APRIA HEALTHCARE GROUP INC
Form 10-Q
August 09, 2013
**Table of Contents**

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

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

**For the quarterly period ended June 30, 2013**

**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 333-168159**

# APRIA HEALTHCARE GROUP INC.

**(Exact name of Registrant as specified in its charter)**

| **Delaware** | **33-0488566** |
|---|---|
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |
| **26220 Enterprise Court** | |
| **Lake Forest, CA** | **92630** |
| **(Address of principal executive offices)** | **(Zip Code)** |

**Registrant s telephone number, including area code: (949) 639-2000**

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

(Note: As a voluntary filer not subject to the filing requirements of Section 13 or 15(d) of the Exchange Act, the registrant has filed all reports pursuant to Section 13 or 15(d) of the Exchange Act during the preceding 12 months as if the registrant were subject to such filing requirements.)

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

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

| Large accelerated filer | ¨ | Accelerated filer | ¨ |
|---|---|---|---|
| Non-accelerated filer | x (Do not check if a smaller reporting company) | Smaller reporting company | ¨ |

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

As of August 5, 2013, there were 100 shares of the issuer s common stock, par value $0.01 per share, issued and outstanding.

**Table of Contents**

**APRIA HEALTHCARE GROUP INC.**

**FORM 10-Q**

**TABLE OF CONTENTS**


| | | Page No. |
|---|---|---|
| | **PART I Financial Information** | |
| Item 1. | Financial Statements | 4 |
| | Unaudited Condensed Consolidated Balance Sheets as of June 30, 2013 and December 31, 2012 | 4 |
| | Unaudited Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2013 and June 30, 2012 | 5 |
| | Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and June 30, 2012 | 6 |
| | Notes to Unaudited Condensed Consolidated Financial Statements | 8 |
| Item 2. | Management s Discussion and Analysis of Financial Condition and Results of Operations | 35 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 63 |
| Item 4. | Controls and Procedures | 64 |
| | **PART II Other Information** | |
| Item 1. | Legal Proceedings | 65 |
| Item 1A. | Risk Factors | 65 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 79 |
| Item 3. | Defaults Upon Senior Securities | 79 |
| Item 4. | Mine Safety Disclosures | 79 |
| Item 5. | Other Information | 79 |
| Item 6. | Exhibits | 80 |
| SIGNATURES | | |

Table of Contents

## CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q includes forward-looking statements regarding, among other things, our plans, strategies and prospects, both business and financial. These statements are based on the beliefs and assumptions of our management. Although we believe that our plans, intentions and expectations reflected in or suggested by these forward-looking statements are reasonable, we cannot assure you that we will achieve or realize these plans, intentions or expectations. Forward-looking statements are inherently subject to risks, uncertainties and assumptions. Generally, statements that are not historical facts, including statements concerning our possible or assumed future actions, business strategies, events or results of operations, are forward-looking statements. These statements may be preceded by, followed by or include the words believes , expects , anticipates , intends , plans , estimates or similar expressions.

Forward-looking statements are not guarantees of performance. You should not put undue reliance on these statements. You should understand that various important factors, in addition to those discussed elsewhere in this quarterly report on Form 10-Q, could affect our future results and could cause those results or other outcomes to differ materially from those expressed or implied in our forward-looking statements. Examples of such factors include the following:

- trends and developments affecting the collectability of accounts receivable;
- government legislative and budget developments that could continue to affect reimbursement levels;
- potential reductions in reimbursement rates by government and third-party payors;
- the effectiveness of our operating systems and controls, systems implementation risks;
- healthcare reform and the effect of federal and state healthcare regulations;
- economic and political events, international conflicts and natural disasters;
- risks associated with our indebtedness;
- risks associated with our reorganization plans;
- acquisition-related risks; and
- the items discussed under Risk Factors in this quarterly report on Form 10-Q.

All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the foregoing cautionary statements. We undertake no obligations to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

As used in this report, unless otherwise noted or the context otherwise requires, references to Company, we, us, and our are to Apria Healthcare Group Inc., a Delaware corporation, and its subsidiaries; references to Apria and the Issuer are to Apria Healthcare Group Inc., exclusive of its subsidiaries; references to Merger Sub are to Sky Merger Sub Corporation, a Delaware corporation; references to Holdings are to Apria Holdings LLC, a Delaware limited liability company, exclusive of its subsidiaries; references to Sky LLC or Buyer are to Sky Acquisition LLC ,

a Delaware limited liability company, exclusive of its subsidiaries; references to Blackstone and the Sponsor are to Blackstone Capital Partners V L.P.; references to the Investor Group are, collectively, to Blackstone and certain funds affiliated with Blackstone, Dr. Norman C. Payson and certain members of our management; and references to home medical equipment, durable medical equipment and DME are used synonymously.
On October 28, 2008, the Company was acquired by private investment funds affiliated with the Sponsor via a merger of the Merger Sub with and into Apria (the Merger ), with Apria being the surviving corporation following the Merger. As a result of the Merger, the Investment Group beneficially owns all of Apria s issued and outstanding common stock.

Table of Contents

**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**APRIA HEALTHCARE GROUP INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(Unaudited)**

| | June 30, 2013 | December 31, 2012 |
|---|---|---|
| | (in thousands, except share data) | |
| **ASSETS** | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | $ 15,853 | $ 27,080 |
| Accounts receivable, less allowance for doubtful accounts of $58,539 and $53,017 at June 30, 2013 and December 31, 2012, respectively | 333,997 | 344,421 |
| Inventories | 73,019 | 68,075 |
| Deferred expenses | 3,409 | 3,798 |
| Prepaid expenses and other current assets | 21,455 | 16,890 |
| TOTAL CURRENT ASSETS | 447,733 | 460,264 |
| PATIENT SERVICE EQUIPMENT, less accumulated depreciation of $191,107 and $185,774 at June 30, 2013 and December 31, 2012, respectively | 191,596 | 186,460 |
| PROPERTY, EQUIPMENT AND IMPROVEMENTS, NET | 73,631 | 76,823 |
| GOODWILL | 258,725 | 258,725 |
| INTANGIBLE ASSETS, NET | 133,409 | 133,781 |
| DEFERRED DEBT ISSUANCE COSTS, NET | 15,187 | 30,207 |
| OTHER ASSETS | 29,253 | 26,448 |
| TOTAL ASSETS | $ 1,149,534 | $ 1,172,708 |
| **LIABILITIES AND STOCKHOLDERS DEFICIT** | | |
| CURRENT LIABILITIES | | |
| Accounts payable | $ 146,270 | $ 157,530 |
| Accrued payroll and related taxes and benefits | 62,091 | 70,547 |
| Deferred income taxes | 1,310 | 986 |
| Other accrued liabilities | 69,666 | 74,464 |
| Deferred revenue | 27,153 | 27,785 |
| Current portion of long-term debt | 39,086 | 25,195 |
| TOTAL CURRENT LIABILITIES | 345,576 | 356,507 |
| LONG-TERM DEBT, net of current portion | 1,039,752 | 1,017,515 |
| DEFERRED INCOME TAXES | 68,997 | 68,907 |
| INCOME TAXES PAYABLE AND OTHER NON-CURRENT LIABILITIES | 61,880 | 61,203 |
| TOTAL LIABILITIES | 1,516,205 | 1,504,132 |
| COMMITMENTS AND CONTINGENCIES | | |
| STOCKHOLDERS DEFICIT | | |
| Common stock, $0.01 par value: 1,000 shares authorized; 100 shares issued at June 30, 2013 and December 31, 2012 | | |
| Additional paid-in capital | 697,955 | 695,211 |

| | | |
|---|---|---|
| Accumulated deficit | (1,064,626) | (1,026,635) |
| TOTAL STOCKHOLDERS DEFICIT | (366,671) | (331,424) |
| | $ 1,149,534 | $ 1,172,708 |

*See notes to unaudited condensed consolidated financial statements.*

4

Table of Contents

**APRIA HEALTHCARE GROUP INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(Unaudited)**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| | (in thousands) | | | |
| Net revenues: | | | | |
| Fee-for-service arrangements | $ 575,299 | $ 561,447 | $ 1,144,819 | $ 1,113,063 |
| Capitation | 45,324 | 46,225 | 90,559 | 90,322 |
| TOTAL NET REVENUES | 620,623 | 607,672 | 1,235,378 | 1,203,385 |
| Costs and expenses: | | | | |
| Cost of net revenues: | | | | |
| Product and supply costs | 230,149 | 214,136 | 450,903 | 421,548 |
| Patient service equipment depreciation | 22,690 | 20,386 | 42,148 | 41,082 |
| Home respiratory therapy services | 5,739 | 7,018 | 11,388 | 14,307 |
| Nursing services | 10,306 | 10,709 | 20,259 | 21,932 |
| Other | 4,436 | 3,948 | 8,844 | 8,994 |
| TOTAL COST OF NET REVENUES | 273,320 | 256,197 | 533,542 | 507,863 |
| Provision for doubtful accounts | 13,092 | 20,790 | 36,227 | 32,648 |
| Selling, distribution and administrative | 293,455 | 308,837 | 592,604 | 626,259 |
| Amortization of intangible assets | 186 | 483 | 372 | 1,144 |
| TOTAL COSTS AND EXPENSES | 580,053 | 586,307 | 1,162,745 | 1,167,914 |
| OPERATING INCOME | 40,570 | 21,365 | 72,633 | 35,471 |
| Interest expense | 32,177 | 33,878 | 66,389 | 67,395 |
| Loss on early retirement of debt | 44,221 | | 44,221 | |
| Interest income and other | (643) | (69) | (1,153) | (771) |
| LOSS BEFORE TAXES | (35,185) | (12,444) | (36,824) | (31,153) |
| Income tax expense | 913 | 292 | 1,167 | 1,190 |
| NET LOSS | $ (36,098) | $ (12,736) | $ (37,991) | $ (32,343) |

*See notes to unaudited condensed consolidated financial statements.*

Table of Contents

**APRIA HEALTHCARE GROUP INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

| | Six Months Ended June 30, | |
|---|---|---|
| | 2013 | 2012 (As Restated See Note 2) |
| | (in thousands) | |
| OPERATING ACTIVITIES | | |
| Net loss | $ (37,991) | $ (32,343) |
| Items included in net loss not requiring cash: | | |
| Provision for doubtful accounts | 36,227 | 32,648 |
| Depreciation | 56,078 | 57,082 |
| Amortization of intangible assets | 372 | 1,144 |
| Amortization of deferred debt issuance costs | 6,328 | 7,025 |
| Deferred income taxes | 413 | 275 |
| Profit interest compensation | 2,744 | 1,565 |
| Gain on sale of patient service equipment and other | (10,184) | (12,146) |
| Loss on early retirement of debt | 44,221 | |
| Changes in operating assets and liabilities, exclusive of effects of acquisitions | | |
| Accounts receivable | (25,804) | (58,787) |
| Inventories | (4,943) | (11,740) |
| Prepaid expenses and other assets | (7,371) | 7,903 |
| Accounts payable | (9,982) | 8,772 |
| Accrued payroll and related taxes and benefits | (8,456) | (7,826) |
| Income taxes payable | 245 | 429 |
| Deferred revenue, net of related expenses | (243) | 70 |
| Accrued expenses | (4,365) | 4,450 |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | 37,289 | (1,479) |
| INVESTING ACTIVITIES | | |
| Purchases of patient service equipment and property, equipment and improvements, exclusive of effects of acquisitions | (70,450) | (85,113) |
| Proceeds from sale of patient service equipment and other | 21,328 | 23,111 |
| Cash paid for acquisitions | | (121) |
| NET CASH USED IN INVESTING ACTIVITIES | (49,122) | (62,123) |
| FINANCING ACTIVITIES | | |
| Proceeds from ABL Facility | 346,000 | 209,000 |
| Payments on ABL Facility | (341,000) | (150,000) |
| Payments on Series A-1 Notes | (700,000) | |
| Payments on Series A-2 Notes | (160,000) | |
| Proceeds from Senior Secured Term Loan | 900,000 | |
| Premium paid on early retirement of Series A-1 and A-2 Notes | (24,641) | |
| Debt issuance costs on Senior Secured Term Loan | (10,628) | |
| Payment of original issue discount associated with Senior Secured Term Loan | (9,000) | |
| Payments on other long-term debt | (125) | (173) |
| Cash paid on profit interest units | | (82) |

| | | |
|---|---|---|
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 606 | 58,745 |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (11,227) | (4,857) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 27,080 | 29,096 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $ 15,853 | $ 24,239 |

SUPPLEMENTAL DISCLOSURES See Note 5 for a discussion of cash paid for interest and loss on early retirement of debt. See Note 8 for a discussion of cash paid on income taxes.

