SURGICARE INC/DE
Form 10QSB
August 16, 2004

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

[X] Quarterly Report under Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended JUNE 30, 2004

[ ] Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from _________ to ________

SURGICARE, INC.
(NAME OF SMALL BUSINESS ISSUER IN ITS CHARTER)

DELAWARE	58-1597246
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

10700 RICHMOND AVE., SUITE 300, HOUSTON, TEXAS	77042
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	(ZIP CODE)

ISSUER'S TELEPHONE NUMBER: (713) 973-6675

Check whether the Registrant: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

As of August 10, 2004, 28,948,685 shares of Common Stock, $0.005 par value per share, were outstanding.

PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

The information required hereunder is included in this report as set forth in the "Index to Financial Statements"

INDEX TO FINANCIAL STATEMENTS

Consolidated Balance Sheets as of June 30, 2004 and December 31, 2003

Consolidated Statements of Operations for the three months ending June 30, 2004 and 2003

Consolidated Statements of Operations for the six months ending June 30, 2004 and 2003

Consolidated Statements of Cash Flows for the six months ending June, 30 2004 and 2003

Notes to Consolidated Financial Statements

SURGICARE, INC.
CONSOLIDATED BALANCE SHEETS

ASSETS	JUNE 30, 2004 (unaudited)	DECEMBER 31, 2003
CURRENT ASSETS		
Cash and cash equivalents	$ 280,001	$ 141,553
Accounts Receivable:		
Trade (less allowance for contractual adjustments and doubtful accounts of $3,115,867 and $3,768,846 at June 30, 2004 and December 31, 2003, respectively)	868,285	1,309,682
Other receivables	25,161	59,909
Income tax receivables	159,846	
Inventory	341,957	338,470
Prepaid expenses	133,373	133,293
Other current assets	61,375	23,027
Total Current Assets	1,710,152	2,165,780
PROPERTY AND EQUIPMENT		
Office furniture and equipment	399,912	399,912
Medical and surgical equipment	4,802,979	3,748,559
Leasehold improvements	1,184,890	946,890

Computer equipment	384,911	382,263
Transportation equipment	19,015	19,015
	6,791,706	5,496,639
Less: Accumulated depreciation and amortization	3,613,004	3,237,657
Total Property and Equipment	3,178,702	2,258,982
GOODWILL	8,110,235	8,105,735
REAL ESTATE	2,612,412	4,000,000
INVESTMENT IN LIMITED PARTNERSHIPS	387,609	381,434
PREPAID LIMITED PARTNER DISTRIBUTIONS	440,423	440,423
LOAN FEES (net of amortization of $217,471 at June 30, 2004 and $198,249 at December 31, 2003)	84,566	103,788
TOTAL ASSETS	$16,524,099	$17,456,142

SURGICARE, INC.
CONSOLIDATED BALANCE SHEETS (CONTINUED)

	JUNE 30, 2004	DECEMBER 31 2003
LIABILITIES	(unaudited)	
CURRENT LIABILITIES		
Accounts payable	$ 3,378,588	$ 2,864,19
Accrued expenses	2,139,011	1,274,34
Line of credit	1,402,588	1,331,47
Current maturities of long-term debt	8,083,173	6,928,54
Current portion of capital leases	359,587	265,25
Total Current Liabilities	15,362,947	12,663,80
LONG-TERM CAPITAL LEASE OBLIGATIONS	545,057	103,34
TOTAL LIABILITIES	15,908,004	12,767,14
SHAREHOLDERS' EQUITY		
PREFERRED STOCK, Series A, par value $.001, 1,650,000 authorized, 1,137,700 issued and outstanding at December 31, 2003 (Redemption and liquidation value $5,688,500)		1,13
PREFERRED STOCK, Series AA, par value $.001, 1,200,000 shares authorized, 900,000 issued and outstanding at June 30, 2004 and December 31, 2003	900	90

COMMON STOCK, par value $.005, 50,000,000 shares authorized; 28,948,685 issued and 28,857,285outstanding at June 30, 2004; 27,082,843 issued and 26,991,143 outstanding at December 31, 2003	144,743	135,41
ADDITIONAL PAID-IN CAPITAL	17,604,714	17,116,52
RETAINED EARNINGS	(17,087,694)	(12,518,41
LESS: TREASURY STOCK-at cost, 91,400 at June 30, 2004 and December 31, 2003	(38,318)	(38,31
SHAREHOLDERS RECEIVABLE	(8,250)	(8,25
TOTAL SHAREHOLDERS' EQUITY	616,095	4,688,99
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 16,524,099	$ 17,456,14

See notes to consolidated financial statements.

SURGICARE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	FOR THE THREE MONTHS ENDING JUNE 30,	
	2004	2003
REVENUES, NET	$ 1,652,960	$ 1,939,008
DIRECT COST OF REVENUES:		
Surgical costs	391,919	399,109
Clinical salaries & benefits	469,601	455,739
Other	223,170	213,783
Total Direct Surgical Expenses	1,084,690	1,068,631
GENERAL AND ADMINISTRATIVE EXPENSES:		
Salaries and benefits	365,491	383,975
Rent	226,514	235,062
Depreciation and amortization	188,986	225,085
Professional fees	406,885	299,487
Provision for doubtful accounts	60,161	291,530
Other	301,639	333,102
Total General & Administrative Expenses	1,549,676	1,768,241

OTHER OPERATING EXPENSES (INCOME):		
Gain on sale of partnership interest		(319,086)
Impairment on investment in land	1,387,588	
Total Other Operating Expenses (Income)	1,387,588	(319,086)
Total Operating Expenses	4,021,954	2,517,786
OPERATING LOSS	(2,368,994)	(578,778)
OTHER INCOME (EXPENSE):		
Miscellaneous income	28	8,250
Equity in Earnings of Limited Partnerships	18,451	80,297
Interest Expense	(471,516)	(468,906)
Total Other Income (Expense)	(453,037)	(380,359)
LOSS BEFORE MINORITY INTEREST AND FEDERAL INCOME TAX BENEFIT	(2,822,031)	(959,137)
MINORITY INTEREST IN LOSSES OF PARTNERSHIPS		49,984
Loss Before Income Tax Expenses	(2,822,031)	(909,153)
FEDERAL INCOME TAX BENEFIT		
NET LOSS	$ (2,822,031)	$ (909,153)
Loss per share - Basic	$ (.10)	$ (.04)
Loss per share - Diluted	$ (.10)	$ (.04)
Weighted Average Shares Outstanding:		
Basic	28,794,399	24,877,900
Diluted	28,794,399	24,877,900

See notes to consolidated financial statements.

