NEIGHBORCARE INC
Form 10-Q
August 11, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2004

or

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

For the transition period from to

Commission File Number: 000-33217

NEIGHBORCARE, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	**06-1132947** (I.R.S. Employer Identification No.)
601 East Pratt Street, 3rd Floor **Baltimore, Maryland** (Address of principal executive offices)	**21202** (Zip code)

(410) 528-7300
(Registrant s telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES ý NO o

Indicate by check mark whether the registrant is an accelerated filer (as defined by Rule 12b-2 of the Act).

YES ý NO o

As of August 12, 2004, 43,964,464 shares of the registrant s common stock were outstanding and 259,612 shares are to be issued in connection with the registrant s joint plan of reorganization confirmed by the Bankruptcy Court on September 20, 2001.

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS.

Indicate by check mark whether the registrant has filed all documents and 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 ý NO o

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

As used herein, unless the context otherwise requires, NeighborCare, the Company, we, our or us refers to NeighborCare, Inc. and our 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, and the notes to our unaudited condensed consolidated financial statements, such as our ability to meet our liquidity needs, scheduled debt and interest payments, and expected future capital expenditure requirements; the expected effects of government regulation on our business including the Medicare Prescription Drug, Improvement and Modernization Act of 2003; our ability to successfully implement our strategic objectives, including the effects of the spin-off of Genesis Healthcare Corporation (GHC) and the achievement of certain performance improvement initiatives within our institutional pharmacy segment, in order to improve current pharmacy profitability; costs associated with an unsolicited offer to acquire the Company; estimates in our significant accounting policies, including our allowance for doubtful accounts and the anticipated impact of long-lived asset impairments;

certain statements in Quantitative and Qualitative Disclosures About Market Risk; 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:

our ability, and the ability of our customers, to comply with Medicare or Medicaid reimbursement regulations or other applicable laws;

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 impact of federal and state regulations;

the impact of investigations and audits relating to alleged violations of federal and/or state regulations;

changes in the acuity of patients, payor mix and payment methodologies;

our ability, and the ability of our subsidiary guarantors, to fulfill debt obligations;

the ability of GHC, as our largest customer, to operate as a separate entity;

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

competition in our businesses;

the impact of Omnicare, Inc. s unsolicited tender offer to acquire all of our outstanding common stock;

the effect of the expiration or termination of certain service and supply contracts;

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

competition for qualified management and pharmacy professionals;

our ability to control operating costs and generate sufficient cash flow to meet operational and financial requirements;

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

the impact of our reliance on one supplier to provide a significant portion of our pharmacy products;

the impact of future acquisitions on our operations;

availability of financial and other resources to us after the spin-off of GHC;

federal income tax liabilities and indemnification obligations related to the spin-off of GHC;

conflicts of interest as a result of our continuing relationship with GHC after the spin-off;

the ability to implement and achieve certain strategic objectives; and

acts of God or public authorities, war, civil unrest, terrorism, fire, floods, earthquakes and other matters beyond our control.

Certain of these risks are described in more detail in our Annual Report on Form 10-K for the fiscal year ended September 30, 2003, as reclassified in the Company s Current Report on Form 8-K filed with the Securities and Exchange Commission on May 3, 2004.

In addition to these factors and any risks and uncertainties specifically identified in the text surrounding forward-looking statements, any statements in this report or the reports and other documents filed by us with the SEC that warn of risks or uncertainties associated with future results, events or circumstances also identify factors that could cause actual results to differ materially from those expressed in or implied by the forward-looking statements.

All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. We do not undertake any obligation to release publicly any revisions to these forward-looking statements to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events, except as may be required under applicable securities law.

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

NEIGHBORCARE, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

(unaudited)

	June 30, 2004	September 30, 2003
ASSETS		
Current assets		
Cash and cash equivalents	$ 70,144	$ 132,726
Restricted investments in marketable securities		29,320
Accounts receivable, net of allowance of $12.8 million and $48.6 million, respectively	225,480	366,886
Inventories	66,170	66,747
Prepaid expenses and other current assets	36,355	89,918
Total current assets	398,149	685,597
Property, plant and equipment, net	80,251	751,996
Restricted investments in marketable securities		61,271
Notes receivable and other investments		19,252
Other long-term assets	21,272	62,052
Identifiable intangible assets, net	13,852	20,866
Goodwill	356,776	337,695
Total assets	$ 870,300	$ 1,938,729
LIABILITIES and SHAREHOLDERS EQUITY		
Current liabilities		
Current portion of long-term debt	$ 4,275	$ 20,135
Accounts payable and accrued expenses	106,430	214,689
Income taxes payable		4,116
Total current liabilities	110,705	238,940
Long-term debt	258,921	591,484
Other long-term liabilities	31,742	134,952
Total liabilities	401,368	965,376
Minority interest	9,596	10,359
Redeemable preferred stock		46,831
SHAREHOLDERS EQUITY	459,336	916,163
Total liabilities and shareholders equity	$ 870,300	$ 1,938,729

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

NEIGHBORCARE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME (LOSS)

(unaudited, in thousands except per share amounts)

	Three Months Ended June 30, 2004		Three Months Ended June 30, 2003	
Net revenues	$	371,094	$	318,886
Cost of revenues		294,061		246,360
Gross profit		77,033		72,526
Selling, general and administrative		48,807		54,600
Depreciation and amortization		7,107		7,785
Strategic planning, severance and other operating items		792		11,474
Takeover defense expenses		16,751		
Operating income (loss)		3,576		(1,333)
Interest expense, net		4,492		3,419
Other expense		1,137		1,151
Loss before income tax provision (benefit)		(2,053)		(5,903)
Income tax provision (benefit)		4,720		(11,851)
Income (loss) from continuing operations		(6,773)		5,948
Income from discontinued operations, net of taxes				1,184
Net income (loss)		(6,773)		7,132
Preferred stock dividends				660
Net income (loss) available to common shareholders	$	(6,773)	$	6,472
Other comprehensive income:				
Unrealized gain on marketable securities				240
Fair value change of derivative instruments, net				(1,869)
Comprehensive income (loss)	$	(6,773)	$	4,843
Per common share data				
Basic				
Income (loss) from continuing operations	$	(0.16)	$	0.13
Income from discontinued operations	$		$	0.03
Net income (loss) available to common shareholders	$	(0.16)	$	0.16
Weighted average shares outstanding		43,682		40,097
Diluted				
Income (loss) from continuing operations	$	(0.16)	$	0.13
Income from discontinued operations	$		$	0.03
Net income (loss) available to common shareholders	$	(0.16)	$	0.16
Weighted average shares outstanding		43,682		40,097