6

**Table of Contents**

Purchases of patient service equipment and property, equipment and improvements exclude purchases that remain unpaid at the end of the respective quarter. Such amounts are then included in the following period s purchases when paid. Unpaid purchases were $12.8 million and $13.3 million at June 30, 2013 and June 30, 2012, respectively.

*See notes to unaudited condensed consolidated financial statements.*

Table of Contents

**APRIA HEALTHCARE GROUP INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Basis of Presentation*: The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. These statements include the accounts of Apria Healthcare Group Inc. ( Apria or the Company ) and its subsidiaries. Intercompany transactions and accounts have been eliminated in consolidation.

In the opinion of management, all adjustments, consisting of normal recurring accruals necessary for a fair presentation of the results of operations for the interim periods presented, have been reflected herein. The unaudited results of operations for interim periods are not necessarily indicative of the results to be expected for the entire year. For further information, refer to the consolidated financial statements and notes thereto for the fiscal year ended December 31, 2012.

On October 28, 2008, the Company completed the Merger with Merger Sub, a Delaware corporation and wholly-owned subsidiary of Sky LLC. Buyer is controlled by private investment funds affiliated with the Sponsor.

*Company Background*: The Company operates in the home healthcare segment of the healthcare industry, providing a variety of high-quality clinical patient care management programs, related products and supplies as prescribed by a physician and/or authorized by a case manager as part of a care plan. Essentially all products and services offered by the Company are provided through the Company s network of approximately 510 locations, which are located throughout the United States. The Company provides services and products in two operating segments: home respiratory therapy/home medical equipment and home infusion therapy. Each operating segment constitutes a separate reporting unit and within these two operating segments there are four core service lines: home respiratory therapy, home medical equipment, home infusion therapy, including total parenteral nutrition ( TPN ), and enteral nutrition services. Both segments provide products and services in the home setting to patients and are primarily paid for by a third-party payor, such as Medicare, Medicaid, managed care or other third-party insurer. Sales for both segments are primarily derived from referral sources such as hospital discharge planners, medical groups or independent physicians.

*Use of Accounting Estimates*: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Among the significant estimates affecting the consolidated financial statements are those related to revenue recognition and the resulting accounts receivable, share-based compensation, income taxes, goodwill and long-lived assets.

*Revenue Recognition and Concentration of Credit Risk*: Revenues are recognized under fee-for-service/product arrangements for equipment the Company rents to patients, sales of equipment, supplies, pharmaceuticals and other items the Company sells to patients and under capitation arrangements with third party payors for services and equipment the Company provides to the patients of these payors. Revenue generated from equipment that the Company rents to patients is recognized over the rental period, typically one month, and commences on delivery of the equipment to the patients. Revenue related to sales of equipment, supplies and pharmaceuticals is recognized on the date of delivery to the patients. Revenues derived from capitation arrangements were approximately 7% of total net revenues for the three and six months ended June 30, 2013 and approximately 8% of total net revenues for the three and six months ended June 30, 2012. Capitation revenue is earned as a result of entering into a contract with a third party to provide its members certain services without regard to the actual services provided, therefore revenue is recognized in the period that the beneficiaries are entitled to healthcare services. All revenues are recorded at amounts estimated to be received under reimbursement arrangements with third-party payors, including private insurers, prepaid health plans, Medicare and Medicaid. Revenues reimbursed under arrangements with Medicare and Medicaid were approximately 23% and 6% of total net revenues for the three and six months ended June 30, 2013, and 23% and 6% for the three and six months ended June 30, 2012. No other third-party payor group represented more than 9% of the Company s revenues.

Rental and sale revenues in the fee-for-service / product arrangement revenue line item were:

| | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| *(dollars in millions)* | **2013** | | **2012** | | **2013** | | **2012** | |
| Rental | $ 165.4 | 28.8% | $ 163.9 | 29.2% | $ 334.1 | 29.2% | $ 330.6 | 29.7% |
| Sale | 409.9 | 71.2 | 397.5 | 70.8 | 810.7 | 70.8 | 782.5 | 70.3 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Total fee for service | $ 575.3 | 100.0% | $ 561.4 | 100.0% | $ 1,144.8 | 100.0% | $ 1,113.1 | 100.0% |

**Table of Contents**

The Company provides various services and products to patients. These arrangements involve the sale of equipment, pharmaceuticals and medical supplies. Revenues from the sale of equipment, pharmaceuticals and medical supplies are recognized upon confirmation of delivery of the products. Additionally, the Company provides clinical nursing services to patients. Nursing services are recognized as revenue when the service is rendered.

*Cash and Cash Equivalents*: Cash is maintained with various financial institutions. These financial institutions are located throughout the United States and the Company s cash management practices limit exposure to any one institution. Management considers all highly liquid instruments purchased with a maturity of less than three months to be cash equivalents.

*Accounts Receivable*: Included in accounts receivable are earned but unbilled receivables of $52.1 million at June 30, 2013 and $56.8 million at December 31, 2012. Delays ranging from a day up to several weeks between the date of service and billing can occur due to delays in obtaining certain required payor-specific documentation from internal and external sources. Unbilled receivables can also be impacted by the transition of patients during the integration of acquisitions and overall revenue growth. Earned but unbilled receivables are aged from date of service and are considered in the analysis of historical performance and collectability.

Due to the nature of the industry and the reimbursement environment in which the Company operates, certain estimates are required to record total net revenues and accounts receivable at their net realizable values. Inherent in these estimates is the risk that they will have to be revised or updated as additional information becomes available. Specifically, the complexity of many third-party billing arrangements and the uncertainty of reimbursement amounts for certain services from certain payors may result in adjustments to amounts originally recorded. Such adjustments are typically identified and recorded at the point of cash application, claim denial or account review.

Management performs periodic analyses to evaluate accounts receivable balances to ensure that recorded amounts reflect estimated net realizable value. Specifically, management considers historical realization data, accounts receivable aging trends, other operating trends, the extent of contracted business and business combinations. Also considered are relevant business conditions such as governmental and managed care payor claims processing procedures and system changes. Additionally, focused reviews of certain large and/or problematic payors are performed. Due to continuing changes in the healthcare industry and third-party reimbursement, it is possible that management s estimates could change in the near term, which could have an impact on operations and cash flows.

Accounts receivable are reduced by an allowance for doubtful accounts which provides for those accounts from which payment is not expected to be received, although services were provided and revenue was earned. Upon determination that an account is uncollectible, it is written-off and charged to the allowance.

*Deferred Revenue and Deferred Expense*: A lessor is required to recognize rental income over the lease term. Rental of patient equipment is billed on a monthly basis beginning on the date the equipment is delivered. Since deliveries can occur on any day during a month, the amount of billings that apply to the next month are deferred. Only the direct costs associated with the initial rental period are deferred.

*Inventories*: Inventories are stated at the lower of cost (first-in, first-out method) or market and consist primarily of pharmaceuticals and items used in conjunction with patient service equipment.

*Patient Service Equipment*: Patient service equipment is stated at cost less depreciation and consists of medical equipment rented to patients on a month-to-month basis. Depreciation is provided using the straight-line method over the estimated useful lives of the equipment, which range from one to ten years.

*Property, Equipment and Improvements*: Property, equipment and improvements are stated at cost less depreciation. Depreciation is provided using the straight-line method over the estimated useful lives of the assets, which range from one to fifteen years or for leasehold improvements the shorter of the useful life of the asset or the remaining life of the related lease.

*Capitalized Software*: Included in property, equipment and improvements are costs related to internally developed and purchased software that are capitalized and amortized over periods that the assets are expected to provide benefit. Capitalized costs include direct costs of materials and services incurred in developing or obtaining internal-use software and payroll and benefit costs for employees directly involved in the development of internal-use software. Additions to capitalized internally developed software totaled $2.4 million and $2.1 million for the three months ended June 30, 2013 and 2012, respectively, and $4.4 million and $4.3 million for the six months ended June 30, 2013 and 2012, respectively.

**Table of Contents**

*Goodwill and Long-Lived Assets*: Goodwill is recorded as the difference, if any, between the aggregate consideration paid for an acquisition and the fair value of the net tangible and intangible assets acquired. The amounts and useful lives assigned to intangible assets acquired, other than goodwill, impact the amount and timing of future amortization.

Goodwill and indefinite-lived intangible assets are not amortized but instead tested at least annually for impairment, or more frequently when events or changes in circumstances indicate that the assets might be impaired. Goodwill is tested for impairment by comparing the carrying value to the fair value of the reporting unit to which the goodwill is assigned. A two-step test is used to identify the potential impairment and to measure the amount of impairment, if any. The first step is to compare the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill is considered not impaired; otherwise, goodwill is impaired and the loss is measured by performing step two. Under step two, the impairment loss is measured by comparing the implied fair value of the reporting unit with the carrying amount of goodwill. Management has determined that our two operating segments are reporting units. As such, the Company has two reporting units: home respiratory therapy/home medical equipment and home infusion therapy. The Company performs the annual test for impairment as of the first day of its fourth quarter and determines fair value based on a combination of the income approach and the market approach. The income approach is based on discounted cash flows. The market approach uses a selection of comparable companies in determining market value. The fair values of trade names are also tested for impairment on the first day of its fourth quarter by comparing the carrying value to the fair value. Fair value of a trade name is determined using a relief from royalty method under the income approach, which uses projected revenue allocable to the trade name and an assumed royalty rate.

Long-lived assets, including property and equipment and purchased definite-lived intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Significant judgment is required in determining whether a potential indicator of impairment of long-lived assets exists and in estimating future cash flows for any necessary impairment tests. Recoverability of assets to be held and used is measured by the comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such an asset is considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Remaining intangible assets on the Company s consolidated balance sheets consist primarily of trade names, patient backlog, capitated relationships and payor relationships resulting from the Merger. Purchased intangible assets that have definite lives are amortized over the estimated useful lives of the related assets, generally ranging from one to twenty years.

*Deferred Debt Issuance Costs*: Capitalized debt issuance costs include those associated with the Company s Senior Secured Term Loan, Series A-1 Notes, Series A-2 Notes and Asset Based Revolving Credit Facility ( ABL Facility ). Such costs are classified as non-current assets. Costs relating to the ABL Facility are being amortized through the maturity date of August 2014. Costs relating to the Series A-1 Notes and Series A-2 Notes are amortized from the issuance date through October 2014. Costs related to the Senior Secured Term Loan are amortized from the issuance date through the maturity date of March 2020. See Note 5 Long-term Debt.

