FORM 10-Q

PROVIDENCE SERVICE CORP - PRSC

Filed: August 10, 2009 (period: June 30, 2009)

Quarterly report which provides a continuing view of a company's financial position

Table of Contents

10-Q - FORM 10-Q

PART I

Item 1. 1

PART I

Item 1. Financial Statements.
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.
Item 3. Quantitative and Qualitative Disclosures About Market Risk.
Item 4. Controls and Procedures.

PART II

Item 1. Legal Proceedings.
Item 1A. Risk Factors.
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.
Item 3. Defaults Upon Senior Securities.
Item 4. Submission of Matters to a Vote of Security Holders.
Item 5. Other Information.
Item 6. Exhibits.

SIGNATURES
EXHIBIT INDEX
EX-4.1 (FORM OF 6.5% CONVERTIBLE SENIOR SUBORDINATED NOTE DUE 2014)
EX-31.1 (SECTION 302 CEO CERTIFICATION)

EX-31.2 (SECTION 302 CFO CERTIFICATION)

EX-32.1 (SECTION 906 CEO CERTIFICATION)

EX-32.2 (SECTION 906 CFO CERTIFICATION)

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 June 30, 2009

OR

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

For the transition period from to

Commission File No. 001-34221

The Providence Service Corporation
(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**86-0845127** **(I.R.S. Employer Identification No.)**
5524 East Fourth Street, **Tucson, Arizona** **(Address of principal executive offices)**	**85711** **(Zip code)**

(520) 747-6600
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ☐ Yes ☐ No

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

Large accelerated filer	☐	Accelerated filer	☒
Non-accelerated filer	☐ (Do not check if a smaller reporting company)	Smaller reporting company	☐

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

As of August 5, 2009, there were outstanding 12,864,091 shares (excluding treasury shares of 619,768) of the registrant's Common Stock, $0.001 par value per share.

TABLE OF CONTENTS

		Page
PART I—FINANCIAL INFORMATION		1
Item 1.	Financial Statements	1
	Condensed Consolidated Balance Sheets – December 31, 2008 and June 30, 2009 (unaudited)	1
	Unaudited Condensed Consolidated Statements of Income – Three and six months ended June 30, 2008 and 2009	2
	Unaudited Condensed Consolidated Statements of Cash Flows – Six months ended June 30, 2008 and 2009	3
	Notes to Unaudited Condensed Consolidated Financial Statements – June 30, 2009	4
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	22
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	46
Item 4.	Controls and Procedures	47
PART II—OTHER INFORMATION		48
Item 1.	Legal Proceedings	48
Item 1A.	Risk Factors	48
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	48
Item 3.	Defaults Upon Senior Securities	48
Item 4.	Submission of Matters to a Vote of Security Holders	48
Item 5.	Other Information	49
Item 6.	Exhibits	49

Table of Contents

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements.

The Providence Service Corporation
Condensed Consolidated Balance Sheets

	December 31, 2008	June 30, 2009 (Unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$ 29,364,247	$ 38,694,732
Accounts receivable—billed, net of allowance of $3.4 million in 2008 and $4.2 million in 2009	72,617,418	79,350,590
Accounts receivable—unbilled	423,817	433,750
Management fee receivable	7,702,608	7,347,862
Other receivables	3,148,970	4,982,570
Notes receivable	467,682	125,182
Restricted cash	7,803,808	6,989,652
Prepaid expenses and other	15,377,639	16,054,041
Deferred tax assets	4,757,535	3,909,469
Total current assets	141,663,724	157,887,848
Property and equipment, net	11,983,368	11,656,583
Notes receivable, less current portion	132,159	—
Goodwill	112,770,566	113,230,916
Intangible assets, net	81,555,587	77,904,524
Restricted cash, less current portion	5,207,132	5,941,014
Other assets	12,350,697	11,788,146
Total assets	$ 365,663,233	$ 378,409,031
Liabilities and stockholders' equity		
Current liabilities:		
Current portion of long-term obligations	$ 14,264,925	$ 17,890,981
Accounts payable	3,004,608	4,068,494
Accrued expenses	27,232,740	30,477,454
Accrued transportation costs	32,051,325	31,411,932
Deferred revenue	3,375,231	5,124,549
Current portion of interest rate swap	1,431,036	1,277,890
Reinsurance liability reserve	8,846,910	10,015,372
Total current liabilities	90,206,775	100,266,672
Long-term obligations, less current portion	223,493,680	212,725,000
Other long-term liabilities	3,975,278	4,295,820
Deferred tax liabilities	10,096,297	10,979,960
Total liabilities	327,772,030	328,267,452
Commitments and contingencies		
Stockholders' equity		
Common stock: Authorized 40,000,000 shares; $0.001 par value; 13,462,356 and 13,483,859 issued and outstanding (including treasury shares)	13,462	13,484
Additional paid-in capital	169,698,598	170,119,238
Retained deficit	(123,253,836)	(112,126,846)
Accumulated other comprehensive loss, net of tax	(4,449,547)	(3,440,867)
Treasury shares, at cost, 619,768 shares	(11,383,967)	(11,383,967)
Total Providence stockholders' equity	30,624,710	43,181,042
Non-controlling interest	7,266,493	6,960,537
Total stockholders' equity	37,891,203	50,141,579
Total liabilities and stockholders' equity	$ 365,663,233	$ 378,409,031

See accompanying notes to unaudited condensed consolidated financial statements

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

The Providence Service Corporation
Unaudited Condensed Consolidated Statements of Income

	Three months ended June 30,		Six months ended June 30,	
	2008	2009	2008	2009
Revenues:				
Home and community based services	$ 65,385,543	$ 74,501,279	$ 131,281,207	$ 147,192,019
Foster care services	7,565,686	9,445,616	14,518,000	18,393,469
Management fees	5,425,539	3,736,046	10,667,966	7,328,368
Non-emergency transportation services	94,648,593	104,149,003	190,222,646	205,630,255
	173,025,361	191,831,944	346,689,819	378,544,111
Operating expenses:				
Client service expense	62,172,252	69,482,021	123,655,898	136,356,498
Cost of non-emergency transportation services	87,458,931	95,222,873	173,706,561	185,044,404
General and administrative expense	10,099,428	10,056,177	21,765,584	21,946,892
Depreciation and amortization	3,166,238	3,096,558	6,485,787	6,180,756
Total operating expenses	162,896,849	177,857,629	325,613,830	349,528,550
Operating income	10,128,512	13,974,315	21,075,989	29,015,561
Other (income) expense:				
Interest expense	4,708,955	5,398,027	9,994,901	10,712,048
Interest income	(240,206)	(62,355)	(598,619)	(178,305)
Income before income taxes	5,659,763	8,638,643	11,679,707	18,481,818
Provision for income taxes	2,221,770	3,388,309	4,537,596	7,354,828
Net income	$ 3,437,993	$ 5,250,334	$ 7,142,111	$ 11,126,990
Earnings per common share:				
Basic	$ 0.27	$ 0.40	$ 0.57	$ 0.85
Diluted	$ 0.27	$ 0.40	$ 0.56	$ 0.84
Weighted-average number of common shares outstanding:				
Basic	12,519,527	13,120,345	12,484,331	13,117,697
Diluted	12,693,880	13,207,330	12,677,379	13,189,950

See accompanying notes to unaudited condensed consolidated financial statements

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

The Providence Service Corporation
Unaudited Condensed Consolidated Statements of Cash Flows

	Six months ended June 30, 2008	Six months ended June 30, 2009
Operating activities		
Net income	$ 7,142,111	$ 11,126,990
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	2,313,363	2,326,652
Amortization	4,172,424	3,854,104
Amortization of deferred financing costs	1,201,054	1,687,953
Provision for doubful accounts	994,353	1,630,325
Deferred income taxes	(483,580)	1,526,361
Stock based compensation	1,163,014	62,024
Excess tax benefit upon exercise of stock options	(184,569)	(36,241)
Other	22,073	270,155
Changes in operating assets and liabilities, net of effects of acquisitions:		
Billed and unbilled accounts receivable	(2,283,624)	(7,267,671)
Management fee receivable	(791,883)	354,497
Other receivables	(1,345,559)	(2,320,122)
Restricted cash	456,553	121,627
Reinsurance liability reserve	2,094,060	1,490,400
Prepaid expenses and other	(5,299,737)	1,839,703
Accounts payable and accrued expenses	3,666,383	1,224,435
Accrued transportation costs	(798,194)	(639,394)
Deferred revenue	(522,119)	1,740,857
Other long-term liabilities	50,883	80,741
Net cash provided by operating activities	11,567,006	19,073,396
Investing activities		
Purchase of property and equipment, net	(2,075,199)	(1,957,150)
Acquisition of businesses, net of cash acquired	(537,119)	(277,144)
Acquisition earnout payments	(6,670,655)	—
Restricted cash for contract performance	2,535,891	(41,353)
Purchase of short-term investments, net	(45,073)	(122,207)
Collection of notes receivable	2,873,390	474,659
Net cash used in investing activities	(3,918,765)	(1,923,195)
Financing activities		
Repurchase of common stock, for treasury	(55,448)	—
Proceeds from common stock issued pursuant to stock option exercise	469,320	16,440
Excess tax benefit upon exercise of stock options	184,569	36,241
Repayment of long-term debt	(4,325,000)	(7,142,624)
Debt financing costs	(88,775)	(791,519)
Capital lease payments	—	(51,467)
Net cash used in financing activities	(3,815,334)	(7,932,929)
Effect of exchange rate changes on cash	(140,751)	113,213
Net change in cash	3,692,156	9,330,485
Cash at beginning of period	35,378,645	29,364,247
Cash at end of period	$ 39,070,801	$ 38,694,732
Supplemental cash flow information:		
Cash paid for interest	$ 8,341,066	$ 8,723,502
Cash paid for income taxes	$ 2,313,941	$ 2,062,838

See accompanying notes to unaudited condensed consolidated financial statements

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

The Providence Service Corporation
Notes to Unaudited Condensed Consolidated Financial Statements
June 30, 2009

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements (the "consolidated financial statements") include the accounts of The Providence Service Corporation and its wholly-owned subsidiaries, including its foreign wholly-owned subsidiary WCG International Ltd. ("WCG"). Unless the context otherwise requires, references to the "Company", "our", "we" and "us" mean The Providence Service Corporation and its wholly-owned subsidiaries. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for fair presentation have been included. Operating results for the six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2009.

The consolidated balance sheet at December 31, 2008 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The consolidated financial statements contained herein should be read in conjunction with the audited financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

2. Description of Business and Summary of Critical Accounting Estimates

Description of Business

The Company is a government outsourcing privatization company. The Company operates in the following two segments: Social Services and Non-Emergency Transportation Services ("NET Services"). As of June 30, 2009, the Company operated in 42 states, and the District of Columbia, United States, and British Columbia, Canada.

The Social Services operating segment responds to governmental privatization initiatives in adult and juvenile justice, corrections, social services, welfare systems, education and workforce development by providing home-based and community-based counseling services and foster care to at-risk families and children. These services are purchased primarily by state, county and city levels of government, and are delivered under block purchase, cost based and fee-for-service arrangements. The Company also contracts with not-for-profit organizations to provide management services for a fee.

The NET Services operating segment provides non-emergency transportation management services, primarily to Medicaid beneficiaries. The entities that pay for non-emergency medical transportation services primarily include state Medicaid programs, health maintenance organizations and commercial insurers. Most of the Company's non-emergency medical transportation services are delivered under capitated contracts where the Company assumes the responsibility of meeting the transportation needs of a specific geographic population.

Concentration of Credit Risk

Contracts entered into with governmental agencies and other entities that contract with governmental agencies accounted for approximately 84% and 81% of the Company's revenue for the six months ended June 30, 2008 and 2009, respectively. The related contracts are subject to possible statutory and regulatory changes, rate adjustments, administrative rulings, rate freezes and funding reductions. Reductions in amounts paid under these contracts for the Company's services or changes in methods or regulations governing payments for the Company's services could materially adversely affect its revenue and profitability.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

For the six months ended June 30, 2008 and 2009, the Company conducted a portion of its operations in Canada through WCG. At June 30, 2008 and 2009, approximately $22.5 million, or 11.3%, and $12.7 million, or 25.4%, of the Company's net assets, respectively, were located in Canada. In addition, approximately $18.0 million, or 5.2%, and $10.9 million, or 2.9%, of the Company's consolidated revenue for the six months ended June 30, 2008 and 2009, respectively, was generated from the Company's Canadian operations. The Company is subject to the risks inherent in conducting business across national boundaries, any one of which could adversely impact its business. In addition to currency fluctuations, these risks include, among other things: (i) economic downturns; (ii) changes in or interpretations of local law, governmental policy or regulation; (iii) restrictions on the transfer of funds into or out of the country; (iv) varying tax systems; (v) delays from doing business with governmental agencies; (vi) nationalization of foreign assets; and (vii) government protectionism. The Company intends to continue to evaluate opportunities to establish additional operations in Canada. One or more of the foregoing factors could impair the Company's current or future operations and, as a result, harm its overall business.

Foreign Currency Translation

The financial position and results of operations of WCG are measured using WCG's local currency (Canadian Dollar) as the functional currency. Revenues and expenses of WCG have been translated into U.S. dollars at average exchange rates prevailing during the period. Assets and liabilities have been translated at the rates of exchange on the balance sheet date. The resulting translation gain and loss adjustments are recorded directly as a separate component of stockholders' equity. At present and for the foreseeable future, the Company intends to reinvest any undistributed earnings of its foreign subsidiary in foreign operations. As a result, the Company is not providing for U.S. or additional foreign withholding taxes on its foreign subsidiary's undistributed earnings. Generally, such earnings become subject to U.S. tax upon the remittance of dividends and under certain other circumstances. It is not practicable to estimate the amount of unrecognized deferred tax liability for temporary differences that are essentially permanent in duration on such undistributed earnings.

Derivative Instruments and Hedging Activities

The Company holds a derivative financial instrument for the purpose of hedging interest rate risk. The type of risk hedged relates to the variability of future earnings and cash flows caused by movements in interest rates applied to the Company's floating rate long-term debt. The Company documented its risk management strategy and hedge effectiveness at the inception of the hedge and will continue to assess its effectiveness during the term of the hedge. The Company has designated the interest rate swap as a cash flow hedge under Statement of Financial Accounting Standards ("SFAS") No. 133, "*Accounting for Derivative Instruments and Hedging Activities*" ("SFAS 133").

Derivatives that have been designated and qualify as cash flow hedging instruments are reported at fair value. The Company measures hedge effectiveness by formally assessing, at least quarterly, the correlation of the expected future cash flows of the hedged item and the derivative hedging instrument. The gain or loss on the effective portion of the hedge (i.e. change in fair value) is initially reported as a component of other comprehensive income. The remaining gain or loss of the ineffective portion of the hedge, if any, is recognized in earnings. The fair value of the cash flow hedging instrument was a liability of approximately $1.6 million and $1.3 million as of December 31, 2008 and June 30, 2009, respectively, which was classified as "Current portion of interest rate swap" and "Other long-term liabilities" in the accompanying consolidated balance sheet with respect to the balance at December 31, 2008 and as "Current portion of interest rate swap" in the accompanying consolidated balance sheet at June 30, 2009.

Cash Equivalents

Cash and cash equivalents include all cash balances and highly liquid investments with an initial maturity of three months or less. Investments in cash equivalents are carried at cost, which approximates fair value. The Company places its temporary cash investments with high credit quality financial institutions. At times such investments may be in excess of the Federal Deposit Insurance Corporation (FDIC) and the Canada Deposit Insurance Corporation (CDIC) insurance limits.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

Table of Contents

At December 31, 2008 and June 30, 2009, approximately $2.0 million and $1.9 million, respectively, of cash was held by WCG and was not freely transferable without unfavorable tax consequences between the Company and WCG.

Restricted Cash

The Company had approximately $13.0 million and $12.9 million of restricted cash at December 31, 2008 and June 30, 2009, respectively, as follows:

	December 31, 2008	June 30, 2009
Collateral for letters of credit—Contractual obligations	$ 175,000	$ 175,000
Contractual obligations	898,844	777,217
Subtotal restricted cash for contractual obligations	1,073,844	952,217
Collateral for letters of credit—Reinsured claims losses	3,311,000	4,041,000
Escrow—Reinsured claims losses	8,626,096	7,937,449
Subtotal restricted cash for reinsured claims losses	11,937,096	11,978,449
Total restricted cash	13,010,940	12,930,666
Less current portion	7,803,808	6,989,652
	$ 5,207,132	$ 5,941,014

Of the restricted cash amount at December 31, 2008 and June 30, 2009:

- $175,000 served as collateral for irrevocable standby letters of credit that provide financial assurance that the Company will fulfill certain contractual obligations;
- approximately $3.3 million and $4.0 million, respectively, served as collateral for irrevocable standby letters of credit to secure any reinsured claims losses under the Company's general and professional liability and workers' compensation reinsurance programs and was classified as noncurrent assets in the accompanying balance sheets;
- approximately $899,000 and $777,000, respectively, was held to fund the Company's obligations under arrangements with various governmental agencies through the correctional services business acquired by the Company in 2006 ("Correctional Services");
- approximately $1.6 million was restricted and held in trust for reinsurance claims losses under the Company's general and professional liability reinsurance program; and
- approximately $7.0 million and $6.3 million, respectively, was restricted in relation to the services provided by a captive insurance subsidiary (acquired by the Company in connection with the acquisition of Charter LCI Corporation in 2007).

At June 30, 2009, approximately $4.2 million, $1.6 million, $6.0 million and $250,000 of the restricted cash was held in custody by the Bank of Tucson, Wells Fargo, Fifth Third Bank and Bank of America, respectively. The cash is restricted as to withdrawal or use and is currently invested in certificates of deposit or short-term marketable securities. The remaining balance of approximately $777,000 is also restricted as to withdrawal or use, and is currently held in various non-interest bearing bank accounts related to Correctional Services.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

Non-Controlling Interest

In connection with the Company's acquisition of WCG in August 2007, PSC of Canada Exchange Corp. ("PSC"), a subsidiary established by the Company to facilitate the purchase of all of the equity interest in WCG, issued 287,576 exchangeable shares as part of the purchase price consideration. The exchangeable shares were valued at approximately $7.8 million in accordance with the provisions of the purchase agreement ($7.6 million for accounting purposes). For accounting purposes, the value of the exchangeable shares issued by PSC was determined based upon the product of the average market price for the Company's common stock for the five trading days ended August 3, 2007 of $26.59 and 287,576 shares issued. The shares are exchangeable at each shareholder's option, for no additional consideration, into shares of the Company's common stock on a one-for-one basis ("Exchangeable Shares"). Of the 287,576 Exchangeable Shares, 25,882 were exchanged as of June 30, 2009. The Exchangeable Shares are non-participating such that they are not entitled to any allocation of income or loss of PSC. The Exchangeable Shares represent ownership in PSC and are accounted for as "Non-controlling interest" included in stockholders' equity in the accompanying consolidated balance sheets at December 31, 2008 and June 30, 2009. The Company adopted the provisions of SFAS No. 160, "*Noncontrolling Interest in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51*" ("SFAS 160") on January 1, 2009 and as a result reclassified the ownership interest in PSC (represented by the Exchangeable Shares) held by the WCG sellers of approximately $7.3 million and $7.0 million, respectively, as of December 31, 2008 and June 30, 2009, as equity. Prior to January 1, 2009, the Company classified this ownership interest as "Non-controlling interest" included in liabilities and stockholders' equity in its consolidated balance sheets.

Stock-Based Compensation Arrangements

Stock-based compensation expense charged against income for stock options and stock grants awarded subsequent to December 31, 2005 (the date of acceleration of all of the then outstanding unvested stock options) for the six months ended June 30, 2008 was based on the grant-date fair value adjusted for estimated forfeitures based on awards expected to vest in accordance with the provisions of SFAS No. 123R, *"Share-Based Payment"* ("SFAS 123R"), and amounted to approximately $689,000 (net of tax of $474,000). On December 30, 2008, the Compensation Committee of the Board approved, effective as of that date, the acceleration of the vesting dates of all outstanding unvested stock options and restricted stock awarded subsequent to December 31, 2005 to eligible employees, directors and consultants, including stock options and restricted stock granted to executive officers and non-employee directors, under the Company's 2006 Long-Term Incentive Plan ("2006 Plan"); provided the equity holder was actively an employee, director or consultant of the Company on December 30, 2008. All other terms of the stock options and restricted stock remained the same. Stock-based compensation expense charged against income for stock options and stock grants awarded subsequent to December 30, 2008 for the six months ended June 30, 2009 was based on the grant-date fair value adjusted for estimated forfeitures based on awards expected to vest in accordance with the provisions of SFAS 123R and totaled approximately $60,000 (net of tax of $2,000). SFAS 123R requires forfeitures to be estimated at the time of grant and revised as necessary in subsequent periods if the actual forfeitures differ from those estimates.