SURGICARE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	FOR THE SIX MONTHS ENDING JUNE 30,	
	2004	2003
REVENUES, NET	$ 3,343,484	$ 4,219,129
DIRECT COST OF REVENUES:		
Surgical costs	792,745	871,686
Clinical salaries & benefits	950,837	927,167

Other	418,060	506,108
Total Direct Surgical Expenses	2,161,642	2,304,961
GENERAL AND ADMINISTRATIVE EXPENSES:		
Salaries and benefits	751,156	770,371
Rent	453,028	468,105
Depreciation and amortization	375,348	444,103
Professional fees	940,983	514,584
Provision for doubtful accounts	116,488	300,692
Other	643,173	667,590
Total General & Administrative Expenses	3,280,176	3,165,445
OTHER OPERATING EXPENSES (INCOME):		
Gain on sale of partnership interest		(319,086)
Loss on sale of assets		168
Impairment on investment in land	1,387,588	
Forgiveness of debt	(58,625)	
Total Other Operating Income (Expense)	1,328,963	(318,918)
Total Operating Expenses	6,770,781	5,151,488
OPERATING LOSS	(3,427,297)	(932,359)
OTHER INCOME (EXPENSE):		
Miscellaneous income	2,549	20,219
Equity in Earnings of Limited Partnerships	20,586	167,939
Interest Expense	(1,165,119)	(909,018)
Total Other Income (Expense)	(1,141,984)	(720,860)
LOSS BEFORE MINORITY INTEREST AND FEDERAL INCOME TAX BENEFIT	(4,569,281)	(1,653,219)
MINORITY INTEREST IN LOSSES OF PARTNERSHIPS		52,018
Loss Before Income Tax Expenses	(4,569,281)	(1,601,201)
FEDERAL INCOME TAX BENEFIT		(13,561)
NET LOSS	(4,569,281)	(1,587,640)
Loss per share - Basic	$ (.16)	$ (.07)
Loss per share - Diluted	$ (.16)	$ (.07)
Weighted Average Shares Outstanding:		
Basic	28,373,482	24,232,458
Diluted	28,373,482	24,232,458

See notes to consolidated financial statements.

SURGICARE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	FOR THE SIX MONTHS EN JUNE 30,	
	2004	200
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(4,569,281)	$(1,58
Adjustments to reconcile net earnings to net cash provided by operations:		
Equity in earnings of limited partnerships	(20,586)	(16
Minority interest in loss of partnerships		(5
Depreciation and amortization	375,348	44
Amortization of debt discount	37,718	7
Amortization of loan fees	19,222	
Gain on sale of interest in limited partnership		(31
Interest expense recognized on beneficial conversion features of convertible notes payable	206,693	
Provision for doubtful accounts	116,488	30
Impairment on investment in land	1,387,588	
Forgiveness of debt	(58,625)	
Change in:		
Accounts receivable	359,657	18
Inventory	(3,487)	3
Prepaid expenses	(80)	(6
Other current assets	(38,348)	2
Federal income tax	159,846	
Accounts payable	846,168	27
Accrued expenses	864,671	29
Net Cash Used in Operating Activities	(317,008)	(56
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(695,068)	(2
Distributions from partnerships	14,411	
Proceeds from sale of interest in limited partnership		42
Buyout of limited partners	(4,500)	
Net Cash Provided by (Used in) Investing Activities	(685,157)	39
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings on lines of credit	196,625	2,79
Payments on lines of credit	(125,512)	(3,14
Borrowings on debt	1,325,411	
Payments on debt	(208,498)	(50
Principal payments on capital lease	(63,948)	(5
Proceeds from issuance of common stock		1,06
Proceeds from exercise of warrants	16,535	
Purchase of treasury stock		(
Net Cash Provided by Financing Activities	1,140,613	16
Net Increase in Cash and Cash Equivalents	138,448	
Cash and Cash Equivalents - Beginning of Period	141,553	26
Cash and Cash Equivalents - End of Period	$ 280,001	$ 26

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SURGICARE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(UNAUDITED)

	FOR THE SIX MONTHS ENDING JUNE 30,	
	2004	2003
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest	$ 76,930	$667,828
Non-cash investing and financing activities:		
Issuance of common shares in payment of accounts payable	273,154	70,000
Equipment acquired under capital lease obligation	600,000	

See notes to consolidated financial statements.

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SURGICARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 - GENERAL

SurgiCare, Inc. ("SurgiCare", the "Company", "we", "us", or "our"), through its wholly owned subsidiaries, owns a majority interest in limited partnerships or corporations that operate three surgery centers. The Company also owns a minority interest as general partner in a limited partnership that operates a surgery center. The consolidated statements include the accounts of the Company and its subsidiaries and its majority owned limited partnerships.

These financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") for interim financial reporting and in accordance with Securities and Exchange Commission ("SEC") Rule 310(b) of Regulation S-B. In the opinion of management, the accompanying unaudited consolidated financial statements include all adjustments consisting of only normal recurring adjustments necessary for a fair presentation of the Company's financial position and the results of operations and cash flows for the interim

periods presented. The results of operations for any interim period are not necessarily indicative of results for the full year.

The accompanying unaudited consolidated financial statements should be read in conjunction with the financial statements and related notes included in SurgiCare's 2003 Annual Report on Form 10-KSB.

NOTE 2 - USE OF ESTIMATES

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could vary from those estimates.

The determination of contractual allowances constitutes a significant estimate. In determining the amount of contractual allowances, management considers such factors as historical trends of billing and cash collections, established fee schedules, accounts receivable agings and contractual relationships with third-party payers. Contractual adjustments and accounts deemed uncollectible are applied against the allowance account.

NOTE 3 - REVENUE RECOGNITION

Surgical revenue is recognized on the date the procedures are performed, and accounts receivable are recorded at that time. Such revenues are reported at the estimated net realizable amounts from patients and third-party payers. If such third-party payers were to change their reimbursement policies, the effect on revenue could be significant. Earnings are charged with a provision for contractual adjustments and doubtful accounts based on such factors as historical trends of billing and cash collections, established fee schedules, accounts receivable agings and contractual relationships with third-party payers. Contractual allowances are estimated primarily using each surgery center's collection experience. Contractual rates and fee schedules are also helpful in this process. On a rolling average basis, the Company tracks collections as a percentage of related billed charges. This percentage, which is adjusted on a quarterly basis, has proved to be the best indicator of expected net realizable amounts from patients and third-party payers. Contractual adjustments and accounts deemed uncollectible are applied against the allowance account. The Company is not aware of any material claims, disputes or unsettled matters with third-party payers.

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Management fees are based on a percentage of customers' collected revenues and are recognized during the period which services were performed.

NOTE 4 - GOODWILL

Goodwill represents the excess of cost over the fair value of net assets of companies acquired in business combinations accounted for using the purchase method. Goodwill acquired in business combinations prior to June 30, 2001 had been amortized using the straight-line method over an estimated useful life of 20 years. In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that the purchase method of accounting be used for all business

combinations initiated after June 30, 2001. SFAS No. 142 requires that goodwill no longer be amortized but instead be reviewed periodically for possible impairment. The Company has adopted SFAS No. 142 effective January 1, 2002 and is no longer amortizing goodwill.

Under SFAS No. 142, goodwill is required to be tested annually and more frequently if an event occurs which indicates the goodwill may be impaired. Upon adoption of SFAS 142, as well as on December 31, 2003 and 2002, the Company performed an impairment test of its goodwill and determined that no impairment of the recorded goodwill existed.