*Fair Value of Financial Instruments*: The carrying value of debt approximates fair value because the underlying instruments are variable notes that reprice frequently. The fair values of cash and cash equivalents, short-term investments, Senior Secured Term Loan and the Series A-2 Notes and are determined based upon Level 1 inputs, consisting of quoted prices in active markets for identical items. The fair value of the Senior Secured Term Loan and Series A-2 Notes was $899.7 million and $159.8 million at June 30, 2013, respectively. The carrying amounts of cash and cash equivalents, accounts receivable, ABL Facility, trade payables and accrued expenses approximate fair value due to their short maturity.

*Product and Supply Costs*: Product and supply costs presented within cost of total net revenues are comprised primarily of the cost of supplies and equipment provided to patients, infusion drug costs and enteral product costs.

*Home Respiratory Therapy Expenses*: Home respiratory therapy expenses presented within cost of total net revenues are comprised primarily of employee salary and benefit costs or contract fees paid to respiratory therapists and other related professionals who are deployed to service a patient. Home respiratory therapy personnel are also engaged in a number of administrative and marketing tasks, and accordingly, these costs are classified within selling, distribution and administrative expenses and amounted to $7.2 million and $9.9 million in the three months ended June 30, 2013 and June 30, 2012, respectively, and $15.7 million and $19.9 million in the six months ended June 30, 2013 and June 30, 2012, respectively.

*Distribution Expenses*: Distribution expenses are included in selling, distribution and administrative expenses and totaled $44.6 million and $49.3 million in the three months ended June 30, 2013 and June 30, 2012, respectively, and $93.5 million and $99.3 million in the six months ended June 30, 2013 and June 30, 2012, respectively. Such expense represents

Table of Contents

the cost incurred to coordinate and deliver products and services to the patients. Included in distribution expenses are leasing, maintenance, licensing and fuel costs for the vehicle fleet; salaries and other costs related to drivers and dispatch personnel; and amounts paid to courier and other outside shipping vendors. Such expenses fall within the definition of shipping and handling costs and are classified within selling and administrative expenses and may not be comparable to other companies.

*Self-Insurance*: Coverage for certain employee medical claims and benefits, as well as workers compensation, professional and general liability, and vehicle liability are self-insured. Amounts accrued for costs of workers compensation, medical, professional and general liability, and vehicle are classified as current or long-term liabilities based upon an estimate of when the liability will ultimately be paid.

Amounts accrued as current liabilities within other accrued liabilities are as follows:

| ***(in thousands)*** | **June 30, 2013** | **December 31, 2012** |
|---|---|---|
| Workers compensation | $ 11,502 | $ 10,927 |
| Professional and general liability/vehicle | 4,170 | 3,773 |
| Medical insurance | 4,975 | 6,608 |

Amounts accrued as long-term liabilities within income taxes payable and other non-current liabilities are as follows:

| ***(in thousands)*** | **June 30, 2013** | **December 31, 2012** |
|---|---|---|
| Workers compensation | $ 33,997 | $ 33,130 |
| Professional and general liability/vehicle | 7,838 | 8,565 |

*Income Taxes*: The Company s provision for income taxes is based on expected income, permanent book/tax differences and statutory tax rates in the various jurisdictions in which the Company operates. Significant management estimates and judgments are required in determining the provision for income taxes.

*Profit Interest Units*: The Company measures and recognizes compensation expense for all profit interest unit awards made to employees based on estimated fair values on the date of grant. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service period in the Company s consolidated financial statements. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Profit interest unit expense is recognized on a straight-line basis over the requisite service period. The estimate of fair value of profit interest unit awards on the date of grant is determined through the allocation of all outstanding securities to a business enterprise valuation. The enterprise valuation is based upon a combination of the income approach and the market approach. The income approach is based on discounted cash flows. The market approach uses a selection of comparable companies in determining value. This determination of fair value is affected by assumptions regarding a number of highly complex and subjective variables. Changes in the subjective assumptions can materially affect the estimate of their fair value.

*Recent Accounting Pronouncements*: In July 2013, the FASB issued a new accounting standard on the financial statement presentation of unrecognized tax benefits. The new standard provides that a liability related to an unrecognized tax benefit would be presented as a reduction of a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax position is disallowed. The new standard becomes effective for the Company on January 1, 2014 and it should be applied prospectively to unrecognized tax benefits that exist at the effective date with retrospective application permitted. The Company is currently accessing the impacts of this new standard.

In December 2011, the Financial Accounting Standards Board ( FASB ) issued guidance enhancing disclosure requirements about the nature of an entity s right to offset and related arrangements associated with its financial instruments and derivative instruments. The new guidance requires the disclosure of the gross amounts subject to rights of set-off, amounts offset in accordance with the accounting standards followed, and the related net exposure. The new guidance will be effective for us beginning July 1, 2013. Other than requiring additional disclosures, the Company does not anticipate material impacts on its financial statements upon adoption.

**NOTE 2 RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS**

Historically, the Company accounted for cash receipts from the sale of patient service equipment in operating activities in its consolidated statements of cash flows. Subsequent to the issuance of the 2011 financial statements, the Company

concluded that the cash receipts from the sale of patient service equipment should be recorded in investing activities on the Company s consolidated statements of cash flows. Accordingly, the Company has restated its consolidated statements of cash flows for the six months ended June 30, 2012. The impact of the restatement decreased net cash provided by operating activities in the Company s consolidated statements of cash flows by $23.0 million or 106.9% for the six months ended June 30, 2012. Additionally, net cash used in investing activities in the Company s consolidated statements of cash flows decreased by $23.0 million or 27.0% in the six months ended June 30, 2012. There is no change to the total cash flows in the six months ended June 30, 2012.

The following tables show the impact of the restatement.

**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS ITEMS**

| | Six Months Ended June 30, 2012 | | |
|---|---|---|---|
| **(in thousands)** | **(As Previously Reported)** | **(Adjustments)** | **(As Restated)** |
| Loss (Gain) on sale of patient service equipment and other | $ 10,810 | $ (22,956) | $ (12,146) |
| Net cash provided by (used in) operating activities | 21,477 | (22,956) | (1,479) |
| Proceeds from sale of patient service equipment and other | 155 | 22,956 | 23,111 |
| Net cash used in investing activities | $ (85,079) | $ 22,956 | $ (62,123) |

The restatement described above did not impact the Company s consolidated statements of operations or total cash flows for six months ended June 30, 2012.

**NOTE 3 BUSINESS COMBINATIONS**

The Company periodically acquires complementary businesses. The results of operations of the acquired companies are included in the accompanying condensed consolidated statements of operations from the dates of acquisition.

During the six months ended June 30, 2013 there were no acquisitions. During the six months ended June 30, 2012, the Company purchased certain assets and businesses for total consideration of $0.1 million.

**NOTE 4 GOODWILL AND INTANGIBLE ASSETS**

Changes in goodwill by segment are as follows:

| *(in thousands)* | **Home Infusion Therapy** | **Home Respiratory Therapy and Home Medical Equipment** | **Total** |
|---|---|---|---|
| Balance, December 31, 2012 | $ 258,725 | $ | $ 258,725 |
| Acquisitions | | | |
| Balance, June 30, 2013 | $ 258,725 | $ | $ 258,725 |

The Company recorded a non-cash impairment charge of $350.0 million related to intangible assets in the year ended December 31, 2012, of which $270.0 million related to the home respiratory therapy/home medical equipment reporting unit and $80.0 million related to the enteral business, which is part of the home infusion therapy reporting unit.

Table of Contents

Intangible assets consist of the following:

| *(dollars in thousands)* | Average Life in Years | June 30, 2013 Gross Carrying Amount | June 30, 2013 Accumulated Amortization | June 30, 2013 Net Book Value | December 31, 2012 Gross Carrying Amount | December 31, 2012 Accumulated Amortization | December 31, 2012 Impairment Charge | December 31, 2012 Net Book Value |
|---|---|---|---|---|---|---|---|---|
| Intangible assets subject to amortization: | | | | | | | | |
| Capitated relationships | 20.0 | $ 4,400 | $ (1,424) | $ 2,976 | $ 4,400 | $ (1,327) | | $ 3,073 |
| Payor relationships | 20.0 | 11,000 | (2,567) | 8,433 | 11,000 | (2,292) | | 8,708 |
| Customer list | 0.9 | | | | 121 | (121) | | |
| Subtotal | | 15,400 | (3,991) | 11,409 | 15,521 | (3,740) | | 11,781 |
| Intangible assets not subject to amortization: | | | | | | | | |
| Trade names | | 115,000 | | 115,000 | 465,000 | | (350,000) | 115,000 |
| Accreditations with commissions | | 7,000 | | 7,000 | 7,000 | | | 7,000 |
| Subtotal | | 122,000 | | 122,000 | 472,000 | | (350,000) | 122,000 |
| Total | | $ 137,400 | $ (3,991) | $ 133,409 | $ 487,521 | $ (3,740) | $ (350,000) | $ 133,781 |

Amortization expense amounted to $0.4 million and $1.1 million for the six months ended June 30, 2013 and 2012, respectively. Estimated amortization expense for each of the fiscal years ending December 31 is presented below:

| Year Ending December 31, | (in thousands) |
|---|---|
| 2013 | $ 744 |
| 2014 | 744 |
| 2015 | 744 |
| 2016 | 744 |
| 2017 | 744 |
| Thereafter | 8,060 |

**NOTE 5 LONG-TERM DEBT**

Long-term debt consists of the following:

| *(in thousands)* | June 30, 2013 | December 31, 2012 |
|---|---|---|
| Series A-1 Notes | $ | $ 700,000 |
| Series A-2 Notes | 157,500 | 317,500 |
| Senior Secured Term Loan | 900,000 | |
| Unamortized original issue discount associated with Senior Secured Term Loan | (8,748) | |
| Amended ABL Facility | 30,000 | 25,000 |
| Capital lease obligations | 86 | 210 |
| | 1,078,838 | 1,042,710 |
| Less: current maturities | (39,086) | (25,195) |
| | $ 1,039,752 | $ 1,017,515 |

*Senior Secured Term Loan.* On April 5, 2013, the Company entered into a senior secured credit agreement (the Senior Secured Term Loan ), among Apria, as borrower, Sky Acquisition LLC, as parent, the other guarantors party thereto from time to time, Bank of America, N.A., as administrative agent, U.S. Bank National Association as collateral agent, certain other agents party thereto and a syndicate of financial institutions and institutional lenders.

On April 5, 2013, the Company borrowed $900.0 million in aggregate principal amount of term loans under the Senior Secured Term Loan. At the Company s option, the Company may borrow additional term loans under the Senior Secured Term Loan, subject to certain customary conditions, including consent of the lenders providing such additional term loans, in an amount not to exceed $175.0 million, plus the aggregate principal amount of voluntary prepayments of term loans on or prior to such time, plus additional amounts subject to compliance on a pro forma basis with certain financial ratio tests.

**Table of Contents**

Borrowings under the Senior Secured Term Loan bear interest at a fluctuating rate per annum equal to, at the Company s option (i) a base rate equal to the highest of (a) the federal funds rate plus 1/2 of 1%, (b) the rate of interest in effect for such day as publicly announced from time to time by Bank of America, N.A. as its prime rate and (c) the one month LIBOR Rate plus 1.00% (provided that in no event shall such base rate with respect to the initial Term Loans be less than 2.25% per annum), in each case plus an applicable margin of 4.50% or (ii) a LIBOR Rate for the applicable interest period (provided that in no event shall such LIBOR rate with respect to the initial Term Loans be less than 1.25% per annum) plus an applicable margin of 5.50%.

The Senior Secured Term Loan will mature on April 5, 2020 and will amortize in equal quarterly installments in aggregate annual amounts equal to 1% of the original principal amount of term loans, with the balance payable on the final maturity date; *provided* that the Senior Secured Term Loan provides the right for individual lenders to agree to extend the maturity date of their outstanding term loans upon the Company s request and without the consent of any other lender, subject to customary terms and conditions.

