		119,660
TOTAL ASSETS	$	16,274,242	$	9,223,729
LIABILITIES AND STOCKHOLDERS' EQUITY/(DEFICIENCY IN ASSETS)				
CURRENT LIABILITIES				
Advances from HMO	$	-	$	164,536
Accounts payable		378,215		1,756,347
Accrued expenses		1,823,978		1,413,195
Current maturities of capital lease obligations		7,640		104,315

Current maturities of long-term debt		600,000		975,169
Payroll taxes payable		4,717		3,408,736
TOTAL CURRENT LIABILITIES		2,814,550		7,822,298
CAPITAL LEASE OBLIGATIONS		-		3,092
LONG-TERM DEBT		400,000		1,901,000
TOTAL LIABILITIES		3,214,550		9,726,390
COMMITMENTS AND CONTINGENCIES				
STOCKHOLDERS' EQUITY/(DEFICIENCY IN ASSETS)				
Preferred stock, par value $.001 per share; stated value $100 per share;				
10,000,000 shares authorized; 5,000 issued and outstanding		500,000		500,000
Common stock, par value $.001 per share; 80,000,000 shares authorized;				
46,808,993 and 38,527,699 issued and outstanding, respectively		46,809		38,527
Additional paid-in capital		35,901,738		31,343,887
Accumulated deficit		(23,269,504)		(32,238,333)
Common stock issued for services to be rendered		(119,351)		(146,742)
TOTAL STOCKHOLDERS' EQUITY/(DEFICIENCY IN ASSETS)		13,059,692		(502,661)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY/(DEFICIENCY IN ASSETS)	$	16,274,242	$	9,223,729

See accompanying notes - unaudited

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

	For the nine months ended September 30,		For the three months ended September 30,	
	2004	**2003**	**2004**	**2003**
	(Unaudited)	**(Unaudited)**	**(Unaudited)**	**(Unaudited)**
REVENUES	$ 117,189,228	$ 108,422,050	$ 40,091,999	$ 35,680,129
EXPENSES				
Direct medical costs	95,934,070	91,802,409	32,155,171	29,994,259
Payroll, payroll taxes and benefits	6,731,202	5,516,682	2,399,245	1,803,664
Medical supplies	1,132,488	1,477,204	269,989	585,804
Depreciation and amortization	283,698	517,176	70,429	176,549
Rent and leases	856,305	744,861	292,190	263,232
Consulting expense	444,517	1,053,648	195,959	328,813
General and administrative	2,371,373	2,025,101	998,745	559,486
TOTAL EXPENSES	107,753,653	103,137,081	36,381,728	33,711,807
INCOME BEFORE OTHER INCOME (EXPENSE)	9,435,575	5,284,969	3,710,271	1,968,322
OTHER INCOME (EXPENSE):				
Interest and penalty expense	(301,843)	(1,018,180)	(82,977)	(283,305)
Interest income	59,276	10,930	26,132	3,426
Other income	20,800	19,632	1,177	5,152
TOTAL OTHER INCOME (EXPENSE)	(221,767)	(987,618)	(55,668)	(274,727)
INCOME FROM CONTINUING OPERATIONS	9,213,808	4,297,351	3,654,603	1,693,595

DISCONTINUED OPERATIONS:								
(Loss)/Income from operations of discontinued								
business segments		(44,979)		(1,460,988)		12,143		(520,623)
Reserve on note receivable pharmacy		(200,000)		-		-		-
TOTAL DISCONTINUED OPERATIONS		(244,979)		(1,460,988)		12,143		(520,623)
NET INCOME	$	8,968,829	$	2,836,363	$	3,666,746	$	1,172,972
WEIGHTED AVERAGE NUMBER OF COMMON								
SHARES OUTSTANDING		44,492,521		33,882,789		46,013,313		34,954,992
INCOME FROM CONTINUING OPERATIONS:								
Basic	$	0.21	$	0.13	$	0.08	$	0.05
Diluted	$	0.19	$	0.10	$	0.07	$	0.04
LOSS FROM DISCONTINUED OPERATIONS:								
Basic	$	(0.01)	$	(0.05)	$	-	$	(0.02)
Diluted	$	(0.01)	$	(0.03)	$	-	$	(0.01)
NET EARNINGS PER SHARE:								
Basic	$	0.20	$	0.08	$	0.08	$	0.03
Diluted	$	0.18	$	0.07	$	0.07	$	0.03

See accompanying notes - unaudited

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

	For the nine months ended September 30, 2004 (Unaudited)	2003 (Unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 8,968,829	$ 2,836,363
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	259,357	410,749
Reserve on note receivable - pharmacy	200,000	-
Amortization of discount on notes payable	52,185	146,943
Stock issued for interest and late fees	578	80,000
Stock issued for compensation and services	60,000	270,218
Amortization of securities issued for professional services	88,058	268,221
Changes in assets and liabilities:		
Accounts receivable, net	(656,553)	19,319
Inventory	18,539	(81,323)
Other current assets	(186,646)	(579,287)
Net change in operating assets held for sale	-	76,707
Other assets	(45,468)	16,595
Accounts payable and accrued expenses	(988,176)	(1,151,454)
Payroll taxes payable	(3,404,019)	263,654
Total adjustments	(4,602,145)	(259,658)
Net cash provided by operating activities	4,366,684	2,576,705
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of restricted certificates of deposit	-	(100,000)
Capital expenditures	(240,578)	(115,512)
Net cash used in investing activities	(240,578)	(215,512)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings on notes payable	-	637,137
Repayments on notes payable	(913,354)	(1,610,453)
Repayments on capital lease obligations	(99,767)	(110,571)
Repurchase of warrants	(113,250)	-
Proceeds from exercise of options and warrants	590,138	-

Net proceeds from issuance of common stock		2,953,000		-
Repayments to HMO		(164,536)		(1,403,900)
Net cash provided by/(used in) financing activities		2,252,231		(2,487,787)
NET INCREASE IN CASH AND EQUIVALENTS		6,378,337		(126,594)
CASH AND EQUIVALENTS - BEGINNING		2,176,204		399,614
CASH AND EQUIVALENTS - ENDING	$	8,554,541	$	273,020

See accompanying notes - unaudited

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METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

METROPOLITAN 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, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

The audited financial statements at December 31, 2003, which are included in the Company s Form 10-K/A, 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 our 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 2003 it operated in two segments for purposes of presenting financial information and evaluating performance, the Provider Service Network (managed care and direct medical services) (PSN) and pharmacy segments. The pharmacy operations were sold in November 2003. In 2004, the Company began operating a development stage Medicare Advantage HMO. Accordingly, in 2004, the Company has operated and continues to operate in two segments, the PSN and 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 5. Business Segment Information for additional information regarding the Company s business segments.

INCOME TAXES

The Company accounts for income taxes according to Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, which proscribes the use of the asset and liability approach in calculating deferred income taxes. Under this method, a deferred tax asset or liability is determined based on the enacted tax rates that will be in effect when the difference between the financial statement carrying amounts and the tax bases of the existing assets and liabilities are expected to be reported in an institution s income tax returns. A valuation allowance is established when it is more likely than not that some or all of the deferred tax assets will not be realized.

As of September 30, 2004, the Company had net operating loss carryforwards of approximately $19,160,000, expiring in various years through 2022, resulting in a deferred tax asset of approximately $7,300,000, which is completely offset by a valuation allowance. Accordingly, income tax expense for the three and nine months ended September 30, 2004 has been offset by a decrease in the deferred tax asset valuation allowance.

REVENUES

Revenues are recorded when services are rendered. Revenues from one health maintenance organization, Humana Inc. (the HMO) accounted for approximately 99% of the Company s total revenues for the three and nine months ended September 30, 2004 and 2003.

Contracts with the HMO renew automatically unless cancelled by either party with 180-day notice. These contracts are in effect through December 31, 2004 and the Company expects the contracts to continue for the foreseeable future.