For the six months ended June 30, 2008 and 2009, the amount of excess tax benefits resulting from the exercise of stock options was approximately $185,000 and $36,000. These amounts are reflected as cash flows from financing activities for the six months ended June 30, 2008 and 2009 in the accompanying consolidated statements of cash flows.

As of June 30, 2009, there was approximately $1.3 million of unrecognized compensation cost related to non-vested stock-based compensation arrangements granted under the 2006 Plan. The cost is expected to be recognized over a weighted-average period of 2.86 years.

Critical Accounting Estimates

The Company has made a number of estimates relating to the reporting of assets and liabilities, revenues and expenses and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with accounting principles generally accepted in the United States ("GAAP"). The Company based its estimates on historical experience and on various other assumptions the Company believes to be reasonable under the circumstances. However, actual results may differ from these

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

estimates under different assumptions or conditions. Some of the more significant estimates impact revenue recognition, accounts receivable and allowance for doubtful accounts, accounting for business combinations, goodwill and other intangible assets, accrued transportation costs, accounting for management agreement relationships, loss reserves for reinsurance and self-funded insurance programs, stock-based compensation, foreign currency translation, derivative instruments and hedging activities and income taxes.

New Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") issued SFAS No. 157, "*Fair Value Measurement*" ("SFAS 157") in September 2006 to define fair value and require that the measurement thereof be determined based on the assumptions that market participants would use in pricing an asset or liability and expand disclosures about fair value measurements. Additionally, SFAS 157 establishes a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from sources independent of the reporting entity and (2) the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances. SFAS 157 is effective for financial assets and financial liabilities for fiscal years beginning after November 15, 2007. On February 12, 2008, the FASB issued FSP No. FAS 157-2, "*Effective Date of FASB Statement No. 157*", which delayed the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on at least an annual basis. The statement is effective for fiscal years beginning after December 31, 2008. The Company adopted SFAS 157 as of January 1, 2008, with the exception of the application of the statement to non-recurring nonfinancial assets and nonfinancial liabilities. On January 1, 2009, the Company adopted the provisions of SFAS 157 relating to non-recurring nonfinancial assets and nonfinancial liabilities. Non-recurring nonfinancial assets and nonfinancial liabilities for which the Company had not applied the provisions of SFAS 157 prior to January 1, 2009 included those measured at fair value in goodwill impairment testing and indefinite life intangible assets measured at fair value for impairment testing. Although the adoption of SFAS 157 related to financial assets and financial liabilities did not materially impact its financial condition, results of operations, or cash flow, the Company is required to provide additional disclosures as part of its financial statements. The Company has determined that there was no material impact of adopting the provisions of SFAS 157 relating to non-recurring nonfinancial assets and nonfinancial liabilities on its financial condition, results of operations and cash flow.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "*Business Combinations*" ("SFAS 141R"). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective as of the beginning of an entity's fiscal year that begins after December 15, 2008. On January 1, 2009, the Company adopted SFAS 141R. In addition, the Company determined that there was no material impact of the adoption of SFAS 141R on its consolidated results of operations and financial condition.

In December 2007 the FASB issued SFAS 160. SFAS 160 establishes accounting and reporting standards for ownership interest in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interest of the parent and the interests of the noncontrolling owners. SFAS 160 is effective as of the beginning of an entity's fiscal year that begins after December 15, 2008. The Company adopted the provisions of SFAS 160 on January 1, 2009 and as a result reclassified the ownership interest in PSC

(represented by the Exchangeable Shares) held by the sellers related to the Company's acquisition of WCG of approximately $7.3 million and $7.0 million, respectively, as of December 31, 2008 and June 30, 2009, as equity. Prior to January 1, 2009, the Company classified this ownership interest as "Non-controlling interest" in its consolidated balance sheets. The Company determined that the adoption of the other provisions of SFAS 160 did not have a material impact on its consolidated results of operations and financial condition.

In March 2008, the FASB issued SFAS No. 161, "*Disclosures about Derivative Instruments and Hedging Activities*" ("SFAS 161"), which amends SFAS 133. SFAS 161 requires companies with derivative instruments to disclose information about how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS 133, and how derivative instruments and related hedged items affect a company's financial position, financial performance, and cash flows. The required disclosures include the fair value of derivative instruments and their gains or losses in tabular format, information about credit-risk-related contingent features in derivative agreements, counterparty credit risk, and the company's strategies and objectives for using derivative instruments. SFAS 161 expands the current disclosure framework in SFAS 133. SFAS 161 is effective prospectively for periods beginning on or after November 15, 2008. On January 1, 2009, the Company adopted the provisions of SFAS 161 and determined that, other than the additional disclosures related to its interest rate swap the Company is now required to make, the adoption of SFAS 161 did not have a material impact on its consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position ("FSP") 142-3, "*Determination of the Useful Life of Intangible Assets*" ("FSP 142-3"). FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "*Goodwill and Other Intangible Assets*" ("SFAS 142"). In developing assumptions about renewal or extension used to determine the useful life of a recognized intangible asset, an entity may consider its own historical experience in renewing or extending similar arrangements; however, these assumptions should be adjusted for the entity-specific factors set forth in paragraph 11 of SFAS 142. In addition, FSP 142-3, requires disclosure of information that enables users of financial statements to assess the extent to which the expected future cash flows associated with the asset are affected by the entity's intent and/or ability to renew or extend the arrangement for a recognized intangible asset. FSP 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. On January 1, 2009, the Company adopted the provisions of FSP 142-3. The adoption of FSP 142-3 did not have a material impact on the Company's consolidated results of operations and financial condition.

In June 2008, the FASB issued Emerging Issues Task Force ("EITF") Issue 07-5, "*Determining whether an Instrument (or Embedded Feature) is indexed to an Entity's Own Stock*" ("EITF 07-5"). EITF No. 07-5 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application is not permitted. Paragraph 11(a) of SFAS 133 specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company's own stock and (b) classified in stockholders' equity in the statement of financial position would not be considered a derivative financial instrument. EITF 07-5 provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and thus able to qualify for the SFAS 133 paragraph 11(a) scope exception. The Company's 6.5% Convertible Senior Subordinated Notes due 2014 (the "Notes") are subject to the provisions of EITF 07-5 since the notes are indexed to the Company's own stock, they are convertible, under certain circumstances, into common stock at a specified conversion rate. Based on the Company's analysis of the Notes under SFAS 133, EITF 07-5 and other related guidance, the Company concluded that the embedded conversion option qualifies for the scope exception in paragraph 11(a) of SFAS 133 because it is both (1) indexed to the Company's own stock by virtue of the fact that all of the triggering conversion events are contingencies that are not based on an observable market or an observable index and that the only variables that affect the settlement amount of the conversion in each case would be inputs to the fair value of a fixed-for-fixed option on equity shares as they relate to stock price and (2) would be classified in stockholders' equity if it were a freestanding instrument. The Notes including the embedded conversion option are classified as a liability in the accompanying consolidated balance sheets. EITF 07-5 requires issuers of convertible notes that protect holders from declines in the issuer's stock price ("down-round" protection) to account for these instruments as derivatives under SFAS 133. The Notes do not contain any "down-round" protection, therefore the adoption of EITF 07-5 as of January 1, 2009 did not impact the Company's consolidated financial statements.

In April 2009, FASB issued FSP FAS 141(R)-1, "*Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*" ("FSP FAS 141(R)-1"). FSP FAS 141(R)-1 amends the provisions in SFAS 141(R), for the initial recognition and measurement, subsequent measurement and accounting, and disclosures for assets and liabilities arising from contingencies in

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

business combinations. No subsequent accounting guidance is provided in the FSP, and the FASB expects an acquirer to develop a systematic and rational basis for subsequently measuring and accounting for acquired contingencies depending on their nature. FSP FAS 141(R)-1 is effective for contingent assets or contingent liabilities acquired in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company has determined that the adoption of FSP FAS 141(R)-1 did not have a material impact on its consolidated financial statements.

On April 9, 2009, FASB issued FSP 157-4, "*Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*" ("FSP 157-4"). FSP 157-4 provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased. In addition, FSP 157-4 includes guidance on identifying circumstances that indicate a transaction is not orderly. Further, this FSP emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. FSP 157-4 is effective for interim and annual reporting periods ending after June 15, 2009, and is to be applied prospectively. Early adoption is permitted. The Company adopted the provisions of FSP 157-4 beginning with the quarterly period ended June 30, 2009 and determined that the adoption of FSP 157-4 did not have a material impact on its consolidated financial statements.

On April 9, 2009, FASB issued FSP 107-1 and APB 28-1, "*Interim Disclosures about Fair Value of Financial Instruments*" ("FSP 107-1"). FSP 107-1 amends SFAS No. 107, "*Disclosures about Fair Value of Financial Instruments*" to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, "*Interim Financial Reporting*", to require those disclosures in summarized financial information at interim reporting periods. FSP 107-1 is effective for interim reporting periods ending after June 15, 2009. The Company adopted the provisions of FSP 107-1 beginning with the quarterly period ended June 30, 2009 and determined that, other than the additional disclosures related to the fair value of financial instruments the Company is now required to make, the adoption of FSP 107-1 did not have a material impact on its consolidated financial statements.

In May 2009, FASB issued SFAS No. 165, "*Subsequent Events*" ("SFAS 165"). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, SFAS 165 sets forth the period and circumstances during and under which an entity should evaluate events or transactions occurring after the balance sheet date for potential recognition and disclosure in the financial statements. SFAS 165 also provides guidance regarding the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. The Company adopted the provisions of SFAS 165 beginning with the quarterly period ended June 30, 2009 in accordance with SFAS 165's effective date. The Company has determined that the adoption of SFAS 165 did not have a material impact on its consolidated financial statements as no significant event occurred subsequent to June 30, 2009 up to the filing date of this report on Form 10-Q.

Pending Accounting Pronouncements

In June 2009, the FASB issued SFAS No. 168, "*The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162*.", ("SFAS 168"). FASB issued this statement to replace FASB Statement No. 162, "*The Hierarchy of Generally Accepted Accounting Principles*," and to establish the *FASB Accounting Standards Codification* as the source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with GAAP. SFAS 168 does not affect the rules and interpretive releases of the Securities and Exchange Commission ("SEC"), which are also sources of authoritative GAAP for SEC registrants. SFAS 168 is effective for financial statements

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

issued for interim and annual periods ending after September 15, 2009. The Company has determined that the adoption of SFAS 168, will not have an impact on its consolidated financial statements because SFAS 168 only codifies existing non-SEC accounting literature.

Other accounting standards that have been issued or proposed by the FASB or other standards setting bodies that do not require adoption until a future date are not expected to have a material impact on the Company's consolidated financial statements upon adoption.

3. Fair Value Measurements

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on the Company's assumptions used to measure assets and liabilities at fair value. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The following table provides the assets and liabilities carried at fair value measured on a recurring basis at June 30, 2009:

		Fair Value Measurement at June 30, 2009 Using		
	Total Carrying Value at June 30, 2009	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Interest rate swap	$ (1,277,890)	$ —	$ (1,277,890)	$ —

The Company's interest rate swap is carried at fair value measured on a recurring basis. The Company has elected to use the income approach to value the derivatives, using observable Level 2 market expectations at measurement date and standard valuation techniques to convert future amounts to a single present amount assuming that participants are motivated, but not compelled to transact. Level 2 inputs for the swap valuations are limited to quoted prices for similar assets or liabilities in active markets (specifically futures contracts) and inputs other than quoted prices that are observable for the asset or liability (e.g., LIBOR cash and swap rates and credit risk at commonly quoted intervals as published by Bloomberg on the last day of the period for financial institutions with the same credit rating as the counterparty). Mid-market pricing is used as a practical expedient for fair value measurements. Key inputs, including the cash rates for short term, futures rates and swap rates beyond the derivative maturity are used to interpolate the spot rates at the three month rate resets specified by each swap. A credit default swap rate based on the current credit rating of the counterparty is applied to all cash flows when the swap is in an asset position. The Company uses the floating rate factor related to its variable rate debt (6.5%) to discount all cash flows when the derivative is in a liability position to reflect the potential credit risk to lenders.

4. Other Receivables

At December 31, 2008 and June 30, 2009, insurance premiums of approximately $2.4 million and $4.4 million, respectively, were receivable from third parties related to the reinsurance activities of the Company's two captive subsidiaries. The insurance premiums receivable is classified as "Other

receivables" in the accompanying consolidated balance sheets. In addition, the Company's expected losses related to workers' compensation and general and professional liability in excess of the Company's liability under its associated reinsurance programs at June 30, 2009 was approximately $1.6 million, of which approximately $456,000 was classified as "Other receivables" and approximately $1.1 million was classified as "Other assets" in the accompanying consolidated balance sheet. The Company's expected losses related to workers' compensation and general and professional liability in excess of the Company's liability under its associated reinsurance programs at December 31, 2008 was approximately $1.4 million, of which approximately $446,000 was classified as "Other receivables" and approximately $1.0 million was classified as "Other assets" in the accompanying consolidated balance sheet. The Company recorded a corresponding liability, which offset these expected losses. This liability was classified as "Reinsurance liability reserve" in current liabilities and "Other long-term liabilities" in the accompanying consolidated balance sheet.

5. Prepaid Expenses and Other

Prepaid expenses and other were comprised of the following:

	December 31, 2008	June 30, 2009
Prepaid payroll	$ 2,703,503	$ 2,491,562
Prepaid insurance	3,381,451	4,913,202
Prepaid taxes	3,978,742	2,764,505
Prepaid rent	737,847	863,242
Provider advances	285,020	221,335
Prepaid maintenance agreements and copier leases	608,075	683,878
Prepaid bus tokens and passes	1,133,290	851,670
Prepaid commissions and brokerage fees	548,446	580,543
Interest receivable—certificates of deposit	694,852	817,059
Other	1,306,413	1,867,045
Total prepaid expenses and other	$ 15,377,639	$ 16,054,041

6. Acquisitions and Goodwill

The following acquisition has been accounted for using the purchase method of accounting and the results of operations are included in the Company's consolidated financial statements from the date of acquisition. The cost of this acquisition has been allocated to the assets and liabilities acquired based on a preliminary evaluation of their respective fair values and may change when the final valuation of certain intangible assets and deferred taxes are determined.

Effective September 30, 2008, the Company acquired all of the equity interest in AmericanWork, Inc. ("AW"), a community based mental health provider operating in 23 Georgia locations. AW provides, among other things, independent living services and training in support of individuals with mental illness, outpatient individual and group behavioral health services, and community based vocational and peer supported vocational and employment services. The total purchase price consisted of cash in the amount of approximately $3.5 million, with approximately $3.0 million paid by the Company at closing on October 14, 2008 and the balance held by the Company for one year to secure potential indemnity obligations. In April 2009, the purchase price adjustment as provided for in the associated purchase agreement was finalized resulting in an additional amount payable by the Company of approximately $270,000, which the Company paid to the seller on April 14, 2009. The Company believes this acquisition enhances its community based social services offering, expands its presence in Georgia, and further positions the Company for growth. The purchase price and the additional amount resulting from the final working capital adjustment was funded by cash generated from the Company's operations.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

Table of Contents

The following represents the Company's preliminary allocation of the purchase price.

Consideration:	
Cash	$3,244,979
Due to former shareholder	525,000
Estimated cost of acquisition	49,831
	$3,819,810

Allocated to:	
Goodwill	$ 839,591
Intangibles	1,387,441
Fixed assets	528,989
Working capital	944,979
Other assets	118,810
	$3,819,810

Currently, the above goodwill is expected to be tax deductible.

Goodwill

Changes in goodwill were as follows:

	Social Services	NET Services	Consolidated Total
Balance at December 31, 2008	$ 17,585,055	$ 95,185,511	$ 112,770,566
AW working capital true-up and other adjustments	348,049	—	348,049
WCG foreign currency adjustments	111,150	—	111,150
Camelot Community Care, Inc. additional acquisition costs	1,151	—	1,151
Balance at June 30, 2009	$ 18,045,405	$ 95,185,511	$ 113,230,916

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

7. Long-Term Obligations

	December 31, 2008	June 30, 2009
5% unsecured, subordinated note to former stockholder of acquired company, interest payable semi-annually beginning December 2005 and all unpaid principal and any accrued and unpaid interest due June 2010	$ 618,680	$ 618,680
4% unsecured, subordinated note to former owner of acquired company, interest payable semi-annually beginning April 2008 with principal of $300,000 due April 2008, but withheld due to a dispute, and all remaining unpaid principal and any accrued and unpaid interest due April 2010	1,800,000	1,800,000
5.85% secured, note payable, interest and principal payable monthly beginning January 2009 through September 2009	989,925	334,801
6.5% convertible senior subordinated notes, interest payable semi-annually beginning May 2008 with principal due May 2014	70,000,000	70,000,000
$30,000,000 revolving loan, LIBOR plus 6.5% (effective rate of 6.82% at June 30, 2009) through December 2012	—	—
$173,000,000 term loan, LIBOR plus 6.5% with principal and interest payable quarterly (as described below) through December 2013	164,350,000	157,862,500
	237,758,605	230,615,981
Less current portion	14,264,925	17,890,981
	$ 223,493,680	$ 212,725,000

The fair value of the Company’s long-term obligations was estimated based on interest rates for the same or similar debt offered to the Company having same or similar remaining maturities and collateral requirements. The carrying amount of the long-term obligations approximated its fair value at December 31, 2008 and June 30, 2009.

Credit facility.

On December 7, 2007, the Company entered into a Credit and Guaranty Agreement (the “Credit Agreement”) with CIT Healthcare LLC, as administrative agent, Bank of America, N.A. and SunTrust Bank, as co-documentation agents, ING Capital LLC and Royal Bank of Canada, as co-syndication agents, other lenders party thereto, and CIT Capital Securities LLC, as sole lead arranger and bookrunner. The Credit Agreement replaced the Company’s previous credit facility with CIT Healthcare LLC.

On March 11, 2009, the Company agreed with its creditors to amend certain terms in the Credit Agreement (“Amendment No. 1 to the Credit Agreement” and, together with the Credit Agreement, the “Amended Credit Agreement”) to, among other things:

- decrease the revolving credit facility from $40 million to $30 million;
- increase the interest rate spread on the annual interest rate from LIBOR plus 3.5% to LIBOR plus 6.5% and, with respect to Base Rate Loans (as such term is defined in the Credit Agreement), increase the interest rate spread on the annual interest rate from Base Rate plus 2.5% to Base Rate plus 5.5% effective March 11, 2009; provided the interest rate will be adjusted upwards and the Company will incur a fee if certain consolidated senior leverage ratios exceed the corresponding ratio ceilings set forth in Amendment No. 1 to the Credit Agreement determined as of September 30, 2009 and December 31, 2009;
- amend certain financial covenants to change the requirements to a level where the Company met the requirements for the fourth quarter of 2008 and the first and second quarters of 2009, and the Company believes it will meet the requirements for the remainder of 2009;

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

- establish a new financial covenant through December 31, 2009 based upon the Company's operations maintaining a minimum monthly earnings before interest, taxes, depreciation and amortization level (as such term is defined in Amendment No. 1 to the Credit Agreement) commencing with the three months ended March 31, 2009; and,

- require the Company to deliver to the lenders monthly consolidated financial statements and a 13-week rolling cash flow forecast each week from the effective date of Amendment No. 1 to the Credit Agreement to December 31, 2009.

In exchange for the amendments described above, the Company paid an amendment fee to certain lenders equal to $565,000 (0.40% of the aggregate amount of the Revolving Commitment and Term Loan outstanding related to those lenders (as such terms are defined in the Amended Credit Agreement)), which was capitalized as deferred financing fees and is included in "Other assets" in the accompanying consolidated balance sheet at June 30, 2009. In addition, in connection with this transaction, the Company incurred fees and expenses of approximately $2.0 million, including arrangement, legal, accounting and other related costs. These fees and expenses are reflected in "General and administrative expense" in the amount of approximately $1.7 million and "Interest expense" in the amount of approximately $348,000 in the accompanying consolidated statement of income for the six months ended June 30, 2009.

