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GENESIS HEALTH VENTURES INC /PA
Form 10-Q
May 17, 2001

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 March 31, 2001

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: 1-11666

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

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

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 (i) 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, and (ii) has been subject to such filing requirements for the past 90 days.

YES [x] NO []

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 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.

Note: The Company is currently in the process of formulating a plan of reorganization in connection with the registrant and certain of its subsidiaries' filings under Chapter 11 of the Bankruptcy Code. Consequently, no plan of reorganization has been submitted to or confirmed by a bankruptcy court.

YES [x] NO []

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Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of May 9, 2001: 48,641,456 shares of common stock

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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 statements as to:

- o certain statements in "Management's Discussion and Analysis of Financial Condition and Results Of Operations," such as our ability or inability to meet our liquidity needs, make scheduled debt and interest payments, meet expected future capital expenditure requirements, obtain affordable insurance coverage and control costs; and the expected effects of government regulation on reimbursement for services provided and on the costs of doing business; and
- o certain statements in "Legal Proceedings" regarding the effects of

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litigation.

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

- o our bankruptcy cases and our ability to continue as a going concern;
- o risks associated with operating a business in Chapter 11;
- o the delays or the inability to complete and/or consummate our plan of reorganization;
- o our ability to comply with the provisions of our debtor-in-possession financing;
- o our substantial indebtedness and significant debt service obligations;
- o our default under our senior credit agreement and our senior subordinated and other notes;
- o adverse actions which may be taken by creditors;
- o adverse developments with respect to our liquidity or results of operations;
- o the effect of planned dispositions of assets;
- o our ability to consummate or complete development projects or to profitably operate or successfully integrate enterprises into our other operations;
- o our ability or inability to secure the capital and the related cost of the capital necessary to fund future growth;
- o our ability to attract customers given our current financial position;
- o our ability to attract and retain key executives and other personnel;
- o the impact of health care reform, including the Medicare Prospective Payment System ("PPS"), the Balanced Budget Refinement Act ("BBRA") and the Benefit Improvement and Protection Act of 2000 ("BIPA") and the adoption of cost containment measures by the federal and state governments;
- o the impact of government regulation, including our ability to operate in a heavily regulated environment and to satisfy regulatory authorities;
- o the occurrence of changes in the mix of payment sources utilized by patients to pay for services;
- o the adoption of cost containment measures by other third party payors;
- o competition in our industry; and
- o changes in general economic conditions.

The forward-looking statements involve known and unknown risks, uncertainties and other factors that are, in some cases, beyond our control. We caution investors that any forward-looking statements made by us are not guarantees of future performance. We disclaim any obligation to update any such factors or to announce publicly the results of any revisions to any of the forward-looking statements to reflect future events or developments.

Our bankruptcy cases and recurring losses, among other things, raise substantial doubt about our ability to continue as a going concern.

On June 22, 2000, (the "Petition Date") Genesis Health Ventures, Inc. 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, Genesis' 43.6% owned affiliate, The Multicare Companies, Inc. ("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" or "the bankruptcy cases" unless the context otherwise requires). Both companies are currently operating as debtors-in-possession subject to the jurisdiction of the Bankruptcy Court. These cases, among other factors such as the Company's recurring losses and defaults under various loan agreements, raise substantial doubt about the Company's ability to continue as a going concern. The accompanying unaudited condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern with the realization of assets and the settlement of liabilities and commitments in the normal course of business. However, as a result of the bankruptcy cases and circumstances relating to this event, including the Company's leveraged financial structure and losses from operations, such realization of assets and liquidation of liabilities is subject to significant uncertainty. While under the protection of Chapter 11, the Company may sell or otherwise dispose of assets, and liquidate or settle liabilities, for amounts other than those reflected in the accompanying unaudited condensed consolidated financial statements. Further, a plan of reorganization could materially change the amounts reported in the accompanying unaudited condensed consolidated financial statements, which do not give effect to all adjustments of the carrying value of assets or liabilities that might be necessary as a consequence of a plan of reorganization. Additionally, a deadline of December 19, 2000 was established for the assertion of pre-bankruptcy claims against the Company (commonly referred to as a bar date); including contingent, unliquidated or disputed claims, which claims could result in an increase in liabilities subject to compromise as reported in the accompanying unaudited condensed consolidated financial statements. The Company's ability to continue as a going concern is dependent upon, among other things, confirmation of a plan of reorganization, future profitable operations, the ability to comply with the terms of the Company's debtor-in-possession financing agreements and the ability to generate sufficient cash from operations and financing arrangements to meet obligations.

Part I: FINANCIAL INFORMATION

Item 1. Financial Statements

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

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	March
	2001
<hr/>	
Assets	
Current assets:	
Cash and equivalents	\$ 23,
Restricted investments in marketable securities	34,
Accounts receivable, net of allowance for doubtful accounts	438,
Inventory	64,
Prepaid expenses and other current assets	68,
<hr/>	
Total current assets	630,
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Property, plant and equipment, net	1,082,
Notes receivable and other investments	30,
Other long-term assets	100,
Investments in unconsolidated affiliates	23,
Goodwill and other intangibles, net	1,216,
<hr/>	
Total assets	\$ 3,083,
<hr/>	
Liabilities and Shareholders' Deficit	
Current liabilities not subject to compromise:	
Debtor-in-possession financing	\$ 165,
Accounts payable and accrued expenses	191,
<hr/>	
Total current liabilities not subject to compromise	356,
<hr/>	
Liabilities subject to compromise	2,420,
Long-term debt	15,
Deferred income taxes	54,
Deferred gain and other long-term liabilities	48,
Minority interest	49,
Redeemable preferred stock, including accrued dividends (subject to compromise)	455,
<hr/>	
Shareholders' deficit:	
Series G Cumulative Convertible Preferred Stock, par \$.01, authorized 5,000,000 shares, 589,714 issued and outstanding at March 31, 2001 and September 30, 2000	
Common stock, par \$.02, authorized 200,000,000 shares, issued and outstanding 48,641,456 and 48,641,194 at March 31, 2001 and September 30, 2000	
Additional paid-in capital	803,
Accumulated deficit	(1,118,
Accumulated other comprehensive loss	(
Treasury stock, at cost	(
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Total shareholders' deficit	(315,
<hr/>	
Total liabilities and shareholders' deficit	\$ 3,083,
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See accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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

	Three months ended March 31,	
	2001	2000
<hr style="border-top: 1px dashed black;"/>		
Net revenues:		
Inpatient services	\$ 334,275	\$ 331,084
Pharmacy and medical supply services	255,601	232,942
Other revenue	40,206	40,817
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Total net revenues	630,082	604,843
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Operating expenses:		
Operating expenses	575,652	531,313
Debt restructuring, reorganization costs and other charges	13,997	36,393
Gain on sale of eldercare center	-	-
Loss on sale of eldercare center	2,310	-
Multicare joint venture restructuring charge	-	-
Depreciation and amortization	26,461	29,037
Lease expense	9,096	9,486
Interest expense (contractual interest for the three and six months ended March 31, 2001 is \$56,703 and \$116,113, respectively)	31,613	56,726
<hr style="border-top: 1px dashed black;"/>		
Loss before income tax benefit, minority interest, equity in net loss of unconsolidated affiliates and cumulative effect of accounting change	(29,047)	(58,112)
Income tax benefit	-	(8,455)
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Loss before minority interest, equity in net loss of unconsolidated affiliates and cumulative effect of accounting change	(29,047)	(49,657)
Minority interest	4,387	6,762
Equity in net loss of unconsolidated affiliates	(814)	(662)
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Loss before cumulative effect of accounting change	(25,474)	(43,557)
Cumulative effect of accounting change	-	-
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Net loss	(25,474)	(43,557)
Preferred stock dividends	11,249	11,375
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Loss attributed to common shareholders	\$ (36,723)	\$ (54,932)
<hr style="border-top: 1px dashed black;"/>		
Per common share data:		
Basic and Diluted		
Loss before cumulative effect of accounting change	\$ (0.75)	\$ (1.13)
Net loss	\$ (0.75)	\$ (1.13)
Weighted average shares of common stock	48,641,456	48,640,162
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See accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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

	2
Cash flows from operating activities:	
Net loss	\$ (4
Net charges included in operations not requiring funds	9
Changes in current assets and liabilities excluding the effects of acquisitions	
Accounts receivable	(1
Accounts payable and accrued expenses	(1
Other, net	(
Net cash provided by (used in) operating activities before debt restructuring, reorganization costs and other charges	
Cash paid for debt restructuring, reorganization costs and other charges	(2
Net cash used in operating activities	(1
Cash flows from investing activities:	
Purchase of marketable securities	(
Proceeds on sale of eldercare center	
Capital expenditures	(2
Proceeds from unconsolidated affiliates	
Notes receivable and other investments, and other long-term asset additions, net	
Net cash used in investing activities	(1
Cash flows from financing activities:	
Net borrowings under working capital revolving credit facilities	3
Repayment of long-term debt and payment of sinking fund requirements	
Proceeds from issuance of long-term debt	
Proceeds from issuance of common stock	
Debt issuance and debt restructuring costs	
Net cash provided by financing activities	3
Net increase in cash and equivalents	
Cash and equivalents	
Beginning of period	2
End of period	\$ 2

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See accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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Genesis Health Ventures, Inc. and Subsidiaries (Debtor-in-Possession)

Notes To Unaudited Condensed Consolidated Financial Statements

1. Organization and Basis of Presentation

Genesis Health Ventures, Inc. and its subsidiaries, ("the Company", "Genesis", "we", or "our") provide a broad range of healthcare services to the geriatric population, principally within five geographic markets in the eastern United States. These services include healthcare services traditionally provided in eldercare centers and specialty medical services; such as rehabilitation therapy, institutional pharmacy and medical supply services, community-based pharmacies and management services, provided to independent geriatric care providers.

Prior to October 1, 1999, Genesis accounted for its 43.6% owned investment in The Multicare Companies, Inc. ("Multicare") using the equity method of accounting. Upon consummation of a restructuring transaction, more fully described in Footnote 5 - Multicare Transaction and its Restructuring, Genesis consolidated the financial results of Multicare since Genesis has managerial, operational and financial control of Multicare under the terms of the Restructuring Agreement. Accordingly, Multicare's assets, liabilities, revenues and expenses are consolidated at their recorded historical amounts and the financial impact of transactions between Genesis and Multicare are eliminated in consolidation. The non-Genesis shareholders' remaining 56.4% interest in Multicare is carried as minority interest based on their proportionate share of Multicare's historical book equity. For so long as there is a minority interest in Multicare, the minority shareholders' proportionate share of Multicare's net income or loss will be recorded through an adjustment to minority interest. If losses applicable to the minority shareholders exceed the minority interest in the equity of Multicare, such excess and future losses applicable to the minority shareholders will be charged to the consolidated results of Genesis.

Other than Multicare, investments in unconsolidated affiliated companies, owned 20% to 50% inclusive, are stated at cost of acquisition plus the Company's equity in undistributed net income (loss) since acquisition. The change in the equity in net income (loss) of these companies is reflected as a component of net income or loss on the accompanying unaudited condensed consolidated statements of operations.

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, 2000. The accompanying unaudited condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern. On June 22, 2000, (the "Petition Date") Genesis Health Ventures, Inc. 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, 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" or "the bankruptcy cases" unless the context otherwise requires). Both companies are currently operating as debtors-in-possession subject to the jurisdiction of the Bankruptcy Court. These cases, among other factors such as the Company's recurring losses and defaults of various loan agreements, raise substantial doubt about the Company's ability to continue as a going concern. See Footnote 2 - Voluntary Petitions for Relief Under Chapter 11 of the United

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States Bankruptcy Code.

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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, subsequent to the Petition Date, all adjustments pursuant to the American Institute of Certified Public Accountants ("AICPA") Statement of Position No. 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. SOP 90-7 requires a segregation of liabilities subject to compromise by the Bankruptcy Court as of the Petition Date and identification of all transactions and events that are directly associated with the reorganization of the Company. Pursuant to SOP 90-7, prepetition liabilities are reported on the basis of the expected amounts of such allowed claims, as opposed to the amounts for which those claims may be settled. Under a confirmed final plan of reorganization, those claims may be settled at amounts substantially less than their allowed amounts.

Certain prior year amounts have been reclassified to conform to the current year presentation.

2. Voluntary Petition for Relief Under Chapter 11 of the United States Bankruptcy Code

Except for relief that might otherwise be granted by the Bankruptcy Court overseeing the Chapter 11 cases, and further subject to certain statutory exceptions, the automatic stay protection afforded by Chapter 11 of the Bankruptcy Code cases prevents any creditor or other third parties from taking any action in connection with any defaults under prepetition debt obligations or agreements of the Company and those of its subsidiaries or affiliates which are debtors in the Chapter 11 cases. In connection with the Chapter 11 cases, the Company expects to develop a plan of reorganization that will be approved by its creditors and confirmed by the Bankruptcy Court overseeing the Company's Chapter 11 cases. In the event the plan of reorganization is accepted, continuation of the business thereafter is dependent on the Company's ability to achieve successful future operations.

The Bankruptcy Court approved, on a final basis, borrowings of up to \$250,000,000 in respect of the Genesis debtor-in-possession financing facility (the "Genesis DIP Facility") with Mellon Bank, N.A. as Agent and a syndicate of lenders. The Bankruptcy Court also approved, on a final basis, borrowings of up to \$50,000,000 in respect of the Multicare debtor-in-possession financing facility (the "Multicare DIP Facility") with Mellon Bank, N.A. as Agent and a syndicate of lenders. The Genesis and Multicare Debtors intend to utilize the DIP Facilities of the respective companies and existing cash flows to fund ongoing operations during the Chapter 11 cases. As of March 31, 2001, approximately \$165,000,000 of borrowings under the Genesis DIP Facility were outstanding and no borrowings were outstanding under the Multicare DIP Facility.

