GENESIS HEALTH VENTURES INC /PA
Form 10-Q
August 14, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2002

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 Number: 000-33217

GENESIS HEALTH VENTURES, INC.
(Exact name of registrant as specified in its charter)

Pennsylvania	06-1132947
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

101 East State Street
Kennett Square, Pennsylvania 19348
(Address, including zip code, of principal executive offices)

(610) 444-6350
(Registrant's telephone number including area code)

Indicate by check mark whether the registrant has (1) 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, and (2) has been subject to such filing requirements for the past 90 days.

YES [X] NO [ ]

Indicate by check mark whether the registrant has filed all reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

YES [X] NO [ ]

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of August 9, 2002: 40,602,659 shares of common stock issued and 815,150 are to be issued in connection with the Company's plan of Reorganization confirmed by the Bankruptcy Court on September 20, 2001.

TABLE OF CONTENTS

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Part I: FINANCIAL INFORMATION

Item 1. Financial Statements

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Part II: OTHER INFORMATION

Item 1. Legal Proceedings

Item 2. Changes in 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 and Reports on Form 8-K

SIGNATURES

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

As used herein, unless the context otherwise requires, "Genesis," the "Company," "we," "our" or "us" refers to Genesis Health Ventures, Inc. and its subsidiaries.

Statements made in this report, and in our other public filings and releases, which are not historical facts contain "forward-looking" statements (as defined in the Private Securities Litigation Reform Act of 1995) that involve risks and uncertainties and are subject to change at any time. These forward-looking statements may include, but are not limited to:

- certain statements in "Management's Discussion and Analysis of Financial Condition and Results of Operations," such as our ability to meet our liquidity needs, scheduled debt and interest payments, expected future capital expenditure requirements; to effect repayment of trade payables due

to our primary supplier of pharmacy products; and to successfully implement our strategic objectives in "Liquidity and Capital Resources - Strategic Objectives";

- certain statements in the Notes to Unaudited Condensed Consolidated Financial Statements concerning pro forma adjustments; and

- certain statements in "Legal Proceedings" regarding the effects of litigation.

The forward-looking statements involve known and unknown risks, uncertainties and other factors that are, in some cases, beyond our control. You are cautioned that these statements are not guarantees of future performance and that actual results and trends in the future may differ materially.

Factors that could cause actual results to differ materially include, but are not limited to the following:

- changes in the reimbursement rates or methods of payment from Medicare and Medicaid, or the implementation of other measures to reduce the reimbursement for our services;

- changes in pharmacy legislation and payment formulas;

- the expiration of enactments providing for additional governmental funding;

- efforts of third party payors to control costs;

- the impact of federal and state regulations;

- changes in payor mix and payment methodologies;

- further consolidation of managed care organizations and other third party payors;

- competition in our business;

- an increase in insurance costs and potential liability for losses not covered by, or in excess of, our insurance;

- competition for qualified staff in the healthcare industry;

- our ability to control operating costs;

- our ability to successfully consummate a strategic pharmacy acquisition and upon consummation to realize anticipated benefits of the integration of those operations into our existing pharmacy business; and

- an economic downturn or changes in the laws affecting our business in those markets in which we operate.

Certain of these risks are described in more detail in our Annual Report on Form 10-K.

Part I: FINANCIAL INFORMATION

Item 1. Financial Statements

Genesis Health Ventures, Inc. and Subsidiaries
Unaudited Condensed Consolidated Balance Sheets
(in thousands, except share and per share data)

	Successor Company June 30, 2002	Su Se
Assets		
Current assets:		
Cash and equivalents	$ 103,477	$
Restricted investments in marketable securities	74,912	
Accounts receivable, net of allowance for doubtful accounts	383,251	
Inventory	62,647	
Prepaid expenses and other current assets	55,519	
Total current assets	679,806	
Property, plant and equipment, net	841,971	
Other long-term assets	53,964	
Investments in unconsolidated affiliates	14,843	
Identifiable intangible assets, net	26,955	
Goodwill	304,572	
Total assets	$ 1,922,111	$
Liabilities and Shareholders' Equity		
Current liabilities:		
Current installments of long-term debt	$ 9,369	$
Accounts payable and accrued expenses	222,757	
Total current liabilities	232,126	
Long-term debt	678,100	
Deferred income taxes	3,930	
Other long-term liabilities	52,607	
Minority interest	9,742	
Redeemable preferred stock, including accrued dividends	44,516	
Shareholders' equity:		
Common stock, par $.02, 200,000,000 shares authorized, 40,555,598 and 39,671,279 shares issued and outstanding at June 30, 2002 and September 30, 2001, respectively, and 815,150 and 1,328,721 shares to be issued at June 30, 2002 and September 30, 2001, respectively	827	
Additional paid-in capital	840,869	
Retained earnings	59,131	
Accumulated other comprehensive income	263	
Total shareholders' equity	901,090	
Total liabilities and shareholders' equity	$ 1,922,111	$

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements

Genesis Health Ventures, Inc. and Subsidiaries
Unaudited Condensed Consolidated Statements of Operations
(in thousands, except share and per share data)

	Successor Company Three months ended June 30, 2002	Predece[ssor] Three [months ended] Jun[e 30, 2001]
Net revenues:		
Inpatient services	$ 356,424	$
Pharmacy and medical supply services	283,644	
Other revenue	42,663	
Total net revenues	682,731	
Operating expenses:		
Salaries, wages and benefits	291,751	
Cost of sales	169,505	
Other operating expenses	155,994	
Severance and related costs	12,568	
Gain from arbitration award	(229)	
Depreciation and amortization expense	16,471	
Lease expense	7,218	
Interest expense (contractual interest for the three months ended June 30, 2001 was $50,848)	11,245	
Income (loss) from continuing operations before debt restructuring and reorganization costs, income tax benefit, equity in net earnings (loss) of unconsolidated affiliates and minority interests	18,208	
Debt restructuring and reorganization costs	2,570	
Income (loss) from continuing operations before income tax benefit, equity in net earnings (loss) of unconsolidated affiliates and minority interests	15,638	
Income tax benefit	(4,212)	
Income (loss) from continuing operations before equity in net earnings (loss) of unconsolidated affiliates and minority interests	19,850	
Equity in net earnings (loss) of unconsolidated affiliates	279	
Minority interests	(592)	
Income (loss) from continuing operations before preferred stock dividends	19,537	
Preferred stock dividends	656	
Income (loss) from continuing operations	18,881	
Loss from discontinued operations, net of taxes	(1,428)	
Net income (loss) attributed to common shareholders	$ 17,453	$
Per common share data:		
Basic		

Income (loss) from continuing operations	$ 0.46	|	$
Loss from discontinued operations	(0.03)	|	
Net income (loss)	$ 0.42	|	$
Weighted average shares	41,341,830	|	48,
Diluted		|	
Income (loss) from continuing operations	$ 0.45	|	$
Loss from discontinued operations	(0.03)	|	
Net income (loss)	$ 0.42	|	$
Weighted average shares	43,470,082	|	48,

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements

---

Genesis Health Ventures, Inc. and Subsidiaries
Unaudited Condensed Consolidated Statements of Operations
(in thousands, except share and per share data)

	Successor Nine mont June 30
Net revenues:	
Inpatient services	$ 1
Pharmacy and medical supply services	
Other revenue	
Total net revenues	2
Operating expenses:	
Salaries, wages and benefits	
Cost of sales	
Other operating expenses	
Severance and related costs	
Gain from arbitration award	
Gain on sale of eldercare center	
Loss on sale of eldercare center	
Depreciation and amortization expense	
Lease expense	
Interest expense (contractual interest for the nine months ended June 30, 2001 was $166,961)	
Income (loss) from continuing operations before debt restructuring and reorganization costs, income tax benefit, equity in net earnings (loss) of unconsolidated affiliates and minority interests	
Debt restructuring and reorganization costs	
Income (loss) from continuing operations before income tax benefit, equity in net earnings (loss) of unconsolidated affiliates and minority interests	
Income tax benefit	

Income (loss) from continuing operations before equity in net earnings (loss) of unconsolidated affiliates and minority interests	
Equity in net income (loss) of unconsolidated affiliates	
Minority interests	
Income (loss) from continuing operations before preferred stock dividends	
Preferred stock dividends	
Income (loss) from continuing operations	
Loss from discontinued operations, net of taxes	
Net income (loss) attributed to common shareholders	$
Per common share data:	
Basic	
Income (loss) from continuing operations	$
Loss from discontinued operations	
Net income (loss)	$
Weighted average shares	41
Diluted	
Income (loss) from continuing operations	$
Loss from discontinued operations	
Net income (loss)	$
Weighted average shares	43

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements

Genesis Health Ventures, Inc. and Subsidiaries
Unaudited Condensed Consolidated Statements of Cash Flows
(in thousands)

	Successor Nine mont June 30,
Cash flows from operating activities:	
Net income (loss) attributed to common shareholders	$
Net charges included in operations not requiring funds	
Changes in assets and liabilities:	
Accounts receivable	
Accounts payable and accrued expenses	
Refinancing of pharmacy supplier credit terms	
Other, net	
Net cash provided by operating activities before debt restructuring and reorganization costs	
Cash paid for debt restructuring and reorganization costs	

Net cash provided by (used in) operating activities	
Cash flows from investing activities:	
Capital expenditures	
Net purchases of restricted marketable securities	
Proceeds from sale of eldercare center	
Purchase of eldercare centers	
Other long-term assets and liabilities, net	
Net cash used in investing activities	
Cash flows from financing activities:	
Net borrowings under working capital revolving credit facilities	
Repayment of long-term debt and payment of sinking fund requirements	
Proceeds from issuance of long-term debt	
Net cash provided by financing activities	
Net increase in cash and equivalents	
Cash and equivalents:	
Beginning of period	
End of period	$
Supplemental cash flow information:	
Interest paid	$
Income taxes paid (net of receipts)	

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements

6

Genesis Health Ventures, Inc. and Subsidiaries
Notes To Unaudited Condensed Consolidated Financial Statements

1. Business

Genesis Health Ventures, Inc. and its subsidiaries ("Genesis" or the "Company") provide a broad range of healthcare services to the geriatric population, principally within five geographic markets in the eastern United States. The Company's operations are comprised of two primary business segments: (1) inpatient services and (2) pharmacy and medical supply services. Inpatient services are provided through a network of skilled nursing and assisted living centers. Pharmacy and medical supply services are provided through long-term care pharmacies serving approximately 250,000 institutional beds; medical supply and home medical equipment distribution centers; community-based pharmacies; and infusion therapy services. The Company's reportable segments are complemented by an array of other service capabilities through the Genesis ElderCare(R) delivery model of integrated healthcare networks.

2. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's annual report on Form 10-K for the fiscal year

ended September 30, 2001.

The accompanying condensed consolidated financial statements are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America. In the opinion of management, the unaudited condensed consolidated financial statements include all necessary adjustments consisting of normal recurring accruals, and from June 22, 2000 (the "Petition Date") to September 30, 2001, all adjustments pursuant to the American Institute of Certified Public Accountants Statement of Position 90-7, "Financial Reporting By Entities in Reorganization Under the Bankruptcy Code" ("SOP 90-7"), for a fair presentation of the financial position and results of operations for the periods presented. Also in accordance with the provisions of SOP 90-7, the unaudited condensed consolidated balance sheets include all necessary adjustments incorporating the provisions of fresh-start reporting at September 30, 2001. Certain prior period amounts have been reclassified to conform to the current period presentation.

3. Factors Affecting Comparability of Financial Information

As a consequence of the implementation of fresh-start reporting effective September 30, 2001 (see "Footnote 4 - Reorganization"), the financial information presented in the unaudited condensed consolidated statement of operations for the three and nine months ended June 30, 2002 and the corresponding statements of cash flows for the nine month period ended June 30, 2002 are generally not comparable to the financial results for the corresponding periods in the prior year. To highlight the lack of comparability, a dashed line separates the pre-emergence financial information from the post-emergence financial information in the accompanying unaudited condensed consolidated financial statements and the notes thereto. Any financial information herein labeled "Predecessor Company" refers to periods prior to the adoption of fresh-start reporting, while those labeled "Successor Company" refer to periods following the Company's adoption of fresh-start reporting.

The lack of comparability in the accompanying unaudited condensed consolidated financial statements is most apparent in the Company's capital costs (lease, interest, depreciation and amortization), as well as with income taxes, minority interests, debt restructuring and reorganization costs, and preferred dividends. Management believes that business segment operating revenues and operating income of the Predecessor Company are generally comparable to those of the Successor Company.

---

4. Reorganization

Background.

On June 22, 2000, Genesis and certain of its direct and indirect subsidiaries filed for voluntary relief under Chapter 11 of the United States Code (the "Bankruptcy Code") with the United States Bankruptcy Court for the District of Delaware (the "Bankruptcy Court"). On the same date, a 43.6% owned affiliate of Genesis, The Multicare Companies, Inc. and certain of its direct and indirect subsidiaries ("Multicare") and certain of its affiliates also filed for relief under Chapter 11 of the Bankruptcy Code with the Bankruptcy Court (singularly and collectively referred to herein as "the Chapter 11 cases" unless the context otherwise requires).

