SECURITY CAPITAL CORP/DE/
Form 10-K
March 31, 2006

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

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# FORM 10-K

**(Mark One)**

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

**For the fiscal year ended December 31, 2005**

**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: 1-7921**

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# SECURITY CAPITAL CORPORATION

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **13-3003070** |
| (State or other jurisdiction of | (I.R.S. Employer |

| | |
|---|---|
| incorporation or organization) | Identification No.) |

**Eight Greenwich Office Park**

**Greenwich, Connecticut 06831**

(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: **(203) 625-0770**

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SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

| Title of each class | Name of each exchange on which registered |
|---|---|
| Class A Common Stock, $0.01 par value | American Stock Exchange |

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

**None.**

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Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ý

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes o No ý

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

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 o Non-accelerated Filer ý

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No ý

As of June 30, 2005, 6,770,967 shares of the Registrant s voting stock were outstanding, of which 5,597,632 shares were held by affiliates of the Registrant. The aggregate market value of the remaining 1,173,335 shares of voting stock held by non-affiliates (based upon the closing price of the Registrant s Class A Common Stock on June 30, 2005 of $13.43) was $15,757,889.

As of March 24, 2006, 7,148,587 shares of the Registrant s Class A Common Stock and 380 shares of the Registrant s Common Stock were outstanding.

**Documents Incorporated by Reference**

Part III incorporates information by reference from the Registrant s definitive Proxy Statement to be filed for its 2006 Annual Meeting of Stockholders. Part IV incorporates certain exhibits by reference from the Registrant s previous filings.

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# PART I

## ITEM 1. BUSINESS

### General

Security Capital Corporation ( Security Capital , the Company , we , us and our ) operates as a holding company that actively participates in the management of its subsidiaries. We conduct business through our two operating subsidiaries, Primrose Holdings, Inc. ( Primrose ) and WC Holdings, Inc. ( WC ). We have a 98.5% ownership interest in Primrose and an 84.4% ownership interest in WC. Each subsidiary has a certain degree of operating autonomy, with its own chief executive officer and senior management.

WC, through its wholly owned subsidiary, CompManagement, Inc. ( CMI ), is a leading independent provider of comprehensive claims management, cost containment and consulting services designed to control the cost to employers of workers compensation, medical malpractice, automobile, general liability, unemployment and short- and long-term disability insurance benefits. WC s activities are primarily centered in Ohio, California, Virginia, Maryland, Texas, Michigan, Florida, Washington, Minnesota and New York. The operations of WC, CMI, and CMI s wholly owned subsidiaries are reported in our Employer Cost Containment and Health Services segment.

Primrose, through its wholly owned subsidiary, Primrose School Franchising Company, Inc., is the exclusive franchisor of Primrose Schools, an industry leader in early childhood education and high-quality childcare services, with related activities in real estate consulting and site selection services. Primrose schools are currently located in 13 states throughout the Southeast, Southwest and Midwest. The operations of Primrose and its wholly owned subsidiaries comprise our Educational Services segment.

In January 2004, we announced that our Board of Directors had formed a Special Committee to explore strategic alternatives to maximize stockholder value and provide an opportunity for liquidity to our public stockholders. During 2004, the Special Committee considered offers from the Company s Chairman and the representative of its controlling stockholder, Capital Partners, Inc. ( Capital Partners ), for the public shares they did not control, as well as other offers from third parties for the entire Company. In June 2005, the Company announced that the Board of Directors, upon the recommendation of the Special Committee, had determined to switch to a formal sale process to seek the highest price reasonably attainable for the Company, believing that a formal sale process represented the best possibility to maximize stockholder value.