On or about May 14, 2001, the official committee of Multicare unsecured creditors (the "Multicare Creditors' Committee") appointed in the Multicare Chapter 11 cases filed a motion (the "Trustee Motion") with the Bankruptcy Court requesting entry of an order directing the appointment of a trustee in the Multicare cases. By the Trustee Motion, the Multicare Creditors' Committee seeks the appointment of a trustee to, generally, (a) evaluate and negotiate the various contractual and other relationships between Multicare and Genesis and its related entities, (b) evaluate and prosecute claims of Multicare against

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Genesis, and (c) propose and seek confirmation of a plan of reorganization for Multicare. Alternatively, the Multicare Creditors' Committee has requested in the Trustee Motion that Multicare be directed to engage in a market bid process with respect to its contractual and other relationships with Genesis. Although there can be no assurances as to the outcome of the Trustee Motion, the Company does not believe that the relief requested in the motion is warranted and intends to vigorously oppose such motion in the Bankruptcy Court. A hearing date on the Trustee Motion is presently scheduled to take place on June 6, 2001, although the Company and the Multicare Creditors' Committee have engaged in discussions concerning, among other related matters, an adjournment of the presently scheduled hearing date.

On June 23, 2000 the Bankruptcy Court entered an order authorizing the Debtors to pay certain prepetition wages, salaries, benefits and other employee obligations, as well as to continue in place the Debtors' various employee compensation programs and procedures. On that date, the Bankruptcy Court also authorized the Debtors to pay, among other claims, the prepetition claims of certain critical vendors and patients. All other unsecured prepetition liabilities are classified in the unaudited condensed consolidated balance sheet as liabilities subject to compromise. The Debtors intend to remain in possession of their assets and continue in the management and operation of their properties and businesses, and to pay the post-petition claims of their various vendors and providers in the ordinary course of business.

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A summary of the principal categories of claims classified as liabilities subject to compromise under the Chapter 11 cases as of March 31, 2001 and September 30, 2000 follows (in thousands):

	March 31, 2001	Septem 20

Liabilities subject to compromise:		
Revolving credit and term loans	\$1,485,247	\$1,48
Senior subordinated notes	616,643	61
Revenue bonds and other indebtedness	130,431	15

Subtotal - long-term debt subject to compromise	\$2,232,321	\$2,25

Accounts payable and accrued liabilities	56,473	6
Accrued interest (including a \$28,331 swap termination fee)	86,575	8
Accrued preferred stock dividends on Series G Preferred Stock	44,755	3

	\$2,420,124	\$2,44

A summary of the principal categories of debt restructuring and reorganization costs follows (in thousands):

	Three Months Ended March 31, 2001	Si Months March 3

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Debt restructuring and reorganization costs:

Legal, accounting, bank and consulting fees	\$ 8,113	\$ 1
Exit costs of terminated businesses	492	
Employee benefit related costs	1,892	
<hr/>		
	\$ 10,497	\$ 2
<hr/>		

3. Certain Significant Risks and Uncertainties

Going Concern

In connection with the Chapter 11 cases, the Company expects to develop a plan of reorganization that will be approved by its creditors and confirmed by the Bankruptcy Court overseeing the Company's Chapter 11 cases. In the event the plan of reorganization is accepted, continuation of the business thereafter is dependent on the Company's ability to achieve successful future operations. The Company's ability to continue as a going concern is dependent upon, among other things, confirmation of a plan of reorganization, future profitable operations, the ability to comply with the terms of the Company's debtor-in-possession financing agreements and the ability to generate sufficient cash from operations and financing arrangements to meet obligations. There can be no assurances the Company will be successful in achieving a confirmed plan of reorganization, future profitable operations, compliance with the terms of the debtor-in-possession financing arrangements and sufficient cash flows from operations and financing arrangements to meet obligations.

Following the Petition Date, Genesis continues to pay interest on approximately \$1,100,000,000 of certain prepetition senior long term debt obligations, which has, in part, resulted in Genesis' active borrowing under the Genesis DIP Facility. Multicare discontinued paying interest on virtually all of its prepetition long term debt obligations following the Petition Date, which has, in part, resulted in Multicare's ability to fund capital and working capital needs through operations without borrowing under the Multicare DIP Facility. An event of default and any related borrowing restrictions placed under the respective DIP Facilities could have a material adverse effect on the financial position of Genesis and Multicare, resulting in factors including, but not limited to:

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- o Genesis' inability to continue funding prepetition senior long term debt interest obligations, which could be disruptive to ongoing reorganization negotiations;
- o Genesis' and/or Multicare's inability to extend required letters of credit in the ordinary course of business;
- o Genesis' and/or Multicare's inability to fund capital and working capital requirements; and
- o Genesis' and/or Multicare's inability to successfully reorganize.

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 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

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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.

Congress has enacted three major laws during the past five years that have significantly altered payment for nursing home and medical ancillary services. The Balanced Budget Act of 1997 ("the 1997 Act"), signed into law on August 5, 1997, reduced federal spending on the Medicare and Medicaid programs. As implemented by HCFA, the 1997 Act has had an adverse impact on the Medicare revenues of many skilled nursing facilities. There have been three primary problems with the 1997 Act. First, the base year calculations understate costs. Second, the market basket index used to trend payments forward does not adequately reflect market experience. Third, the Resource Utilization Groups ("RUGs") case mix allocation is not adequately predictive of the costs of care for patients, and does not equitably allocate funding, especially for non-therapy ancillary services. The Medicare Balanced Budget Refinement Act ("BBRA"), enacted in November 1999, addressed a number of the funding difficulties caused by the 1997 Act. A second enactment, the Benefits Improvement and Protection Act of 2000 ("BIPA"), was enacted on December 15, 2000, further modifying the law and restoring additional funding.

The reimbursement rates for pharmacy services under Medicaid are determined on a state-by-state basis subject to review by HCFA and applicable federal law. In most states, pharmacy services are priced at the lower of "usual and customary" charges or cost (which generally is defined as a function of average wholesale price and may include a profit percentage) plus a dispensing fee. Certain states have "lowest charge legislation" or "most favored nation provisions" which require our institutional pharmacy and medical supply operation ("NeighborCare(R)") to charge Medicaid no more than its lowest charge to other consumers in the state. During 2000, Federal Medicaid requirements establishing payment caps on certain drugs were revised ("Federal Upper Limits"). The final rule relating to Federal Upper Limits was substantially modified, reducing the impact of the new rules on NeighborCare operations.

Pharmacy coverage and cost containment are important policy debates at both the Federal and state levels. Congress has considered proposals to expand Medicare coverage for outpatient pharmacy services. Enactment of such legislation could affect institutional pharmacy services. Likewise, a number of states have proposed cost containment initiatives pending. Changes in payment formulas and delivery requirements could impact NeighborCare.

Congress and state governments continue to focus on efforts to curb spending on health care programs such as Medicare and Medicaid. Such efforts have not been limited to skilled nursing facilities, but have and will most likely include other services provided by us, including pharmacy and therapy services. We cannot at this time predict the extent to which these proposals will be adopted or, if adopted and implemented, what effect, if any, such proposals will have on us. Efforts to impose reduced allowances, greater discounts and more stringent cost controls by government and other payors are expected to continue.

While the Company has prepared certain estimates of the impact of the above changes, 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 its business. Accordingly, there can be no assurance that the impact of these changes will not be greater than estimated or that 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

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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 the Company's 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 pharmacy operations to provide services to HCR Manor Care constituting approximately eleven percent and four percent of the net revenues of NeighborCare and Genesis, respectively. These service contracts with HCR Manor Care are the subject of certain litigation. See "Legal Proceedings".

NeighborCare pharmacy operations provide services to Mariner Post-Acute Network, Inc. and Mariner Health Group, Inc. (collectively, "Mariner") under certain service contracts. On January 18, 2000, Mariner filed voluntary petitions under Chapter 11 with the Bankruptcy Court. To date, the service contracts with Mariner have been honored; however, Mariner has certain rights under the protection of the Bankruptcy Court to reject these contracts, which represent six percent and two percent of the net revenues of NeighborCare and Genesis, respectively. Genesis participates as a member of the official Mariner unsecured creditors committee.

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4. Long-Term Debt

Long-term debt at March 31, 2001 and September 30, 2000 consists of the following (in thousands):

	March 31, 2001	Septem 2000

Secured debt		
Debtor-in-possession financing facilities	\$ 165,000	\$
Credit facilities	1,485,247	
Mortgage and other secured debt, including unamortized debt premium	137,159	

Total secured debt	1,787,406	
Unsecured debt		
Senior subordinated notes, net of unamortized debt discount	616,643	
Notes payable and other unsecured debt	8,336	

Total unsecured debt	624,979	
Total Debt	2,412,385	
Less:		
Current portion of long-term debt	(165,000)	
Long term debt subject to compromise	(2,232,321)	(

Long-term debt	\$ 15,064	\$

In connection with the Chapter 11 cases, no principal or interest payments have been made on certain indebtedness incurred by the Company prior to June 22, 2000 ("Prepetition Debt"). With regard to Multicare, no principal or interest payments have been made on \$424,110,000 of the Multicare Credit Facility,

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\$250,000,000 of senior subordinated notes and \$32,489,000 of other indebtedness. Multicare continues to pay interest on an aggregate outstanding balance of \$10,047,000 in connection with two secured loans of subsidiaries not party to the Chapter 11 cases. With regard to Genesis, no principal or interest payments have been made on \$371,590,000 of senior subordinated notes and approximately \$97,000,000 of other indebtedness. Subsequent to June 22, 2000, Genesis repaid \$40,000,000 of Tranche II Prepetition Debt under the Genesis Credit Facility and all interest incurred prior to June 22, 2000 on Prepetition Debt under the Genesis Credit Facility as adequate protection. Interest incurred on \$1,061,137,000 of Prepetition Debt under the Genesis Credit Facility subsequent to June 22, 2000 continues to be paid as billed. Genesis is also current in paying interest on balances outstanding under the Genesis Debtor-in-Possession Financing.

Secured Debt

Genesis Debtor-in- Possession Financing

Among the orders entered by the Bankruptcy Court on June 23, 2000 were orders approving on an interim basis, a) the use of cash collateral by the Company and those of its subsidiaries and affiliates which had filed petitions for reorganization under Chapter 11 of the Bankruptcy Code and (excluding Multicare and its direct and indirect subsidiaries), b) authorization for the Company to enter into a secured debtor-in-possession revolving credit facility with a group of banks led by Mellon Bank, N. A., (the "Genesis DIP Facility") and authorizing advances in the interim period of up to \$150,000,000 out of a possible \$250,000,000 facility. On July 18, 2000, the Bankruptcy Court entered the Final Order approving the \$250,000,000 Genesis DIP Facility and permitting full usage thereunder. Usage under the Genesis DIP Facility is subject to a Borrowing Base which provides for maximum borrowings (subject to the \$250,000,000 commitment limit) by the Company equal to the sum of (i) up to 90% of outstanding eligible accounts receivable, as defined and (ii) up to \$175,000,000 against real property. The Genesis DIP Facility, which is classified as a current liability, matures on December 21, 2001 and advances thereunder accrue interest at either Prime plus 2.25% or the Eurodollar Rate ("LIBO Rate") plus 3.75%. Proceeds of the Genesis DIP Facility are available for general working capital purposes and as a condition of the loan, were required to refinance the \$40,000,000 outstanding under the Company's prepetition priority Tranche II sub-facility.

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Additionally, \$44,000,000 of proceeds were used to satisfy all unpaid interest and rent obligations to the senior secured creditors under the Fourth Amended and Restated Credit Agreement dated August 20, 1999 and the Synthetic Lease dated October 7, 1996 as adequate protection for any diminution in value of the prepetition senior secured lenders in these facilities, respectively. The Company will continue to pay interest and rent pursuant to these agreements as adequate protection. Interest is accrued and paid at the Prime Rate as announced by the administrative agent, or the applicable Adjusted LIBO Rate plus, in either event, a margin that is dependent upon a certain financial ratio test. Through May 9, 2001, borrowings outstanding under the Genesis DIP Facility were \$173,000,000. The Genesis DIP Facility provides for the issuance of up to \$25,000,000 in standby letters of credit. Through May 9, 2001, there were \$2,451,000 in letters of credit issued thereunder, for a total utilization under the Genesis DIP Facility of \$175,451,000.

Pursuant to the agreement, the Company and each of its subsidiaries named as borrowers or guarantors under the Genesis DIP Facility have granted to the lenders first priority liens and security interests (subject to valid, perfected, enforceable and nonavoidable liens of record existing immediately

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prior to the petition date and other carve-outs and exceptions as fully described in the Genesis DIP Facility) in all unencumbered pre- and post-petition property of the Company. The Genesis DIP Facility also has priority over the liens on all collateral pledged under (i) the Genesis Credit Facility (later defined), (ii) the Synthetic Lease dated October 7, 1996 and (iii) other obligations covered by the Collateral Agency Agreement, including any Swap Agreement, which collateral includes, but is not limited to, all personal property, including bank accounts and investment property, accounts receivable, inventory, equipment, and general intangibles, substantially all fee-owned real property, and the capital stock of Genesis and its borrower and guarantor subsidiaries.

The Genesis DIP financing agreement limits, among other things, the Company's ability to incur additional indebtedness or contingent obligations, to permit additional liens, to make additional acquisitions, to sell or dispose of assets, to create or incur liens on assets, to pay dividends and to merge or consolidate with any other person. The Genesis DIP Facility contains customary representations, warranties and covenants, including certain financial covenants relating to minimum EBITDA, occupancy and Genesis DIP Facility usage amounts and maximum capital expenditures. The breach of any such provisions, to the extent not waived or cured within any applicable grace or cure periods, could result in the Company's inability to obtain further advances under the Genesis DIP Facility and the potential exercise of remedies by the Genesis DIP Facility lenders (without regard to the automatic stay unless reimposed by the Bankruptcy Court) which could materially impair the ability of the Company to successfully reorganize under Chapter 11.

On February 14, 2001, Genesis received a waiver from its lenders (the "Genesis DIP Lenders") under the Genesis DIP Facility for any event of default regarding certain financial covenants relating to minimum EBITDA that may have resulted from asset impairment and other non-recurring charges recorded by Genesis in the fourth quarter of Fiscal 2000. The waiver concerning the minimum EBITDA covenant requirements extended through December 31, 2000. In addition, Genesis received certain amendments to the Genesis DIP Facility, including an amendment that makes the minimum EBITDA covenant less restrictive in future periods (the "Genesis EBITDA Amendment"). On April 4, 2001, the Bankruptcy Court granted approval for the payment of an amendment fee related thereto.