8. Interest Rate Swap

In February 2008, the Company entered into an interest rate swap to convert a portion of its floating rate long-term debt expense to fixed rate debt expense. The purpose of this instrument is to hedge the variability of the Company's future earnings and cash flows caused by movements in interest rates applied to its floating rate long-term debt. The Company holds this derivative only for the purpose of hedging such risks, not for speculation. Under the swap agreement, the Company will pay 3.026% and receive three-month LIBOR on a notional amount of $86.5 million through February 2010. The Company designated the interest rate swap as a cash flow hedge under SFAS 133. Prior to Amendment No. 1 to the Credit Agreement described in note 7, the Company anticipated that it would not be in compliance with certain financial covenants as of December 31, 2008. As a result, during the first quarter of 2009, the Company's long-term debt was converted from a LIBOR Loan to a Base Rate Loan in accordance with the terms of the Credit Agreement beginning February 27, 2009 through April 1, 2009. The swap was de-designated and all changes in the fair value of the swap from the last effective date (January 31, 2009) were recognized in earnings. Additionally, the balance in other comprehensive income at January 31, 2009 will be recognized to income ratably through the maturity date of the swap in February 2010. On March 31, 2009, the swap was re-designated as a cash flow hedge under SFAS 133 and beginning April 2, 2009 the Company's long-term debt was converted from a Base Rate Loan to a LIBOR Loan. The swap's effectiveness is evaluated monthly and effective gains and losses are accumulated in other comprehensive income until the hedged interest expense is accrued.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

Table of Contents

The fair value amounts in the consolidated balance sheet at June 30, 2009, related to the Company's interest rate swap were as follows:

	Liability Derivatives June 30, 2009	
	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments under SFAS 133		
Interest rate contracts	Current portion of interest rate swap	$ 1,277,890
Interest rate contracts	Other long-term liabilities	—
Total derivatives designated as hedging instruments under SFAS 133		1,277,890
Total derivatives		$ 1,277,890

The derivative gains and losses in the consolidated statement of income for the six months ended June 30, 2009, related to the Company's interest rate swap were as follows:

Derivatives in SFAS 133 cash flow hedging relationships	Pretax gain recognized in Other Comprehensive Income on effective portion of derivative	Pretax loss on effective portion of derivative in Accumulated Other Comprehensive Loss		Ineffective portion of loss on derivative and amount excluded from effectiveness testing recognized in income	
	Amount	Location	Amount	Location	Amount
Interest rate contract	$ 119,238	Interest expense	$ (481,961)	Interest expense	$ (122,843)
Total	$ 119,238		$ (481,961)		$ (122,843)

Derivatives not designated as hedging instruments under SFAS 133	Location of amounts recognized in income on derivative	Amount of loss recognized in income on derivative
Interest rate contract	Interest expense	$ (127,381)
Total		$ (127,381)

Additional information regarding the Company's interest rate swap is included in notes 2 and 3 above and note 10 below.

9. Business Segments

The Company's operations are organized and reviewed by management along its services lines. After the consummation of the acquisition of Charter LCI Corporation, including its subsidiaries, in December 2007 ("LogistiCare"), the Company operates in two reportable segments: Social Services and NET

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

Services. The Company operates these reportable segments as separate divisions and differentiates the segments based on the nature of the services they offer. The following describes each of the Company's segments and its corporate services area.

Social Services. Social Services includes government sponsored social services that the Company has historically offered. Primary services in this segment include home and community based counseling, foster care and not-for-profit management services. Through Social Services the Company provides services to a common customer group, principally individuals and families. All of the operating entities within Social Services follow similar operating procedures and methods in managing their operations and each operating entity works within a similar regulatory environment, primarily under Medicaid regulations. The Company manages the activities of Social Services by actual to budget comparisons within each operating entity rather than by comparison between entities. The Company's budget related to Social Services is prepared on an entity-by-entity basis which represents the aggregation of individual location operating budgets within each Social Services entity and is comprised of:

- Payer specific revenue streams based upon contracted amounts;
- Payroll and related employee expenses by position corresponding to the contracted revenue streams; and
- Other operating expenses such as facilities costs, employee training, mileage and telephone in support of operations.

The Company's actual operating contribution margins by operating entity related to Social Services ranged from approximately 2% to 12% as of December 31, 2008. The Company believes that the long term operating contribution margins of its operating entities within Social Services will approximate between 10% and 15% as the respective entities' markets mature, the Company cross sells its services within markets, and its operating model is standardized among entities including recent acquisitions. The Company also believes that its targeted contribution margin of approximately 15% is allowable by its state and local governmental payers over the long term.

In evaluating the financial performance and economic characteristics of Social Services, the Company's chief operating decision maker regularly reviews the following types of financial and non-financial information for each operating entity within Social Services:

- Consolidated financial statements;
- Separate condensed financial statements for each individual operating entity versus their budget;
- Monthly non-financial statistical information;
- Productivity reports; and
- Payroll reports.

While the Company's chief operating decision maker evaluates performance in comparison to budget based on the operating results of the individual operating entities within Social Services, the operating entities are aggregated into one reporting segment for financial reporting purposes because the Company believes that the operating entities exhibit similar long term financial performance. In conjunction with the financial performance trends, the Company believes the similar qualitative characteristics of the operating entities it aggregates within Social Services and budgetary constraints of the Company's payers in each market provide a foundation to conclude that the entities that the Company aggregates within Social Services have similar economic characteristics. Thus, the Company believes the economic characteristics of its operating entities within Social Services meet the criteria for aggregation into a single reporting segment under SFAS No. 131, "*Disclosures about Segments of an Enterprise and Related Information*".

Social Services is a separate division of the Company with management and service offerings distinct from the Company's NET Services segment.

NET Services. NET Services includes managing the delivery of non-emergency transportation services. NET Services is a separate division of the Company with operational management and service offerings distinct from the Company's Social Services operating segment.

Corporate. Corporate includes corporate accounting and finance, information technology, internal audit, corporate training, legal and various other overhead costs, all of which are directly allocated to the operating segments.

Segment asset disclosures include property and equipment and other intangible assets. The accounting policies of the Company's segments are the same as those of the consolidated Company. The Company evaluates performance based on operating income. Operating income is revenue less operating expenses (including client services expense, cost of non-emergency transportation services, general and administrative expense and depreciation and amortization) but is not affected by other income/expense or by income taxes. Other income/expense consists principally of interest income and interest expense. In calculating operating income for each segment, general and administrative expenses incurred at the corporate level are allocated to each segment based upon their relative direct expense levels excluding costs for purchased services. All intercompany transactions have been eliminated.

The following table sets forth certain financial information attributable to the Company's business segments for the three and six months ended June 30, 2008 and 2009. In addition, none of the segments have significant non-cash items other than depreciation and amortization in reported income.

	For the three months ended June 30, 2008			
	Social Services	NET Services	Corporate (a)	Consolidated Total
Revenues	$ 78,372,601	$ 94,648,593	$ 4,167	$ 173,025,361
Depreciation and amortization	$ 1,365,538	$ 1,800,700	$ —	$ 3,166,238
Operating income	$ 6,408,935	$ 3,715,410	$ 4,167	$ 10,128,512
Net interest expense (income)	$ (156,850)	$ 4,625,599	$ —	$ 4,468,749
Capital expenditures	$ 305,718	$ 687,134	$ 65,744	$ 1,058,596

	For the three months ended June 30, 2009			
	Social Services (c)	NET Services	Corporate (a)	Consolidated Total
Revenues	$ 87,682,940	$ 104,149,004	$ —	$ 191,831,944
Depreciation and amortization	$ 1,500,749	$ 1,595,809	$ —	$ 3,096,558
Operating income	$ 8,323,336	$ 5,650,979	$ —	$ 13,974,315
Net interest expense (income)	$ (16,416)	$ 5,352,088	$ —	$ 5,335,672
Capital expenditures	$ 382,784	$ 551,988	$ 355,418	$ 1,290,190

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

	For the six months ended June 30, 2008			
	Social Services	NET Services	Corporate (a)(b)	Consolidated Total
Revenues	$ 156,433,137	$ 190,222,646	$ 34,036	$ 346,689,819
Depreciation and amortization	$ 2,720,380	$ 3,765,407	$ —	$ 6,485,787
Operating income	$ 11,993,759	$ 9,048,194	$ 34,036	$ 21,075,989
Net interest expense (income)	$ (374,503)	$ 9,770,785	$ —	$ 9,396,282
Total assets	$ 219,336,599	$ 314,035,832	$ 14,115,315	$ 547,487,746
Capital expenditures	$ 676,849	$ 1,280,739	$ 117,611	$ 2,075,199

	For the six months ended June 30, 2009			
	Social Services (c)	NET Services	Corporate (a)(b)	Consolidated Total
Revenues	$ 172,913,855	$ 205,630,256	$ —	$ 378,544,111
Depreciation and amortization	$ 2,980,734	$ 3,200,022	$ —	$ 6,180,756
Operating income	$ 16,487,089	$ 12,528,472	$ —	$ 29,015,561
Net interest expense (income)	$ (75,645)	$ 10,609,388	$ —	$ 10,533,743
Total assets	$ 156,933,401	$ 207,489,214	$ 13,986,416	$ 378,409,031
Capital expenditures	$ 841,614	$ 706,672	$ 408,864	$ 1,957,150

(a) Corporate costs have been allocated to the Social Services and NET Services operating segments.

(b) Corporate assets as of June 30, 2008 and 2009 include cash totaling approximately $12.1 million and $11.1 million, notes receivable totaling approximately $408,000 and $75,000, property and equipment totaling approximately $1.0 million and $1.7 million, and other assets of approximately $546,000 and $571,000, respectively. In addition, corporate assets as of June 30, 2009 included prepaid expenses totaling approximately $593,000.

(c) Excludes intersegment revenues of approximately $46,000 that have been eliminated in consolidation.

10. Stockholders' Equity and Other Comprehensive Income

The Company's second amended and restated certificate of incorporation provides that the Company's authorized capital stock consists of 40,000,000 shares of common stock, $0.001 par value per share, and 10,000,000 shares of preferred stock, $0.001 par value per share.

During the six months ended June 30, 2009, the Company granted a total of 170,000 ten-year options under its 2006 Plan to purchase the Company's common stock at exercise prices equal to the market value of the Company's common stock on the date of grant. The options were granted to a non-employee director of its board of directors, an executive officer and certain key employees. The option exercise price for all options granted ranged from $1.55 to $13.07 and the options vest in three equal installments on the first, second and third anniversaries of the date of grant. The weighted-average fair value of the options granted during the six months ended June 30, 2009 totaled $11.20 per share.

The Company granted a total of 2,000 shares of restricted stock to a non-employee director of its board of directors during the six months ended June 30, 2009. The award vests in three equal installments on the first, second and third anniversaries of the date of grant. The weighted-average fair value of this award totaled $13.07 per share.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

At December 31, 2008 and June 30, 2009, there were 13,462,356 and 13,483,859 shares of the Company's common stock outstanding, respectively, (including 619,768 treasury shares at December 31, 2008 and June 30, 2009) and no shares of preferred stock outstanding.

Other comprehensive income included foreign currency translation adjustments which amounted to a gain of approximately $649,000 for the six months ended June 30, 2009. In addition, other comprehensive income included an aggregate gain of approximately $360,000, net of tax, which resulted from the accounting for the Company's interest rate swap and the impact of the de-designation of the swap (as more fully described in note 8 above) for the six months ended June 30, 2009.

The components of comprehensive income, net of taxes, for the three and six months ended June 30, 2008 and 2009 were as follows:

	Three months ended June 30,		Six months ended June 30,	
	2008	**2009**	**2008**	**2009**
Net income	$ 3,437,993	$ 5,250,334	$ 7,142,111	$ 11,126,990
Other comprehensive income:				
Change related to derivative, net of income tax (A)	859,734	86,351	263,571	359,839
Foreign currency translation adjustments	255,808	877,822	(618,787)	648,841
Total other comprehensive income	1,115,542	964,173	(355,216)	1,008,680
Total comprehensive income	$ 4,553,535	$ 6,214,507	$ 6,786,895	$ 12,135,670

(A) For the three months ended June 30, 2008 and 2009, the change in fair value of the interest rate swap was net of tax of approximately $591,000 and $146,000, respectively. For the six months ended June 30, 2008 and 2009, the change in fair value of the interest rate swap was net of tax of approximately $181,000 and $241,000, respectively.

The following table reflects changes in common stock, additional paid-in capital, non-controlling interest and accumulated other comprehensive income for the six months ended June 30, 2009:

	Common Stock		Additional		Accumulated Other
	Shares	Amount	Paid-In Capital	Non-Controlling Interest	Comprehensive Income
Balance at December 31, 2008	13,462,356	$ 13,462	$ 169,698,598	$ 7,266,493	$ (4,449,547)
Stock-based compensation	—	—	62,025	—	—
Exercise of employee stock options, including tax benefit of $36,000	10,000	10	52,671	—	—
Change in fair value of derivative and impact of de-designation, net of income tax of $241,000	—	—	—	—	359,839
PSC of Canada Exchange Corp. shares exchanged	11,503	12	305,944	(305,956)	—
Foreign currency translation adjustments	—	—	—	—	648,841
Balance at June 30, 2009	13,483,859	$ 13,484	$ 170,119,238	$ 6,960,537	$ (3,440,867)

11. Earnings Per Share

The following table details the computation of basic and diluted earnings per share:

	Three months ended June 30,		Six months ended June 30,	
	2008	2009	2008	2009
Numerator:				
Net income available to common stockholders, basic and diluted	$ 3,437,993	$ 5,250,334	$ 7,142,111	$ 11,126,990
Denominator:				
Denominator for basic earnings per share — weighted-average shares	12,519,527	13,120,345	12,484,331	13,117,697
Effect of dilutive securities:				
Common stock options and restricted stock awards	174,353	86,985	193,048	72,253
Denominator for diluted earnings per share — adjusted weighted-average shares assumed conversion	12,693,880	13,207,330	12,677,379	13,189,950
Basic earnings per share	$ 0.27	$ 0.40	$ 0.57	$ 0.85
Diluted earnings per share	$ 0.27	$ 0.40	$ 0.56	$ 0.84

For the six months ended June 30, 2008 and 2009, employee stock options to purchase 26,162 and 1,308 shares of common stock, respectively, were not included in the computation of diluted earnings per share as the exercise price of these options was greater than the average fair value of the common stock for the period and, therefore, the effect of these options would have been antidilutive. In addition, the effect of issuing 1,678,740 shares of common stock on an assumed conversion basis related to the Notes was not included in the computation of diluted earnings per share for the three and six months ended June 30, 2008 and 2009 as it would have been antidilutive.

12. Income Taxes

The Company's effective income tax rate for the interim periods was based on management's estimate of the Company's effective tax rate for the applicable year and differs from the federal statutory income tax rate primarily due to nondeductible permanent differences such as meals and state income taxes.

13. Commitments and Contingencies

The Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial position, results of operations, or liquidity.

The Company has two deferred compensation plans for management and highly compensated employees. These deferred compensation plans are unfunded; therefore, benefits are paid from the general assets of the Company. The total of participant deferrals, which is reflected in "Other long-term liabilities" in the accompanying consolidated balance sheets, was approximately $273,000 and $354,000 at December 31, 2008 and June 30, 2009, respectively.

The Company may be obligated to pay an amount up to $650,000 to the sellers under an earn out provision pursuant to a formula specified in an asset purchase agreement dated July 1, 2009 by which the Company acquired certain assets of an entity located in California. The earn out payment as such term is defined in the asset purchase agreement, if earned, will be paid in cash. If the contingency is resolved in accordance with the related provisions of the asset purchase agreement and the additional consideration becomes distributable, the Company will record the fair value of the consideration issued as an additional cost to acquire the associated assets.

14. Transactions with Related Parties

Upon the Company's acquisition of Maple Services, LLC in August 2005, Mr. McCusker, the Company's chief executive officer, Mr. Deitch, the Company's chief financial officer, and Mr. Norris, the Company's chief operating officer, became members of the board of directors of the not-for-profit organization (Maple Star Colorado, Inc.) formerly managed by Maple Services, LLC. Maple Star Colorado, Inc. is a non-profit member organization governed by its board of directors and the state laws of Colorado in which it is incorporated. Maple Star Colorado, Inc. is not a federally tax exempt organization and neither the Internal Revenue Service rules governing IRC Section 501(c)(3) exempt organizations, nor any other IRC sections applicable to tax exempt organizations, apply to this organization. The Company provided management services to Maple Star Colorado, Inc. under a management agreement for consideration in the amount of approximately $252,000 and $151,000 for the six months ended June 30, 2008 and 2009, respectively. Amounts due to the Company from Maple Star Colorado, Inc. for management services provided to it by the Company at December 31, 2008 and June 30, 2009 were approximately $448,000 and $369,000, respectively.

The Company is using a twin propeller KingAir airplane operated by Las Montanas Aviation, LLC for approved business travel purposes on an as needed basis subject to a joint operating agreement and regulated by Federal Aviation Administration Code of Federal Regulations 91:501. Las Montanas Aviation, LLC is owned by Mr. McCusker. The Company currently pays a flat fee of $9,000 per month plus incidental costs such as fuel and landing fees. For the six months ended June 30, 2008 and 2009, the Company expensed amounts related to Las Montanas Aviation, LLC of approximately $17,000 and $72,000, respectively, for use of the airplane for business travel purposes. The plane is available for use related to the Company's business only when commercial flights are not practical. During the first six months of 2009, the Company utilized the plane five times. The logged hours for these trips totaled 19 for an aggregated cost of approximately $63,000. By comparison, FlexJet (which has provided chartered flight services to the Company historically) would have charged the Company approximately $103,000 for a comparable schedule.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with our consolidated financial statements and accompanying notes for the three and six months ended June 30, 2009 as well as our consolidated financial statements and accompanying notes and management's discussion and analysis of financial condition and results of operations included in our Form 10-K for the year ended December 31, 2008.

Overview of our business

We provide government sponsored social services directly and through not-for-profit social services organizations whose operations we manage, and we arrange for and manage non-emergency transportation

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

services. As a result of and in response to the large and growing population of eligible beneficiaries of government sponsored social services and non-emergency transportation services, increasing pressure on governments to control costs and increasing acceptance of privatized social services, we have grown both organically and by consummating strategic acquisitions.

As a result of consummating certain acquisitions we have significant contractual obligations, including financial covenant requirements, related to our long-term debt for the fiscal year 2009 and beyond. To address our liquidity concerns related to our ability to meet our financial covenant requirements, we entered into an amendment to our credit and guaranty agreement with CIT Capital Securities LLC, or CIT, on March 11, 2009 to, among other things, change those requirements as more fully described below under the heading entitled "Liquidity and capital resources." As a result of this amendment, we believe that we will meet all of our financial covenant requirements and that we have sufficient resources to fund our normal operations for the foreseeable future.

We have implemented several strategic options to enhance stockholder value relating to, among other things, growing our core social services business, reducing corporate and client service costs and reducing or delevering our debt. As a result, we have accomplished the following:

- *Growing our core social services business.* We have increased our client census. Our client census (including direct and managed clients) as of June 2009 was nearly 79,000 an increase over June 2008 of approximately 1,000 clients. We have also won new contract awards. In February 2009, we were awarded a U.S. $16.4 million three-year contract in Canada to operate a work force development program for returning veterans and two new annual contracts in California (aggregating $2.5 million per year) to operate adult mental health wellness centers. In addition, in April 2009, we were awarded a five year contract in the state of New Jersey to provide non-emergency transportation services.

- *Reducing corporate and client costs.* We have taken several steps to increase our profitability by decreasing our operating expenses. We implemented an across-the-board wage freeze and made reductions in vacation, sick and holiday pay effective as of January 1, 2009; health care benefit reductions were made effective as of July 1, 2009; we have reduced our workforce in Pennsylvania, North Carolina and Canada; and, in selected markets, we have decreased the use of fixed-salaried personnel in favor of hourly employees. We have also suspended the executive salary parity recommendations for 2009 that had been provided to the Compensation Committee of our Board of Directors, or Committee, by an independent outside compensation consultant engaged by the Committee to provide information and advice related to the compensation of our chief executive officer and other four highest paid executive officers for 2008 and 2009, as more fully described in management's discussion and analysis of financial condition and results of operations included in our report on Form 10-K for the year ended December 31, 2008.