RECLASSIFICATION

Certain amounts reported in the comparative financial statements have been reclassified to conform to the presentation for the periods ended September 30, 2004.

USE OF ESTIMATES

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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

ACCOUNTS RECEIVABLE

Accounts receivable at September 30, 2004 and December 31, 2003 were as follows:

	September 30, 2004	December 31, 2003
HMO accounts receivable, net	$ 2,541,000	$ 1,780,000
Non-HMO accounts receivable, net	254,000	359,000
Accounts receivable	$ 2,795,000	$ 2,139,000

In the health care industry, estimates often change as a result of one or more future events. With regard to revenues, expenses and receivables arising from agreements with the HMO, the Company uses judgments and assumptions to estimate amounts it believes will ultimately be realizable. It is 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.

Direct medical costs are based in part upon estimates of claims incurred but not reported (IBNR) and estimates of retroactive adjustments or unsettled costs to be applied by the HMO. The IBNR estimates are made by the HMO utilizing actuarial methods and are continually evaluated by management of the Company, based upon its specific claims experience. The estimates of retroactive adjustments or unsettled costs to be applied by the HMO are based upon current agreements and understandings with the HMO to modify certain amounts previously charged to the Company s fund balances. Management believes its estimates of IBNR claims and estimates of retroactive adjustments or unsettled costs are reasonable, however, it is possible the Company's estimate of these costs could change in the near term and those changes may be material.

From time to time, the Company is charged for certain medical expenses for which it believes it is not liable under its contracts with the HMO. In connection therewith, as of September 30, 2004, the Company was contesting certain costs aggregating to approximately $4.2 million. Management s estimate of recovery on these contestations is determined based upon its judgment and its consideration of several factors including, but not limited to, the nature of the contestations, historical recovery rates and other qualitative factors. Accordingly, accounts receivable due from the HMO include approximately $435,000, which represents the estimated recovery of contestations outstanding at September 30, 2004. It is possible the Company s estimate of these recoveries could change in the near term and those changes may be material.

Non-HMO accounts receivable, aggregating to approximately $3.0 million at September 30, 2004 relate principally to medical services provided on a fee for service basis, and are reduced by amounts estimated to be uncollectible (approximately $2.8 million). These receivables are typically uncollateralized customer obligations due under normal trade terms requiring payment within 30-90 days from the invoice date. The Company does not charge late fees or penalties on delinquent invoices, however it continually evaluates the need for a valuation allowance. Management s estimate of uncollectible amounts is based upon its analysis of historical collections and other qualitative factors. Non-HMO accounts receivable included approximately $2.0 million from operations discontinued in prior years. Although the Company seeks to collect such accounts receivable, it has previously established a reserve for these balances.

NET INCOME 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 months ended September 30,			
		2004		**2003**		**2004**		**2003**
Net Income from continuing operations	$	9,213,808	$	4,297,351	$	3,654,603	$	1,693,595
Less: Preferred stock dividend		(37,500)		(37,500)		(12,500)		(12,500)
		9,176,308		4,259,851		3,642,103		1,681,095
(Loss)/Income from discontinued operations		(244,979)		(1,460,988)		12,143		(520,623)
Income available to common shareholders	$	8,931,329	$	2,798,863	$	3,654,246	$	1,160,472
Denominator:								
Weighted average common shares outstanding, basic		44,492,521		33,882,789		46,013,313		34,954,992
Basic earnings per	$	0.20	$	0.08	$	0.08	$	0.03

common share								
Net Income	$	8,968,829	$	2,836,363	$	3,666,746	$	1,172,972
Interest on convertible securities		2,565		68,134		-		20,155
	$	8,971,394	$	2,904,497	$	3,666,746	$	1,193,127
Denominator:								
Weighted average common shares outstanding, basic		44,492,521		33,882,789		46,013,313		34,954,992
Common share equivalents of outstanding stock:								
Convertible preferred		1,301,876		4,901,963		1,131,647		6,962,208
Convertible debt		121,662		3,739,535		-		3,739,535
Options		2,485,312		-		2,838,139		-
Warrants		400,642		-		361,010		-
Weighted average common shares outstanding, diluted		48,802,013		42,524,287		50,344,109		45,656,735
Diluted earnings per common share	$	0.18	$	0.07	$	0.07	$	0.03

STOCK COMPENSATION

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure-an amendment of FASB Statement No. 123 . SFAS No. 123, "Accounting for Stock-Based Compensation," establishes financial accounting and reporting standards for stock-based compensation plans and allows two alternative accounting methods: (1) a fair-value-based method, or (2) an intrinsic-value-based method as prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB No. 25) and related interpretations.

SFAS No. 148 amends the disclosure requirements of SFAS 123 to require disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method on reported results.

The Company adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, (SFAS 123). The Company has elected to continue using Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees in accounting for employee stock options.

Accordingly, the Company would record compensation expense for options granted to employees to the extent the market value of the underlying common stock exceeds the exercise price at the date of grant. If compensation expense had been determined based on the fair value at the grant date for awards of options during the three and nine months ended September 30, 2004 and 2003, consistent with the provisions of SFAS 123, the Company's net income and income per share would have been reduced to the pro-forma amounts indicated below:

	For the nine months ended September 30,				For the three months ended September 30,			
		2004		**2003**		**2004**		**2003**
Net Income	$	8,968,829	$	2,836,363	$	3,666,746	$	1,172,972
Less: Total stock-based employee compensation expense determined using the fair value method, net of related tax		53,000		357,000		18,000		339,000
Adjusted net income	$	8,915,829	$	2,479,363	$	3,648,746	$	833,972
Earnings per share:								
Basic, as reported	$	0.20	$	0.08	$	0.08	$	0.03
Basic, pro forma	$	0.20	$	0.07	$	0.08	$	0.02
Diluted, as reported	$	0.18	$	0.07	$	0.07	$	0.03
Diluted, pro forma	$	0.18	$	0.06	$	0.07	$	0.02

NEW ACCOUNTING PRONOUNCEMENTS

In December 2003, the FASB issued FIN 46R, "Consolidation of Variable Interest Entities," a revision to FIN 46, which was issued in January 2003. Under FIN 46R, a variable interest entity must be consolidated by a company if that company is subject to a majority of the entity's expected losses or entitled to receive a majority of the entity's expected residual returns or both. FIN 46R requires disclosures about variable interest entities that a company is not required to consolidate, but in which it has a significant variable interest. The consolidation requirements apply to existing entities in the first reporting period that ends after March 15, 2004. Adoption of FIN 46R did not have any impact on the Company s financial statements.

NOTE 2. DEBT

As of September 30, 2004, the Company had $1,000,000 in principal amount of debt. During the first nine months of 2004, the Company repaid $913,000 of long-term debt and restructured a $1.2 million note due May 2004 (the Note).

The new terms of the Note provide for monthly payments of $50,000 plus interest over twenty-four months beginning June 2004, with interest at 12%. There is no prepayment penalty for early repayment of the Note. Upon an uncured event of default, the Note will be automatically converted into 6% Convertible Debentures with a principal amount equal to the principal amount and accrued interest outstanding under the Note. The Company issued 100,000 shares of common stock in conjunction with the restructuring of the Note.

NOTE 3. STOCKHOLDERS EQUITY

In February 2004, the Company issued an aggregate of 5,004,999 shares of common stock (the Private Placement Shares) at a price of $0.60 per share to 24 accredited investors and 1 non-accredited investor. The Company received $2,953,000 in net proceeds from the sale of these Private Placement Shares.

In January 2004, an investor exercised its option to convert the balance of a 6% Convertible Debenture dated May 24, 2002 in the amount of $715,000 into shares of the Company s common stock. The stock was converted at $0.57 per share and 1,258,372 shares of common stock were issued.