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

NEIGHBORCARE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME (LOSS)

(unaudited, in thousands except per share amounts)

	Nine Months Ended June 30, 2004		Nine Months Ended June 30, 2003	
Net revenues	$	1,066,134	$	920,924
Cost of revenues		838,317		710,817
Gross profit		227,817		210,107
Selling, general and administrative		145,286		163,507
Depreciation and amortization		19,263		23,048
Strategic planning, severance and other operating items		43,494		9,603
Takeover defense expenses		16,751		
Operating income		3,023		13,949
Interest expense, net		14,699		10,636
Other expense		3,454		3,281
Income (loss) before income tax benefit		(15,130)		32
Income tax benefit		(2,423)		(4,404)
Income (loss) from continuing operations		(12,707)		4,436
Income from discontinued operations, net of taxes		8,435		20,646
Net income (loss)		(4,272)		25,082
Preferred stock dividends				2,009
Net income (loss) available to common shareholders	$	(4,272)	$	23,073
Other comprehensive income (loss):				
Unrealized gain on marketable securities				211
Fair value change of derivative instruments, net				(3,430)
Comprehensive income (loss)	$	(4,272)	$	19,854
Per common share data				
Basic				
Income (loss) from continuing operations	$	(0.30)	$	0.06
Income from discontinued operations	$	0.20	$	0.50
Net income (loss) available to common shareholders	$	(0.10)	$	0.56
Weighted average shares outstanding		42,565		41,135
Diluted				
Income (loss) from continuing operations	$	(0.30)	$	0.06
Income from discontinued operations	$	0.20	$	0.50
Net income (loss) available to common shareholders	$	(0.10)	$	0.56
Weighted average shares outstanding		42,565		41,135

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

NEIGHBORCARE, INC

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, in thousands)

	Nine Months Ended June 30, 2004		Nine Months Ended June 30, 2003	
Cash flows from operating activities				
Net income (loss) available to common shareholders	$	(4,271)	$	23,073
Net charges included in operations not requiring funds		40,408		106,836
Changes in operating assets and liabilities				
Change in accounts receivable, net		(52,884)		(23,835)
Change in accounts payable and accrued expenses		81,785		(16,606)
Cash paid for debt restructuring costs				(1,677)
Other, net		(21,723)		(6,673)
Net cash provided by operating activities		43,315		81,118
Cash flows from investing activities				
Capital expenditures		(21,866)		(42,496)
Business acquisitions, net of cash acquired		(26,309)		
Other, net		(33,432)		50,258
Net cash (used in) provided by investing activities		(81,607)		7,762
Cash flows from financing activities				
Distributions of cash to GHC		(72,161)		
Funds received from GHC for debt financing		353,001		
Repayment of long-term debt		(557,918)		(66,617)
Proceeds from issuance of long-term debt, net of debt issuance costs		240,804		
Repurchase of common stock				(36,207)
Other		11,984		
Net cash used in financing activities		(24,290)		(102,824)
Net decrease in cash and cash equivalents		(62,582)		(13,944)
Cash and cash equivalents at beginning of period		132,726		148,030
Cash and cash equivalents at end of period	$	70,144	$	134,086
Non-cash investing and financing activities				
Distribution of net assets to GHC		(437,157)		
Conversion of preferred stock to common stock		(46,831)		

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

NeighborCare, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

1. Background and Basis of Presentation

NeighborCare, Inc. (formerly named Genesis Health Ventures, Inc.) was incorporated in May 1985 as a Pennsylvania corporation. As used herein, unless the context otherwise requires, NeighborCare, or the Company, we, our or us refers to NeighborCare, Inc. and its subsidiaries.

NeighborCare is the third largest provider of institutional pharmacy services in the United States. As of June 30, 2004, NeighborCare provided pharmacy services for approximately 263,000 beds in long-term care facilities in 32 states and the District of Columbia. The Company s pharmacy operations consist of 66 institutional pharmacies (five are jointly-owned), 32 community-based professional retail pharmacies (two are jointly-owned) and 20 on-site pharmacies which are located in customers facilities and serve only customers of that facility. In addition, NeighborCare operates 16 home infusion, respiratory and medical equipment distribution centers (four are jointly-owned). Jointly-owned facilities and the operations conducted therein are part of joint ventures which are owned by NeighborCare and at least one other unaffiliated party.

On December 1, 2003, the Company completed the distribution (the spin-off) of the common stock of Genesis Healthcare Corporation (GHC), previously reported as the inpatient services division of the Company. On December 2, 2003, the Company changed its name to NeighborCare, Inc. The spin-off was effected by way of a pro-rata tax free distribution of the common stock of GHC to holders of NeighborCare s common stock on December 1, 2003 at a rate of 0.5 shares of GHC stock for each share of NeighborCare, Inc. common stock owned as of October 15, 2003.

In general, pursuant to the terms of the separation and distribution agreement between NeighborCare and GHC, all assets of the inpatient services business prior to the date of the spin-off became assets of GHC. The separation and distribution agreement also provides for assumptions of liabilities and cross-indemnities arising out of or in connection with the inpatient services business to GHC and all liabilities arising out of or in connection with the pharmacy services business to NeighborCare. In addition, GHC will indemnify NeighborCare for liabilities relating to the past inpatient services business. As a result of the spin-off, the Company s consolidated financial statements have been reclassified to reflect GHC as discontinued operations in the condensed consolidated statements of operations for all periods presented.

On November 4, 2003, in anticipation of the spin-off, the Company refinanced all of its remaining long-term debt through the issuance of $250 million aggregate principal amount of its 6.875% senior subordinated notes due 2013 and through proceeds received from GHC in accordance with its issuance in October 2003 of $225 million aggregate principal amount of 8% senior subordinated notes due 2013.

