

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

FORM 10-Q

(MARK ONE)

**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 1-11151

U.S. PHYSICAL THERAPY, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

NEVADA
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

76-0364866
(I.R.S. EMPLOYER
IDENTIFICATION NO.)

1300 WEST SAM HOUSTON PARKWAY SOUTH, SUITE 300,
HOUSTON, TEXAS
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

77042
(ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (713) 297-7000

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 No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of November 5, 2004, the number of shares outstanding of the registrant's common stock, par value \$.01 per share, was 12,439,455.

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ITEM 1. FINANCIAL STATEMENTS

U.S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

	September 30, 2004	December 31, 2003
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 24,776	\$ 16,822
Patient accounts receivable, less allowance for doubtful accounts of \$2,790 and \$3,456, respectively.....	16,229	14,135
Accounts receivable -- other.....	467	266
Other current assets.....	<u>1,088</u>	<u>1,802</u>
Total current assets.....	42,560	33,025
Fixed assets:		
Furniture and equipment.....	22,211	20,598
Leasehold improvements.....	<u>11,307</u>	<u>10,760</u>
	33,518	31,358
Less accumulated depreciation and amortization.....	<u>21,514</u>	<u>19,550</u>
	12,004	11,808
Goodwill.....	6,011	5,685
Other assets, net of amortization of \$432.....	<u>1,734</u>	<u>1,955</u>
	<u>\$ 62,309</u>	<u>\$ 52,473</u>
 LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable -- trade.....	\$ 648	\$ 498
Accrued expenses.....	4,280	2,549
Notes payable.....	70	39
Convertible subordinated note payable.....	<u>-</u>	<u>2,333</u>
Total current liabilities.....	4,998	5,419
Notes payable -- long-term portion.....	94	83
Other long-term liabilities.....	<u>530</u>	<u>346</u>
Total liabilities.....	5,622	5,848
Minority interests in subsidiary limited partnerships.....	3,475	3,278
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$.01 par value, 500,000 shares authorized, no shares issued and outstanding.....	--	--
Common stock, \$.01 par value, 20,000,000 shares authorized, 13,414,015 and 12,242,577 shares issued at September 30, 2004 and December 31, 2003, respectively.....	134	122
Additional paid-in capital.....	32,456	26,808
Retained earnings.....	33,801	28,939
Treasury stock at cost, 997,100 and 947,100 shares held on September 30, 2004 and December 31, 2003 respectively.....	<u>(13,179)</u>	<u>(12,522)</u>
Total shareholders' equity.....	<u>53,212</u>	<u>43,347</u>
	<u>\$ 62,309</u>	<u>\$ 52,473</u>

See notes to consolidated financial statements.

U.S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
 (IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)
 (unaudited)

	Three Months		Nine Months	
	Ended September 30,		Ended September 30,	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Net patient revenues.....	\$ 29,253	\$ 26,224	\$ 86,882	\$ 77,089
Management contract revenues.....	379	588	1,547	1,647
Other revenues.....	<u>77</u>	<u>42</u>	<u>163</u>	<u>127</u>
Net revenues.....	29,709	26,854	88,592	78,863
Clinic operating costs:				
Salaries and related costs.....	15,140	13,364	44,253	38,657
Rent, clinic supplies and other.....	6,176	5,258	18,207	15,638
Provision for (recovery of) doubtful accounts.....	<u>316</u>	<u>(45)</u>	<u>1,027</u>	<u>711</u>
	21,632	18,577	63,487	55,006
Closure costs.....	815	-	815	-
(Gain) loss on sale or disposal of fixed assets.....	7	(1)	(443)	(36)
Corporate office costs.....	<u>4,213</u>	<u>3,806</u>	<u>12,752</u>	<u>10,328</u>
Operating income.....	3,042	4,472	11,981	13,565
Other income (expense)				
Interest expense.....	(5)	(47)	(74)	(141)
Minority interests in earnings of subsidiary limited partnerships..	<u>(1,328)</u>	<u>(1,370)</u>	<u>(4,055)</u>	<u>(3,919)</u>
	(1,333)	(1,417)	(4,129)	(4,060)
Income before income taxes.....	1,709	3,055	7,852	9,505
Provision for income taxes.....	<u>655</u>	<u>1,154</u>	<u>2,987</u>	<u>3,604</u>
Net income.....	<u>\$ 1,054</u>	<u>\$ 1,901</u>	<u>\$ 4,865</u>	<u>\$ 5,901</u>
Basic earnings per common shares.....	<u>\$ 0.09</u>	<u>\$ 0.17</u>	<u>\$ 0.41</u>	<u>\$ 0.54</u>
Diluted earnings per common shares.....	<u>\$ 0.08</u>	<u>\$ 0.15</u>	<u>\$ 0.40</u>	<u>\$ 0.48</u>
Shares used in computing basic earnings per common shares.....	<u>12,328,000</u>	<u>11,088,000</u>	<u>11,772,000</u>	<u>10,986,000</u>
Shares used in computing diluted earnings per common shares.....	<u>12,530,000</u>	<u>12,525,000</u>	<u>12,420,000</u>	<u>12,470,000</u>

See notes to consolidated financial statements.

U.S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

(unaudited)

	Nine Months Ended September 30,	
	<u>2004</u>	<u>2003</u>
OPERATING ACTIVITIES		
Net income.....	\$ 4,865	\$ 5,901
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization.....	2,873	2,636
Gain on sale or disposal of fixed assets.....	(261)	(36)
Minority interests in earnings of subsidiary limited partnerships.....	4,055	3,919
Provision for doubtful accounts.....	1,027	711
Tax benefit from exercise of stock options.....	1,550	1,124
Deferred income taxes.....	(136)	(453)
Changes in operating assets and liabilities:		
Increase in patient accounts receivable.....	(3,121)	(1,655)
Increase in accounts receivable -- other.....	(201)	(55)
Decrease in other assets.....	935	1,132
Increase in accounts payable and accrued expenses.....	2,016	232
Increase in other liabilities.....	264	28
Other.....	-	(33)
Net cash provided by operating activities.....	<u>13,866</u>	<u>13,451</u>
INVESTING ACTIVITIES		
Purchase of fixed assets.....	(3,307)	(3,935)
Purchase of intangibles.....	(253)	(31)
Proceeds on sale of fixed assets.....	<u>499</u>	<u>129</u>
Net cash used in investing activities.....	(3,061)	(3,837)
FINANCING ACTIVITIES		
Distributions to minority investors in subsidiary limited partnerships.....	(3,859)	(3,654)
Payment of notes payable.....	(39)	(3)
Repurchase of common stock.....	(657)	(20)
Proceeds from exercise of stock options.....	<u>1,704</u>	<u>1,136</u>
Net cash used in financing activities.....	(2,851)	(2,541)
Net increase in cash and cash equivalents.....	7,954	7,073
Cash and cash equivalents -- beginning of period.....	<u>16,822</u>	<u>7,610</u>
Cash and cash equivalents -- end of period.....	<u>\$ 24,776</u>	<u>\$ 14,683</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Income taxes.....	\$ 1,796	\$ 2,453
Interest.....	\$ 69	\$ 187
Non-cash transactions during the period:		
Common stock issued in connection with the purchase of intangibles/ minority interest.....	\$ 73	\$ 104
Common stock issued in connection with the conversion of Series C Note into common stock.....	\$ 2,333	\$ -