All the Company s obligations under the Senior Secured Term Loan (i) are unconditionally guaranteed by the Company s parent and substantially all of its existing and future, direct and indirect, wholly-owned domestic restricted subsidiaries and (ii) are secured, subject to certain exceptions, by substantially all of the Company s assets and the assets of the guarantors.

The Senior Secured Term Loan is entitled to a priority of payment over the Series A-2 Notes in certain circumstances, including upon any acceleration of the obligations in respect of the Senior Secured Term Loan, the Series A-2 Notes or any bankruptcy or insolvency event or default with respect to Apria or any guarantor of the Senior Secured Term Loan and the Series A-2 Notes.

The Senior Secured Term Loan includes a financial maintenance covenant that prohibits the Company s consolidated first priority net leverage ratio as of the last day of any test period of four consecutive fiscal quarters (commencing with the test period ending September 30, 2013) to exceed 5.50 to 1.00.

The Senior Secured Term Loan also includes customary negative covenants that, subject to certain exceptions, limit the Company s ability and the ability of the Company s parent and subsidiaries to, among other things: incur liens; make investments or loans; incur, assume or permit to exist additional indebtedness or guarantees; and pay dividends, make payments or redeem or repurchase capital stock.

Under the terms of the Senior Secured Term Loan, outstanding loans under the Senior Secured Term Loan may be accelerated if more than $75.0 million of the Series A-2 Notes remain outstanding on or after September 2, 2014.

The Company used proceeds from the borrowings under the Senior Secured Term Loan to: (i) redeem all of the Company s outstanding 11.25% Senior Secured Notes due 2014 (Series A-1) (the Series A-1 Notes ); (ii) redeem an aggregate principal amount of $160.0 million of the Company s outstanding 12.375% Senior Secured Notes due 2014 (Series A-2) (the Series A-2 Notes and, together with the Series A-1 Notes, the Notes ) and (iii) pay fees and expenses associated with the entering into the Senior Secured Term Loan and the redemption of the Notes.

In connection with the redemption of the Series A-1 Notes and a portion of the Series A-2 Notes, the Company paid $24.6 million of premiums to the holders of such Series A-1 Notes and Series A-2 Notes. In addition, the Company wrote-off $19.6 million of unamortized debt issuance costs related to the Series A-1 Notes and the portion of the Series A-2 Notes that were redeemed. Such amounts are included in Loss on Early Retirement of Debt on the Company s Condensed Consolidated Statement of Operations for the three and six months ended June 30, 2013.

Borrowings under the Senior Secured Term Loan were incurred with an original issue discount of $9.0 million. The Company incurred $10.6 million of debt issuance costs in connection with the Senior Secured Term Loan.

*Series A-1 Notes and Series A-2 Notes*. Series A-1 Notes and Series A-2 Notes were issued by us in May 2009 and August 2009, respectively. On April 5, 2013, all Series A-1 Notes and $160.0 million of Series A-2 Notes were refinanced using the proceeds of the Senior Secured Term Loan as described above. The Series A-1 Notes and the Series A-2 Notes bear interest at a rate equal to 11.25% per annum and 12.375% per annum, respectively. The indenture governing the Series A-1 Notes and the Series A-2 Notes, among other restrictions, limits our ability and the ability of its restricted subsidiaries to:

- incur additional debt;

pay dividends and make other distributions;

make certain investments;

repurchase the Company stock;

incur certain liens;

enter into transactions with affiliates;

merge or consolidate;

enter into agreements that restrict the ability of the Company s subsidiaries to make dividends or other payments to us; and

transfer or sell assets.

Subject to certain exceptions, the indenture governing the Series A-2 Notes permits us and our restricted subsidiaries to incur additional indebtedness, including senior indebtedness and secured indebtedness.

The remaining balance of the Series A-2 Notes will mature on November 1, 2014. On and after November 1, 2011, we may redeem the Series A-2 Notes, in whole or in part, at the redemption prices described below:

| Series A-2 Notes | Percentage |
| --- | --- |
| November 1, 2012 | 103.094% |
| November 1, 2013 and thereafter | 100.000% |

Substantially all of the Company s 100% owned subsidiaries (the Guarantors ) jointly and severally, unconditionally guarantee the $900 million Senior Secured Term Loan and the $157.50 million Series A-2 Notes on a senior secured basis. The Guarantors also guarantee Apria s ABL Facility.

*Amended and Restated ABL Facility*. On August 8, 2011, we entered into a senior secured asset-based revolving credit facility, or ABL Facility, with Bank of America, N.A., as administrative agent and collateral agent and a syndicate of financial institutions and institutional lenders. The ABL Facility amended and restated our prior senior secured asset-based revolving credit facility dated October 28, 2008, which provided for a revolving credit financing of up to $150.0 million.

The ABL Facility provides for revolving credit financing of up to $250.0 million, subject to borrowing base availability, with a maturity of the earlier of (a) five years and (b) 90 days prior to the earliest maturity of our outstanding Senior Secured Term Loan and Series A-2 Notes, and includes both a letter of credit and swingline loan sub-facility. The borrowing base at any time is equal to the sum (subject to certain reserves and other adjustments) of (i) 85% of eligible receivables, (ii) the least of (a) 85% of eligible self-pay accounts, (b) 10% of the borrowing base, (c) $25,000,000 and (d) the aggregate amount of self-pay accounts collected within the previous 90 days, (iii) the lesser of (a) 85% of eligible accounts invoiced but unpaid for more than 180 days but less than 360 days and (b) 10% of eligible accounts invoiced but unpaid for 180 days or less and (iv) the lesser of (a) 85% of the net orderly liquidation value of eligible inventory and (b) $35.0 million.

Borrowings under our ABL Facility bear interest at a rate per annum equal to, at our option, either (a) a base rate determined by reference to the higher of (1) the prime rate of Bank of America, N.A. and (2) the federal funds effective rate plus 1/2 of 1% ( Base Rate ), plus an applicable margin (currently 1.25%) or (b) a LIBOR rate determined by reference to LIBOR, adjusted for statutory reserve requirements, plus an applicable margin (currently 2.25%). The applicable margin for borrowings under our ABL Facility is subject to (a) 25 basis points step ups and step downs based on average excess availability under the ABL Facility and (b) a step down of 25 basis points based on achieving a consolidated fixed charge coverage ratio greater than 1.75 to 1.00. In addition to paying interest on outstanding amounts under our ABL Facility, we are required to pay a commitment fee, in respect of the unutilized commitments thereunder, ranging from 0.375% to 0.50% per annum, which fee will be determined based on utilization of our ABL Facility (increasing when utilization is low and decreasing when utilization is high). We also pay customary letter of credit fees equal to the applicable margin on LIBOR loans and other customary letter of credit and agency fees.

From time to time, we issue letters of credit in connection with our business, including commercial contracts, leases, insurance and workers compensation arrangements. If the holders of our letters of credit draw funds under such letters of credit, it would increase our outstanding senior secured indebtedness.

As of June 30, 2013, there was $30.0 million outstanding under the ABL Facility, outstanding letters of credit totaled $23.5 million and additional availability under the ABL Facility, subject to the borrowing base, was $196.5 million. As of June 30, 2013, the available borrowing base did not constrain our ability to borrow the entire $196.5 million available borrowing capacity under our ABL Facility. At June 30, 2013, we were in compliance with all of the financial covenants required by the credit agreement governing the ABL Facility. As of August 5, 2013, there was approximately $42.0 million outstanding under the ABL Facility.

Table of Contents

*Interest Paid*. Interest paid on debt totaled $61.1 million and $59.8 million for the three months ended June 30, 2013 and 2012, respectively, and $61.8 and $60.4 million for the six months ended June 30, 2013 and 2012, respectively. In addition, the Company paid $24.6 million of premiums to the holders of such Series A-1 Notes and Series A-2 Notes in connection with the redemption of the Series A-1 Notes and a portion of the Series A-2 Notes for the three months ended June 30, 2013.

*Loss on Early Retirement of Debt*. The Company paid $24.6 million of premiums to the holders of the Series A-1 Notes and Series A-2 Notes in connection with the redemption of the Series A-1 Notes and a portion of the Series A-2 Notes for the three and six months ended June 30, 2013. In addition, the Company wrote-off $19.6 million of unamortized debt issuance costs related to the Series A-1 Notes and the portion of the Series A-2 Notes that were repaid for the three and six months ended June 30, 2013.

Maturities of long-term debt and the ABL Facility are as follows:

| Year Ending December 31, | (in thousands) |
|---|---|
| 2013 | $ 34,586 |
| 2014 | 166,500 |
| 2015 | 9,000 |
| 2016 | 9,000 |
| 2017 | 9,000 |
| Thereafter | 859,500 |
| | $ 1,087,586 |

The Company and its major equity holders, including the Sponsor and its affiliates, may from time to time, depending upon market conditions, seek to refinance or repurchase our debt securities or loans in privately negotiated or open market transactions, by tender offer or otherwise.

**NOTE 6 STOCKHOLDERS DEFICIT**

For the six months ended June 30, 2013, changes to stockholders deficit were comprised of the following amounts (in thousands):

| | Common Stock | Additional Paid In Capital | Accumulated Deficit | Total Stockholders Deficit |
|---|---|---|---|---|
| Balance as of December 31, 2012 | $ | $ 695,211 | $ (1,026,635) | $ (331,424) |
| Net loss | | | (37,991) | (37,991) |
| Profit interest compensation | | 2,744 | | 2,744 |
| Balance as of June 30, 2013 | $ | $ 697,955 | $ (1,064,626) | $ (366,671) |

**NOTE 7 PROFIT INTEREST UNITS**

*Profit Interest Units*. In November and December of 2008, BP Healthcare Holdings LLC ( BP Holdings ) and Sky LLC, parent entities of the Company affiliated with the Sponsor, granted equity units to the Company s former Chief Executive Officer and the Company s former Chief Financial Officer for purposes of retaining them and enabling such individuals to participate in the long-term growth and financial success of the Company. In addition, in 2009, 2010 and 2011, Sky LLC (and following the Company s reorganization in March 2010, Apria Holdings LLC) granted equity units to certain management employees for purposes of retaining them and enabling such individuals to participate in the long-term growth and financial success of the Company. Profit interest units are measured at the grant date, based on the calculated fair value of the award, and are recognized as an expense over the employee s requisite service period. These equity awards were issued in exchange for services to be performed.

In November 2008, BP Holdings granted Norman C. Payson, M.D., who was then the Company s Chief Executive Officer, 38,697,318 Class B units, all of which were subject to vesting terms based on either (i) continued service to BP Holdings or its subsidiaries and/or

(ii) performance/market conditions.

*Time-Vesting Units*. The portion of the Class B units that vest based on continued service represent 80% of the total Class B units. These units vest over four years starting on October 28, 2008 based on continued service, but will become fully vested on an accelerated basis either (x) upon a change in control while the Company s Chief Executive Officer continues to provide services to BP Holdings or its subsidiaries or

16

**Table of Contents**

(y) if affiliates of the Sponsor receive cash proceeds in respect to 50% of their units in BP Holdings equal to at least 200% of their aggregate capital contributions in respect of such units while the Company s Chief Executive Officer continues to provide services to BP Holdings or its subsidiaries. In addition, if the Company s Chief Executive Officer s services are terminated (a) by the Company without cause or (b) by the Chief Executive Officer as a result of constructive termination, an additional number of these time-vesting Class B units will vest equal to the number that would have vested over the 24-month period following the applicable termination date. Any of these time-vesting Class B units that are unvested on termination of the executive s services will be forfeited. These units were fully vested as of December 31, 2012.