In March 2004, an investor exercised his option to convert a 6% Convertible Debenture dated August 16, 2002 in the amount of $168,000 into shares of the Company s common stock. The stock was converted at $0.43 per share and 390,698 shares of common stock were issued.

In March 2004, the Company issued 220,000 shares of common stock to an investor for $0.60 per share in satisfaction of a Promissory Note, dated August 16, 2002 issued by the Company to the investor in the principal amount of $132,000.

In March 2004, the Company issued 100,000 shares of common stock to an investor as a fee in connection with its agreement to extend a $1.2 million Promissory Note issued by the Company, due May 24, 2004 (the Note).

On February 4, 2004, the Company hired a new General Counsel and issued to him stock options to purchase an aggregate of 150,000 shares of Common Stock, subject to certain anti-dilution protections, exercisable at $0.67 per share and vesting over a three year period. The options, if not exercised, will expire five years from the date of vesting.

In addition, during the first nine months of 2004 the Company issued 1,310,265 shares of common stock relating to the exercise of stock options and warrants and board compensation. Also, the Company repurchased warrants to acquire 493,125 common shares at prices ranging from $0.32 to $0.68 for an aggregate purchase price of $113,250.

NOTE 4. 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.

PAYROLL TAXES PAYABLE

In February 2004, the Company was successful in negotiating a settlement with the IRS on its outstanding payroll tax liabilities for an amount totaling approximately $3.4 million. This amount has been paid in full.

NOTE 5. BUSINESS SEGMENT INFORMATION

In 2004, the Company has operated and continues to operate in two segments for purposes of presenting financial information and evaluating performance, the PSN (managed care and direct medical services) and the HMO. The HMO division is in the development stage. During 2003, the Company also operated in two segments, the PSN segment and the pharmacy segment. The Company allocated corporate overhead to the pharmacy during the period it was operational. However, the overhead allocation is not included in the loss from operations of the discontinued business segments shown in the condensed consolidated statements of operations.

NINE MONTHS ENDED SEPTEMBER 30, 2004	PSN	HMO	Pharmacy	Total
Revenues from external customers	$ 117,189,000	$ -	$ -	$ 117,189,000
Segment gain (loss) before allocated overhead	13,400,000	(138,000)	(245,000)	13,017,000
Allocated corporate overhead	3,969,000	79,000	-	4,048,000
Segment gain (loss) after allocated overhead	9,431,000	(217,000)	(245,000)	8,969,000
Segment assets	13,343,000	2,931,000	-	16,274,000

NINE MONTHS ENDED SEPTEMBER 30, 2003	PSN	HMO	Pharmacy	Total
Revenues from external customers	$ 108,422,000	$ -	$ -	$ 108,422,000
Intersegment revenues from discontinued business segments	-	-	1,032,000	1,032,000
Revenues from discontinued business segments	-	-	10,977,000	10,977,000
Segment gain (loss) before allocated overhead	8,549,000	-	(1,461,000)	7,088,000
Allocated corporate overhead	2,588,000	-	1,664,000	4,252,000
Segment gain (loss) after allocated overhead	5,961,000	-	(3,125,000)	2,836,000

THREE MONTHS ENDED SEPTEMBER 30, 2004	PSN	HMO	Pharmacy	Total
Revenues from external customers	$ 40,092,000	$ -	$ -	$ 40,092,000
Segment gain (loss) before allocated overhead	5,311,000	(125,000)	12,000	5,198,000
Allocated corporate overhead	1,456,000	75,000	-	1,531,000
Segment gain (loss) after allocated overhead	3,855,000	(200,000)	12,000	3,667,000

THREE MONTHS ENDED SEPTEMBER 30, 2003	PSN	HMO	Pharmacy	Total
Revenues from external customers	$ 35,680,000	$ -	$ -	$ 35,680,000
		-	362,000	362,000

Intersegment revenues from discontinued business segments	-			
Revenues from discontinued business segments	-	-	3,595,000	3,595,000
Segment gain (loss) before allocated overhead	2,918,000	-	(521,000)	2,397,000
Allocated corporate overhead	760,000	-	464,000	1,224,000
Segment gain (loss) after allocated overhead	2,158,000	-	(985,000)	1,173,000

NOTE 6. SUBSEQUENT EVENTS

Effective October 1, 2004, the Company s contract with a South Florida primary care provider was terminated and replaced by the opening of a wholly-owned center in the same service area. The Company estimates the net loss of membership from this change to be approximately 250 members. In addition, effective December 1, 2004, the Company will add four South Florida primary care physician practices to its network. These independent practices serve nearly 900 Humana Medicare Advantage members.

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

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, belie could, should, may, and similar expressions may be deemed to create forward-looking statements. Accordingly, suc 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:

- our ability to renew our managed care agreements and negotiate terms which are favorable to us and affiliated physicians;
- our ability to respond to future changes in Medicare reimbursement levels and reimbursement rates from other third parties;
- our ability to enhance the services we provide to our members;
- our ability to strengthen our medical management capabilities;
- our ability to improve our physician network;
- our ability to establish business relationships and expand into new geographic markets;
- our ability to service our indebtedness, make capital expenditures and respond to capital needs; and
- our ability to restructure any of our debt or current liabilities.

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:

- pricing pressures exerted on us by managed care organizations and the level of payments we receive under governmental programs or from other payers;
- future legislation and changes in governmental regulations;
- the impact of Medicare Risk Adjustments on payments we receive for our managed care operations;
- loss of significant contracts;
- general economic and business conditions;
- the relative health of our patients;
- the ability to obtain flu vaccine for our membership;

changes in estimates and judgments associated with our critical accounting policies;

federal and state investigations;

the enactment of unfavorable legislation by the Congress of the United States;

our ability to successfully recruit and retain 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, including the section entitled Risk Factors in our Annual Report on Form 10-K/A for the year ended December 31, 2003.

We disclaim any intent or obligation to update forward looking statements .

OVERVIEW

The Company was incorporated in the State of Florida in January 1996, and began operations as a physician practice group. During the late 1990 s Metcare acquired a number of physician practices and ancillary service providers. In late 1999, the group practice strategy was abandoned, in favor of developing a managed care business.

The first managed care risk contract was secured with Humana Inc. (Humana) in 1999. In 2000, an additional contract was secured to manage all of Humana s Medicare Advantage lives in the Daytona, Florida area (Flagler and Volusia Counties). Under its risk agreements, the Company receives credit for a significant percentage of the monthly Medicare premiums received by Humana from the Centers for Medicare and Medicaid Services (CMS) and is obligated to provide all of the covered healthcare benefits for the member lives. To the extent the costs of providing such benefits is less than the related premiums received, Metropolitan would report a gross profit. Conversely, if the costs exceed related premiums, the Company loses money. As of September 30, 2004, the Daytona contract accounted for over 19,000 lives or 74% of the Company s total Medicare Advantage lives. The balance of the Company s Humana members, approximating 7,000 in number, resided in South Florida (Palm Beach, Broward and Miami-Dade Counties).

The Company is currently pursuing a business plan to develop and license its own Medicare Advantage HMO to operate in certain Florida markets underserved by this program. Management does not intend to compete in markets in which it is contracted with Humana and views this growth strategy as an extension of its existing core competency and organization. The current plan calls for operations to begin in 2005. Management believes that the proposed development efforts, required reserve requirements and start-up costs for the HMO can be funded by the Company s current resources and projected cash flows from operations.

Although the Company has operated as a risk provider since 1999, it has not operated as a HMO. To successfully operate an HMO the Company believes it will have to develop the following capabilities, among others: sales and marketing, customer service, claims administration and regulatory compliance. No assurances can be given that the Company will be successful in developing, licensing or operating the new plan.