Genesis and Multicare's financial difficulties were attributed to a number of factors. First, the federal government made fundamental changes to the reimbursement for medical services provided to individuals. The changes had a

significant adverse impact on the healthcare industry as a whole and on Genesis' and Multicare's cash flows. Second, the federal reimbursement changes exacerbated a long-standing problem of inadequate reimbursement by the states for medical services provided to indigent persons under the various state Medicaid programs. Third, numerous other factors adversely affected Genesis and Multicare's cash flows, including increased labor costs, increased professional liability and other insurance costs, and increased interest rates. Finally, as a result of declining governmental reimbursement rates and in the face of rising inflationary costs, Genesis and Multicare were too highly leveraged to service their debt, including their long-term lease obligations.

On October 2, 2001, (the "Effective Date"), Genesis and Multicare consummated a joint plan of reorganization (the "Plan") under Chapter 11 of the Bankruptcy Code (the "Reorganization") pursuant to a September 20, 2001 order entered by the Bankruptcy Court approving the Plan proposed by Genesis and Multicare. The principal provisions of the Plan were as follows:

- Multicare became a wholly-owned subsidiary of Genesis. Genesis previously owned 43.6% of Multicare and managed its skilled nursing and assisted living facilities under the Genesis Eldercare(R) brand name;
- New senior notes, new convertible preferred stock, new common stock and new warrants were issued to Genesis and Multicare's creditors. Approximately 93% of the Successor Company's new common stock, $242.6 million in new senior notes and new preferred stock with a liquidation preference of $42.6 million were issued to the Genesis and Multicare senior secured creditors. New one year warrants to purchase an additional 11% of the new common stock and approximately 7% of the new common stock have been or will be issued to the Genesis and Multicare unsecured creditors;
- Holders of Genesis and Multicare pre-Chapter 11 preferred and common stock received no distribution and those instruments were canceled;
- Claims between Genesis and Multicare were set-off against one another and any remaining claims were waived and released; and
- A new Board of Directors was constituted.

On the Effective Date, and in connection with the consummation of the Plan, the Successor Company entered into a new Senior Credit Facility (defined in "Footnote 6 - Long-Term Debt").

In accordance with SOP 90-7, the Company has recorded all expenses incurred as a result of the bankruptcy filing separately as debt restructuring and reorganization costs. A summary of the principal categories of debt restructuring and reorganization costs are as follows (in thousands):

	Successor Company	Predecessor Company	Successor Company
	Three months ended June 30, 2002	Three months ended June 30, 2001	Nine months ended June 30, 2002

Professional, bank and other fees	$ 2,570	$ 10,628	$ 2,570
Employee benefit related costs, including severance	--	3,022	--
Exit costs of terminated businesses	--	4,264	--
Post confirmation mortgage adjustment	--	--	1,700
Total	$ 2,570	$ 17,914	$ 4,270

Professional, bank and other fees recorded in the three and nine months ended June 30, 2002 represent post confirmation liabilities payable to the United States Trustee related to Chapter 11 cases that remained open through the nine month period ended June 30, 2002. With the exception of three cases which remain open, all of the Chapter 11 cases were closed subsequent to June 30, 2002. The post confirmation mortgage adjustment recorded during the nine months ended June 30, 2002 is the result of a settlement reached with the lender of a pre-petition mortgage obligation for an amount that exceeded the estimated loan value established in the September 30, 2001 fresh-start balance sheet by $1.7 million.

Fresh-Start Reporting.
For financial reporting purposes, the Company adopted the provisions of fresh-start reporting effective September 30, 2001. In connection with the adoption of fresh-start reporting, a new entity was deemed created for financial reporting purposes, the provisions of the Company's reorganization plan were implemented, assets and liabilities were adjusted to their estimated fair values and the Company's accumulated deficit was eliminated.

Merger of Genesis and Multicare.
In accordance with the Plan, Multicare became a wholly-owned subsidiary of Genesis on the Effective Date. Under fresh-start reporting, the Company consolidated its 100% interest in Multicare as of September 30, 2001. Genesis previously owned 43.6% of Multicare.

The consummation of the Company's Plan constitutes a change in the controlling interests of the Company. The provisions of the Plan have a material effect on the operating results of the Successor Company in the periods following the Reorganization.

The following unaudited pro forma statement of operations information gives effect to the Plan as if it were consummated on October 1, 2000. The unaudited pro forma statement of operations information has been prepared to reflect the consolidation of the financial results of Multicare, with no minority interest. The pro forma statement of operations information includes consideration for the Company's new capital structure, the elimination of restructuring related charges, and changes in depreciation and amortization expense following the revaluation of assets and liabilities to their estimated fair value. The pro forma statement of operations information does not necessarily reflect the results of operations that would have occurred had the Reorganization actually occurred at the beginning of the period presented.

(Unaudited, in thousands, except per share amounts)	Nine M Ended J 200

Pro Forma Statement of Operations Information:	
Total net revenues	$ 1,88
Net income from continuing operations	3
Net income from continuing operations per common share - Basic	
Net income from continuing operations per common share - Diluted	$

5. Certain Significant Risks and Uncertainties
Revenue Sources.
The Company receives revenues from Medicare, Medicaid, private insurance, self-pay residents, other third party payors and long-term care facilities which utilize our pharmacy and other specialty medical services. The healthcare industry is experiencing the effects of the federal and state governments' trend toward cost containment, as government and other third party payors seek to impose lower reimbursement and utilization rates and negotiate reduced payment schedules with providers. These cost containment measures, combined with the increasing influence of managed care payors and competition for patients, have resulted in reduced rates of reimbursement for services provided by the Company. The Company receive approximately 61% of its customer service revenues from Medicare and Medicaid. See "Part I: Item 1 - Business - Revenue Sources" herein and in the Company's Annual Report on Form 10-K.

A number of the provisions of the Balanced Budget Refinement Act ("BBRA") and the Benefits Improvement Protection Act ("BIPA") enactments providing additional funding for Medicare participating skilled nursing facilities expire on September 30, 2002. Expiring provisions are estimated to, on average, reduce per beneficiary per diems by $34. On April 23, 2002, the Centers for Medicare and Medicaid Services ("CMS") issued a press statement announcing that the agency would not proceed with its previously announced changes in the skilled nursing facility case-mix classification system. In its announcement, CMS made it clear that case-mix refinements would be postponed for a full year. CMS issued notice of fiscal year 2003 rates in the Federal Register, July 31, 2002. Effective October 1, 2002, rates will be increased by a 2.6% annual market basket adjustment. CMS estimates that even with this upward adjustment, average rates will be 8.8% lower than the current year because of the reduced payment caused by the expiring statutory add-ons.

The House of Representatives passed a package of Medicare amendments in late June, 2002. Under the House-passed measure, portions of the expiring provisions would be retained. The BBRA increase of 4% would expire, and the BIPA 16.6% add-on to the nursing portion of the SNF PPS rates would be reduced to 12% in 2003, 10% in 2004, and 8% in 2005. Under this proposal, fiscal year 2003 rates would be 5.2% lower than the current year. The Senate is expected to consider Medicare provider relief during September. Details of the Senate leadership proposal have not been released. It is premature to forecast the outcome of Congressional action.

The Company's estimate of the impact of the "SNF Medicare Cliff", factoring in the administrative decision not to proceed with changes in the case mix refinements at this time and without factoring in any additional Congressional action, exposes the skilled nursing facility sector to a 10% reduction. For the Company, this could have an adverse revenue impact exceeding $35 million annually. The Company is very involved with trade organizations representing the skilled nursing facility sector in aggressively pursing strategies to minimize the potentially adverse impact.

There may be additional provisions in the Medicare legislation affecting the Company's other businesses. Congress is expected to consider changes affecting

pharmacy, rehabilitation therapy, diagnostic services and the payment for services in other health settings.

It is not possible to fully quantify the effect of recent legislation, the interpretation or administration of such legislation or any other governmental initiatives on the Company's business. Accordingly, there can be no assurance that the impact of these changes or any future healthcare legislation will not adversely affect the Company's business. There can be no assurance that payments under governmental and private third party payor programs will be timely, will remain at levels comparable to present levels or will, in the future, be sufficient to cover the costs allocable to patients eligible for reimbursement pursuant to such programs. The Company's financial condition and results of operations may be affected by the reimbursement process, which in our industry is complex and can involve lengthy delays between the time that revenue is recognized and the time that reimbursement amounts are settled.

Legal Proceedings Potentially Affecting Revenues.
Certain service contracts permit the Company's NeighborCare(R) pharmacy operations to provide services to HCR Manor Care, constituting approximately ten percent and five percent of the net revenues of NeighborCareand Genesis, respectively. These service contracts with HCR Manor Care are the subject of certain litigation. See "Part II: Other Information, Item 1 - Legal Proceedings" herein and in the Company's Annual Report on Form 10-K. See also "Footnote 13 - Arbitration Award".

6. Long-Term Debt
Long-term debt at June 30, 2002 and September 30, 2001 consists of the following (in thousands):

	June 30, 2002	Sep
Secured debt		
Senior Credit Facility		
Term Loan	$ 282,287	$
Delayed Draw Term Loan	79,438	
Total Senior Credit Facility	361,725	
Senior Secured Notes	242,605	
Mortgage and other secured debts	83,139	
Total debt	687,469	
Less:		
Current installments of long-term debt	(9,369)	
Long-term debt	$ 678,100	$

Senior Credit Facility.
On the Effective Date, and in connection with the consummation of the Plan, the Successor Company entered into a Senior Credit Facility consisting of the following: (1) a $150 million revolving line of credit (the "Revolving Credit

Facility"); (2) a $285 million term loan (the "Term Loan"); and (3) an $80 million delayed draw term loan (the "Delayed Draw Term Loan") (collectively the "Senior Credit Facility"). The outstanding amounts under the Term Loan and the Delayed Draw Term Loan bear interest at the London Inter-bank Offered Rate ("LIBOR") plus 3.50%, or approximately 5.36% at June 30, 2002. The outstanding amounts under the Revolving Credit Facility, if any, bear interest based upon a performance related grid.

The Senior Credit Facility requires the Successor Company to maintain compliance with certain financial and non-financial covenants, including minimum EBITDAR (as defined); limitations on capital expenditures, maximum leverage ratios, minimum fixed charge coverage ratios and minimum net worth.

In June 2002, the Senior Credit Facility was amended in order to extend the date by which the Company is required to achieve certain levels of fixed versus variable interest rate exposure. As amended, by September 30, 2002, the Company is required to either enter into interest rate swap agreements that effectively fix or cap the interest cost on at least 50% of its consolidated debt or refinance such debt to achieve a mix of fixed rate debt of at least 50%. At June 30, 2002, the Company's debt mix is approximately 12% fixed-rate and 88% variable-rate.

The Revolving Credit Facility is available to fund obligations under the Plan and for general working capital requirements. The Revolving Credit Facility matures on October 2, 2006. Usage under the Revolving Credit Facility is subject to a Borrowing Base (as defined) calculation based upon real property collateral value and a percentage of eligible accounts receivable (as defined). Excluding an approximately $0.9 million posted letter of credit, no borrowings were outstanding under the Revolving Credit Facility at June 30, 2002.

The Delayed Draw Term Loan, as originally contracted, was to be used to (1) fund the purchase price of a proposed acquisition of a pharmacy operation; (2) pay certain outstanding amounts owed to ElderTrust on certain loans secured by mortgages; (3) fund the exercise of an option to purchase three eldercare centers; and (4) to make other Specific Payments (as defined). Once repaid, the Delayed Draw Term Loan cannot be re-borrowed. The Delayed Draw Term Loan amortizes at a rate of one percent per year, and matures on April 2, 2007. As a result of subsequent developments in the Company's bid to consummate a proposed acquisition of a pharmacy operation, the Delayed Draw Term Loan was amended in December 2001 to allow available borrowings that were otherwise earmarked for the proposed pharmacy transaction to be used to restructure credit terms with NeighborCare(R) pharmacy's primary supplier of pharmacy products.

In the nine months ended June 30, 2002, the Company borrowed approximately $42 million from the Delayed Draw Term Loan to finance the repayment of all trade balances due to NeighborCare pharmacy's primary supplier of pharmacy products. This change in credit terms has resulted in reduced pharmacy product acquisition costs, partially offset by an increase in interest expense on the incremental Delayed Draw Term Loan borrowings. In addition, the Company utilized approximately $10 million from the Delayed Draw Term Loan to fund the exercise of the purchase option on three eldercare centers, previously described, and the Company utilized approximately $28 million from the Delayed Draw Term Loan to satisfy certain mortgages as previously described. The Delayed Draw Term Loan is fully drawn at June 30, 2002 and is being repaid with no additional borrowings available under the Delayed Draw Term Loan.

Senior Secured Notes.
On the Effective Date, and in connection with the consummation of the Plan, the Successor Company entered into an indenture agreement in the principal amount of $242.6 million (the "Senior Secured Notes"). The Senior Secured Notes bear interest at LIBOR plus 5.0% (approximately 6.86% at June 30, 2002), amortize one percent each year and mature on April 2, 2007.