Through December 31, 2005, we had received several indications of interest for our Primrose business, our WC business, and the entire Company; however, no definitive offers for Primrose, WC or the entire Company had been received. On January 18, 2006, three independent third parties submitted offer letters and financing commitments to the Company to purchase our Primrose business. Shortly after receiving these offers, the Board of Directors considered whether to sell the Primrose business regardless of whether WC and the balance of the Company were sold, or to continue to pursue the sale of the entire Company to a single buyer. Subsequent to year-end, the Board decided to sell Primrose, and to pursue the sale of the WC business and the balance of the Company in another separate transaction.

On February 10, 2006, the Company signed a definitive agreement for the sale of Primrose to an affiliate of American Capital Strategies, Ltd. for an aggregate purchase price of $85 million, subject to adjustment. After adjustment for transaction costs and certain items specified in the agreement, the net purchase price is anticipated to be approximately $82.8 million. The Company expects to net, after taxes, approximately

$58.2 million for its 91.5% fully diluted interest in Primrose, or approximately $8.44 per diluted share. The Primrose sale, which is subject to customary closing conditions, is anticipated to close by March 31, 2006.

We continue to seek to sell the WC business and the balance of the Company. The Company is considering offers for its interest in WC and the balance of the Company. The Company currently expects to enter into a definitive agreement during the second quarter of 2006 to sell WC and the balance of the Company.

**EMPLOYER COST CONTAINMENT AND HEALTH SERVICES SEGMENT**

**Overview**

As a result of several acquisitions and internal growth, revenues for the Employer Cost Containment and Health Services segment have grown from $53.6 million in 2001 to $140.8 million for the year ended December 31, 2005. Segment revenues were $140.8 million, $121.3 million and $84.6 million, representing approximately 90% of consolidated revenues from continuing operations, for each of the years ended December 31, 2005, 2004 and 2003, respectively.

In March 2005, Octagon Risk Services ( Octagon ), a wholly owned subsidiary of CMI, acquired 100% of the outstanding stock of Managed Care Holdings Corporation and its wholly owned subsidiary, Caronia Corporation ( Caronia ). Caronia provides third-party professional medical liability claims administration and risk management services to over 700 hospitals, 23,000 physicians and 4,000 long-term care facilities. Its business is headquartered in Melville, New York, and it services clients through 40 locations nationwide. Professional liability claims administration has become an increasingly important portion of our CMI business, and with the acquisition of Caronia, management believes that CMI is now one of the largest independent providers of professional medical liability claims services in the United States.

In May 2004, CMI acquired 100% of the outstanding stock of Integrated Claims Strategies ( ICS ), a provider of insurance claims processing and administrative services in the Tampa, Florida area, and in January 2004, CMI acquired 100% of the outstanding stock of KRAMMCO, Inc., a management company whose sole asset is a management contract with the North American Employer s Council, Inc. In October 2003, CMI acquired 100% of the outstanding stock of Octagon, a California-based full-service claims administration and consulting services provider for workers compensation, medical professional liability and general liability. In October 2002, CMI acquired 100% of the outstanding stock of Barron Risk Management Services, Inc., a third party administrator ( TPA ) in Texas that offers various services for the administration of self-insured property and casualty programs, and in April 2001, CMI acquired 100% of the outstanding stock of Trigon Administrators, Inc., a TPA in Virginia, Maryland and North Carolina.

**Services**

CMI s services primarily include cost management, medical management and administrative services related to workers compensation and medical professional liability claims, consulting, training and education services designed to improve and manage the costs of workplace health and safety, management and administrative services related to auto and general liability, short- and long-term disability insurance and Family Medical Leave Act claims. CMI s services are categorized into two general categories: (1) TPA services related to workers compensation, professional medical liability, automobile, general liability and short- and long-term disability claims and (2) medical management of workers compensation claims, or MCO services.

*Third-Party Administration Services*

Through its TPA operations, CMI provides comprehensive claims management to employers that is designed to control the employers costs of workers compensation, medical malpractice, automobile, general liability, short- and long-term disability insurance and Family Medical Leave Act claims. TPA services are provided primarily to the public sector (cities and counties), educational entities (universities), healthcare organizations (hospitals, physician groups, nursing homes) and industrial and commercial business and include group rating, claims administration, medical cost containment, risk management, disability management, managed care services, comprehensive web-enabled data management and consulting services, and safety and loss prevention.