Multicare Debtor-in-Possession Financing

Among the orders entered by the Bankruptcy Court on June 23, 2000 were orders approving on an interim basis, a) the use of cash collateral by Multicare and those of its affiliates which had filed petitions for reorganization under Chapter 11 of the Bankruptcy Code and b) authorization for Multicare to enter into a secured debtor-in-possession revolving credit facility with a group of banks led by Mellon Bank, N. A., (the "Multicare DIP Facility") and authorizing advances in the interim period of up to \$30,000,000 out of a possible \$50,000,000. On July 18, 2000, the Bankruptcy Court entered the Final Order approving the \$50,000,000 Multicare DIP Facility and permitting full usage thereunder. Usage under the Multicare DIP Facility is subject to a Borrowing Base which provides for maximum borrowings (subject to the \$50,000,000 commitment limit) by Multicare of up to 90% of outstanding eligible accounts receivable, as defined, and a real estate component. The Multicare DIP Facility matures on December 21, 2001 and advances thereunder accrue interest at either Prime plus 2.25% or the LIBO Rate plus 3.75%. Proceeds of the Multicare DIP Facility are available for general working capital purposes. Through May 9, 2001, there has been no usage under the Multicare DIP Facility other than standby letters of credit. The Multicare DIP Facility provides for the issuance of up to \$20,000,000 in standby letters of credit. Through May 9, 2001, there were \$2,203,000 in letters of credit issued thereunder.

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Pursuant to the agreement, Multicare and each of its affiliates named as borrowers or guarantors under the Multicare DIP Facility have granted to the lenders first priority liens and security interests (subject to valid, perfected, enforceable and nonavoidable liens of record existing immediately prior to the petition date and other carve-outs and exceptions as fully described in the Multicare DIP Facility) in all unencumbered pre- and post-petition property of Multicare. The Multicare DIP Facility also has priority over the liens on all collateral pledged under the prepetition Multicare Credit Facility (later defined) dated as of October 9, 1997 as amended, which collateral includes, but is not limited to, all personal property, including bank accounts and investment property, accounts receivable, inventory, equipment, and general intangibles, substantially all fee owned real property, and the capital stock of Multicare and its borrower and guarantor affiliates.

The Multicare DIP financing agreement limits, among other things, Multicare's ability to incur additional indebtedness or contingent obligations, to permit additional liens, to make additional acquisitions, to sell or dispose of assets, to create or incur liens on assets, to pay dividends and to merge or consolidate with any other person. The Multicare DIP Facility contains customary representations, warranties and covenants, including certain financial covenants relating to minimum EBITDA, occupancy and Multicare DIP Facility usage amounts and maximum capital expenditures. The breach of any such provisions, to the extent not waived or cured within any applicable grace or cure periods, could result in Multicare's inability to obtain further advances under the Multicare DIP Facility and the potential exercise of remedies by the Multicare DIP Facility lenders (without regard to the automatic stay unless reimposed by the Bankruptcy Court) which could materially impair the ability of Multicare to successfully reorganize under Chapter 11.

On February 14, 2001, Multicare received a waiver from its lenders (the "Multicare DIP Lenders") under the Multicare DIP Facility for any event of default regarding certain financial covenants relating to minimum EBITDA that may have resulted from asset impairment and other non-recurring charges recorded in the fourth quarter of Fiscal 2000. The waiver concerning the minimum EBITDA covenant requirements extended through December 31, 2000. In addition, Multicare received certain amendments to the Multicare DIP Facility, including an amendment that makes the minimum EBITDA covenant less restrictive in future periods (the "Multicare EBITDA Amendment"). On April 4, 2001, the Bankruptcy Court granted approval for the payment of an amendment fee related thereto.

Genesis Credit Facility

Genesis and certain of its subsidiaries (excluding Multicare) are borrowers under a prepetition credit facility totaling \$1,250,000,000 (the "Genesis Credit Facility"). As of March 31, 2001, \$1,061,137,000 was outstanding under the Genesis Credit Facility, which is classified as a liability subject to compromise.

Subject to liens granted under the Genesis DIP Facility, the Genesis Credit Facility (as amended) is secured by a first priority security interest in all of the stock, partnership interests and other equity of all of Genesis' present and future subsidiaries (including Genesis ElderCare Corp.) other than the stock of Multicare and its subsidiaries, and also by first priority security interests in substantially all personal property, excluding inventory, including accounts receivable, equipment and general intangibles. Mortgages on substantially all of Genesis' subsidiaries' real property were also granted.

Genesis is in default under the Genesis Credit Facility. Interest under the Genesis Credit Facility incurred prior to and subsequent to the Petition Date has been paid, or is accrued and paid when due.

Multicare Credit Facility

Multicare and certain of its subsidiaries are borrowers under a prepetition credit facility totaling \$525,000,000 (the "Multicare Credit Facility"). As of March 31, 2001, \$424,110,000 was outstanding under the Multicare Credit Facility, which is classified as a liability subject to compromise.

Subject to liens granted under the Multicare DIP Facility, the Multicare Credit Facility (as amended) is secured by first priority security interests (subject to certain exceptions) in all personal property, including inventory, accounts receivable, equipment and general intangibles. Mortgages on certain of Multicare's subsidiaries' real property were also granted.

Multicare is in default under the Multicare Credit Facility and has not made any scheduled interest payments since March 29, 2000.

Mortgage and Other Secured Debt

At March 31, 2001, the Company has \$137,159,000 of mortgage and other secured debt consisting principally of secured revenue bonds and secured bank loans, including loans insured by the Department of Housing and Urban Development. With exception to \$15,064,000, the aggregate balance of mortgage and other secured debt is classified as liabilities subject to compromise.

Unsecured Debt

Senior Subordinated Notes

At March 31, 2001, the following senior subordinated notes, net of discounts, were outstanding (in thousands):

Issuer	Maturity Date	Interest Rate	Outstanding
Genesis	2009	9.88%	
Genesis	2006	9.25%	
Genesis	2005	9.75%	
Genesis	Matured and untendered	9.38%	
Multicare	2007	9.00%	

Genesis and Multicare are in default of the indenture agreements of the above referenced senior subordinated notes. The outstanding balances of the senior subordinated notes are classified as liabilities subject to compromise.

Notes Payable and Other Unsecured Debt

Notes payable and other unsecured debt principally consists of seller notes due to the previous owners of businesses acquired.

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In October 1997, Genesis, The Cypress Group (together with its affiliates, "Cypress"), TPG Partners II, L.P., (together with its affiliates, "TPG") and Nazem, Inc. ("Nazem") acquired all of the issued and outstanding common stock of Genesis ElderCare Corp., a Delaware corporation. Cypress, TPG and Nazem purchased 210,000, 199,500 and 10,500 shares of Genesis ElderCare Corp. common stock, respectively, representing in the aggregate approximately 56.4% of the issued and outstanding common stock of Genesis ElderCare Corp., for an aggregate purchase price of \$420,000,000. Genesis purchased 325,000 shares of Genesis ElderCare Corp. common stock, representing approximately 43.6% of the issued and outstanding common stock of Genesis ElderCare Corp., for an aggregate purchase price of \$325,000,000. Cypress, TPG and Nazem are sometimes collectively referred to herein as the "Sponsors."

In October 1997, as a result of a tender offer and a merger transaction, Genesis ElderCare Corp. acquired 100% of the outstanding shares of common stock of The Multicare Companies, Inc. ("Multicare"), making Multicare a wholly-owned subsidiary of Genesis ElderCare Corp. In connection with their investments in the common stock of Genesis ElderCare Corp., Genesis, Cypress, TPG and Nazem entered into a stockholders agreement dated October 9, 1997 (the "Multicare Stockholders Agreement"), and Genesis, Cypress, TPG and Nazem entered into a put/call agreement, dated as of October 9, 1997 (the "Put/Call Agreement") relating to their respective ownership interests in Genesis ElderCare Corp. pursuant to which, among other things, Genesis had the option to purchase (the "Call") Genesis ElderCare Corp. common stock held by Cypress, TPG and Nazem at a price determined pursuant to the terms of the Put/Call Agreement. Cypress, TPG and Nazem had the option to sell (the "Put") such Genesis ElderCare Corp. common stock at a price determined pursuant to the Put/Call Agreement.

On October 8, 1999, Genesis entered into a restructuring agreement with Cypress, TPG and Nazem (the "Restructuring Agreement") to restructure their joint investment in Genesis ElderCare Corp., the parent company of Multicare.

Pursuant to the Restructuring Agreement, the Put under the Put/Call Agreement was terminated in exchange for:

- o 24,369 shares of Genesis' Series H Senior Convertible Participating Cumulative Preferred Stock (the "Series H Preferred"), which were issued to Cypress, TPG and Nazem, or their affiliated investment funds, in proportion to their respective investments in Genesis ElderCare Corp.; and
- o 17,631 shares of Genesis' Series I Senior Convertible Exchangeable Participating Cumulative Preferred Stock, (the "Series I Preferred") which were issued to Cypress, TPG and Nazem, or their affiliated investment funds, in proportion to their respective investments in Genesis ElderCare Corp.

Cypress and TPG invested in the aggregate, directly or through affiliated investment funds, \$50,000,000 into Genesis in exchange for 12,500,000 shares of Genesis Common Stock and a ten year warrant to purchase 2,000,000 shares of Genesis Common Stock at an exercise price of \$5.00 per share.

In connection with the restructuring transaction, Genesis recorded a non-cash charge of approximately \$420,000,000 during the quarter ended December 31, 1999, representing the estimated cost to terminate the Put in consideration for the issuance of the Series H Preferred and Series I Preferred. The cost to terminate the Put was estimated based upon the Company's assessment that no incremental value was realized by Genesis as a result of the changes in the equity ownership structure of Multicare brought about by the restructuring of the Multicare joint venture.

6. Loss Per Share

The following table sets forth the computation of basic and diluted loss attributed to common shares (in thousands, except per share data):

	Three Months Ended March 31, 2001	Three Months Ended March 31, 2000	Six Months Ended March 31, 2001	Six Months Ended March 2000

Basic and Diluted Loss Per Share:				
Loss before cumulative effect of accounting change	\$ (36,723)	\$ (54,932)	\$ (69,534)	\$ (494,7
Cumulative effect of accounting change	-	-	-	(10,4

Net loss attributed to common shareholders	\$ (36,723)	\$ (54,932)	\$ (69,534)	\$ (505,1

Weighted average shares	48,641	48,640	48,641	45,4

Loss per share before cumulative effect of accounting change	\$ (0.75)	\$ (1.13)	\$ (1.43)	\$ (10.
Cumulative effect of accounting change	-	-	-	(0.

Loss per share	\$ (0.75)	\$ (1.13)	\$ (1.43)	\$ (11.

For the three and six months ended March 31, 2001 and 2000, no exercise of stock options is assumed since their effect is antidilutive.

7. Comprehensive Loss

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

	Three Months Ended March 31, 2001	Three Months Ended March 31, 2000	Six Months Ended March 31, 2001	Six Months Ended March 31, 2000

Loss attributed to common shareholders	\$ (36,723)	\$ (54,932)	\$ (69,534)	\$ (505,114)
Unrealized gain (loss) on marketable securities	713	(336)	1,400	(597)

Total comprehensive loss	\$ (36,010)	\$ (55,268)	\$ (68,134)	\$ (505,711)

Accumulated other comprehensive loss, which is composed of net unrealized gains and losses on marketable securities, was (\$389,000) and (\$1,789,000) at March 31, 2001 and September 30, 2000, respectively.

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8. Cumulative Effect of Accounting Change

Effective October 1, 1999, the Company adopted the provisions of the AICPA's Statement of Position 98-5, "Reporting on the Costs of Start-up Activities", ("SOP 98-5") which requires the costs of start-up activities be expensed as incurred, rather than capitalized and subsequently amortized. The adoption of SOP 98-5 resulted in the write-off of \$10,412,000, net of tax, of unamortized start-up costs and is reflected as a cumulative effect of accounting change in the unaudited condensed consolidated statements of operations for the six months ended March 31, 2000.

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) Pharmacy and medical supplies services and (2) Inpatient services.

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 (three 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 29 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 in Fiscal 2000 were generated through external contracts with independent healthcare providers with the balance attributable to centers owned or leased by the Company, including the jointly-owned Multicare centers.

The Company includes in inpatient service revenue all room and board charges and ancillary service revenue for its eldercare customers at its 195 owned and leased eldercare centers, including the jointly-owned Multicare centers. The centers offer three levels of care for their customers: skilled, intermediate and personal.

The accounting policies of the segments are the same as those of the consolidated company. All intersegment sales prices are market based. The Company evaluates performance of its operating segments based on income before interest, income taxes, depreciation, amortization, rent and nonrecurring items.

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Summarized financial information concerning the Company's reportable segments is shown in the following table. The "Other" column 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, transportation services, diagnostic services, hospitality services, respiratory health services, group purchasing fees and other healthcare related services. In addition, the "Other" column includes the elimination of intersegment transactions.

(in thousands)	Pharmacy and Medical Supply Services	Inpatient Services	Other	Tot
Three months ended				

March 31, 2001				

Revenue from external customers	\$ 255,601	\$ 334,275	\$ 40,206	\$ 630,082
Revenue from intersegment customers	25,088	-	49,190	74,278
Operating income (1)	21,925	39,827	(7,322)	54,430
Total assets	1,058,449	1,720,523	304,830	3,083,802

March 31, 2000				

Revenue from external customers	\$ 232,942	\$ 331,084	\$ 40,817	\$ 604,843
Revenue from intersegment customers	25,448	-	45,558	71,006
Operating income (1)	26,612	48,640	(1,722)	73,530
Total assets	1,088,689	1,797,492	650,891	3,537,072

(in thousands)	Pharmacy and Medical Supply Services	Inpatient Services	Other	Tot
Six months ended				

March 31, 2001				

Revenue from external customers	\$ 511,175	\$ 667,974	\$ 79,952	\$ 1,259,101
Revenue from intersegment customers	47,258	-	96,205	143,463
Operating income (1)	45,122	85,568	(16,242)	114,448
Total assets	1,058,449	1,720,523	304,830	3,083,802

March 31, 2000				

Revenue from external customers	\$ 456,849	\$ 657,411	\$ 77,467	\$ 1,191,727
Revenue from intersegment customers	51,769	-	85,857	137,626
Operating income (1)	54,306	98,797	(6,103)	146,999
Total assets	1,088,689	1,797,492	650,891	3,537,072

(1) Operating income is defined as income before interest, income taxes, depreciation, amortization, rent and nonrecurring items. The Company's segment information does not include an allocation of overhead costs, which for the inpatient services segment are between 3% - 4% of inpatient services net

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revenues, and for the pharmacy and medical supply segment are approximately 1% of the net revenues of that segment. Certain prior year amounts have been reclassified to conform to the current year presentation.