Other Secured Indebtedness.
During the nine months ended June 30, 2002, the Company refinanced approximately $28.0 million of other secured indebtedness with proceeds from the Delayed Draw Term Loan and used approximately $9.9 million in cash to make an unscheduled principle payment to reduce outstanding mortgage debt. At June 30, 2002, the Company had approximately $83.1 million of other secured debt consisting principally of revenue bonds and secured bank loans.

7. Income Taxes
The Company's income tax for the three and nine months ended June 30, 2002 was a benefit of $4.2 million and an expense of $25.4 million, respectively. This provision includes a $10.3 million reduction to tax expense realized in the third quarter 2002 resulting from the Job Creation and Worker Assistance Act of 2002 which extended the net operating loss carryback period.

12

The Company realizes tax benefits through the realization of Net Operating Loss ("NOL") carryforwards. Pursuant to SOP 90-7, the income tax benefits of any future realization of the NOL carryforwards are applied first as a reduction to goodwill.

8. Net Income (Loss) Per Share
The following table sets forth the computation of basic and diluted net income (loss) attributed to common shares (in thousands, except per share data):

	Successor Company	Predecessor Company
	Three Months Ended June 30, 2002	Three Months Ended June 30, 2001
Basic:		
Numerator:		
Income (loss) from continuing operations	$ 18,881	$ (27,502)
Loss from discontinued operations	(1,428)	(789)
Net income (loss) attributed to common shareholders	$ 17,453	$ (28,291)
Denominator:		
Weighted average shares	41,342	48,641
Earnings (loss) per share:		
Income (loss) from continuing operations	$ 0.46	$ (0.57)

Loss from discontinued operations	(0.03)	(0.02)
Net income (loss) attributed to common shareholders	$ 0.42	$ (0.58)
Diluted:		
Numerator:		
Income (loss) from continuing operations	$ 18,881	$ (27,502)
Elimination of preferred dividend requirements upon assumed conversion of preferred stock	656	--
Income (loss) from continuing operations for purposes of diluted calculation	19,537	(27,502)
Loss from discontinued operations	(1,428)	(789)
Net income (loss) attributed to common shareholders for purposes of diluted calculation	$ 18,109	$ (28,291)
Denominator:		
Weighted average shares - basic	41,342	48,641
Add:		
Assumed conversion of preferred stock	2,095	--
Dilutive effect of contingent issuable stock	33	--
Weighted average shares - diluted	43,470	48,641
Earnings (loss) per share:		
Income (loss) from continuing operations	$ 0.45	$ (0.57)
Loss from discontinued operations	(0.03)	(0.02)
Net income (loss) attributed to common shareholders	$ 0.42	$ (0.58)

13

Basic earnings per share is calculated by dividing net income (numerator) by the weighted average number of shares of common stock outstanding during the respective reporting period (denominator). Included in the calculation of basic weighted average shares of 41,341,830 and 41,211,603 for the three and nine months ended June 30, 2002, respectively, are 815,150 shares to be issued in connection with a plan confirmed by the bankruptcy court.

Diluted earnings per share is calculated in a manner consistent with basic earnings per share except that the weighted average shares outstanding are increased to include additional shares from the assumed conversion of Series A Convertible Preferred Stock and contingent issuable stock. No conversion of preferred stock is assumed in the three and nine months ended June 30, 2001 since their effect is antidilutive, however, the conversion of preferred stock is assumed in the three and nine months ended June 30, 2002 since their effect is dilutive. No exercise of warrants or employee stock options is assumed for the three and nine months ended June 30, 2002 since their effect is antidilutive.

9. Comprehensive Income (Loss)

The following table sets forth the computation of comprehensive income (loss) (in thousands):

	Successor Company	Predecessor Company	Successor Company
	Three Months Ended June 30, 2002	Three Months Ended June 30, 2001	Nine Months Ended June 30, 2002
Net income (loss) attributed to common shareholders	$ 17,453	$ (28,291)	$ 57,99
Unrealized gain (loss) on marketable securities	317	(105)	7
Total comprehensive income (loss)	$ 17,770	$ (28,396)	$ 58,06

10. Discontinued Operations
On October 1, 2001, the Company adopted the provisions of Statement of Financial Accounting Standards, No. 144 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" ("SFAS 144"). Under SFAS 144, discontinued businesses or assets held for sale are removed from the results of continuing operations. During the nine months ended June 30, 2002, the Company classified its ambulance business, five eldercare centers and one medical supply distribution site as discontinued operations. The results of operations in the current and prior year periods, along with any costs to exit such businesses in the current year period, have been classified as discontinued operations in the condensed consolidated statements of operations. Businesses sold or closed prior to the Company's adoption of SFAS 144 continue to be reported in the results of continuing operations.

The following table sets forth the components of losses from discontinued operations (in thousands):

	Successor Company	Predecessor Company	Succe Comp
	Three Months Ended June 30, 2002	Three Months Ended June 30, 2001	Ni Mon End June 20
Revenue	$ 3,403	$ 9,054	$ 1
Operating losses of discontinued businesses	(1,396)	(789)	(
Loss on discontinuation of businesses	(945)	--	(
Income tax benefit	913	--	

Loss from discontinued operations, net of taxes	$ (1,428)	$ (789)	$ (

The loss on discontinuation of businesses includes the write-down of assets to estimated net realizable value.

The following table sets forth the carrying amounts of the major classes of assets and liabilities of discontinued operations (in thousands):

	Successor Company	Su C
	June 30, 2002	Sep
Current assets	$ 5,508	$
Non current assets (including property, plant and equipment)	898	
Current liabilities	$ 3,232	$

11. Segment Information

The Company's principal operating segments are identified by the types of products and services from which revenues are derived and are consistent with the reporting structure of the Company's internal organization.

The Company has two reportable segments: (1) inpatient services and (2) pharmacy and medical supplies services.

The Company includes in inpatient services revenues all room and board charges and ancillary service revenue for its eldercare customers at its 188 owned and leased eldercare centers. The centers offer three levels of care for their customers: skilled, intermediate and personal.

The Company provides pharmacy and medical supply services through its NeighborCare(R) pharmacy subsidiaries. Included in pharmacy and medical supply service revenues are institutional pharmacy revenues, which include the provision of infusion therapy, medical supplies and equipment provided to eldercare centers it operates, as well as to independent healthcare providers by contract. The Company provides these services through 64 institutional pharmacies (eight are jointly-owned) and 22 medical supply and home medical equipment distribution centers (four are jointly-owned) located in its various market areas. In addition, the Company operates 31 community-based pharmacies (two are jointly-owned) which are located in or near medical centers, hospitals and physician office complexes. The community-based pharmacies provide prescription and over-the-counter medications and certain medical supplies, as well as personal service and consultation by licensed professional pharmacists. Approximately 91% of the sales attributable to all pharmacy operations are generated through external contracts with independent healthcare providers with the balance attributable to centers owned or leased by the Company.

The accounting policies of the segments are the same as those of the consolidated organization. All intersegment sales prices are market based.

The carrying value of the Company's assets in the following segment information at June 30, 2002 and September 30, 2001, and the capital costs (depreciation and amortization, lease expense, and interest), as well as income taxes, minority interest and preferred dividends for the three and nine months ended June 30, 2002 reflect the provisions of the Plan and the impact of fresh-start reporting. These costs for periods prior to the Company's emergence from bankruptcy generally were recorded based on historical costs or contractual agreements and do not reflect the provisions of the Plan. Accordingly, capital costs of the Successor Company for the three and nine months ended June 30, 2002 are not comparable to those of the Predecessor Company for the same period in the prior year.

Summarized financial information concerning the Company's reportable segments is shown in the following table. The "All other" category of revenues and operating income represents operating information of business units below the prescribed quantitative thresholds. These business units derive revenues from the following services: rehabilitation therapy, management services, consulting services, homecare services, physician services, diagnostic services, hospitality services, group purchasing fees, respiratory health services, staffing services and other healthcare related services. The "Corporate and other" category consists of the Company's general and administrative function, for which there is generally no revenue generated, as well as other unallocated expenses.

(in thousands)	Successor Company	Predecessor Company	Su C
	Three months ended June 30, 2002	Three months ended (1) June 30, 2001	Nin e Ju
Revenues:			
Inpatient services - external	$ 356,424	$ 338,716	$ 1
Pharmacy and medical supply services:			
External	283,644	262,698	
Intersegment	26,678	25,526	
All other:			
External	42,663	40,273	
Intersegment	42,726	48,746	
Elimination of intersegment revenues	(69,404)	(74,272)	
Total net revenues	$ 682,731	$ 641,687	$ 2
Operating income (2):			
Inpatient services	$ 43,818	$ 42,828	$
Pharmacy and medical supply services	27,275	27,005	
All other	10,935	10,753	
Corporate and other	(29,115)	(18,501)	
Total operating income	$ 52,913	$ 62,085	$
Capital and other:			
Consolidated:			
Depreciation and amortization	$ 16,471	$ 26,496	$
Lease expense	7,218	8,834	
Interest expense	11,245	26,872	

Gain on arbitration award	(229)	--	
Gain on sale of eldercare center	--	--	
Loss on sale of eldercare center	--	--	
Debt restructuring and reorganization costs	2,570	17,914	
Income tax provision (benefit)	(4,212)	--	
Equity in earnings (loss) of unconsolidated affiliates	(279)	173	
Minority interests	592	(2,077)	
Preferred stock dividends	656	11,375	
Income (loss) from continuing operations	18,881	(27,502)	
Loss from discontinued operations, net of taxes	(1,428)	(789)	
Net income (loss) attributed to common shareholders	$ 17,453	$ (28,291)	$

16

(in thousands)	Successor Company June 30, 2002	Suc Co Septe 200
Assets:		
Inpatient services	$ 942,612	$ 1,
Pharmacy and medical supply services	667,459	
Other	312,040	
	$ 1,922,111	$ 1,

(1) The June 30, 2001 and September 30, 2001 periods were restated to conform to the current period presentation which considers direct overhead costs in the calculation of inpatient services operating income and realigns overhead businesses within the inpatient services segment for the asset information. The summary segment information for pharmacy and medical supplies has historically included direct overhead costs. In accordance with our adoption of SFAS 144, all segments were restated to remove discontinued businesses from the results of continuing operations for the period ended June 30, 2001.

(2) Operating income is defined as income after operating expenses as they appear on the Company's unaudited condensed consolidated statements of operations and is calculated by subtracting salaries, wages and benefits, cost of sales and other operating expenses, including severance and related costs for the period ended June 30, 2002, from net revenues.

12. Restricted Assets

At June 30, 2002 and September 30, 2001, the Company reported restricted

investments in marketable securities of $74.9 million and $51.6 million, respectively, which are held by Liberty Health Corp. LTD. ("LHC"), Genesis' wholly-owned captive insurance subsidiary incorporated under the laws of Bermuda. The investments held by LHC are restricted by statutory capital requirements in Bermuda. In addition, certain of these investments are pledged as security for letters of credit issued by LHC. As a result of such restrictions and encumbrances, Genesis and LHC are precluded from freely transferring funds through intercompany loans, advances or cash dividends.

13. Arbitraton Award

On February 14, 2002, the arbitrator ruled in favor of NeighborCare(R) on all claims and counterclaims in the lawsuit involving Manor Care, Inc. and Manorcare Health Services, Inc. ("Manor Care"). The arbitrator found that Manor Care did not lawfully terminate the Master Service Agreements with NeighborCare, so that those contracts remain in full force and effect until the end of September 2004. The arbitrator awarded NeighborCare $23.0 million in damages, of which $21.7 was recognized in the second quarter of 2002, for respondents' failure to allow NeighborCare to exercise its right under the Master Service Agreements to service facilities owned and operated by a subsidiary of respondent Manor Care. In addition, the arbitrator terminated his prior ruling that allowed respondents to withhold 10% of their payments to NeighborCare, and respondents paid NeighborCare an additional $8.8 million in funds representing the amounts withheld during the course of the Arbitration pursuant to the arbitrator's prior ruling.

In response to post-award motions filed by NeighborCare and by respondents, the arbitrator recalculated NeighborCare's damages, reducing them by approximately $2.0 million, and ruled that NeighborCare is not obligated, as a result of certain past events, to renegotiate the prices it offers to respondents for pharmacy and infusion therapy products and services. There is no financial statement impact as a result of this decision as the Company was accounting for the remaining amount in dispute as a gain contingency.

Through June 30, 2002, the Company recorded a net gain of $21.9 million resulting from the award in the Manor Care arbitration. See "Part II: Other Information, Item 1 - Legal Proceedings" herein and in the Company's Annual Report of Form 10-K.

---

14. Other Events

Management Transition.

On May 28, 2002, the Company announced that Michael R. Walker resigned as Chief Executive Officer of the Company. The Company's Board of Directors appointed Robert H. Fish as interim Chief Executive Officer. On June 21, 2002, the Company announced that David C. Barr resigned as Vice Chairman. Mr. Barr will continue with the Company as a consultant. The Company recognized approximately $12.6 million in severance and related costs in the fiscal quarter ended June 30, 2002 relating to the transition agreements with Mr. Walker and Mr. Barr.

Medical Supplies Services Agreement.