In order to facilitate the transition to two separate publicly traded companies, NeighborCare and GHC have entered into certain agreements that, among other things, will govern the ongoing relationship between NeighborCare and GHC. These agreements include a tax sharing agreement, a transition services agreement, a pharmacy services agreement, a Tidewater membership agreement, employee benefit and pharmacy management agreements, and a master agreement for specialty beds and oxygen concentrators. See Management s Discussion and Analysis of Financial Condition and Results of Operations Certain Transactions and Events Agreements with GHC for more detail regarding the Company s agreements with GHC.

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 NeighborCare s management, the unaudited condensed consolidated financial statements include all necessary adjustments consisting of normal recurring accruals and adjustments for a fair presentation of the financial position and results of operations for the periods presented. Certain reclassifications have been made to the prior year s financial statements to conform to the current year s presentation.

For further information, refer to the audited consolidated financial statements and notes included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2003, as reclassified in the Company s Current Report on Form 8-K filed with the Securities and Exchange Commission on May 3, 2004.

2. Significant Accounting Policies

Management s Use of Estimates

An accounting policy is considered to be significant if it is important to the Company s financial condition and results of operations, and requires significant judgment and estimates on the part of management in its application. Significant accounting estimates and the related assumptions are evaluated periodically as conditions warrant, and changes to such estimates are recorded as new information or changed conditions require revision. Application of certain accounting policies requires management s significant judgments, often as the result of the need to make estimates of matters that are inherently uncertain. If actual results were to differ materially from the estimates made, the reported results could be materially affected. The following represent significant accounting policies requiring the use of estimates:

Allowance for Doubtful Accounts;

Inventories, Including Vendor Rebates;

Revenue Recognition / Contractual Allowances; and

Valuation of Long-Lived Assets.

Senior management has reviewed these significant accounting policies and estimates with the Company s audit committee. During the current quarter, there were no material changes made to the estimates or methods by which estimates are derived with regard to the significant accounting policies of the Company. See Management s Discussion and Analysis of Financial Condition and Results of Operations Significant Accounting Policies for more detail regarding the Company s significant accounting policies.

Cost of Revenues

Costs of revenues include the net product costs of pharmaceuticals sold and direct charges attributable to providing revenue-generating services. This presentation is applicable to NeighborCare, Inc. as all of the revenues generated from operations are derived from pharmacy services. This presentation was not applicable in prior periods as the revenues from operations were inclusive of both pharmacy and inpatient services and a gross profit presentation was not indicative of the Company s gross margin. As such, prior periods have been reclassified to reflect this presentation.

Stock Option Accounting

In December 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS 148). SFAS 148 amends the transition and disclosure requirements of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123). As permitted by SFAS 148, the Company applies the intrinsic value method as defined in APB Opinion No. 25, *Accounting for Stock Issued to Employees*, in accounting for its stock option and restricted stock plans. The intrinsic value of the restricted stock awards granted during fiscal 2004 is equal to the fair value as defined by SFAS 123, therefore, there is no pro forma impact to the financial statements. Had the Company determined compensation cost of outstanding stock options based on the fair value at the grant date consistent with the provisions of SFAS 123, the Company s net income (loss) would have been changed to the pro forma amounts indicated below (in thousands):

	Three months ended		Nine months ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Net income (loss) available to common shareholders-as reported	$ (6,773)	$ 6,472	$ (4,272)	$ 23,072
Add stock-based compensation expense included in net income (loss) as reported, net of tax effect	271		485	
Deduct stock-based compensation expense determined under the fair-value-based method for all awards, net of tax effect	(626)	(1,260)	(4,471)	(2,463)
Net income (loss) available to common shareholders-pro forma	$ (7,128)	$ 5,212	$ (8,258)	$ 20,609
Earnings per share:				
Basic as reported	$ (0.16)	$ 0.16	$ (0.10)	$ 0.56
Basic pro forma	(0.16)	0.13	(0.19)	0.50
Diluted as reported	(0.16)	0.16	(0.10)	0.56
Diluted pro forma	(0.16)	0.13	(0.19)	0.50

At June 30, 2004, 2,281,904 options to purchase NeighborCare common stock were outstanding with exercise prices ranging from $10.73 to $21.50. Of the outstanding options, 1,259,796 are vested and fully exercisable and 1,022,108 remain unvested at June 30, 2004. The fair value of stock options granted during the three and nine month periods ended June 30, 2004 and 2003, respectively, is estimated at the grant date using the Black-Scholes option-pricing model with the following assumptions for 2004 and 2003:

	Three months ended		Nine months ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Volatility	120.66%	25.61%	80.75%	41.83%
Expected life (in years)	5	3.3	5	3.3
Rate of return	3.1%	2.54%	3.1%	2.54%
Dividend yield	0%	0%	0%	0%

3. Discontinued Operations

Effective December 1, 2003, NeighborCare completed its plan of disposition for GHC through a distribution of GHC common stock to NeighborCare s shareholders of record as of October 15, 2003 in the form of a tax-free spin-off as described in Note 1.

In the normal course of business, NeighborCare evaluates the performance of its operating units, with an emphasis on selling or closing under-performing or non-strategic assets. Under SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144), discontinued businesses, including assets held for sale or distributed to shareholders, are removed from the results of continuing operations. The results of operations in both the current and prior year periods are classified as discontinued operations in the unaudited condensed consolidated statements of operations.

The following table sets forth the components of income from discontinued operations for the current quarter and year to date periods compared to the same periods last year (in thousands):

	Three months ended June 30, 2004	Three months ended June 30, 2003	Nine months ended June 30, 2004	Nine months ended June 30, 2003
Net revenues of GHC	$	$ 349,773	$ 250,927	$ 1,064,800
Net operating income of GHC		16,498	16,450	51,724
Net operating loss of other units		(291)		(804)
Income from discontinued operations before interest and taxes		16,207	16,450	50,920
Interest expense allocation		4,807	2,467	14,939
Income tax expense		10,216	5,548	15,335
Net income from discontinued operations	$	$ 1,184	$ 8,435	$ 20,646

4. Strategic Planning, Severance and Other Operating Items

NeighborCare has incurred costs that are directly attributable to the Company s transforming to a pharmacy-based business and certain of its short-term strategic objectives. These costs are segregated in the unaudited condensed consolidated statements of operations as Strategic planning, severance and other operating items. A summary of these costs for the nine months ended June 30, 2004 follows (in thousands):