10. Restricted Assets

The Company's cash balance at March 31, 2001 was approximately \$23,867,000 (\$23,867,000 held by Multicare and \$0 held by Genesis). As a result of certain restrictions placed on Multicare and Genesis by their respective senior credit agreements and the automatic stay provisions imposed by the Bankruptcy Court, Genesis and Multicare are precluded from freely transferring funds through intercompany loans, advances or cash dividends. Consequently, the \$23,867,000 of cash and other assets held by Multicare at March 31, 2001 is not available to Genesis.

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At March 31, 2001, the Company reported restricted investments in marketable securities of \$34,493,000 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. LHC is not a party to the Chapter 11 cases.

11. ElderTrust Transactions

Effective January 31, 2001, we restructured our relationship with ElderTrust, a Maryland healthcare real estate investment trust (the "ElderTrust Transactions"). The related agreements encompass, among other things, the resolution of leases and mortgages for 33 properties operated by Genesis and Multicare either directly or through joint ventures. Under its agreement, Genesis assumed the ElderTrust leases subject to certain modifications, including a reduction in Genesis' annual lease expense of \$745,000; extended the maturity and reduced the principal balances of loans for three assisted living properties by \$8,500,000 by satisfaction of an ElderTrust obligation of like amount; and acquired a building previously leased from ElderTrust, which is located on the campus of a Genesis skilled nursing facility, for \$1,250,000. In its agreement with ElderTrust, Multicare sold three owned assisted living properties that were mortgaged to ElderTrust for principal amounts totaling \$19,650,000 in exchange for the outstanding indebtedness. ElderTrust leases the properties back to Multicare under a new ten-year lease with annual rents of \$792,000. The net impact of these transactions to the Company was a gain of \$2,229,000, which has been deferred over the average term of the lease agreements.

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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: pharmacy and medical supply services, and inpatient services; however, we also derive revenue from other sources.

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We include in inpatient services revenue all room and board charges and ancillary service revenue for our eldercare customers at our 195 owned, leased and Multicare jointly-owned eldercare centers.

We provide pharmacy and medical supply services through our 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 operated by Genesis, as well as to independent healthcare providers by contract. We provide these services through 64 institutional pharmacies (three 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 29 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 charged to 89 independently and jointly owned eldercare centers, consulting services, homecare services, physician services, transportation services, diagnostic services, hospitality services, group purchasing fees, respiratory health services and other healthcare related services.

Certain Transactions and Events

Liquidity and Going Concern Assumption

The accompanying unaudited condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern with the realization of assets and the settlement of liabilities and commitments in the normal course of business. However, as a result of the Bankruptcy cases and circumstances relating to this event, including the Company's leveraged financial structure, losses from operations and defaults under various loan agreements, such realization of assets and liquidation of liabilities is subject to significant uncertainty. While under the protection of Chapter 11, the Company may sell or otherwise dispose of assets, and liquidate or settle liabilities, for amounts other than those reflected in the financial statements. Further, a plan of reorganization could materially change the amounts reported in the financial statements, which do not give effect to all adjustments of the carrying value of assets or liabilities that might be necessary as a consequence of a plan of reorganization. The Company's ability to continue as a going concern is dependent upon, among other things, confirmation of a plan of reorganization, future profitable operations, the ability to comply with the terms of the Company's debtor-in-possession financing agreements and the ability to generate sufficient cash flow.

Our financial difficulties are attributed to a number of factors. First, the federal government has made fundamental changes to the reimbursement for medical services provided to individuals. The changes have had a significant adverse impact on the healthcare industry as a whole and on our cash flows. Second, the federal reimbursement changes have exacerbated a long-standing problem of less than fair reimbursement by the states for medical services provided to indigent persons under the various state Medicaid programs. Third, numerous other factors have adversely affected our 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 were too highly leveraged to service our debt, including our long-term lease obligations.

Multicare Transaction and its Restructuring

In October 1997, Genesis, The Cypress Group (together with its affiliates, "Cypress"), TPG Partners II, L.P., (together with its affiliates, "TPG") and Nazem, Inc. ("Nazem") acquired all of the issued and outstanding common stock of Genesis ElderCare Corp., a Delaware corporation. Cypress, TPG and Nazem purchased 210,000, 199,500 and 10,500 shares of Genesis ElderCare Corp. common stock, respectively, representing in the aggregate approximately 56.4% of the issued and outstanding common stock of Genesis ElderCare Corp., for an aggregate purchase price of \$420,000,000. Genesis purchased 325,000 shares of Genesis ElderCare Corp. common stock, representing approximately 43.6% of the issued and outstanding common stock of Genesis ElderCare Corp., for an aggregate purchase price of \$325,000,000. Cypress, TPG and Nazem are sometimes collectively referred to herein as the "Sponsors".

In October 1997, as a result of a tender offer and a merger transaction, Genesis ElderCare Corp. acquired 100% of the outstanding shares of common stock of Multicare, making Multicare a wholly-owned subsidiary of Genesis ElderCare Corp. (the "Merger"). In connection with their investments in the common stock of Genesis ElderCare Corp., Genesis, Cypress, TPG and Nazem entered into a stockholders agreement dated as of October 9, 1997 (the "Multicare Stockholders Agreement"), and Genesis, Cypress, TPG and Nazem entered into a put/call agreement, dated as of October 9, 1997 (the "Put/Call Agreement") relating to their respective ownership interests in Genesis ElderCare Corp. pursuant to which, among other things, Genesis had the option to purchase (the "Call") Genesis ElderCare Corp. common stock held by Cypress, TPG and Nazem at a price determined pursuant to the terms of the Put/Call Agreement. Cypress, TPG and Nazem had the option to sell (the "Put") such Genesis ElderCare Corp. common stock at a price determined pursuant to the Put/Call Agreement.

On October 8, 1999, Genesis entered into a restructuring agreement with Cypress, TPG and Nazem (the "Restructuring Agreement") to restructure their joint investment in Genesis ElderCare Corp., the parent company of Multicare.

Pursuant to the Restructuring Agreement, the Put under the Put/Call Agreement was terminated in exchange for:

- o 24,369 shares of Genesis' Series H Senior Convertible Participating Cumulative Preferred Stock (the "Series H Preferred"), which were issued to Cypress, TPG and Nazem, or their affiliated investment funds, in proportion to their respective investments in Genesis ElderCare Corp.; and
- o 17,631 shares of Genesis' Series I Senior Convertible Exchangeable Participating Cumulative Preferred Stock, (the "Series I Preferred") which were issued to Cypress, TPG and Nazem, or their affiliated investment funds, in proportion to their respective investments in Genesis ElderCare Corp.

Cypress and TPG invested in the aggregate, directly or through affiliated investment funds, \$50,000,000 into Genesis in exchange for 12,500,000 shares of Genesis Common Stock and a ten year warrant to purchase 2,000,000 shares of Genesis Common Stock at an exercise price of \$5.00 per share.

ElderTrust Transactions

Effective January 31, 2001, we restructured our relationship with ElderTrust, a Maryland healthcare real estate investment trust (the "ElderTrust

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Transactions"). The related agreements encompass, among other things, the resolution of leases and mortgages for 33 properties operated by Genesis and Multicare either directly or through joint ventures. Under its agreement, Genesis assumed the ElderTrust leases subject to certain modifications, including a reduction in Genesis' annual lease expense of \$745,000; extended the maturity and reduced the principal balances of loans for three assisted living properties by \$8,500,000 by satisfaction of an ElderTrust obligation of like amount; and acquired a building previously leased from ElderTrust, which is located on the campus of a Genesis skilled nursing facility, for \$1,250,000. In its agreement with ElderTrust, Multicare sold three owned assisted living properties that were mortgaged to ElderTrust for principal amounts totaling \$19,650,000 in exchange for the outstanding indebtedness. ElderTrust leases the properties back to Multicare under a new ten-year lease with annual rents of \$792,000. The net impact of these transactions to the Company was a gain of \$2,229,000, which has been deferred over the average term of the lease agreements.

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AGE Institute

In the fourth fiscal quarter of 2000, we received notice from the AGE Holdings, Inc., a not-for-profit owner / sponsor of 20 eldercare centers with approximately 2,400 beds, that it wished to discontinue our management contracts and ancillary service contracts (the "AGE Contracts"). Effective October 31, 2000, the AGE Contracts were terminated. In fiscal 2000, the AGE Contracts generated approximately \$19,000,000 in revenue and \$2,000,000 in operating income.

On November 27, 2000, Genesis Health Ventures, Inc., along with several subsidiaries, filed an adversary proceeding in the Genesis bankruptcy cases against four related nursing home owners (AGE Institute of Pennsylvania, Inc.; AGE Institute of Massachusetts, Inc.; AGE Institute of Florida, Inc.; and Delaware Valley Convalescent Homes, Inc.); and their parent company AGE Holdings, Inc. The complaint seeks to recover approximately \$20,800,000 owed to Genesis through the AGE Contracts, by which Genesis provided services to 20 nursing homes owned by the defendants in Pennsylvania, Massachusetts and Florida. The complaint asserts counts against all defendants for breach of contract, civil conspiracy and unjust enrichment, and against AGE Institute of Pennsylvania, Inc. and AGE Institute of Massachusetts, Inc. for breach of certain trust indentures. On January 4, 2001, the AGE defendants filed a motion to dismiss the claims for conspiracy and for breach of the trust indentures; to dismiss AGE Holdings, Inc., as a defendant; and to strike Genesis' demands for punitive damages and attorneys' fees. Genesis has filed a response to the motion, which is pending. Following a scheduling conference on April 26, 2001, the United States District Court for the District of Delaware circulated a proposed scheduling order which set forth the following deadlines (1) on or before May 21, 2001, defendants shall file their answer to all allegations not subject to a motion to dismiss, and shall include therewith any affirmative defenses and counterclaims; (2) on or before May 21, 2001, the parties shall exchange self-executing disclosures; (3) on or before October 1, 2001, all motions to join other parties shall be filed; (4) on or before March 15, 2002, all fact and expert discovery shall be completed; (5) on or before October 1, 2001, all motions to amend pleadings shall be filed; (6) on or before March 29, 2002, case dispositive motions shall be filed with an opening brief; (7) a pretrial conference will be held on May 2, 2002. Trial is scheduled to commence on June 3, 2002.

Sale of Ohio Operations

In the third fiscal quarter of 2000, effective May 31, 2000, Multicare sold 14 eldercare centers with 1,128 beds located in the state of Ohio for approximately

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\$33,000,000. The Company recorded a loss on sale of the Ohio properties of approximately \$7,922,000.

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Results of Operations

Three months ended March 31, 2001 compared to three months ended March 31, 2000

The Company's total net revenues for the quarter ended March 31, 2001 were \$630,082,000 compared to \$604,843,000 for the quarter ended March 31, 2000, an increase of \$25,239,000, or 4%.

Inpatient service revenue increased \$3,191,000, or 1%, to \$334,275,000 from \$331,084,000. Of this increase, approximately \$3,008,000 is attributed to the consolidation of two eldercare centers previously under joint ownership that became wholly-owned effective July 1, 2000 (the "P&R Transaction"). Approximately \$326,000 of the increase resulted from the consolidation of one additional eldercare center previously under joint ownership that became wholly-owned effective January 31, 2001 in connection with the ElderTrust Transactions. Approximately \$17,546,000 is principally attributed to increased payment rates and higher Medicare, private pay and insurance patient days ("Quality Mix") as a percentage of total patient days. The Company's average rate per patient day for the quarter ended March 31, 2001 was \$165 compared to \$153 for the comparable period in the prior year. This increase in the average rate per patient day is principally driven by the effect of the BBRA on our average Medicare rate per patient day, which increased to \$315 for the quarter ended March 31, 2001 compared to \$288 for the comparable period in the prior year. The Company's revenue Quality Mix for the quarter ended March 31, 2001 was 51.3% compared to 50.2% for the comparable period in the prior year. These rate and mix increases are offset by a decrease in revenue of approximately \$17,689,000 resulting from the sale, closure or lease terminations of certain eldercare centers. Total patient days decreased 149,378 to 2,020,767 during the quarter ended March 31, 2001 compared to 2,170,145 during the comparable period last year. Of this decrease, 133,209 patient days are attributed to the sale, closure or lease terminations of certain eldercare centers; offset by the consolidation of 23,847 patient days of three eldercare centers following the P&R and Eldertrust Transactions. A decrease of 22,385 days compared to the comparable period last year is attributed to one additional calendar day in the March 31, 2000 quarter due to a leap year. The remaining decrease of 17,631 patient days is the result of a decrease in overall occupancy.

Pharmacy and medical supply service revenue was \$255,601,000 for the quarter ended March 31, 2001 compared to \$232,942,000 for the quarter ended March 31, 2000. Pharmacy and medical supply service revenues increased approximately \$22,660,000, or 10%, due primarily to net revenue growth with external customers.

Other revenues decreased approximately \$611,000 from \$40,817,000 to \$40,206,000. This decline is partially offset by approximately \$3,200,000 due to the consolidation of a respiratory health services business acquired in the fourth fiscal quarter of 2000, and by a decline in revenue of approximately \$2,000,000 resulting from the termination of certain management contracts, primarily contracts with AGE Institute. The remaining decrease of approximately \$1,800,000 is attributed to a decline in interest income, development fee revenue and a net decline in revenues of other service businesses.