During the third quarter, NeighborCare entered into a seven year agreement with Medline Industries, Inc. ("Medline") for the fulfillment of NeighborCare's bulk medical supply services to its customers. Under the agreement Medline will provide order intake, warehousing, delivery and invoicing services. NeighborCare will earn a service fee from Medline for providing traditional sales and marketing services, calculated as a percentage of the revenues earned by Medline for sales to NeighborCare customers. As a result of this agreement, NeighborCare

will no longer recognize revenue for the sale of bulk medical supplies to its customers. The agreement does not include certain products and services. It is estimated that the agreement will result in an annual reduction of medical supply revenue of approximately $45 million with no significant impact on net income.

15. Subsequent Event

Age Institute Settlement Agreement.

On July 9, 2002, Genesis and the AGE Entities entered into a Settlement Agreement and Mutual Release whereby the adversary proceeding and all counterclaims were dismissed with prejudice. Pursuant to the settlement, Genesis will receive a cash payment of approximately $0.5 million on or before December 31, 2002 and a five year promissory note in the principle amount of approximately $1.6 million. Existing promissory notes due to Genesis totaling approximately $7.2 million were reaffirmed. The Company has fully reserved amounts due from AGE Entities, and intends to recognize any recovery as amounts become recoverable. In addition, beginning January 1, 2003, Genesis and the AGE Entities will enter into three year contracts (with two successive renewal terms of three years each) for the provision of pharmacy services at each of the 20 currently owned and operated AGE facilities.

NCS Transaction.

On July 28, 2002, the Company and the Company's wholly-owned subsidiary, Geneva Sub, Inc. ("Geneva Sub"), entered into an agreement and plan of merger (the "Merger Agreement") with NCS HealthCare, Inc. ("NCS"), pursuant to which NCS will become a wholly owned subsidiary of the Company (the "NCS Transaction"). NCS provides institutional pharmacy services to approximately 203,000 long-term care and assisted living beds in 36 states. The merger will consolidate the operations of NCS and NeighborCare.

Under the terms of the Merger Agreement, each share of NCS class A and class B common stock will be converted into 0.1 of a share of Genesis common stock. The NCS Transaction has been approved by the Boards of Directors of both Genesis and NCS, as well as by a special committee of independent directors of NCS.

At the closing of the NCS Transaction, Genesis will repay in full the outstanding debt of NCS, which includes $206 million of senior debt, and will redeem $102 million of 5.75% convertible subordinated debentures of NCS, including any accrued and unpaid interest. In total, the NCS Transaction purchase price is estimated at $340 million, net of the application of approximately $20 million in excess cash at NCS.

Genesis intends to finance the cash portion of the purchase price with existing cash on hand, and through an expansion of its existing senior credit facility.

Consummation of the NCS Transaction, which is expected to occur in the fourth calendar quarter of 2002, is subject to regulatory approval, approval by the NCS stockholders and other customary conditions. In connection with the NCS Transaction, two NCS directors holding approximately 65% of the voting power in NCS have entered into Voting Agreements with the Company and NCS ("Voting Agreements") in which they agreed to, and have granted a limited proxy to the Company to, vote in favor of the Merger Agreement and against certain other actions specified in the Voting Agreements.

Since the Merger Agreement was entered, seven separate lawsuits have been filed alleging in general that certain officers and directors of NCS breached their fiduciary duties to the NCS stockholders by entering into the Merger Agreement and Voting Agreements. The plaintiffs in these lawsuits seek, among other things, to preliminarily and permanently enjoin the NCS Transaction.

In two of the lawsuits, the Company and Geneva Sub were also named as defendants. On August 1, 2002, Omnicare, Inc. filed a lawsuit in the Court of Chancery, County of New Castle, State of Delaware against NCS, its directors, the Company and Geneva Sub. In its amended complaint, filed August 12, 2002, Omnicare alleges, among other things, that by agreeing to the terms of the Voting Agreements and the Merger Agreement, the named NCS directors breached their statutory obligation to manage NCS and breached their fiduciary duties to NCS and NCS stockholders; that the grant of proxy under the Voting Agreements violated NCS's certificate of incorporation and resulted in the shares of NCS class B common stock subject to those agreements (which carry 10 votes per share) being converted automatically into shares of NCS class A common stock (which carry 1 vote per share); and that the termination fee that would be paid by NCS to the Company under some circumstances is unreasonably high and therefore unenforceable. Omnicare also alleges that the Company and Geneva Sub aided and abetted the NCS directors in breaching their fiduciary duties to NCS stockholders by entering into the Voting Agreements and Merger Agreement. Omnicare is asking that the court to (i) declare that the NCS class B shares subject to the Voting Agreements have been irrevocably converted into NCS class A shares; (ii) declare the Merger Agreement null and void; (iii) preliminarily and permanently enjoin NCS, the NCS directors, the Company and Geneva Sub from taking further steps or actions with respect to the Voting Agreements and the Merger Agreement; (iv) preliminarily and permanently enjoin the Company and Geneva Sub from aiding and abetting the named NCS directors from breaching their fiduciary duties; (v) declare the Termination Fee unreasonable, invalid and unenforceable; and (vi) grant Omnicare such other relief as the court deems just and proper, including the cost and disbursements of the action and reasonable attorneys' fees.

On August 7, 2002, Dolphin Limited Partnership L.L.P. ("Dolphin"), on behalf of all holders of NCS Class A common stock (other than the named NCS defendant directors), filed a lawsuit in the Court of Chancery, County of New Castle, State of Delaware against NCS, its directors, the Company and Genesis Sub (sic). In its complaint, Dolphin alleges that the named NCS directors breached their fiduciary duties to holders of NCS Class A common stock by, among other things, entering into the Voting Agreements and the Merger Agreement, refusing to consider Omnicare's bid and not conditioning the NCS Transaction on the approval of the holders of the NCS Class A common stock as a separate class. Dolphin also alleges that the Company aided and abetted the named NCS directors in breaching their fiduciary duties to the holders of NCS Class A common stock. Dolphin is asking that the court to (i) declare that the action is a class action and certify Dolphin as the class representative and Dolphin's counsel as the class counsel; (ii) enjoin, preliminarily and permanently, the NCS Transaction; (iii) direct that the NCS Transaction be conditioned on the approval of the holders of NCS Class A common stock as a separate class; (iv) rescind the NCS Transaction in the event that it occurs prior to the court's final judgment or award the holders of NCS Class A common stock recissory damages; (v) direct that the named defendants account to Dolphin and the holders of NCS Class A common stock for all damages caused by the defendants and account for all profits and any special benefits obtained as a result of the alleged breaches of fiduciary duties; (vi) award Dolphin the costs and disbursements of the action, including a reasonable allowance for the fees and expenses of Dolphin's attorneys and experts; and (vii) grant Dolphin and the holders of NCS Class A common stock such further relief as the court deems just and proper.

No court dates have been set for these matters. The Company believes that the allegations set forth in these lawsuits are without merit and intends to

contest them vigorously; however, the ultimate outcome of these lawsuits cannot be predicted with certainty. These lawsuits could adversely affect the Company's ability to consummate the NCS Transaction by end of the fourth calendar quarter of 2002, if at all.

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

General

Since we began operations in July 1985, we have focused our efforts on providing an expanding array of specialty medical services to elderly customers. We generate revenues primarily from two sources: inpatient services and pharmacy and medical supply services. However, we also derive revenue from other sources.

Inpatient services revenues include all room and board charges and ancillary service revenue for our eldercare customers at our 188 owned and leased eldercare centers. The centers offer three levels of care for their customers: skilled, intermediate and personal.

We provide pharmacy and medical supply services through our NeighborCare(R) pharmacy operations. Included in pharmacy and medical supply service revenues are institutional pharmacy revenues, which include the provision of infusion therapy, medical supplies and equipment provided to eldercare centers operated by us, as well as to independent healthcare providers by contract. We provide these services through 64 institutional pharmacies (eight are jointly-owned) and 22 medical supply and home medical equipment distribution centers (four are jointly-owned) located in our various market areas. In addition, we operate 31 community-based pharmacies (two are jointly-owned), which are located in or near medical centers, hospitals and physician office complexes. The community-based pharmacies provide prescription and over-the-counter medications and certain medical supplies, as well as personal service and consultation by licensed professional pharmacists.

We include the following service revenue in other revenues: rehabilitation therapy services, management fees, consulting services, homecare services, physician services, diagnostic services, hospitality services, group purchasing fees, respiratory health services, staffing services and other healthcare related services.

Certain Transactions and Events

NCS Transaction.

On July 28, 2002, we and our wholly-owned subsidiary, Geneva Sub, Inc. ("Geneva Sub"), entered into an agreement and plan of merger (the "merger agreement") with NCS HealthCare, Inc. ("NCS"), pursuant to which NCS will become our wholly-owned subsidiary (the "NCS transaction"). NCS provides institutional pharmacy services to approximately 203,000 long-term care and assisted living beds in 36 states. The merger will consolidate the operations of NCS and NeighborCare.

Under the terms of the merger agreement, each share of NCS class A and class B common stock will be converted into 0.1 of a share of our common stock. The NCS transaction has been approved by the boards of directors of both us and NCS, as well as by a special committee of independent directors of NCS.

At the closing of the NCS transaction, we will repay in full the outstanding debt of NCS, which includes $206 million of senior debt, and will redeem $102 million of 5.75% convertible subordinated debentures of NCS, including any accrued and unpaid interest. In total, the NCS transaction purchase price is estimated at $340 million, net of the application of approximately $20 million in excess cash at NCS.

We intend to finance the cash portion of the purchase price with existing cash on hand, and through an expansion of our existing senior credit facility.

Consummation of the NCS transaction, which is expected to occur in the fourth calendar quarter of 2002, is subject to regulatory approval, approval by the NCS stockholders and other customary conditions. In connection with the NCS transaction, two NCS directors holding approximately 65% of the voting power in NCS have entered into voting agreements with us and NCS (the "voting agreements") in which they agreed to, and have granted a limited proxy to us to, vote in favor of the merger agreement and against certain other actions specified in the voting agreements.

Since the merger agreement was entered, seven separate lawsuits have been filed alleging in general that certain officers and directors of NCS breached their fiduciary duties to the NCS stockholders by entering into the merger agreement and voting agreements. The plaintiffs in these lawsuits seek, among other things, to preliminarily and permanently enjoin the NCS transaction.

In two of the lawsuits, we and Geneva Sub were also named as defendants. On August 1, 2002, Omnicare, Inc. filed a lawsuit in the Court of Chancery, County of New Castle, State of Delaware against NCS, its directors, us and Geneva Sub. In its amended complaint, filed August 12, 2002, Omnicare alleges, among other things, that by agreeing to the terms of the voting agreements and the merger agreement, the named NCS directors breached their statutory obligation to manage NCS and breached their fiduciary duties to NCS and NCS stockholders; that the grant of proxy under the voting agreements violated NCS's certificate of incorporation and resulted in the shares of NCS class B common stock subject to those agreements (which carry 10 votes per share) being converted automatically into shares of NCS class A common stock (which carry 1 vote per share); and that the termination fee that would be paid by NCS to us under some circumstances is unreasonably high and therefore unenforceable. Omnicare also alleges that we and Geneva Sub aided and abetted the NCS directors in breaching their fiduciary duties to NCS stockholders by entering into the voting agreements and merger agreement. Omnicare is asking the court to (i) declare that the NCS class B shares subject to the voting agreements have been irrevocably converted into NCS class A shares; (ii) declare the merger agreement null and void; (iii) preliminarily and permanently enjoin NCS, the NCS directors, us and Geneva Sub from taking further steps or actions with respect to the voting agreements and the merger agreement; (iv) preliminarily and permanently enjoin us and Geneva Sub from aiding and abetting the named NCS directors from breaching their fiduciary duties; (v) declare the termination fee unreasonable, invalid and unenforceable; and (vi) grant Omnicare such other relief as the court deems just

and proper, including the cost and disbursements of the action and reasonable attorneys' fees.

On August 7, 2002, Dolphin Limited Partnership L.L.P. ("Dolphin"), on behalf of all holders of NCS Class A common stock (other than the named NCS defendant directors), filed a lawsuit in the Court of Chancery, County of New Castle, State of Delaware against NCS, its directors, us and Genesis Sub (sic). In its complaint, Dolphin alleges that the named NCS directors breached their fiduciary duties to holders of NCS Class A common stock by, among other things, entering into the voting agreements and the merger agreement, refusing to consider Omnicare's bid and not conditioning the NCS transaction on the approval of the holders of the NCS Class A common stock as a separate class. Dolphin also alleges that we aided and abetted the named NCS directors in breaching their fiduciary duties to the holders of NCS Class A common stock. Dolphin is asking that the court to (i) declare that the action is a class action and certify Dolphin as the class representative and Dolphin's counsel as the class counsel; (ii) enjoin, preliminarily and permanently, the NCS transaction; (iii) direct that the NCS transaction be conditioned on the approval of the holders of NCS Class A common stock as a separate class; (iv) rescind the NCS transaction in the event that it occurs prior to the court's final judgment or award the holders of NCS Class A common stock recissory damages; (v) direct that the named defendants account to Dolphin and the holders of NCS Class A common stock for all damages caused by the defendants and account for all profits and any special benefits obtained as a result of the alleged breaches of fiduciary duties; (vi) award Dolphin the costs and disbursements of the action, including a reasonable allowance for the fees and expenses of Dolphin's attorneys and experts; and (vii) grant Dolphin and the holders of NCS Class A common stock such further relief as the court deems just and proper.