	Accrued at September 30, 2003	Nine Months Ended June 30, 2004 Provision	Paid	Non-Cash	Accrued at June 30,2004
Employee contract termination, transaction completion bonuses, severance and related costs	$ 1,000	$ 12,311	$ 10,601	$ 833	$ 1,877
Strategic planning and other items	2,160	31,183	27,203	6,112	28
Total	$ 3,160	$ 43,494	$ 37,804	$ 6,945	$ 1,905

Strategic planning, severance and other operating items for the nine months ended June 30, 2004 relate primarily to legal, professional and other fees incurred to complete the spin-off transaction of $16.7 million; costs incurred pursuant to the termination provisions of employment contracts and transaction completion bonuses with NeighborCare and GHC executives of $10.2 million, including severance incurred due to the resignation of the Company s former Chief Financial Officer; costs incurred to extinguish long-term debt and related obligations in connection with the spin-off of $14.5 million; and severance and related costs incurred pursuant to the Company s corporate and regional consolidations in the second and third quarter of fiscal 2004 of $2.1 million. Debt extinguishment costs represent the write-off of unamortized deferred financing costs of $5.9 million, consent fees required to eliminate the Company s commitments under GHC debt of $5.0 million and the settlement of interest rate swap arrangements related to debt extinguishment of $3.6 million. The majority of the amounts accrued at June 30, 2004 are expected to be paid during the fourth quarter of fiscal 2004.

Strategic planning, severance and other operating items for the nine months ended June 30, 2003 are primarily attributable to the Company entering into a termination and settlement agreement with Omnicare, Inc. whereby the Company agreed to terminate a merger agreement it had entered into with NCS Healthcare, Inc., a provider of institutional pharmacy services. Pursuant to the termination and settlement agreement, the Company agreed to terminate the merger agreement with NCS and Omnicare agreed to pay the Company a $22.0 million break-up fee. On December 16, 2002, the Company terminated the merger agreement. The Company recognized the break-up fee net of $11.8 million of financing, legal and other costs directly attributable to the proposed merger with NCS. The Company collected $6.0 million of the break-up fee in December 2002, with the remaining $16.0 million received in January 2003. The net gain was offset by severance and related costs associated with the resignation of Richard R. Howard, the Company s former vice-chairman, of approximately $4.8 million. The remaining $16.6 million of strategic planning and other operating items for the period primarily relate to consulting and other professional fees.

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5. Takeover Defense Expenses

On May 24, 2004, Omnicare, Inc. announced its intention to purchase all of the outstanding shares of NeighborCare common stock for $30 per share in cash. On May 25, 2004, the Company announced that the board of directors unanimously rejected the proposal. On June 3, 2004, Omincare, Inc. announced its intention to commence a tender offer to purchase all of the outstanding shares of NeighborCare common stock for $30 per share in cash. The tender offer formally commenced on June 4, 2004 and was originally stated to expire on July 7, 2004. On June 25, 2004, Omnicare, Inc. amended its offer extending the expiration date to July 30, 2004. On July 31, 2004, Omnicare, Inc. further amended its offer extending the expiration date to August 31, 2004. For further information relating to the tender offer, refer to the Company s Schedule 14D-9 filed with the Securities Exchange Commission on June 14, 2004, and subsequent amendments thereof.

As a result of the tender offer, the Company incurred various expenses in connection with its defense of the tender offer including legal, investment banking and other fees aggregating $16.8 million as of June 30, 2004. These amounts remain accrued at June 30, 2004.

6. Long-Term Debt

Long-term debt at June 30, 2004 and September 30, 2003 consists of the following (in thousands):

	June 30, 2004	September 30, 2003
Secured debt		
Senior Credit Facility		
Term Loan	$	$ 246,875
Delayed Draw Term Loan		68,162
Total Senior Credit Facility		315,037
Senior Secured Notes		240,176
Senior Subordinated Notes due 2013	250,000	
Capital leases and other secured debt	13,196	56,406
Total debt	263,196	611,619
Less:		
Current portion of long-term debt	(4,275)	(20,135)
Long-term debt	$ 258,921	$ 591,484

During the quarter ended December 31, 2003, the Company repaid substantially all of its existing long-term debt using the proceeds of the Company s $250 million senior subordinated notes offering and GHC s $225 million senior subordinated notes offering.

7. Guarantor Subsidiaries and Condensed Consolidated Financial Statements

The Company s $250 million senior subordinated notes due 2013 are fully and unconditionally guaranteed on a joint and several basis by certain 100% owned subsidiaries of the Company (Guarantors). Those subsidiaries that do not guarantee the notes consist of the joint ventures in which NeighborCare has a greater than 50% share in the equity and earnings thereof (Non-Guarantors). Separate financial statements of the guarantor subsidiaries have not been prepared because management believes it would not be material to investors. The following tables present the condensed consolidating financial statements of NeighborCare, Inc. (Parent), the guarantor subsidiaries and the non-guarantor subsidiaries:

Condensed Consolidating Balance Sheets
June 30, 2004
(in thousands)

	Parent	Guarantors	Non-Guarantors	Eliminations	Consolidated
Assets					
Accounts receivable, net	$ 166,467	$ 194,275	$ 18,212	$ (153,474)	$ 225,480
Other current assets	93,112	67,947	11,610		172,669
Property, plant and equipment, net	17,765	54,831	7,655		80,251
Investment in subsidiaries	24,334	1,299		(25,133)	500
Goodwill	331,024	23,494	2,258		356,776
Other long-term assets	28,197	6,354	73		34,624
	$ 660,899	$ 348,200	$ 39,808	$ (178,607)	$ 870,300
Liabilities and Shareholders Equity					
Accounts payable and accrued expenses	$ 72,352	$ 182,702	$ 4,850	$ (153,474)	$ 106,430
Current portion of long-term debt	4,262		13		4,275
Long-term debt less current portion	256,537	893	1,491		258,921
Other non-current liabilities	41,338				41,338
Shareholders equity	286,410	164,605	33,454	(25,133)	459,336
	$ 660,899	$ 348,200	$ 39,808	$ (178,607)	$ 870,300

Condensed Consolidating Balance Sheets
September 30, 2003
(in thousands)