- *Selling non-strategic assets.* In November 2008, we retained an investment bank to serve as our financial advisor in connection with the potential sale of our non-emergency transportation (NET) services operations, which are conducted through our subsidiary, Charter LCI Corporation, and its associated operating subsidiaries, collectively referred to as LogistiCare. After consideration of purchase offers to buy LogistiCare, the recent earnings growth in our NET services operations, the improvement in performance in both segments of our operations, the current favorable Medicaid outlook and anticipated new funding availability for our payers, the Board suspended efforts to sell LogistiCare in favor of growing both segments of our business and keeping them working together on behalf of our state payers. Our Board believes that, at the current time, this course of action is more likely to maximize value for our stockholders than would a sale of LogistiCare. Consequently, while we may in the future determine to reinstitute marketing efforts for the sale of LogistiCare, there is no current plan with respect thereto and no assurance that we will ever make such determination or complete the sale of LogistiCare or any other assets.

- *Reducing or delevering our debt.* If we ultimately sell any of our assets, we intend to use the proceeds from such sales to pay down our senior debt. However, to address our liquidity concerns with respect to this debt, we entered into the March 2009 amendment to our credit agreement with CIT, discussed above, changing certain of our financial covenant requirements with respect to such debt to a level where we believe we will continue to meet our covenant requirements for the foreseeable future without regard to the sale of any assets.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

Focusing on our core competencies in the delivery of home and community based counseling, foster care and not-for-profit managed services, we believe we are well positioned to offer the highest quality of service to our clients and provide much needed products to state and local governments. Our goal is to be the primary provider of choice to the social services industry.

As of June 30, 2009, we provided social services directly and through the entities we manage to approximately 79,000 clients, and had 6.7 million individuals eligible to receive services under our non-emergency transportation services contracts. We provided services to these clients from 430 locations in 42 states, the District of Columbia and British Columbia.

Our working capital requirements are primarily funded by cash from operations and borrowings from our credit facility with CIT, which provides funding for general corporate purposes and acquisitions.

Critical accounting estimates

In preparing our financial statements in accordance with accounting principles generally accepted in the United States, we are required to make estimates and judgments that affect the amounts reflected in our financial statements. We base our estimates on historical experience and on various other assumptions we believe to be reasonable under the circumstances. However, actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are those policies most important to the portrayal of our financial condition and results of operations. These policies require our most difficult, subjective or complex judgments, often employing the use of estimates about the effect of matters inherently uncertain. Our most critical accounting policies pertain to revenue recognition, accounts receivable and allowance for doubtful accounts, accounting for business combinations, goodwill and other intangible assets, accrued transportation costs, accounting for management agreement relationships, loss reserves for certain reinsurance and self-funded insurance programs, stock-based compensation, foreign currency translation, derivative instruments and hedging activities, and income taxes.

As of June 30, 2009, there has been no change in our accounting policies or the underlying assumptions or methodology used to fairly present our financial position, results of operations and cash flows for the periods covered by this report.

For further discussion of our critical accounting policies see management's discussion and analysis of financial condition and results of operations contained in our Form 10-K for the year ended December 31, 2008.

Results of operations

Segment reporting. Our operations are organized and reviewed by our chief operating decision maker along our service lines in two reportable segments (i.e., Social Services and NET Services). We operate these reportable segments as separate divisions and differentiate the segments based on the nature of the services they offer. The following describes each of our segments.

Social Services

Social Services includes government sponsored social services that we have historically offered. Primary services in this segment include home and community based counseling, foster care and not-for-profit management services. Our operating entities within Social Services provide services to a common customer group, principally individuals and families. All of our operating entities within Social Services follow similar operating procedures and methods in managing their operations and each operating entity works within a similar regulatory environment, primarily under Medicaid regulations. We manage our operating activities within Social Services by actual to budget comparisons within each operating entity rather than by comparison between entities.

Our actual operating contribution margins by operating entity within Social Services ranged from approximately 2% to 12% as of December 31, 2008. We believe that the long term operating contribution margins of our operating entities that comprise Social Services will approximate between 10% and 15% as the respective entities' markets mature, we cross sell our services within markets, and standardize our operating model among entities including recent acquisitions. We also believe that our targeted contribution margin of approximately 15% is allowable by our state and local governmental payers over the long term.

Our chief operating decision maker regularly reviews financial and non-financial information for each individual entity within Social Services. While financial performance in comparison to budget is evaluated on an entity-by-entity basis, our operating entities comprising Social Services are aggregated into one reporting segment for financial reporting purposes because we believe that the operating entities exhibit similar long term financial performance. In addition, our revenues, costs and contribution margins are not significantly affected by allocating more or less resources to individual operating entities within Social Services because the economic characteristics of our business are substantially dependent upon individualized market demographics which affect the amount and type of services in demand as well as our cost structure (e.g., payroll) and contract rates with payers. In conjunction with the financial performance trends, we believe the similar qualitative characteristics of the operating entities we aggregate within Social Services and budgetary constraints of our payers in each market provide a foundation to conclude that the entities that we aggregate within Social Services have similar economic characteristics. Thus, we believe the economic characteristics of our operating entities within Social Services meet the criteria for aggregation into a single reporting segment under SFAS No. 131, "*Disclosures about Segments of an Enterprise and Related Information*."

NET Services

NET Services includes managing the delivery of non-emergency transportation services. We operate NET Services as a separate division with operational management and service offerings distinct from our Social Services operating segment.

Table of Contents

The following table sets forth the percentage of consolidated total revenues represented by items in our consolidated statements of income for the periods presented:

	Three months ended June 30,		Six months ended June 30,	
	2008	2009	2008	2009
Revenues:				
Home and community based services	37.8%	38.8%	37.8%	38.9%
Foster care services	4.4	4.9	4.2	4.9
Management fees	3.1	2.0	3.1	1.9
Non-emergency transportation services	54.7	54.3	54.9	54.3
Total revenues	100.0	100.0	100.0	100.0
Operating expenses:				
Client service expense	35.9	36.2	35.7	36.0
Cost of non-emergency transportation services	50.6	49.7	50.1	48.9
General and administrative expense	5.8	5.2	6.3	5.8
Depreciation and amortization	1.8	1.6	1.8	1.6
Total operating expenses	94.1	92.7	93.9	92.3
Operating income	5.9	7.3	6.1	7.7
Non-operating expense (income):				
Interest expense (income), net	2.6	2.8	2.7	2.8
Income before income taxes	3.3	4.5	3.4	4.9
Provision for income taxes	1.3	1.8	1.3	2.0
Net income	2.0%	2.7%	2.1%	2.9%

Overview of our results of operations for the three and six months ended June 30, 2009

Our financial results for the three months ended June 30, 2009 were positively impacted by our efforts to reduce corporate and client costs that included an across-the-board wage freeze, reductions in vacation, sick and holiday pay, suspension of executive salary parity recommendations for 2009 made by an independent executive compensation consultant, workforce reductions in Pennsylvania, North Carolina and Canada, and, in selected markets, decreased use of fixed-salaried personnel in favor of hourly employees. For the three months ended June 30, 2009, utilization of our education and other school-based programs increased significantly compared to the utilization levels in 2008. For the six months ended June 30, 2009, we saw our payer environment begin to stabilize in our social services markets supported by the favorable reaction to the passage of the Children's Health Insurance Program Reauthorization Act (signed into law in February 2009), the American Recovery and Reinvestment Act of 2009, and a Federal court decision that permanently enjoined the State of California from making Medicaid rate reductions. With respect to our Net Services operating segment, we saw some rates improve along with lower utilization, which resulted in improved operating margin for the three and six months ended June 30, 2009.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

Three months ended June 30, 2009 compared to three months ended June 30, 2008

Revenues

	Three Months Ended June 30,		Percent change
	2008	2009	
Home and community based services	$ 65,385,543	$ 74,501,279	13.9%
Foster care services	7,565,686	9,445,616	24.8%
Management fees	5,425,539	3,736,046	-31.1%
Non-emergency transportation services	94,648,593	104,149,003	10.0%
Total revenues	$ 173,025,361	$ 191,831,944	10.9%

Home and community based services. The acquisition of AmericanWork, Inc, or AW, in September 2008 added approximately $3.4 million to home and community based services revenue for the three months ended June 30, 2009 as compared to the same three month period in 2008.

Excluding the business acquisition noted above, our home and community based services provided additional revenue of approximately $5.7 million for the three months ended June 30, 2009 as compared to the three months ended June 30, 2008. This increase was primarily due to the net effect of client volume increases in new and existing locations, rate increases for services provided offsetting the loss of one contract in British Columbia during 2008.

Foster care services. The acquisition of substantially all of the assets in Illinois and Indiana of Camelot Community Care, Inc., or CCC, in September 2008 added approximately $3.1 million to foster care services revenue for the three months ended June 30, 2009 as compared to the same three month period one year ago. Partially offsetting the increase in foster care services revenue for the three months ended June 30, 2009 as compared to the three months ended June 30, 2008 was the impact of our exit from the foster care market in Kentucky in January 2009 and various state foster care program restructurings which resulted in a decrease in foster care services revenue of approximately $1.2 million. We continuously recruit additional foster care homes in many of our markets which we expect will increase our foster care service offerings.

Management fees. Revenue for entities we manage but do not consolidate for financial reporting purposes (managed entity revenue) decreased to $54.4 million for the three months ended June 30, 2009 as compared to $62.8 million for the same three month period last year. The decrease of approximately $1.7 million in management fees for the three month period ended June 30, 2009 as compared to the three months ended June 30, 2008 was primarily attributable to the acquisition of assets from CCC (a managed entity) in September 2008 and the effect of changes made to management services arrangements with certain of our managed entities effective January 1, 2009.

Non-emergency transportation services. We generated all of our non-emergency transportation services revenue for the three months ended June 30, 2008 and 2009 through our NET Services operating segment. The increase in non-emergency transportation services revenue for the three months ended June 30, 2009 as compared to the same three month period one year ago was due to additional membership related to new contracts, membership increases under existing contracts and a negotiated rate increase for services provided due to increased utilization. A significant portion of this revenue was generated under capitated contracts where we assumed the responsibility of meeting the transportation needs of a specific geographic population. Due to the fixed revenue stream and variable expense base structure of our NET Services operating segment, expenses related to this segment vary with seasonal fluctuations. We expect our operating results will continuously fluctuate on a quarterly basis.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

Operating expenses

Client service expense. Client service expense included the following for the three months ended June 30, 2008 and 2009:

	Three months ended June 30,		Percent change
	2008	2009	
Payroll and related costs	$ 43,400,244	$ 48,681,319	12.2%
Purchased services	9,702,200	8,578,606	-11.6%
Other operating expenses	8,892,874	12,166,459	36.8%
Stock-based compensation	176,934	55,637	-68.6%
Total client service expense	$ 62,172,252	$ 69,482,021	11.8%

Payroll and related costs. Our payroll and related costs increased for the three months ended June 30, 2009 as compared to the same three month period one year ago, as we added new direct care providers, administrative staff and other employees to support our growth. In addition, we added over 300 new employees in connection with the purchase of assets from CCC and the acquisition of AW, which resulted in an increase in payroll and related costs of approximately $2.7 million in the aggregate for the three months ended June 30, 2009 as compared to the three months ended June 30, 2008. As a percentage of revenue, excluding NET Services revenue, payroll and related costs increased slightly from 55.4% for the three months ended June 30, 2008 to 55.5% for the three months ended June 30, 2009 due to the addition of new employees to support our growth.

Purchased services. We subcontract with a network of providers for a portion of the workforce development services we provide throughout British Columbia. In addition, we incur a variety of other support service expenses in the normal course of business. For the three months ended June 30, 2009, use of these services decreased by approximately $1.7 million as compared to the same three month period in 2008. The decrease was primarily attributable to the termination of a contract in British Columbia in 2008, the effect of imposed revenue caps and decreases in other support services. Partially offsetting the decrease in purchased services for the three months ended June 30, 2009 as compared to the three months ended June 30, 2008 were increases in foster parent payments amounting to approximately $583,000. Increases in foster parent payments were primarily attributable to the assets acquired from CCC in September 2008. As a percentage of revenue, excluding NET Services revenue, purchased services decreased from 12.4% for the three months ended June 30, 2008 to 9.8% for the three months ended June 30, 2009 primarily due to the effects of the items noted above related to our operations in British Columbia.

Other operating expenses. The assets acquired from CCC and the acquisition of AW in September 2008 added approximately $1.2 million to other operating expenses for the three months ended June 30, 2009 as compared to the three months ended June 30, 2008. Further, for the three months ended June 30, 2009, other operating expenses such as client mileage, transportation expenses, minor equipment and temporary labor increased as compared to the same prior year period due to the growth in the number of clients serviced in existing markets. In addition to the effect of our efforts to cut costs generally, our operating expenses in British Columbia have decreased approximately $681,000 primarily due to the contract termination noted above. As a percentage of revenue, excluding NET Services revenue, other operating expenses increased to 13.9% for the three months ended June 30, 2009 from 11.3% for the three months ended June 30, 2008 due to the growth in the number of clients serviced in existing markets where other operating expenses incurred have increased (offset by a corresponding decrease in payroll and related costs as a percentage of revenue) under certain cost based service contracts.

Stock-based compensation. Stock-based compensation of approximately $56,000 for the three months ended June 30, 2009 represents the amortization of the fair value of stock options awarded to key employees since January 1, 2009 under our 2006 Long-Term Incentive Plan. All stock-based compensation expense for non-corporate employees for the three months ended June 30, 2009 was expensed as part of client service expense. Of the total stock-based compensation expense of approximately $609,000 for the three months ended June 30, 2008, approximately $177,000 was expensed as part of client service expense and the remainder as general and administrative expense.

On December 30, 2008, the Committee approved the acceleration of vesting of all unvested stock-based awards outstanding on that day. The acceleration of vesting of all unvested stock-based awards in

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

2008 eliminated stock-based compensation expense that would have been charged in 2009 for awards granted prior to December 30, 2008 and accounted for the decrease in stock-based compensation expense for the three months ended June 30, 2009 as compared to the same three month period one year ago.

Cost of non-emergency transportation services.

	Three months ended June 30,		Percent
	2008	2009	Change
Payroll and related costs	$ 10,209,421	$ 11,906,568	16.6%
Purchased services	72,991,240	77,715,449	6.5%
Other operating expenses	4,258,270	5,600,856	31.5%
Total client service expense	$ 87,458,931	$ 95,222,873	8.9%

<u>Payroll and related costs</u>. The increase in payroll and related costs of our NET Services segment for the three months ended June 30, 2009 as compared to the same three month period in 2008 was due to the addition of administrative staff and other employees to support our growth. As a percentage of NET Services revenue, payroll and related costs increased from 10.8% for the three months ended June 30, 2008 to 11.4% for the three months ended June 30, 2009 primarily due to new hires and related costs for start-up contracts in new and existing markets, particularly in Hawaii, New Jersey and New Mexico.

<u>Purchased services.</u> Through our NET Services operating segment we subcontract with a number of third party transportation providers to provide non-emergency transportation services to our clients. For the three months ended June 30, 2009, purchased transportation costs increased due to services provided under new contracts as compared to the three months ended June 30, 2008. As a percentage of NET Services revenue, purchased services decreased from approximately 77.1% for the three months ended June 30, 2008 to approximately 74.6% for the three months ended June 30, 2009. Lower utilization due to membership increases under existing contracts and business mix due to higher growth in the higher margin HMO business during the three months ended June 30, 2009 resulted in lower purchased services expense as a percentage of revenue for the three months ended June 30, 2009 as compared to the three months ended June 30, 2008.

<u>Other operating expenses.</u> Other operating expenses of our NET Services operating segment as a percentage of NET Services revenue increased from 4.5% for the three months ended June 30, 2008 to 5.4% for the same current year three month period. The increase is mostly attributable to costs incurred for the implementation of new contracts.

General and administrative expense.

Three months ended June 30,		Percent
2008	2009	change
$ 10,099,428	$ 10,056,177	-0.4%

Due to the acceleration of vesting of all unvested stock-based awards as of December 30, 2008, stock-based compensation expense that would have been charged in 2009 for awards granted prior to December 30, 2008 was eliminated. As a result, general and administrative expense for the three months ended June 30, 2009 decreased by approximately $426,000 as compared the same prior year period. Additionally, payroll and related costs decreased for the three months ended June 30, 2009 as compared to the three months ended June 30, 2008 by approximately $846,000 primarily due to the modifications of our management services arrangements with managed entities that resulted in a reduction in employees in response to lower management services fees. Additional decreases in general and administrative expenses resulted from the effect of our efforts to cut costs generally.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

Partially offsetting the decrease in general and administrative expense was the impact of our acquisition of the assets of CCC and the acquisition of AW in September 2008, which accounted for an increase of approximately $385,000 in general and administrative expenses related to facilities management for the three months ended June 30, 2009 as compared to the same three month period last year. Also contributing to an increase in corporate administrative expenses were arrangement, legal and other fees related to the 2009 proxy contest initiated by a dissident stockholder, professional service fees related to the amendment to our credit agreement with CIT and other expenses aggregating to an increase over the three month period ended June 30, 2008 of approximately $990,000. In addition, as a result of our growth over the twelve month period ended June 30, 2009, rent and facilities costs increased $242,000 for the three months ended June 30, 2009 excluding the impact of the CCC and AW acquisitions. As a percentage of revenue, general and administrative expense decreased from 5.8% for the three months ended June 30, 2008 to 5.2% for the three months ended June 30, 2009 due to the effect of lower incremental general and administrative expense of our NET Services operating segment relative to its total revenue contribution and the decrease in stock-based compensation expense noted above.

Depreciation and amortization.

Three months ended June 30,		Percent
2008	**2009**	**change**
$ 3,166,238	$ 3,096,558	-2.2%

The decrease in depreciation and amortization from period to period primarily resulted from the write-down of intangible assets resulting from the impairment of customer relationships in 2008 as well as fully depreciated property and equipment on which no depreciation was recognized. As a percentage of revenues, depreciation and amortization was approximately 1.8% for the three months ended June 30, 2008 and 1.6% for the three months ended June 30, 2009.

Non-operating (income) expense

Interest expense. Our current and long-term debt obligations have decreased to approximately $230.6 million in principal amount at June 30, 2009 from $241.1 million in principal amount at June 30, 2008; however, effective March 11, 2009 (pursuant to the amendment to our credit and guaranty agreement with CIT), the interest rate related to our term loan increased from LIBOR plus 3.5% to LIBOR plus 6.5%. This resulted in an net increase in the associated interest expense of approximately $47,000 for the three months ended June 30, 2009 as compared to the three months ended June 30, 2008. The remaining increase in interest expense for the three months ended June 30, 2009 as compared to the same prior year period is attributable to increased deferred financing costs related to the amendment to our credit and guaranty agreement with CIT and interest expense associated with the interest rate swap.

Interest income. Interest income for the three months ended June 30, 2008 and 2009 was approximately $240,000 and $62,000, respectively, and resulted primarily from interest earned on interest bearing bank and money market accounts.

Provision for income taxes

The provision for income taxes is based on our estimated annual effective income tax rate for the full fiscal year equal to approximately 40.1% for 2009 as compared to an actual effective rate of 7.3% for 2008 (including the tax effect of goodwill impairment charges for 2008). Our effective income tax rate (including discrete items) for the three months ended June 30, 2009 was 39.2%, which differs from the federal statutory rate primarily due to state income taxes and nondeductible permanent differences.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

Table of Contents

Six months ended June 30, 2009 compared to six months ended June 30, 2008

Revenues

	Six Months Ended June 30,		Percent
	2008	2009	change
Home and community based services	$ 131,281,207	$ 147,192,019	12.1%
Foster care services	14,518,000	18,393,469	26.7%
Management fees	10,667,966	7,328,368	-31.3%
Non-emergency transportation services	190,222,646	205,630,255	8.1%
Total revenues	$ 346,689,819	$ 378,544,111	9.2%

Home and community based services. The acquisition of AW in September 2008 added approximately $6.9 million to home and community based services revenue for the six months ended June 30, 2009 as compared to the same six month period in 2008.