No court dates have been set for these matters. We believe that the allegations set forth in these lawsuits are without merit and intend to contest them vigorously; however, the ultimate outcome of these lawsuits cannot be predicted with certainty. These lawsuits could adversely affect our ability to consummate the NCS transaction by end of the fourth calendar quarter of 2002, if at all.

Management Transition.
On May 28, 2002, we announced that Michael R. Walker resigned as our Chief Executive Officer. Our Board of Directors appointed Robert H. Fish as interim Chief Executive Officer. On June 21, 2002, we announced that David C. Barr resigned as Vice Chairman. Mr. Barr will continue with us as a consultant. We recognized approximately $12.6 million in severance and related costs in the fiscal quarter ended June 30, 2002 relating to the transition agreements with Mr. Walker and Mr. Barr.

Medical Supplies Services Agreement.
During the third quarter, NeighborCare entered into a seven year agreement with Medline Industries, Inc. ("Medline") for the fulfillment of NeighborCare's bulk medical supply services to its customers. Under the agreement Medline will provide order intake, warehousing, delivery and invoicing services. NeighborCare will earn a service fee from Medline for providing traditional sales and marketing services, calculated as a percentage of the revenues earned by Medline for sales to NeighborCare customers. As a result of this agreement, NeighborCare will no longer recognize revenue for the sale of bulk medical supplies to its customers. The agreement does not include certain products and services. It is

estimated that the agreement will result in an annual reduction of medical supply revenue of approximately $45 million with no significant impact on net income.

Reorganization:

Background.

On June 22, 2000, (the "Petition Date") we and certain of our direct and indirect subsidiaries filed for voluntary relief under Chapter 11 of the United States Code (the "Bankruptcy Code") with the United States Bankruptcy Court for the District of Delaware (the "Bankruptcy Court"). On the same date, our 43.6% owned affiliate, The Multicare Companies, Inc. and certain of its direct and indirect subsidiaries ("Multicare") and certain of its affiliates also filed for relief under Chapter 11 of the Bankruptcy Code with the Bankruptcy Court (singularly and collectively referred to herein as "the Chapter 11 cases" unless the context otherwise requires).

Our and Multicare's financial difficulties were attributed to a number of factors. First, the federal government made fundamental changes to the reimbursement for medical services provided to individuals. The changes had a significant adverse impact on the healthcare industry as a whole and on our and Multicare's cash flows. Second, the federal reimbursement changes exacerbated a long-standing problem of inadequate reimbursement by the states for medical services provided to indigent persons under the various state Medicaid programs. Third, numerous other factors adversely affected our and Multicare's cash flows, including increased labor costs, increased professional liability and other insurance costs, and increased interest rates. Finally, as a result of declining governmental reimbursement rates and in the face of rising inflationary costs, we and Multicare were too highly leveraged to service our debt, including our long-term lease obligations.

On October 2, 2001, (the "Effective Date"), we and Multicare consummated a joint plan of reorganization (the "Plan") under Chapter 11 of the Bankruptcy Code (the "Reorganization") pursuant to a September 20, 2001 order entered by the Bankruptcy Court approving the Plan proposed by us, and Multicare. The principal provisions of the Plan were as follows:

- Multicare became our wholly-owned subsidiary. We previously owned 43.6% of Multicare and managed its skilled nursing and assisted living facilities under the Genesis Eldercare(R) brand name;
- New senior notes, new convertible preferred stock, new common stock and new warrants were issued to our and Multicare's creditors. Approximately 93% of new common stock, $242.6 million in new senior notes and new preferred stock with a liquidation preference of $42.6 million were issued to our and Multicare's senior secured creditors. New one year warrants to purchase an additional 11% of the new common stock and approximately 7% of the new common stock have been or will be issued to our and Multicare's unsecured creditors;

- Holders of our and Multicare's pre-Chapter 11 preferred and common stock received no distribution and those instruments were canceled;
- Claims between us and Multicare were set-off against one another and any remaining claims were waived and released; and
- A new Board of Directors was constituted.

On the Effective Date, and in connection with the consummation of the Plan, we entered into a Senior Credit Facility consisting of the following: (1) a $150

million revolving line of credit (the "Revolving Credit Facility"); (2) a $285 million term loan (the "Term Loan") and (3) an $80 million delayed draw term loan (the "Delayed Draw Term Loan") (collectively the "Senior Credit Facility").

In accordance with SOP 90-7 (as defined below under "Fresh-Start Reporting"), we recorded all expenses incurred as a result of the Bankruptcy filing separately as debt restructuring and reorganization costs. A summary of the principal categories of debt restructuring and reorganization costs follows (in thousands):

	Successor Company	Predecessor Company	S
	Three months ended June 30, 2002	Three months ended June 30, 2001	
Professional, bank and other fees	$ 2,570	$ 10,628	$
Employee benefit related costs, including severance	--	3,022	
Exit costs of terminated businesses	--	4,264	
Post confirmation mortgage adjustment	--	--	
Total	$ 2,570	$ 17,914	$

Professional, bank and other fees recorded in the three and nine months ended June 30, 2002 represent post confirmation liabilities payable to the United States Trustee related to the Chapter 11 cases that remained open through the nine month period ended June 30, 2002. With the exception of three cases which remain open, all of the Chapter 11 cases were closed subsequent to June 30, 2002. The post confirmation mortgage adjustment recorded during the nine months ended June 30, 2002 is the result of a settlement reached with the lender of a pre-petition mortgage obligation for an amount that exceeded the estimated loan value established in the September 30, 2001 fresh-start balance sheet by $1.7 million.

Fresh-Start Reporting.

Upon emergence from our Chapter 11 proceedings, we adopted the principles of fresh-start reporting in accordance with the American Institute of Certified Public Accountants Statement of Position 90-7, "Financial Reporting By Entities in Reorganization Under the Bankruptcy Code" ("SOP 90-7") / ("fresh-start reporting"). For financial reporting purposes, we adopted the provisions of fresh-start reporting effective September 30, 2001. In connection with the adoption of fresh-start reporting, a new entity was deemed created for financial reporting purposes, the provisions of our Plan were implemented, assets and liabilities were adjusted to their estimated fair values and our accumulated deficit was eliminated.

Factors Affecting Comparability of Financial Information.

As a consequence of the implementation of fresh-start reporting effective September 30, 2001, the financial information presented in the unaudited condensed consolidated statement of operations for the three and nine months ended June 30, 2002 and the statement of cash flows for the nine months ended June 30, 2002 are generally not comparable to the financial results for the corresponding periods in the prior year. To highlight the lack of comparability, a dashed line separates the pre-emergence financial information from the

post-emergence financial information in the accompanying unaudited condensed consolidated financial statements and the notes thereto. Any financial information herein labeled "Predecessor Company" refers to periods prior to the adoption of fresh-start reporting, while those labeled "Successor Company" refer to periods following adoption of fresh-start reporting.

The lack of comparability in the accompanying unaudited condensed consolidated financial statements is most apparent in our capital costs (lease, interest, depreciation and amortization), as well as with income taxes, minority interests, debt restructuring and reorganization costs, and preferred dividends. We believe that business segment operating revenue and operating income of the Predecessor Company are generally comparable to those of the Successor Company.

Results of Operations
Three months ended June 30, 2002 compared to three months ended June 30, 2001
Inpatient Services
Inpatient services revenue increased $17.7 million, or 5%, to $356.4 million for the three months ended June 30, 2002 from $338.7 million for the same period in the previous year. Approximately $19.9 million of the growth is principally attributed to increased payment rates. Our average rate per patient day for the three months ended June 30, 2002 was $183 compared to $169 for the comparable period in the prior year. Our revenue Quality Mix (Medicare, private pay and insurance payors) for the three months ended June 30, 2002 declined to 51.7% from 51.8% for the comparable period in the prior year. The remaining decline in revenue of approximately $2.2 million resulted from eldercare center divestitures. Total patient days decreased 59,054 to 1,966,187 during the three months ended June 30, 2002 compared to 2,025,241 during the comparable period last year. Of this decrease, 52,909 patient days are attributed to divestitures of eldercare centers in the prior year period. The remaining decrease of 6,145 patient days is the result of a decline in overall occupancy.

Operating expenses for the three months ended June 30, 2002 increased $16.7 million, or 6%, to $312.6 million from $295.9 million for the same period in the prior year. The primary cost for this segment is salary, wage and benefit costs, which increased $13.0 million, or 8% for the three month period ended June 30, 2002 to $176.6 million from $163.6 million for the same period in the prior year. This increase is net of a reduction of approximately $2.2 million in salary, wage and benefit costs resulting from the divestiture of eldercare centers. Salary, wage and benefit costs, considering the impact of divested eldercare centers, increased $15.2 million, or 9%, driven by inflationary cost increases and the relative mix of employed labor versus agency labor costs. As a percentage of net revenue, salary, wage and benefit costs, once adjusted for the impact of divested eldercare centers, increased to 49.5% for the three months ended June 30, 2002, compared to 48.0% for the comparable period in the prior year. This increase is the result of continued pressure on wage and benefit related costs mitigated by less reliance on agency labor (primarily nursing costs) resulting from improved hiring and retention trends. Other operating expenses, once reduced for the impact of new and divested eldercare centers ($1.1 million for the three months ended June 30, 2001), increased $4.8 million, or 4%, to $136.0 million for the three months ended June 30, 2002 compared to $131.2 million for the same period last year. The increase was primarily driven by additional ancillary supply costs to treat a higher acuity customer base of approximately $3.0 million, increased property and general liability insurance of approximately $0.6 million and other operating costs of approximately $2.2 million. These increases were offset by reduced bad debt expense of $0.4 million and declining agency labor costs (principally nursing costs) of approximately

$0.6 million. External labor agencies charge us a premium labor rate compared to salary, wages and benefits earned by employees. The declining reliance upon such external labor agencies serves to reduce overall operating expense while increasing salary, wages and benefits costs.

Operating income increased $1.0 million, to $43.8 million for three months ended June 30, 2002 from $42.8 million for the same period in the prior year.

Pharmacy and medical supply services

Pharmacy and medical supply services revenue (before intersegment eliminations) increased $22.1 million, or 8%, to $310.3 million for the three months ended June 30, 2002 compared to $288.2 million for the three months ended June 30, 2001. Revenues from intersegment customers, which are eliminated in consolidation, increased approximately $1.2 million, or 5%, to $26.7 million for the three months ended June 30, 2002 compared to $25.5 million for the same period of the prior year. The remaining increase in net pharmacy and medical supply service revenues of approximately $20.9 million, or 8%, is due primarily to rate increases and shifts in customer and product mix with external customers.

Cost of sales (before intersegment eliminations) increased $15.7 million, or 9%, for the three month period ended June 30, 2002, to $195.1 million from $179.4 million for the same period in the prior year. Of this growth, $13.8 million is attributed to pharmacy and medical supply revenue growth, and $1.9 million is attributed to changes in customer and product mix. As a percentage of revenue, cost of sales for the three month period ended June 30, 2002 was 62.9% compared to 62.2% for the comparable period in the prior year. Other operating expenses for this segment, including salaries, wages and benefits, increased $6.1 million, or 8%, to $87.9 million for the three months ended June 30, 2002 compared to $81.8 million for the same period in the prior year. As a percentage of revenue, other operating costs were 28% for the three month periods ended June 30, 2002 and 2001.

Operating income increased $0.3 million, to $27.3 million for three months ended June 30, 2002 from $27.0 million for the same period in the prior year.

During the second quarter of fiscal 2002, we borrowed approximately $42 million from the Delayed Draw Term Loan to finance the repayment of all trade balances due to NeighborCare(R) pharmacy's primary supplier of pharmacy products. This change in credit terms resulted in reduced pharmacy product acquisition costs.

All Other

All other includes operating information of business units below the prescribed quantitative thresholds. These business units derive revenues and expenses from the following services: rehabilitation therapy, management services, consulting services, homecare services, physician services, diagnostic services, hospitality services, group purchasing fees, respiratory health services, staffing services and other healthcare related services. Revenues, including intersegment revenues, from these business units decreased approximately $3.6 million to $85.4 million from $89.0 million for the three month periods ended June 30, 2002 and June 30, 2001, respectively. The decline was primarily caused by less management fee revenue resulting from the post-bankruptcy termination of the Multicare management agreement, offset by growth in other service related businesses' revenue.

Operating income for all other businesses increased $0.1 million, to $10.9

million for three months ended June 30, 2002 from $10.8 million for the same period in the prior year.

Corporate and other

The "Corporate and other" category consists of our general and administrative function and other unallocated amounts, for which there is generally no revenue generated. Operating expenses increased $10.6 million in the three months ended June 30, 2002 to $29.1 million compared to $18.5 million in the comparable period in the prior year. Of this increase, $12.6 million relates to severance and related costs incurred in the three months ended June 30, 2002 related to the resignations of our Chief Executive Officer and our Vice Chairman, and approximately $1.6 million is principally attributed to labor related and other operating expense growth in our corporate support functions. These increases are offset by reductions of approximately $1.2 million in expense levels for our cash based incentive compensation program and an executive non-cash stock based compensation program, approximately $2.1 million for a settlement agreement recorded in the three months ended June 30, 2001, and approximately $0.3 million related to other unallocated employee benefit costs.