NOTE 5 - RECENT ACCOUNTING PRONOUNCEMENTS

In January 2003, the FASB issued Interpretation No. 46, "CONSOLIDATION OF VARIABLE INTEREST ENTITIES," and subsequently revised the Interpretation in December 2003 ("FIN 46R"). This Interpretation of Accounting Research Bulletin No. 51, "CONSOLIDATED FINANCIAL STATEMENTS," addresses consolidation by business enterprises of variable interest entities, which have certain characteristics. As revised, FIN 46R is now generally effective for financial statements for interim periods or annual periods ending on or after March 15, 2004. We have not identified any variable interest entities and the requirements of FIN 46R have not had a material impact on our consolidated financial statements.

NOTE 6 - LAND IMPAIRMENT

On June 23, 2004, the Company agreed to sell its five tracts of undeveloped land along with accelerated conversion of its 900,000 shares of Series AA Redeemable Preferred Stock (see Note 12 -SUBSEQUENT EVENTS below for further discussion). As a result, the Company recorded an impairment charge of $1,387,588 in the second quarter of 2004.

NOTE 7 - DEBT

Loan agreements relating to the majority of the Company's credit lines, notes payable and capital leases contain requirements for maintenance of defined minimum financial ratios. The Company is not in compliance with all such provisions as of June 30, 2004. Further, the Company is delinquent in payments on the majority of its outstanding debt. All notes and capital leases in default have been shown as current in these financial statements. On August 25, 2003 the Company's senior lender, DVI Business Credit Corp. and DVI Financial Services, Inc. ("DVI") announced that it is seeking protection under Chapter 11 of the United States Bankruptcy laws.

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In July 2004, SurgiCare and Integrated Physician Solutions, Inc. (see Note 12 - SUBSEQUENT EVENTS) completed negotiations to settle the companies' combined debt with DVI and U.S. Bank Corp., which totals $10.1 million. The settlement calls for $6.5 million in payments to be made as follows: $2,000,000 payment at the closing of the Transactions; $500,000 on the date 12 months after the closing; $250,000 on the date 18 months after the closing; $2,500 per month for the first 24 months after closing; $45,628 per month in years starting in the 25th month and continuing through the 72nd month after closing; and a $1,500,000 balloon payment at the completion of 72 months after closing.

The Company has historically financed its growth primarily though the issuance of equity and secured and/or convertible debt. As of June 30, 2004, the

Company does not have any credit facilities available with financial institutions or other third parties to provide for working capital shortages. Although the Company believes it will generate cash flow from operations in future quarters, due to its debt load, it is not able to fund its current operations solely from its cash flow.

In November 2003, SurgiCare completed a $470,000 financing for working capital through the issuance of one-year convertible unsecured promissory notes bearing interest at 10% per annum. The notes are convertible into shares of Company common stock, at any time, at the option of the note holders. The conversion price for the notes was equal to (a) $.35 per share, if the notes had been converted on or prior to January 31, 2004, or (b) if the notes are converted after January 31, 2004, the lower of (i) $0.25 or (ii) seventy-five percent (75%) of the average closing price for the 20 trading days immediately prior to the conversion date. Based on the relative fair value of the beneficial conversion feature of the notes, a charge of $123,566 was recorded to interest expense in the fourth quarter of 2003 and $206,693 in the first quarter of 2004. The notes were not converted prior to January 31, 2004, and the charge in the first quarter of 2004 reflects the change in conversion price after January 31, 2004. The note holders also received five-year warrants to purchase an aggregate of 335,713 shares of Company common stock. The warrants may be exercised at an exercise price of $0.35 per share, and may be exercised on a cashless basis at the option of the holder. Based on the relative fair value of the warrants, a discount of $76,834 was recorded at the time of issuance and is being amortized to interest expense over the one-year term of the notes. The notes will mature on October 31, 2004.

In the six months ended June 30, 2004, the Company borrowed $1,325,411 from a participant in the proposed restructuring transactions (See Note 12) to make necessary payments on debt and to fund operations.

The Company believes that additional sales of debt and/or equity securities will be required to continue operations. See Note 12- SUBSEQUENT EVENTS for a description of a series of transactions recently announced by the Company that, if consummated, will involve an equity investment and recapitalization of the Company. Prior to the closing of such contemplated transactions, any additional sales of debt and/or equity by the Company will be subject to the prior approval of the counterparties to the applicable transactions. The Company can provide no assurance that it will be successful in any future financing effort to obtain the necessary working capital to support its operations, or fund acquisitions for its anticipated growth. In the event that any future financing efforts are not successful, the Company will be forced to liquidate assets and/or curtail operations.

NOTE 8 - EARNINGS PER SHARE

Basic earnings per share are calculated on the basis of the weighted average number of shares outstanding. Diluted earnings per share, in addition to the weighted average determined for basic loss per share, include common stock equivalents, which would arise from the exercise of stock options and warrants using the treasury stock method, and assumes the conversion of the Company's preferred stock for the period outstanding, since their issuance.

	For the Three Months Ended	For the Six Months Ended

	June 30,		June 30,	
	2004	2003	2004	2003
Basic Loss Per Share:				
Net Loss	$(2,822,031)	$ (909,153)	$(4,569,281)	$(1,587,640)
Weighted average shares outstanding	28,794,399	24,877,900	28,373,482	24,232,458
Dilutive stock options and warrants	(a)	(a)	(a)	(a)
Conversion of preferred shares	(b)	(b)	(b)	(b)
Conversion of debt	(c)	(c)	(c)	(c)
Weighted average common shares outstanding for diluted net loss per share	24,877,900	28,373,482	24,232,458	28,794,399
Net loss per share - Basic	$ (.10)	$ (.04)	$ (.16)	$ (.07)
Net loss per share - Diluted	$ (.10)	$ (.04)	$ (.16)	$ (.07)

The following potentially dilutive shares are not included because their effect would be anti-dilutive due to the net loss for the period:

a. 8,085,261 and 10,942,807 options and warrants outstanding as of June 30, 2004 and June 30, 2003, respectively.

b. 900,000 shares of Series AA Preferred Stock convertible into $4,500,000 of common shares as of June 30 2004 and June 30, 2003. 1,225,000 shares of Series A Preferred stock convertible into 1,225,000 common shares as of June 30, 2003.

c. $1,000,000 of debentures convertible into common stock at a price equal to $1.50 per share at June 30, 2004. $470,000 of notes payable were convertible into common stock at a price of $.25 per share as of June 30, 2004.

NOTE 9 - LITIGATION

On July 7, 2003, SurgiCare, Inc. was named as a party in the arbitration entitled Brewer & Pritchard, P.C. vs. SurgiCare, Inc. before the American Arbitration Association. Brewer & Pritchard have claimed breach of contract and demanded payment of $131,294.88 in billed and unbilled legal fees plus third party expenses, interest at the highest legal rate, costs, legal fees and damages from breach of contract. This case was settled in November 2003 and SurgiCare issued shares of common stock valued at $117,500 as compensation for past legal fees.