See notes to consolidated financial statements.

U.S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2004
(unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements include the accounts of U.S. Physical Therapy, Inc. and its subsidiaries (the "Company"). All intercompany transactions and balances have been eliminated. The Company primarily operates through subsidiary clinic partnerships, in which the Company generally owns a 1% general partnership interest and a 64% limited partnership interest. The managing therapist(s) of each clinic owns the remaining limited partnership interest in the majority of the clinics. In 2003, the Company began to develop new clinics under profit sharing arrangements with therapists. Such facilities are operated through wholly owned subsidiaries. The Company recently announced that it will increase its focus on developing new clinics through partnerships and reduce its emphasis on profit sharing arrangements. The Company has developed satellite clinic facilities as extensions of existing clinics, with the result that some clinic groups operate more than one clinic location.

The accompanying unaudited consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the instructions for Form 10-Q. However, the statements 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.

The Company believes, and the Chief Executive Officer, Chief Financial Officer and Controller have certified, that the financial statements included in this report contain all necessary adjustments (consisting only of normal recurring adjustments) to present fairly the Company's financial position, results of operations and cash flows for the interim periods presented. For further information regarding the Company's accounting policies, please read the audited financial statements included in the Company's Form 10-K for the year ended December 31, 2003.

Operating results for the nine months ended September 30, 2004 are not necessarily indicative of the results the Company expects for the entire year. Please also review the risk factors included in our Form 10-K for the year ended December 31, 2003.

Significant Accounting Policies

Revenue Recognition

Revenues are recognized in the period in which services are rendered and are reported at estimated net realizable amounts. Net patient revenues are reported at the estimated net realizable amounts from insurance companies, third-party payors, patients and others for services rendered. The Company has agreements with third-party payors that provide for payments to the Company at amounts different from its established rates. The Company determines allowances for doubtful accounts based on the specific agings and payor classifications at each clinic, and contractual adjustments based on historical experience and the terms of payor contracts. Net accounts receivable includes only those amounts the Company estimates to be collectible.

Allowance for Doubtful Accounts

We review the accounts receivable aging and rely on prior experience with particular payors at each clinic to determine an appropriate reserve for doubtful accounts. Historically, clinics that have large numbers of aged accounts generally have less favorable collection experience, and thus they require a higher allowance. Accounts that are ultimately determined to be uncollectible are written off against our bad debt allowance. The amount of our aggregate bad debt allowance is periodically reviewed for adequacy in light of current and historical experience.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Stock Options

The Company applies the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations including Financial Accounting Standards Board (“FASB”) Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25*, to account for its fixed-plan stock options. Under this method, the compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price. FASB Statement No. 123, *Accounting for Stock-Based Compensation* and FASB Statement No. 148, *Accounting for Stock-Based Compensation – Transition and Disclosure, an amendment of FASB Statement No. 123*, established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As permitted by existing accounting standards, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of Statement 123, as amended. Under APB Opinion No. 25, the Company recaptured \$26,000 and \$61,000 of compensation cost in net income for the three and nine months ended September 30, 2004, respectively. No compensation cost related to stock plans was recognized for the quarter ended September 30, 2004. No compensation cost related to stock plans was recognized for the quarter and period ended September 30, 2003.

The fair value of these options was estimated at the date of grant using a Black-Scholes option pricing model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The pro forma effect on net income for the quarters and nine months ended September 30, 2004 and 2003 is not representative of the pro forma effect on net income in future years because it does not take into consideration pro forma compensation expense related to grants made prior to 1995. The Company's pro forma information follows (in thousands except for earnings per share information):

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	2004	2003	2004	2003
Actual net income.....	\$1,054	\$1,901	\$4,865	\$5,901
Deduct: Total stock based compensation expense determined under the fair value method, net of taxes.....	733	260	1,496	744
Pro forma net income.....	<u>\$321</u>	<u>\$1,641</u>	<u>\$3,369</u>	<u>\$5,157</u>
Earnings per share:				
Actual basic earnings per common share.....	\$0.09	\$0.17	\$0.41	\$0.54
Actual diluted earnings per common share.....	\$0.08	\$0.15	\$0.40	\$0.48
Pro forma basic earnings per common share.....	\$0.03	\$0.15	\$0.29	\$0.47
Pro forma diluted earnings per common share.....	\$0.03	\$0.13	\$0.28	\$0.42

Goodwill

Goodwill has been recognized for the amount of the excess of the purchase price paid over the fair value of the net tangible assets of the minority interest acquired and accounted for in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, ("SFAS 142") issued by the FASB in July 2001. Provisions of SFAS 142 that were effective for the Company January 1, 2002, require that goodwill and other intangible assets with indefinite lives no longer be amortized. SFAS 142 further requires the fair value of goodwill and other intangible assets with indefinite lives be tested for impairment upon adoption of this statement, annually and upon the occurrence of certain events and be written down to fair value if considered impaired. In accordance with SFAS 142, the Company did not have any amortization expense related to goodwill during 2004 and 2003. During the three and nine months ended September 30, 2004, the Company recognized an approximate \$20,000 in impairment of goodwill related to the closure of a clinic.

