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

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

Amendment No. 1 to
FORM 10-Q/A

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

For the quarterly period ended June 30, 2006

OR

o 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 (State or other jurisdiction of incorporation or organization)	65-0635748 (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 o

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 o Accelerated filer x Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o 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 July 31, 2006
Common Stock, $.001 par value per share	50,106,526 shares

Metropolitan Health Networks, Inc.

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Explanatory Note

This Amendment No. 1 on Form 10-Q/A (this "Amendment") amends the Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006 filed on August 14, 2006 (the "Original Filing"). Metropolitan Health Network, Inc. (“we” or “the Company”) has filed this Amendment to correct certain errors in the Unaudited Consolidated Balances Sheet and Statements of Operations as described in Note 7, Restatement of Condensed Consolidated Financial Statements, as well as to make corresponding textual changes in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations. The remaining Items required by Form 10-Q are not amended hereby and have been omitted. Other information contained herein has not been updated. Therefore, you should read this Amendment together with other documents and reports that we have filed with the Securities and Exchange Commission subsequent to the filing of the Original Filing. Information in such documents and reports updates and supersedes certain information contained in the Original Filing and this Amendment. More current information with respect to the Company is contained within its Quarterly Report on Form 10-Q for the quarter ended September 30, 2006, and other filings with the Securities and Exchange Commission.

PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

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

ASSETS		**June 30, 2006 (Unaudited, as restated)**		**December 31, 2005 (Audited)**
CURRENT ASSETS				
Cash and equivalents	$	15,633,283	$	15,572,862
Short-term investments		5,677,050		-
Accounts receivable, net of allowance		3,823,658		4,183,974
Inventory		241,263		201,430
Prepaid expenses		1,070,721		473,286
Deferred income taxes		3,400,000		3,500,000
Other current assets		251,082		547,976
TOTAL CURRENT ASSETS		30,097,057		24,479,528
PROPERTY AND EQUIPMENT, net		1,139,907		899,998
INVESTMENTS		940,757		627,819
GOODWILL, net		1,992,133		1,992,133
DEFERRED INCOME TAXES		4,182,000		4,493,000
OTHER ASSETS		1,012,774		622,628
TOTAL ASSETS	$	39,364,628	$	33,115,106
LIABILITIES AND STOCKHOLDERS' EQUITY				
CURRENT LIABILITIES				
Accounts payable	$	645,831	$	969,184
Advance and unearned premiums		3,337,226		-
Estimated medical expenses payable		2,601,708		694,410
Accrued payroll and payroll taxes		1,147,750		1,459,098
Accrued expenses		742,980		293,552
TOTAL CURRENT LIABILITIES		8,475,495		3,416,244
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		500,000
Common stock, par value $.001 per share; 80,000,000 shares authorized; 50,106,526 and 49,851,526 issued and outstanding, respectively		50,106		49,851
Additional paid-in capital		40,712,061		40,182,889
Accumulated deficit		(10,373,034)		(11,033,878)

TOTAL STOCKHOLDERS' EQUITY		30,889,133		29,698,862
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	39,364,628	$	33,115,106

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 six months ended June 30, 2006 (Unaudited, as restated)	2005 (Unaudited)	For the three months ended June 30, 2006 (Unaudited, as restated)	2005 (Unaudited)
REVENUES, net	$ 111,649,144	$ 91,688,772	$ 56,881,610	$ 46,169,207
OPERATING EXPENSES				
Direct medical costs	95,297,419	77,332,404	48,334,576	38,799,286
Other medical costs	5,144,944	5,210,820	2,559,277	2,573,845
Total medical expenses	100,442,363	82,543,224	50,893,853	41,373,131
Administrative payroll, payroll taxes and benefits	5,003,185	2,682,290	2,555,386	1,416,029
Marketing and advertising	1,995,854	156,189	1,021,924	155,819
General and administrative	3,549,237	2,739,344	1,977,221	1,371,308
TOTAL EXPENSES	110,990,639	88,121,047	56,448,384	44,316,287
OPERATING INCOME	658,505	3,567,725	433,226	1,852,920
OTHER INCOME				
Interest income, net	412,138	137,049	222,700	71,975
Other	1,201	129,614	21	67,891
TOTAL OTHER INCOME	413,339	266,663	222,721	139,866
INCOME BEFORE INCOME TAXES	1,071,844	3,834,388	655,947	1,992,786
INCOME TAXES	(411,000)	(1,447,000)	(251,800)	(750,000)
NET INCOME	$ 660,844	$ 2,387,388	$ 404,147	$ 1,242,786
NET EARNINGS PER SHARE:				
Basic	$ 0.01	$ 0.05	$ 0.01	$ 0.03
Diluted	$ 0.01	$ 0.05	$ 0.01	$ 0.02