On February 10, 2003, SurgiCare, Inc. was named as a defendant in a suit entitled S.E. Altman v. SurgiCare. S.E. Altman has sued for breach of contract, alleging that SurgiCare did not pay monies owed under a "Finders Fee Contract." Plaintiff asserts damages in the amount of $217,000, plus interest and attorneys' fees. International Diversified Corporation, Limited has indemnified SurgiCare with respect to any fees owed to Altman under the Finders Fee Contract. The case has been dismissed in favor of arbitration. In March 2004, the parties executed a Settlement Agreement and Release of Claims to resolve the

dispute in which SurgiCare issued Mr. Altman 540,000 shares of common stock, which was registered with the Securities and Exchange Commission on Form S-8.

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On April 14, 2003, SurgiCare, Inc. was named as a defendant in a suit entitled A.I. International Corporate Holdings, Ltd. v. SurgiCare, Inc. in the U.S. District Court for the Southern District of New York. Subsequently, SurgiCare filed suit against A.I. International Corporate Holdings, Ltd. and First National Bank, S.A.L. of Lebanon in the 215th Judicial District Court of Harris County, Texas. The New York case involves allegations that SurgiCare defaulted on its loan agreement. The plaintiffs in the New York case are suing SurgiCare for $834,252 representing the loan amount and interest, plus $219,000, representing damages for "No-filing Charges" and "Non-Effective Charges" under the contract. SurgiCare's lawsuit in Texas asserted that the loan agreement is usurious. The parties signed an agreement to settle this matter, which will close after the consummation of the Transactions. Pursuant to this settlement, SurgiCare will pay Plaintiffs $220,000 in cash and issue 2,100,000 shares of SurgiCare common stock (210,000 shares after giving effect to the reverse stock split contemplated in connection with the merger and equity transactions set forth above), to be paid and issued after the closing of such transactions.

On November 24, 2003, SurgiCare, Inc. was named as a defendant in a suit entitled Vincent A. Giammalva, Trustee v. SurgiCare, Inc., Keith G. LeBlanc, and Phillip C. Scott; in the 344th Judicial District Court of Chambers County, Texas. This case involves allegations that SurgiCare defaulted on a contract to sell a parcel of real estate to plaintiff. Plaintiff also claims that LeBlanc and Scott committed fraud. SurgiCare states that it could not sell the parcel of land because of a lien on the property. The plaintiff seeks specific performance, forcing SurgiCare to sell the property, as well as actual damages. SurgiCare is negotiating with the plaintiff in an effort to settle this matter. AII has agreed to indemnify SurgiCare, Inc., Keith LeBlanc and Phillip Scott for all claims asserted in this litigation by agreement dated June 23, 2004.

In addition, we are involved in various other legal proceedings and claims arising in the ordinary course of business. Our management believes that the disposition of these additional matters, individually or in the aggregate, is not expected to have a materially adverse effect on our financial condition. However, depending on the amount and timing of such disposition, an unfavorable resolution of some or all of these matters could materially affect our future results of operations or cash flows in a particular period.

NOTE 10 - EMPLOYEE STOCK-BASED COMPENSATION

The Company accounts for its employee stock options and warrants under the Accounting Principles Board Opinion No. 25, "ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES," and related interpretations. No stock-based employee compensation cost is reflected in net loss, as all employee options and warrants granted had an exercise price equal to the market value of the underlying common stock on the date of grant.

The Company also grants options and warrants to non-employees for goods and services and in conjunction with certain agreements. These grants are accounted for under FASB Statement No. 123, "ACCOUNTING FOR STOCK-BASED COMPENSATION" based on the grant date fair values.

The following table illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123 to stock-based employee compensation.

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	THREE MONTHS ENDED		SIX MONTHS END
	JUNE 30, 2004	JUNE 30, 2003	JUNE 30, 2004
Net loss - as reported	$ (2,822,031)	$ (909,153)	$ (4,569,281)
Deduct: Total stock-based employee compensation (expense determined under the fair value based method for all awards), net of tax effect	(52,725)	(52,725)	(105,450)
Pro forma net loss	$ (2,874,756)	$ (961,878)	(4,674,731)
Loss per share:			
Basic net loss per share - as reported	$ (.10)	$ (.04)	$ (.16)
Basic net loss per share - pro forma	$ (.10)	$ (.04)	$ (.16)
Diluted net loss per share - as reported	$ (.10)	$ (.04)	$ (.16)
Diluted net loss per share - pro forma	$ (.10)	$ (.04)	$ (.16)

The above pro forma effects on net loss and net loss per share are not likely to be representative of the effects on reported net earnings (loss) for future years because options vest over several years and additional awards could be made each year.

NOTE 11 - GUARANTEES

The Company is guarantor on a working capital line of credit for San Jacinto Surgery Center, L.P. ("San Jacinto"), in which the Company owns a 10% general partnership interest through a wholly-owned subsidiary. As of June 30, 2004, the line of credit facility had a balance of $337,054 and is recorded on San Jacinto's balance sheet, which is not consolidated with the Company's financial statements. The line is secured by the accounts receivable and equipment of San Jacinto. The line expires on February 2, 2005.

NOTE 12 - SUBSEQUENT EVENTS

We have negotiated a series of transactions that will restructure SurgiCare and result in a change of control. The transactions include the acquisition of three new businesses and issuance of new equity securities for cash and contribution of outstanding debt. We also intend to complete a reverse stock split and change our name to Orion. Our board of directors has approved all of these actions and a special meeting of stockholders in lieu of an annual meeting will be held to approve them. The highlights of the financial transactions include:

- Effecting a one-for-ten reverse stock split and re-designating our outstanding common stock as Class A common stock.

- Issuing a new class of common stock Class B common stock to Brantley Partners IV, L.P., a private investor ("Brantley IV") or its assignees. Brantley IV will purchase the Class B common stock for $10 million in cash plus cash in the amount of the accrued but unpaid interest immediately

prior to the closing of the transactions owed to a subsidiary of Brantley IV by SurgiCare and Integrated Physician Solutions, Inc. ("IPS") on amounts advanced prior to October 24, 2003, which as of August 10, 2004 was $92,510. A portion of Brantley IV's cash investment will be used to pay off the indebtedness owed by SurgiCare and IPS to the subsidiary of Brantley IV. Based on the interest accrued on such indebtedness through August 10, 2004, it is estimated that the net cash proceeds to SurgiCare will be approximately $5,361,287. The shares to be received by Brantley IV or its assignees will constitute approximately 58.9% of SurgiCare's outstanding equity after the transactions on an as-converted basis. Brantley IV will also receive the option to purchase shares of Class A stock for cash in an amount up to an aggregate of $3 million after the closing of the transactions.

- Acquiring IPS, a holding company whose two business units provide business management services dedicated to the practice of pediatrics and integrated business and clinical software applications for physicians, in a merger in which we will issue Class A common stock to the IPS stockholders and certain IPS creditors. After the transactions, former IPS stockholders and creditors will own approximately 18.2% of our outstanding equity on an as-converted basis.