*Performance-Vesting Units*. The remaining portion of the Class B units that vest based on performance/market conditions represent 20% of the total Class B units. One-half of these units will vest if affiliates of the Sponsor receive cash proceeds equal to at least 200% of their aggregate capital contributions in respect of all of their units in BP Holdings, with the other half eligible to vest if they receive cash proceeds equal to at least 300% of their aggregate capital contributions in respect of all of their units in BP Holdings. Any of these performance-vesting units that are unvested upon a termination of the Company s Chief Executive Officer s services (x) by the Company without cause, (y) by the executive as a result of constructive termination or (z) by the executive for any reason on or following October 28, 2012, will remain outstanding until the second anniversary of the applicable termination date (unless they vest prior to that date). If the units do not vest by such anniversary, then any unvested performance-vesting units shall be immediately forfeited.

Assumptions used were as follows:

| | |
|---|---|
| Expected Asset Volatility(1) | 23.0% |
| Risk Free Interest Rate(2) | 2.24% |
| Expected Life(3) | 5.0 years |

(1) The expected asset volatility is derived from the asset volatilities of comparable publicly traded companies.
(2) The risk free interest rate is interpolated from the constant maturity treasury rate ( CMT Rate ) as of the valuation date with the maturity matching the expected life.
(3) The expected life is based on management s estimate.

On November 29, 2012, Norman C. Payson, M.D. announced his retirement from his position as Chief Executive Officer and Chairman of the Board of Directors. Dr. Payson will remain on the Company s Board of Directors and serve as a senior advisor to the Company. In connection with Dr. Payson s retirement, the Board of Directors determined that in order to retain Dr. Payson s continued services it was appropriate to amend the terms of his existing performance-vesting Class B Units to, among other things, provide that (1) his performance-vesting Class B Units will become time-vesting units and will vest in equal monthly installments over a two-year period commencing on November 29, 2012 (or an earlier termination of his services) regardless of whether the existing performance-vesting conditions are met during such time and (2) his performance-vesting Class B units will become fully vested on an accelerated basis upon (x) a change in control while he continues to serve as an advisor or director or (y) if his advisory or board services are terminated without cause or if he resigns as a result of a constructive termination on or prior to November 29, 2014. In addition, Dr. Payson was granted an additional 3,830,365 time-vesting Class B Units which will generally vest in equal installments every three months over a period of four years from the grant date.

Table of Contents

The following table summarizes activity for profit interest units for the period December 31, 2012 to June 30, 2013:

| | Class B Units |
|---|---|
| Balance at December 31, 2012 | 42,527,683 |
| Granted | |
| Exercised | |
| Forfeited | |
| Balance at June 30, 2013 | 42,527,683 |
| Vested units at June 30, 2013 | 33,693,994 |

There is no stated contractual life for the B units.

In December 2008, Sky LLC granted to Chris A. Karkenny, who was then the Company s Chief Financial Officer, 500,000 Class A-2 units, 6,675,287 Class B units and 2,225,096 Class C units, all of which were subject to vesting terms based on either (i) continued service to Sky LLC or its subsidiaries or (ii) performance/market conditions.

*Class A-2 Units*. The Class A-2 units vest if an initial public offering ( IPO ) or change of control occurs and the valuation of Class A-1 units of Sky LLC implied by the transaction exceeds 110% of the aggregate capital contributions of affiliates of the Sponsor for the Class A-1 units. The Company s Chief Financial Officer does not need to be employed at the time of the IPO or change in control to vest. The Class A-2 Units will be forfeited if an IPO or change of control occurs at a valuation that does not result in vesting.

*Time-Vesting Units*. The portion of the Class B units that vest based on continued service represent 66 2/3% of the total Class B units. These units vest over 57 months starting on October 28, 2008 based on continued service, but will become fully vested on an accelerated basis upon a change in control while the Company s Chief Financial Officer continues to provide services to Sky LLC or its subsidiaries. Any of these time-vesting Class B units that are unvested on termination of the executive s services will be forfeited.

*Performance-Vesting Units*. The remaining portion of the Class B units and all of the Class C units vest based on performance/market conditions. These units will vest if affiliates of the Sponsor receive cash proceeds equal to at least 200% of their aggregate capital contributions in respect of 25% of their units in Sky LLC while the Company s Chief Financial Officer continues to provide services to Sky LLC or its subsidiaries.

Assumptions used were as follows:

| | |
|---|---|
| Expected Asset Volatility(1) | 23.0% |
| Risk Free Interest Rate(2) | 1.35% |
| Expected Life(3) | 5.0 years |

(1) The expected asset volatility is derived from the asset volatilities of comparable publicly traded companies.
(2) The risk free interest rate is interpolated from the CMT Rate as of the valuation date with the maturity matching the expected life.
(3) The expected life is based on management s estimates.

On December 28, 2012, it was announced that Chris A. Karkenny, the Company s Executive Vice President and Chief Financial Officer, would leave the Company effective as of December 31, 2012 to pursue other business opportunities. In connection with Mr. Karkenny s termination of employment, the Board of Directors determined to amend his management unit subscription agreement to (1) provide that his performance-vesting Class B and Class C Units would not be forfeited as a result of his termination of employment and instead will remain

eligible to vest if the performance conditions are satisfied prior to March 31, 2014 and (2) provide that his vested units can only be purchased by the Company during the period from March 31, 2014 to June 1, 2014. Mr. Karkenny forfeited 667,529 units, which were unvested time-vesting units on the date of his departure.

Table of Contents

The following table summarizes activity for profit interest units for the period December 31, 2012 to June 30, 2013:

| | Class A-2 Units | Class B Units | Class C Units |
|---|---|---|---|
| Balance at December 31, 2012 | 500,000 | 6,007,758 | 2,225,096 |
| Exercised | | | |
| Forfeited | | | |
| Balance at June 30, 2013 | 500,000 | 6,007,758 | 2,225,096 |
| Vested units at June 30, 2013 | | 3,782,284 | |

There are no stated contractual lives for the A-2, B or C units.

Sky LLC (and following the Company s reorganization in March 2010, Apria Holdings LLC) granted certain management employees 72,394,024 Class B units and 20,592,816 Class C units, all of which are subject to vesting terms based on either (i) continued service to Sky LLC or its subsidiaries or (ii) performance/market conditions.

*Time-Vesting Units*. The portion of the Class B units that vest based on continued service represent 66 2/3% of the total Class B units. These units vest over five years starting on the later of (x) October 28, 2008 and (y) the date the employee commenced employment based on continued service, but will become fully vested on an accelerated basis upon a change in control while the employee continues to provide services to Sky LLC or its subsidiaries. Any of these time-vesting Class B units that are unvested on termination of the employee s services will be forfeited.

*Performance-Vesting Units*. The remaining portion of the Class B units and all of the Class C units vest based on performance/market conditions. These units will vest if affiliates of the Sponsor receive cash proceeds equal to at least 200% of their aggregate capital contributions in respect of 25% of their units in Sky LLC while the employee continues to provide services to Sky LLC or its subsidiaries.

Notwithstanding the vesting terms described above, if the employee voluntarily resigns (in the absence of constructive termination ) on or prior to the second anniversary of the applicable grant date, then Sky LLC may require the forfeiture of any vested Class B or C units.

Assumptions used were as follows:

| | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|
| Expected Asset Volatility(1) | 25.0% | 25.0% | 25.0% | 30.0% |
| Risk Free Interest Rate(2) | 2.39% | 2.01% | 0.83% | 0.72% |
| Expected Life(3) | 5.0 years | 5.0 years | 5.0 years | 5.0 years |

(1) The expected asset volatility is derived from the asset volatilities of comparable publicly traded companies.
(2) The risk free interest rate is interpolated from the CMT Rate as of the valuation date with the maturity matching the expected life.
(3) The expected life is based on management s estimate.

The following table summarizes activity for profit interest units for the period December 31, 2012 to June 30, 2013:

| | Class A-2 Units | Class B Units | Class C Units |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Balance at December 31, 2012 | 1,075,000 | 42,852,564 | 11,078,113 |
| Granted | | 6,530,175 | 2,176,724 |
| Forfeited | | (3,743,966) | (1,247,989) |
| Balance at June 30, 2013 | 1,075,000 | 45,638,773 | 12,006,848 |
| Vested units at June 30, 2013 | | 15,373,727 | |

There are no stated contractual lives for the A-2, B or C units.

Pursuant to a reorganization the Company conducted in March 2010, units of Sky LLC were converted or exchanged into units of Apria Holdings LLC, its parent entity.

**Table of Contents**

In October 2011, Apria Holdings LLC granted to Mike S. Zafirovski, a Board member, 5,030,651 Class B units, all of which are subject to vesting terms based on either (i) continued service or (ii) performance/market conditions.

*Time-Vesting Units*. The portion of the Class B units that vest based on continued service represent 33 1/3% of the total Class B units. These units vest over three years starting on the anniversary of the grant date, but will become fully vested on an accelerated basis upon a change in control while the director continues to provide services to Sky LLC or its subsidiaries. Any of these time-vesting Class B units that are unvested on termination of the director s services will be forfeited; provided however, if Mr. Zafirovski s service is terminated by the Company without cause or due to his death or disability, a pro-rata portion of the time-vesting Class B units that would have vested on the next anniversary of the grant date will vest.

*Performance-Vesting Units*. The remaining portion of the Class B units vest based on performance/market conditions. These units are divided into two categories, with vesting in each category based on the Company s achievement of EBITDA (as defined in the Company s credit agreement) targets and return on the investment of the Sponsor (defined as Blackstone Capital Partners V L.P. and its affiliates). The first category of the target-based Class B Units will vest if either of the following conditions is satisfied while Mr. Zafirovski continues to serve as a director (or within 24 months after termination by the Company of his service on the Board of Directors without cause): (1) the Company achieves a specified EBITDA target for each of fiscal year 2012 and fiscal year 2013; or (2) the Sponsor achieves a specified return on investment on or prior to December 31, 2014. The second category of the target-based Class B Units will vest if both of the following conditions are satisfied while Mr. Zafirovski continues to serve as a director (or within 24 months after a termination by the Company of his service on the Board of Directors without cause): (1) the Company achieves a more challenging specified EBITDA target for either fiscal year 2012 or fiscal year 2013 (such year of achievement, the Subject Year ); and (2) one of the following conditions is satisfied: (a) the Company achieves a more challenging specified EBITDA target for the fiscal year immediately succeeding the Subject Year; or (b) the Sponsor achieves a specified return on investment on or prior to December 31, 2014. The Company believes that the targets set for the target based Class B Units are reasonable, although neither automatically nor easily achieved.

The Class B units acquired by Mr. Zafirovski are similar to the other Class B units, except that the Class B units granted to Mr. Zafirovski contain a special term that would require the value of Holdings Class A-2 Units to exceed $1.63 for him to receive any value, such that no payment would be made in respect of a Class B Unit if the value of a Class A-2 Unit fails to exceed $1.63.

Assumptions used were as follows for the 2011 grants:

| | |
|---|---|
| Expected Asset Volatility(1) | 25.0% |
| Risk Free Interest Rate(2) | 2.01% |
| Expected Life(3) | 5.0 years |

(1) The expected asset volatility is derived from the asset volatilities of comparable publicly traded companies.
(2) The risk free interest rate is interpolated from the CMT Rate as of the valuation date with the maturity matching the expected life.
(3) The expected life is based on management s estimate.