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 six months ended June 30, 2006 (Unaudited, as restated)	2005 (Unaudited)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 660,844	$ 2,387,388
Adjustments to reconcile net income to net cash		
provided by operating activities:		
Depreciation and amortization	214,973	164,972
Deferred income taxes	411,000	870,000
Stock-based compensation expense	363,502	-
Tax benefit on exercise of stock options	-	577,000
Loss on disposal of assets	103	-
Amortization of securities issued for professional services	26,175	88,375
Changes in operating assets and liabilities:		
Accounts receivable, net	360,316	(2,125,986)
Inventory	(39,833)	17,872
Prepaid expenses	(597,435)	(549,788)
Other current assets	296,895	236,624
Other assets	3,367	(287,947)
Accounts payable	(323,352)	(294,258)
Advance and unearned premiums	3,337,226	-
Estimated medical expenses payable	1,907,298	-
Accrued payroll	(311,348)	(619,519)
Accrued expenses	449,427	467,303
Total adjustments	6,098,314	(1,455,352)
Net cash provided by operating activities	6,759,158	932,036
CASH FLOWS FROM INVESTING ACTIVITIES:		
Short-term investments	(5,677,050)	1,500,000
Investments	(312,938)	(601,783)
Redemption of restricted certificates of deposit	-	1,000,000
Capital expenditures	(848,499)	(160,322)
Net cash (used in)/provided by investing activities	(6,838,487)	1,737,895
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments on notes payable	-	(991,000)
Repurchase of warrants	-	(85,000)
Proceeds from exercise of stock options and warrants	139,750	384,435

Net proceeds from issuance of common stock		-		134,750
Net cash provided by/(used in) financing activities		139,750		(556,815)
NET INCREASE IN CASH AND EQUIVALENTS		60,421		2,113,116
CASH AND EQUIVALENTS - BEGINNING		15,572,862		11,344,113
CASH AND EQUIVALENTS - ENDING	$	15,633,283	$	13,457,229

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

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 six months ended June 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." The Company determines the appropriate classification at the time of purchase. As of June 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 six months ended June 30, 2006 was recorded as interest income.

LONG-TERM INVESTMENTS

Long-term investments, which consist primarily of an 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. Also included in long-term investments were certain certificates of deposit with original maturities in excess of one year. All income generated from these long-term certificates of deposit during the three and six months ended June 30, 2006 was recorded as interest income.

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

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 six months ended June 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 its patients through wholly-owned and contracted independent medical practices and providers (collectively, the “Affiliated Providers”). Accordingly, 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 the 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 88% and 99% of the Company’s total revenues for the quarters ended June 30, 2006 and 2005, respectively, and approximately 89% and 99% of the Company’s total revenues for the six months ended June 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.

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

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 had 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 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 $1.0 million and $156,000 for the quarters ended June 30, 2006 and 2005, respectively, and $2.0 million and $156,000 for the six months ended June 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 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 six months ended June 30, 2006, while an additional $500,000 was written off due to revised guidance issued by CMS in July 2006 regarding the costs payable by CMS in connection with these procedures. Accordingly, related accounts receivable in the accompanying consolidated balance sheets were $1.3 million and $2.2 million at June 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.

METROPOLITAN HEALTH NETWORKS, INC. AND SUBSIDIARIES
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Included in revenues for the quarter and six months ended June 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 anticipated to be completed in 2007. Based on the Company’s applicable risk scores, the Company accrued approximately $3.5 million during the six months ended June 30, 2006 related to incremental revenues anticipated to be received as a result of the MRA funding increases. These amounts, which are included in accounts receivable in the accompanying consolidated balance sheets at June 30, 2006, are expected to be received by the Company in the second half of the year, consistent with the timing of prior year payments. 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 $1,145,000 and $797,000 at June 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 $755,000 and $555,000 at June 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 June 30, 2006 and December 31, 2005 includes approximately $299,000 and $159,000, respectively, due to the HMO from CMS and HMO enrollees.

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 cannot estimate the amount of the anticipated increase at this time but believes this amount may be material to the results of the HMO.