	Parent	Guarantors	Non-Guarantors	Eliminations	Consolidated
Assets					
Accounts receivable, net	$ 777,592	$ 155,782	$ 213,111	$ (779,599)	$ 366,886
Other current assets	186,884	61,069	70,758		318,711
Property, plant and equipment, net	14,687	51,682	685,627		751,996
Investment in subsidiaries	25,435	1,088	10,058	(27,759)	8,822
Goodwill	330,975	1,509	5,211		337,695
Other long-term assets	64,300	3,604	86,715		154,619
	$ 1,399,873	$ 274,734	$ 1,071,480	$ (807,358)	$ 1,938,729
Liabilities and Shareholders Equity					
Accounts payable and accrued expenses	$ 29,786	$ 117,386	$ 851,232	$ (779,599)	218,805
Current portion of long-term debt	18,069		2,066		20,135
Long-term debt less current portion	545,224	340	45,920		591,484
Other non-current liabilities	152,918	9,856	29,368		192,142
Shareholders equity	653,876	147,152	142,894	(27,759)	916,163
	$ 1,399,873	$ 274,734	$ 1,071,480	$ (807,358)	$ 1,938,729

Condensed Consolidating Statements of Operations
Three months ended
June 30, 2004
(in thousands)

	Parent	Guarantors	Non-Guarantors	Consolidated
Net revenues	$	$ 332,189	$ 38,905	$ 371,094
Cost of revenues		265,603	28,458	294,061
Gross profit		66,586	10,447	77,033
Operating expenses	32,491	35,270	5,696	73,457
Interest expense (income), net	4,463	(24)	53	4,492
Other expense (income)	1,280	(143)		1,137
Income (loss) before income tax provision	(38,234)	31,483	4,698	(2,053)
Income tax provision	4,720			4,720
Income (loss) from continuing operations and net income (loss)	$ (42,954)	$ 31,483	$ 4,698	$ (6,773)

Condensed Consolidating Statements of Operations
Three months ended
June 30, 2003
(in thousands)

	Parent	Guarantors	Non-Guarantors	Consolidated
Net revenues	$	$ 284,291	$ 34,595	$ 318,886
Cost of revenues		221,713	24,647	246,360
Gross profit		62,578	9,948	72,526
Operating expenses	33,109	35,438	5,312	73,859
Interest expense (income), net	3,393	(41)	67	3,419
Other expense (income)	1,314	(163)		1,151
Income (loss) before income tax provision (benefit)	(37,816)	27,344	4,569	(5,903)
Income tax provision (benefit)	(12,029)	178		(11,851)
Income (loss) from continuing operations	(25,787)	27,166	4,569	5,948
Income from discontinued operations, net of taxes	1,184			1,184
Net income (loss)	$ (24,603)	$ 27,166	$ 4,569	$ 7,132

Condensed Consolidating Statements of Operations

Nine months ended

June 30, 2004

(in thousands)

	Parent	Guarantors	Non-Guarantors	Consolidated
Net revenues	$	$ 952,053	$ 114,081	$ 1,066,134
Cost of revenues		755,185	83,132	838,317
Gross profit		196,868	30,949	227,817
Operating expenses	99,777	108,291	16,726	224,794
Interest expense, net	14,392	147	160	14,699
Other expense (income)	3,945	(491)		3,454
Income (loss) before income taxes	(118,114)	88,921	14,063	(15,130)
Income tax benefit	(2,423)			(2,423)
Income (loss) from continuing operations	(115,691)	88,921	14,063	(12,707)
Income from discontinued operations, net of taxes	8,435			8,435
Net income (loss)	$ (107,256)	$ 88,921	$ 14,063	$ (4,272)

Condensed Consolidating Statements of Operations

Nine months ended

June 30, 2003

(in thousands)

	Parent	Guarantors	Non-Guarantors	Consolidated
Net revenues	$	$ 821,027	$ 99,897	$ 920,924
Cost of revenues		639,569	71,248	710,817
Gross profit		181,458	28,649	210,107
Operating expenses	72,592	108,048	15,518	196,158
Interest expense (income), net	10,685	(221)	172	10,636
Other expense (income)	3,720	(439)		3,281
Income (loss) before income tax provision (benefit)	(86,997)	74,070	12,959	32
Income tax provision (benefit)	(5,175)	771		(4,404)
Income from continuing operations	(81,822)	73,299	12,959	4,436
Income from discontinued operations, net of taxes	20,646			20,646
Net income (loss)	$ (61,176)	$ 73,299	$ 12,959	$ 25,082

Condensed Consolidating Statements of Cash Flows

Nine months ended
June 30, 2004
(in thousands)

	Parent	Guarantors	Non-Guarantors	Consolidated
Cash flow from operating activities	$ (15,626)	$ 121,272	$ (62,331)	$ 43,315
Cash flow from investing activities	(77,573)	(970)	(3,064)	(81,607)
Cash flow from financing activities	(34,239)	534	9,415	(24,290)

Condensed Consolidating Statements of Cash Flows

Nine months ended
June 30, 2003
(in thousands)

	Parent	Guarantors	Non-Guarantors	Consolidated
Cash flow from operating activities	$ (2,329)	$ 59,592	$ 23,855	$ 81,118
Cash flow from investing activities	(27,656)	(6,416)	41,834	7,762
Cash flow from financing activities	(131,523)	224	28,475	(102,824)

8. Earnings (Loss) Per Share

The following table sets forth the computation of basic and diluted earnings (loss) per share for the three month and nine month periods ended June 30, 2004 and 2003 (in thousands, except per share data):

	Three months ended		Nine months ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Earnings:				
Basic and diluted calculation:				
Income (loss) from continuing operations, net of preferred dividends	$ (6,773)	$ 5,288	$ (12,707)	$ 2,426
Income from discontinued operations		1,184	8,435	20,646
Net income (loss) available to common shareholders	$ (6,773)	$ 6,472	$ (4,272)	$ 23,072
Shares:				
Weighted average shares outstanding basic	43,682	40,097	42,565	41,135
Assumed conversion of preferred stock				
Weighted average shares outstanding diluted	43,682	40,097	42,565	41,135
Per common share data:				
Basic:				
Income (loss) from continuing operations	$ (0.16)	$ 0.13	$ (0.30)	$ 0.06
Income from discontinued operations		0.03	0.20	0.50
Net income available to common shareholders	(0.16)	0.16	(0.10)	0.56
Diluted:				
Income (loss) from continuing operations	$ (0.16)	$ 0.13	$ (0.30)	$ 0.06
Income from discontinued operations		0.03	0.20	0.50
Net income available to common shareholders	(0.16)	0.16	(0.10)	0.56

Basic earnings per share is calculated by dividing earnings (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 for the current quarter and year to date periods are approximately 260,000 shares to be issued in connection with the joint plan of reorganization confirmed by the bankruptcy court.