The following table summarizes activity for profit interest units for the period December 31, 2012 to June 30, 2013:

| | Class A-2 Units | Class B Units | Class C Units |
|---|---|---|---|
| Balance at December 31, 2012 | 1,000,000 | 5,030,651 | |
| Granted | | | |
| Balance at June 30, 2013 | 1,000,000 | 5,030,651 | |

| Vested units at June 30, 2013 | 558,956 |
| --- | --- |

In December 2012, BP Holdings and the new Chief Executive Officer and Chairman of the Board of Directors, John G. Figueroa, entered into a management unit subscription agreement pursuant to which Mr. Figueroa purchased 1,000,000 Class A-2 Units of Holdings at the price of $1.00 per unit. The Class A-2 Units purchased by Mr. Figueroa were fully vested when purchased and contain different economic terms than Holdings normal Class A-2 Units which will not entitle him to receive any value above $1.00 per Class A-2 Unit unless and until the cumulative value attributable to each of his Class A-2 Units exceeds $1.10, at which point the special Class A-2 Units will become entitled to receive $0.10 per unit and thereafter will become entitled to receive the same amount as other Class A-2 Units.

**Table of Contents**

BP Holdings granted Mr. Figueroa 12,257,169 Class B Units, all of which are subject to vesting terms based on continued service to BP Holdings or its subsidiaries. The Class B Units granted to Mr. Figueroa contain a special term that requires the value of Holdings Class A Units to exceed $1.10 in order for him to receive any value from such units, such that no payment will be made in respect of his Class B Units if the value a Class A Unit fails to exceed $1.10.

*Time Vesting Units*. All of Mr. Figueroa s Class B Units are time-vesting, with 20% of the Class B Units vesting on December 5, 2013 and an additional 5% of the Class B Units vesting every three months for a period of four years thereafter. The Class B Units will become fully vested if a change in control of Holdings occurs while Mr. Figueroa is still employed with the Company. Any Class B Units that are unvested upon termination of Mr. Figueroa s employment will be forfeited.

Assumptions used were as follows:

| | |
|---|---|
| Expected Asset Volatility(1) | 25.0% |
| Risk Free Interest Rate(2) | 0.83% |
| Expected Life(3) | 5.0 years |

(1) The expected asset volatility is derived from the asset volatilities of comparable publicly traded companies.
(2) The risk free interest rate is interpolated from the CMT Rate as of the valuation date with the maturity matching the expected life.
(3) The expected life is based on management s estimate.

The following table summarizes activity for profit interest units for the period December 31, 2012 to June 30, 2013:

| | Class A-2 Units | Class B Units | Class C Units |
|---|---|---|---|
| Balance at December 31, 2012 | 1,000,000 | 12,257,169 | |
| Granted | | | |
| Forfeited | | | |
| Balance at June 30, 2013 | 1,000,000 | 12,257,169 | |
| Vested units at June 30, 2013 | | | |

In May 2013, Apria Holdings LLC granted a subsidiary s board member 1,160,920 Class B units, all of which are subject to time vesting terms based on continued service. The Class B units vest based on continued service, with 10% vesting immediately, an additional 23 1/3% of the Class B units vesting on September 4, 2013, an additional 34 1/3% of the Class B units vesting on September 4, 2014 and an additional 32 1/3% of the Class B units vesting on September 4, 2015. These units will become fully vested on an accelerated basis upon a change in control while the director continues to provide services to the subsidiary. Any of these Class B units that are unvested on termination of the director s services will be forfeited.

Assumptions used were as follows for the 2013 grants:

| | |
|---|---|
| Expected Asset Volatility(1) | 30.0% |
| Risk Free Interest Rate(2) | 0.72% |
| Expected Life(3) | 5.0 years |

(1) The expected asset volatility is derived from the asset volatilities of comparable publicly traded companies.
(2) The risk free interest rate is interpolated from the CMT Rate as of the valuation date with the maturity matching the expected life.

(3) The expected life is based on management s estimate.

Table of Contents

The following table summarizes activity for profit interest units for the period December 31, 2012 to June 30, 2013:

| | Class A-2 Units | Class B Units | Class C Units |
|---|---|---|---|
| Balance at December 31, 2012 | | | |
| Granted | | 1,160,920 | |
| Balance at June 30, 2013 | | 1,160,920 | |
| Vested units at June 30, 2013 | | 116,092 | |

Expense recorded related to profit interest units was $1.4 million and $0.7 million in each of the three months ended June 30, 2013 and 2012, respectively, and $2.7 million and $1.6 million in each of the six months ended June 30, 2013 and 2012, respectively. As of June 30, 2013, total unrecognized profit interest compensation cost related to unvested profit interest units was $10.3 million, which is expected to be expensed over a weighted average period of 3.6 years. The total fair market value of shares vested was $1.3 million and $1.3 million in the three months ended June 30, 2013 and 2012, respectively, and $2.2 million and $2.4 million in the six months ended June 30, 2013 and 2012, respectively.

The following table summarizes activity for all profit interest units for the period December 31, 2012 to June 30, 2013:

| | Class A-2 Shares | Weighted-Average Grant Date Fair Value | Class B Units | Weighted-Average Grant Date Fair Value | Class C Units | Weighted-Average Grant Date Fair Value |
|---|---|---|---|---|---|---|
| Balance at December 31, 2012 | 3,575,000 | 0.81 | 108,675,825 | 0.37 | 13,303,209 | 0.21 |
| Granted | | | 7,691,095 | 0.38 | 2,176,724 | 0.21 |
| Forfeited | | | (3,743,966) | 0.38 | (1,247,989) | 0.23 |
| Balance at June 30, 2013 | 3,575,000 | 0.81 | 112,622,954 | 0.37 | 14,231,944 | 0.21 |

**NOTE 8 INCOME TAXES**

The Company s effective tax rate was (2.6)% for the three months ended June 30, 2013, compared to (2.3)% for the three months ended June 30, 2012. The Company s effective tax rate was (3.2)% for the six months ended June 30, 2013, compared to (3.8)% for the six months ended June 30, 2012. For the three and six months ended June 30, 2013 and 2012, the Company s effective tax rate differed from federal and state statutory rates primarily due to the accrual of a valuation allowance against substantially all of the Company s net deferred tax assets.

Deferred income tax assets and liabilities are computed for differences between the carrying amounts of assets and liabilities for financial statement and tax purposes. Deferred income tax assets are required to be reduced by a valuation allowance when it is determined that it is more likely than not that all or a portion of a deferred tax asset will not be realized.

Beginning with the year ended December 31, 2011, the Company accrued a valuation allowance against substantially all of its net deferred tax assets since the Company determined that it is more likely than not that substantially all of its net deferred tax assets will not be realized. The Company intends to maintain its valuation allowance until sufficient positive evidence exists to support the reversal of all or a portion of its valuation allowance.

The Company increased its valuation allowance by $13.4 million to $251.9 million at June 30, 2013 from $238.5 million at December 31, 2012 to offset corresponding increases in its net deferred tax assets for the six months ended June 30, 2013. The Company increased its valuation allowance by $13.1 million to $251.9 million at June 30, 2013 from $238.8 million at March 31, 2013 to offset corresponding increases in its net deferred tax assets for the three months ended June 30, 2013.

The Company accounts for its tax uncertainties under generally accepted accounting principles. Accordingly, the Company is required to disclose certain information, within its interim financial statements, when material changes occur regarding its tax uncertainties. For the six

months ended June 30, 2013, no material changes occurred with respect to the Company s tax uncertainties which would require disclosure.

As of June 30, 2013, federal net operating loss ( NOLs ) carryforwards of approximately $467.9 million were available to offset future federal taxable income. Such NOLs will expire at various times and in varying amounts during the Company s calendar 2015 through 2033 tax years. A significant portion of these NOLs are subject to an annual utilization limitation as required by Section 382 of the Internal Revenue Code of 1986, as amended.

Table of Contents

The Company files federal and state income tax returns in jurisdictions with varying statutes of limitations expiration dates. The Company s calendar 2009 through 2012 tax years generally remain subject to examination by tax authorities. The Internal Revenue Service ( IRS ) has recently completed its audit of the Company s calendar 2009 Federal income tax return and made immaterial changes to the Company s NOL carryforwards. Certain state tax agencies are currently examining the tax years 2006 and forward.

Net income tax payments made (and refunds received) for the six-month period ended June 30, 2013 and 2012 amounted to $0.7 million and $0.5 million, respectively.

**NOTE 9 COMMITMENTS AND CONTINGENCIES**

*Litigation*: The Company is engaged in the defense of certain claims and lawsuits arising out of the ordinary course and conduct of its business, the outcomes of which are not determinable at this time. Insurance policies covering such potential losses, where such coverage is cost effective, are maintained. In the opinion of management, any liability that might be incurred upon the resolution of these claims and lawsuits will not, in the aggregate, have a material adverse effect on the Company s financial condition or results of operations, cash flows and liquidity.

*Medicare and Medicaid Reimbursement*: There are a number of provisions contained within recent, proposed or contemplated legislation that affect or may affect Medicare and Medicaid reimbursement policies for items and services provided. The Company cannot be certain of the ultimate impact of all legislated and contemplated changes, and therefore cannot provide assurance that these changes will not have a material adverse effect on the Company s financial condition or results of operations.

*Supplier Concentration*: Currently, on a year to date basis, approximately 73.0% of purchases for patient service equipment and supplies are from five vendors. Although there are a limited number of suppliers, management believes that other vendors could provide similar products on comparable terms. However, a change in suppliers could cause delays in service delivery and possible losses in revenue, which could adversely affect the Company s financial condition or operating results.

*Guarantees and Indemnities*: From time to time, certain types of contracts are entered into that contingently require indemnification of parties against third party claims. These contracts primarily relate to (i) certain asset purchase agreements, under which indemnification may be provided to the seller of the business being acquired; (ii) certain real estate leases, which may require indemnification to property owners for environmental or other liabilities and other claims arising from use of the applicable premises; and (iii) certain agreements with officers, directors and employees, which may require indemnification of such persons for liabilities arising out of their relationship with the Company.

The terms of such obligations vary by contract and in most instances a specific or maximum dollar amount is not explicitly stated therein. Generally, amounts under these contracts cannot be reasonably estimated until a specific claim is asserted. Consequently, no liabilities have been recorded for these obligations on the balance sheets for any of the periods presented.

**NOTE 10 SEGMENTS**

The Company has two reportable operating segments: (1) home respiratory therapy and home medical equipment and (2) home infusion therapy. Within these two operating segments there are four core service lines: home respiratory therapy, home medical equipment, home infusion therapy, including TPN services, and enteral nutrition services. The home respiratory therapy and home medical equipment segment provides services and equipment to assist patients with oxygen systems, sleep apnea, ambulation and general care around the home, as well as to provide respiratory medications and related services. The home infusion therapy segment primarily provides patients with pharmaceuticals and services prescribed in conjunction with the administration of nutrients or medication intravenously or through a gastrointestinal tube.

Segment financial results are based on directly assignable net revenues, cost of goods sold, bad debt expenses and selling, distribution and administrative costs, where available. Costs that are not directly assignable, such as corporate costs and certain selling, distribution and administrative expenses, are allocated based on various metrics including billed census, headcount and branch locations by segment, among others.