Capital costs and other

Our capital costs for the three months ended June 30, 2002 reflect the impact of fresh-start reporting following our emergence from bankruptcy. Those adjustments materially changed the recorded amounts of capital costs, most notably depreciation and amortization, lease expense, interest expense, income taxes, minority interest and preferred stock dividends, and as a result, will not be comparable to those for the three months ended June 30, 2001.

Depreciation and amortization expense decreased $10.0 million to $16.5 million for the three months ended June 30, 2002 compared to $26.5 million for the same period in the prior year. The decrease was primarily caused by the impact of fresh-start reporting on the carrying value of our property, plant and equipment, which were adjusted to their estimated fair values as of September 30, 2001, and our October 1, 2001 adoption of an accounting pronouncement which prohibits the amortization of unimpaired goodwill.

Lease expense decreased $1.6 million for the three months ended June 30, 2002, to $7.2 million compared to $8.8 million for the same period in the prior year. Of this decrease, approximately $0.6 million is attributed to the divestiture or lease modifications of certain leased eldercare centers. The remaining decrease of approximately $1.0 million is principally attributed to the discharge in bankruptcy of our lease financing facility.

Interest expense decreased $15.7 million for the three months ended June 30, 2002, to $11.2 million compared to $26.9 million for the same period in the prior year. For the three months ended June 30, 2001, in accordance with SOP 90-7, we ceased accruing interest following the Petition Date on certain long-term debt instruments classified as liabilities subject to compromise. Our contractual interest expense for the three months ended June 30, 2001 was $50.8 million, leaving $23.9 million of interest expense unaccrued for that period as a result of the Chapter 11 cases. Interest expense for the three months ended June 30, 2002 has been accrued at the contractual rates. Contractual interest expense for the three months ended June 30, 2002 decreased by $39.6 million compared to the same period in the prior year. This decrease is attributed to the overall reduction of debt levels following our emergence from bankruptcy in addition to a lower weighted average borrowing rate.

In June 2002, we recorded an additional gain of $0.2 million resulting from the award in the HCR Manor Care arbitration. See "Part II: Other Information, Item 1 - Legal Proceedings" herein and in the Company's Annual Report of Form 10-K.

During the three months ended June 30, 2002, we recorded approximately $2.6 million for post confirmation liabilities payable to the United States Trustee related to the Chapter 11 cases that remained open. With the exception of three cases which remain open, all of the Chapter 11 cases were closed subsequent to June 30, 2002. During the same period in the prior year, we recorded legal, bank, accounting and other costs of approximately $10.6 million in connection with the Chapter 11 cases. In addition, we incurred costs of $3.0 million in the three months ended June 30, 2001 for certain bankruptcy related salary and benefit related costs, principally for a court approved special recognition program. Also, we incurred approximately $4.3 million of costs associated with the divestiture of certain businesses.

Minority interest decreased $2.7 million during the three months ended June 30, 2002 to ($0.6) million compared to $2.1 million for the comparable period in the prior year. This decrease is primarily due to the 56.4% interest in the net losses of Multicare attributable to the joint venture partners in the three months ended June 30, 2001. Upon our emergence from bankruptcy, we and Multicare merged, effectively terminating the joint venture and any interest the joint venture partners had in Multicare.

Preferred stock dividends decreased $10.7 million to $0.7 million during the three months ended June 30, 2002 compared to $11.4 million for the comparable period in the prior year. This decrease is attributed to the cancellation of our Predecessor Company preferred stock and related dividends, and offset with dividends on $42.6 million of Series A Redeemable Preferred Stock issued in connection with the Plan. At June 30, 2002, there were 425,946 shares of Series A Redeemable Preferred Stock outstanding.

Losses from discontinued operations increased $0.6 million for the three months ended June 30, 2002, to ($1.4) million from ($0.8) million for the same period in the prior year. On October 1, 2001, we adopted the provisions of Statement of Financial Accounting Standards, No. 144 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" ("SFAS 144"). Under SFAS 144, discontinued businesses or assets held for sale are removed from the results of continuing operations. During the three months ended June 30, 2002, three businesses were identified as discontinued operations. The results of operations in the current year and prior year periods, along with any costs to exit such businesses in the current year period, have been classified as discontinued operations in the accompanying financial statements. Businesses sold or closed prior to our adoption of SFAS 144 continue to be reported in the results of continuing operations.

Nine months ended June 30, 2002 compared to nine months ended June 30, 2001

Inpatient Services

Inpatient services revenue increased $63.1 million, or 6%, to $1,058.0 million for the nine months ended June 30, 2002 from $994.9 million for the same period in the previous year. Approximately $75.2 million is principally attributed to increased payment rates and higher Quality Mix as a percentage of total patient days. Our average rate per patient day for the nine months ended June 30, 2002 was $179 compared to $165 for the comparable period in the prior year. This increase in the average rate per patient day is principally driven by the effect of BIPA on our average Medicare rate per patient day, which increased to $337

for the nine months ended June 30, 2002 compared to $323 for the comparable period in the prior year. As time passes, BIPA will have a diminishing impact on the fiscal year-to-date revenue and rate comparisons since its economic or financial benefit was realized April 1, 2001. Our revenue Quality Mix for the nine months ended June 30, 2002 was 51.4% compared to 51.1% for the comparable period in the prior year. These rate and Quality Mix increases are offset by a decrease in revenue of approximately $12.1 million resulting from eldercare center divestitures. Total patient days decreased 161,686 to 5,961,730 during the nine months ended June 30, 2002 compared to 6,123,416 during the comparable period last year. Of this decrease, 164,462 patient days are attributed to eldercare center divestitures and decreased operating census of 5,579 patient days as the result of a decline in overall occupancy; offset by the addition of 8,355 patient days of two new eldercare centers.

Operating expenses for the nine months ended June 30, 2002 increased $46.0 million, or 5%, to $923.2 million from $877.2 million for the same period in the prior year. The primary cost for this segment is salary, wage and benefit costs, which increased $30.6 million, or 6% for the nine months ended June 30, 2002 to $519.8 million from $489.2 million for the same period in the prior year. This increase includes the reduction of approximately $9.1 million in salary, wage and benefit costs resulting from eldercare center divestitures. Salary, wage and benefit costs, considering the impact of divested eldercare centers, increased $39.7 million, or 8%, driven by inflationary cost increases and the relative mix of employed labor versus agency labor costs. As a percentage of net revenue, salary, wage and benefit costs, once adjusted for the impact of divested eldercare centers, was approximately 49.1% for the nine months ended June 30, 2002 compared to 48.9% for the comparable period in the prior year, despite a disproportionate per diem rate growth, largely created by the effect of BIPA, previously discussed. The inpatient services segment has experienced continued pressure on wage and benefit related costs mitigated by less reliance on agency labor (primarily nursing costs) resulting from improved hiring and retention trends. Other operating expense, once reduced for the impact of divested eldercare centers ($4.1 million for the nine months ended June 30, 2001), increased $19.5 million, or 5%, to $403.4 million for the nine months ended June 30, 2002 compared to $383.9 million for the same period last year. The increase was primarily driven by approximately $10.7 million of additional ancillary supply costs to treat a higher acuity customer base, increased property and general liability insurance of approximately $1.8 million and other operating costs of approximately $7.6 million; offset by decreased agency labor costs (principally nursing costs) of approximately $0.6 million. External labor agencies charge the Company a premium labor rate compared to salary, wage and benefits earned by employees.

Operating income increased $17.2 million, to $134.9 million for nine months ended June 30, 2002 from $117.7 million for the same period in the prior year.

Pharmacy and medical supply services

Pharmacy and medical supply services revenue (before intersegment eliminations) increased $70.5 million, or 8%, to $915.0 million for the nine months ended June 30, 2002 compared to $844.5 million for nine months ended June 30, 2001. Revenues from intersegment customers, which are eliminated in consolidation, increased approximately $6.8 million, or 9%, to $79.6 million for the nine months ended June 30, 2002 compared to $72.8 million for the same period in the prior year. The remaining increase in net pharmacy and medical supply service revenues of approximately $63.7 million, or 8%, is due primarily to rate increases and shifts in customer and product mix with external customers.

Cost of sales (before intersegment eliminations) increased $50.0 million, or 10%, for the nine months ended June 30, 2002, to $576.3 million from $526.3 million for the same period in the prior year. Of this growth, $44.0 million is attributed to pharmacy and medical supply revenue growth, and $6.0 million is attributed to changes in customer and product mix. As a percentage of revenue, cost of sales for the nine months ended June 30, 2002 was 63.0% compared to 62.3% for the comparable period in the prior year. Other operating expenses for this segment, including salaries, wages and benefits, increased $11.4 million, or 5%, to $258.0 million for the nine months ended June 30, 2002 compared to $246.6 million for the same period in the prior year. As a percentage of revenue, other operating costs declined to 28% for nine months ended June 30, 2002 from 29% for the comparable period in the prior year. This decline is attributed to improved cost control and the absorption of fixed costs by the relative level of revenue.

Operating income increased $8.9 million, to $80.4 million for nine months ended June 30, 2002 from $71.5 million for the same period in the prior year.

During the second quarter of fiscal 2002, we borrowed approximately $42 million from the Delayed Draw Term Loan to finance the repayment of all trade balances due to NeighborCare pharmacy's primary supplier of pharmacy products. This change in credit terms resulted in reduced pharmacy product acquisition costs.

All Other

All other includes operating information of business units below the prescribed quantitative thresholds. These business units derive revenues and expenses from the following services: rehabilitation therapy, management services, consulting services, homecare services, physician services, diagnostic services, hospitality services, group purchasing fees, respiratory health services, staffing services and other healthcare related services. Revenues, including intersegment revenues, from these business units decreased approximately $5.0 million to $254.5 million from $259.5 million for nine months ended June 30, 2002 and June 30, 2001, respectively. The decline was primarily caused by less management fee revenue resulting from the post-bankruptcy termination of the Multicare management agreement, offset by growth in other service related businesses' revenue.

Operating income for all other businesses increased $1.5 million, to $34.5 million for nine months ended June 30, 2002 from $33.0 million for the same period in the prior year.

Corporate and other

The "Corporate and other" category consists of our general and administrative function and other unallocated amounts, for which there is generally no revenue generated. Operating expenses increased $21.5 million in the nine months ended June 30, 2002 to $70.0 million compared to $48.5 million in the comparable period in the prior year. Of this increase, $12.6 million relates to severance and related costs incurred in the nine months ended June 30, 2002 related to the resignation of our Chief Executive Officer and our Vice Chairman, approximately $6.4 million is related to increased expense levels for our cash based incentive compensation program and an executive non-cash stock based compensation program, approximately $2.3 million relates to other unallocated employee benefit costs, and the remaining increase of approximately $5.8 million is principally attributed to labor related and other operating expense growth in our corporate support functions. These increases are offset by approximately $2.1 million for a settlement agreement recorded in the nine months ended June 30, 2001 and a $3.5 million charge recognized in the nine months ended in June 30, 2001 in connection with the renegotiation of the pharmacy supply agreement with our principle supplier of pharmacy related products. These negotiations resulted in more beneficial credit terms and improved pricing on certain products.

Capital costs and other
Our capital costs for the nine months ended June 30, 2002 reflect the impact of fresh-start reporting following our emergence from bankruptcy. Those adjustments materially changed the recorded amounts of capital costs, most notably depreciation and amortization, lease expense, interest expense, income taxes, minority interest and preferred stock dividends, and as a result, will not be comparable to those for the nine months ended June 30, 2001.

Depreciation and amortization expense decreased $31.3 million to $48.2 million for the nine months ended June 30, 2002 compared to $79.5 million for the same period in the prior year. The decrease was primarily caused by the impact of fresh-start reporting on the carrying value of our property, plant and equipment, which were adjusted to their estimated fair values as of September 30, 2001, and our October 1, 2001 adoption of an accounting pronouncement which prohibits the amortization of unimpaired goodwill.

Lease expense decreased $6.3 million for the nine months ended June 30, 2002, to $20.7 million compared to $27.0 million for the same period in the prior year. Of this decrease, approximately $1.7 million is attributed to the divestitures or lease modifications of certain leased eldercare centers. The remaining decrease of approximately $4.6 million is principally attributed to the discharge in bankruptcy of our lease financing facility.

Interest expense decreased $55.4 million for the nine months ended June 30, 2002, to $36.9 million compared to $92.3 million for the same period in the prior year. For the nine months ended June 30, 2001, in accordance with SOP 90-7, we ceased accruing interest following the Petition Date on certain long-term debt instruments classified as liabilities subject to compromise. Our contractual interest expense for the nine months ended June 30, 2001 was $167.0 million, leaving $74.7 million of interest expense unaccrued for that period as a result of the Chapter 11 cases. Interest expense for the nine months ended June 30, 2002 has been accrued at the contractual rates. Contractual interest expense for the nine months ended June 30, 2002 decreased by $130.1 million compared to the same period in the prior year. This decrease is attributed to the overall reduction of debt levels following our emergence from bankruptcy in addition to a lower weighted average borrowing rate.