Diluted earnings per share is calculated in a manner consistent with basic earnings per share except, where applicable, the weighted average shares outstanding are increased to include additional shares from the assumed exercise of stock options, vesting of restricted stock awards and also the assumed conversion of preferred stock. For the three and nine months ended June 30, 2004 basic and diluted shares outstanding are the same because the Company reported a net loss from continuing operations for the periods; thus the effect of including the additional shares from such assumed exercise would be anti-dilutive. For the three and nine months ended June 30, 2003, the assumed conversion of preferred stock is antidilutive and therefore is not included in calculating diluted shares outstanding. As of June 30, 2004, there were 291,530 shares of restricted stock issued and outstanding of which 59,262 were vested. Also as of June 30, 2004, there were 2,281,904 stock options outstanding of which 1,259,796 are fully vested.

9. 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) institutional pharmacy business and (2) corporate and other.

The institutional pharmacy business provides prescription and non-prescription pharmaceuticals, infusion therapy and medical supplies and equipment to the elderly, chronically ill and disabled in long-term care facilities, including skilled nursing facilities, assisted living facilities, residential and independent living communities and other institutional healthcare facilities. The pharmacy services provided in these settings are tailored to meet the needs of the institutional customer. These services include highly specialized packaging and dispensing systems, computerized medical records processing and 24-hour emergency services. The Company also provides pharmacy consulting services to assure proper and effective drug therapy, including monitoring and reporting on prescription drug therapy and assisting the facility in compliance with applicable federal and state regulations.

Summarized financial information concerning the Company s reportable segments is shown in the following table for the current quarter, compared with the same period last year. The table has been reclassified to reflect the spin-off of GHC, the previously reported Inpatient Services segment. The Corporate and Other category of operations represents operating information of business units below the prescribed quantitative thresholds under SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information.* Revenues from these business units are primarily derived from the Company s community-based professional pharmacy business, home infusion, respiratory and medical equipment business and long-term care group purchasing business (Tidewater). The Corporate and Other category also consists of the Company s corporate general and administrative function, for which there is generally no revenue generated.

This approach to segment reporting is consistent with the Company s internal financial reporting and the information used by the chief operating decision makers regarding the performance of the reportable and non-reportable segments. The accounting policies of the segments are the same as those of the consolidated organization.

	Institutional Pharmacy	Corporate and Other (in thousands)	Consolidated
Three months ended June 30, 2004			
Net revenues	$ 317,794	$ 53,300	$ 371,094
Gross profit	60,952	16,081	77,033
Operating income (loss)	31,063	(27,487)	3,576
Three months ended June 30, 2003			
Net revenues	$ 264,035	$ 54,851	$ 318,886
Gross profit	54,081	18,445	72,526
Operating income (loss)	24,206	(25,539)	(1,333)
Nine months ended June 30, 2004			
Net revenues	$ 902,840	$ 163,294	$ 1,066,134
Gross profit	176,784	51,033	227,817
Operating income (loss)	86,158	(83,135)	3,023
Nine months ended June 30, 2003			
Net revenues	$ 760,021	$ 160,903	$ 920,924
Gross profit	156,915	53,192	210,107
Operating income (loss)	66,447	(52,498)	13,949
Total assets as of			
June 30, 2004	$ 194,426	$ 675,874	$ 870,300
September 30, 2003	192,149	1,746,580	1,938,729

10. Guarantees

In December 2002, the FASB issued Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. FIN 45 requires that at the time a company issues a guarantee, the company must recognize an initial liability for the fair value, or market value, of the obligations it assumes under that guarantee. As of June 30, 2004, the Company had guaranty obligations related to various leases and subleases entered into by GHC, the former inpatient services business of NeighborCare. These obligations remained with NeighborCare following the spin-off and certain of these guarantees were not assigned under the separation and distribution agreement. The guarantees secure the payment of annual rents due to lessors for various long-term care facilities and specialized nursing centers. The nature of the guarantees only require cash payment in the event of default by GHC and does not guarantee residual values of the leased properties, and as such, no initial liability was recorded. The obligations in the aggregate require the guarantee of future lease payments of $2.6 million for the remainder of fiscal 2004, $5.8 million in fiscal 2005, $5.6 million in fiscal 2006, $4.6 million in fiscal 2007 and $4.2 million thereafter. Remaining annual rents for these guaranteed leases and subleases that are not indemnified by GHC aggregate $1.0 million for the remainder of 2004 and $4.2 million annually thereafter through March 2, 2009.

11. **Acquisitions**

On June 1, 2004, the Company completed the acquisition of The Medicine Centre, LLC by purchasing all outstanding ownership interests in The Medicine Centre, LLC. Also on June 1, 2004, the Company acquired all of the outstanding stock of Capitol Home Infusion, Inc. On January 22, 2004, the Company completed the acquisition of certain of the assets of Texas Long-Term Care Pharmacy Services, LLC. The aggregate purchase price for these acquisitions was approximately $28.8 million including liabilities assumed.

Results of these completed acquisitions are included in the Company s consolidated statements of operations from the date of acquisition. The Company s preliminary purchase price allocation is as follows (in thousands):

Accounts receivable, net	$	3,883
Inventories		1,789
Other current assets		835
Property, plant and equipment		966
Goodwill		20,225
Other intangible assets		3,036
Total liabilities assumed		(3,549)
Net assets acquired through acquisitions	$	27,185

12. **Income Taxes**

The Company s provision (benefit) for income taxes from continuing operations for the three months ended June 30, 2004 and 2003 and the nine months ended June 30, 2004 and 2003 was $4.7 million, $(11.9) million, $(2.4) million and $(4.4) million, respectively. The income tax benefit of any NOL carryforward utilization will be applied first as a reduction to goodwill and, thereafter, as a direct addition to paid in capital, pursuant to Statement of Position (SOP) No. 90-7, *Financial Reporting by Entities in Reorganization under the Bankruptcy Code*, at such time it is assured.