- Acquiring Medical Billing Services, Inc. ("MBS"), and Dennis Cain Physician Solutions, Ltd. ("DCPS"), two providers of physician management, billing, consulting and collection services in an acquisition in which we will pay between $2.9 million and $3.5 million cash and issue promissory notes in the aggregate principal amount of $500,000 and Class C common stock to the current equity holders of MBS and DCPS. The amount of consideration received depends upon the fair market value of our common stock at the time of the closing of the transactions, and the consideration is also subject to retroactive increase or decrease, including the issuance of additional shares of Class A common stock. We will also issue shares of Class A common stock as directed by the DCPS and MBS equity holders, and may be required to make additional payments in certain circumstances. Immediately after the transactions, the equity holders of these two companies and their designees will own Class A common stock and Class C common stock which may amount to as much as approximately 6.7% of our outstanding equity on an as-converted basis.

These transactions are contingent upon refinancing SurgiCare's, IPS's and MBS's debt. The transactions and the refinancing will provide SurgiCare with increased revenues and earnings, an improved balance sheet and the opportunity to grow the business. Please review our proxy statement for our special meeting of stockholders in lieu of an annual meeting, filed with the SEC for the full details of the proposed restructuring.

On August 2, 2004, the Company sold its five tracts of undeveloped land to American International Industries, Inc. ("AII") and agreed to accelerate the conversion of SurgiCare's 900,000 shares of Series AA Redeemable Preferred Stock ("Preferred Stock") held by AII into 8,750,000 shares of SurgiCare common stock, subject to approval of the listing of the shares on the American Stock Exchange and certain other conditions. The Preferred Stock has a preference value of $4.5 million. Under the previous agreement, 300,000 shares of the Preferred Stock were to be converted or redeemed annually through June 2006. At a floor price of $0.41 per share, the potential maximum conversion was 10,975,610 common shares. As part of this agreement, AII paid SurgiCare $250,000 and paid off SurgiCare's loan (collateralized by the land) of approximately $1.1 million.

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

FORWARD-LOOKING STATEMENTS

The information contained herein contains certain forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended, which are intended to be covered by the safe harbors created thereby. Investors are cautioned that all forward looking statements involve risks and uncertainty, including, without limitation,

our ability to continue our expansion strategy, changes in federal or state healthcare laws and regulations or third party payor practices, our historical and current compliance with existing or future healthcare laws and regulations and third party payor requirements, changes in costs of supplies, labor and employee benefits, as well as general market conditions, competition and pricing. Although we believe that the assumptions underlying the forward looking statements contained herein are reasonable, any of the assumptions could be inaccurate, and therefore, there can be no assurance that the forward looking statements included in this Form 10-QSB will prove to be accurate. In view of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by management or any other person that our objectives and plans will be achieved. We undertake no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results over time.

CRITICAL ACCOUNTING POLICIES

In December 2001, the SEC requested that reporting companies discuss their most "critical accounting policies" in management's discussion and analysis of financial condition and results of operations. The SEC indicated that a "critical accounting policy" is one that is important to the portrayal of a company's financial condition and operating results and requires management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

We have identified the policies below as critical to our business operations and the understanding of our results of operations. The impact and any associated risks related to these policies on our business operations is discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations where such policies affect our reported and expected financial results. For a detailed discussion on the application of this and other accounting policies, see Notes 1 and 2 in the Notes to the Consolidated Financial Statements of our Annual Report on Form 10-KSB. Our preparation of this Form 10-QSB and our Annual Report on Form 10-KSB requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as of the date of our financial statements. Therefore, actual results may differ from those estimates.

REVENUE RECOGNITION - Revenue is recognized on the date the procedures are performed, and accounts receivable are recorded at that time. Revenues are reported at the estimated net realizable amounts from patients and third-party payers. If such third-party payers were to change their reimbursement policies,

the effect on revenue could be significant. Earnings are charged with a provision for contractual adjustments and doubtful accounts based on such factors as historical trends of billing and cash collections, established fee schedules, accounts receivable agings and contractual relationships with third-party payers. Contractual allowances are estimated primarily using each surgery center's collection experience. Contractual rates and fee schedules are also helpful in this process. On a rolling average basis, the Company tracks collections as a percentage of related billed charges. This percentage, which is adjusted on a quarterly basis, has proved to be the best indicator of expected net realizable amounts from patients and third-party payers. Contractual adjustments and accounts deemed uncollectible are applied against the allowance account. The Company is not aware of any material claims, disputes or unsettled matters with third-party payers.

INVESTMENT IN LIMITED PARTNERSHIPS - The investments in limited partnerships are accounted for by the equity method. Under the equity method, the investment is initially recorded at cost and is subsequently increased to reflect the Company's share of the income of the investee and reduced to reflect the share of the losses of the investee or distributions from the investee.

These general partnership interests were accounted for as investment in limited partnerships due to the interpretation of FAS 94/ARB 51 and the interpretations of such by Issue 96-16 and SOP 78-9. Under those interpretations, SurgiCare could not consolidate its interest in those facilities in which it held a minority general interest partnership interest due to management restrictions, shared operating decision- making, capital expenditure and debt approval by limited partners and the general form versus substance analysis. Therefore, SurgiCare recorded these general partnership interests as investments in limited partnerships.

GOODWILL - Goodwill represents the excess of cost over the fair value of net assets of companies acquired in business combinations accounted for using the purchase method. Goodwill acquired in business combinations prior to June 30, 2001 had been amortized using the straight-line method over an estimated useful life of 20 years. In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS No. 142 requires that goodwill no longer be amortized but instead be reviewed periodically for possible impairment. The Company has adopted SFAS No. 142 effective January 1, 2002 and is no longer amortizing goodwill.

Upon adoption of SFAS 142, as well as December 31, 2003 and 2002, the Company performed an impairment test of its goodwill and determined that no impairment of the recorded goodwill existed. Under SFAS No. 142, goodwill is tested annually and more frequently if an event occurs which indicates the goodwill may be impaired.

OVERVIEW

SurgiCare's principal business strategies are to (a) increase physician utilization of existing facilities, (b) increase both the revenue and profits from current cases and procedures being performed in existing facilities (c) achieve growth and expand revenues by pursuing strategic acquisitions of existing, and the development of new, physician owned ambulatory surgical centers, and (d) expand into related healthcare facilities, including imaging,

surgical hospitals and practice management.

SurgiCare is in the process of identifying ambulatory surgical centers, imaging centers and practice management companies as potential acquisition targets and has, in some cases, conducted preliminary discussions with representatives of these organizations. No commitments were made for new acquisitions in the first six months of 2004. Although there are no commitments, understandings, or agreements with any other potential acquisition targets, talks are ongoing for the acquisition of additional entities. All of such discussions have been tentative in nature and there can be no assurance that we will acquire any entity with whom discussions have been conducted.

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FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following table sets forth for the periods indicated the percentages of revenues represented by income statement items.