During the nine months ended June 30, 2002, we recorded a net gain of $21.9 million resulting from the award in the Manor Care arbitration. See "Part II: Other Information, Item 1 - Legal Proceedings" herein and in the Company's Annual Report of Form 10-K.

In October 2000, we sold an idle 232 bed eldercare center for cash consideration of approximately $7.0 million, resulting in a net gain on sale of approximately $1.8 million. In April 2001, we sold an operational 121 bed eldercare center for cash consideration of approximately $0.5 million. The sale resulted in a net loss of approximately $2.3 million.

During the nine months ended June 30, 2002, we recorded approximately $2.6 million for post confirmation liabilities payable to the United States Trustee related to Chapter 11 cases that remained open. With the exception of three cases which remain open, all of the Chapter 11 cases were closed subsequent to June 30, 2002. In that same period we recorded a post confirmation charge resulting from a settlement reached with the lender of a pre-petition mortgage obligation for an amount that exceeded the estimated loan value established in the September 30, 2001 fresh-start balance sheet by approximately $1.7 million.

During the nine months ended June 30, 2001, we recorded legal, bank, accounting and other costs of approximately $28.8 million in connection with the Chapter 11 cases. In addition, we incurred costs of $8.9 million in the nine months ended June 30, 2001 for certain bankruptcy related salary and benefit related costs, principally for a court approved special recognition program. Also in that same period, we incurred approximately $4.9 million of costs associated with the divestiture of certain businesses.

Minority interest decreased $9.6 million during the nine months ended June 30, 2002 to a loss of $1.3 million compared to $8.3 million for the comparable period in the prior year. This decrease is primarily due to the 56.4% interest in the net losses of Multicare attributable to the joint venture partners during the nine months ended June 30, 2001. Upon our emergence from bankruptcy, we and Multicare merged, effectively terminating the joint venture and any interest the joint venture partners had in Multicare.

Preferred stock dividends decreased $32.2 million to $1.9 million during the nine months ended June 30, 2002 compared to $34.1 million for the comparable period in the prior year. This decrease is attributed to the cancellation of our Predecessor Company preferred stock and related dividends, and offset with dividends on $42.6 million of Series A Redeemable Preferred Stock issued in connection with the Plan. At June 30, 2002, there were 425,946 shares of Series A Redeemable Preferred Stock outstanding.

Losses from discontinued operations increased $3.3 million for the nine months ended June 30, 2002, to $5.8 million from $2.5 million for the same period in the prior year. During the nine months ended June 30, 2002, we identified seven businesses as discontinued operations. The results of operations in the current year and prior year periods, along with any costs to exit such businesses in the current year period, have been classified as discontinued operations in the attached financial highlights and consolidated statements of operations. Businesses sold or closed prior to our October 1, 2001 adoption of SFAS 144 continue to be reported in the results of continuing operations.

Liquidity and Capital Resources

Working Capital and Cash Flows
At June 30, 2002, we had cash and equivalents of $103.5 million, net working capital of $447.7 million and approximately $149.1 million of unused commitment under our $150 million Revolving Credit Facility.

At June 30, 2002, we had restricted investments in marketable securities of $74.9 million, which are held by Liberty Health Corp. LTD., referred to as LHC, our wholly-owned captive insurance subsidiary incorporated under the laws of Bermuda. The investments held by LHC are restricted by statutory capital requirements in Bermuda. In addition, certain of these investments are pledged as security for letters of credit issued by LHC. As a result of such restrictions and encumbrances, we and LHC are precluded from freely transferring funds through intercompany loans, advances or cash dividends.

Our cash flow from operations before debt restructuring and reorganization costs for the nine months ended June 30, 2002 was a source of cash of $132.3 million compared to a source of cash of $19.1 million for the nine months ended June 30, 2001, principally due to reduced interest and lease payments following our reorganization, improvement in the collection of accounts receivable, receipt of $21.9 million in cash proceeds for an arbitration award and the timing of vendor

payments and employee wages. During the second quarter of fiscal 2002, we borrowed approximately $42 million from the Delayed Draw Term Loan to finance the repayment of all trade balances due to NeighborCare(R) Pharmacy's primary supplier of pharmacy products. This change in credit terms resulted in reduced pharmacy product acquisition costs, partially offset by an increase in interest expense on the incremental Delayed Draw Term Loan borrowings. Assuming no future changes in variable rates of interest, the net impact of this transaction is positive to our cash flows. Cash payments for debt restructuring and reorganization costs were approximately $44.3 million during the nine months ended June 30, 2002 compared to $35.1 million for the same period in the prior year. We believe that cash flow from operations, along with available borrowings under our Revolving Credit Facility, are sufficient to meet our current liquidity needs.

Our days sales outstanding at June 30, 2002 was approximately 53 days compared to approximately 60 days at September 30, 2001. This reduction is principally due to improvement in the collection of accounts receivable.

On January 30, 2002, the Compensation Committee of the Board of Directors approved a cash-based incentive compensation program that provides for awards to eligible employees based upon the achievement of certain specified minimum targets directly related to our consolidated financial performance. The incentive compensation program provides for awards to eligible employees on a graduated basis as actual operating performance exceeds certain minimum financial targets.

Our net cash used for investing activities for the nine months ended June 30, 2002 was $50.7 million, and includes approximately $33.0 million of capital expenditures. Capital expenditures consist primarily of betterments and expansion of eldercare centers and investments in data processing hardware and software. In order to maintain our physical properties in a suitable condition to conduct our business and meet regulatory requirements, we expect to continue to incur capital expenditure costs at levels at or above those for the nine months ended June 30, 2002 for the foreseeable future.

Our investing activities for the nine months ended June 30, 2002 also include: approximately $12.7 million in net investments in restricted investments in marketable securities, representing the current period funding of self insured workers' compensation and general / professional liability insurance retentions held by LHC; and approximately $10.5 million in connection with the exercise of an option to purchase three formerly leased eldercare centers.

Our cash flows from investing activities for the nine months ended June 30, 2001 include approximately $7 million of cash proceeds from the sale of an eldercare center.

Our financing activities for the nine months ended June 30, 2002, resulted in net cash inflows of $34.0 million, and include approximately $80.0 million of cash proceeds from borrowings under the Delayed Draw Term Loan, of which, $10.0 million were used to finance the price of the purchase option previously described, and $28.0 million was used to refinance several mortgages at more favorable rates of interest. The Delayed Draw Term Loan was amended in December 2001 to allow $42.0 million of available credit under that loan to be used to restructure credit terms with NeighborCare(R) pharmacy's primary supplier of pharmacy products, as previously discussed. The Delayed Draw Term Loan is fully drawn at June 30, 2002 and is being repaid with no additional borrowings

available under the Delayed Draw Term Loan.

In June 2002, the Senior Credit Facility was amended in order to extend the date by which we are required to achieve certain levels of fixed versus variable interest rate exposure. As amended, by September 30, 2002, we are required to either enter into interest rate swap agreements that effectively fix or cap the interest cost on at least 50% of its consolidated debt or refinance such debt to achieve a mix of fixed rate debt of at least 50%. At June 30, 2002, our debt mix is approximately 12% fixed-rate and 88% variable-rate.

For the nine months ended June 30, 2002, we incurred approximately $20.7 million of lease obligation costs and expect to continue to incur lease costs at or above levels approximating those for the nine months ended June 30, 2002 for the foreseeable future.

We believe that we have adequate capital resources at our disposal to fund currently anticipated capital expenditures as well as current and projected debt service requirements.

Strategic Objectives

We are focusing our efforts on the following strategic objectives in order to improve overall operating performance and efficiency:

- evaluate and reduce corporate overhead;
- implement pharmacy and medical supply segment margin expansion plans;

- pursue operational efficiencies in the inpatient services segment;
- retain a permanent Chief Executive Officer;
- pursue selective acquisitions; and
- evaluate and rationalize under-performing assets and business lines.

Our plan to evaluate and reduce corporate overhead will result in the elimination of certain duplicative and non-critical positions. We expect to implement this plan in the fourth fiscal quarter of 2002.

The primary elements of our pharmacy and medical supply segment margin expansion plans include reducing product acquisition costs, improving labor utilization, evaluating segment specific overhead costs and improving credit administration.

The primary elements of our inpatient services segment operational efficiency improvements include a continued focus on increasing quality payor mix, improving labor utilization, consolidating key business processes and better leveraging our existing infrastructure within core markets to improve occupancy.

We have engaged an outside executive search firm to identify and recruit a permanent Chief Executive Officer.

We continue to critically evaluate selective acquisitions, particularly pharmacy and other health service related businesses. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Certain Transactions and Events - NCS Transaction".

In the normal course of business, we continually evaluate the performance of our operating units, with an emphasis on selling or closing under-performing or non-strategic assets.

There can be no assurances that we will be successful in implementing any of our strategic objectives. Nor can there be any assurances that, if implemented, such objectives will achieve desired results.

NCS Transaction

At the closing of the NCS transaction, we will repay in full the outstanding debt of NCS which includes $206 million of senior debt, and will redeem $102 million of 5.75% convertible subordinated debentures, including any accrued and unpaid interest. In total, the NCS transaction purchase price is estimated at $340 million, net of the application of approximately $20 million in excess cash at NCS.

We intend to finance the cash portion of the purchase price with existing cash on hand, and through an expansion of an existing senior credit facility.

Financial Commitments

Requests for providing commitments to extend financial guarantees and extend credit are reviewed and approved by senior management. Management regularly reviews all outstanding commitments, letters of credit and financial guarantees, and the results of these reviews are considered in assessing the need for any reserves for possible credit and guarantee loss.

We have posted $1.9 million of outstanding letters of credit. The letters of credit guarantee performance to third parties of various trade activities. The letters of credit are not recorded as liabilities on our balance sheet unless they are utilized by the third party. The financial risk approximates the amount of outstanding letters of credit.

We have extended approximately $7.4 million in working capital lines of credit to certain jointly owned and managed companies, of which $5.0 million were unused at June 30, 2002. Credit risk represents the accounting loss that would be recognized at the reporting date if the affiliate companies were deemed unable to repay any amounts utilized under the working capital lines of credit. Commitments to extend credit to third parties are conditional agreements generally having fixed expiration or termination dates and specific interest rates and purposes.

We are a party to joint venture partnerships whereby our ownership interests are less than 50% of the total capital of the partnerships. We account for these partnerships using the equity method of accounting and, therefore, the assets, liabilities and operating results of these partnerships are not consolidated with ours. Although we are not contractually obligated to fund operating losses of these partnerships, in certain cases, we have extended credit to such joint venture partnerships in the past and may decide to do so in the future in order to realize economic benefits from our joint venture relationship. Management assesses the creditworthiness of such partnerships in the same manner it does other third-parties. We have provided $10.9 million of financial guarantees related to loan commitments of four jointly owned and managed companies. We have also provided $11.1 million of financial guarantees related to lease obligations of one jointly-owned and managed company. The guarantees are not recorded as liabilities on our balance sheet unless we are required to perform under the guarantee. Credit risk represents the accounting loss that would be recognized at the reporting date if counter-parties failed to perform completely as contracted. The credit risk amounts are equal to the contractual amounts, assuming that the amounts are fully advanced and that no amounts could be

recovered from other parties.

Warrants

In connection with our Reorganization, we issued warrants to purchase 4,559,475 shares of new common stock. This represents approximately 11% of the new common stock issued on the Effective Date. The warrants expire on October 2, 2002 and have an exercise price of $20.33 per share of new common stock.

Income Taxes

Our income tax for the three and nine months ended June 30, 2002 was a benefit of $4.2 million and an expense of $25.4 million, respectively. This provision includes a $10.3 million reduction to tax expense realized in the third quarter 2002 resulting from the Job Creation and Worker Assistance Act of 2002 which extended the net operating loss carryback period.

The Company realizes tax benefits through the realization of Net Operating Loss ("NOL") carryforwards. Pursuant to SOP 90-7, the income tax benefits of any future realization of the NOL carryforwards are applied first as a reduction to goodwill.

Revenue Sources

We receive revenues from Medicare, Medicaid, private insurance, self-pay residents, other third party payors and long-term care facilities which utilize our pharmacy and other specialty medical services. The healthcare industry is experiencing the effects of the federal and state governments' trend toward cost containment, as government and other third party payors seek to impose lower reimbursement and utilization rates and negotiate reduced payment schedules with providers. These cost containment measures, combined with the increasing influence of managed care payors and competition for patients, have resulted in reduced rates of reimbursement for services provided by us. We receive approximately 61% of our customer service revenues from Medicare and Medicaid. See "Part I: Item 1 - Business - Revenue Sources" herein and in the Company's Annual Report on Form 10-K.