Excluding the acquisition of AW noted above, our home and community based services provided additional revenue of approximately $9.0 million for the six months ended June 30, 2009 as compared to the six months ended June 30, 2008. This increase was primarily due to the net effect of client volume increases in new and existing locations, rate increases for services provided, reductions in funding from North Carolina, the loss of one contract in British Columbia during 2008, and implementation of managed care initiatives in Pennsylvania.

Foster care services. The acquisition of substantially all of the assets in Illinois and Indiana of CCC in September 2008 added approximately $6.0 million to foster care services revenue for the six months ended June 30, 2009 as compared to the same six month period one year ago. Partially offsetting the increase in foster care services revenue for the six months ended June 30, 2009 as compared to the six months ended June 30, 2008 was the impact of our exit from the foster care market in Kentucky in January 2009 and various state foster care program restructurings which resulted in a decrease in foster care services revenue of approximately $2.1 million.

Management fees. Revenue for entities we manage but do not consolidate for financial reporting purposes (managed entity revenue) decreased to $107.8 million for the six months ended June 30, 2009 as compared to $124.2 million for the same six month period last year. The decrease of approximately $3.3 million in management fees for the six month period ended June 30, 2009 as compared to the six months ended June 30, 2008 was primarily attributable to the acquisition of assets from CCC (a managed entity) in September 2008 and the effect of changes made to management services arrangements with certain of our managed entities effective January 1, 2009.

Non-emergency transportation services. The increase in non-emergency transportation services revenue was due to additional membership related to new contracts, membership increases under existing contracts and a negotiated rate increase for services provided due to increased utilization. A significant portion of this revenue was generated under capitated contracts where we assumed the responsibility of meeting the transportation needs of a specific geographic population. Due to the fixed revenue stream and variable expense base structure of our NET Services operating segment, expenses related to this segment vary with seasonal fluctuations. We expect our operating results will continuously fluctuate on a quarterly basis.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

Operating expenses

Client service expense. Client service expense included the following for the six months ended June 30, 2008 and 2009:

	Six months ended June 30,		Percent change
	2008	2009	
Payroll and related costs	$ 87,133,299	$ 97,721,460	12.2%
Purchased services	18,640,165	16,950,262	-9.1%
Other operating expenses	17,542,017	21,628,366	23.3%
Stock-based compensation	340,417	56,410	-83.4%
Total client service expense	$ 123,655,898	$ 136,356,498	10.3%

Payroll and related costs. Our payroll and related costs increased for the six months ended June 30, 2009 as compared to the same six month period one year ago, as we added new direct care providers, administrative staff and other employees or outside contractors to support our growth. In addition, we added over 300 new employees in connection with the purchase of assets from CCC and the acquisition of AW, which resulted in an increase in payroll and related costs of approximately $5.4 million in the aggregate for the six months ended June 30, 2009 as compared to the six months ended June 30, 2008. Partially offsetting the increases in payroll and related costs for the six months ended June 30, 2009 as compared to the six months ended June 30, 2008 was a decrease in payroll and related costs of approximately $400,000 due to a discretionary management bonus that was paid during the six months ended June 30, 2008 and charged to client services expense that was not paid during the same current year six month period. As a percentage of revenue, excluding NET Services revenue, payroll and related costs increased from 55.7% for the six months ended June 30, 2008 to 56.5% for the six months ended June 30, 2009 due to the addition of new employees to support our growth.

Purchased services. We subcontract with a network of providers for a portion of the workforce development services we provide throughout British Columbia. In addition, we incur a variety of other support service expenses in the normal course of business. For the six months ended June 30, 2009, use of these services decreased by approximately $3.6 million as compared to the same six month period in 2008. The decrease was primarily attributable to the termination of a contract in British Columbia in 2008 and the effect of imposed revenue caps. Partially offsetting the decrease in purchased services for the six months ended June 30, 2009 as compared to the six months ended June 30, 2008 were increases in foster parent payments, pharmacy and out-of-home placements amounting to approximately $1.9 million. Increases in foster parent payments were primarily attributable to the assets acquired from CCC in September 2008. As a percentage of revenue, excluding NET Services revenue, purchased services decreased from 11.9% for the six months ended June 30, 2008 to 9.8% for the six months ended June 30, 2009 primarily due to the effects of the items noted above related to our operations in British Columbia.

Other operating expenses. The assets acquired from CCC and the acquisition of AW in September 2008 added approximately $2.2 million to other operating expenses for the six months ended June 30, 2009 as compared to the six months ended June 30, 2008. Further, for the six months ended June 30, 2009, other operating expenses such as client mileage, transportation expenses, minor equipment and temporary labor increased as compared to the same prior year period due to the growth in the number of clients serviced in existing markets. In addition to the effect of our efforts to cut costs generally, our operating expenses in British Columbia have decreased approximately $1.6 million primarily due to the contract termination noted above. As a percentage of revenue, excluding NET Services revenue, other operating expenses increased to 12.5% for the six months ended June 30, 2009 from 11.2% for the six months ended June 30, 2008 due to the growth in the number of clients serviced in existing markets where other operating expenses incurred have increased (offset by a corresponding decrease in payroll and related costs as a percentage of revenue) under certain cost based service contracts.

Stock-based compensation. Stock-based compensation of approximately $56,000 for the six months ended June 30, 2009 represents the amortization of the fair value of stock options awarded to key employees beginning in January 2009 under our 2006 Long-Term Incentive Plan. All stock-based compensation expense for non-corporate employees for the six months ended June 30, 2009 was expensed as part of client service expense. Of the total stock-based compensation expense of approximately $1.2

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

million for the six months ended June 30, 2008, approximately $340,000 was expensed as part of client service expense and the remainder as general and administrative expense.

On December 30, 2008, the Committee approved the acceleration of vesting of all unvested stock-based awards outstanding on that day. The acceleration of vesting of all unvested stock-based awards in 2008 eliminated stock-based compensation expense that would have been charged in 2009 for awards granted prior to December 30, 2008 and accounted for the decrease in stock-based compensation expense for the six months ended June 30, 2009 as compared to the same six month period one year ago.

Cost of non-emergency transportation services.

	Six months ended June 30,		Percent Change
	2008	2009	
Payroll and related costs	$ 20,162,679	$ 22,431,737	11.3%
Purchased services	144,737,316	152,533,537	5.4%
Other operating expenses	8,806,566	10,079,130	14.5%
Total client service expense	$ 173,706,561	$ 185,044,404	6.5%

Payroll and related costs. The increase in payroll and related costs of our NET Services segment for the six months ended June 30, 2009 as compared to the same six month period in 2008 was due to the addition of administrative staff and other employees to support our growth. As a percentage of NET Services revenue, payroll and related costs increased from 10.6% for the six months ended June 30, 2008 to 10.9% for the six months ended June 30, 2009 primarily due to new hires and related costs for start-up contracts in new and existing markets, particularly in Hawaii, New Jersey and New Mexico.

Purchased services. Through our NET Services operating segment we subcontract with a number of third party transportation providers to provide non-emergency transportation services to our clients. For the six months ended June 30, 2009, purchased transportation costs increased due to services provided under new contracts as compared to the six months ended June 30, 2008. As a percentage of NET Services revenue, purchased services decreased from approximately 76.1% for the six months ended June 30, 2008 to approximately 74.2% for the six months ended June 30, 2009. Lower utilization due to inclimate weather (not seen in 2008), membership increases under existing contracts, and business mix due to higher growth in the higher margin HMO business during the six months ended June 30, 2009 resulted in lower purchased services expense as a percentage of revenue for the six months ended June 30, 2009 as compared to the six months ended June 30, 2008.

Other operating expenses. Other operating expenses of our NET Services operating segment as a percentage of NET Services revenue increased from 4.6% for the six months ended June 30, 2008 to 4.9% for the six months ended June 30, 2009. The increase is primarily due to costs incurred for the implementation of new contracts.

General and administrative expense.

Six months ended June 30,		Percent change
2008	2009	
$ 21,765,584	$ 21,946,892	0.8%

The assets acquired from CCC and the acquisition of AW in September 2008 accounted for an increase of approximately $744,000 in general and administrative expenses related to facilities management for the six months ended June 30, 2009 as compared to the same six month period last year. Also contributing to the increase in corporate administrative expenses were arrangement, legal, accounting and other expenses related to the amended credit and guarantee agreement discussed below, legal and other fees

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

related to the 2009 consent solicitation and 2009 proxy contest initiated by a dissident stockholder, costs related to the potential sale of assets and other expenses aggregating to an increase over the six month period ended June 30, 2008 of approximately $3.5 million. In addition, as a result of our growth over the twelve month period ended June 30, 2009, rent and facilities costs increased $374,000 for the six months ended June 30, 2009 excluding the impact of the CCC and AW acquisitions.

Partially offsetting the increases in general and administrative expenses for the six months ended June 30, 2009 as compared to the six months ended June 30, 2008 was a decrease in payroll and related costs totaling approximately $3.1 million partially due to discretionary bonuses that were paid during the six months ended June 30, 2008 that were not paid during the same current year six month period and the reduction of employees in response to lower management services fees under modified management services agreements. Due to the acceleration of vesting of all unvested stock-based awards as of December 30, 2008, stock-based compensation expense that would have been charged in 2009 for awards granted prior to December 30, 2008 was eliminated. As a result, general and administrative expense for the six months ended June 30, 2009 decreased by approximately $817,000 as compared the same prior year period. Additional decreases in general and administrative expenses resulted from the effect of our efforts to cut costs generally. As a percentage of revenue, general and administrative expense decreased from 6.3% for the six months ended June 30, 2008 to 5.8% for the six months ended June 30, 2009 due to the effect of lower incremental general and administrative expense of our NET Services operating segment relative to its total revenue contribution, discretionary bonuses not paid during the six months ended June 30, 2009 as compared to the same prior year period and the decrease in stock-based compensation expense noted above.

Depreciation and amortization.

Six months ended June 30,		Percent
2008	**2009**	**change**
$ 6,485,787	$ 6,180,756	-4.7%

The decrease in depreciation and amortization from period to period primarily resulted from the write-down of intangible assets resulting from the impairment of customer relationships in 2008 as well as fully depreciated property and equipment on which no depreciation was recognized. As a percentage of revenues, depreciation and amortization was approximately 1.9% for the six months ended June 30, 2008 and 1.6% for the six months ended June 30, 2009.

Non-operating (income) expense

Interest expense. Increased interest expense for the six months ended June 30, 2009 as compared to the six months ended June 30, 2008 was primarily due to accelerated amortization of deferred financing fees (related to the amendment of our credit and guarantee agreement with CIT) and interest expense associated with the interest rate swap. Our current and long-term debt obligations have decreased to approximately $230.6 million at June 30, 2009 from $241.1 million at June 30, 2008; however, effective March 11, 2009 (pursuant to the amendment to our credit and guaranty agreement), the interest rate related to our term loan increased from LIBOR plus 3.5% to LIBOR plus 6.5%. The impact of a decrease in the principal amount of our long-term debt (partially offset by an increase in the associated interest rate) resulted in a net decrease in the related interest expense from approximately $6.1 million for the six months ended June 30, 2008 to approximately $5.4 million for the six months ended June 30, 2009.

Interest income. Interest income for the six months ended June 30, 2008 and 2009 was approximately $599,000 and $178,000, respectively, and resulted primarily from interest earned on interest bearing bank and money market accounts.

Provision for income taxes

The provision for income taxes is based on our estimated annual effective income tax rate for the full fiscal year equal to approximately 40.1% for 2009 as compared to an actual effective rate of 7.3% for 2008 (including the tax effect of goodwill impairment charges for 2008). Our effective income tax rate (including discrete items) for the six months ended June 30, 2009 was 39.8%, which differs from the federal statutory rate primarily due to state income taxes and nondeductible permanent differences.

Seasonality

Our quarterly operating results and operating cash flows normally fluctuate as a result of seasonal variations in our business. In our Social Services operating segment, lower client demand for our home and community based services during the holiday and summer seasons generally results in lower revenue during those periods; however, our expenses related to the Social Services operating segment do not vary significantly with these changes. As a result, our Social Services operating segment experiences lower operating margins during the holiday and summer seasons. Our NET Services operating segment also experiences fluctuations in demand for our non-emergency transportation services during the summer, winter and holiday seasons. Due to higher demand in the summer months and lower demand in the winter and holiday seasons, coupled with a fixed revenue stream based on a per member per month base structure, our NET Services operating segment experiences lower operating margins in the summer season and higher operating margins in the winter and holiday seasons.

We expect quarterly fluctuations in operating results and operating cash flows to continue as a result of the seasonal demand for our home and community based services and non-emergency transportation services. As we enter new markets, we could be subject to additional seasonal variations along with any competitive response by other social services and transportation providers.

Liquidity and capital resources

Short-term liquidity requirements consist primarily of recurring operating expenses and debt service requirements. We expect to meet these requirements through available cash, generation of cash from our operating segments, and our revolving and term loan credit facility.

Sources of cash for the six months ended June 30, 2009 were primarily from operations and cash received from payments of notes receivable. Our balance of cash and cash equivalents was approximately $38.7 million at June 30, 2009, up from $29.4 million at December 31, 2008. Approximately $1.9 million of cash was held by WCG at June 30, 2009 and is not freely transferable without unfavorable tax consequences. We had restricted cash of approximately $12.9 million and $13.0 million at June 30, 2009 and December 31, 2008, respectively, related to contractual obligations and activities of our captive insurance subsidiaries and correctional services business. At June 30, 2009 and December 31, 2008, our total debt was approximately $230.6 million and $237.8 million, respectively.

Cash flows

Operating activities. Net income of approximately $11.1 million plus non-cash depreciation, amortization, amortization of deferred financing costs, provision for doubtful accounts, stock-based compensation, deferred income taxes and other items of approximately $11.3 million was partially offset by the growth of our billed and unbilled accounts receivable of $7.3 million and growth of other receivables of $2.3 million for the six months ended June 30, 2009. The growth of our billed and unbilled accounts receivable during the six months ended June 30, 2009 was mostly due to revenue growth.

For the six months ended June 30, 2009, net cash flow from operating activities totaled approximately $19.1 million. Decreases in management fees receivable, prepaid expenses and other assets resulted in an increase in cash flow from operations of approximately $2.2 million. Restricted cash related to the collection activities of the correctional services business resulted in additional cash provided by operating activities of approximately $122,000. Changes in accounts payable, accrued expenses, deferred revenue and other long-term liabilities resulted in cash provided by operating activities of $3.1 million, while decreases in accrued transportation costs resulted in cash used in operating activities of

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

approximately $639,000. Reinsurance liability reserves related to our reinsurance programs increased resulting in cash provided by operating activities of approximately $1.5 million.

Investing activities. Net cash used in investing activities totaled approximately $1.9 million for the six months ended June 30, 2009. We collected approximately $475,000 from notes receivable during the six months ended June 30, 2009. We spent approximately $2.0 million for property and equipment and we paid an additional amount of approximately $270,000 to the sellers of AW to settle our obligation pursuant to the final determination of working capital we acquired in this acquisition. Additionally, investments in certificates of deposit and changes in restricted cash resulted in cash used in investing activities of approximately $164,000.

Financing activities. Net cash used in financing activities totaled approximately $7.9 million for the six months ended June 30, 2009. We repaid approximately $7.1 million of long-term debt during this period and incurred additional deferred financing fees of approximately $792,000.

Exchange rate change. The effect of exchange rate changes on our cash flow related to the activities of WCG for the six months ended June 30, 2009 was an increase to cash of approximately $113,000.

Obligations and commitments

Convertible senior subordinated notes. On November 13, 2007, we issued $70.0 million in aggregate principal amount of the Notes under the amended note purchase agreement dated November 9, 2007 to the purchasers named therein in connection with the acquisition of LogistiCare. The proceeds of $70.0 million were ultimately used to partially fund the cash portion of the purchase price paid by us to acquire LogistiCare. The Notes are general unsecured obligations subordinated in right of payment to any existing or future senior debt including our credit facility with CIT described below.

In connection with our issuance of the Notes, we entered into an Indenture between us, as issuer, and The Bank of New York Trust Company, N.A., as trustee, or the Indenture.

We pay interest on the Notes in cash semiannually in arrears on May 15 and November 15 of each year. The Notes will mature on May 15, 2014.

The Notes are convertible, under certain circumstances, into common stock at a conversion rate, subject to adjustment as provided for in the Indenture, of 23.982 shares per $1,000 principal amount of Notes. This conversion rate is equivalent to an initial conversion price of approximately $41.698 per share. On and after the occurrence of a fundamental change (as defined below), the Notes will be convertible at any time prior to the close of business on the business day before the stated maturity date of the Notes. In the event of a fundamental change as described in the Indenture, each holder of the notes shall have the right to require us to repurchase the Notes for cash. A fundamental change includes among other things: (i) the acquisition in a transaction or series of transactions of 50% or more of the total voting power of all shares our of capital stock; (ii) a merger or consolidation of our company with or into another entity, merger of another entity into our company, or the sale, transfer or lease of all or substantially all of our assets to another entity (other than to one or more of our wholly-owned subsidiaries), other than any such transaction (A) pursuant to which holders of 50% or more of the total voting power of our capital stock entitled to vote in the election of directors immediately prior to such transaction have or are entitled to receive, directly or indirectly, at least 50% or more of the total voting power of the capital stock entitled to vote in the election of directors of the continuing or surviving corporation immediately after such transaction or (B) which is effected solely to change the jurisdiction of incorporation of our company and results in a reclassification, conversion or exchange of outstanding shares of our common stock into solely shares of common stock; (iii) if, during any consecutive two-year period, individuals who at the beginning of that two-year period constituted our board of directors, together with any new directors whose election to our board of directors or whose nomination for election by our stockholders, was approved by a vote of a majority of the directors then still in office who were either directors at the beginning of such period or whose election or nomination for election was previously approved, cease for any reason to constitute a majority of our board of directors then in office; (iv) if a resolution approving a plan of liquidation or dissolution of our company is approved by our board of directors or our stockholders; and (v) upon the occurrence of a termination of trading as defined in the Indenture.

The Indenture contains customary terms and provisions that provide that upon certain events of default, including, without limitation, the failure to pay amounts due under the Notes when due, the failure to perform or observe any term, covenant or agreement under the Indenture, or certain defaults under other agreements or instruments, occurring and continuing, either the trustee or the holders of not less than 25% in aggregate principal amount of the Notes then outstanding may declare the principal of the Notes and any accrued and unpaid interest through the date of such declaration immediately due and payable. Upon any such declaration, such principal, premium, if any, and interest shall become due and payable immediately. In the case of certain events of bankruptcy or insolvency relating to us or any significant subsidiary of our company, the principal amount of the Notes together with any accrued interest through the occurrence of such event shall automatically become and be immediately due and payable without any declaration or other act of the Trustee or the holders of the Notes.

Credit facility. On December 7, 2007, we entered into a Credit and Guaranty Agreement, or the Credit Agreement, with CIT Healthcare LLC, as administrative agent, Bank of America, N.A. and SunTrust Bank, as co-documentation agents, ING Capital LLC and Royal Bank of Canada, as co-syndication agents, other lenders party thereto and CIT, as sole lead arranger and bookrunner. The Credit Agreement replaced our previous credit facility with CIT Healthcare LLC. On March 11, 2009, the Credit Agreement was amended as discussed below.

The Credit Agreement provides us with a senior secured first lien credit facility in aggregate principal amount of $213.0 million comprised of a $173.0 million, six year term loan and a $40.0 million, five year revolving credit facility, or the Credit Facility. On December 7, 2007, we borrowed the entire amount available under the term loan facility and used the proceeds of the term loan to (i) fund a portion of the purchase price paid by us to acquire LogistiCare; (ii) refinance all of the existing indebtedness under our second amended loan agreement with CIT Healthcare LLC in the amount of approximately $17.3 million; and (iii) pay fees and expenses related to the acquisition of LogistiCare and the financing thereof. The revolving credit facility must be used to (i) provide funds for general corporate purposes of our company; (ii) fund permitted acquisitions; (iii) fund ongoing working capital requirements; (iv) collateralize letters of credit; and (v) make capital expenditures. We intend to draw down on the revolving credit facility from time-to-time for these uses. At December 31, 2008, the outstanding principal amount of the loans accrue at the per annum rate of LIBOR plus 3.5% or the Base Rate plus 2.5% (as defined in the Credit Agreement), at our election. In addition, we are subject to a 0.75% fee per annum on the unused portion of the available funds as well as other administrative fees. The interest rate applied to our term loan at June 30, 2009 was 6.82% (LIBOR plus 6.5% per the terms of the amendment to the Credit Agreement discussed below). No amounts were borrowed under the revolving credit facility as of June 30, 2009, but the entire amount available under this facility may be allocated to collateralize certain letters of credit. As of December 31, 2008, there were five letters of credit in the amount of $6.8 million and five letters of credit in the amount of approximately $7.3 million as of June 30, 2009 collateralized under the revolving credit facility. At December 31, 2008 and June 30, 2009, our available credit under the revolving credit facility was $33.2 million and $22.7 million, respectively.