Workers compensation programs are legislated on a state-by-state basis and range from a monopolistic system in which a state agency underwrites all insurance risk and manages administration of the program to largely privatized systems in which insurance can be underwritten by private insurance companies, individual self-insured employers, self-insured employer groups or state risk pools. CMI is one of the largest workers compensation TPAs in Ohio, which operates as a monopolistic system. All workers compensation risk and administration is underwritten by the Ohio Bureau of Workers Compensation (the OBWC ). Other states that operate under a monopolistic system where CMI operates include Washington and West Virginia (along with Ohio, State Fund ). State Fund services include the review and processing of an employer s workers compensation claims, the performance of risk analysis for an employer s experience rating, the design of individual programs to improve an employer s experience ratings, the review of premium audits on behalf of employers and analysis of employers for inclusion in group rating plans. In the State of Ohio, CMI services also include assisting employers before the Ohio Industrial Commission and the OBWC. Many Ohio employers have entered into contracts with CMI because of their participation in group rating plans sponsored by trade associations of which such employers are members.

CMI also acts as a TPA of workers compensation claims for self-insured employers. Each employer selects the types of services it desires and CMI is able to customize its service offerings to meet the specific needs of the customer. Customers generally enter into contracts with CMI for one-year periods; however, CMI enjoys a high customer retention rate. CMI currently provides its TPA services to over 23,000 State Fund and self-insured employers, many of which also receive MCO services (see below). CMI has one customer that accounted for approximately 12% and 13% of the Employer Cost Containment and Health services segment revenues, and 11% and 12% of consolidated revenues for 2005 and 2004, respectively.

*MCO Services*

Managed care services are designed to control the cost of healthcare services and to measure the performance of providers through intervention and ongoing review of services proposed and those actually provided. CMI operates a state-wide MCO under Ohio s Health Partnership Program, pursuant to a contract with the OBWC. Under this contract, CMI is responsible for providing, among other things, a state-wide health care provider network; treatment guidelines and utilization review procedures; peer review and quality assurance programs; provider sanction and termination procedures; medical and vocational case management programs; utilization management programs; medical bill adjudication and payment procedures; dispute resolution procedures; provider, employer and employee relations and education programs; and health care fraud detection and reporting programs.

CMI receives an administrative fee based on volume of activity, as defined by the OBWC. The administrative fee is paid monthly and is subject to setoffs if CMI does not meet certain criteria with respect to first report of injuries, bill submissions or data accuracy, or if CMI makes a misfiling of death claims. CMI can also earn a quarterly incentive payment provided that CMI meets certain performance criteria specified in the contract with the OBWC. Revenues from the contract with the OBWC were $28.9 million, $29.0 million and $27.2 million, representing 21%, 24% and 32% of total segment revenues in 2005, 2004 and 2003, respectively. The current contract with the OBWC is scheduled to expire in December 2006. CMI considers its relationship with the OBWC to be good, and while this contract has historically been renewed, no assurances can be given that the contract will be renewed.

CMI also provides MCO services to self-insured and insurance company customers throughout its national network, either separately or integrated with TPA services provided to the same customer. MCO services include treatment guidelines, case management, bill review, utilization review and payment and quality assessment. The majority of TPA customers also purchase MCO services, although a significant number of customers purchase MCO services only. CMI owns or has arrangements with various state-wide health care provider networks consisting of physicians, hospitals and ancillary providers. In those states where CMI operates its own network (South Carolina, Maryland, Virginia and Texas), CMI has a provider services department, which recruits new providers for its own network and offers educational materials and training seminars to its customers. CMI currently provides MCO services to over 55,000 customers.