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,	
	2004	2003	2004	2003
Revenues, net	100.0%	100.0%	100.0%	100.00%
Expenses:				
Direct Cost of Services	65.6%	55.1%	64.6%	54.6%
General & Administrative Expenses	93.8%	91.2%	98.1%	75.0%
Other Operating Expenses (Income)	83.9%	(16.4%)	39.8%	(7.5%)
Total Operating Expenses	243.3%	129.9%	202.5%	122.1%
Operating Loss	(143.3%)	(29.9%)	(102.5%)	(22.1%)
Other Loss	(27.4%)	(19.6%)	(34.2%)	(17.1%)
Minority Interest in Losses of Partnerships	--	2.6%	--	1.2%
Loss Before Federal Income Tax Expense	(170.7%)	(46.9%)	(136.7%)	-38.0%
Federal Income Tax Expense Benefit	--	--	--	.3%
Net Earnings (Loss)	(170.7%)	(46.9%)	(136.7%)	-37.6%

RESULTS OF OPERATIONS

THREE MONTHS ENDED JUNE 30, 2004 vs. THREE MONTHS ENDED JUNE 30, 2003

NET REVENUE. Case volume decreased 18.6% to 1,409 in the three months ended June 30, 2004 from 1,731 in the 2003 comparable period. Revenue declined $286,048, or 14.8% to $1,652,960 in the three months ended June 30, 2004, from $1,939,008 in the comparable 2003 period. On a per-case basis, revenue increased to $1,173 in the three months ended June 30, 2004 from $1,120 in the 2003 comparable period. The average contractual allowance from gross revenues was 75.4% in the three months ended June 30, 2004 compared to 69.5% in the comparable 2003 period. The decrease in revenue is predominantly due to the related decrease in case volume, although the Company has lost minimal doctors who perform cases. Due to the length of time to complete the pending transaction (see Note 12 to the accompanying consolidated financial statements), and due to the uncertainty surrounding the Company's financial condition, some physicians are splitting their caseload with other competing surgery centers, which has resulted in the decrease in cases.

DIRECT COST OF REVENUES. Direct Cost of Revenues increased $16,059, or 1.5% to $1,084,690 in the three months ended June 30, 2004 from $1,068,631 in the comparable 2003 period. Surgical costs decreased $7,190 or 1.8% to $391,919 in the three months ended June 30, 2004 from $399,109 in the comparable 2003 period. Direct clinical salaries and benefits increased $13,862, or 3.0% to $469,601 in the three months ended June 30, 2004 compared to $455,739 in the comparable 2003 period. These costs are predominantly fixed and the centers were already at base staffing levels in 2003. Other direct costs increased $9,387, or 4.4% to $223,170 in the three months ended June 30, 2004 from $213,783 in the comparable 2003 period. The increase is primarily due to pre-lease interim rental costs on MRI equipment for the Company's new imaging center in Ohio, which opened in July 2004.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative costs decreased $218,565, or 12.4% to $1,549,676 in the three months ended June 30, 2004 from $1,768,241 in the 2003 comparable period, primarily due to a decrease in the provision for doubtful accounts. The provision for doubtful accounts decreased $231,369, or 79.4% to $60,161 in the three months ended June 30, 2004 from $291,530 in the comparable 2003 period primarily due to an increased focus on more timely and accurate billings, which included outsourcing the billing and collections at its centers in Houston, Texas. To a lesser extent, approximately $43,000 of the decrease in the provision for doubtful accounts is due to the related decrease in revenues.

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OTHER OPERATING EXPENSES (INCOME). In the three months ended June 30, 2004, the Company recorded an impairment charge of $1,387,588 against its investment in land in connection with its sale of the land in August 2004 (see Note 12, SUBSEQUENT EVENTS to the accompanying consolidated financial statements). In the three months ended June 30, 2003, the Company recorded a gain of $319,086 recognized on the sale of the Company's 10% interest in Physicians Endoscopy Center.

TOTAL OPERATING EXPENSES. Total Operating Expenses increased $1,504,168, or 59.7% to $4,021,954 in the three months ended June 30, 2004 from $2,517,786 in the comparable 2003 period. As a percent of revenue, total expenses increased to 243.3% of revenue in the three months ended June 30, 2004 from 129.9% in the 2003 comparable period. The increased costs, expressed both in dollars and as a percentage of revenue, are related to the factors discussed above.

OTHER INCOME (EXPENSE). Total Other Income (Expense) increased $72,678, or 19.1% to $453,037 in the three months ended June 30, 2004 from $380,359 in the 2003 comparable period. The increase was primarily due to a decrease in Equity

in Earnings of Limited Partnerships of $61,846, or 77.0% between the two comparable three-month periods. The decrease is primarily attributable to the Company's sale of its interest in Physicians Endoscopy Center in June 2003, where in the three months ended June 30, 2003, the Company's equity in that center's earnings was $68,162.

FEDERAL INCOME TAX BENEFIT. For the three months ended June 30, 2004, the Company did not record a tax benefit on its pre-tax loss of $2,822,031 due to a valuation allowance recorded against the Company's deferred tax assets. The valuation allowance was necessary due to the uncertainty of recovery of the deferred tax assets.

NET LOSS. Due to the factors discussed above, the Company's net loss increased $1,912,878, or 210.4% to $2,822,031 in the three months ended June 30, 2004 from $909,153 in the 2003 comparable period. The Company's operating results were negatively impacted by the land impairment of $1,387,588 and the decrease in gross margin of $302,107 (revenue minus direct cost of revenues).

SIX MONTHS ENDED JUNE 30, 2004 vs. SIX MONTHS ENDED JUNE 30, 2003

NET REVENUE. Case volume decreased 17.9% to 2,886 in the six months ended June 30, 2004 from 3,517 in the 2003 comparable period. Revenue declined $875,645, or 20.8% to $3,343,484 in the six months ended June 30, 2004, from $4,219,129 in the comparable 2003 period. On a per-case basis, revenue decreased to $1,159 in the six months ended June 30, 2004 from $1,200 in the 2003 comparable period. The average contractual allowance from gross revenues was 76.0% in the six months ended June 30, 2004 compared to 68.2% in the comparable 2003 period. The decrease in revenue is predominantly due to the related decrease in case volume, although the Company has lost minimal doctors who perform cases. However, due to the length of time to complete the pending transaction (see Note 12 to the accompanying consolidated financial statements), and due to the uncertainty surrounding the Company's financial condition, some physicians are splitting their caseload with other competing surgery centers, which has resulted in the decrease in cases performed.

DIRECT COST OF REVENUES. Direct Cost of Revenues decreased $143,319, or 6.2% to $2,161,642 in the six months ended June 30, 2004 from $2,034,961 in the comparable 2003 period. Surgical costs decreased $78,941, or 9.1% to $792,745 in the six months ended June 30, 2004 from $871,686 in the comparable 2003 period. Direct clinical salaries and benefits increased $23,670, or 2.6% to $950,837 in the six months ended June 30, 2004 compared to $927,167 in the comparable 2003 period. These costs are predominantly fixed and the centers were already at base staffing levels in 2003. Other direct costs decreased $88,048, or 17.4% to $418,060 in the six months ended June 30, 2004 from $506,108 in the comparable 2003 period. The decrease is primarily related to the revenue decrease and included decreases in contract nursing ($44,720), patient transportation ($25,874) and equipment repairs ($23,754).