The Company acquired a seventh wholly-owned physician practice effective September 1, 2004. Located in Broward County, Florida, this multi-specialty practice serves in excess of 1,000 Humana Medicare Advantage members and several hundred fee-for-service patients. The Company assumed the ongoing operating expenses of the office and the full risk for the Medicare Advantage members, consistent with the Company s business model. No material consideration was involved in the transaction.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company s management to make a variety of estimates and assumptions. These estimates and assumptions affect, among other things, the reported amounts of assets and liabilities, the disclosure of contingent liabilities and the reported amounts of revenues and expenses. Actual results can differ from the amounts previously estimated, which were based on the information available at the time the estimates were made.

The critical accounting policies described below are those that the Company believes are important to the portrayal of the Company s financial condition and results, and which require management to make difficult, subjective and/or complex judgments. Critical accounting policies cover accounting matters that are inherently uncertain because the future resolution of such matters is unknown. The Company believes that critical accounting policies include accounts receivable and revenue recognition, use of estimates and goodwill.

Accounts Receivable and Revenue Recognition

The Company is a party to certain managed care contracts and provides medical care to its patients through owned and non-owned medical practices. In connection with its Provider Service Network (PSN) operations, the Company is exposed to losses to the extent of its share of deficits. Accordingly, revenues under these contracts are reported as PSN revenue, and the cost of provider services under these contracts are reported as an operating expense.

The Company recognizes non-Humana revenues, net of contractual allowances, as medical services are provided. These services are typically billed to patients, Medicare, Medicaid, health maintenance organizations, insurance companies and other third parties. 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.

Use of Estimates-PSN

In HMO-PSN arrangements, accounts receivable estimates often change as a result of one or more future events. With regard to revenues, expenses and resulting accounts receivable arising from agreements with Humana, the Company, through the use of judgments and assumptions, estimates amounts it believes will ultimately be realizable. Contractual terms with an HMO are sometimes complex and, at times, subject to different interpretation by the Company and Humana. As a result, certain revenue, expense and accounts receivable estimates may change from amounts previously recorded in the financial statements and may require subsequent adjustments. To assist in estimating and collecting amounts due from Humana, the Company has contracted with outside consultants that have worked closely with Humana or other HMOs for extended periods of time. These consultants provide numerous services including, but not limited to, revenue, expense and accounts receivable analysis, and monthly claims and contestation analysis. However, it is possible that actual results may differ from the estimates.

Direct medical expenses include costs incurred directly by the Company and costs paid by Humana on the Company s behalf. These costs also include estimates of claims incurred but not reported (IBNR), estimates of retroactive adjustments to be applied by Humana and adjustments for charges for which the Company believes it is not liable (contestations). The IBNR estimates are made by Humana utilizing actuarial methods and are continually evaluated and adjusted by management of the Company, based upon its specific claims experience and input from outside consultants. The Company bases its estimates of retroactive adjustments on agreements with Humana to modify previous charges. Some of these adjustments have been quantified while others involve situations where Humana has agreed the charges were processed at incorrect rates, but the amount of the correction has not yet been quantified. Contestations involve charges where the Company, with the assistance of its consultants, contest certain expenses charged by Humana. The estimate of direct medical expense includes an estimated recovery of 10-20% of outstanding contestations with Humana. It is possible that estimates of such recoveries could change and the effect of the change could be material.

Accounts receivable from Humana represents the Company s interpretation of the contract with Humana and Humana s payment patterns. Collection times on these accounts often exceed normal collection periods.

Goodwill

The Company has made several acquisitions in the past that included a significant amount of goodwill. Under accounting principles generally accepted in the United States of America in effect through December 31, 2001, these assets were amortized over their useful lives and tested periodically to determine if they were recoverable from operating earnings on a discounted basis over their useful lives.

Effective January 1, 2002, goodwill is accounted for under SFAS No. 142, Goodwill and Other Intangible Assets . The new rules eliminate amortization of goodwill but subject these assets to impairment tests. Management is required to make assumptions and estimates, such as the discount factor, in determining fair value. Such estimated fair values might produce significantly different results if other reasonable assumptions and estimates were to be used.

RESULTS OF OPERATIONS

The Company recognized revenues of $40.1 million for the quarter ended September 30, 2004 compared to $35.7 million in the comparable prior year quarter, an increase of $4.4 million, or 12.4%. Net income for the 2004 third quarter was $3.7 million compared to $1.2 million for the quarter ended September 30, 2003. The 2003 quarter included approximately $521,000 in losses related to the Company s discontinued pharmacy operations. Net income per share was $0.08 for the quarter ended September 30, 2004 compared to $0.03 in the prior year quarter. The increase in the net income per share for the three months ended September 30, 2004 was partially offset by an increase in the number of weighted average shares outstanding, from 34,954,992 at September 30, 2003 to 46,013,313 in the current year.

During the quarter ended September 30, 2004, the Company was credited with Medicare Risk Adjustment funding increases for the first three quarters of 2004, amounting to approximately $1.2 million. These increases, which were paid in October 2004, were applied retroactively to January 1, 2004. Effective October 1, 2004, the Company s monthly funding will reflect the effect of these increases. The purpose of risk adjustment 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. The Balanced Budget Act of 1997 directed the Health Care Financing Administration (now CMS) to implement a risk adjustment payment system for Medicare health plans by January 2000. CMS initially phased-in risk adjustment with a risk adjustment model that based payment on principal hospital inpatient diagnoses, as well as demographic factors such as gender, age, and Medicaid eligibility. From 2000 to 2003, risk adjusted payment has accounted for only 10 percent of Medicare health plans payment, with the remaining 90 percent being based on demographic factors used before the BBA was enacted.

Pursuant to the Benefits and Improvements Protection Act of 2000 (BIPA), CMS implemented a new risk adjustment model that uses additional diagnosis data from ambulatory treatment settings (hospital outpatient department and physician visits). CMS has also redesigned its data collection and processing system to further reduce administrative data burden on Medicare health plans. In 2004, the portion of risk-adjusted payment was increased to 30 percent, from 10 percent in 2003. The 100% phase-in of risk-adjusted payment will be completed in 2007; the portion of risk-adjusted payment will increase to 50 percent in 2005 and 75 percent in 2006. In addition, the frailty adjuster has been applied to adjust payment for frail elderly enrolled in the Program for All-inclusive Care for the Elderly (PACE) and certain demonstrations.

For the nine months ended September 30, 2004, the Company recognized revenues of $117.2 million compared to $108.4 million in the prior year, an increase of $8.8 million or 8.1%. Net income for the 2004 period was $9.0 million compared to $2.8 million for the nine months ended September 30, 2003. The 2003 period included approximately $1.5 million in losses related to its discontinued pharmacy operations, compared to $245,000 in the current year period. Net income per share was $0.20 for the nine months ended September 30, 2004 compared to $0.08 in the prior year period. The increase in the net income per share for the nine months ended September 30, 2004 was partially offset by an increase in the number of weighted average shares outstanding, from 33,882,789 at September 30, 2003 to 44,492,521 in the current year.

The Company operated two business segments in 2003, managed care and direct medical services (PSN) and pharmacy. The Company disposed of its pharmacy division in November 2003 and, accordingly, the operations of the pharmacy division are reported as discontinued operations. The remaining PSN segment, prior to allocation of corporate overhead, reported an increase in income as a percentage of revenue, from 8.2% in the third quarter of 2003 to 13.2% in the current year period, and from 7.9% in the first nine months of 2003 to 11.4% in 2004. In 2004, the Company began the process of developing its own Medicare Advantage HMO and, as of September 30, 2004, had incurred $156,000 of expenses in connection with this development process.

Total Medicare Advantage lives increased approximately 400 members from September 30, 2003 to a membership of 25,900 at September 30, 2004. An incremental increase in excess of 1,000 members resulted from the acquisition of a South Florida physician practice effective September 1, 2004, which was partially offset by a 600 member decrease attributable to net attrition. Attrition has slowed considerably in 2004, the result of the increased funding and a corresponding improvement in member benefits provided by the Medicare Modernization Act, or MMA, which was signed into law in December 2003. As a result, the Company s core Medicare Advantage membership has remained nearly level since March 31, 2004. The MMA funding increases are intended to both offset medical cost inflation and to allow enhanced plan benefit design to encourage increased participation in Medicare Advantage plans.