13. **Preferred Stock Conversion**

Effective December 16, 2003, the Company s board of directors exercised its option for mandatory conversion of the Series A preferred stock, at a per share conversion price of $12.60 (as adjusted from $20.33 in connection with the spin-off), into 3,464,255 shares of NeighborCare, Inc. common stock pursuant to the terms of the Company s amended and restated articles of incorporation. Prior to December 16, 2003, 38,377 shares of Series A preferred stock were voluntarily converted into 293,643 shares of the Company s common stock. The Series A preferred stock is reflected in the September 30, 2003 consolidated balance sheet under redeemable preferred stock.

14. **Restricted Stock**

On June 15, 2004, the Company s shareholders approved the 2004 Performance Incentive Plan (the Plan). The aggregate number of shares that may be issued under the Plan is 5,000,000. As of June 30, 2004, 296,946 shares of restricted stock have been issued to NeighborCare employees under the Plan, of which 64,678 are fully vested and 26,647 have been surrendered to fulfill employee income tax obligations resulting from the grants. These restricted stock grants were issued out of the treasury shares held on June 15, 2004. Restrictions on grants to employees typically vest ratably over three years from the date of grant such that the employee cannot sell or trade the restricted stock until it becomes vested. In addition, as of June 30, 2004, 21,232 shares of restricted stock have been issued to members of the Company s board of directors. Restricted shares issued to current board members are restricted such that the holder cannot sell or trade the stock unless the seller s holdings in NeighborCare stock exceed $285,000 after the sale or trade occurs. The restrictions immediately lapse upon the holder s termination of board membership.

15. Changes in Shareholders Equity

The rollforward of shareholders equity is as follows (in thousands):

Balance at September 30, 2003	$	916,163
Conversion of preferred stock		46,831
Distribution to shareholders of common stock of GHC		(509,687)
Other		10,301
Net loss		(4,272)
Balance at June 30, 2004	$	459,336

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

General

NeighborCare, Inc. (formerly named Genesis Health Ventures, Inc.) was incorporated in May 1985 as a Pennsylvania corporation. As used herein, unless the context otherwise requires, NeighborCare, or the Company, we, our or us refers to NeighborCare, Inc. and its subsidiaries.

We are the third largest provider of institutional pharmacy services in the United States. As of June 30, 2004, we provided pharmacy services for approximately 263,000 beds in long-term care facilities in 32 states and the District of Columbia. Our pharmacy operations consist of 66 institutional pharmacies (five are jointly-owned), 32 community-based professional retail pharmacies (two are jointly-owned) and 20 on-site pharmacies which are located in customers facilities and serve only customers of that facility. In addition, we operate 16 home infusion, respiratory and medical equipment distribution centers (four are jointly-owned). Jointly-owned facilities and the operations conducted therein are part of joint ventures which are owned by NeighborCare and at least one other unaffiliated party.

Our institutional pharmacy business provides prescription and non-prescription pharmaceuticals, infusion therapy and medical supplies and equipment to the elderly, chronically ill and disabled in long-term care facilities, including skilled nursing facilities, assisted living facilities, residential and independent living communities and other institutional healthcare facilities. The pharmacy services provided in these settings are tailored to meet the needs of the institutional customer. These services include highly specialized packaging and dispensing systems, computerized medical records processing and 24-hour emergency services. We also provide pharmacy consulting services to assure proper and effective drug therapy, including monitoring and reporting on prescription drug therapy and assisting the facility in compliance with applicable federal and state regulations.

Our community-based professional pharmacies are retail operations branded under the NeighborCare® name that are located in or near medical centers, hospitals and physician office complexes which provide prescription and non-prescription medications and certain medical supplies, as well as personal service and consultation by licensed pharmacists.

Our home infusion, respiratory and medical equipment distribution business provides a wide array of products and services to support the home care needs of a range of individuals of all ages. We work with physicians, hospital discharge planners, case managers and managed care organizations who refer these individuals to us. Services include respiratory and medical equipment (such as oxygen, hospital beds, wheelchairs and respiratory medications), as well as home infusion (such as antibiotics, total parenteral nutrition, chemotherapy and pain management).

We also own and operate Tidewater Healthcare Shared Services Group, Inc. (Tidewater), one of the largest long-term care group purchasing organizations in the country. Tidewater provides purchasing and shared service programs specially designed to meet the needs of eldercare centers and other long-term care facilities.

On December 1, 2003, we completed the distribution (the spin-off) of the common stock of Genesis Healthcare Corporation (GHC), previously reported as our inpatient services division. On December 2, 2003, we changed our name to NeighborCare, Inc. The spin-off was effected by way of a pro-rata tax free distribution of the common stock of GHC to holders of our common stock on December 1, 2003 at a rate of 0.5 shares of GHC stock for each share of our common stock owned as of October 15, 2003. On November 4, 2003, in anticipation of the spin-off, we refinanced all of our remaining long-term debt through the issuance of $250 million aggregate principal amount of our 6.875% senior subordinated notes due 2013 and through proceeds received from GHC in accordance with its issuance in October 2003 of $225 million aggregate principal amount of 8% senior subordinated notes due 2013.

Certain Transactions and Events

Change in Strategic Direction and Objectives

Since our inception, our principal business plan was to build networks of skilled nursing and assisted living centers in concentrated geographic markets and broaden our array of higher margin specialty medical services; principally institutional pharmacy and rehabilitation services. By offering a broad array of services, we sought to create an integrated delivery system connecting our eldercare centers and ancillary service capabilities to hospitals, physicians, managed care plans and other providers in a seamless delivery network. Through acquisitions of both eldercare facilities and pharmacy operations in the 1990 s, we fulfilled our stated business plan and operated under the mission to redefine how eldercare is delivered.

In 2000, we and certain of our direct and indirect subsidiaries filed for voluntary relief under Chapter 11 of the United States Code with the United States Bankruptcy Court for the District of Delaware. We emerged from bankruptcy in late 2001 and constituted a new board of directors who evaluated our current business portfolio and identified strategies to optimize the performance of our operations. The new board of directors initially decided to focus on expanding the growth and margins of our pharmacy services segment and to maintain the current market position of our inpatient services segment. This was primarily the result of our inpatient services segment suffering from significant cuts in funding sources, nursing labor cost increases in excess of inflation, intensified regulatory oversight and intervention and increases in the cost of medical malpractice insurance. The new board of directors also implemented a short-term strategy to reduce overhead costs to pursue operational efficiencies with the intent of absorbing the financial performance of the inpatient services business.