The Company's operating expenses before depreciation, amortization, lease

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expense, interest expense and certain charges, more fully described in paragraphs that follow, increased \$44,339,000, or 8%, to \$575,652,000 for the quarter ended March 31, 2001 from \$531,313,000 for the comparable period in the prior year. This net increase is attributed to approximately \$3,900,000 from the consolidation of a respiratory health services business acquired in the fourth fiscal quarter of 2000, approximately \$3,062,000 is attributed to the consolidation of the operating expenses of three eldercare centers following the P&R and ElderTrust Transactions, approximately \$3,978,000 is attributed to increases in the cost of certain self-insured employee health coverage, approximately \$2,745,000 is attributed to higher bad debt provisions; approximately \$20,900,000 is attributed to an increase in pharmacy and medical supply cost of sales (\$13,600,000 of which is attributed to pharmacy and medical supply revenue volume growth, and \$7,300,000 is attributed to price decreases to major customers, the impact of changes in reimbursement, and changes in customer and product mix); and is offset by \$16,048,000 of operating cost savings resulting from the sale, closure or lease terminations of certain eldercare centers. The remaining increase in operating expenses of approximately \$25,800,000 is attributed to growth in labor related costs, property and liability insurance related costs and general inflationary cost increases.

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The accelerated operating cost growth rate is attributed to continued pressure on wage and benefit related costs in all of our operating businesses. The Company and the industry continue to experience significant shortages in qualified professional clinical staff. As the demand for these services continually exceeds the supply of available and qualified staff, the Company and our competitors have been forced to offer more attractive wage and benefit packages to these professionals and to utilize outside contractors for these services at premium rates. Furthermore, the competitive arena for this shrinking labor market has created high turnover among clinical professional staff as many seek to take advantage of the supply of available positions, many offering new and more attractive wage and benefit packages. In addition to the wage pressures inherent in this environment, the cost of training new employees amid the high turnover rates has caused added pressure on our operating margins. In addition to labor pressures, the Company and industry continue to experience an adverse effect on operating profits due to an increase in the cost of certain of its insurance programs. Rising costs of eldercare malpractice litigation involving nursing care operators and losses stemming from these malpractice lawsuits has caused many insurance providers to raise the cost of insurance premiums or refuse to write insurance policies for nursing homes. Accordingly, the costs of general and professional liability and property insurance premiums have increased. Also, the impact of government regulation in a heavily regulated environment has adversely impacted our ability to reduce costs. The pressures on operating expenses described above are coupled with the effects of the federal and state governments' and other third party payors' trend toward imposing lower reimbursement rates, resulting in our inability to grow revenues at a rate that equals or exceeds the growth in our cost levels. The downward trend of reimbursement rates to nursing care operators and the cost pressures previously described have adversely impacted customers of our ancillary service businesses, resulting in pricing pressures in those businesses.

During the three months ended March 31, 2001 and 2000, the Company recorded charges in connection with debt restructuring, reorganization costs and other charges; and the loss on the sale of an eldercare center. The following table and discussion provides additional information on these charges.

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Debt Restructuring and Reorganization Costs:		
Professional, bank and other fees	\$ 8,113,000	\$ 5,000,000
Interest Rate Swap Termination	-	28,300,000
Employee benefit related costs	1,892,000	
Exit costs of terminated businesses	492,000	
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Total debt restructuring and reorganization costs	\$ 10,497,000	\$ 33,300,000
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Other Charges:		
Exit costs and write-offs of unrecoverable assets of a closed eldercare center	\$ -	\$ 3,000,000
Renegotiated pharmacy contract charge	3,500,000	
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Total other charges	\$ 3,500,000	\$ 3,000,000
<hr style="border-top: 1px dashed black;"/>		
Total debt restructuring, reorganization costs and other charges	\$ 13,997,000	\$ 36,300,000
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Loss on sale of an eldercare center	\$ 2,310,000	\$ -
<hr style="border-top: 1px dashed black;"/>		

During the three months ended March 31, 2001, we incurred approximately \$10,497,000 of legal, bank, accounting and other costs in connection with our debt restructuring and the Chapter 11 cases. Of these charges, approximately \$8,113,000 is attributed to professional, bank and other fees and approximately \$1,892,000 pertains to certain salary and benefit related costs, principally for a court approved special recognition program. In addition, we incurred approximately \$492,000 of costs associated with exiting certain terminated businesses. The Company expects that such debt restructuring, reorganization costs and other charges will continue at current, and perhaps accelerated, levels throughout the course of our Chapter 11 cases. During the three months ended March 31, 2000, the Company began discussions with its lenders under the Genesis and Multicare Credit Facilities to revise the Company's capital structure. During the discussion period, Genesis and Multicare did not make certain scheduled principal and interest payments under the Genesis and Multicare Credit Facilities or certain scheduled interest payments under certain of the Genesis senior subordinated debt agreements. In connection with the potential debt restructuring, the Company incurred during the three months ended March 31, 2000 legal, bank, accounting and other professional fees of approximately \$5,000,000. As a result of the nonpayment of interest under the Genesis Credit Facility, certain provisions under existing interest rate swap arrangements with Citibank were triggered. Citibank notified Genesis that they elected to force early termination of the interest rate swap arrangements, and asserted a \$28,300,000 obligation.

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During the three months ended March 31, 2001, we renegotiated the pharmacy supply agreement with our principal supplier of pharmacy related products. These negotiations resulted in more beneficial credit terms and reductions to the pricing on certain products. In connection with this renegotiation, the company paid \$3,500,000.

During the quarter ended March 31, 2000, the company decided to close an underperforming eldercare center resulting in a charge of approximately \$3,100,000 for certain closure costs and impaired assets at that center.

In April of 2001, the Company sold an operational 121 bed eldercare center for cash consideration of approximately \$461,000. The sale resulted in a net loss on

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sale of approximately \$2,310,000 which has been accrued at March 31, 2001.

Depreciation and amortization expense decreased \$2,576,000, principally attributed to the fourth quarter of fiscal 2000 write-off of impaired goodwill and property, plant and equipment and the sale, closure or lease terminations of certain eldercare centers.

Lease expense decreased \$390,000, of which approximately \$480,000 is attributed to the sale, closure or lease terminations of certain eldercare centers, offset by an increase of approximately \$304,000 attributed to the consolidation of two leased eldercare centers in connection of the P&R Transaction. The remaining decrease of approximately \$214,000 is due to the effects of the ElderTrust Transactions; partially offset by growth in the cost of a variable rate lease financing facility and scheduled increases in fixed lease rates.

Interest expense decreased \$25,113,000. In accordance with SOP 90-7, the Company ceased accruing interest following the Petition Date on certain long-term debt instruments classified as liabilities subject to compromise. The Company's contractual interest expense for the three months ended March 31, 2001 was \$56,703,000, leaving \$25,090,000 of interest expense unaccrued for the three months ended March 31, 2001 as a result of the Chapter 11 filings. Contractual interest expense for the three months ended March 31, 2001 was relatively unchanged compared to \$56,726,000 for the same period in the prior year due to debt reductions resulting from the Eldertrust Transactions and the Ohio Sale; offset by additional net capital and working capital borrowings and an increase in the Company's weighted average borrowing rate prompted by increases in market rates of interest and higher interest rate spreads charged by the Company's lenders in connection with the Company's worsening financial condition and the Chapter 11 cases.

As a result of the Company's Chapter 11 filings and uncertainties regarding its ability to generate sufficient taxable income to utilize future net operating loss carryforwards, the Company recorded a valuation allowance on all incremental net operating loss carryforward benefits during the three months ended March 31, 2001 and consequently, did not report an income tax benefit for the three months ended March 31, 2001. The Company reported a \$8,455,000 tax benefit for the three months ended March 31, 2000.

Equity in net loss of unconsolidated affiliates for the three months ended March 31, 2001 was \$814,000 compared to \$662,000 for the comparable period in the prior year, which is attributed to changes in the earnings / losses reported by the Company's unconsolidated affiliates, as well as the P&R Transaction.

Minority interest decreased \$2,375,000 during the three months ended March 31, 2001 to \$4,387,000 compared to \$6,762,000 for the comparable period in the prior year. This decrease is principally attributed to a lower net loss reported by Multicare and the resulting Genesis' Multicare joint venture partners' 56.4% interest in the Multicare net loss for the period. The Multicare net loss was reduced during the three months ended March 31, 2001 compared to the comparable period in the prior year, principally due to lower interest expense recognition under SOP 90-7.

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Preferred stock dividends decreased \$126,000 to \$11,249,000 during the three months ended March 31, 2001 compared to \$11,375,000 for the comparable period in the prior year. This decrease is attributed to there being one additional day in the quarter ended March 31, 2000 due to a leap year.

Six months ended March 31, 2001 compared to six months ended March 31, 2000

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The Company's total net revenues for the six months ended March 31, 2001 were \$1,259,101,000 compared to \$1,191,727,000 for the six months ended March 31, 2000, an increase of \$67,374,000, or 6%.

Inpatient service revenue increased \$10,563,000, or 2%, to \$667,974,000 from \$657,411,000. Of this increase, approximately \$6,100,000 is attributed to the consolidation of two eldercare centers previously under joint ownership that became wholly-owned effective July 1, 2000 (the "P&R Transaction"). Approximately \$326,000 of the increase resulted from the consolidation of one additional eldercare center previously under joint ownership that became wholly-owned effective January 31, 2001 in connection with the ElderTrust Transactions. Approximately \$41,546,000 is principally attributed to increased payment rates and higher Medicare, private pay and insurance patient days ("Quality Mix") as a percentage of total patient days. The Company's average rate per patient day for the six months ended March 31, 2001 was \$163 compared to \$150 for the comparable period in the prior year. This increase in the average rate per patient day is principally driven by the effect of the BBRA on our average Medicare rate per patient day, which increased to \$315 for the six months ended March 31, 2001 compared to \$289 for the comparable period in the prior year. The Company's revenue Quality Mix for the six months ended March 31, 2001 was 50.7% compared to 49.6% for the comparable period in the prior year. These rate and mix increases are offset by a decrease in revenue of approximately \$37,400,000 resulting from the sale, closure or lease terminations of certain eldercare centers. Total patient days decreased 282,809 to 4,098,175 during the six months ended March 31, 2001 compared to 4,380,984 during the comparable period last year. Of this decrease, 282,708 patient days are attributed to the sale, closure or lease terminations of certain eldercare centers; offset by the consolidation of 44,672 patient days of three eldercare centers following the P&R and Eldertrust Transactions. A decrease of 22,385 days compared to the comparable period last year is attributed to one additional calendar day in the March 31, 2000 quarter due to a leap year. The remaining decrease of 22,388 patient days is the result of a decrease in overall occupancy.

Pharmacy and medical supply service revenue was \$511,175,000 for the six months ended March 31, 2001 compared to \$456,849,000 for the six months ended March 31, 2000. Pharmacy and medical supply service revenues increased approximately \$54,326,000, or 12%, due primarily to net revenue growth with external customers.

Other revenues increased approximately \$2,485,000 from \$77,467,000 to \$79,952,000. Approximately \$6,500,000 of this increase is attributed to the revenues of a respiratory health services business acquired in the fourth fiscal quarter of 2000, offset by a decline in revenue of approximately \$3,400,000 resulting from the termination of certain management contracts, primarily with AGE Institute. The remaining decrease of approximately \$614,000 is attributed to a decline in interest income, development fee revenue and a net decline in revenues of other service businesses.

The Company's operating expenses before depreciation, amortization, lease expense, interest expense and certain charges, more fully described in paragraphs that follow, increased \$99,926,000, or 10%, to \$1,144,653,000 for the six months ended March 31, 2001 from \$1,044,727,000 for the comparable period in the prior year. This net increase is attributed to approximately \$7,800,000 from the consolidation of a respiratory health services business acquired in the fourth fiscal quarter of 2000, approximately \$5,840,000 is attributed to the consolidation of the operating expenses of three eldercare centers following the P&R and ElderTrust Transactions, approximately \$7,700,000 is attributed to increases in the cost of certain self-insured employee health coverage, approximately \$4,776,000 is attributed to higher bad debt provisions; approximately \$49,000,000 is attributed to an increase in pharmacy and medical supply cost of sales (\$32,100,000 of which is attributed to pharmacy and medical

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supply revenue volume growth, and \$16,900,000 is attributed to price decreases to major customers, the impact of changes in reimbursement, and changes in

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customer and product mix); and is offset by \$33,900,000 of operating cost savings resulting from the sale, closure or lease terminations of certain eldercare centers. The remaining increase in operating expenses of approximately \$58,700,000 is attributed to growth in labor related costs, property and liability insurance related costs and general inflationary cost increases.

The accelerated operating cost growth rate is attributed to continued pressure on wage and benefit related costs in all of our operating businesses. The Company and the industry continue to experience significant shortages in qualified professional clinical staff. As the demand for these services continually exceeds the supply of available and qualified staff, the Company and our competitors have been forced to offer more attractive wage and benefit packages to these professionals and to utilize outside contractors for these services at premium rates. Furthermore, the competitive arena for this shrinking labor market has created high turnover among clinical professional staff as many seek to take advantage of the supply of available positions, many offering new and more attractive wage and benefit packages. In addition to the wage pressures inherent in this environment, the cost of training new employees amid the high turnover rates has caused added pressure on our operating margins. In addition to labor pressures, the Company and industry continue to experience an adverse effect on operating profits due to an increase in the cost of certain of its insurance programs. Rising costs of eldercare malpractice litigation involving nursing care operators and losses stemming from these malpractice lawsuits has caused many insurance providers to raise the cost of insurance premiums or refuse to write insurance policies for nursing homes. Accordingly, the costs of general and professional liability and property insurance premiums have increased. Also, the impact of government regulation in a heavily regulated environment has adversely impacted our ability to reduce costs. The pressures on operating expenses described above are coupled with the effects of the federal and state governments' and other third party payors' trend toward imposing lower reimbursement rates, resulting in our inability to grow revenues at a rate that equals or exceeds the growth in our cost levels. The downward trend of reimbursement rates to nursing care operators and the cost pressures previously described have adversely impacted customers of our ancillary service businesses, resulting in pricing pressures in those businesses.