The Credit Agreement contains customary representations and warranties, affirmative and negative covenants, yield protection, indemnities, expense reimbursement, material adverse change clauses, and events of default and other terms and conditions. In addition, we are required to maintain certain financial covenants under the Credit Agreement. Under the amendment to the Credit Agreement described below, we are in compliance with all financial covenants as of June 30, 2009. We are also prohibited from paying cash dividends if there is a default under the facility or if the payment of any cash dividends would result in default.

Our obligations under the Credit Facility are guaranteed by all of our present and future domestic subsidiaries, or the Guarantors, other than our insurance subsidiaries and not-for-profit subsidiaries. Our and each Guarantors' obligations under the Credit Facility are secured by a first priority lien, subject to certain permitted encumbrances, on our assets and the assets of each Guarantor, including a pledge of 100% of the issued and outstanding stock of our domestic subsidiaries and 65% of the issued and outstanding stock of our first tier foreign subsidiaries. If an event of default occurs, including, but not limited to, failure to pay any installment of principal or interest when due, failure to pay any other charges, fees, expenses or other monetary obligations owing to CIT when due or particular covenant defaults, as

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

more fully described in the Credit Agreement, the required lenders may cause CIT to declare all unpaid principal and any accrued and unpaid interest and all fees and expenses immediately due. Under the Credit Agreement, the initiation of any bankruptcy or related proceedings will automatically cause all unpaid principal and any accrued and unpaid interest and all fees and expenses to become due and payable. In addition, it is an event of default under the Credit Agreement if we default on any indebtedness having a principal amount in excess of $5.0 million.

Each extension of credit under the Credit Facility is conditioned upon: (i) the accuracy in all material respects of all representations and warranties in the definitive loan documentation; and (ii) there being no default or event of default at the time of such extension of credit. Under the repayment terms of the Credit Agreement, we are obligated to repay the term loan in quarterly installments on the last day of each calendar quarter so that the following percentages of the term loan borrowed on the closing date are paid as follows: 5% in 2008, 7.5% in 2009, 10% in 2010, 12.5% in 2011, 15% in 2012 and the remaining balance in 2013. With respect to the revolving credit facility, we must repay the outstanding principal balance and any accrued but unpaid interest by December 2012. With respect to required debt repayment, our Credit Agreement with CIT requires that upon receipt of any proceeds from a disposition, involuntary disposition, equity issuance, or debt issuance (as such terms are defined in the Credit Agreement) we must prepay principal then outstanding in an aggregate amount equal to 50% of such proceeds. In addition, we may at any time and from time-to-time prepay the Credit Facility without premium or penalty, provided that we may not re-borrow any portion of the term loan repaid.

The Credit Facility also requires us to prepay the loan in an aggregate amount equal to 100% of the net cash proceeds of any disposition, or, to the extent the applicable net cash proceeds exceed $500,000. Notwithstanding the foregoing, if at the time of the receipt or application of such net cash proceeds no default or event of default has occurred and is continuing and we deliver to the administrative agent a certificate, executed by our chief financial officer, that we intend within three hundred sixty-five days after receipt thereof to use all or part of such net cash proceeds either to purchase assets used in the ordinary course of our business and our subsidiaries or to make capital expenditures, we may use all or part of such net cash proceeds in the manner set forth in such certificate; provided, however, that, (A) any such net cash proceeds not so used within the period set forth in such certificate shall, on the first business day immediately following such period, be applied as a prepayment and (B) any assets so acquired shall be subject to the security interests under the collateral documents in the same priority (subject to permitted liens) as the assets subject to such disposition or involuntary disposition.

We agreed with CIT to subordinate our management fee receivable pursuant to management agreements established with our managed entities, which have stand-alone credit facilities with CIT Healthcare LLC, to the claims of CIT in the event one of these managed entities defaults under its credit facility. Additionally, any other monetary obligations of these managed entities owing to us are subordinated to the claims of CIT in the event one of these managed entities defaults under its credit facility with CIT Healthcare LLC. As of December 31, 2008 and June 30, 2009, approximately $733,000 and $723,000 of our management fees receivable related to these managed entities was subject to this subordination agreement.

We agreed to indemnify and hold harmless, the agents, each lender and their respective affiliates and officers, directors, employees, counsel, trustees, advisors, agents and attorneys-in-fact from and against any and all liabilities obligations, losses, damages, penalties, claims, demands, actions, judgments, suits, costs, expenses and disbursements to which any such indemnified party may become subject arising out of or in connection with the Credit Facility or any related transaction regardless of whether any such indemnified person is a party thereto, and to reimburse each such indemnified person upon demand for any reasonable legal or other expenses incurred in connection with investigating or defending any of the foregoing, subject to the terms and conditions set forth in the Credit Agreement.

On March 11, 2009, we agreed with our creditors to amend certain terms in the Credit Agreement (this amendment referred to as Amendment No. 1 to the Credit Agreement and, together with the Credit Agreement, the Amended Credit Agreement) to, among other things:

- decrease the revolving credit facility from $40 million to $30 million;

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

- increase the interest rate spread on the annual interest rate from LIBOR plus 3.5% to LIBOR plus 6.5% and, with respect to Base Rate Loans (as such term is defined in the Credit Agreement), increase the interest rate spread on the annual interest rate from Base Rate plus 2.5% to Base Rate plus 5.5% effective March 11, 2009; provided the interest rate will be adjusted upwards and we will incur a fee if certain consolidated senior leverage ratios exceed the corresponding ratio ceilings set forth in Amendment No. 1 to the Credit Agreement determined as of September 30, 2009 and December 31, 2009;
- amend certain financial covenants to change the requirements to a level where we met the requirements for the fourth quarter of 2008 and first quarter of 2009 and we believe will meet the requirements for the remainder of 2009;
- establish a new financial covenant through December 31, 2009 based upon our operations maintaining a minimum EBITDA level (as such term is defined in Amendment No. 1 to the Credit Agreement) commencing with the three months ended March 31, 2009; and,
- require us to deliver to the lenders monthly consolidated financial statements and a 13-week rolling cash flow forecast each week from the effective date of Amendment No. 1 to the Credit Agreement to December 31, 2009.

In exchange for the amendments described above, we agreed to pay an amendment fee to certain lenders equal to $565,000 (0.40% of the aggregate amount of the Revolving Commitment and Term Loan outstanding related to those lenders (as such terms are defined in the Amended Credit Agreement)), which was capitalized as deferred financing fees and is included in “Other assets” in the accompanying consolidated balance sheet at June 30, 2009. In addition, in connection with this transaction, we incurred fees and expenses of approximately $2.0 million, including arrangement, legal, accounting and other related costs. These fees and expenses are reflected in “General and administrative expense” in the amount of approximately $1.7 million and “Interest expense” in the amount of approximately $348,000 in the accompanying consolidated statement of income for the six months ended June 30, 2009.

There can be no assurances that we will be able to maintain compliance with the financial and other covenants in the Amended Credit Agreement. In the event we are unable to comply with these covenants during future periods, it is uncertain whether our creditors will grant waivers for our non-compliance. See Item 1A “Risk Factors—Our increased indebtedness may harm our financial condition and results of operations” included in our Form 10-K for the year ended December 31, 2008.

On February 27, 2008, we entered into an interest rate swap to convert a portion of our floating rate long-term debt to fixed rate debt. The purpose of this instrument is to hedge the variability of our future earnings and cash flows caused by movements in interest rates applied to our floating rate long-term debt. We hold this derivative only for the purpose of hedging such risks, not for speculation. We entered into the interest rate swap with a notional amount of $86.5 million maturing on February 27, 2010. Under the swap agreement, we receive interest equivalent to three-month LIBOR and pay a fixed rate of interest of 3.026% with settlement occurring quarterly.

Promissory notes. We have two unsecured, subordinated promissory notes outstanding at June 30, 2009 in connection with acquisitions completed in 2005 and 2007 in the principal amount of approximately $619,000 and $1.8 million, respectively. These promissory notes bear a fixed interest rate of between 4% and 5%, and are due in 2010. In addition, we have one secured promissory note outstanding at June 30, 2009, whereby we financed the premiums on certain of our general, auto and other liabilities insurance coverage related to our NET Services operating segment, in the principal amount of approximately $335,000. The note bears a fixed interest rate of 5.85% with principal and interest due in nine monthly installments of approximately $113,000 beginning January 2009. The note is secured by all of the unearned premiums related to the insurance policies issued by Provado Insurance Services, Inc. (one of our captive insurance subsidiaries), or Provado, and listed in the loan agreement.

Subject to our right to cure and our set off rights, failure to pay any installment of principal or interest when due or the initiation of bankruptcy or related proceedings by us related to the unsecured, subordinated promissory notes issued to the sellers in connection with the acquisitions completed in 2005 and 2007, constitutes an event of default under the promissory note provisions. If a failure to pay any installment of

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

principal or interest when due remains uncured after the time provided by the promissory notes, the unpaid principal and any accrued and unpaid interest may become due immediately. In such event, a cross default could be triggered under the Amended Credit Agreement with CIT. In the case of bankruptcy or related proceedings initiated by us, the unpaid principal and any accrued and unpaid interest becomes due immediately.

Contingent obligations. On August 13, 2007, our board of directors adopted The Providence Service Corporation Deferred Compensation Plan, or the Deferred Compensation Plan, for our eligible employees and independent contractors or a participating employer (as defined in the Deferred Compensation Plan). Under the Deferred Compensation Plan participants may defer all or a portion of their base salary, service bonus, performance-based compensation earned in a period of 12 months or more, commissions and, in the case of independent contractors, compensation reportable on Form 1099. The Deferred Compensation Plan is unfunded and benefits are paid from our general assets. As of June 30, 2009, there were seven participants in the Deferred Compensation Plan. We also maintain a 409(A) Deferred Compensation Rabbi Trust Plan for highly compensated employees of our NET Services operating segment. Benefits are paid from our general assets under this plan. As of June 30, 2009, 19 highly compensated employees participated in this plan.

We may be obligated to pay an amount up to $650,000 to the sellers under an earn out provision pursuant to a formula specified in an asset purchase agreement effective July 1, 2009 by which we acquired certain assets of an entity located in California. The earn out payment as such term is defined in the asset purchase agreement, if earned, will be paid in cash. If the contingency is resolved in accordance with the related provisions of the asset purchase agreement and the additional consideration becomes distributable, we will record the fair value of the consideration issued as an additional cost to acquire the associated assets.

Management agreements

We maintain management agreements with a number of not-for-profit social services organizations that require us to provide management and administrative services for each organization. In exchange for these services, we receive a management fee that is either based upon a percentage of the revenues of these organizations or a predetermined fee. The not-for-profit social services organizations managed by us that qualify under Section 501(c)(3) of the Internal Revenue Code, referred to as a 501(c)(3) entity, each maintain a board of directors, a majority of which are independent. All economic decisions by the board of any 501(c)(3) entity that affect us are made solely by the independent board members. Our management agreements with each 501(c)(3) entity are typically subject to third party fairness opinions from an independent appraiser retained by the independent board members of the tax exempt organizations.

Management fees generated under our management agreements represented 2.0% and 3.0% of our revenue for the six months ended June 30, 2009 and 2008, respectively. In accordance with our management agreements with these not-for-profit organizations, we have obligations to manage their business and services.

Management fee receivable at December 31, 2008 and June 30, 2009 totaled $7.7 million and $7.3 million, respectively, and management fee revenue was recognized on all of these receivables. In order to enhance liquidity of the entities we manage, we may allow the managed entities to defer payment of their respective management fees. In addition, since government contractors who provide social or similar services to government beneficiaries sometimes experience collection delays due to either lack of proper documentation of claims, government budgetary processes or similar reasons outside the contractors' control (either directly or as managers of other contracting entities), we generally do not consider a management fee receivable to be uncollectible due solely to its age until it is 365 days old.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

Table of Contents

The following is a summary of the aging of our management fee receivable balances as of June 30, September 30 and December 31, 2008 and March 31 and June 30, 2009:

At	Less than 30 days	30-60 days	60-90 days	90-180 days	Over 180 days
June 30, 2008	$ 1,679,994	$ 1,601,390	$ 1,609,904	$ 3,641,565	$ 2,424,580
September 30, 2008	$ 1,334,910	$ 1,073,025	$ 1,100,535	$ 2,509,546	$ 900,808
December 31, 2008	$ 1,143,736	$ 1,071,743	$ 1,003,070	$ 3,027,380	$ 1,456,679
March 31, 2009	$ 1,189,600	$ 784,103	$ 746,446	$ 2,560,829	$ 2,362,554
June 30, 2009	$ 1,254,508	$ 889,063	$ 712,056	$ 1,933,016	$ 2,559,219

Each month we examine each of our managed entities with regard to its solvency, outlook and ability to pay us any outstanding management fees. If the likelihood that we will not be paid is other than remote, we defer the recognition of these management fees until we are certain that payment is probable. We have deemed payment of all of the management fee receivables to be probable based on our collection history with these entities as the long-term manager of their operations.

Our days sales outstanding for our managed entities increased from 139 days at December 31, 2008 to 159 days at June 30, 2009.

Reinsurance and Self-Funded Insurance Programs

Reinsurance

We reinsure a substantial portion of our general and professional liability and workers' compensation costs and the general and professional liability and workers' compensation costs of certain designated entities we manage under reinsurance programs through our wholly-owned captive insurance subsidiary, Social Services Providers Captive Insurance Company, or SPCIC. We also provide reinsurance for policies written by a third party insurer for general liability, automobile liability, and automobile physical damage coverage to certain members of the network of subcontracted transportation providers and independent third parties under our NET Services segment through Provado. Provado, a wholly-owned subsidiary of LogistiCare, is a licensed captive insurance company domiciled in the State of South Carolina. The decision to reinsure our risks and provide a self-funded health insurance program to our employees was made based on current conditions in the insurance marketplace that have led to increasingly higher levels of self-insurance retentions, increasing number of coverage limitations, and fluctuating insurance premium rates.

SPCIC:

SPCIC, which is a licensed captive insurance company domiciled in the State of Arizona, reinsures third-party insurers for general and professional liability exposures for the first dollar of each and every loss up to $1.0 million per loss and $3.0 million in the aggregate. The gross written premiums for this policy at December 31, 2008 and June 30, 2009 were approximately $1.1 million and $1.3 million, respectively. The cumulative reserve for expected losses since inception in 2005 of this reinsurance program at June 30, 2009 was approximately $974,000. The excess premium over our expected losses may be used to fund SPCIC's operating expenses, fund any deficit arising in workers' compensation liability coverage, provide for surplus reserves, and to fund any other risk management activities.

SPCIC reinsures a third-party insurer for worker's compensation insurance for the first dollar of each and every loss up to $250,000 per occurrence with no annual aggregate limit. The third-party insurer provides a deductible buy back policy with a limit of $250,000 per occurrence that provides coverage for all states where coverage is required. The gross written premium for this policy at December 31, 2008 and June 30, 2009 was $1.5 million and $1.7 million, respectively. The cumulative reserve for expected losses since inception in 2005 of this reinsurance program at June 30, 2009 was approximately $2.8 million.

Our expected losses related to workers' compensation and general and professional liability in excess of our liability under our associated reinsurance programs at June 30, 2009 was approximately $1.6 million. We recorded a corresponding liability at June 30, 2009 which offsets these expected losses.

SPCIC had restricted cash of approximately $5.0 million at December 31, 2008 and $5.7 million at June 30, 2009, which was restricted to secure the reinsured claims losses of SPCIC under the general and

professional liability and workers' compensation reinsurance programs. The full extent of claims may not be fully determined for years. Therefore, the estimates of potential obligations are based on recommendations of an independent actuary using historical data, industry data, and our experience. Although we believe that the amounts accrued for losses incurred but not reported under the terms of our reinsurance programs are sufficient, any significant increase in the number of claims or costs associated with these claims made under these programs could have a material adverse effect on our financial results.

Provado:

Under a reinsurance agreement with a third party insurer, Provado reinsures the third party insurer for the first $250,000 of each loss for each line of coverage. Provado also reinsures the third party insurer within a finite corridor of $750,000 excess of the $250,000 layer of coverage. The reinsurance agreement is subject to an annual aggregate equal to 120% of gross written premium. The corridor is subject to a $1.1 million aggregate limit. The estimated gross written premium is $6.2 million for the policy year ending February 14, 2010. The third party insurer retains approximately 4.9% of gross written premium and a ceding commission of 18.8%. The reserve for expected losses of this reinsurance program at June 30, 2009 was approximately $4.6 million.

The liabilities for expected losses and loss adjustment expenses are based primarily on individual case estimates for losses reported by claimants. An estimate is provided for losses and loss adjustment expenses incurred but not reported on the basis of claim experience and claim experience of the industry. These estimates are reviewed at least annually by independent consulting actuaries. As experience develops and new information becomes known, the estimates are adjusted as necessary.

Health Insurance

We offer our employees an option to participate in a self-funded health insurance program. With respect to our social services operating segment, health claims were self-funded with a stop-loss umbrella policy with a third party insurer to limit the maximum potential liability for individual claims to $150,000 per person and for a maximum potential claim liability based on member enrollment. With respect to our NET Services operating segment, we offer self-funded health insurance to our employees. Health claims under this program are self-funded with a stop-loss umbrella policy with a third party insurer to limit the maximum potential liability to $75,000 per incident and a maximum potential claim liability based on member enrollment.

Health insurance claims are paid as they are submitted to the plan administrator. We maintain accruals for claims that have been incurred but not yet reported to the plan administrator and therefore have not been paid. The incurred but not reported reserve is based on an established cap and current payment trends of health insurance claims. The liability for the self-funded health plan of approximately $1.5 million and $1.4 million as of December 31, 2008 and June 30, 2009, respectively, was recorded in "Reinsurance liability reserve" in our consolidated balance sheets.

We charge our employees a portion of the costs of our self-funded group health insurance programs. We determine this charge at the beginning of each plan year based upon historical and projected medical utilization data. Any difference between our projections and our actual experience is borne by us. We estimate potential obligations for liabilities under this program to reserve what we believe to be a sufficient amount to cover liabilities based on our past experience. Any significant increase in the number of claims or costs associated with claims made under this program above what we reserve could have a material adverse effect on our financial results.

Liquidity matters

We believe that our existing cash and cash equivalents and Amended Credit Agreement provide funds necessary to meet our operating plan for 2009 and early 2010. The expected operating plan for this period provides for full operation of our businesses, and interest and projected principal payments on our debt. In addition, we are focusing on several strategic options to reduce our debt. Additionally, we have taken steps to reduce both corporate and client services costs by suspending all pay increases for all of our employees and reducing holiday and sick leave and employee health benefits beginning in 2009.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

We may also access capital markets to raise equity financing for various business reasons, including required debt payments and acquisitions that make both strategic and economic sense. The timing, term, size, and pricing of any such financing will depend on investor interest and market conditions, and there can be no assurance that we will be able to obtain any such financing. In addition, with respect to required debt payments, the Amended Credit Agreement with CIT requires that upon receipt of any proceeds from a disposition, involuntary disposition, equity issuance, or debt issuance (as defined in the Amended Credit Agreement) we must prepay principal then outstanding in an aggregate amount equal to at least 50% of such proceeds except where the disposition requires the consent of the lenders, in which case the net cash proceeds will be used to prepay outstanding principal.

Our liquidity and financial position will continue to be affected by changes in prevailing interest rates on the portion of debt that bears interest at variable interest rates. We believe we have sufficient resources to fund our normal operations for the foreseeable future.