As of September 30, 2004, the Company had net operating loss carryforwards of approximately $19,160,000, expiring in various years through 2022, resulting in a deferred tax asset of approximately $7,300,000, which is completely offset by a valuation allowance. Accordingly, income tax expense for the three and nine months ended September 30, 2004 has been offset by a decrease in the deferred tax asset valuation allowance.

Comparison of the Quarter ended September 30, 2004 to the Quarter ended September 30, 2003

REVENUES

Revenues for the quarter ended September 30, 2004 increased $4.4 million, or 12.4%, over the prior year, from $35.7 million to $40.1 million. PSN revenues from Humana increased 12.8%, from $35.3 million to $39.8 million. Approximately $5.3 million in incremental quarterly revenues were generated by Medicare funding and MRA increases that have totaled 13.3% in the Daytona market and 14.1% in South Florida while the addition of a new South Florida medical practice effective September 1, 2004 accounted for $556,000 in incremental revenue. These increases were partially offset by net declines in membership from the 2003 to 2004 third quarter, resulting in approximately $1.1 million in reduced revenue. In addition, effective August 1, 2003 the Company cancelled its risk arrangement with one of its South Florida centers due to noncompliance with the Company s policies and procedures, resulting in a funding decrease of $232,000.

Non-Humana revenue for Metcare s wholly owned physician practices in the third quarter of 2004 declined $92,000 over the same period in 2003, to a total of $302,000. The Company operated six physician practices and an oncology center in both quarters, adding a seventh practice in September 2004.

EXPENSES

Expenses for the quarter ended September 30, 2004 increased $2.7 million over the prior year quarter, from $33.7 million to $36.4 million, but improved as a percentage of revenue from 94.5% in 2003 to 90.7% in the current year period. Direct medical costs, the largest component of expense, represents costs associated with providing services of the PSN operation including direct medical payments to physicians, hospitals and ancillary service providers on a capitated or fee for service basis. Direct medical costs for the third quarter of 2004 were $32.2 million compared to $30.0 million for 2003. As a percentage of PSN revenues, direct medical costs improved from 85.0% in 2003 quarter to 80.8% in the 2004 period. While Humana enhanced its 2004 Medicare Advantage benefit plans in the Company s markets, increased Medicare funding and favorable medical utilization more than offset the increased benefit costs. In addition, there was a $248,000 decrease in spending due to the cancellation of a South Florida center in 2003 combined with decreases due to a decline in the number of patients in our network.

Payroll, payroll taxes and benefits for the 2004 quarter was $2.4 million, an increase of $596,000 over the prior year quarter s total of $1.8 million. As a result of the Company s improved performance in 2004, the 2004 quarter included $325,000 in incremental accrued bonus and pension expenses. In addition, an increase of approximately $94,000 resulted from the hiring of an oncologist in late 2003, whereas in the 2003 period a consultant was utilized. An additional $92,000 was incurred at the Company s new South Florida medical center. Increased staffing, salary increases and rising benefit costs accounted for the balance of the increase.

Medical supplies were $270,000 for the 2004 quarter, compared to $586,000 in 2003. Medical supply costs are incurred in all the Company s medical offices, but most prominently in the Company s Daytona oncology offices, accounting for 92.2% of the 2004 expense.

Depreciation and amortization for the quarter ended September 30, 2004 totaled $70,000, a 60.1% decrease over the prior year total of $177,000, as many of the Company s fixed assets are fully depreciated.

Rents and leases for the quarter ended September 30, 2004 increased $29,000 (11.0%) over the prior year quarter, resulting from annual rent increases as per the terms of the property leases combined with one month s rent incurred at its new South Florida physicians office.

Consulting expense for the quarter decreased approximately $133,000 (40.4%), from $329,000 in 2003 to $196,000 in 2004. A reduction of $140,000 resulted from the hiring of an oncologist, whereas in the prior year a consultant was utilized. In addition, approximately $41,000 in savings was realized through a reduction in marketing and hospitalist consultants. These savings were partially offset by $49,000 in expenses incurred in the development of the Company s HMO.

General and administrative expenses for the 2004 quarter amounted to $999,000, a increase of $439,000 (78.5%) over the prior year quarter. Among the increases, $100,000 resulted from contributions made by the Company to relief efforts in the aftermath of Hurricanes Francis and Jeanne, which had a significant impact on the Company s service area. Additionally, $86,000 of incremental expense was incurred in the development of the Company s HMO, while $73,000 of increased legal expense was due in large part to the Company s Corporate Governance and Sarbanes-Oxley compliance efforts. Increased director fees amounted to $22,000 with the balance of the increase resulting from small increases over a wide range of expense categories.

Other income and expenses for the quarter included a decrease in interest expense of $200,000 from the prior year due to the decreased average amount of debt and IRS obligations carried by the Company in the 2004 quarter as compared to the prior year quarter.

Losses related to the discontinued pharmacy operations for the 2003 quarter, were $521,000 as compared to a profit of $12,000 in 2004. The pharmacy operations were sold in November 2003

Comparison of the Nine months ended September 30, 2004 to the Nine months ended September 30, 2003

REVENUES

Revenues for the nine months ended September 30, 2004 increased $8.8 million, or 8.1%, over the prior year, from $108.4 million to $117.2 million. PSN revenues from Humana increased 8.4%, from $107.3 million to $116.3 million. Approximately $14.7 million in incremental revenues were generated by Medicare funding and MRA increases that have totaled 13.3% in the Daytona market and 14.1% in South Florida while the addition of a new South Florida medical practice effective September 1, 2004 accounted for $556,000 in incremental revenue. These increases were partially offset by net declines in membership, resulting in approximately $4.5 million in reduced revenue. In addition, effective August 1, 2003 the Company cancelled its risk arrangement with one of its South Florida centers due to noncompliance with the Company s policies and procedures, resulting in a funding decrease of $1.7 million for the nine months ended September 30, 2003 as compared to the same period in 2004.

Non-Humana revenue for Metcare s wholly owned physician practices in the first nine months of 2004 declined, relative to the first nine months of 2003, by $292,000, to a total of $848,000. The Company operated six physician practices and an oncology center in both quarters, adding a seventh practice in September 2004.

EXPENSES

Total expenses for the nine months ended September 30, 2004 increased $4.6 million, or 4.5%, over the nine months ended September 30, 2003, from $103.1 million to $107.8 million, but improved as a percentage of revenue from 95.1% in 2003 to 91.9% in the current year. Direct medical costs, the largest component of expense, represents costs associated with providing services of the PSN operation including direct medical payments to physician providers, hospitals and ancillaries on a capitated or fee for service basis. Direct medical costs for the first nine months of 2004 were $95.9 million compared to $91.8 million for 2003. As a percentage of PSN revenues, direct medical costs improved from 85.6% in the 2003 period to 82.5% in the current year. While Humana enhanced its 2004 Medicare Advantage benefit plans in the Company s markets, increased Medicare funding and favorable medical utilization more than offset the increased benefit costs, despite the effects of the 2003/2004 flu season, the most severe in four years, which resulted in increased hospital admissions and lengths of stay in the first quarter of 2004. Additionally, there was a $1.9 million decrease in medical expense due to the cancellation of a South Florida center combined with decreases due to a decline in the number of patients in our network.

Payroll, payroll taxes and benefits for the nine months of 2004 was $6.7 million, as compared to the prior year s total of $5.5 million, a $1.2 million increase. The 2004 period included $825,000 in incremental accrued bonus and pension expenses, the result of the Company s improved performance in 2004. In addition, an increase of approximately $290,000 resulted from the hiring of an oncologist in late 2003, whereas in the 2003 period a consultant was utilized. An additional $92,000 was incurred at the Company s new South Florida medical center. Savings of approximately $171,000 were realized through the closure of the Company s hospitalist program in early 2003. Staffing and salary increases combined with increased benefit costs accounted for the balance of the incremental expense.