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GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative costs increased $114,731, or 3.6% to $3,280,176 in the six months ended June 30, 2004 from $3,165,445 in the 2003 comparable period, primarily due to a an increase in professional fees. Professional fees increased $426,399, or 82.9% to $940,983 in the six months ended June 30, 2004 from $514,584 in the comparable 2003 period. In 2004, the Company recorded a charge of $202,000 to professional fees related to a settlement with S.E. Altman on a "Finders Fee Contract." The remaining increase is due to legal, professional and accounting fees related to the series of pending transactions that will restructure SurgiCare and result in a change in control. The transactions include the acquisition of three new businesses and

issuance of new equity securities for cash and debt forgiveness (see Note 12 to the accompanying consolidated financial statements). The increase in professional fees was offset by a decrease in the Company's provision for doubtful accounts of $184,204, or 61.3% to $116,488 in the six months ended June 30, 2004 from $300,692 in the comparable 2003 period primarily due to an increased focus on more timely and accurate billings, which included outsourcing the billing and collections at its centers in Houston, Texas. To a lesser extent, approximately $62,000 of the decrease in the provision for doubtful accounts is due to the related decrease in revenues.

OTHER OPERATING EXPENSES (INCOME). Other Operating Expenses (Income) increased $1,647,881 to a net expense of $1,328,963 in the six months ended June 30, 2004 from a net gain of $318,918 in the comparable 2003 period. In the six months ended June 30, 2004, the Company recorded an impairment charge of $1,387,588 against its investment in land in connection with its sale of the land in August 2004 (see Note 12, SUBSEQUENT EVENTS to the accompanying financial statements). In the six months ended June 30, 2003, the Company recorded a gain of $319,086 recognized on the sale of the Company's 10% interest in Physicians Endoscopy Center.

TOTAL OPERATING EXPENSES. Total Operating Expenses increased $1,619,293, or 31.4% to $6,770,781 in the six months ended June 30, 2004 from $5,151,488 in the comparable 2003 period. As a percent of revenue, total expenses increased to 202.5% of revenue in the six months ended June 30, 2004 from 122.1% in the 2003 comparable period. The increased costs, expressed both in dollars and as a percentage of revenue, are related to the factors discussed above.

OTHER INCOME (EXPENSE). Total Other Income (Expense) increased $421,124, or 58.4% to $1,141,984 in the six months ended June 30, 2004 from $720,860 in the 2003 comparable period. The increase was primarily due to an increase in interest expense of $256,101, or 28.2% to $1,165,119 from $909,018 in the 2003 period. In the six months ended June 30, 2004, the Company recorded a $206,693 charge to interest expense, based on the change in relative fair value of its convertible unsecured promissory notes (see Note 6 to the accompanying consolidated financial statements). Since the notes were not converted by January 31, 2004, the conversion price changed from $.35 per share to $.25 per share. The remaining increase in interest expense of $49,408 was due to additional borrowings for working capital purposes. Additionally, Equity in Earnings of Limited Partnerships decreased by $147,353, or 87.7% between the two comparable six-month periods. The decrease is primarily attributable to the Company's sale of its interest in Physicians Endoscopy Center in June 2003, where in the six months ended June 30, 2003, the Company's equity in that center's earnings was $131,490.

FEDERAL INCOME TAX BENEFIT. For the six months ended June 30, 2004, the Company did not record a tax benefit on its pre-tax loss of $4,569,281 due to a valuation allowance recorded against the Company's deferred tax assets. The valuation allowance was necessary due to the uncertainty of recovery of the deferred tax assets.

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NET LOSS. Due to the factors discussed above, the Company's net loss increased $2,981,641, or 187.8% to $4,569,281 in the six months ended June 30, 2004 from $1,587,640 in the 2003 comparable period. The Company's operating results were negatively impacted by: the land impairment of $1,387,588; the decrease in gross margin of $732,326 (revenue minus direct cost of revenues); the increase in professional fees of $426,399 due to the Altman settlement and expenses related to the pending series of transactions; and the increase in interest expense of $256,101 due to the charge related to the beneficial

conversion factor of the convertible notes and additional borrowings for working capital purposes.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operating activities was $317,008 and $560,085 for the six months ended June 30, 2004 and 2003, respectively. The primary reason for the usage of cash is due to continued operating losses in both periods.

Net cash used in investing activities was $685,157 for the six months ended June 30, 2004. In the second quarter of 2004, the Company purchased open MRI (magnetic resonance imaging) equipment and related build-out totaling approximately $1.2 million, of which $600,000 was financed through a capital lease. The Company also purchased approximately $86,000 of replacement equipment for it existing centers. Cash provided by investing activities for the six months ended June 30, 2003 was $399,205, primarily due to the Company selling its ownership interest in Physicians Endoscopy Center for $425,000 cash.

Net cash provided by financing activities increased to $1,140,613 for the six months ended June 30, 2004 from $162,454 in the 2003 comparable period. The Company has financed its working capital needs primarily through the issuance of equity, secured and/or convertible debt. As of June 30, 2004, SurgiCare does not have any credit facilities available with financial institutions to provide for working capital shortages. In the six months ended June 30, 2004, the Company borrowed $1,325,411 from a participant in the proposed restructuring transactions (See Note 12 to the accompanying unaudited financial statements) to make necessary payments on debt and to fund operations.

In the six months ended June 30, 2003, the Company raised cash of $1,069,897 through the sale of common stock offset by net pay downs of credit lines and other outstanding debt of approximately $903,000.

In the first six months of 2004, the Company did not raise any substantial funds through the sale of equity securities, though $16,535 was recorded on the exercise of outstanding warrants. Although the Company believes it will generate cash from operations in the future, due to its debt load, it is not able to fund its current operations solely from its cash flow.

The Company believes that additional sales of debt and/or equity securities will be required to continue operations. See Note 12 to the accompanying unaudited financial statements for a description of a series of transactions recently announced by the Company that, if consummated, will involve an equity investment and recapitalization of the Company. Prior to the closing of such contemplated transactions, any additional sales of debt and/or equity by the Company will be subject to the prior approval of the counterparties to the applicable transaction documents. The Company can provide no assurance that it will be successful in any future financing effort to obtain the necessary working capital to support its operations, or fund acquisitions for its anticipated growth. In the event that any future financing efforts are not successful, the Company will be forced to liquidate assets and/or curtail operations.

As of June 30, 2004, the Company had cash and cash equivalents of $280,001 and negative working capital of $13,652,796. SurgiCare has a total of $6,267,762 in long-term debt and an additional $1,402,588 in revolving lines of credit currently in default. SurgiCare has defaulted on certain provisions of its Loan and Security Agreement with its senior lender, DVI Business Credit Corporation

and DVI Financial Services, Inc. ("DVI"). On August 25,2003, DVI filed for protection under Chapter 11 of the U.S. Bankruptcy laws. Integrated Physician Solutions, Inc. ("IPS") and SurgiCare completed negotiations with DVI, which resulted in a decrease of their combined debt of approximately $10.1 million to a combined payout of approximately $6.5 million including a buy-out of the revolving lines of credit. As part of that agreement, the companies have executed a new loan agreement with U.S. Bank Portfolio Services ("USBPS"), as servicer for payees, for payment of the revolving line of credit and renegotiated the term loan amounts. The sum due to DVI at the closing of the aforementioned merger and equity transactions is $2,000,000. As a part of that transaction, the companies have signed a term sheet for a new revolving line of credit, which will be used to pay off the DVI revolving line of credit.