The changes in the carrying amount of goodwill consisted of the following for the nine months ended September 30, 2004 and the year ended December 31, 2003, respectively (in thousands):

	September 30,	December 31,
	<u>2004</u>	<u>2003</u>
Beginning balance	\$ 5,685	\$ 5,590
Goodwill acquired during the period	346	95
Goodwill impairment related to clinic closure	<u>(20)</u>	<u>-</u>
Ending balance	<u>\$ 6,011</u>	<u>\$ 5,685</u>

Long-Lived Assets

Fixed assets are stated at cost. Depreciation is computed on the straight-line method over the estimated useful lives of the related assets. Estimated useful lives for furniture and equipment range from three to eight years. Leasehold improvements are amortized over the estimated useful lives of the assets or the related lease terms, whichever is shorter.

Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

In October 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, ("SFAS 144") which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. While SFAS 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, it retains many of the fundamental provisions of that statement. SFAS 144 also supersedes the accounting and reporting provisions of APB Opinion No. 30, *Reporting for the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, for the disposal of a segment of a business.

The Company reviews property and equipment and intangible assets for impairment when events or circumstances indicate that the related amounts might be impaired. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Use of Estimates

In preparing the Company's consolidated financial statements, management makes certain estimates and assumptions primarily related to contractual allowances, bad debt reserves and goodwill recoverability that affect the amounts reported in the consolidated financial statements and related disclosures. Actual results may differ from these estimates.

Reclassifications

Certain reclassifications have been made to prior period amounts to conform to the current period presentation.

Recently Promulgated Accounting Pronouncements

In December 2003, the FASB issued Revised Interpretation No. 46, *Consolidation of Variable Interest Entities* ("FIN 46R"), which requires the consolidation of variable interest entities. FIN 46R, as revised, was applicable to financial statements of companies that had interests in "special purpose entities" during 2003. Effective as of the first quarter of

2004, FIN 46R is applicable to financial statements of companies that have interests in all other types of entities. Adoption of FIN 46R had no effect on the Company's financial position, results of operations or cash flows.

FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* ("SFAS 150"), was issued in May 2003. SFAS 150 establishes standards for the classification and measurement of certain financial instruments of both liabilities and equity. The Statement also includes disclosures for financial instruments within its scope. For the Company, SFAS 150 was effective for instruments entered into or modified after May 31, 2003 and otherwise was effective as of January 1, 2004, except for mandatorily redeemable financial instruments. For certain redeemable financial instruments, the Statement will be effective for the Company on January 1, 2005. The effective date has been deferred indefinitely for certain other types of mandatory instruments. The adoption of SFAS 150 did not have an impact on the Company's financial condition or results of operations.

On May 19, 2004, the FASB issued FASB Staff Position 106-2, 'Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003' ("FSP 106-2"), which requires measures of the accumulated postretirement benefit obligation and net periodic postretirement benefit costs to reflect the effects of the Medicare Prescription Drug, Improvement and Modernization Act of 2003. FSP 106-2 supersedes FSP 106-1 and is effective for interim or annual reporting periods beginning after June 15, 2004. The adoption of FSP 106-2 did not have an impact on the Company's financial condition or results of operations.

2. EARNINGS PER SHARE

The computations of basic and diluted earnings per share for the Company are as follows (in thousands, except per share data):

	For The Three Months		For the Nine Months	
	Ended September 30,		Ended September 30,	
	2004	2003	2004	2003
Numerator:				
Net income.....	\$ 1,054	\$ 1,901	\$ 4,865	\$ 5,901
Numerator for basic earnings per share.....	1,054	1,901	4,865	5,901
Effect of dilutive securities:				
Interest on convertible subordinated note payable.....	-	31	45	92
Numerator for diluted earnings per share --- income available to common stockholders after assumed conversions.....	<u>\$ 1,054</u>	<u>\$ 1,932</u>	<u>\$ 4,910</u>	<u>\$ 5,993</u>
Denominator:				
Denominator for basic earnings per share --- weighted average shares.....	12,328	11,088	11,772	10,986
Effect of dilutive securities:				
Stock options.....	202	737	310	784
Convertible subordinated note payable.....	-	700	338	700
Dilutive potential common shares.....	<u>202</u>	<u>1,437</u>	<u>648</u>	<u>1,484</u>
Denominator for diluted earnings per share --- adjusted weighted average shares and assumed conversions.....	<u>12,530</u>	<u>12,525</u>	<u>12,420</u>	<u>12,470</u>
Basic earnings per common share.....	<u>\$ 0.09</u>	<u>\$ 0.17</u>	<u>\$ 0.41</u>	<u>\$ 0.54</u>
Diluted earnings per common share.....	<u>\$ 0.08</u>	<u>\$ 0.15</u>	<u>\$ 0.40</u>	<u>\$ 0.48</u>

Options to purchase 606,980 and 509,919 shares for the three months ended September 30, 2004 and September 30, 2003, respectively, and 445,589 and 491,790 shares for the nine months ended September 30, 2004 and September 30, 2003, respectively, were excluded from the diluted earnings per share calculations for the respective periods because the options' exercise prices were greater than the average market price of the common shares during the periods.

3. NOTES PAYABLE

In May 1994, the Company issued a \$3 million 8% Convertible Subordinated Note, Series C, due June 30, 2004 (the "Series C Note"). The Series C Note was convertible at the option of the holder into shares of Company common stock determined by dividing the principal amount of the Note being converted by \$3.33. The Series C Note bore interest from the date of issuance at a rate of 8% per annum, payable quarterly. In June 2002, \$667,000 of the Series C Note was converted by the note holder into 200,100 shares of common stock. The principal amount under the Series C Note was \$2.3 million at December 31, 2003. On January 12, 2004, \$666,660 of the Series C Note was converted by the note holder into 200,000 shares of common stock. On June 30, 2004, the remaining \$1.7 million of the Series C Note was converted by the note holder into 499,900 shares of common stock. The Series C Note was unsecured and subordinated in right of payment to all other indebtedness for borrowed money incurred by the Company.

4. PURCHASE OF COMMON STOCK

In September 2001, the Company's Board of Directors (the "Board") authorized the Company to purchase, in the open market or in privately negotiated transactions, up to 1,000,000 shares of its common stock. Shares purchased are held as treasury shares and may be used for such valid corporate purposes or retired as the Board deems advisable. For the three and nine months ending September 30, 2004, the Company purchased 50,000 shares of common stock at a cost of \$657,000. As of September 30, 2004, the Company may purchase an additional 17,600 shares under this original Board authorized program.