**Customers and Marketing**

CMI markets its TPA and MCO services through internal sales and service representatives, direct marketing staff, external national sales representatives and senior management who manage most large account sales efforts. In addition, CMI has relationships with over 700 independent insurance agencies and brokers. CMI maintains five regional centers with 65 service locations throughout 25 states. Marketing efforts are directed at the risk management staff of prospective customer, as well as their advisors, usually insurance brokers and individual agents.

**Competition**

The TPA and MCO markets consist of approximately a dozen national companies, including CMI, that target Fortune 1000 companies and large government agencies, a number of independent companies, typically operating on a regional basis that target middle market corporate employers, municipalities and other non-profit entities, and a proliferation of local providers that serve smaller local businesses. Management considers the large, national companies to be the primary competitors of CMI; however, the regional independent companies offer one or more services similar to those offered by CMI. Some of CMI s competitors are significantly larger and have greater financial and marketing resources than CMI.

The principal competitive factors are the range of services offered and responsiveness to customer needs. CMI competes principally on the basis of its specialization in the non-health claims management area, breadth of services, attention to customer service and independence from insurance carriers and brokers.

**Government Regulation**

Regulation of CMI s TPA business varies on a state-by-state basis and ranges from no specific government regulation or oversight to specific licensing requirements. CMI s Ohio MCO is certified and regulated by the OBWC under Ohio s Health Partnership Program. The MCO, however, is not subject to Ohio s laws governing health insuring corporations, since it is not responsible for payment of health care claims or benefits, nor is it otherwise responsible for risk-bearing activities commonly associated with organizations licensed under Ohio s insurance laws. Management believes that its MCO operation is presently in compliance in all material respects with all applicable laws, regulations and certification requirements. See Item 3. Legal Proceedings of this Form 10-K for a discussion of litigation with respect to whether certain practices by CMI and its hearing representatives in Ohio constituted the unauthorized practice of law.

**Employees**

CMI has approximately 1,400 employees. CMI s employees are not represented by a union, and CMI considers its relationship with its employees to be good.

**EDUCATIONAL SERVICES SEGMENT**

**Overview**

Primrose is a leading provider of early childhood education and high-quality childcare services for children six weeks to five years old and after-school programs for children five through 12 years old. Primrose is a franchised system of private, educational-based childcare that targets the upscale demographic segment of the childcare industry. It is one of the largest franchisors of childcare programs in the United States. At December 31, 2005, Primrose had 149 franchise schools operating in the Southeast, Southwest and Midwest and had awarded 51 additional franchise units that were in various stages of development and construction. Primrose also has a company-owned school that serves an important role in training, testing new curricula, and business initiatives.

Revenues from the Educational Services segment are composed of royalties, franchise fees, assignment and real estate services fees, transfer fees, forfeiture fees and tuition fees. Royalties, which account for approximately 80% of total Educational Services revenues, are received from franchisees based on a percentage of a school s revenue. Revenues from the Educational Services segment have experienced double-digit annual growth due to the quality of the brand, opening of additional franchise schools and higher royalties from increases in same school revenues.

Segment revenues were $14.5 million, $11.6 million and $9.8 million, representing approximately 10% of consolidated revenues from continuing operations, for each of the years ended December 31, 2005, 2004 and 2003.

**Educational Services**

Primrose aims at delivering a consistent, high-quality educational product throughout all its schools. The overall franchise system and product are tightly controlled and uniform. Primrose provides a proven copyrighted early childhood curriculum and programming to its franchisees. These include detailed daily educational lesson plans, management guidelines and other collateral materials. Primrose integrates nationally recognized packaged curriculums with its own copyrighted Balanced Learning$^{sm}$ programs. Primrose s proprietary curriculum has received accreditation by the Southern Association of Colleges and Schools and the North Central Association Commission on Accreditation of School Improvement.