**Table of Contents**

During the fourth quarter of 2012, the Company revised its allocation to its reporting segments. This allocation is based on how the Company currently manages and discusses its operations.

| | Net Revenue | | | |
|---|---|---|---|---|
| | Three Months Ended June 30, | | Six Months Ended June 30, | |
| *(in thousands)* | 2013 | 2012 | 2013 | 2012 |
| **Operating Segment** | | | | |
| Home Respiratory Therapy and Home Medical Equipment | $ 290,665 | $ 303,428 | $ 589,190 | $ 604,326 |
| Home Infusion Therapy | 329,958 | 304,244 | 646,188 | 599,059 |
| Total | $ 620,623 | $ 607,672 | $ 1,235,378 | $ 1,203,385 |

| | EBIT | | | |
|---|---|---|---|---|
| | Three Months Ended June 30, | | Six Months Ended June 30, | |
| *(in thousands)* | 2013 | 2012 | 2013 | 2012 |
| **Operating Segment** | | | | |
| Home Respiratory Therapy and Home Medical Equipment | $ 44 | $ (10,733) | $ 628 | $ (26,733) |
| Home Infusion Therapy | 40,526 | 32,098 | 72,005 | 62,204 |
| Total | $ 40,570 | $ 21,365 | $ 72,633 | $ 35,471 |

| | Depreciation and Amortization | | | |
|---|---|---|---|---|
| | Three Months Ended June 30, | | Six Months Ended June 30, | |
| *(in thousands)* | 2013 | 2012 | 2013 | 2012 |
| **Operating Segment** | | | | |
| Home Respiratory Therapy and Home Medical Equipment | $ 25,994 | $ 24,617 | $ 48,590 | $ 49,582 |
| Home Infusion Therapy | 3,909 | 4,243 | 7,860 | 8,644 |
| Total | $ 29,903 | $ 28,860 | $ 56,450 | $ 58,226 |

The Company s Chief Operating Decision Maker ( CODM ) does not review assets assigned to segments. Therefore, such items are not reflected in the table above.

Earnings before interest and taxes ( EBIT ). EBIT is the measure used by the Company s management to measure operating performance. EBIT is defined as net income (loss) plus interest expense, loss on early retirement of debt and income taxes. EBIT is not a recognized term under Generally Accepted Accounting Principles ( GAAP ) and does not purport to be an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity.

The following table provides a reconciliation from net loss to EBIT:

| *(in thousands)* | Three Months Ended June 30, 2013 | Three Months Ended June 30, 2012 | Six Months Ended June 30, 2013 | Six Months Ended June 30, 2012 |
|---|---|---|---|---|
| Net loss | $ (36,098) | $ (12,736) | $ (37,991) | $ (32,343) |
| Interest expense, net (a) | 31,534 | 33,809 | 65,236 | 66,624 |
| Loss on early retirement of debt (b) | 44,221 | | 44,221 | |
| Income tax expense | 913 | 292 | 1,167 | 1,190 |
| EBIT | $ 40,570 | $ 21,365 | $ 72,633 | $ 35,471 |

(a) Reflects $32.2 million of interest expense, net of $0.6 million of interest income for the three months ended June 30, 2013. Reflects $33.9 million of interest expense, net of $0.1 million of interest income for the three months ended June 30, 2012. Reflects $66.4 million of interest expense, net of $1.2 million of interest income for the six months ended June 30, 2013. Reflects $67.4 million of interest expense, net of $0.8 million of interest income for the six months ended June 30, 2012

(b) Reflects $24.6 million of premiums paid to the holders of the redeemed Series A-1 Notes and the portion of the Series A-2 Notes that were redeemed for the three and six months ended June 30, 2013. Reflects $19.6 million of unamortized debt issuance costs related to the Series A-1 Notes and the portion of the Series A-2 Notes that were redeemed in the three and six months ended June 30, 2013.

Table of Contents

The Company allocates certain corporate expenses that are not directly attributable to a product line based upon Company metrics. The following table shows corporate costs allocated to each segment for the three and six months ended June 30, 2013 and June 30, 2012.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| *(in millions)* | **2013** | **2012** | **2013** | **2012** |
| **Operating Segment** | | | | |
| Home Respiratory Therapy and Home Medical Equipment | $ 33.6 | $ 36.6 | $ 63.8 | $ 74.2 |
| Home Infusion Therapy | $ 16.9 | $ 12.8 | $ 31.2 | $ 25.4 |

**NOTE 11 CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS**

*Management Fee Agreement*: In connection with the Merger, Merger Sub entered into a management fee agreement with Blackstone Management Partners V L.L.C. ( BMP ). The Company succeeded to and assumed the rights and obligations of Merger Sub pursuant to the transaction and management fee agreement upon the closing of the Merger. Under the management fee agreement, BMP (including through its affiliates) agreed to provide services, including without limitation, (a) advice regarding the structure, distribution and timing of debt and equity offerings and advice regarding relationships with the Company s lenders and bankers, (b) advice regarding the business and strategy of the Company, including compensation arrangements, (c) advice regarding dispositions and/or acquisitions and (d) such advice directly related or ancillary to the above financial advisory services as may be reasonably requested by the Company. In consideration for the services, the Company pays BMP at the beginning of each fiscal year a management fee equal to the greater of $7.0 million or 2.0% of the Company s consolidated EBITDA, as defined in the agreement, for the immediately preceding fiscal year. BMP shall have no obligation to provide any other services to the Company absent express agreement. In addition, in the absence of an express agreement to provide investment banking or other financial advisory services to the Company, and without regard to whether such services were provided, BMP is entitled to receive a fee equal to 1.0% of the aggregate transaction value upon the consummation of any acquisition, divestiture, disposition, merger, consolidation, restructuring, refinancing, recapitalization, issuance of private or public debt of equity securities (including an initial public offering of equity securities), financing or similar transaction by the Company.

At any time in connection with or in anticipation of a change of control of the Company, a sale of all or substantially all of the Company s assets or an initial public offering of common equity of the Company or its successor, BMP may elect to receive, in consideration of BMP s role in facilitating such transaction and in settlement of the termination of the services, a single lump sum cash payment equal to the then-present value of all then-current and future annual management fees payable under the transaction and management fee agreement, assuming a hypothetical termination date of the agreement to be the twelfth anniversary of such election. The transaction and management fee agreement will continue until the earlier of the twelfth anniversary of the date of the agreement or such date as the Company and BMP may mutually determine. The Company has agreed to indemnify BMP and its affiliates, directors, officers, employees, agents and representatives from and against all liabilities relating to the services contemplated by the transaction and management fee agreement and the engagement of BMP pursuant to, and the performance of BMP and its affiliates of the services contemplated by, the transaction and management fee agreement. In accordance with the management agreement, the Company expensed $1.8 million for both the quarters ended June 30, 2013 and 2012.

*Intelenet Agreement*: In May 2009, the Company entered into a Master Services Agreement ( the Intelenet Agreement ) with Intelenet Global Services Private Limited ( Intelenet ), an Indian company then-affiliated with the Sponsor, regarding the outsourcing of certain functions relating to billing, collections and other administrative and clerical services. In July 2011 an affiliate of the Sponsor, along with other shareholders of Intelenet, sold Intelenet to Serco Group PLC, an international services company. In April 2013, Intelenet was merged with and into an affiliate of Serco Group PLC, Serco BPO Private Limited ( Serco ). During the six months ended June 30, 2013 and June 30, 2012, the Company paid approximately $7.7 million and $8.4 million, respectively, to Intelenet and Serco. The Company continues to rely on Serco to perform certain administrative functions, but other administrative functions included in the original Intelenet Agreement are now incorporated into our internal Company-run customer care centers and branch operations staffed with our personnel.

*Equity Healthcare Agreement*: Effective as of January 1, 2010, the Company entered into an employer health program agreement with Equity Healthcare LLC ( Equity Healthcare ), an affiliate of the Sponsor, pursuant to which Equity Healthcare will provide to the Company certain negotiating, monitoring and other services in connection with our health benefit plans. Because of the combined purchasing power of its client participants, Equity Healthcare is able to negotiate pricing terms for providers that are believed to be more favorable than the companies could obtain for themselves on an individual basis. In consideration for Equity Healthcare s services, the Company paid Equity Healthcare a fee of $2 per

25

participating employee per month (the PEPM Fee ) until the parties entered into an amended agreement on December 22, 2011. Under the amendment, in consideration for Equity Healthcare s services, the Company paid Equity Healthcare a PEPM fee of $2.25 or $2.50 in 2012, and will pay $2.35 or $2.60 in 2013, depending upon whether the Company s employees are enrolled in a grandfathered or custom health benefit plan. As of June 30, 2013, the Company had approximately 6,900 employees enrolled in Equity Healthcare health benefit plans.

**NOTE 12 FINANCIAL GUARANTEES**

The Company conducts substantially all of its business through its subsidiaries. Substantially all of the Company s 100%-owned subsidiaries, jointly and severally, unconditionally guarantee the Senior Secured Term Loan and the Series A-2 Notes on a senior secured basis. The Guarantors also guarantee the Company s ABL Facility. See also Note 5 Long-Term Debt.

The following condensed consolidating financial statements quantify the financial position as of June 30, 2013 and December 31, 2012, the operations for the three and six months ended June 30, 2013 and 2012, and the cash flows for the three months ended June 30, 2013 and 2012. These condensed consolidating financial statements present financial information for the parent issuer, the guarantor subsidiaries, the non-guarantor subsidiaries and consolidating adjustments, consisting of the entries that eliminate the investment in subsidiaries and intercompany balances and transactions.

The financial information as presented below is based on estimates to bifurcate shared resources, costs and revenues between entities and such information may not be indicative of results, if separate financial statements were prepared for these subsidiaries.

Table of Contents

**CONDENSED CONSOLIDATING BALANCE SHEETS**

**June 30, 2013**

**(Unaudited)**

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries (in thousands) | Consolidating Adjustments | Consolidated |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| CURRENT ASSETS | | | | | |
| Cash and cash equivalents | $ 21,893 | $ (6,310) | $ 270 | $ | $ 15,853 |
| Accounts receivable less allowance for doubtful accounts | | 332,384 | 1,613 | | 333,997 |
| Inventories, net | | 72,544 | 475 | | 73,019 |
| Deferred expenses | | 3,409 | | | 3,409 |
| Intercompany | 243,728 | 1,026,981 | | (1,270,709) | |
| Prepaid expenses and other current assets | 1,069 | 20,374 | 12 | | 21,455 |
| Intercompany loan | 710,000 | | | (710,000) | |
| TOTAL CURRENT ASSETS | 976,690 | 1,449,382 | 2,370 | (1,980,709) | 447,733 |
| PATIENT SERVICE EQUIPMENT, less accumulated depreciation | | 191,593 | 3 | | 191,596 |
| PROPERTY, EQUIPMENT AND IMPROVEMENTS, NET | 37,058 | 36,418 | 155 | | 73,631 |
| GOODWILL | | 258,725 | | | 258,725 |
| INTANGIBLE ASSETS, NET | 50,000 | 83,409 | | | 133,409 |
| DEFERRED DEBT ISSUANCE COSTS, NET | 15,187 | | | | 15,187 |
| INVESTMENT IN SUBSIDIARIES | (251,215) | 445,425 | | (194,210) | |
| OTHER ASSETS | 5,733 | 23,520 | | | 29,253 |
| TOTAL ASSETS | $ 833,453 | $ 2,488,472 | $ 2,528 | $ (2,174,919) | $ 1,149,534 |
| **LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY** | | | | | |
| CURRENT LIABILITIES | | | | | |
| Accounts payable | $ 1,768 | $ 144,253 | $ 249 | $ | $ 146,270 |
| Accrued payroll and related taxes and benefits | 7,583 | 54,359 | 149 | | 62,091 |
| Deferred income taxes current | 6,685 | (5,375) | | | 1,310 |
| Other accrued liabilities | 18,131 | 51,329 | 206 | | 69,666 |
| Deferred revenue | | 27,153 | | | 27,153 |
| Intercompany | 93,457 | 1,177,252 | | (1,270,709) | |
| Current portion of long-term debt | 39,000 | 710,086 | | (710,000) | 39,086 |
| TOTAL CURRENT LIABILITIES | 166,624 | 2,159,057 | 604 | (1,980,709) | 345,576 |
| LONG-TERM DEBT, net of current portion | 1,039,752 | | | | 1,039,752 |
| DEFERRED INCOME TAXES | 12,115 | 56,882 | | | 68,997 |
| INCOME TAXES PAYABLE & OTHER NON-CURRENT LIABILITIES | 7,195 | 53,727 | 958 | | 61,880 |
| TOTAL LIABILITIES | 1,225,686 | 2,269,666 | 1,562 | (1,980,709) | 1,516,205 |
| COMMITMENTS AND CONTINGENCIES | | | | | |
| STOCKHOLDERS (DEFICIT) EQUITY | | | | | |
| Additional paid-in capital | 697,954 | 194,211 | | (194,210) | 697,955 |

| | | | | | |
|---|---|---|---|---|---|
| (Accumulated deficit) retained earnings | (1,090,187) | 24,595 | 966 | | (1,064,626) |
| TOTAL STOCKHOLDERS (DEFICIT) EQUITY | (392,233) | 218,806 | 966 | (194,210) | (366,671) |
| | $ 833,453 | $ 2,488,472 | $ 2,528 | $ (2,174,919) | $ 1,149,534 |