In February 2003, the Board authorized a new share repurchase program of up to 250,000 additional shares of the Company's outstanding common stock. As there is no expiration for this Board authorization, additional shares may be purchased from time to time in the open market or private transactions depending on price, availability and the Company's cash position.

5. ACQUISITIONS AND DISPOSALS

Acquisition of Minority Interests

On June 1, 2002, the Company purchased a 35% minority interest in a limited partnership for \$220,000. Additional consideration may be paid in the future based upon clinic performance. The Company paid the minority partner \$73,000 in undistributed earnings. Based on the clinic's having met specified criteria, the Company paid additional consideration of \$31,000 and \$41,000 in August 2003 and 2004, respectively. In July 2002, the Company sold half of the purchased interest to another therapist for \$220,000, payable from future profits of the partnership. The Company discounted the note receivable by 50% and is recognizing the gain as payments are made.

On August 1, 2003, the Company purchased a 35% minority interest in a limited partnership for \$64,000 and agreed to pay the minority partner \$75,000 in undistributed earnings. The purchase was made under a note, which is payable in three installments. On September 10, 2003, the Company paid the first installment of \$35,000. The remaining principal amount due under the note payable was \$104,000 at December 31, 2003 of which \$34,000 was paid on August 1, 2004 and \$70,000 is payable on August 1, 2005.

On April 28, 2004, the Company purchased a 17.5% minority interest in a limited partnership for \$138,000 and agreed to pay the minority partner \$36,000 in undistributed earnings.

On June 2, 2004, the Company purchased a 17.5% minority interest in a limited partnership for \$25,000 and agreed to pay the minority partner \$11,000 in undistributed earnings.

On September 30, 2001, the Company purchased a 35% minority interest in a limited partnership which owns nine clinics in Michigan for consideration aggregating \$2,111,000. Additional purchase consideration was contingent upon future clinic performance. In September 2004, the Company paid additional consideration of \$105,000 based on the clinics having met specified criteria. The consideration consisted of \$32,000 cash and 5,440 shares of common stock with a value of \$73,000. The common stock consideration is a non-cash investing and financing transaction and has been excluded from the consolidated statements of cash flows.

The Company's minority interest purchases were accounted for as purchases and accordingly, the results of operations of the acquired minority interest percentage are included in the accompanying financial statements from the dates of purchase. In addition, the Company is permitted to make, and has occasionally made, changes to preliminary purchase price allocation during the first year after completing the purchase.

Sale of Assets

On June 30, 2004, the Company sold all of its assets in a clinic. Net proceeds from the sale were \$473,000 on assets with a carrying value of \$17,000. After recording certain costs associated with the sale, the Company recorded a gain of \$452,000.

Closure Costs

During the three months ending September 30, 2004, management decided to close eight unprofitable clinics after a thorough review of the Company's clinics. The Company recognized \$815,000 in closure costs relating to these clinics. The breakdown of these charges by major type of cost follows:

<u>Type of Cost</u>	<u>Amount</u>
Lease obligations	\$431,000
Unamortized leasehold improvements	181,000
Other assets	70,000
Unamortized goodwill	20,000
Severance	<u>113,000</u>
Total	<u>\$815,000</u>

Lease obligations represent the future payments remaining under lease agreements adjusted for estimated early settlements and severance costs primarily represent the costs associated with the settlement of employment contracts.

6. MINORITY INTEREST

In the majority of the Company's partnership agreements, the therapist partner begins with a 20% profit interest in his or her clinic partnership, which increases by 3% at the end of each year until his or her interest reaches 35%. Within the balance sheet and statement of operations the Company records partner therapists' profit interest in the clinic partnerships as minority interests in subsidiary limited partnerships. The Emerging Issues Task Force ("EITF") issued EITF 00-23, *Issues Related to Accounting for Stock Compensation under APB No. 25 and FASB Interpretation No. 44* ("EITF 00-23"), which provides specific accounting guidance relating to various incentive compensation issues. The Company reviewed EITF 00-23 with respect to the partnership's structure and the accounting for minority interest and concluded that for partnerships formed after January 18, 2001, EITF 00-23 requires the Company to expense as compensation rather than as minority interest in earnings, the clinic partners' interest in profits. Moreover, EITF 00-23 also requires that the Company expense as compensation rather than capitalize as goodwill, the purchase of minority interest in the partnerships, of clinic partnerships formed after January 18, 2001. At this time, the Company operates 76 wholly-owned clinics without any minority interest.

Pursuant to EITF 00-23, the Company classified \$201,000 and \$156,000 for the quarters ended September 30, 2004 and 2003, respectively, of the minority interest in earnings of subsidiary limited partnerships relating to the 30 partnerships formed after January 18, 2001, as salaries and related costs and \$599,000 and \$285,000 for the nine months ended September 30, 2004 and 2003, respectively. As of September 30, 2004 and December 31, 2003, \$530,000 and \$346,000, respectively, in undistributed minority interests related to the 30 partnerships are classified as other long-term liabilities.

7. EMPLOYEE TERMINATION BENEFITS

As a result of events that occurred during the period relating to the resignation of Roy Spradlin, former President, Chief Executive Officer and Chairman of the Board, certain costs were incurred during the quarter ended June 30, 2004. Pursuant to FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Terminations Benefits* (SFAS 88), an employer that provides contractual termination benefits is required to recognize a liability and a loss in connection with the termination of an employee in the period when that termination is known, if the amount can be reasonably estimated. In accordance with SFAS 88, the Company accrued severance of \$650,000 in the quarter ended June 30, 2004 in accordance with Mr. Spradlin's employment contract. Additionally, recruiting expense of \$153,000 and \$220,000 were recognized for the three and nine months ending September 30, 2004 relating to a new CEO search.

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

EXECUTIVE SUMMARY

Our Business

We operate outpatient physical and occupational therapy clinics that provide pre- and post-operative care and treatment for a variety of orthopedic-related disorders and sports-related injuries. At September 30, 2004, we operated 254 outpatient physical and occupational therapy clinics in 35 states. The average age of our clinics at September 30, 2004, was 4.02 years. We have developed 248 of the clinics and acquired six. Since inception, we have sold four clinics, closed 33 facilities due to substandard clinic performance, and consolidated three clinics with other existing clinics. In 2003, we opened 48 new clinics. During the first nine months of 2004, we have opened 24 new clinics with the goal of opening between 34 and 38 clinics by the end of 2004. During 2003, eight clinics were closed and for the nine months ending September 30, 2004, we closed 12 clinics.