Primrose provides extensive training to new franchisees prior to the opening of their schools and provides its franchisees with detailed on-line manuals that cover all aspects of operating a Primrose school. Primrose has an ongoing operations support infrastructure that includes comprehensive business, operational and marketing plans for franchisees.

Operations consultants provide consulting services and visit schools on a regular basis to ensure that Primrose s quality standards are maintained. A complete internal and external equipment package is provided by Primrose for franchisees use in their schools. This package includes furniture, educational programs and materials, playground equipment, school supplies and customized childcare management software.

**Real Estate and Marketing Services**

Primrose provides real estate services and marketing services to its franchisees. Real estate services include site selection, assistance with the permitting process and development consulting. Real estate services are charged on a fixed fee basis, based upon the level of services provided to the franchisee.

Marketing efforts are directed in two areas: (i) creating consumer demand for Primrose s early childhood education and high-quality childcare services at the end-user level; and (ii) creating demand for Primrose School franchises among potential franchisees. Primrose markets its franchise schools primarily to working parents who desire more than daycare or babysitting through targeted marketing with numerous media, including public relations, direct mail, radio, newspapers, Internet and various magazines.

Its franchise opportunities are targeted towards successful individuals with management experience and entrepreneurial desires. Primrose receives favorable publicity generated by its quality curriculum and service. Marketing efforts include advertising in newspapers, trade publications, and magazines, conducting presentations in targeted cities, and customer referrals.

All franchisees pay advertising and marketing fees to Primrose equal to 1% of monthly gross revenues (although the franchise agreement allows the Company to charge up to 2%). These funds are restricted and can only be used by Primrose to help fund its various advertising and marketing programs for the schools.

Primrose has alliances with national lending sources to provide competitive financing for franchisees. These strategic partnerships provide a degree of familiarity and efficiency to the financing process for Primrose franchisees. Primrose does not guarantee any franchisee loans or leases.

**Trademarks and Other Proprietary Rights**

Primrose owns and maintains trademarks and copyrights relating to its curriculum, programs, characters, logos and building plans.

**Competition and Markets**

Primrose competes in the center-based for-profit sector of the childcare industry. The industry is highly fragmented with more than 113,000 licensed childcare centers, of which only a small percentage consists of national for-profit childcare chains such as Primrose. In addition to the national for-profit childcare centers, Primrose competes with family childcare operated out of the caregiver s home, residential and work-site childcare centers, full- and part-time nursery schools, pre-kindergarten and kindergarten programs offered in private and public schools and church-affiliated and other not-for-profit providers. In addition, substitutes for organized childcare, such as relatives and nannies can represent lower cost alternatives to the Company s services. Management believes the fragmented nature of the industry, together with an increasing demand for educational childcare, provides growth opportunities for well-managed childcare centers with professional, owner-operated childcare providers.

Management believes that the principal elements defining competitiveness are curriculum, product quality and consistency, well-trained staff, strong customer service and good business center management. Although Primrose competes favorably with respect to these factors, some of Primrose s competitors are larger and have greater financial resources, with a larger number of facilities and a broader national or regional presence.

**Government Regulation**

Primrose and its franchisees are subject to various federal, state and local laws as well as to a variety of regulatory provisions relating to zoning of school sites, sanitation, curriculum, health and safety. As a franchisor, Primrose is subject to state and federal laws regulating various aspects of franchise operations and sales. These laws impose registration and disclosure requirements on franchisors in the offer and sale of franchises. In certain cases, they also apply substantive standards to the relationship between franchisor and franchisee, relating primarily to default, termination and non-renewal of franchises and the potential impact of new Primrose schools on enrollment levels at existing Primrose sites. Management believes that Primrose is presently in compliance in all material respects with all applicable federal, state and local laws and regulatory provisions.

Various federal and state labor laws also govern Primrose s and its franchisees relationships with their employees. These include such matters as minimum wage requirements, overtime and other working conditions. Significant additional government-imposed increases in paid leaves of absence or mandated health benefits could be detrimental to the economic viability of franchisee-operated schools.