New Accounting Pronouncements

The Financial Accounting Standards Board, or FASB, issued SFAS No. 157, "*Fair Value Measurement*", or SFAS 157, in September 2006 to define fair value and require that the measurement thereof be determined based on the assumptions that market participants would use in pricing an asset or liability and expand disclosures about fair value measurements. Additionally, SFAS 157 establishes a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from sources independent of the reporting entity and (2) the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances. SFAS 157 is effective for financial assets and financial liabilities for fiscal years beginning after November 15, 2007. On February 12, 2008, the FASB issued FSP No. FAS 157-2, "*Effective Date of FASB Statement No. 157*", which delayed the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on at least an annual basis. The statement is effective for fiscal years beginning after December 31, 2008. We adopted SFAS 157 as of January 1, 2008, with the exception of the application of the statement to non-recurring nonfinancial assets and nonfinancial liabilities. On January 1, 2009, we adopted the provisions of SFAS 157 relating to non-recurring nonfinancial assets and nonfinancial liabilities. Non-recurring nonfinancial assets and nonfinancial liabilities for which we had not applied the provisions of SFAS 157 prior to January 1, 2009 included those measured at fair value in goodwill impairment testing and indefinite life intangible assets measured at fair value for impairment testing. Although the adoption of SFAS 157 related to financial assets and financial liabilities did not materially impact our financial condition, results of operations, or cash flow, we are required to provide additional disclosures as part of our financial statements. We have determined that there was no material impact of adopting the provisions of SFAS 157 relating to non-recurring nonfinancial assets and nonfinancial liabilities on our financial condition, results of operations and cash flow.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "*Business Combinations*", or SFAS 141R. SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141R is effective as of the beginning of an entity's fiscal year that begins after December 15, 2008. On January 1, 2009, we adopted SFAS 141R. In addition, we determined that there was no material impact of the adoption of SFAS 141R on our consolidated results of operations and financial condition.

In December 2007 the FASB issued SFAS 160. SFAS 160 establishes accounting and reporting standards for ownership interest in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interest of the parent and the interests of the noncontrolling owners. SFAS 160 is effective as of the beginning of an entity's fiscal year that begins after December 15, 2008. We adopted the provisions of SFAS 160 on January 1, 2009 and as a result reclassified the ownership interest in PSC (represented by

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

the Exchangeable Shares) held by the sellers related to our acquisition of WCG of approximately $7.3 million and $7.0 million, respectively, as of December 31, 2008 and June 30, 2009, as equity. Prior to January 1, 2009, we classified this ownership interest as "Non-controlling interest" in our consolidated balance sheets. We determined that the adoption of the other provisions of SFAS 160 did not have a material impact on our consolidated results of operations and financial condition.

In March 2008, the FASB issued SFAS No. 161, "*Disclosures about Derivative Instruments and Hedging Activities*", or SFAS 161, which amends SFAS 133. SFAS 161 requires companies with derivative instruments to disclose information about how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS 133, and how derivative instruments and related hedged items affect a company's financial position, financial performance, and cash flows. The required disclosures include the fair value of derivative instruments and their gains or losses in tabular format, information about credit-risk-related contingent features in derivative agreements, counterparty credit risk, and the company's strategies and objectives for using derivative instruments. SFAS 161 expands the current disclosure framework in SFAS 133. SFAS 161 is effective prospectively for periods beginning on or after November 15, 2008. On January 1, 2009, we adopted the provisions of SFAS 161 and determined that, other than the additional disclosures related to our interest rate swap we are now required to make, the adoption of SFAS 161 did not have a material impact on our consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position, or FSP, 142-3, "*Determination of the Useful Life of Intangible Assets*", or FSP 142-3. FSP 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "*Goodwill and Other Intangible Assets*", or SFAS 142. In developing assumptions about renewal or extension used to determine the useful life of a recognized intangible asset, an entity may consider its own historical experience in renewing or extending similar arrangements; however, these assumptions should be adjusted for the entity-specific factors set forth in paragraph 11 of SFAS 142. In addition, FSP 142-3, requires disclosure of information that enables users of financial statements to assess the extent to which the expected future cash flows associated with the asset are affected by the entity's intent and/or ability to renew or extend the arrangement for a recognized intangible asset. FSP 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption is prohibited. On January 1, 2009, we adopted the provisions of FSP 142-3. The adoption of FSP 142-3 did not have a material impact on our consolidated results of operations and financial condition.

In June 2008, the FASB issued Emerging Issues Task Force, or EITF, Issue 07-5, "*Determining whether an Instrument (or Embedded Feature) is indexed to an Entity's Own Stock*" ("EITF 07-5"). EITF No. 07-5 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application is not permitted. Paragraph 11(a) of SFAS 133 specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company's own stock and (b) classified in stockholders' equity in the statement of financial position would not be considered a derivative financial instrument. EITF 07-5 provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and thus able to qualify for the SFAS 133 paragraph 11(a) scope exception. Our 6.5% Convertible Senior Subordinated Notes due 2014 (the "Notes") are subject to the provisions of EITF 07-5 since the notes are indexed to our own stock, they are convertible, under certain circumstances, into common stock at a specified conversion rate. Based on our analysis of the Notes under SFAS 133, EITF 07-5 and other related guidance, we concluded that the embedded conversion option qualifies for the scope exception in paragraph 11(a) of SFAS 133 because it is both (1) indexed to our own stock by virtue of the fact that all of the triggering conversion events are contingencies that are not based on an observable market or an observable index and that the only variables that affect the settlement amount of the conversion in each case would be inputs to the fair value of a fixed-for-fixed option on equity shares as they relate to stock price and (2) would be classified in stockholders' equity if it were a freestanding instrument. The Notes including the embedded conversion option are classified as a liability in our consolidated balance sheets. EITF 07-5 requires issuers of convertible notes that protect holders from declines in the issuer's stock price ("down-round" protection) to account for these instruments as derivatives under SFAS 133. The Notes do not contain any "down-round" protection, therefore the adoption of EITF 07-5 as of January 1, 2009 did not impact our consolidated financial statements.

In April 2009, FASB issued FSP FAS 141(R)-1, "*Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*", or FSP FAS 141(R)-1. FSP FAS 141(R)-1 amends the provisions in SFAS 141(R), for the initial recognition and measurement, subsequent measurement and accounting, and disclosures for assets and liabilities arising from contingencies in business combinations. No subsequent accounting guidance is provided in the FSP, and the FASB expects an acquirer to develop a systematic and rational basis for subsequently measuring and accounting for

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

acquired contingencies depending on their nature. FSP FAS 141(R)-1 is effective for contingent assets or contingent liabilities acquired in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We have determined that the adoption of FSP FAS 141(R)-1 did not have a material impact on our consolidated financial statements.

On April 9, 2009, FASB issued FSP 157-4, "*Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*" or FSP 157-4. FSP 157-4 provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased. In addition, FSP 157-4 includes guidance on identifying circumstances that indicate a transaction is not orderly. Further, this FSP emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. FSP 157-4 is effective for interim and annual reporting periods ending after June 15, 2009, and is to be applied prospectively. Early adoption is permitted. We adopted the provisions of FSP 157-4 beginning with the quarterly period ended June 30, 2009 and determined that the adoption of FSP 157-4 did not have a material impact on our consolidated financial statements.

On April 9, 2009, FASB issued FSP 107-1 and APB 28-1, "*Interim Disclosures about Fair Value of Financial Instruments*", or FSP 107-1. FSP 107-1 amends SFAS No. 107, "*Disclosures about Fair Value of Financial Instruments*" to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends APB Opinion No. 28, "*Interim Financial Reporting*", to require those disclosures in summarized financial information at interim reporting periods. FSP 107-1 is effective for interim reporting periods ending after June 15, 2009. We adopted the provisions of FSP 107-1 beginning with the quarterly period ended June 30, 2009 and determined that, other than the additional disclosures related to the fair value of financial instruments we are now required to make, the adoption of FSP 107-1 did not have a material impact on our consolidated financial statements.

In May 2009, FASB issued SFAS No. 165, "*Subsequent Events*", or SFAS 165. SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, SFAS 165 sets forth the period and circumstances during and under which an entity should evaluate events or transactions occurring after the balance sheet date for potential recognition and disclosure in the financial statements. SFAS 165 also provides guidance regarding the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. We adopted the provisions of SFAS 165 beginning with the quarterly period ended June 30, 2009 in accordance with SFAS 165's effective date. We have determined that the adoption of SFAS 165 did not have a material impact on our consolidated financial statements as no significant event occurred subsequent to June 30, 2009 up to the filing date of this report on Form 10-Q.

Pending Accounting Pronouncements

In June 2009, the FASB issued SFAS No. 168, "*The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162*.", or SFAS 168. FASB issued this statement to replace FASB Statement No. 162, "*The Hierarchy of Generally Accepted Accounting Principles*," and to establish the *FASB Accounting Standards Codification* as the source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with GAAP. SFAS 168 does not affect the rules and interpretive releases of the Securities and Exchange Commission, or SEC, which are also sources of authoritative GAAP for SEC registrants. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. We have determined that the adoption of SFAS 168, will not have an impact on our consolidated financial statements because SFAS 168 only codifies existing non-SEC accounting literature.

Table of Contents

Other accounting standards that have been issued or proposed by the FASB or other standards setting bodies that do not require adoption until a future date are not expected to have a material impact on the Company's consolidated financial statements upon adoption.

Forward-Looking Statements

Certain statements contained in this quarterly report on Form 10-Q, such as any statements about our confidence or strategies or our expectations about revenues, liabilities, results of operations, ability to fund operations, profitability, ability to meet financial covenants, contracts or market opportunities, constitute forward-looking statements within the meaning of section 27A of the Securities Act of 1933 and section 21E of the Securities Exchange Act of 1934. These forward-looking statements are based on our current expectations, assumptions, estimates and projections about our business and our industry. You can identify forward-looking statements by the use of words such as "may," "should," "will," "could," "estimates," "predicts," "potential," "continue," "anticipates," "believes," "plans," "expects," "future," and "intends" and similar expressions which are intended to identify forward-looking statements.

The forward-looking statements contained herein are not guarantees of our future performance and are subject to a number of known and unknown risks, uncertainties and other factors disclosed in our annual report on Form 10-K for the year ended December 31, 2008. Some of these risks, uncertainties and other factors are beyond our control and difficult to predict and could cause our actual results or achievements to differ materially from those expressed, implied or forecasted in the forward-looking statements.

All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements contained above and throughout this report. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statement was made. We do not intend to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Foreign currency translation

We conduct business in Canada through our wholly-owned subsidiary WCG, and as such, our cash flows and earnings are subject to fluctuations from changes in foreign currency exchange rates. We believe that the impact of currency fluctuations does not represent a significant risk to us given the size and scope of our current international operations. Therefore, we do not hedge against the possible impact of this risk. A 10% adverse change in the foreign currency exchange rate would not have a significant impact on our consolidated results of operations or financial position.

Interest rate and market risk

As of June 30, 2009, we had borrowings under our term loan of approximately $157.9 million and no borrowings under our revolving line of credit. Borrowings under the Amended Credit Agreement accrued interest at LIBOR plus 6.5% per annum as of June 30, 2009. An increase of 1% in the LIBOR rate would cause an increase in interest expense of up to $4.5 million over the remaining term of the Amended Credit Agreement.

We have convertible senior subordinated notes of $70 million outstanding at June 30, 2009 in connection with an acquisition completed in 2007. These notes bear a fixed interest rate of 6.5%.

We have two unsecured, subordinated promissory notes outstanding at June 30, 2009 in connection with acquisitions completed in 2005 and 2007. The principal amounts of the notes approximate $619,000 and $1.8 million, respectively, as of June 30, 2009. These promissory notes bear fixed interest rates of 5% and 4%, respectively. Additionally, we have one secured note payable of approximately $335,000 at June 30, 2009, which bears a fixed interest rate of 5.85%.

Effective February 27, 2008, we entered into an interest rate swap with a notional amount of $86.5 million maturing on February 27, 2010. Under the swap agreement, we receive interest equivalent to three-

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

month LIBOR and pay a fixed rate of interest of 3.026% with settlement occurring quarterly. By entering into the interest rate swap, we effectively fixed the interest rate payable by us on $86.5 million of our floating rate senior term debt at 6.526% for the period February 27, 2008 to March 10, 2009. Concurrent with the effective date of Amendment No. 1 to the Credit Agreement (March 11, 2009), the interest rate payable by us on $86.5 million of our floating rate senior term debt was fixed at 9.526% for the period March 11, 2009 to February 27, 2010.

We assess the significance of interest rate market risk on a periodic basis and may implement strategies to manage such risk as we deem appropriate.

Concentration of credit risk

We provide and manage government sponsored social services to individuals and families pursuant to over 925 contracts as of June 30, 2009. Contracts we enter into with governmental agencies and with other entities that contract with governmental agencies accounted for approximately 84% and 81% of our revenue for the six months ended June 30, 2008 and 2009, respectively. The related contracts are subject to possible statutory and regulatory changes, rate adjustments, administrative rulings, rate freezes and funding reductions. Reductions in amounts paid under these contracts for our services or changes in methods or regulations governing payments for our services could materially adversely affect our revenue and profitability. For the six months ended June 30, 2009, we conducted a portion of our operations in Canada through WCG. At June 30, 2009, approximately $12.7 million, or 25.4%, of our net assets were located in Canada. We are subject to the risks inherent in conducting business across national boundaries, any one of which could adversely impact our business. In addition to currency fluctuations, these risks include, among other things: (i) economic downturns; (ii) changes in or interpretations of local law, governmental policy or regulation; (iii) restrictions on the transfer of funds into or out of the country; (iv) varying tax systems; (v) delays from doing business with governmental agencies; (vi) nationalization of foreign assets; and (vii) government protectionism. We intend to continue to evaluate opportunities to establish additional operations in Canada. One or more of the foregoing factors could impair our current or future operations and, as a result, harm our overall business.

Item 4. Controls and Procedures.

(a) Evaluation of disclosure controls and procedures

The Company, under the supervision and with the participation of its management, including its principal executive officer and principal financial officer, evaluated the effectiveness of the design and operation of its disclosure controls and procedures, as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) as of the end of the period covered by this report (June 30, 2009) (“Disclosure Controls”). Based upon the Disclosure Controls evaluation, the principal executive officer and principal financial officer have concluded that the Disclosure Controls are effective in reaching a reasonable level of assurance that (i) information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms and (ii) information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in internal controls

The principal executive officer and principal financial officer also conducted an evaluation of the Company’s internal control over financial reporting (“Internal Control”) to determine whether any changes in Internal Control occurred during the quarter ended June 30, 2009 that have materially affected or which are reasonably likely to materially affect Internal Control. Based on that evaluation, there has been no such change during the quarter ended June 30, 2009.

(c) Limitations on the Effectiveness of Controls

Control systems, no matter how well conceived and operated, are designed to provide a reasonable, but not an absolute, level of assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. The Company conducts periodic evaluations of its internal controls to enhance, where necessary, its procedures and controls.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

Although we believe we are not currently a party to any material litigation, we may from time to time become involved in litigation relating to claims arising from our ordinary course of business. These claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2008, which could materially affect our business, financial condition or future results. The risk factors in our Annual Report on Form 10-K have not materially changed. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Restrictions Upon the Payment of Dividends

Under our credit facility we are prohibited from paying any cash dividends if there is a default under the facility or if the payment of any cash dividends would result in a default.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

Our annual meeting of stockholders was held on June 15, 2009 for the following purposes:

a) To elect two Class 3 directors to each serve for a three-year term until the 2012 annual meeting of stockholders and until their respective successors have been duly elected and qualified. The vote of the stockholders for each nominee was as follows:

	Total Affirmative Votes	Total Votes Withheld
Fletcher Jay McCusker (1)	7,620,364	360,170
Kristi L. Meints (1)	7,329,265	651,269
Michael C. Bradley (2)	2,511,984	656,836
Captain Brian T. Costello (ret.) (2)	2,511,984	656,836

(1) Nominees of our board of directors.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

(2) Nominees of Avalon Correctional Services, Inc., 73114 Investments, L.L.C., Donald E. Smith, Tiffany Smith, Michael C. Bradley and Eric S. Gray.

Fletcher Jay McCusker and Kristi L. Meints were elected to serve as Class 3 directors at the annual meeting.

The Class 1 and Class 2 directors who were not up for re-election at this meeting and continue to serve as directors are: Terence Cryan, Hunter Hurst III, Craig Norris, Warren S. Rustand and Richard Singleton.

b) To ratify the appointment of KPMG LLP as our independent registered public accounting firm to serve for the 2009 fiscal year. The proposal to ratify the appointment of KPMG LLP as our independent registered public accounting firm was approved by the stockholders as follows:

Votes For	10,692,373
Votes Against	382,627
Abstentions	75,154
Broker Non-Votes	—

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit Number	Description
4.1	Form of 6.5% Convertible Senior Subordinated Note due 2014
31.1	Certification pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 of the Chief Executive Officer
31.2	Certification pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 of the Chief Financial Officer
32.1	Certification pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Executive Officer
32.2	Certification pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Financial Officer

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

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.

THE PROVIDENCE SERVICE CORPORATION

Date: August 10, 2009

By: /s/ FLETCHER JAY MCCUSKER

Fletcher Jay McCusker
Chairman of the Board, Chief Executive Officer
(Principal Executive Officer)

Date: August 10, 2009

By: /s/ MICHAEL N. DEITCH

Michael N. Deitch
Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

Exhibit Number	Description
4.1	Form of 6.5% Convertible Senior Subordinated Note due 2014
31.1	Certification pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 of the Chief Executive Officer
31.2	Certification pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 of the Chief Financial Officer
32.1	Certification pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Executive Officer
32.2	Certification pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Financial Officer

Exhibit 4.1

[FACE OF NOTE]

[Global Notes Legend]

[The following legend shall appear on the face of each Global Note:

THIS NOTE IS A GLOBAL NOTE WITHIN THE MEANING OF THE INDENTURE HEREINAFTER REFERRED TO AND IS REGISTERED IN THE NAME OF THE DEPOSITARY OR A NOMINEE OF THE DEPOSITARY, WHICH MAY BE TREATED BY THE COMPANY, THE TRUSTEE AND ANY AGENT THEREOF AS OWNER AND HOLDER OF THIS NOTE FOR ALL PURPOSES.]

[The following legend shall appear on the face of each Global Note for which The Depository Trust Company is to be the Depositary:

UNLESS THIS CERTIFICATE IS PRESENTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITARY TRUST COMPANY, A NEW YORK CORPORATION ("DTC"), TO THE COMPANY OR ITS AGENT FOR REGISTRATION OF TRANSFER, EXCHANGE OR PAYMENT, AND ANY CERTIFICATE ISSUED IS REGISTERED IN THE NAME OF CEDE & CO. OR IN SUCH OTHER NAME AS IS REQUESTED BY THE AUTHORIZED REPRESENTATIVE OF DTC (AND ANY PAYMENT IS MADE TO CEDE & CO. OR TO SUCH OTHER ENTITY AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OR DTC), ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL INASMUCH AS THE REGISTERED OWNER HEREOF, CEDE & CO., HAS AN INTEREST HEREIN.

UNLESS AND UNTIL IT IS EXCHANGED IN WHOLE OR IN PART FOR REGISTERED NOTES IN DEFINITIVE REGISTERED FORM IN THE LIMITED CIRCUMSTANCES REFERRED TO IN THE INDENTURE, THIS GLOBAL NOTE MAY NOT BE TRANSFERRED EXCEPT AS A WHOLE BY THE DEPOSITARY TO A NOMINEE OF THE DEPOSITARY OR BY A NOMINEE OF THE DEPOSITARY TO THE DEPOSITARY OR ANOTHER NOMINEE OF THE DEPOSITARY OR BY THE DEPOSITARY OR ANY SUCH NOMINEE TO A SUCCESSOR DEPOSITARY OR A NOMINEE OR SUCH SUCCESSOR DEPOSITARY.]