In addition to our owned clinics, we also manage physical therapy facilities for third parties, primarily physicians, with three third-party facilities under management as of September 30, 2004.

Selected Operating and Financial Data

The following table presents selected operating and financial data. We view these non-financial data points as key indicators of our operating performance.

	For The Three Months Ended September 30,		For The Nine Months Ended September 30,	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
Number of clinics	254	235	254	235
Working days	64	64	191	191
Average visits per day per clinic	18.7	19.6	19.1	20.3
Total patient visits	305,000	282,000	902,000	832,000
Net patient revenue per visit	\$96.06	\$93.14	\$96.31	\$92.67
Statements of operations per visit:				
Net revenues	\$97.41	\$95.23	\$98.22	\$94.79
Salaries and related costs	(49.64)	(47.39)	(49.06)	(46.46)
Rent, clinic supplies and other	(20.25)	(18.64)	(20.19)	(18.80)
(Provision for) recovery of doubtful accounts	<u>(1.04)</u>	<u>.16</u>	<u>(1.14)</u>	<u>(.86)</u>
	26.48	29.36	27.83	28.67
Closure costs	(2.67)	--	(0.90)	--
Gain (Loss) on sale of assets	<u>(0.02)</u>	<u>--</u>	<u>.49</u>	<u>.04</u>
Total contribution from clinics	23.79	29.36	27.42	28.71
Corporate office costs	<u>(13.81)</u>	<u>(13.50)</u>	<u>(14.14)</u>	<u>(12.41)</u>
Operating income	<u>\$9.97</u>	<u>\$15.86</u>	<u>\$13.28</u>	<u>\$16.30</u>

Recent Developments

On October 13, 2004, the Company's board of directors promoted Chris Reading to President and Chief Executive Officer and Larry McAfee to Executive Vice President. Mr. McAfee also remains Chief Financial Officer. Both appointments were effective November 1, 2004. Messrs. Reading and McAfee have also been elected to the Company's Board of Directors expanding the board from eight to ten members.

RESULTS OF OPERATIONS

Three Months Ended September 30, 2004 Compared to the Three Months Ended September 30, 2003

- Net revenues rose 10.6% to \$29.7 million for the three months ended September 30, 2004 ("2004 third quarter") from \$26.9 million for the three months ended September 30, 2003 ("2003 third quarter") due to an 8.2% increase in patient visits to 305,000 from 282,000 combined with a 3.1% increase from \$93.14 to \$96.06 in net patient revenue per visit.
- Earnings were \$0.08 per diluted share for the 2004 third quarter as compared to \$0.15 for the 2003 third quarter. Net income for the 2004 third quarter decreased to \$1.1 million from \$1.9 million, or 44.6% compared to the 2003 third quarter. Total diluted shares outstanding were 12.5 million for both 2004 third quarter and 2003 third quarter.

Net Patient Revenues

- Net patient revenues increased to \$29.3 million for the 2004 third quarter from \$26.2 million for the 2003 third quarter, an increase of \$3.0 million, or 11.5%, primarily due to an 8.2% increase in patient visits to 305,000 and a \$2.92 increase in net patient revenues per visit to \$96.06. The increase in patient revenues per visit was primarily due to contractual fee increases.
- Total patient visits increased 23,000 or 8.2% to 305,000 for the 2004 third quarter from 282,000 for the 2003 third quarter. The growth in visits for the 2004 third quarter was primarily attributable to an increase of approximately 15,500 visits in clinics opened between October 1, 2003 and September 30, 2004 (the "New Clinics") and to an increase of approximately 7,500, or a 2.7% in visits for clinics opened before October 1, 2003 (the "Mature Clinics").
- Net patient revenues from New Clinics accounted for approximately 50% of the total revenue increase, or approximately \$1.5 million. The remaining increase of \$1.5 million in net patient revenues was from Mature Clinics.

Net patient revenues are based on established billing rates less allowances and discounts for patients covered by contractual programs and workers' compensation. Net patient revenues reflect contractual and other adjustments, which we evaluate quarterly, relating to patient discounts from certain payors. Payments received under these programs are based on predetermined rates and are generally less than the established billing rates of the clinics.

Clinic Operating Costs

Clinic operating costs as a percent of net revenues were 76% for the 2004 third quarter and 69% for the 2003 third quarter. Excluding closure costs and gain or loss on sale or disposal of fixed assets, clinic operating costs were 73% for the 2004 third quarter and 69% for the 2003 third quarter.

Clinic Operating Costs - Salaries and Related Costs

Salaries and related costs increased to \$15.1 million for the 2004 third quarter from \$13.4 million for the 2003 third quarter, an increase of \$1.8 million, or 13%. Approximately 55% of the increase, or \$968,000 was attributable to the New Clinics. The remaining 45% increase, or \$832,000 was attributable to the Mature Clinics. Salaries and related costs as a percent of revenues were 51% for the 2004 third quarter and 50% for the 2003 third quarter.

Clinic Operating Costs - Rent, Clinic Supplies and Other

Rent, clinic supplies and other costs increased to \$6.2 million for the 2004 third quarter from \$5.3 million for the 2003 third quarter, an increase of \$918,000, or 18%. Approximately 66% of the increase, or \$604,000, was attributable to the New Clinics. The remaining increase of 34%, or \$314,000 was attributable to the Mature Clinics. Rent, clinic supplies and other costs as a percent of revenues was 21% for the 2004 third quarter and 20% for the 2003 third quarter.

Clinic Operating Costs - Provision for Doubtful Accounts

The provision for doubtful accounts increased to \$316,000 for the 2004 third quarter from (\$45,000) for the 2003 third quarter, an increase of \$361,000. The bad debt provision was decreased by \$340,000 in September 2003 to reverse previous estimates which were determined to not be required. Thus the bad debt expense for the third quarter of 2003 was a net recovery. The provision for doubtful accounts as a percent of net patient revenues was 1.0% for the 2004 third quarter. The provision for doubtful accounts for each period is based on a detailed, clinic-by-clinic review of overdue accounts and is periodically reviewed in the aggregate in light of current and historical experience.