During the six months ended March 31, 2001 and 2000, the Company recorded charges in connection with the Multicare joint venture restructuring; debt restructuring, reorganization costs and other charges; and a gain/loss on the sale of two eldercare centers. The following table and discussion provides additional information on these charges.

	2001	2000
Multicare joint-venture restructuring	\$ -	\$ 420,000

Debt Restructuring and Reorganization Costs:		
Professional, bank and other fees	\$ 18,212,000	\$ 5,000,000
Interest Rate Swap Termination	-	28,300,000
Employee benefit related costs	5,854,000	
Stock option redemption program	-	7,700,000

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Exit costs of terminated businesses	640,000	
Total debt restructuring and reorganization costs	\$ 24,706,000	\$ 41,0
Other Charges:		
Exit costs and write-offs of unrecoverable assets of a closed eldercare center	\$ -	\$ 3,0
Renegotiated pharmacy contract charge	3,500,000	
Total other charges	\$ 3,500,000	\$ 3,0
Total debt restructuring, reorganization costs and other charges	\$ 28,206,000	\$ 44,1
Gain on sale of an eldercare center	\$ (1,770,000)	\$
Loss on sale of an eldercare center	\$ 2,310,000	\$

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In connection with the restructuring transaction in the six months ended March 31, 2000, Genesis recorded a non-cash charge of approximately \$420,000,000 representing the estimated cost to terminate the Put in consideration for the issuance of the Series H Preferred and Series I Preferred. The cost to terminate the Put was estimated based upon our assessment that no incremental value was realized by Genesis as a result of the changes in the equity ownership structure of Multicare brought about by the restructuring of the Multicare joint venture.

During the six months ended March 31, 2001, we incurred approximately \$24,706,000 of legal, bank, accounting and other costs in connection with our debt restructuring and the Chapter 11 cases. Of these charges, approximately \$18,212,000 is attributed to professional, bank and other fees and approximately \$5,854,000 pertains to certain salary and benefit related costs, principally for a court approved special recognition program. In addition, we incurred approximately \$640,000 of costs associated with exiting certain terminated businesses. The Company expects that such debt restructuring, reorganization costs and other charges will continue at current, and perhaps accelerated, levels throughout the course of our Chapter 11 cases. During the six months ended March 31, 2000, the Company began discussions with its lenders under the Genesis and Multicare Credit Facilities to revise the Company's capital structure. During the discussion period, Genesis and Multicare did not make certain scheduled principal and interest payments under the Genesis and Multicare Credit Facilities or certain scheduled interest payments under certain of the Genesis senior subordinated debt agreements. In connection with the potential debt restructuring, the Company incurred during the three months ended March 31, 2000 legal, bank, accounting and other professional fees of approximately \$5,000,000. As a result of the nonpayment of interest under the Genesis Credit Facility, certain provisions under existing interest rate swap arrangements with Citibank were triggered. Citibank notified Genesis that they elected to force early termination of the interest rate swap arrangements, and asserted a \$28,300,000 obligation.

During the six months ended March 31, 2000, the Company recorded a non-cash pre tax charge of \$7,720,000 for a stock option redemption program (the "Redemption Program") under which current Genesis employees and directors elected to surrender certain Genesis stock options for unrestricted shares of Genesis Common Stock. The Redemption Plan was approved by shareholder vote at the

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Company's 2000 Annual Meeting. As a result of the Company's worsening financial condition and other considerations, the Company determined not to proceed with the Redemption Program, and therefore the \$7,720,000 charge recorded in the first quarter of fiscal 2000 was subsequently reversed. The elections made by optionees would have resulted in the redemption of approximately 4,600,000 stock options in exchange for approximately 4,000,000 shares of Genesis Common Stock.

During the six months ended March 31, 2001, we renegotiated the pharmacy supply agreement with our principal supplier of pharmacy related products. These negotiations resulted in more beneficial credit terms and reductions to the pricing on certain products. In connection with this renegotiation, the company paid \$3,500,000.

In October of 2000, the Company sold an idle 232 bed eldercare center for cash consideration of approximately \$7,000,000, resulting in a net gain of approximately \$1,770,000. In April of 2001, the Company sold an underperforming 121 bed eldercare center for cash consideration of approximately \$461,000. The sale resulted in a net loss of approximately \$2,310,000 which has been accrued at March 31, 2001.

Depreciation and amortization expense decreased \$4,768,000, principally attributed to the fourth quarter of fiscal 2000 write-off of impaired goodwill and property, plant and equipment and the sale, closure or lease terminations of certain eldercare centers.

Lease expense decreased \$512,000, of which approximately \$1,158,000 is attributed to the sale, closure or lease terminations of certain eldercare centers, offset by an increase of approximately \$608,000 attributed to the consolidation of two leased eldercare centers in connection with the P&R Transaction. The remaining increase of approximately \$38,000 is attributed to growth in the cost of a variable rate lease financing facility and scheduled increases in fixed lease rates; offset by the effects of the ElderTrust Transactions.

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Interest expense decreased \$43,735,000. In accordance with SOP 90-7, the Company ceased accruing interest following the Petition Date on certain long-term debt instruments classified as liabilities subject to compromise. The Company's contractual interest expense for the six months ended March 31, 2001 was \$116,113,000, leaving \$50,346,000 of interest expense unaccrued for the six months ended March 31, 2001 as a result of the Chapter 11 filings. The relative increase in contractual interest expense of \$6,611,000 for the six months ended March 31, 2001 compared to the same period in the prior year is the result of additional net capital and working capital borrowings and an increase in the Company's weighted average borrowing rate prompted by increases in market rates of interest and higher interest rate spreads charged by the Company's lenders in connection with the Company's worsening financial condition and the Chapter 11 cases; offset by the effect of debt reductions as a result of the Eldertrust Transactions and the Ohio Sale.

As a result of the Company's Chapter 11 filings and uncertainties regarding its ability to generate sufficient taxable income to utilize future net operating loss carryforwards, the Company recorded a valuation allowance on all incremental net operating loss carryforward benefits during the six months ended March 31, 2001 and consequently, did not report an income tax benefit for the six months ended March 31, 2001. The Company reported a \$15,735,000 tax benefit for the six months ended March 31, 2000.

Equity in net loss of unconsolidated affiliates for the six months ended March 31, 2001 was \$1,030,000 compared to \$1,268,000 for the comparable period in the

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prior year, which is attributed to changes in the earnings / losses reported by the Company's unconsolidated affiliates, as well as the P&R Transaction.

Minority interest decreased \$8,097,000 during the six months ended March 31, 2001 to \$6,198,000 compared to \$14,295,000 for the comparable period in the prior year. This decrease is principally attributed to a lower net loss reported by Multicare and the resulting Genesis' Multicare joint venture partners' 56.4% interest in the Multicare net loss for the period. The Multicare net loss was reduced during the six months ended March 31, 2001 compared to the comparable period in the prior year, principally due to lower interest expense recognition under SOP 90-7.

Effective October 1, 1999, Genesis adopted the provisions of the American Institute of Certified Public Accountant's Statement of Position 98-5 "Reporting on the Costs of Start-Up Activities" (SOP 98-5) which requires start-up costs be expensed as incurred. For the six months ended March 31, 2000, the cumulative effect of expensing all unamortized start-up costs at October 1, 1999 was \$16,400,000 pre tax and \$10,412,000 after tax.

Preferred stock dividends increased \$3,068,000 to \$22,749,000 during the six months ended March 31, 2001 compared to \$19,681,000 for the comparable period in the prior year. This increase is attributed to a full six months of accrued dividends for the six months ended March 31, 2001, in connection with the issuance of Series H and Series I Preferred Stock in mid-November, 1999, offset partially by there being one additional day in the six months ended March 31, 2000 due to a leap year.

Liquidity and Capital Resources

Chapter 11 Bankruptcy and Debtor-In-Possession Financing

On June 22, 2000 (the "Petition Date"), the Company and substantially all of its subsidiaries and affiliates, filed voluntary petitions in the United States Bankruptcy Court for the District of Delaware under the Bankruptcy Code. While this action constituted a default under the Company's and such subsidiaries and affiliates various financing arrangements, Section 362(a) of the Bankruptcy Code imposes an automatic stay that generally precludes creditors and other interested parties under such arrangements from taking any remedial action in response to any such resulting default without prior Bankruptcy Court approval. Among the orders entered by the Bankruptcy Court on June 23, 2000 were orders approving on an interim basis, a) the use of cash collateral by the Company and those of its subsidiaries and affiliates which had filed petitions for reorganization under Chapter 11 of the Bankruptcy Code and (excluding Multicare and its direct and indirect subsidiaries), b) authorization for Genesis to enter into a secured debtor-in-possession revolving credit facility with a group of banks led by Mellon Bank, N. A., (the "Genesis DIP Facility") and authorizing advances in the interim period of up to \$150,000,000 out of a possible \$250,000,000 facility. On July 18, 2000, the Bankruptcy Court entered the Final

Order approving the \$250,000,000 Genesis DIP Facility and permitting full usage thereunder. Usage under the Genesis DIP Facility is subject to a Borrowing Base which provides for maximum borrowings (subject to the \$250,000,000 commitment limit) by the Company equal to the sum of (i) up to 90% of outstanding eligible accounts receivable, as defined and (ii) up to \$175,000,000 against real property. The Genesis DIP Facility, which is classified as a current liability, matures on December 21, 2001 and advances thereunder accrue interest at either Prime plus 2.25% or the Eurodollar ("LIBO") Rate plus 3.75%. Proceeds of the Genesis DIP Facility are available for general working capital purposes and as a

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condition of the loan, were required to refinance the \$40,000,000 outstanding under the Company's prepetition priority Tranche II sub-facility. Additionally, \$44,000,000 of proceeds were used to satisfy all unpaid interest and rent obligations to the senior secured creditors under the Fourth Amended and Restated Credit Agreement dated August 20, 1999 and the Synthetic Lease dated October 7, 1996 as adequate protection for any diminution in value of the prepetition senior secured lenders in these facilities, respectively. The Company will continue to pay interest and rent pursuant to these agreements as adequate protection. Interest is accrued and paid at the Prime Rate as announced by the administrative agent, or the applicable Adjusted LIBO Rate plus, in either event, a margin that is dependent upon a certain financial ratio test. As of March 31, 2001 borrowings outstanding under the Genesis DIP Facility were \$165,000,000. Through May 9, 2001 borrowings outstanding under the Genesis DIP Facility were \$173,000,000. The Genesis DIP Facility provides for the issuance of up to \$25,000,000 in standby letters of credit. Through May 9, 2001 there was \$2,451,000 in letters of credit issued thereunder for a total utilization under the Genesis DIP Facility of \$175,451,000.

Pursuant to the agreement, the Company and each of its subsidiaries named as borrowers or guarantors under the Genesis DIP Facility have granted to the lenders first priority liens and security interests (subject to valid, perfected, enforceable and nonavoidable liens of record existing immediately prior to the petition date and other carve-outs and exceptions as fully described in the Genesis DIP Facility) in all unencumbered pre- and post-petition property of the Company. The Genesis DIP Facility also has priority over the liens on all collateral pledged under (i) the Genesis Credit Facility, (ii) the Synthetic Lease dated October 7, 1996 and (iii) other obligations covered by the Collateral Agency Agreement, including any Swap Agreement, which collateral includes, but is not limited to, all personal property, including bank accounts and investment property, accounts receivable, inventory, equipment, and general intangibles, substantially all fee owned real property, and the capital stock of Genesis and its borrower and guarantor subsidiaries.

The Genesis DIP financing agreement limits, among other things, the Company's ability to incur additional indebtedness or contingent obligations, to permit additional liens, to make additional acquisitions, to sell or dispose of assets, to create or incur liens on assets, to pay dividends and to merge or consolidate with any other person. The Genesis DIP Facility contains customary representations, warranties and covenants, including certain financial covenants relating to minimum EBITDA, occupancy and Genesis DIP Facility usage amounts and maximum capital expenditures. The breach of any such provisions, to the extent not waived or cured within any applicable grace or cure periods, could result in the Company's inability to obtain further advances under the Genesis DIP Facility and the potential exercise of remedies by the Genesis DIP Facility lenders (without regard to the automatic stay unless reimposed by the Bankruptcy Court) which could materially impair the ability of the Company to successfully reorganize under Chapter 11.

On February 14, 2001, Genesis received a waiver from its lenders (the "Genesis DIP Lenders") under the Genesis DIP Facility for any event of default regarding certain financial covenants relating to minimum EBITDA that may have resulted from asset impairment and other non-recurring charges recorded by Genesis in the fourth quarter of Fiscal 2000. The waiver concerning the minimum EBITDA covenant requirements extended through December 31, 2000. In addition, Genesis received certain amendments to the Genesis DIP Facility, including an amendment that makes the minimum EBITDA covenant less restrictive in future periods (the "Genesis EBITDA Amendment"). On April 4, 2001, the Bankruptcy Court granted approval for the payment of an amendment fee related thereto.

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Following the Petition Date, Genesis continues to pay interest on approximately \$1,100,000,000 of certain prepetition senior long term debt obligations, which has, in part, resulted in Genesis' active borrowing under the Genesis DIP Facility. An event of default and any related borrowing restrictions placed under the Genesis DIP Facility could have a material adverse effect on the financial position of Genesis, resulting in factors, including, but not limited to, Genesis' inability to:

- o continue funding prepetition senior long term debt interest obligations, which could be disruptive to ongoing reorganization negotiations;
- o extend required letters of credit in the ordinary course of business;
- o fund capital and working capital requirements; and
- o successfully reorganize.