ITEM 3. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

We maintain a set of disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports filed by us under the Securities and Exchange Act of 1934, as amended ("Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. As of the end of the period covered by this report, we evaluated, under the supervision and with the participation of our management, including our President and Chief Executive Officer and our Secretary and Chief Financial Officer, the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 of the Exchange Act. Based on that evaluation, our President and Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective.

CHANGES IN INTERNAL CONTROLS

During the most recent fiscal quarter, there have been no changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

On February 10, 2003, SurgiCare, Inc. was named as a defendant in a suit entitled S.E. Altman v. SurgiCare. S.E. Altman has sued for breach of contract, alleging that SurgiCare did not pay monies owed under a "Finders Fee Contract." Plaintiff asserts damages in the amount of $217,000, plus interest and attorneys' fees. International Diversified Corporation, Limited has indemnified SurgiCare with respect to any fees owed to Altman under the Finders Fee Contract. The case has been dismissed in favor of arbitration. In March 2004, the parties executed a Settlement Agreement and Release of Claims to resolve the dispute in which SurgiCare agreed to issue Mr. Altman 540,000 shares of common stock, which were registered with the Securities and Exchange Commission on Form S-8 in April 2004.

On April 14, 2003, SurgiCare, Inc. was named as a defendant in a suit entitled A.I. International Corporate Holdings, Ltd. v. SurgiCare, Inc. in the U.S. District Court for the Southern District of New York. Subsequently, SurgiCare filed suit against A.I. International Corporate Holdings, Ltd. and First National Bank, S.A.L. of Lebanon in the 215th Judicial District Court of Harris County, Texas. The New York case involves allegations that SurgiCare defaulted on its loan agreement. The plaintiffs in the New York case are suing SurgiCare for $834,252 representing the loan amount and interest, plus $219,000, representing damages for "No-filing Charges" and "Non-Effective Charges" under the contract. SurgiCare's lawsuit in Texas asserts that the loan agreement is usurious. The parties signed an agreement to settle this matter, which will close after the consummation of the Transactions. Pursuant to this settlement, SurgiCare will pay Plaintiffs $220,000 in cash and issue 2,100,000 shares of SurgiCare common stock (210,000 shares after giving effect to the reverse stock split contemplated in connection with the merger and equity transactions discussed in Note 12 to the accompanying consolidated financial statements) to be paid and issued after the closing of such transactions.

On November 24, 2003, SurgiCare, Inc. was named as a defendant in a suit entitled Vincent A. Giammalva, Trustee v. SurgiCare, Inc., Keith G. LeBlanc, and Phillip C. Scott; in the 344th Judicial District Court of Chambers County, Texas. This case involves allegations that SurgiCare defaulted on a contract to sell a parcel of real estate to plaintiff. Plaintiff also claims that LeBlanc and Scott committed fraud. SurgiCare states that it could not sell the parcel of land because of a lien on the property. The plaintiff seeks specific performance, forcing SurgiCare to sell the property, as well as actual damages. SurgiCare is negotiating with the plaintiff in an effort to settle this matter. American International Industries, Inc. ("AII") has agreed to indemnify SurgiCare, Inc., Keith LeBlanc and Phillip Scott for all claims asserted in this litigation by agreement dated June 23, 2004.

In addition, we are involved in various other legal proceedings and claims arising in the ordinary course of business. Our management believes that the disposition of these additional matters, individually or in the aggregate, is not expected to have a materially adverse effect on our financial condition. However, depending on the amount and timing of such disposition, an unfavorable resolution of some or all of these matters could materially affect our future results of operations or cash flows in a particular period.

ITEM 2. CHANGE IN SECURITIES.

On April 26, 2004, the Company issued 540,000 shares of common stock to S.E. Altman, an accredited investor, for services rendered. The stock was issued in a privately negotiated transaction in reliance on the exemption provided by Section 4(2) of the Securities Act.

ITEM 3. DEFAULT UPON SENIOR SECURITIES.

SurgiCare has defaulted on certain provisions of its Loan and Security Agreement with its senior lender, DVI Business Credit Corporation and DVI Financial Services, Inc. ("DVI"). On August 25,2003, DVI filed for protection under Chapter 11 of the U.S. Bankruptcy laws. IPS and SurgiCare completed negotiations with DVI, which resulted in a decrease of their combined debt of approximately $10.1 million to a combined payout of approximately $6.5 million including a buy-out of the revolving lines of credit. As part of that agreement, the companies have executed a new loan agreement with U.S. Bank Portfolio Services ("USBPS"), as servicer for payees, for payment of the revolving line of credit and renegotiated the term loan amounts. The sum due to DVI at the closing of the aforementioned merger and equity transactions is $2,000,000. As a part of that transaction, the companies have signed a term sheet for a new revolving

line of credit, which will be used to pay off the DVI revolving line of credit.

SurgiCare has defaulted on its convertible Debenture Agreement for failure to file a registration statement for the resale of certain securities pursuant to the agreement and has been sued by the primary debenture holder. The parties signed an agreement to settle this matter, which will close after the consummation of the Transactions. Pursuant to this settlement, SurgiCare will pay Plaintiffs $220,000 in cash and issue 2,100,000 shares of SurgiCare common stock (210,000 shares after giving effect to the reverse stock split contemplated in connection with the merger and equity transactions discussed in Note 12 to the accompanying consolidated financial statements) to be paid and issued after the closing of such transactions.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits

EXHIBIT NO.	DESCRIPTION
31.1	Rule 13a-14(a)/15d-14(a) Certification
31.2	Rule 13a-14(a)/15d-14(a) Certification
32.1	18 U.S.C.ss.1350 Certification
32.2	18 U.S.C.ss.1350 Certification

(b) Reports on Form 8-K

During the quarter ended June 30, 2004, we filed the following reports on Form 8-K:

Dated May 10, 2004, SurgiCare issued a press release to announce that on April 27,2004, it filed amended preliminary proxy materials with the Securities and Exchange Commission.

Dated May 14, 2004, SurgiCare issued a press release announcing its first quarter 2004 financial results.

Dated June 17, 2004, to provide clarification of unauthorized information posted on an internet message board.

Dated July 2, 2004 (after the close of the second fiscal quarter), SurgiCare issued a press release to announce that it had entered into agreements to: convert its Series AA Redeemable Preferred Stock to common; sell its five tracts of undeveloped land; and settle its debt with its senior lender. SurgiCare also announced a change in its CFO position.

SIGNATURES

In accordance with the requirements of the Exchange Act, the Registrant caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: August 13, 2004

REGISTRANT:

SurgiCare, Inc.

By: /s/ Keith G. Leblanc

Keith G. LeBlanc
Chief Executive Officer

By: /s/ Roger S. Huntington

Roger S. Huntington
Chief Financial Officer