Closure Costs

In the 2004 third quarter, we recognized a loss of \$815,000 related to the closure of eight clinics. See Note 5 of the Notes to Consolidated Financial Statements for further discussion.

Corporate Office Costs

Corporate office costs, consisting primarily of salaries and benefits of corporate office personnel, rent, insurance costs, depreciation and amortization, travel, legal, professional, and recruiting fees, increased to \$4.2 million for the 2004 third quarter from \$3.8 million for the 2003 third quarter, an increase of \$407,000, or 11%. Corporate office costs increased due to increased recruiting fees of \$208,000 primarily related to the CEO search. There were also increases in legal and accounting fees of \$219,000 primarily due to the implementation of requirements of the Sarbanes-Oxley Act of 2002. Corporate office costs as a percent of net revenues were 14% for both the 2004 third quarter and the 2003 third quarter.

Minority Interests in Earnings of Subsidiary Limited Partnerships

Minority interests in earnings of subsidiary limited partnerships were \$1.3 million for the 2004 third quarter and \$1.4 million for the 2003 third quarter. As a percentage of operating income, minority interest was 44% for the 2004 third quarter and 31% for the 2003 third quarter. The increase is attributable to the inclusion of \$815,000 in clinic closure costs in the 2004 third quarter.

Provision for Income Taxes

The provision for income taxes was \$655,000 for the 2004 third quarter and \$1.2 million for the 2003 third quarter. The effective state and federal tax rate accrued for the 2004 third quarter was 38.3% and 37.8% for the 2003 third quarter.

Nine Months Ended September 30, 2004 Compared to the Nine Months Ended September 30, 2003

- Net revenues rose 12% to \$88.6 million from \$78.9 million primarily due to an 8% increase in patient visits to 902,000 and a 4% increase in net patient revenues per visit to \$96.31.
- Net income declined 18% to \$4.9 million from \$5.9 million.
- Earnings per share decreased 17% to \$0.40 per diluted share from \$0.48 per diluted share. Total diluted shares outstanding at September 30, 2004 and 2003 were 12.4 million and 12.5 million, respectively.

Net Patient Revenues

- Net patient revenues increased to \$86.9 million for the nine months ended September 30, 2004 ("2004 nine months") from \$77.1 million for the nine months ended September 30, 2003 ("2003 nine months"), an increase of \$9.8 million, or 13%, primarily due to an 8% increase in patient visits to 902,000 and a \$3.64 increase in patient revenues per visit to \$96.31. The increase in patient revenues per visit was primarily due to contractual fee increases.
- Total patient visits increased 70,000, or 8%, to 902,000 for the 2004 nine months from 832,000 for the 2003 nine months. The growth in visits for the period was attributable to an increase of approximately 29,000 visits in New Clinics together with a 41,000 or 5% increase in visits for Mature Clinics.
- Net patient revenues from New Clinics accounted for approximately 28% of the total increase, or approximately \$2.8 million. The remaining increase of \$7.0 million in net patient revenues was from Mature Clinics.

Clinic Operating Costs

Clinic operating costs were 72% of net revenues for the 2004 nine months and 70% of net revenues for the 2003 nine months. Excluding closure costs and gain or loss on sale or disposal of fixed assets, clinic operating costs remained the same for both periods.

Clinic Operating Costs - Salaries and Related Costs

Salaries and related costs increased to \$44.2 million for the 2004 Nine months from \$38.7 million for the 2003 Nine months, an increase of \$5.6 million, or 14%. Approximately 32% of the increase, or \$1.8 million, was attributable to the New Clinics. The remaining 68% increase, or \$3.8 million, was due higher costs at various Mature Clinics. Salaries and related costs as a percent of net revenues was 50% for the 2004 nine months and 49% for the 2003 nine months.

Clinic Operating Costs - Rent, Clinic Supplies and Other

Rent, clinic supplies and other costs increased to \$18.2 million for the 2004 nine months from \$15.6 million for the 2003 nine months, an increase of \$2.6 million, or 16%. Approximately 49% of the increase or \$1.3 million, was attributable to the New Clinics and the other \$1.3 million was attributable to various Mature Clinics. Rent, clinic supplies and other costs as a percent of net revenues was 21% and 20% for the 2004 nine months and the 2003 nine months, respectively.

Clinic Operating Costs - Provision for Doubtful Accounts

The provision for doubtful accounts increased to \$1 million for the 2004 nine months from \$711,000 for the 2003 nine months, an increase of \$316,000 or 44%. Approximately 21% of the increase or \$67,000 was due to the New Clinics. The provision for doubtful accounts as a percent of net patient revenues was 1.2% for the 2004 nine months from 0.9% for the 2003 nine months. Our allowance for bad debts as a percent of total patient accounts receivable was 15% at September 30, 2004, as compared to 20% at December 31, 2003.

Closure Costs

In the 2004 third quarter, we recognized a loss of \$815,000 related to the closure of eight clinics. See Note 5 of the Notes to Consolidated Financial Statements for further discussion.

Gain on Sale of Clinic Assets

On June 30, 2004, we recognized a gain of \$443,000 primarily related to the sale of a clinic. See Note 5 of the Notes to Consolidated Financial Statements for further discussion.

Corporate Office Costs

Corporate office costs, consisting primarily of salaries and benefits of corporate office personnel, rent, insurance costs, depreciation and amortization, travel, legal, professional, marketing and recruiting fees, increased to \$12.8 million for the 2004 nine months from \$10.3 million for the 2003 nine months, an increase of \$2.5 million, or 23%. Salary expense increased due to a one time charge of \$650,000 related the CEO resignation along with \$220,000 in recruiting fees primarily related to the CEO search. Additionally, there was an increase of \$325,000 related to the new Chief Operating and Financial Officers and corporate bonus accruals of \$300,000. There was also additional legal expense of \$394,000 due to the sale of a clinic, a new stock option plan and billings for various other legal issues. Accounting fees increased by \$333,000 primarily due to implementing requirements of the Sarbanes-Oxley Act of 2002, increased tax compliance and auditing fees. Corporate office costs as a percent of net revenues increased to 14% for the 2004 nine months from 13% for the 2003 nine months.

Minority Interests in Earnings of Subsidiary Limited Partnerships

Minority interests in earnings of subsidiary limited partnerships increased 3.5% to \$4.1 million for the 2004 nine months from \$3.9 million for the 2003 nine months. As a percentage of operating income, minority interest increased to 34% for the 2004 nine months from 29% for the 2003 nine months.