On June 22, 2000, Multicare and substantially all of its affiliates, filed voluntary petitions in the United States Bankruptcy Court for the District of Delaware under the Bankruptcy Code. While this action constituted a default under Multicare's and such affiliates various financing arrangements, Section 362(a) of the Bankruptcy Code imposes an automatic stay that generally precludes creditors and other interested parties under such arrangements from taking any remedial action in response to any such resulting default without prior Bankruptcy Court approval. Among the orders entered by the Bankruptcy Court on June 23, 2000 were orders approving on an interim basis, a) the use of cash collateral by Multicare and those of its affiliates which had filed petitions for reorganization under Chapter 11 of the Bankruptcy Code and (b) authorization for Multicare to enter into a secured debtor-in-possession revolving credit facility with a group of banks led by Mellon Bank, N. A., (the "Multicare DIP Facility") and authorizing advances in the interim period of up to \$30,000,000 out of a possible \$50,000,000. On July 18, 2000, the Bankruptcy Court entered the Final Order approving the \$50,000,000 Multicare DIP Facility and permitting full usage thereunder. Usage under the Multicare DIP Facility is subject to a Borrowing Base which provides for maximum borrowings (subject to the \$50,000,000 commitment limit) by Multicare of up to 90% of outstanding eligible accounts receivable, as defined, and a real estate component. The Multicare DIP Facility matures on December 21, 2001 and advances thereunder accrue interest at either Prime plus 2.25% or the LIBO Rate plus 3.75%. Proceeds of the Multicare DIP Facility are available for general working capital purposes. Through May 9, 2001, there has been no usage under the Multicare DIP Facility, other than for standby letters of credit. The Multicare DIP Facility provides for the issuance of up to \$20,000,000 in standby letters of credit. Through May 9, 2001 there was \$2,203,000 in letters of credit issued thereunder.

The obligations of Multicare under the Multicare DIP Facility are jointly and severally guaranteed by each of Multicare's filing affiliates. Pursuant to the agreement, Multicare and each of its affiliates named as borrowers or guarantors under the Multicare DIP Facility have granted to the lenders first priority liens and security interests (subject to valid, perfected, enforceable and nonavoidable liens of record existing immediately prior to the petition date and other carve-outs and exceptions as fully described in the Multicare DIP Facility) in all unencumbered pre- and post- petition property of Multicare. The Multicare DIP Facility also has priority over the liens on all collateral pledged under the Multicare Credit Facility, which collateral includes, but is not limited to, all personal property, including bank accounts and investment property, accounts receivable, inventory, equipment, and general intangibles, substantially all fee owned real property, and the capital stock of Multicare and its borrower and guarantor affiliates.

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The Multicare DIP financing agreement limits, among other things, Multicare's ability to incur additional indebtedness or contingent obligations, to permit additional liens, to make additional acquisitions, to sell or dispose of assets, to create or incur liens on assets, to pay dividends and to merge or consolidate with any other person. The Multicare DIP Facility contains customary representations, warranties and covenants, including certain financial covenants relating to minimum EBITDA, occupancy and Multicare DIP Facility usage amounts and maximum capital expenditures. The breach of any such provisions, to the extent not waived or cured within any applicable grace or cure periods, could result in Multicare's inability to obtain further advances under the Multicare DIP Facility and the potential exercise of remedies by the Multicare DIP Facility lenders (without regard to the automatic stay unless reimposed by the Bankruptcy Court) which could materially impair the ability of Multicare to successfully reorganize under Chapter 11.

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On February 14, 2001, Multicare received a waiver from its lenders (the "Multicare DIP Lenders") under the Multicare DIP Facility for any event of default regarding certain financial covenants relating to minimum EBITDA that may have resulted from asset impairment and other non-recurring charges recorded in the fourth quarter of Fiscal 2000. The waiver concerning the minimum EBITDA covenant requirements extended through December 31, 2000. In addition, Multicare received certain amendments to the Multicare DIP Facility, including an amendment that makes the minimum EBITDA covenant less restrictive in future periods (the Multicare EBITDA Amendment"). On April 4, 2001, the Bankruptcy Court granted approval for the payment of an amendment fee related thereto.

Multicare discontinued paying interest on virtually all of its prepetition long term debt obligations following the Petition Date, which has, in part, resulted in Multicare's ability to fund capital and working capital needs through operations without borrowing under the Multicare DIP Facility. An event of default and any related borrowing restrictions placed under the Multicare DIP Facility could have a material adverse effect on the financial position of Multicare, and could result in factors including, but not limited to, Multicare's inability to:

- o extend required letters of credit in the ordinary course of business;
- o fund capital and working capital requirements; and
- o successfully reorganize.

Under the Bankruptcy Code, actions to collect prepetition indebtedness are enjoined and other contractual obligations generally may not be enforced against the Company. In addition, the Company may reject executory contracts and lease obligations. Parties affected by these rejections may file claims with the Bankruptcy Court in accordance with the reorganization process. If the Company is able to successfully reorganize, substantially all unsecured liabilities as of the petition date would be subject to modification under a plan of reorganization to be voted upon by all impaired classes of creditors and equity security holders and approved by the Bankruptcy Court.

On or about May 14, 2001, the official committee of Multicare unsecured creditors (the "Multicare Creditors' Committee") appointed in the Multicare Chapter 11 cases filed a motion (the "Trustee Motion") with the Bankruptcy Court requesting entry of an order directing the appointment of a trustee in the Multicare cases. By the Trustee Motion, the Multicare Creditors' Committee seeks the appointment of a trustee to, generally, (a) evaluate and negotiate the various contractual and other relationships between Multicare and Genesis and

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its related entities, (b) evaluate and prosecute claims of Multicare against Genesis, and (c) propose and seek confirmation of a plan of reorganization for Multicare. Alternatively, the Multicare Creditors' Committee has requested in the Trustee Motion that Multicare be directed to engage in a market bid process with respect to its contractual and other relationships with Genesis. Although there can be no assurances as to the outcome of the Trustee Motion, the Company does not believe that the relief requested in the motion is warranted and intends to vigorously oppose such motion in the Bankruptcy Court. A hearing date on the Trustee Motion is presently scheduled to take place on June 6, 2001, although the Company and the Multicare Creditors' Committee have engaged in discussions concerning, among other related matters, an adjournment of the presently scheduled hearing date.

On June 23, 2000 the Bankruptcy Court entered an order authorizing the Debtors to pay certain prepetition wages, salaries, benefits and other employee obligations, as well as to continue in place the Debtors' various employee compensation programs and procedures. On that date, the Bankruptcy Court also authorized the Debtors to pay, among other claims, the prepetition claims of certain critical vendors and patients. All other unsecured prepetition liabilities are classified in the consolidated balance sheet as liabilities subject to compromise. The Debtors intend to remain in possession of their assets and continue in the management and operation of their properties and businesses, and to pay the post-petition claims of their various vendors and providers in the ordinary course of business.

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A summary of the principal categories of claims classified as liabilities subject to compromise under the Chapter 11 cases as of March 31, 2001 and September 30, 2000 follows (in thousands):

	March 31, 2001	Septem 20

Liabilities subject to compromise:		
Revolving credit and term loans	\$1,485,247	\$1,4
Senior subordinated notes	616,643	6
Revenue bonds and other indebtedness	130,431	1

Subtotal - long-term debt subject to compromise	\$2,232,321	\$2,2

Accounts payable and accrued liabilities	56,473	
Accrued interest (including a \$28,331 swap termination fee)	86,575	
Accrued preferred stock dividends on Series G Preferred Stock	44,755	

	\$2,420,124	\$2,4

A summary of the principal categories of debt restructuring and reorganization costs follows (in thousands):

	Three Months Ended March 31, 2001	S Month March
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Debt restructuring and reorganization costs:

Legal, accounting, bank and consulting fees	\$	8,113	\$
Exit costs and write-off of unrecoverable assets of closed eldercare centers		492	
Employee benefit related costs, including severance		1,892	
		\$ 10,497	\$

General Operations

At March 31, 2001, the Company reported working capital of \$274,382,000 as compared to working capital of \$304,241,000 at September 30, 2000. Genesis' cash flow from operations for the six months ended March 31, 2001 was a use of cash of \$13,369,000 compared to a use of cash of \$33,506,000 for the six months ended March 31, 2000. The improvement in operating cash flows is principally due to the timing of payments to vendors and employees, offset by payments made during the six months ended March 31, 2001 of approximately \$21,902,000 for debt restructuring and reorganization costs. The Company's days sales outstanding for the three months ended March 31, 2001 decreased 3 days to 64 days from 67 days for the three months ended December 31, 2000. The Company's cash balance at March 31, 2001 was approximately \$23,867,000 (\$23,867,000 held by Multicare and \$0 held by Genesis). As a result of certain restrictions placed on Multicare and Genesis by their respective senior credit agreements and the automatic stay provisions imposed by the Bankruptcy Court, Genesis and Multicare are precluded from freely transferring funds through intercompany loans, advances or cash dividends. Consequently, the \$23,867,000 of cash held by Multicare at March 31, 2001 is not available to Genesis.

At March 31, 2001, the Company reported restricted investments in marketable securities of \$34,493,000, 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. LHC is not a party to the Chapter 11 cases.

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Investing activities for the six months ended March 31, 2001 include approximately \$23,300,000 of capital expenditures compared to approximately \$28,000,000 for the comparable period of the prior year. 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, the Company expects to continue to incur capital expenditure costs at levels at or above those for the six months ended March 31, 2001 for the foreseeable future. Cash flows provided by investing activities for the six months ended March 31, 2001 include approximately \$7,000,000 of cash proceeds from the sale of an eldercare center located in the Company's Chesapeake region.

Financing activities for the six months ended March 31, 2001 include net borrowings of \$32,000,000 under the Genesis DIP Facility.

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The Company incurred approximately \$24,706,000 of debt restructuring and reorganization costs for the six months ended March 31, 2001. The Company anticipates that such costs will be incurred throughout the duration of the bankruptcy.

The Company has prepetition long-term debt obligations of approximately \$2,232,321,000 at March 31, 2001, which are classified as liabilities subject to compromise. Due to the failure to make required debt service payments, meet certain financial covenants and the commencement of the Chapter 11 cases, the Company is in default under substantially all of the related debt agreements. The automatic stay protection afforded by the Chapter 11 cases prevents any action from being taken with regard to any of the defaults under the prepetition debt agreements. The Company continues to pay interest on approximately \$1,060,300,000 of the prepetition debt obligations as adequate protection.

For the six months ended March 31, 2001, the Company incurred approximately \$18,500,000 of lease obligation costs and expects to continue to incur lease costs at levels approximating those for the six months ended March 31, 2001 for the foreseeable future.

The Company's ability to continue as a going concern is dependent upon, among other things, confirmation of a plan of reorganization, future profitable operations, the ability to comply with the terms of the Company's debtor-in-possession financing agreements and the ability to generate sufficient cash from operations and financing arrangements to meet obligations. There can be no assurances the Company will be successful in achieving a confirmed plan of reorganization, future profitable operations, compliance with the terms of the debtor-in-possession financing arrangements and sufficient cash flows from operations and financing arrangements to meet obligations.

Although management believes that cash flow from operations, coupled with available borrowings under the DIP Facilities will be sufficient to fund the Company's working capital requirements throughout the bankruptcy proceedings, there can be no assurances that such capital resources will be sufficient to fund operations until such time as the Company is able to propose a plan or reorganization that will be acceptable to creditors and confirmed by the Bankruptcy Court.

Insurance

The Company has experienced an adverse effect on operating cash flow beginning in the third quarter of 2000 due to an increase in the cost of certain of its insurance programs and the timing of funding new policies. Rising costs of eldercare malpractice litigation involving nursing care operators and losses stemming from these malpractice lawsuits has caused many insurance providers to raise the cost of insurance premiums or refuse to write insurance policies for nursing homes. Accordingly, the costs of general and professional liability and property insurance premiums have increased. In addition, as a result of the Company's current financial condition it is unable to continue certain self-insured programs and has replaced these programs with outside insurance carriers.

Prior to June 1, 2000, the Company purchased general and professional liability insurance coverage ("GL/PL") from various commercial insurers on a first dollar coverage basis. Beginning with the June 1, 2000 policy, the Company has purchased GL/PL coverage from a commercial insurer subject to a \$500,000 per claim retention, except in Florida, where the retention is \$2,500,000 per claim. On an annual basis, the cost of the GL/PL has increased by approximately \$7,000,000, for the policy year ending June 1, 2001 as compared to the policy

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year ended June 1, 2000.

LHC, the Company's wholly owned captive insurance subsidiary, provides reinsurance for the Company and others. LHC has, or is currently, reinsuring certain windstorm, workers' compensation and GL/PL deductibles. The Company, based on independent actuarial studies, believes that LHC's reserves are sufficient to meet their obligations. LHC continues to operate as a going concern, and has been excluded from the Company's Chapter 11 cases.

The Company provides several health insurance options to its employees. Prior to Fiscal 1999, the Company offered a self-insured 80/20 indemnity plan (the "80/20 Plan") and several fully insured HMO's. In late Fiscal 1999, a new self insured indemnity plan (the "Choice Plan") was developed and made available to a limited number of employees. The Choice Plan became available to all employees in January 2000. The Choice Plan enabled employees to take advantage of much lower co-pays that were competitive with HMO co-pays, while still allowing them to go to any provider in the 80/20 Plan preferred provider organization. In Fiscal 2000, the medical and pharmacy utilization levels under the Choice Plan and the 80/20 Plan were greater than the Company anticipated, resulting in additional health insurance costs of approximately \$28,000,000. Effective April 1, 2001, the Choice Plan was eliminated from the Company's benefit program and employee co-pays for prescriptions were increased.

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 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.

Congress has enacted three major laws during the past five years that have significantly altered payment for nursing home and medical ancillary services. The Balanced Budget Act of 1997 ("the 1997 Act"), signed into law on August 5, 1997, reduced federal spending on the Medicare and Medicaid programs. As implemented by HCFA, the 1997 Act has had an adverse impact on the Medicare revenues of many skilled nursing facilities. There have been three primary problems with the 1997 Act. First, the base year calculations understate costs. Second, the market basket index used to trend payments forward does not adequately reflect market experience. Third, the RUGs case mix allocation is not adequately predictive of the costs of care for patients, and does not equitably allocate funding, especially for non-therapy ancillary services. The Medicare Balanced Budget Refinement Act ("BBRA"), enacted in November 1999 addressed a number of the funding difficulties caused by the 1997 Act. A second enactment, the Benefits Improvement and Protection Act of 2000 ("BIPA"), was enacted on December 15, 2000, further modifying the law and restoring additional funding.