Medical supplies were $1.1 million for the 2004 period, compared to $1.5 million in 2003. Medical supply costs are incurred in all the Company s medical offices, but most prominently in the Company s Daytona oncology offices, accounting for 93.2% of the 2004 expense.

Depreciation and amortization for the nine months ended September 30, 2004 totaled $284,000, a 45.1% decrease over the prior year total of $517,000, as many of the Company s fixed assets are fully depreciated.

Rents and leases for the nine months ended September 30, 2004 increased $111,000 over the prior year. When the Company negotiated the lease for its new corporate office effective January 2003, it received certain rent concessions in the first quarter of 2003. In addition, in 2004 the Company has incurred annual rent increases as per the terms of the property leases.

Consulting expense for the nine months decreased approximately $609,000, from $1.1 million in 2003 to $445,000 in 2004. Of the reduction, $320,000 resulted from the hiring of an oncologist, whereas in the prior year a consultant was utilized. In addition, approximately $299,000 in savings was realized through a reduction in marketing and administrative consultants and the closure of the Company s hospitalist program in early 2003. These savings were partially offset by $49,000 in expenses incurred in the development of the Company s HMO.

General and administrative expenses for the 2004 period amounted to $2.4 million, an increase of $346,000 over the prior year. Among the increases, $100,000 resulted from contributions made by the Company to relief efforts in the aftermath of Hurricanes Francis and Jeanne, which had a significant impact on the Company s service area. Another $106,000 of incremental expense was incurred in the development of the Company s HMO and increased director fees amounted to $111,000, with the balance of the increase resulting from small increases over a wide range of expense categories.

Other income and expenses for the nine months included a decrease in interest expense of $716,000 from the prior year due to the decreased average amount of debt and IRS obligations carried by the Company in the 2004 period as compared to the prior year.

Losses related to the discontinued pharmacy operations for the nine months were $245,000 in 2004 as compared to $1.5 million in the first nine months of 2003. The pharmacy operations were sold in November 2003. Discontinued operations for the 2004 period included a $200,000 reserve on the note receivable from the purchaser of the pharmacy operations. This note was due in May 2004 and is currently in default.

LIQUIDITY AND CAPITAL RESOURCES

During the nine months ended September 30, 2004, the Company reduced its current liabilities from $7.8 million to $2.8 million and its total liabilities from $9.7 million to $3.2 million. Most significantly, the Company settled its longstanding payroll tax obligation for an amount totaling $3.4 million. The Company s equity totaled $13.1 million at September 30, 2004 compared to a deficit of $503,000 at December 31, 2003. Additionally, working capital improved from a deficit of $2.4 million at year-end 2003 to a surplus of $9.6 million at September 30, 2004, an improvement of $12.0 million.

As of September 30, 2004, the Company had approximately $8.6 million in cash and cash equivalents as compared to approximately $2.2 million at December 31, 2003, an increase of approximately $6.4 million.

Cash flows from operating activities for the nine months ended September 30, 2004 constituted approximately $4.4 million of the $6.4 million. Net income of nearly $9.0 million was the largest source of cash flow from operations. This source of cash was partially offset by $3.4 million, $988,000, $657,000 and $187,000 of cash utilized for payroll taxes payable, accounts payable and accrued expenses, accounts receivable and other current assets. During the quarter ended September 30, 2004, the Company was credited with Medicare Risk Adjustment funding increases for the 2004 year amounting to approximately $1.2 million. These funding increases were paid in October 2004, accounting for the increase in accounts receivable over the quarter ended June 30, 2004. In February 2004, the Company was successful in negotiating a settlement with the IRS on its outstanding payroll tax liabilities for an amount totaling approximately $3.4 million. This amount has been paid in full.

Cash flow from investing activities for the nine months ended September 30, 2004 had a minimal impact on the Company s cash resources, utilizing $241,000 for capital expenditures.

The Company s financing activities for the nine months ended September 30, 2004 provided the Company approximately $2.3 million of cash. The Company generated approximately $3.5 million of cash from the issuance of stock and the exercise of warrants and options. Approximately $1.2 million was used for loan, note and capital lease payments. A significant portion of the cash generated by the Company from financing activities is attributable to approximately $3.0 million of net proceeds received by the Company in connection with a private placement of 5,005,000 shares of its common stock. See Note 3 Stockholders Equity for a description of the private placement.

Although not reflected as a source or use of cash from financing activities on the Company s consolidated statements of cash flow, certain creditors converted $1,015,000 in principal amount of long-term debt into 1,869,070 shares of common stock during the nine months ended September 30, 2004. As well, the Company successfully extended and modified the terms of a $1.2 in principal amount promissory note due May 2004 (the Note). The new terms of the Note provide for monthly payments in the amount of $50,000 plus interest each month over twenty-four months beginning June 2004, with interest at 12%. There is no prepayment penalty for early repayment of the Note. Upon an uncured event of default, the Note will be automatically converted into the Company s 6% Convertible Debentures with a principal amount equal to the principal amount and accrued interest outstanding under the Note. The Company issued 100,000 shares of common stock in conjunction with the restructuring.

The Company has been unable to secure a sufficient supply of flu vaccine for its members due to the announced national shortfall in flu vaccine supply. Doses for approximately 12% of the Company s members have been secured, compared to a vaccination rate of approximately 60% in the prior year s flu season. Efforts are ongoing to obtain additional supplies. In addition, the members have been advised and encouraged to obtain flu shots from other sources, the cost of which is being reimbursed by the Company. While the anticipated additional cost of the vaccine is not expected to be material, influenza and related seasonal illnesses could have a material impact on the Company s results.

The Company anticipates that the development efforts, required reserve requirements and start-up costs for its HMO can be funded by the Company s current resources and projected cash flows from operations. It is expected that the HMO will be licensed and operational in 2005, however no assurances can be given that the Company will be successful in this project.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT 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. We do not currently have any trading derivatives nor do we expect to have any in the future. We have established policies and internal processes related to the management of market risks, which we use in the normal course of our business operations.

Interest Rate Risk

The fair market value of long-term debt is subject to interest rate risk. While changes in market interest rates may affect the fair value of our fixed-rate long-term debt, we believe a change in interest rates would not have a material impact on our financial condition, future results of operations or cash flows.

Intangible Asset Risk

We have a substantial amount of intangible assets. Although at September 30, 2004, we believe our intangible assets are recoverable, changes in the economy, the business in which we operate and our own relative performance could change the assumptions used to evaluate intangible asset recoverability. We continue to monitor those assumptions and their consequent effect on the estimated recoverability of our intangible assets.

Equity Price Risk

We do not own any equity investments, other than in our subsidiaries. As a result, we do not currently have any direct equity price risk.

Commodity Price Risk

We do not enter into contracts for the purchase or sale of commodities. As a result, we do not currently have any direct commodity price risk.

ITEM 4. CONTROLS AND PROCEDURES

Our management, which includes our CEO and our CFO, has conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of the end of the fiscal quarter covered by this report. Based upon that evaluation, our management has concluded that the design and operation of our disclosure controls and procedures are effective for timely gathering, analyzing and disclosing the information we are required to disclose in our reports filed under the Securities Exchange Act of 1934, as amended.