**Employees**

Primrose has approximately 70 employees. The employees are not represented by a labor union, and Primrose considers its relationship with its employees to be good.

**Available Information**

Security Capital files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the SEC ). You may read and copy any document filed at the SEC s public reference room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for information on the public reference room. The SEC maintains a website (www.sec.gov) that contains annual, quarterly and current reports, proxy statements and other information that we file electronically with the SEC. You may also obtain, free of charge, copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to the Securities Exchange Act of 1934 by contacting Investor Relations, at our principal corporate office, Eight Greenwich Office Park, Greenwich, CT 06831, telephone (203) 625-0770, or by visiting our website at www. securitycapitalcorporation.com.

**Executive Officers of the Registrant**

Executive officers serve at the discretion of the Company s Board of Directors. The executive officers of the Company and their positions as of March 24, 2006 are as follows:

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|---|---|---|
| Brian D. Fitzgerald | Chairman of the Board, President and Chief Executive Officer | 61 |
| A. George Gebauer | Vice Chairman of the Board and Secretary | 72 |
| William R. Schlueter | Senior Vice President and Chief Financial Officer | 39 |
| Richard W. O Connor | Controller | 41 |

Mr. Brian D. Fitzgerald has served as the Chairman of the Board since January 1990 and President and CEO since July 2000; President and a director of FGS, Inc. since March 1989; and a partner, general partner, stockholder, officer and/or director of various Capital Partners entities for more than five years.

Mr. A. George Gebauer has served as the Vice Chairman of the Board since July 2000 and Secretary since February 1994; Vice President, Secretary and a director of FGS, Inc. since March 1989; and a partner, general partner, stockholder, officer and/or director of various Capital Partners entities for more than five years. Mr. Gebauer was also the President of the Company from January 1990 to July 2000.

Mr. William R. Schlueter has served as a Senior Vice President since April 2003 and Assistant Secretary since July 2000. In March 2004, he was re-named Chief Financial Officer. He was Vice President and Chief Financial Officer from 1999 through April 2003 and Treasurer from July 2001 to April 2003. He has also been Chief Financial Officer of Capital Partners since 1998 and a Senior Vice President and Managing Director of Capital Partners since 2002.

Mr. Richard W. O Connor has served as the Controller since July 2004 and was named an executive officer of the Company in October 2005. Prior to joining the Company, Mr. O Connor was the Director of Financial Reporting and Budgeting at R.H. Donnelley Corporation, an independent yellow pages directory publisher, from August 1998 to March 2004.

**ITEM 1A. RISK FACTORS**

Certain statements contained in this Annual Report on Form 10-K regarding the Company s future operating results, performance, business plans and prospects and any other statements not constituting historical fact are forward-looking statements subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Words such as believe, expect, anticipate, should, will, would, plan, estimate, p outlook, may, predicts, could, or the negative of those words and other comparable expressions, are used to identify such forward-looking statements. Such statements are based on management s current expectations and are subject to a number of factors and uncertainties that could cause actual results and events to differ materially from those described in the forward-looking statements.

Investors should consider carefully the following risk factors, as well as the other information in this Annual Report and the Company s other filings with the SEC, including the Company s consolidated financial statements and the related notes, before deciding whether to invest or maintain an investment in shares of the Company s common stock. If any of the following risks actually occurs, the Company s business, financial condition, results of operations and cash flows could suffer, and the trading price of the Company s common stock could decline. The risks described below are not the only ones that we face. Additional risks that we currently do not know about or that we currently believe to be immaterial also may impact us and our stock.

All forward-looking statements reflect only our current beliefs and assumptions, and are based solely on information currently available to us. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results or events. These forward-looking statements are made as of the date of this Annual Report and, except as required under the federal securities laws and the rules and regulations of the SEC, we assume no obligation to update or revise them or to provide reasons why actual results or events may differ.