Provision for Income Taxes

The provision for income taxes decreased to \$3.0 million for the 2004 nine months from \$3.6 million for the 2003 nine months, a decrease of approximately \$617,000, or 17% as a result of lower pre-tax income. During the 2004 nine months and the 2003 nine months, we accrued state and federal income taxes at an effective tax rate of 38%.

LIQUIDITY AND CAPITAL RESOURCES

We believe that our business is generating enough cash flow from operating activities to allow us to meet our normal short-term and long-term cash requirements. At September 30, 2004, we had \$24.8 million in cash and cash equivalents compared to \$16.8 million at December 31, 2003. Although the start-up costs associated with opening new clinics, and our planned capital expenditures are significant, we believe that our cash and cash equivalents are sufficient to fund the working capital needs of our operating subsidiaries and future clinic development. Included in cash and cash equivalents at September 30, 2004 were \$2.0 million in a money market fund and \$16.6 million in a short-term debt instrument issued by an agency of the U.S. Government.

The increase in cash of \$8.0 million from December 31, 2003 to September 30, 2004 is due primarily to cash provided by operating activities of \$13.9 million, offset by \$3.0 million of cash used for the purchase of fixed and intangible assets and \$2.9 million used in financing activities. For the period ended September 30, 2004, we had \$4.1 million of cash provided by minority interests in earnings of subsidiary limited partnerships and made \$3.9 million in distributions to minority investors in subsidiary limited partnerships.

Our current ratio increased to 8.52 to 1.00 at September 30, 2004 from 6.09 to 1.00 at December 31, 2003. The increase in the current ratio is due primarily to the increased cash and accounts receivable balances at September 30, 2004, together with the conversion of the remainder of our Series C Convertible Subordinated Note to equity, offset by an increase in accrued expenses largely related to the closure of eight clinics.

At September 30, 2004, we had a debt-to-equity ratio of 0.0 to 1.00 compared to 0.06 to 1.00 at December 31, 2003. The decrease in the debt-to-equity ratio at September 30, 2004 compared to December 31, 2003 resulted from conversion of our remaining Convertible Subordinated Note.

We do not currently have credit lines or other credit arrangements. Historically, we have generated sufficient cash from operations to fund our development activities and cover operational needs. We generally do not acquire clinics through acquisitions, but rather develop new clinics, which we believe generally requires less capital. We have from time to time purchased the minority interests of limited partners in our clinic partnerships. We may purchase additional minority interests in the future. We believe that existing funds, supplemented by cash flows from existing operations, will be sufficient to meet our current operating needs, development plans and any purchases of minority interests through at least 2005.

In 2002, \$667,000 of the principal balance of the Series C Convertible Subordinated Note was converted into common stock, leaving a remaining balance of \$2.3 million at December 31, 2003. On January 12, 2004, \$666,660 of the principal balance of the Series C Convertible Subordinated Note was converted into common stock and on June 30, 2004, the remaining balance of \$1.7 million of the Series C Convertible Subordinated Note was converted into common stock.

In September 2001, the Board authorized us to purchase, in the open market or in privately negotiated transactions, up to 1,000,000 shares of our common stock. There is no expiration for this Board authorization and shares purchased are held as treasury shares and may be used for valid corporate purposes or retired as the Board deems advisable. During the years ended December 31, 2002 and 2003, we purchased 795,600 and 1,800 shares of our common stock on the open market for \$10.5 million and \$20,000, respectively. During the nine months ended September 30 2004, we purchased 50,000 shares of common stock on the open market for a total of \$657,000.

In February 2003, our Board authorized a new share repurchase program of up to 250,000 additional shares of our outstanding common stock. As there is no expiration for this Board authorization, additional shares may be purchased from time to time in the open market or private transactions depending on price, availability and our cash position. As of September 30, 2004, no shares have been repurchased under the new share repurchase program.

FACTORS AFFECTING FUTURE RESULTS

Clinic Development

As of September 30, 2004, we had 254 clinics in operation, 8 of which were opened in the 2004 third quarter. The Company recently announced that our goal for 2004 is to refocus on traditional partner and profit sharing arrangements and to deemphasize opening as many 100% owned company clinics. We therefore anticipate opening between 34 and 38 clinics during 2004, provided we can identify suitable locations and recruit physical and occupational therapists to manage the clinics. We expect to incur initial operating losses from the new clinics, which will impact our operating results. Generally we experience losses during the initial period of a new clinic's operation. Operating margins for newly opened clinics tend to be lower than more seasoned clinics because of start-up costs and lower patient visits and revenues. Patient visits and revenues gradually increase in the second year of operation, as patients and referral sources become aware of the new clinic. Revenues tend to increase significantly during the second and third years following a clinic opening. Based on the historical performance of our new clinics, generally the clinics opened in 2004 would favorably impact our results of operations beginning in 2005.

Annual Limit on Medicare Reimbursement Claims

For the quarter ended September 30, 2004, approximately 21% of our revenues were derived from Medicare. We receive payments from the Medicare program under a fee schedule. Under the Balanced Budget Act of 1997, the total amount paid by Medicare in any one year for outpatient physical (including speech-language pathology) or occupational therapy to any one patient is limited to \$1,500 (the "Medicare Limit"), except for services provided in hospitals. After a three-year moratorium, this Medicare Limit on therapy services was implemented for services rendered on or after September 1, 2003 subject to an adjusted total of \$1,590 (the "Adjusted Medicare Limit"). Effective December 8, 2003, a moratorium was placed on the Adjusted Medicare Limit for the remainder of 2003 and for 2004 and 2005. The potential negative impact on revenue resulting from a Medicare limit could be reduced by receiving payments from secondary insurance carriers and patients electing to self-pay. In the event the moratorium is not extended after 2005 and such negative impact is not mitigated by such efforts, the Adjusted Medicare Limit could have an adverse impact on 2006 and later revenue and income.