There have been no significant changes made in our internal controls over financial reporting that occurred during our last fiscal quarter that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. SUMMARY OF LEGAL PROCEEDINGS

NONE

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

During the quarter ended September 30, 2004, the Company issued an aggregate of 12,800 shares of the Company's common stock to directors of the Company as compensation for their participation in Board committee meetings. The shares of common stock were issued pursuant to the exemption from registration provided by Section 4(2) of the Securities Act.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

NONE

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

NONE

ITEM 5. OTHER INFORMATION

NONE

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a)

Exhibits

3.1	Articles of Incorporation, as amended (1)			
3.2	5,000,000		5.750% due 1/1/33	4,865,550
		15,000,000	5.750% due 1/1/40	14,848,050
			Total Texas	38,466,420
Virginia	**1.8%**			
		3,000,000	Chesterfield County, VA, IDA, PCR, Virginia Electric & Power Co., Remarketed 11/8/02, 5.875% due 6/1/17	3,136,350
		10,000,000		10,007,000

		Virginia State HDA Commonwealth Mortgage Revenue, MBIA, 5.350% due 7/1/31	
		Total Virginia	13,143,350
West Virginia 0.6%			
		West Virginia State Housing Development Fund, Housing Finance Revenue:	
	3,845,000	5.300% due 5/1/24	3,864,763
	400,000	5.350% due 11/1/27	400,972
		Total West Virginia	4,265,735
Wisconsin 0.3%			
		Wisconsin State HEFA Revenue:	
	1,100,000	Kenosha Hospital & Medical Center Project, 5.700% due 5/15/20	1,115,147
	1,250,000	Medical College of Wisconsin Inc. Project, MBIA, 5.400% due 12/1/16	1,259,825
		Total Wisconsin	2,374,972
Wyoming 1.8%			
	13,890,000	Wyoming CDA, Housing Revenue, 5.600% due 6/1/35 (b)	13,476,773
		TOTAL INVESTMENTS BEFORE SHORT-TERM INVESTMENTS (Cost $721,253,831)	738,630,397
SHORT-TERM INVESTMENTS 0.7%			
Florida 0.3%			
	100,000	Jacksonville, FL, Electric Authority Revenue, Electric Systems, SPA-Bank of America, 2.350%, 9/2/08 (g)	100,000
	2,000,000	Orlando & Orange County, FL, Expressway Authority, Revenue, FSA, SPA-Dexia Credit Local, 1.950%, 9/4/08 (g)	2,000,000
		Total Florida	2,100,000
New York 0.3%			
	2,300,000	Long Island Power Authority, NY, Electric System Revenue, FSA, SPA-Dexia Credit Local, 2.100%, 9/5/08 (g)	2,300,000
Tennessee 0.0%			
	300,000	Clarksville, TN, Public Building Authority Revenue, Pooled Financing, Tennessee Municipal Bond Fund, LOC-Bank of America N.A., 2.450%, 9/2/08 (g)	300,000
Virginia 0.1%			
	400,000	Virginia Commonwealth University, LOC-Wachovia Bank NA, AMBAC, 2.450%, 9/2/08 (g)	400,000
		TOTAL SHORT-TERM INVESTMENTS (Cost $5,100,000)	5,100,000
		TOTAL INVESTMENTS 100.0% (Cost $726,353,831#)	743,730,397

See Notes to Schedule of Investments.

Western Asset Managed Municipals Fund Inc.

Schedule of Investments (unaudited) (continued)

August 31, 2008

(a) Pre-Refunded bonds are escrowed with U.S. government obligations and/or U.S. government agency securities and are considered by the manager to be triple-A rated even if issuer has not applied for new ratings.
(b) Income from this issue is considered a preference item for purposes of calculating the alternative minimum tax (AMT).
(c) Variable rate security. Interest rate disclosed is that which is in effect at August 31, 2008.
(d) Bonds are escrowed to maturity by government securities and/or U.S. government agency securities and are considered by the manager to be triple-A rated even if issuer has not applied for new ratings.
(e) All or a portion of this security is held at the broker as collateral for open futures contracts.
(f) Security is exempt from registration under Rule 144A of the Securities Act of 1933. This security may be resold in transactions that are exempt from registration, normally to qualified institutional buyers. This security has been deemed liquid pursuant to guidelines approved by the Board of Directors, unless otherwise noted.
(g) Variable rate demand obligations have a demand feature under which the Fund can tender them back to the issuer on no more than 7 days notice. Date shown is the date of the next interest rate change.
Aggregate cost for federal income tax purposes is substantially the same.

Abbreviations used in this schedule:

AMBAC	-	Ambac Assurance Corporation - Insured Bonds
CDA	-	Community Development Authority
COP	-	Certificate of Participation
DFA	-	Development Finance Agency
EDA	-	Economic Development Authority
EFA	-	Educational Facilities Authority
FGIC	-	Financial Guaranty Insurance Company - Insured Bonds
FHA	-	Federal Housing Administration
FNMA	-	Federal National Mortgage Association
FSA	-	Financial Security Assurance - Insured Bonds
GNMA	-	Government National Mortgage Association
GO	-	General Obligation
HDA	-	Housing Development Agency
HEFA	-	Health & Educational Facilities Authority
IDA	-	Industrial Development Authority
LOC	-	Letter of Credit
MBIA	-	Municipal Bond Investors Assurance Corporation - Insured Bonds
MFH	-	Multi-Family Housing
PCR	-	Pollution Control Revenue
Q-SBLF	-	Qualified School Board Loan Fund
RDA	-	Redevelopment Agency
SPA	-	Standby Bond Purchase Agreement - Insured Bonds
USD	-	Unified School District

Summary of Investments by Industry*

Pre-Refunded/Escrowed to Maturity	30.9%

Hospitals	19.2
Industrial Development	11.3
Housing	10.2
Transportation	5.8
Electric	5.5
Special Tax	4.3
Education	4.0
Local General Obligation	2.6
Water & Sewer	2.1
Resource Recovery	1.3
State General Obligation	1.2
Leasing	0.8
Other Revenue	0.4
Utilities	0.3
Public Facilities	0.1
	100.0%

* As a percentage of total investments. Please note that Fund holdings are as of August 31, 2008 and are subject to change.

See Notes to Schedule of Investments.

Western Asset Managed Municipals Fund Inc.

Schedule of Investments (unaudited) (continued)

August 31, 2008

Ratings Table

S&P/Moody s	
AAA/Aaa	27.0%
AA/ Aa	37.6
A	25.8
BBB/Baa	3.6
BB/Ba	1.0
CCC/Caa	1.1
A-1/VMIG1	0.7
NR	3.2
	100.0%

As a percentage of total investments.

S&P primary rating, then Moody s.

See pages 10 and 11 for definitions of ratings.

See Notes to Schedule of Investments.

Bond Ratings *(unaudited)*

The definitions of the applicable rating symbols are set forth below:

Standard & Poor s Ratings Service (Standard & Poor s) Ratings from AA to CCC may be modified by the addition of a plus (+) or minus ( ) sign to show relative standings within the major rating categories.

AAA	Bonds rated AAA have the highest rating assigned by Standard & Poor s. Capacity to pay interest and repay principal is extremely strong.
AA	Bonds rated AA have a very strong capacity to pay interest and repay principal and differ from the highest rated issues only in a small degree.
A	Bonds rated A have a strong capacity to pay interest and repay principal although they are somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than debt in higher rated categories.
BBB	Bonds rated BBB are regarded as having an adequate capacity to pay interest and repay principal. Whereas they normally exhibit adequate protection parameters, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity to pay interest and repay principal for bonds in this category than in higher rated categories.
BB, B, CCC, CC and C	Bonds rated BB , B , CCC , CC and C are regarded, on balance, as predominantly speculative with respect to capacity to pay interest and repay principal in accordance with the terms of the obligation. BB represents the lowest degree of speculation and C the highest degree of speculation. While such bonds will likely have some quality and protective characteristics, these are outweighed by large uncertainties or major risk exposures to adverse conditions.
D	Bonds rated D are in default and payment of interest and/or repayment of principal is in arrears.

Moody s Investors Service (Moody s) Numerical modifiers 1, 2 and 3 may be applied to each generic rating from Aa to Caa, where 1 is the highest and 3 the lowest ranking within its generic category.