**RISK FACTORS SPECIFIC TO OUR**

**EMPLOYER COST CONTAINMENT AND HEALTH SERVICES SEGMENT**

**Changes in government regulations in the State of Ohio and other states in which we operate could significantly affect and change the way we do business in those states.**

Workers compensation programs are legislated on a state-by-state basis and range from a monopolistic system in which a state agency underwrites all insurance risk and manages administration of the program to largely privatized systems in which insurance can be underwritten by private insurance companies, individual self-insured employers, self-insured employer groups or state risk pools. Three of the states in which we conduct business, Ohio, Washington and West Virginia, operate as a monopolistic system.

We provide managed care services for workers compensation claims in the State of Ohio under a contract with the OBWC for approximately 23,000 employers. While revenues for our services are paid through the OBWC, the OBWC requires all employers to choose from a number of OBWC qualified service providers, of which the Company is one. Revenues from this contract were $28.9 million, $29.0 million and $27.2 million, representing 21%, 24% and 32% of total segment revenues, in 2005, 2004 and 2003, respectively. The current contract with the OBWC is scheduled to expire in December 2006. We consider our relationship with the OBWC to be good, and while this contract has historically been renewed, no assurances can be given that the contract will be renewed. The loss of the OBWC contract could have a material adverse effect on our financial condition, results of operations and cash flows.

Changes in the legislative or political environment in the State of Ohio, or the other states that operate as a monopolistic system, could result in the privatization of the workers compensation system. A change from a monopolistic system to a privatized system would significantly affect the way we conduct business in those states, and no assurances can be given that we will be able to adapt to the new environment in a timely and efficient manner and maintain our market share or level of profitability in those states. Approximately 40% of our Employer Cost Containment and Health Services segment revenues is derived from the State of Ohio, and a change from a monopolistic system of administering workers compensation claims to a privatized system in that State could have a material adverse effect on our financial condition, results of operations and cash flows.

**If the Company fails to manage its growth effectively, it may be unable to execute its business plan, maintain high levels of service or adequately address competitive challenges.**

As highlighted in Item 1. Business above, the historical revenue growth of our Employer Cost Containment and Health Services segment has been fueled, in part, by several strategic acquisitions and internal growth initiatives. The Company s strategy is to continue to pursue internal growth initiatives and strategies, as well as to seek growth through strategic acquisitions of, or relationships with, other companies in related lines of business.

As a result, the Company is subject to certain growth-related risks, including the risk that it will be unable to retain personnel or acquire other resources necessary to service such growth adequately. Expenses arising from the Company s efforts to increase its market penetration may have a negative impact on operating results. Moreover, there can be no assurance that any suitable opportunities for strategic acquisitions or relationships will arise or, if they do arise, that the transactions contemplated thereby could be completed. If such a transaction does occur, there can be no assurance that the Company will be able to integrate effectively any acquired business into the Company.

Because a large portion of the Company s historical revenue growth has been fueled by strategic acquisitions, investors may have developed an expectation that this historical growth will continue in the future. The Company s inability to grow revenues at this historical rate, for whatever reason, could cause investors to reconsider their investment in the Company and result in a decline in the Company s stock price.

**A change in market dynamics could negatively impact the Company.**

Within the past few years, several states have experienced a decline in the frequency of workers compensation claims, which has resulted in workers compensation insurance premium rate reductions in those states. The Company believes that declines in workers compensation premium rates in some states are due principally to intensified efforts by payors to manage and control claim costs, to improved risk management by employers and to legislative reforms. If declines in workers compensation costs occur in many other states and persist over the long-term, they may have an adverse impact on the Company s financial condition, results of operations and cash flows.

The Company provides an outsource service to payors of workers compensation benefits. These payors include insurance companies, TPAs, municipalities, State Funds, and self-insured, self-administered employers. If these payors reduce the amount of work they outsource, the Company s financial condition, results of operations and cash flows could be adversely affected.