A number of the provisions of the Balanced Budget Act and the Benefits Improvement Protection Act enactments providing additional funding for Medicare participating skilled nursing facilities expire on September 30, 2002. Expiring provisions are estimated to, on average, reduce per beneficiary per diems by $34. On April 23, 2002, the Centers for Medicare and Medicaid Services ("CMS") issued a press statement announcing that the agency would not proceed with its previously announced changes in the skilled nursing facility case-mix classification system. In its announcement, CMS made it clear that case-mix refinements would be postponed for a full year. CMS issued notice of fiscal year 2003 rates in the Federal Register, July 31, 2002. Rates effective October 1, 2002 will be increased by a 2.6% annual market basket adjustment. CMS estimates that even with this upward adjustment, average rates will be 8.8% lower than the current year because of the reduced payment caused by the expiring statutory add-ons.

The House of Representatives passed a package of Medicare amendments in late June, 2002. Under the House-passed measure, portions of the expiring provisions would be retained. The BBRA increase of 4% would expire, and the BIPA 16.6% add-on to the nursing portion of the SNF PPS rates would be reduced to 12% in 2003, 10% in 2004, and 8% in 2005. Under this proposal fiscal year 2003 rates would be 5.2% lower than the current year. The Senate is expected to consider Medicare provider relief during September. Details of the Senate leadership

proposal have not been released. It is premature to forecast the outcome of Congressional action.

The Company's estimate of the impact of the "SNF Medicare Cliff ", factoring in the administrative decision not to proceed with changes in the case mix refinements at this time and without factoring in any additional Congressional action, exposes the skilled nursing facility sector to a 10% reduction. For the Company, this could have an adverse revenue impact exceeding $35 million annually. The Company is very involved with trade organizations representing the skilled nursing facility sector in aggressively pursing strategies to minimize the potentially adverse impact.

There may be additional provisions in the Medicare legislation affecting our other businesses. Congress is expected to consider changes affecting pharmacy, rehabilitation therapy, diagnostic services and the payment for services in other health settings.

It is not possible to fully quantify the effect of recent legislation, the interpretation or administration of such legislation or any other governmental initiatives on our business. Accordingly, there can be no assurance that the impact of these changes or any future healthcare legislation will not adversely affect our business. There can be no assurance that payments under governmental and private third party payor programs will be timely, will remain at levels comparable to present levels or will, in the future, be sufficient to cover the costs allocable to patients eligible for reimbursement pursuant to such programs. Our financial condition and results of operations may be affected by the reimbursement process, which in our industry is complex and can involve lengthy delays between the time that revenue is recognized and the time that reimbursement amounts are settled.

Certain service contracts permit our NeighborCare(R) pharmacy operations to provide services to HCR Manor Care, Inc. generating approximately $120 million, or ten percent and five percent of the net annual revenues, of NeighborCareand Genesis, respectively. These service contracts with HCR Manor Care are the subject of certain litigation.

New Accounting Pronouncements
In April 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 145, "Recission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections" ("SFAS 145"). SFAS 145 is effective for fiscal years beginning after May 15, 2002 for provisions related to SFAS No. 4, effective for all transactions occurring after May 15, 2002 for provisions related to SFAS No. 13 and effective for all financial statements issued on or after May 15, 2002 for all other provisions of SFAS 145. We have not determined the impact the adoption of SFAS 145 will have on our results from operations.

In July 2002, the FASB issued SFAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS No. 146"). SFAS No. 146 addresses significant issues regarding the recognition, measurement, and reporting of costs associated with exit and disposal activities, including restructuring activities. SFAS No. 146 also addresses recognition of certain costs related to terminating a contract that is not a capital lease, costs to consolidate facilities or relocate employees, and termination benefits provided to employees that are involuntarily terminated under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred compensation contract. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002.

Other
We manage the operations of 70 eldercare centers. Under a majority of these arrangements, we employ the operational staff of the managed business for ease of benefit administration and bill the related wage and benefit costs on a dollar-for-dollar basis to the owner of the managed property. In this capacity, we operate as an agent on behalf of the managed property owner and are not the primary obligor in the context of a traditional employee / employer relationship. Historically, we have treated these transactions on a "net basis", thereby not reflecting the billed labor and benefit costs as a component of our net revenue or expenses. For the three and nine months ended June 30, 2002, we billed our managed clients approximately $33.2 million and $108.4 million, respectively for such labor related costs.

Seasonality
Our earnings generally fluctuate from quarter to quarter. This seasonality is related to a combination of factors, which include the timing of Medicaid rate increases, seasonal census cycles, and the number of calendar days in a given quarter.

Item 3. Quantitative and Qualitative Disclosures about Market Risk
We are exposed to the impact of interest rate changes. In the past, we employed established policies and procedures to manage our exposure to changes in interest rates. Our objective in managing exposure to interest rate changes is to limit the impact of such changes on earnings and cash flows and to lower our overall borrowing costs. To achieve our objective, we have historically used interest rate swap agreements to manage net exposure to interest rate changes related to our portfolio of borrowings. As of June 30, 2002, no interest rate swap agreements were in place.

In June 2002, the Senior Credit Facility was amended in order to extend the date by which we are required to achieve certain levels of fixed versus variable interest rate exposure. As amended, by September 30, 2002, we are required to either enter into interest rate swap agreements that effectively fix or cap the interest cost on at least 50% of its consolidated debt or refinance such debt to achieve a mix of fixed rate debt of at least 50%. At June 30, 2002, our debt mix is approximately 12% fixed and 88% variable.

At June 30, 2002, we had $604.3 million of debt subject to variable market rates of interest. For each additional percentage point increase in the LIBOR, we will incur additional interest expense of approximately $6.0 million annually.

PART II: OTHER INFORMATION

Item 1. Legal Proceedings

NeighborCare Pharmacy Services, Inc. v. HCR Manor Care, Inc., Manor Care, Inc. and ManorCare Health Services, Inc.

On May 7, 1999, our wholly-owned subsidiary, NeighborCare, filed a demand for arbitration under the commercial arbitration rules of the American Arbitration Association against HCR Manor Care, Inc., Manor Care, Inc. and ManorCare Health Services, Inc, collectively referred to as the respondents. The AAA arbitration principally concerns two long-term master service agreements between NeighborCare and ManorCare Health Services, Inc. Pursuant to one of these agreements, referred to as the master pharmacy agreement, NeighborCare provides pharmacy services to long-term care facilities owned or operated by Manor Care. Pursuant to the other agreement, referred to as the master infusion therapy agreement, NeighborCare provides infusion therapy products and services to Manor Care long-term care facilities.

In the AAA arbitration, NeighborCare sought injunctive relief and compensatory damages in connection with

- respondents' attempt to terminate the master service agreements, and
- respondents' failure to provide NeighborCare with the right to serve as the preferred provider of pharmacy and infusion therapy services to all Manor Care long-term care facilities pursuant to the master service agreements.

Respondents filed counterclaims requesting declaratory relief approving the purported termination of the master service agreements, as well as counterclaims seeking compensatory damages in connection with alleged overcharges under the two agreements.

The arbitrator, on May 17, 2000, declined to dismiss NeighborCare's claims for money damages for breach of its contractual right to serve as the preferred provider to all Manor Care long-term care facilities. However, the arbitrator did dismiss, without prejudice, NeighborCare's claim for specific performance of that right.

On June 15, 2000, in anticipation of our possible bankruptcy filing, the arbitrator stayed the AAA arbitration. In connection with this stay, the parties agreed that respondents may pay NeighborCare 90% of the face amount of all invoices for pharmaceutical and infusion therapy goods and services that NeighborCare renders to respondents under the master service agreements. The parties agreed, however, that respondents must continue to pay NeighborCare the full face amount of all invoices for pharmacy consulting services under the master service agreements.

On February 14, 2002, the arbitrator ruled in favor of NeighborCare. The arbitrator found that Manor Care did not lawfully terminate its service contracts with NeighborCare. As a result, the contracts between NeighborCare and Manor Care, which expire in October 2004, remain in full force until that time. The arbitrator also determined that NeighborCare had the right to damages because it was not offered the opportunity to service facilities owned and operated by Healthcare & Retirement Corporation of America, Inc., which was deemed to be an affiliate of Manor Care under the contract. The arbitrator awarded us $23.4 million, plus pre-judgment interest, in compensatory damages. In addition, the arbitrator terminated his prior ruling that allowed Manor Care to withhold 10% of the payments owed to NeighborCare and Manor Care paid us an additional $8.8 million in funds representing the amounts withheld during the course of the AAA arbitration pursuant to the arbitrator's prior ruling.

In response to post-decision motions filed by NeighborCare and by respondents, the Arbitrator recalculated NeighborCare's damages, reducing them by approximately $2 million, and ruled that NeighborCare is not obligated, as a result of certain past events, to renegotiate the prices it offers to respondents for pharmacy and infusion therapy products and services.

Genesis Health Ventures, Inc. v. HCR Manor Care, Inc., Manor Care, Inc., Paul A. Ormond, and Stewart Bainum, Jr.

On May 7, 1999, we filed an action in the United States District Court for the District of Delaware against HCR Manor Care, Inc., Manor Care, Inc., Paul A. Ormond, and Stewart Bainum, Jr. In this action, we seek compensatory and punitive damages exceeding $2 million for federal securities fraud, common-law fraud, negligent misrepresentation and controlling person liability in connection with material misrepresentations and omissions made by defendants during the course of our acquisition of Vitalink. We further seek injunctive relief with respect to Manor Care's failure to dispose of its ownership interests in Heartland Healthcare Services, a competitor of NeighborCare, pursuant to a non-competition provision found in a side agreement between Genesis, Vitalink and Manor Care.

Defendants filed a motion to dismiss or stay this action pending the resolution of the AAA arbitration. On March 22, 2000, the Court denied the defendants' motion to dismiss, but granted the motion to stay the case pending resolution of the AAA arbitration.

Manor Care, Inc. v. Genesis Health Ventures, Inc.

On August 17, 1999, Manor Care filed a lawsuit in the United States District Court for the District of Delaware against us. In this action, plaintiff brings claims under the federal securities laws resulting from alleged misrepresentations and omissions made by us in connection with Manor Care's acquisition of our series G preferred stock as compensation for its sale of Vitalink to us. Plaintiff seeks compensatory damages of unspecified amount, rescission of Manor Care's purchase of the series G preferred stock, and the return of the consideration paid by Manor Care at the time of our acquisition of Vitalink from Manor Care.

We filed a motion to dismiss this action. On September 29, 2000, the Court granted that motion in part and denied it in part. Specifically, the Court dismissed plaintiff's allegations regarding purportedly fraudulent statements concerning: our knowledge as to certain legislative changes to the Medicare program; the effect of our affiliate Multicare on our earnings; our intent with respect to the issuance of preferred stock; and our ability to declare dividends on the series G preferred stock. Accordingly, the only allegations that were not dismissed from this action concern our alleged failure to include certain financial information in the registration statement we filed in connection with its acquisition of Vitalink, and allegedly fraudulent statements concerning our labor relations. Our motion to consolidate this action with the action Genesis Health Ventures Inc. v. HCR Manor Care, Inc., Manor Care, Inc., Paul A. Ormond, and Stewart Bainum, Jr., described above, has been denied.

On October 22, 2001, plaintiff filed a motion to reconsider the Court's decision to dismiss this action in part, and we filed our opposition to that motion. On December 5, 2001, we filed a motion to dismiss the entire action pursuant to our Joint Plan of Reorganization and the Bankruptcy Court's order confirming that reorganization plan, which extinguish plaintiff's claims against us except to the extent that those claims may be applied as set-off or recoupment against claims brought by us. (As discussed below, the defendants repled the claims in this action as affirmative defenses of set-off or recoupment against the claims we have filed in Genesis Health Ventures, Inc. v. HCR Manor Care, Inc., Civil

Action No. 99-287 (D. Del.).)

The parties have completed briefing on defendants' motion for reconsideration and Genesis' motion to dismiss, and the parties await the Court's decision as to whether oral argument on these motions will be held.

See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Certain Transactions and Events - NCS Transaction" for a discussion of the lawsuits filed by Omnicare, Inc. and Dolphin Limited Partnership I, L.P.

38

Item 2. Changes in Securities and Use of Proceeds - None

Item 3. Defaults Upon Senior Securities - None

Item 4. Submission of Matters to a Vote of Security Holders - None

Item 5. Other Information - None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

10.1 Amendment No. 2, dated as of June 28, 2002, to the Credit, Security, Guaranty and Pledge Agreement dated as of October 2, 2001

(b) Reports on Form 8-K

On July 1, 2002, the Company filed a Report on Form 8-K announcing that Michael R. Walker resigned as Chief Executive Officer of the Company and David C. Barr resigned as our Vice Chairman.

On July 29, 2002, the Company filed a Report on Form 8-K reporting that the Company and a subsidiary of the Company, Geneva Sub, Inc. entered into a definitive agreement and plan of merger with NCS Healthcare Inc. (NCS), whereby NCS will become a wholly-owned subsidiary of the Company.

On August 14, 2002, the Company filed a Report on Form 8-K disclosing the filing of their officers' certifications of certain of the Company's previously filed reports and its Report on Form 10-Q filed on August 14, 2002.

39

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 thereto duly authorized.

GENESIS HEALTH VENTURES, INC.

Date: August 14, 2002

/s/ George V. Hager, Jr.

George V. Hager, Jr.
Executive Vice President and Chief
Financial Officer