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

[Restricted Note Legend]

[The following legend shall appear on the face of each Restricted Note:

THIS NOTE HAS NOT BEEN REGISTERED UNDER THE SECURITIES ACT. THE HOLDER HEREOF, BY PURCHASING THIS NOTE, AGREES THAT IT WILL NOT PRIOR TO THE DATE THAT IS TWO YEARS AFTER THE LATER OF THE ORIGINAL ISSUANCE OF THIS NOTE EVIDENCED HEREBY AND THE LAST DATE ON WHICH THE COMPANY OR ANY "AFFILIATE" (AS DEFINED IN RULE 144 UNDER THE SECURITIES ACT) OF THE COMPANY WAS THE OWNER OF THE SECURITY (THE "RESTRICTION TERMINATION DATE") RESELL OR OTHERWISE TRANSFER THIS NOTE EVIDENCED HEREBY OR THE COMMON STOCK ISSUABLE UPON CONVERSION OF SUCH NOTE OTHER THAN (1) TO THE COMPANY, (2) SO LONG AS THIS NOTE IS ELIGIBLE FOR RESALE PURSUANT TO RULE 144A UNDER THE SECURITIES ACT ("RULE 144A"), TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A, PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER TO WHOM NOTICE IS GIVEN THAT THE RESALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (3) IN AN OFFSHORE TRANSACTION (AS DEFINED IN REGULATION S UNDER THE SECURITIES ACT) IN ACCORDANCE WITH REGULATION S UNDER THE SECURITIES ACT, (4) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 (IF APPLICABLE) UNDER THE SECURITIES ACT OR (5) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. THE HOLDER HEREOF, BY PURCHASING THIS NOTE, REPRESENTS AND AGREES FOR THE BENEFIT OF THE COMPANY THAT IT IS (1) A QUALIFIED INSTITUTIONAL BUYER OR (2) NOT A U.S. PERSON AND IS OUTSIDE THE UNITED STATES WITHIN THE MEANING OF (OR AN ACCOUNT SATISFYING THE REQUIREMENTS OF PARAGRAPH (k)(2) OF RULE 902 UNDER) REGULATION S UNDER THE SECURITIES ACT. IN ANY CASE THE HOLDER HEREOF WILL NOT, DIRECTLY OR INDIRECTLY, ENGAGE IN ANY HEDGING TRANSACTIONS WITH REGARD TO THIS NOTE OR ANY COMMON STOCK ISSUABLE UPON CONVERSION OF THIS NOTE EXCEPT AS PERMITTED BY THE SECURITIES ACT.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

The Providence Service Corporation

6.5% Convertible Senior Subordinated Notes Due May 15, 2014

CUSIP No. [ ][1]

$__________

No. A-__

The Providence Service Corporation, a Delaware corporation (the "Company," which term includes any successor under the Indenture hereinafter referred to), for value received, promises to pay to , or its registered assigns, the principal sum of DOLLARS ($) on May 15, 2014[, which principal amount may from time to time be increased or decreased to such other principal amount (which, taken together with the principal amounts of all other outstanding Notes, shall not exceed $70,000,000) by adjustments on the Schedule of Exchanges of Notes on the other side of this Note in accordance with the Indenture.][1]

Initial Interest Rate: 6.5% per annum.

Interest Payment Dates: May 15 and November 15, commencing May 15, 2008.

Regular Record Dates: May 1 and November 1.

Reference is hereby made to the further provisions of this Note set forth on the reverse hereof, which will for all purposes have the same effect as if set forth at this place.

---

[1] Include only if the Note is a Global Note

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

IN WITNESS WHEREOF, the Company has caused this Note to be signed manually or by facsimile by its duly authorized officers.

Date:

THE PROVIDENCE SERVICE CORPORATION

By: ____________________
Name: Fletcher Jay McCusker
Title: Chief Executive Officer

Attest:

By: ____________________
Name: Michael N. Deitch
Title: Secretary

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

Trustee's Certificate of Authentication

This is one of the 6.5% Convertible Senior Subordinated Notes Due May 15, 2014 described in the Indenture referred to in this Note.

Dated:

THE BANK OF NEW YORK TRUST COMPANY, N.A., AS TRUSTEE

By: ______________________________
Name:
Title: Authorized Signatory

REVERSE SIDE OF NOTE

The Providence Service Corporation

6.5% Convertible Senior Subordinated Notes Due May 15, 2014

1. Principal and Interest.

The Company promises to pay the principal of this Note on May 15, 2014.

The Company promises to pay interest on the principal amount of this Note on each Interest Payment Date, as set forth on the face of this Note, at the rate of 6.5% per annum (subject to adjustment as provided below); provided, however, that if the Company Repurchases this Note pursuant to Section 3.06 of the Indenture the Company shall not be obligated to pay interest on the principal amount of this Note.

Interest will be payable semiannually in arrears (to the holders of record of the Notes at the close of business on the May 1 or November 1 immediately preceding the interest payment date) on each interest payment date, commencing May 15, 2008.

Interest on this Note will accrue from the most recent date to which interest has been paid on this Note or the Note surrendered in exchange for this Note (or, if there is no existing default in the payment of interest and if this Note is authenticated between a regular record date and the next interest payment date, from such interest payment date) or, if no interest has been paid, from the Issue Date. Interest will be computed on the basis of a 360-day year of twelve 30-day months.

The Company will pay interest on overdue principal, premium, if any, and, to the extent lawful, interest at a rate per annum of 8.5%. Interest not paid when due and any interest on principal, premium or interest not paid when due will be paid to the Persons that are Holders on a special record date, which will established as set forth in the Indenture referred to below.

Additional interest will accrue on the Notes at an additional rate per year equal to 0.50% per annum of the principal amount of the Notes under the circumstances set forth in the Registration Rights Agreement (as defined below).

Any payment required to be made on any day that is not a Business Day will be made on the next succeeding Business Day, without additional interest.

2. Registration Rights Agreement.

The Holder of this Note is entitled to the benefits of the Registration Rights Agreement, dated November 13, 2007, between the Company and the Purchasers named therein (the “Registration Rights Agreement”). In the event of a Registration Default, as defined in the Registration Rights Agreement, the Holder is entitled to additional interest for the period from and including the day following the occurrence of the Registration Default to, but excluding, the earlier of the day on which the Registration Default has been cured or the date on which there are no Registrable Securities, as defined in the Registration Rights Agreement. Additional interest will accrue at an additional rate per year equal to 0.50% per annum of the principal amount of the Notes.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

3. Method of Payment.

Subject to the terms and conditions of the Indenture, the Company shall pay interest on this Note to the person who is the Holder of this Note at the close of business on the Regular Record Date next preceding the related Interest Payment Date. The Company will pay any Cash amounts in money of the United States that at the time of payment is legal tender for payment of public and private debts.

4. Paying Agent, Conversion Agent and Registrar.

Initially, the Trustee will act as Paying Agent, Conversion Agent and Registrar. The Company may appoint and change any Paying Agent, Conversion Agent, Registrar or co-registrar without notice, other than notice to the Trustee. The Company or any of its Subsidiaries or any of their Affiliates may act as Paying Agent, Conversion Agent, Registrar or co-registrar. The Company may maintain deposit accounts and conduct other banking transactions with the Trustee in the normal course of business.

5. Indenture.

This is one of the Notes issued under an Indenture dated as of November 13, 2007 (as amended from time to time, the "Indenture"), between the Company and The Bank of New York Trust Company, N.A., as Trustee. Capitalized terms used herein are used as defined in the Indenture unless otherwise indicated. The terms of the Notes include those stated in the Indenture and those made part of the Indenture by reference to the Trust Indenture Act. The Notes are subject to all such terms, and Holders are referred to the Indenture and the Trust Indenture Act for a statement of all such terms. To the extent permitted by applicable law, in the event of any inconsistency between the terms of this Note and the terms of the Indenture, the terms of the Indenture will control.

The Notes are general unsecured obligations of the Company.

6. Repurchase at the Option of the Holder upon a Fundamental Change and on the Mandatory Repurchase Date.

At the option of the Holder and subject to the terms and conditions of the Indenture, the Company shall become obligated to purchase the Notes held by such Holder on the date, at the purchase price and as otherwise provided in the Indenture.

Holders have the right to withdraw any Fundamental Change Purchase Notice by delivering to the Paying Agent a written notice of withdrawal in accordance with the provisions of the Indenture.

If Cash (and/or securities if permitted under the Indenture) sufficient to pay the Fundamental Change Purchase Price of, together with any accrued and unpaid interest with respect to, all Notes or portions thereof to be purchased as of the Fundamental Change Purchase Date is deposited with the Paying Agent on or prior to the third Business Day following the Fundamental Change Purchase Date, interest shall cease to accrue on such Notes (or portions thereof) immediately after such Fundamental Change Purchase Date whether or not the Note is delivered to the Paying Agent, and the Holder thereof shall have no other rights as such (other than the right to receive the Fundamental Change Purchase Price and accrued and unpaid interest upon surrender of such Notes).

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

If the Acquisition is not consummated on or prior to the Mandatory Repurchase Date, then the Company shall be required on the Mandatory Repurchase Date to repurchase all of the Notes at a price payable in cash equal to the Mandatory Repurchase Price.

7. Conversion.

Subject to and upon compliance with the provisions of the Indenture, a Holder may surrender for conversion any Note that is $1,000 principal amount or integral multiples thereof.

8. Defaults and Remedies.

If an Event of Default, as defined in the Indenture, occurs and is continuing, the Trustee or the Holders of at least 25% in principal amount of the Notes may declare all the Notes to be due and payable, subject to certain limitations set forth in the Indenture. If a bankruptcy or insolvency default with respect to the Company occurs and is continuing, the Notes automatically become due and payable. Holders may not enforce the Indenture or the Notes except as provided in the Indenture. The Trustee may require indemnity satisfactory to it before it enforces the Indenture or the Notes. Subject to certain limitations, Holders of a majority in principal amount of the Notes then outstanding may direct the Trustee in its exercise of remedies.

9. Subordination.

To the extent provided in the Indenture, the Notes are subordinated to Senior Debt, as defined in the Indenture. To the extent provided in the Indenture, Senior Debt must be paid in full before the Notes may be paid. The Company agrees, and each Holder by accepting a Note agrees, to the subordination provisions contained in the Indenture and authorizes the Trustee to give it effect and appoints the Trustee as attorney-in-fact for such purpose.

10. Amendment and Waiver.

Subject to certain exceptions set forth in the Indenture, the Indenture and the Notes may be amended, or default may be waived, with the consent of the Holders of a majority in principal amount of the outstanding Notes. Without notice to or the consent of any Holder, the Company and the Trustee may amend or supplement the Indenture or the Notes to, among other things, cure any ambiguity, defect or inconsistency or if such amendment or supplement does not adversely affect the interests of the Holders in any material respect.

11. Registered Form; Denominations; Transfer; Exchange.

The Notes are issued in registered form without coupons in denominations of $1,000 principal amount and integral multiples of $1,000. A Holder may register the transfer or exchange of Notes in accordance with the Indenture. The Trustee may require a Holder to furnish appropriate endorsements and transfer documents and to pay any taxes and fees required by law or permitted by the Indenture. Pursuant to the Indenture, there are certain periods during which the Trustee will not be required to issue, register the transfer of or exchange any Note or certain portions of a Note.

12. Persons Deemed Owners.

The registered Holder of this Note may be treated as the owner of this Note for all purposes.

Source: PROVIDENCE SERVICE C, 10-Q, August 10, 2009

13. Unclaimed Money or Notes.

The Trustee and the Paying Agent shall return to the Company upon written request any money or securities held by them for the payment of any amount with respect to the Notes that remains unclaimed for two years, subject to applicable unclaimed property laws. After return to the Company, Holders entitled to the money or securities must look to the Company for payment as general creditors unless an applicable abandoned property law designates another person.

14. Trustee Dealings with the Company.

Subject to certain limitations imposed by the Trust Indenture Act, the Trustee under the Indenture, in its individual or any other capacity, may become the owner or pledgee of Notes and may otherwise deal with and collect obligations owed to it by the Company or its Affiliates and may otherwise deal with the Company or its Affiliates with the same rights it would have if it were not Trustee.

15. No Recourse Against Others.

A director, officer, incorporator, agent, subsidiary, employee, member or stockholder, as such, of the Company shall not have any liability for any obligations of the Company under the Notes or the Indenture or for any claim based on, in respect of or by reason of such obligations or their creation. By accepting a Note, each Noteholder waives and releases all of the foregoing from such liability. The waiver and release are part of the consideration for the issue of the Notes.

16. Authentication.

This Note shall not be valid until an authorized officer of the Trustee manually signs the Trustee's Certificate of Authentication on the other side of this Note.

17. Governing Law.

THE LAW OF THE STATE OF NEW YORK SHALL GOVERN THE INDENTURE AND THIS NOTE.

18. Abbreviations.

Customary abbreviations may be used in the name of a Holder or an assignee, such as: TEN COM (= tenants in common), TEN ENT (= tenants by the entireties), JT TEN (= joint tenants with right of survivorship and not as tenants in common), CUST (= Custodian) and U/G/M/A/ (= Uniform Gifts to Minors Act).

The Company will furnish a copy of the Indenture to any Holder upon written request and without charge.

FORM OF TRANSFER NOTICE

FOR VALUE RECEIVED the undersigned registered holder hereby sell(s), assign(s) and transfer(s) unto

Insert Taxpayer Identification No.

____

____

Please print or typewrite name and address including zip code of assignee

____

the within Note and all rights thereunder, hereby irrevocably constituting and appointing

____

attorney to transfer said Note on the books of the Company with full power of substitution in the premises.

Date: ______________________________

Your Signature:

____

(Sign exactly as your name appears on the other side of this Note)

*Signature guaranteed by:

By: ______________________________

* The signature must be guaranteed by an institution which is a member of one of the following recognized signature guaranty programs: (i) the Securities Transfer Agent Medallion Program (STAMP); (ii) the New York Stock Exchange Medallion Program (MSP); (iii) the Stock Exchange Medallion Program (SEMP); or (iv) such other guaranty program acceptable to the Trustee.

CONVERSION NOTICE

To convert this Note, check the box: ☐

To convert only part of this Note, state the principal amount to be converted (must be $1,000 principal amount or an integral multiple of $1,000 principal amount): $.

If you want the Cash paid to another person or the stock certificate, if any, made out in another person's name, fill in the form below:

(Insert assignee's soc. sec. or tax I.D. no.)

(Print or type assignee's name, address and zip code)

and irrevocably appoint

agent to transfer this Note on the books of the Company. The agent may substitute another to act for him or her.

Date: Your Signature:

(Sign exactly as your name appears on the other side of this Note)

*Signature guaranteed by:

By:

* The signature must be guaranteed by an institution which is a member of one of the following recognized signature guaranty programs: (i) the Securities Transfer Agent Medallion Program (STAMP); (ii) the New York Stock Exchange Medallion Program (MSP); (iii) the Stock Exchange Medallion Program (SEMP); or (iv) such other guaranty program acceptable to the Trustee.

SCHEDULE OF EXCHANGES OF NOTES[2]

The following exchanges of a part of this Global Note for an interest in another Global Note or for Notes in certificated form, have been made:

Date of Exchange	Amount of decrease in Principal Amount of this Global Note	Amount of Increase in Principal Amount of this Global Note	Principal Amount of this Global Note following such decrease or increase	Signature or authorized signatory of Trustee

2 This schedule should be included only if the Note is a Global Note.

ASSIGNMENT FORM

To assign this Note, fill in the form below:

(I) or (we) assign and transfer this Note to

____

(Insert assignee's social security or tax I.D. no.)

____

____

____

(Print or type assignee's name, address and zip code)

and irrevocably appoint agent to transfer this Note on the books of the Company. The agent may substitute another to act for him.

Your Signature: ______________________________

Sign exactly as your name appears on the other side of this Note

Date: —______________________________

Medallion Signature Guarantee: ______________________________

[FOR INCLUSION ONLY IF THIS NOTE BEARS AN IAI NOTE LEGEND —] Other than pursuant to the sale or transfer of a Note to a transferee that is not an Affiliate of the Initial Purchaser pursuant to an effective Shelf Registration Statement filed in connection with the Registration Rights Agreement, dated as of November 13, 2007, between the Company and the purchasers named therein, in connection with any transfer of any of the Notes evidenced by this certificate which are "restricted securities" (as defined in Rule 144 (or any successor thereto) under the Securities Act), the undersigned confirms that the Notes are being transferred to a Person that is not an Affiliate of the Company and:

CHECK ONE BOX BELOW

(1) ☐ To the Company.

(2) ☐ In connection with a Permitted Transfer.

(3) ☐ A transfer to a transferee that is not an Affiliate of any Sponsor Purchaser pursuant to Rule 144 under the Securities Act.

(4) ☐ Solely if no registration statement under the Securities Act is available for such sale, a transfer to a person that is not an "Affiliate" of any Sponsor Purchaser (as described in Rule 144 under the Securities Act) pursuant to Rule 144A under the Securities Act or pursuant to Regulation S under the Securities Act.

Unless one of the boxes is checked, the Registrar will refuse to register any of the Notes evidenced by this certificate in the name of any Person other than the registered holder thereof; provided, however, that if box (2) is checked, the Trustee may require, prior to registering any such transfer of the Notes, such certifications and other information, including legal opinions, as the Company has reasonably requested in writing, by delivery to the Trustee of a standing letter of instruction, to confirm that such transfer is being made pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act of 1933.

Your Signature: ______________________________________

(Sign exactly as your name appears on the other side of this Note)

Date: ______________________

Medallion Signature Guarantee: ________________

[FOR INCLUSION ONLY IF THIS NOTE BEARS A RESTRICTED NOTE LEGEND —] Other than pursuant to the sale or transfer of the Note under an effective Shelf Registration Statement filed in connection with the Registration Rights Agreement, dated as of November 13, 2007, between the Company and the purchasers named therein, in connection with any transfer of any of the Notes evidenced by this certificate which are "restricted securities" (as defined in Rule 144 (or any successor thereto) under the Securities Act), the undersigned confirms that the Notes are being transferred to a Person that is not an Affiliate of the Company and:

CHECK ONE BOX BELOW

(1) ☐ to the Company; or

(2) ☐ pursuant to and in compliance with Rule 144A under the Securities Act of 1933; or

(3) ☐ pursuant to and in compliance with Regulation S under the Securities Act of 1933; or

(4) ☐ pursuant to an exemption from registration under the Securities Act of 1933 provided by Rule 144 thereunder.

Unless one of the boxes is checked, the Registrar will refuse to register any of the Notes evidenced by this certificate in the name of any Person other than the registered holder thereof; provided, however, that if box (3) or (4) is checked, the Trustee may require, prior to registering any such transfer of the Notes, such certifications and other information, and if box (4) is checked such legal opinions, as the Company has reasonably requested in writing, by delivery to the Trustee of a standing letter of instruction, to confirm that such transfer is being made pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act of 1933; provided that this paragraph shall not be applicable to any Notes which are not "restricted securities" (as defined in Rule 144 (or any successor thereto) under the Securities Act).

Your Signature: ______________________________________

(Sign exactly as your name appears on the other side of this Note)

Date: ______________________

Medallion Signature Guarantee: ________________

Exhibit 31.1

CERTIFICATIONS

I, Fletcher Jay McCusker, certify that:

1. I have reviewed this Form 10-Q of The Providence Service Corporation;

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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) 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

d) 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.

Date: August 10, 2009

/s/ Fletcher J. McCusker

Fletcher J. McCusker
Chief Executive Officer
(Principal Executive Officer)

CERTIFICATIONS

I, Michael N. Deitch, certify that:

1. I have reviewed this Form 10-Q of The Providence Service Corporation;

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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) 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

d) 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.

Date: August 10, 2009

/s/ Michael N. Deitch

Michael N. Deitch
Chief Financial Officer
(Principal Financial and Accounting Officer)

Exhibit 32.1

THE PROVIDENCE SERVICE CORPORATION

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Section 1350 of Chapter 63 of Title 18 of the United States Code), the undersigned officer of The Providence Service Corporation (the "Company") does hereby certify with respect to the Quarterly Report of the Company on Form 10-Q for the quarter ended June 30, 2009 (the "Report") that, to the best of such officer's knowledge:

(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.

Date: August 10, 2009

/s/ Fletcher J. McCusker
Fletcher J. McCusker
Chief Executive Officer
(Principal Executive Officer)

Exhibit 32.2

THE PROVIDENCE SERVICE CORPORATION

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Section 1350 of Chapter 63 of Title 18 of the United States Code), the undersigned officer of The Providence Service Corporation (the "Company") does hereby certify with respect to the Quarterly Report of the Company on Form 10-Q for the quarter ended June 30, 2009 (the "Report") that, to the best of such officer's knowledge:

(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.

Date: August 10, 2009

/s/ Michael N. Deitch
Michael N. Deitch
Chief Financial Officer
(Principal Financial and Accounting Officer)

Created by 10KWizard www.10KWizard.com