FORWARD LOOKING STATEMENTS

We make statements in this report that are considered to be forward-looking statements within the meaning under Section 21E of the Securities Exchange Act of 1934. These statements (often using words such as "believes," "expects," "intends," "plans," "appear," "should" and similar words), which involve numerous risks and uncertainties. Included among such statements are those relating to opening of new clinics, availability of personnel and the reimbursement environment. The forward-looking statements are based on our current views and assumptions and actual results could differ materially from those anticipated in such forward-looking statements as a result of certain risks, uncertainties, and factors, which include, but are not limited to:

- revenue and earnings expectations;
- general economic, business, and regulatory conditions;
- availability of qualified physical and occupational therapists;
- competition;
- federal and state regulations;
- reimbursement rates from third party payers and deductibles and co-pays by patients;
- availability, terms, and use of capital;
- acquisitions; and
- weather.

Most of these factors are beyond our control.

Given these uncertainties, you should not place undue reliance on our forward-looking statements. Please see the other sections of this report and our other periodic reports filed with the Securities and Exchange Commission (the "SEC") for more information on these factors. Our forward-looking statements represent our estimates and assumptions only as of the date of this report. Except as required by law, we are under no obligation to update any forward-looking statement, regardless of the reason the statement is no longer accurate.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We do not maintain any derivative instruments, interest rate swap arrangements, hedging contracts, futures contracts or the like. Upon the conversion of the remaining \$1.7 million of the Series C Convertible Subordinated Note into common stock, described above, we have no funded debt. See Note 3 of the notes to consolidated financial statements.

ITEM 4. CONTROLS AND PROCEDURES.

(a) Evaluation of Disclosure Controls and Procedures

As of the last day of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective in ensuring that information required to be disclosed in our periodic SEC reports is recorded, processed, summarized and reported within the time periods specified in the relevant SEC rules and forms. There have been no material changes in our disclosure controls and procedures that could significantly affect our disclosure controls and procedures subsequent to the date of that evaluation.

(b) Changes in Internal Control Over Financial Reporting

Beginning in 2003, we initiated a company-wide review of our internal controls over financial reporting as part of the process of preparing for compliance with Section 404 and as a complement to our existing overall program of internal controls over financial reporting. This is an on-going process.

There have been no changes in our internal control over financial reporting that occurred during our most recent financial quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. There have been no material changes in our internal controls that could significantly affect our internal controls subsequent to the date of that evaluation.

PART II - OTHER INFORMATION

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

In September 2004, the Company issued 5,440 restricted shares of common stock with a value of \$73,000 as part of additional purchase consideration paid in connection with the Company's purchase on September 30, 2001 of a 35% minority interest in a limited partnership which owns nine clinics in Michigan. The Company's obligation to pay the additional consideration was based on the clinics having met specified criteria. This issuance was part of a privately negotiated transaction and was exempt from registration pursuant to Section 4(2) of the Securities Act of 1933.

The following table provides information regarding shares of the Company's common stock repurchased by the Company during the quarter ended September 30, 2004.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ⁽¹⁾	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs ⁽¹⁾
July 1, 2004 through July 31, 2004	–	–	–	N/A
August 1, 2004 through August 31, 2004	–	–	–	N/A
September 1, 2004 through September 30, 2004	50,000	\$13.09	50,000	267,600
Total	50,000	\$13.09	50,000	267,600

(1) In the Company's Form 10-K for the year ended December 31, 2001, filed with the SEC on April 1, 2002, the Company announced that in September 2001 the Board had authorized the repurchase of up to 1,000,000 shares of the Company's outstanding common stock. All shares of common stock repurchased by the Company during the quarter ended September 30, 2004 were purchased under this program. There are 17,600 shares still available for repurchase

under this program and it does not have an expiration date. In the Company's Form 10-Q for the quarter ended March 31, 2003, filed with the SEC on May 5, 2003, the Company announced that on February 26, 2003 the Board had authorized a new share repurchase program of up to 250,000 shares of the Company's outstanding common stock. No shares have yet been purchased under this program and it does not have an expiration date.

ITEM 6. EXHIBITS.

(a) Exhibits

EXHIBIT NO.	DESCRIPTION
31.1*	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2*	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
31.3*	Rule 13a-14(a)/15d-14(a) Certification of Controller
32*	Certification Pursuant to 18 U.S.C 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith

SIGNATURES

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

U.S. PHYSICAL THERAPY, INC.

Date: November 9, 2004

By: /s/ LAWRENCE W. MCAFEE
Lawrance W. McAfee
Chief Financial Officer
(duly authorized officer and principal financial
and accounting officer)

By: /s/ DAVID RICHARDSON
David Richardson
Controller

INDEX OF EXHIBITS

EXHIBIT NO. -----	DESCRIPTION -----
31.1*	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2*	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
31.3*	Rule 13a-14(a)/15d-14(a) Certification of Controller
32*	Certification Pursuant to 18 U.S.C 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith

EXHIBIT 31.1

CERTIFICATION

I, Christopher J. Reading, certify that:

1. I have reviewed this quarterly report on Form 10-Q of U.S. Physical Therapy, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ CHRISTOPHER J. READING

Christopher J. Reading
Chief Executive Officer
(principal executive officer)

Date: November 9, 2004

EXHIBIT 31.2

CERTIFICATION

I, Lawrance W. McAfee, certify that:

1. I have reviewed this quarterly report on Form 10-Q of U.S. Physical Therapy, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ LAWRANCE W. MCAFEE

Lawrance W. McAfee
Chief Financial Officer
(principal financial and accounting officer)

Date: November 9, 2004

EXHIBIT 31.3

CERTIFICATION

I, David P. Richardson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of U.S. Physical Therapy, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ DAVID P. RICHARDSON
David P. Richardson
Controller

Date: November 9, 2004

EXHIBIT 32

CERTIFICATION OF PERIODIC REPORT

In connection with the Quarterly Report of U.S. Physical Therapy, Inc. (the "Company") on Form 10-Q for the quarterly period ended September 30, 2004, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Christopher J. Reading, Chief Executive Officer of the Company, Lawrance W. McAfee, Chief Financial Officer of the Company and David Richardson, Controller of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

November 9, 2004

/s/ Christopher J. Reading
Christopher J. Reading
Chief Executive Officer

/s/ Lawrance W. McAfee
Lawrance W. McAfee
Chief Financial Officer

/s/ David Richardson
David Richardson
Controller

This certification is made solely pursuant to the requirement of Section 1350 of 18 U.S.C., and is not for any other purpose. A signed original of this certification has been provided to U.S. Physical Therapy, Inc. and will be retained by U.S Physical Therapy, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.