The reimbursement rates for pharmacy services under Medicaid are determined on a state-by-state basis subject to review by HCFA and applicable federal law. In most states, pharmacy services are priced at the lower of "usual and customary" charges or cost (which generally is defined as a function of average wholesale price and may include a profit percentage) plus a dispensing fee. Certain states have "lowest charge legislation" or "most favored nation provisions" which require our institutional pharmacy and medical supply operation ("NeighborCare(R)") to charge Medicaid no more than its lowest charge to other consumers in the state. During 2000, Federal Medicaid requirements establishing payment caps on certain drugs were revised ("Federal Upper Limits"). The final rule relating to Federal Upper Limits was substantially modified, reducing the

impact of the new rules on NeighborCare operations.

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Pharmacy coverage and cost containment are important policy debates at both the Federal and state levels. Congress has considered proposals to expand Medicare coverage for outpatient pharmacy services. Enactment of such legislation could affect institutional pharmacy services. Likewise, a number of states have proposed cost containment initiatives pending. Changes in payment formulas and delivery requirements could impact NeighborCare.

Congress and state governments continue to focus on efforts to curb spending on health care programs such as Medicare and Medicaid. Such efforts have not been limited to skilled nursing facilities, but have and will most likely include other services provided by us, including pharmacy and therapy services. We cannot at this time predict the extent to which these proposals will be adopted or, if adopted and implemented, what effect, if any, such proposals will have on us. Efforts to impose reduced allowances, greater discounts and more stringent cost controls by government and other payors are expected to continue.

While the Company has prepared certain estimates of the impact of the above changes, 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 its business. Accordingly, there can be no assurance that the impact of these changes will not be greater than estimated or that 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 the Company's 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 pharmacy operations to provide services to HCR Manor Care constituting approximately eleven percent and four percent of the net revenues of NeighborCare and Genesis, respectively. These service contracts with HCR Manor Care are the subject of certain litigation. See "Legal Proceedings".

NeighborCare pharmacy operations provide services to Mariner Post-Acute Network, Inc. and Mariner Health Group, Inc. (collectively, "Mariner") under certain service contracts. On January 18, 2000, Mariner filed voluntary petitions under Chapter 11 with the Bankruptcy Court. To date, the service contracts with Mariner have been honored; however, Mariner has certain rights under the protection of the Bankruptcy Court to reject these contracts, which represent six percent and two percent of the net revenues of NeighborCare and Genesis, respectively. Genesis participates as a member of the official Mariner unsecured creditors committee.

Legislative and Regulatory Issues

Legislative and regulatory action, including but not limited to the 1997 Balanced Budget Act, the Balanced Budget Refinement Act and the Benefits Improvement Protection Act of 2000 has resulted in continuing changes in the Medicare and Medicaid reimbursement programs which has adversely impacted the Company. The changes have limited, and are expected to continue to limit, payment increases under these programs. Also, the timing of payments made under the Medicare and Medicaid programs is subject to regulatory action and

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governmental budgetary constraints; in recent years, the time period between submission of claims and payment has increased. Within the statutory framework of the Medicare and Medicaid programs, there are substantial areas subject to administrative rulings and interpretations which may further affect payments made under those programs. Further, the federal and state governments may reduce the funds available under those programs in the future or require more stringent utilization and quality reviews of eldercare centers or other providers. There can be no assurances that adjustments from Medicare or Medicaid audits will not have a material adverse effect on us.

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In July 1998, the Clinton administration issued a new initiative to promote the quality of care in nursing homes. Following this pronouncement, it has become more difficult for nursing facilities to maintain licensing and certification. We have experienced and expect to continue to experience increased costs in connection with maintaining our licenses and certifications as well as increased enforcement actions.

Anticipated Impact of Healthcare Reform

On December 15, 2000, Congress passed the Benefit Improvement and Protection Act of 2000 that, among other provisions, increases the nursing component of Federal PPS rates by approximately 16.7% for the period from April 1, 2001 through September 30, 2002. The legislation will also change the 20% add-on to 3 of the 14 rehabilitation RUG categories to a 6.7% add-on to all 14 rehabilitation RUG categories beginning April 1, 2001. The Part B consolidated billing provision of BBRA will be repealed except for Medicare Part B therapy services and, the moratorium on the \$1,500 therapy caps will be extended through calendar year 2002.

PPS and other existing and future legislation and regulation have already, and may in the future, adversely affect our pharmacy and medical supply revenue, and other specialty medial services.

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

At March 31, 2001, the Company had \$1,650,247,000 of debt subject to variable market rates of interest, of which \$1,485,247,000 is classified as a liability subject to compromise as a result of our Chapter 11 filings. Genesis continues to accrue and pay interest on approximately \$1,226,137,000 of Genesis' variable rate debt. Multicare, as a result of its Chapter 11 cases, ceased accruing and paying interest on all of its variable rate debt following the Petition Date. At March 31, 2001, Genesis and Multicare have no interest rate swap agreements outstanding to manage exposure to increases in market rates of interest.

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PART II: OTHER INFORMATION

Item 1. Legal Proceedings

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The Genesis and Vitalink Actions Against HCR Manor Care

On May 7, 1999, Genesis Health Ventures, Inc. and Vitalink Pharmacy Services (d/b/a NeighborCare(R)), a subsidiary of Genesis, filed multiple lawsuits requesting injunctive relief and compensatory damages against HCR Manor Care, Inc. ("HCR Manor Care"), two of its subsidiaries and two of its principals. The lawsuits arise from HCR Manor Care's threatened termination of long-term pharmacy services contracts effective June 1, 1999. Vitalink filed a complaint against HCR Manor Care and two of its subsidiaries in Baltimore City, Maryland circuit court (the "Maryland State Court Action"). Genesis filed a complaint against HCR Manor Care, a subsidiary, and two of its principals in federal district court in Delaware including, among other counts, securities fraud (the "Delaware Federal Action"). Vitalink has also instituted an arbitration action before the American Arbitration Association (the "Arbitration"). In these actions, Vitalink is seeking a declaration that it has a right to provide pharmacy, infusion therapy and related services to all of HCR Manor Care's facilities and a declaration that HCR Manor Care's threatened termination of the long-term pharmacy service contracts was unlawful. Genesis and Vitalink also seek over \$100,000,000 in compensatory damages and enforcement of a 10-year non-competition clause.

Genesis acquired Vitalink from Manor Care in August 1998. In 1991, Vitalink and Manor Care had entered into long-term master pharmacy, infusion therapy and related agreements which gave Vitalink the right to provide pharmacy services to all facilities owned or licensed by Manor Care and its affiliates. On July 10, 1998, Manor Care advised Vitalink and Genesis that Manor Care would not provide notice of non-renewal of the master service agreements; accordingly the terms of the pharmacy service agreements were extended to September, 2004. Under the master service agreements, Genesis and Vitalink receive revenues at the rate of approximately \$107,000,000 per year.

By agreement dated May 13, 1999, the parties agreed to consolidate the Maryland State Court Action relating to the master service agreements with the Arbitration matter. Accordingly, on May 25, 1999, the Maryland State Court Action was dismissed voluntarily. Until such time as a final decision is rendered in said Arbitration, or by the Bankruptcy Court, as appropriate, the parties have agreed to maintain the master service agreements in full force and effect.

HCR Manor Care and its subsidiaries have pleaded counterclaims in the Arbitration seeking damages for Vitalink's alleged overbilling for products and services provided to HCR Manor Care, a declaration that HCR Manor Care had the right to terminate the master service agreements, and a declaration that Vitalink does not have the right to provide pharmacy, infusion therapy and related services to facilities owned by HCR prior to its merger with Manor Care. According to an expert report submitted by HCR Manor Care on May 8, 2000, HCR Manor Care is seeking \$17,800,000 in compensatory damages for alleged overbilling by Vitalink between September 1, 1998 and March 31, 2000.

On January 14, 2000, HCR Manor Care moved to dismiss Vitalink's claims in the Arbitration that it has a right to provide pharmacy and related services to the HCR Manor Care facilities not previously under the control of Manor Care. On May 17, 2000, the Arbitrator ordered the dismissal of Vitalink's claims seeking a declaratory judgment and injunctive relief for denial of Vitalink's right to service the additional HCR Manor Care facilities, but sustained Vitalink's claim seeking compensatory damages against HCR Manor Care for denial of that

right.

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Trial in the arbitration was originally scheduled to begin on June 12, 2000. On May 23, 2000, however, the Arbitrator postponed the trial indefinitely due to Vitalink's potential bankruptcy filing. In connection with this stay, the parties agreed that HCR Manor Care may pay, on an interim basis, NeighborCare 90 percent 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 remaining 10 percent must be held in a segregated account by Manor Care. After Genesis and its affiliates, including Vitalink, filed voluntary petitions for restructuring under Chapter 11 of the Bankruptcy Code on June 22, 2000, the Arbitration was automatically stayed pursuant to 11 U.S.C. ss. 362(a).

On August 1, 2000, HCR Manor Care moved to lift the automatic stay and compel arbitration. On September 5, 2000, the Bankruptcy Court denied that motion, with leave to refile in 90 days. On December 8, 2000, Manor Care renewed its motion to lift the stay in the arbitration. On January 16, 2001, Genesis filed a motion to assume the master service agreements asserting that the determination of the Bankruptcy Court will supersede a significant number of issues in the Arbitration. On February 6, 2001, the Bankruptcy Court granted Manor Care's renewed motion to lift the stay in the Arbitration, and postponed consideration of Genesis' motion to assume the master service agreements until after the Arbitration is completed. The trial in the Arbitration is now scheduled to begin during the week of July 20, 2001.

On June 29, 1999, defendants moved to dismiss or stay Genesis' securities fraud complaint filed in the Delaware Federal Action. On March 22, 2000, HCR Manor Care's motion was denied with respect to its motion to dismiss the complaint, but was granted to the extent that the action was stayed pending a decision in the Arbitration. Accordingly, Genesis still maintains the Delaware Federal Action. As a result of Genesis' Chapter 11 filing, this action is also automatically stayed pursuant to 11 U.S.C. ss. 362(a).

The Vitalink Action Against Omnicare and Heartland

On July 26, 1999, NeighborCare, through its Maryland counsel, filed an additional complaint against Omnicare, Inc. ("Omnicare") and Heartland Healthcare Services (a joint venture between Omnicare and HCR Manor Care) seeking injunctive relief and compensatory and punitive damages. The complaint includes counts for tortious interference with Vitalink's contractual rights under its exclusive long-term service contracts with HCR Manor Care. On November 12, 1999, in response to a motion filed by the defendants, that action was stayed pending a decision in the Arbitration.

The HCR Manor Care Action Against Genesis in Delaware

On August 27, 1999, Manor Care Inc., a wholly owned subsidiary of HCR Manor Care Inc., filed a lawsuit against Genesis in federal district court in Delaware based upon Section 11 and Section 12 of the Securities Act. Manor Care Inc. alleges that in connection with the sale of the Genesis Series G Preferred Stock issued as part of the purchase price to acquire Vitalink, Genesis failed to disclose or made misrepresentations related to the effects of the conversion to the prospective payment system on Genesis' earnings, the restructuring of the Genesis ElderCare Corp. Joint Venture, the impact of the operations

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of Genesis' Multicare affiliate on Genesis' earnings, the status of Genesis' labor relations, Genesis' ability to declare dividends on the Series G Preferred Stock, the value of the conversion right attached to the Series G Preferred Stock, and information relating to the ratio of combined fixed charges and preference dividends to earnings. Manor Care, Inc. seeks, among other things, compensatory damages and rescission of the purchase of the Series G Preferred Stock.

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On November 23, 1999, Genesis moved to dismiss this action on the grounds, among others, that Manor Care's complaint failed to plead fraud with particularity. On September 29, 2000, the Court granted that motion in part and denied it in part. Specifically, the Court dismissed all of defendants' allegations except those concerning the Company's labor relations and the ratio of combined fixed charges and preference dividends to earnings.

On January 18, 2000, Genesis moved to consolidate this action with the action brought against HCR Manor Care in Delaware federal court. That motion has been fully submitted and is awaiting decision. As a result of Genesis' Chapter 11 filing, this action is also automatically stayed pursuant to 11 U.S.C. ss. 362(a).

The HCR Manor Care Action Against Genesis in Ohio

On December 22, 1999, Manor Care filed a lawsuit against Genesis and others in the United States District Court for the Northern District of Ohio. Manor Care alleges, among other things, that the Series H Senior Convertible Participating Cumulative Preferred Stock (the "Series H Preferred") and Series I Senior Convertible Exchangeable Participating Cumulative Preferred Stock (the "Series I Preferred") were issued in violation of the terms of the Series G Preferred and the Rights Agreement dated as of April 26, 1998 between Genesis and Manor Care. Manor Care seeks, among other things, damages and rescission or cancellation of the Series H and Series I Preferred. On February 29, 2000, Genesis moved to dismiss this action on the ground, among others, that Manor Care's complaint failed to state a cause of action. This motion has been fully submitted, including supplemental briefing by both parties, and is awaiting decision. As a result of Genesis' Chapter 11 filing, this action is also automatically stayed pursuant to 11 U.S.C. ss. 362(a).

Genesis is not able to predict the results of such litigation. However, if the outcome is unfavorable to us, and the claims of HCR Manor Care are upheld, such results would have a material adverse effect on our financial position. See "Cautionary Statement Regarding Forward-Looking Statements" and "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Revenue Sources."

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Item 2. Changes in Securities Not Applicable

Item 3. Defaults Upon Senior Securities

On June 22, 2000, the Company and certain of its subsidiaries and affiliates filed voluntary petitions with the United States Bankruptcy Court for the District of Delaware to reorganize their capital

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structure under Chapter 11 of the United States Bankruptcy Code. As a result of the Chapter 11 cases, no principal or interest payments will be made on certain indebtedness incurred by the Company prior to June 22, 2000, including, among others, senior subordinated notes, until a plan of reorganization defining the payment terms has been approved by the Bankruptcy Court. Additional information regarding the Chapter 11 cases is set forth elsewhere in this Form 10-Q, including Note 2 to the Unaudited Condensed Consolidated Financial Statements and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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

Item 5. Other Information - Not Applicable

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

None

(b) Reports on Form 8-K

None

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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: May 17, 2001

/s/ George V. Hager, Jr.

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

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