**The Company faces competition for staffing, which may increase its labor costs and reduce profitability.**

The Company competes with other health-care providers in recruiting qualified management and staff personnel for the day-to-day operations of its business, as well as health-care professionals such as nurses, claims adjusters and case management professionals. In some markets, the scarcity of health-care professionals has become a significant operating issue for the Company. This shortage may require the Company to increase wages to recruit and retain qualified health-care professionals. Our inability to recruit and retain qualified health-care professionals, or to control labor costs, could have a material adverse effect on our profitability.

**The Company s failure to compete successfully in our industry may limit our ability to retain customers or attract new customers, which could adversely affect our financial condition, results of operations and cash flows.**

The TPA and MCO markets consist of approximately a dozen national companies, including CMI, that target Fortune 1000 companies and large government agencies, a number of independent companies, typically operating on a regional basis that target middle market corporate employers, municipalities and other non-profit entities, and a proliferation of local providers that serve smaller local businesses. Some of our competitors have broader geographical coverage, more established reputations in our markets, greater market share, larger contracting scale, lower costs and/or greater financial and other resources.

We believe that, as managed care techniques continue to gain acceptance in the workers compensation marketplace, our competitors will increasingly consist of nationally focused workers compensation managed care service companies, insurance companies, HMOs and other significant providers of managed care products. Legislative reforms in some states permit employers to designate health plans such as HMOs and PPOs to cover workers compensation claimants. Because many health plans have the ability to manage medical costs for workers compensation claimants, such legislation may intensify competition in the markets served by the Company. Also, decisions by major insurance carriers, underwriters, and brokers to expand their activities as third-party administrators and adjusters could directly compete with our business.

**An adverse decision in the complaint filed by the Cleveland Bar Association against CMI alleging that certain practices by CMI constituted the unauthorized practice of law could have a material adverse effect on our financial condition, results of operations and cash flows.**

On February 8, 2006, the Cleveland Bar Association filed a brief with respect to its pending complaint filed in 2002 against CMI, which alleges that CMI engaged in the unauthorized practice of law in connection with certain activities of CMI. In the latest filing, the Cleveland Bar Association requests penalties of $28 million for past practices of CMI that the Cleveland Bar Association contends constituted the unauthorized practice of law. We believe that this penalty is without merit and intend to continue to vigorously defend ourselves in this matter. The current recommendation of the Board on the Unauthorized Practice of Law to the Ohio Supreme Court is not to assess penalties against CMI. However, no assurances can be given that this complaint will be resolved in a manner that is favorable to CMI, and a decision in favor of the Cleveland Bar Association could have a material adverse effect on our financial condition, results of operations and cash flows. See Item 3.  Legal Proceedings  below for further details.

**RISK FACTORS SPECIFIC TO OUR**

**EDUCATIONAL SERVICES SEGMENT**

**Deterioration in economic conditions, including, but not limited to, an increase in the unemployment rate or a recession, could have an adverse effect on our financial condition, results of operations and cash flows.**

The Company s Educational Services revenues depend, in part, on the number of dual income families and working single parents who require childcare services. An increase in unemployment may adversely impact the Company because of the tendency of out-of-work parents to diminish or discontinue utilization of childcare services. In addition, the Company s franchisees may not be able to increase tuition at a rate consistent with increases in operating costs.

We operate as a franchised system of private, educational-based childcare that targets the upscale demographic segment of the childcare industry. Our success in growing revenues and net income is dependent upon, among other things, our ability to increase the number of franchisees in our system.

In order to be considered for a Primrose franchise, potential franchisees are required to have a minimum level of liquid net worth to be able to fund a portion of the total costs to develop and construct a Primrose school. In periods of economic recession, individuals may experience significant declines in their net worth and not meet the minimum requirements, or have the required minimum level of net worth, but be unable or unwilling to liquidate equity or other holdings in order to raise the cash to fund their share of a school s development and construction costs.