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 prescription drug plans containing benefits in excess of the standard coverage limits.

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

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

The amount of revenue payable to a plan by CMS is subject to adjustment, positive or negative, based upon the application of risk corridors that compare a plan's revenues targeted in their bids ("target amount') to actual prescription drug costs. Variances exceeding certain thresholds may result in CMS making additional payments to the HMO or require the HMO to refund to CMS a portion of the payments it received. Actual prescription drug 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 ("allowable risk corridor costs"). The Company estimates and recognizes an adjustment to premium revenues related to the risk corridor payment adjustment based upon pharmacy claims experience to date as if the annual contract were to end at the end of each reporting period. Accordingly, this estimate provides no consideration to 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 which it assumes no risk, including reinsurance payments and low-income cost subsidies. Claims paid above the out-of-pocket or catastrophic threshold for which the HMO is not at risk are all reimbursed by CMS through the reinsurance subsidy plans. Low-income cost subsidies represent reimbursements from CMS for all or a portion of the deductible, the coinsurance and the 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 Part D premium and expense. As with its 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 $7.6 million at June 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.

ACCOUNTS RECEIVABLE

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

	June 30, 2006 (as restated)	December 31, 2005
Humana accounts receivable, net	$ 3,135,000	$ 3,782,000
Non-Humana accounts receivable, net	689,000	402,000
Accounts receivable, net	$ 3,824,000	$ 4,184,000

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

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 six months ended June 30,		For the three months ended June 30,	
	2006 (as restated)	2005	2006 (as restated)	2005
Net Income	$ 661,000	$ 2,387,000	$ 404,000	$ 1,243,000
Less: Preferred stock dividend	(25,000)	(25,000)	(13,000)	(13,000)
Income available to common shareholders	$ 636,000	$ 2,362,000	$ 391,000	$ 1,230,000
Denominator:				
Weighted average common shares outstanding	49,916,000	48,435,000	49,971,000	48,745,000
Basic earnings per common share	$ 0.01	$ 0.05	$ 0.01	$ 0.03
Income available to common shareholders	$ 636,000	$ 2,362,000	$ 391,000	$ 1,230,000
Denominator:				
Weighted average common shares outstanding	49,916,000	48,435,000	49,971,000	48,745,000
Common share equivalents of outstanding stock:				
Options and warrants	1,356,000	2,351,000	1,369,000	2,135,000
Weighted average common shares outstanding	51,272,000	50,786,000	51,340,000	50,880,000
Diluted earnings per common share	$ 0.01	$ 0.05	$ 0.01	$ 0.02

NEW ACCOUNTING PRONOUNCEMENTS

In November 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 151, "Inventory Costs" ("SFAS No. 151"), which is effective for fiscal periods beginning after June 15, 2005. This statement clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material. These items are required to be recognized as current period charges regardless of whether they meet the criterion of "so abnormal." The adoption of SFAS No. 151 did not have a material impact on the Company's financial statements.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 153, “Exchange of Non-Monetary Assets” (“SFAS No. 153”), which is effective for fiscal periods beginning after June 15, 2005. In the past, the net book value of the assets relinquished in a non-monetary transaction was used to measure the value of the assets exchanged. Under SFAS No. 153, assets exchanged in a non-monetary transaction will be at fair value instead of the net book value of the asset relinquished, as long as the transaction has commercial substance and the fair value of the assets exchanged is determinable within reasonable limits. The adoption of SFAS No. 153 did not have a material effect on the Company’s financial statements.

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.

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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 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.

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 with a new expiration date of 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. 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 June 30, 2006, the Company has not utilized this 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 1,110,110 and 1,365,400 outstanding options granted under the plans, respectively, as of June 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 June 30, 2006, options granted pursuant to the Omnibus Plan to purchase 2,780,033 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 six months ended June 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.

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The fair value for employee stock options granted during the six months ended June 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 six month periods ended June 30, 2006, the Company's income before income taxes was approximately $162,000 and $364,000 lower, respectively, and net income was lower by approximately $101,000 and $227,000, 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 $61,000 and $137,000 for the quarter and six month periods ended June 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 six months ended June 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 six months ended June 30, 2006, the Company issued 170,000 and 195,000 shares of common stock resulting from the exercise of stock options, respectively. Cash received from the option exercises was approximately $131,000 and $140,000 for the quarter and six months ended June 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 six months ended June 30, 2005. For purposes of this pro forma disclosure, the fair value of