Aaa	Bonds rated Aaa are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as gilt edge. Interest payments are protected by a large or by an exceptionally stable margin and principal is secure. While the various protective elements are likely to change, such changes can be visualized as most unlikely to impair the fundamentally strong position of such issues.
Aa	Bonds rated Aa are judged to be of high quality by all standards. Together with the Aaa group they comprise what are generally known as high grade bonds. They are rated lower than the best bonds because margins of protection may not be as large as in Aaa securities or fluctuation of protective elements may be of greater amplitude or there may be other elements present which make the long-term risks appear somewhat larger than in Aaa securities.
A	Bonds rated A possess many favorable investment attributes and are to be considered as upper medium grade obligations. Factors giving security to principal and interest are considered adequate but elements may be present which suggest a susceptibility to impairment some time in the future.
Baa	Bonds rated Baa are considered as medium grade obligations, i.e., they are neither highly protected nor poorly secured. Interest payments and principal security appear adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well.
Ba	Bonds rated Ba are judged to have speculative elements; their future cannot be considered as well assured. Often the protection of interest and principal payments may be very moderate and therefore

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Bond Ratings *(unaudited)(continued)*

	not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class.
B	Bonds rated B generally lack characteristics of desirable investments. Assurance of interest and principal payments or of maintenance of other terms of the contract over any long period of time may be small.
Caa	Bonds rated Caa are of poor standing. These may be in default, or present elements of danger may exist with respect to principal or interest.
Ca	Bonds rated Ca represent obligations which are speculative in a high degree. Such issues are often in default or have other marked short-comings.
C	Bonds rated C are the lowest class of bonds and issues so rated can be regarded as having extremely poor prospects of ever attaining any real investment standing.
NR	Indicates that the bond is not rated by Standard & Poor s or Moody s.

Short-Term Security Ratings *(unaudited)*

SP-1	Standard & Poor s highest rating indicating very strong or strong capacity to pay principal and interest; those issues determined to possess overwhelming safety characteristics are denoted with a plus (+) sign.
A-1	Standard & Poor s highest commercial paper and variable-rate demand obligation (VRDO) rating indicating that the degree of safety regarding timely payment is either overwhelming or very strong; those issues determined to possess overwhelming safety characteristics are denoted with a plus (+) sign.
VMIG 1	Moody s highest rating for issues having a demand feature VRDO.
MIG1	Moody s highest rating for short-term municipal obligations.
P-1	Moody s highest rating for commercial paper and for VRDO prior to the advent of the VMIG 1 rating.

Notes to Schedule of Investments (unaudited)

1. Organization and Significant Accounting Policies

Western Asset Managed Municipals Fund Inc. (the Fund) was incorporated in Maryland and is registered as a non-diversified, closed-end management investment company under the Investment Company Act of 1940, as amended (the 1940 Act). The Fund s investment objective is to seek as high a level of current income exempt from federal tax as is consistent with the preservation of principal.

The following are significant accounting policies consistently followed by the Fund and are in conformity with U.S. generally accepted accounting principles (GAAP).

(a) Financial Futures Contracts. The Fund may enter into financial futures contracts typically to hedge a portion of the portfolio. Upon entering into a financial futures contract, the Fund is required to deposit cash or securities as initial margin, equal to a certain percentage of the contract amount (initial margin deposit). Additional securities are also segregated up to the current market value of the financial futures contracts. Subsequent payments, known as variation margin, are made or received by the Fund each day, depending on the daily fluctuations in the value of the underlying financial instruments. For foreign denominated futures, variation margins are not settled daily. The Fund recognizes an unrealized gain or loss equal to the fluctuation in the value. When the financial futures contracts are closed, a realized gain or loss is recognized equal to the difference between the proceeds from (or cost of) the closing transactions and the Fund s basis in the contracts.

The risks associated with entering into financial futures contracts include the possibility that a change in the value of the contract may not correlate with the changes in the value of the underlying financial instruments. In addition, investing in financial futures contracts involves the risk that the Fund could lose more than the initial margin deposit and subsequent payments required for a futures transaction. Risks may also arise upon entering into these contracts from the potential inability of the counterparties to meet the terms of their contracts.

(b) Security Transactions. Security transactions are accounted for on a trade date basis.

2. Investment Valuation

Effective June 1, 2008, the Fund adopted Statement of Financial Accounting Standards No. 157 (FAS 157). FAS 157 establishes a single definition of fair value, creates a three-tier hierarchy as a framework for measuring fair value based on inputs used to value the Fund s investments, and requires additional disclosure about fair value. The hierarchy of inputs is summarized below.

Level 1 quoted prices in active markets for identical investments
Level 2 other significant observable inputs (including quoted prices for similar investments, interest rates, prepayment speeds, credit risk, etc.)
Level 3 significant unobservable inputs (including the Fund s own assumptions in determining the fair value of investments)

Securities are valued at the mean between the last quoted bid and asked prices provided by an independent pricing service that are based on transactions in municipal obligations, quotations from municipal bond dealers, market transactions in comparable securities and various other relationships between securities. When prices are not readily available, or are determined not to reflect fair value, the Fund may value these securities at fair value as determined in accordance with the procedures approved by the Fund s Board of Directors. Short-term obligations with maturities of 60 days or less are valued at amortized cost, which approximates fair value.

The following is a summary of the inputs used in valuing the Fund s assets carried at fair value:

	August 31, 2008	**Quoted Prices (Level 1)**	**Other Significant Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Investments in Securities	$ 743,730,397		$ 743,730,397	
Other Financial Instruments*	111,414	$ 111,414		
Total	$ 743,841,811	$ 111,414	$ 743,730,397	

* Other financial instruments includes futures contracts.

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Notes to Schedule of Investments (unaudited) (continued)

3. Investments

At August 31, 2008, the aggregate gross unrealized appreciation and depreciation of investments for federal income tax purposes were substantially as follows:

Gross unrealized appreciation	$	28,250,425
Gross unrealized depreciation		(10,873,859)
Net unrealized appreciation	$	17,376,566

At August 31, 2008, the Fund had the following open futures contracts:

	Number of Contracts	Expiration Date	Basis Value	Market Value	Unrealized Gain
Contracts to Sell:					
U.S. Treasury Bonds	474	12/08	$55,717,539	$55,606,125	$111,414

4. Recent Accounting Pronouncement

In March 2008, the Financial Accounting Standards Board issued the Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (FAS 161). FAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008. FAS 161 requires enhanced disclosures about the Fund s derivative and hedging activities, including how such activities are accounted for and their effect on the Fund s financial position, performance and cash flows. Management is currently evaluating the impact the adoption of FAS 161 will have on the Fund s financial statements and related disclosures.

ITEM 2. CONTROLS AND PROCEDURES.

(a) The registrant s principal executive officer and principal financial officer have concluded that the registrant s disclosure controls and procedures (as defined in Rule 30a- 3(c) under the Investment Company Act of 1940, as amended (the 1940 Act)) are effective as of a date within 90 days of the filing date of this report that includes the disclosure required by this paragraph, based on their evaluation of the disclosure controls and procedures required by Rule 30a-3(b) under the 1940 Act and 15d-15(b) under the Securities Exchange Act of 1934.

(b) There were no changes in the registrant s internal control over financial reporting (as defined in Rule 30a-3(d) under the 1940 Act) that occurred during the registrant s last fiscal quarter that have materially affected, or are likely to materially affect the registrant s internal control over financial reporting.

ITEM 3. EXHIBITS.

Certifications pursuant to Rule 30a-2(a) under the Investment Company Act of 1940, as amended, are attached hereto.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Western Asset Managed Municipals Fund Inc.

By /s/ R. Jay Gerken
R. Jay Gerken
Chief Executive Officer

Date: October 29, 2008

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By /s/ R. Jay Gerken
R. Jay Gerken
Chief Executive Officer

Date: October 29, 2008

By /s/ Kaprel Ozsolak
Kaprel Ozsolak
Chief Financial Officer

Date: October 29, 2008