After the short-term objectives of the board of directors were achieved, we continued to evaluate strategic alternatives to enhance shareholder value and improve market performance. Such evaluations led to exploration of separating our business into two distinct businesses. In late 2002, the board of directors retained independent consultants to evaluate the impact of potentially separating the pharmacy business and the eldercare business by way of a spin-off. By February 2003, the board of directors approved a plan to spin-off the inpatient services segment into a separate legal operating entity under the name Genesis Healthcare Corporation (GHC).

Strategic Planning, Severance and Other Operating Items

We have incurred costs that are directly attributable to the transformation to a pharmacy-based business and certain of our short-term strategic objectives. These costs are segregated in the unaudited condensed consolidated statements of operations as Strategic planning, severance and other operating items. A summary of these costs at June 30, 2004 follows (in thousands):

	Accrued at September 30, 2003	Nine Months Ended June 30, 2004 Provision	Paid	Non-Cash	Accrued at June 30, 2004
Employee contract termination, transaction completion bonuses, severance and related costs	$ 1,000	$ 12,311	$ 10,601	$ 833	$ 1,877
Strategic planning and other items	2,160	31,183	27,203	6,112	28

Total	$	3,160	$	43,494	$	37,804	$	6,945	$	1,905

Strategic planning, severance and other operating items for the nine months ended June 30, 2004 relate primarily to legal, professional and other fees incurred to complete the spin-off transaction of $16.7 million; costs incurred pursuant to the termination provisions of employment contracts and transaction completion bonuses with NeighborCare and GHC executives of $10.2 million, including severance to our former Chief Financial Officer as a result of his resignation; costs incurred to extinguish long-term debt and related obligations in connection with the spin-off of $14.5 million; and severance and related costs incurred pursuant to our corporate and regional consolidation in the second and third quarter of fiscal 2004 of $2.1 million. Debt extinguishment costs represent the write-off of unamortized deferred financing costs of $5.9 million, consent fees required to eliminate our commitments under GHC debt of $5.0 million and the settlement of interest rate swap arrangements related to debt extinguishment of $3.6 million. The majority of the amounts accrued at June 30, 2004 are expected to be paid during the fourth quarter of fiscal 2004.

Strategic planning, severance and other operating items for the nine months ended June 30, 2003 are primarily attributable to us entering into a termination and settlement agreement with Omnicare, Inc. whereby we agreed to terminate a merger agreement we had entered into with NCS Healthcare, Inc., a provider of institutional pharmacy services. Pursuant to the termination and settlement agreement, we agreed to terminate the merger agreement with NCS and Omnicare agreed to pay us a $22.0 million break-up fee. On

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December 16, 2002, the Company terminated the merger agreement. The Company recognized the break-up fee net of $11.8 million of financing, legal and other costs directly attributable to the proposed merger with NCS. We collected $6.0 million of the break-up fee in December 2002, with the remaining $16.0 million received in January 2003. The net gain was offset by severance and related costs associated with the resignation of Richard R. Howard, our former vice-chairman, of approximately $4.8 million. The remaining $16.6 million of strategic planning and other operating items for the period primarily relate to consulting and other professional fees.

Omnicare, Inc. Tender Offer

On May 24, 2004, Omnicare, Inc. announced its intention to purchase all of the outstanding shares of our common stock for $30 per share in cash. On May 25, 2004, we announced that our board of directors unanimously rejected the proposal. On June 3, 2004, Omincare, Inc. announced its intention to commence a tender offer to purchase all of the outstanding shares of our common stock for $30 per share in cash. The tender offer formally commenced on June 4, 2004 and was originally stated to expire on July 7, 2004. On June 25, 2004, Omnicare, Inc. amended its offer extending the expiration date to July 30, 2004. On July 31,2004 Omnicare, Inc. further amended its offer extending the expiration date to August 31, 2004. For further information relating to the tender offer, refer to our Schedule 14D-9 filed with the Securities and Exchange Commission on June 14, 2004, and subsequent amendments thereof.

As a result of the tender offer, we incurred various expenses in connection with our defense of the tender offer including legal, investment banking and other fees aggregating $16.8 million as of June 30, 2004. These amounts remain accrued at June 30, 2004.

Discontinued Operations

On December 1, 2003, we completed the plan of disposition of GHC through a distribution of GHC common stock to our shareholders of record as of October 15, 2003 in the form of a tax-free spin-off as previously described.

The following table sets forth the components of net income (loss) from discontinued operations for the current quarter and year to date periods compared to the same periods last year (in thousands):

	Three months ended		Nine months ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Net revenues of GHC	$	$ 349,773	$ 250,927	$ 1,064,800
Net operating income of GHC		16,498	16,450	51,724
Net operating loss of other units		(291)		(804)
Income from discontinued operations before interest and taxes		16,207	16,450	50,920
Interest expense allocation		4,807	2,467	14,939
Income tax expense		10,216	5,548	15,335
Net income from discontinued operations	$	$ 1,184	$ 8,435	$ 20,646

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144), only those overhead costs that are solely attributable to the discontinued business segment can be allocated to discontinued operations. As a result, prior periods include significant overhead expenses that were incurred for the benefit of both our continuing operations and the spun-off operations of GHC which are included in the continuing operations of our entity. Therefore, our operating results for the periods presented do not necessarily reflect the actual operating expenses of our continuing pharmacy operations. Overhead expenses that were not allocated to discontinued operations primarily included corporate selling, general and administrative expenses including salaries, wages and benefits. For purposes of the following table, we allocated the shared overhead expenses based upon revenue or certain expense categories, whichever was deemed more reflective of the underlying expenses. The allocated expenses may not be representative of our overhead cost reductions as a stand-alone company. The following table outlines our operating income assuming that overhead expenses attributable to our former inpatient services business, as allocated, were included in discontinued operations:

	Three months ended		Nine months ended	
	June 30, 2004	**June 30, 2003**	**June 30, 2004**	**June 30, 2003**
Operating income (loss) as reported	$ 3,576	$ (1,333)	$ 3,023	$ 13,949
Overhead expenses allocated to GHC		7,950		23,492
Adjusted operating income	$ 3,576	$ 6,617	$ 3,023	$ 37,441
Income from discontinued operations, net of taxes, as reported	$	$ 1,184	$ 8,435	$ 20,646