Table of Contents

**CONDENSED CONSOLIDATING BALANCE SHEETS**

**December 31, 2012**

**(Unaudited)**

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries (in thousands) | Consolidating Adjustments | Consolidated |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| CURRENT ASSETS | | | | | |
| Cash and cash equivalents | $ 23,457 | $ 3,354 | $ 269 | $ | $ 27,080 |
| Accounts receivable less allowance for doubtful accounts | | 343,100 | 1,321 | | 344,421 |
| Inventories | | 67,857 | 218 | | 68,075 |
| Deferred expenses | | 3,798 | | | 3,798 |
| Intercompany | 667,745 | 475,973 | | (1,143,718) | |
| Prepaid expenses and other current assets | 835 | 16,043 | 12 | | 16,890 |
| Intercompany loan | 710,000 | | | (710,000) | |
| TOTAL CURRENT ASSETS | 1,402,037 | 910,125 | 1,820 | (1,853,718) | 460,264 |
| PATIENT SERVICE EQUIPMENT, less accumulated depreciation | | 186,457 | 3 | | 186,460 |
| PROPERTY, EQUIPMENT AND IMPROVEMENTS, NET | 37,210 | 39,430 | 183 | | 76,823 |
| GOODWILL | | 258,725 | | | 258,725 |
| INTANGIBLE ASSETS, NET | 50,000 | 83,781 | | | 133,781 |
| DEFERRED DEBT ISSUANCE COSTS, NET | 30,207 | | | | 30,207 |
| INVESTMENT IN SUBSIDIARIES | | 774 | | (774) | |
| OTHER ASSETS | 5,390 | 21,058 | | | 26,448 |
| TOTAL ASSETS | $ 1,524,844 | $ 1,500,350 | $ 2,006 | $ (1,854,492) | $ 1,172,708 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | | | |
| CURRENT LIABILITIES | | | | | |
| Accounts payable | $ 4,751 | $ 152,593 | $ 186 | $ | $ 157,530 |
| Accrued payroll and related taxes and benefits | 8,774 | 61,562 | 211 | | 70,547 |
| Deferred income taxes | 3,578 | (2,592) | | | 986 |
| Other accrued liabilities | 19,883 | 54,536 | 45 | | 74,464 |
| Deferred revenue | | 27,785 | | | 27,785 |
| Intercompany | 402,475 | 741,243 | | (1,143,718) | |
| Current portion of long-term debt | 25,000 | 710,195 | | (710,000) | 25,195 |
| TOTAL CURRENT LIABILITIES | 464,461 | 1,745,322 | 442 | (1,853,718) | 356,507 |
| LONG-TERM DEBT, net of current portion | 1,017,500 | 15 | | | 1,017,515 |
| DEFERRED INCOME TAXES | 15,222 | 53,685 | | | 68,907 |
| INVESTMENT IN SUBSIDIARIES | 351,927 | | | (351,927) | |
| INCOME TAXES PAYABLE & OTHER NON-CURRENT LIABILITIES | 7,158 | 53,255 | 790 | | 61,203 |
| TOTAL LIABILITIES | 1,856,268 | 1,852,277 | 1,232 | (2,205,645) | 1,504,132 |
| COMMITMENTS AND CONTINGENCIES | | | | | |
| STOCKHOLDERS EQUITY | | | | | |
| Common stock | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Additional paid-in capital | 695,211 | (247,215) | | 247,215 | 695,211 |
| (Accumulated deficit) retained earnings | (1,026,635) | (104,712) | 774 | 103,938 | (1,026,635) |
| TOTAL STOCKHOLDERS (DEFICIT) EQUITY | (331,424) | (351,927) | 774 | 351,153 | (331,424) |
| | $ 1,524,844 | $ 1,500,350 | $ 2,006 | $ (1,854,492) | $ 1,172,708 |

Table of Contents

**CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS**

**Three Months Ended June 30, 2013**

**(Unaudited)**

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| Operating net revenue | $ | $ 618,250 | $ 2,884 | $ (511) | $ 620,623 |
| Income from subsidiaries | 45,546 | | | (45,546) | |
| TOTAL NET REVENUES | 45,546 | 618,250 | 2,884 | (46,057) | 620,623 |
| TOTAL COST OF NET REVENUES | | 272,181 | 1,650 | (511) | 273,320 |
| Provision for doubtful accounts | | 12,956 | 136 | | 13,092 |
| Selling, distribution and administrative | 41,643 | 296,641 | 717 | (45,546) | 293,455 |
| Amortization of intangible assets | | 186 | | | 186 |
| TOTAL COSTS AND EXPENSES | 41,643 | 581,964 | 2,503 | (46,057) | 580,053 |
| OPERATING INCOME | 3,903 | 36,286 | 381 | | 40,570 |
| Interest expense | 32,168 | 9 | | | 32,177 |
| Loss on early retirement of debt | 44,221 | | | | 44,221 |
| Interest income and other | (11,991) | 11,161 | 187 | | (643) |
| (LOSS) INCOME BEFORE TAXES | (60,495) | 25,116 | 194 | | (35,185) |
| Income tax (benefit) expense | (3,087) | 4,000 | | | 913 |
| NET (LOSS) INCOME | (57,408) | 21,116 | 194 | | (36,098) |
| Equity in income of subsidiaries, net of tax | 21,310 | 194 | | (21,504) | |
| NET (LOSS) INCOME | $ (36,098) | $ 21,310 | $ 194 | $ (21,504) | $ (36,098) |

Table of Contents

**CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS**

**Six Months Ended June 30, 2013**

**(Unaudited)**

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries (in thousands) | Consolidating Adjustments | Consolidated |
|---|---|---|---|---|---|
| Operating net revenue | $ | $ 1,231,364 | $ 5,036 | $ (1,022) | $ 1,235,378 |
| Income from subsidiaries | 99,445 | | | (99,445) | |
| TOTAL NET REVENUES | 99,445 | 1,231,364 | 5,036 | (100,467) | 1,235,378 |
| TOTAL COST OF NET REVENUES | | 531,647 | 2,917 | (1,022) | 533,542 |
| Provision for doubtful accounts | | 36,197 | 30 | | 36,227 |
| Selling, distribution and administrative | 78,913 | 611,724 | 1,412 | (99,445) | 592,604 |
| Amortization of intangible assets | | 372 | | | 372 |
| TOTAL COSTS AND EXPENSES | 78,913 | 1,179,940 | 4,359 | (100,467) | 1,162,745 |
| OPERATING INCOME | 20,532 | 51,424 | 677 | | 72,633 |
| Interest expense | 66,370 | 19 | | | 66,389 |
| Loss on early retirement of debt | 44,221 | | | | 44,221 |
| Interest income and other | (27,367) | 25,882 | 332 | | (1,153) |
| (LOSS) INCOME BEFORE TAXES | (62,692) | 25,523 | 345 | | (36,824) |
| Income tax (benefit) expense | (2,807) | 3,974 | | | 1,167 |
| NET (LOSS) INCOME | (59,885) | 21,549 | 345 | | (37,991) |
| Equity in income of subsidiaries, net of tax | 21,894 | 345 | | (22,239) | |
| NET (LOSS) INCOME | $ (37,991) | $ 21,894 | $ 345 | $ (22,239) | $ (37,991) |

Table of Contents

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**Three Months Ended June 30, 2012**

**(Unaudited)**

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries (in thousands) | Consolidating Adjustments | Consolidated |
|---|---|---|---|---|---|
| Operating net revenue | $ | $ 605,555 | $ 2,645 | $ (705) | $ 607,495 |
| Income from subsidiaries | 41,964 | | | (41,787) | 177 |
| TOTAL NET REVENUES | 41,964 | 605,555 | 2,645 | (42,492) | 607,672 |
| TOTAL COST OF NET REVENUES | | 255,459 | 1,266 | (528) | 256,197 |
| Provision for doubtful accounts | | 20,738 | 52 | | 20,790 |
| Selling, distribution and administrative | 43,668 | 306,361 | 772 | (41,964) | 308,837 |
| Amortization of intangible assets | 77 | 406 | | | 483 |
| TOTAL COSTS AND EXPENSES | 43,745 | 582,964 | 2,090 | (42,492) | 586,307 |
| OPERATING (LOSS) INCOME | (1,781) | 22,591 | 555 | | 21,365 |
| Interest expense | 34,009 | (131) | | | 33,878 |
| Interest income and other | (15,727) | 15,387 | 271 | | (69) |
| (LOSS) INCOME BEFORE TAXES | (20,063) | 7,335 | 284 | | (12,444) |
| Income tax expense (benefit) | 574 | (282) | | | 292 |
| NET (LOSS) INCOME | (20,637) | 7,617 | 284 | | (12,736) |
| Equity in income of subsidiaries, net of tax | 7,901 | 284 | | (8,185) | |
| NET (LOSS) INCOME | $ (12,736) | $ 7,901 | $ 284 | $ (8,185) | $ (12,736) |

31

Table of Contents

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**Six Months Ended June 30, 2012**

**(Unaudited)**

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidating Adjustments | Consolidated |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| Operating net revenue | $ | $ 1,198,963 | $ 5,127 | $ (705) | $ 1,203,385 |
| Income from subsidiaries | 102,352 | | | (102,352) | |
| TOTAL NET REVENUES | 102,352 | 1,198,963 | 5,127 | (103,057) | 1,203,385 |
| TOTAL COST OF NET REVENUES | | 505,943 | 2,625 | (705) | 507,863 |
| Provision for doubtful accounts | | 32,538 | 110 | | 32,648 |
| Selling, distribution and administrative | 87,948 | 639,150 | 1,513 | (102,352) | 626,259 |
| Amortization of intangible assets | 306 | 838 | | | 1,144 |
| TOTAL COSTS AND EXPENSES | 88,254 | 1,178,469 | 4,248 | (103,057) | 1,167,914 |
| OPERATING INCOME | 14,098 | 20,494 | 879 | | 35,471 |
| Interest expense | 67,054 | 341 | | | 67,395 |
| Interest income and other | (31,457) | 30,256 | 430 | | (771) |
| (LOSS) INCOME BEFORE TAXES | (21,499) | (10,103) | 449 | | (31,153) |
| Income tax expense | 567 | 623 | | | 1,190 |
| NET (LOSS) INCOME | (22,066) | (10,726) | 449 | | (32,343) |
| Equity in income of subsidiaries, net of tax | (10,277) | 449 | | 9,828 | |
| NET (LOSS) INCOME | $ (32,343) | $ (10,277) | $ 449 | $ 9,828 | $ (32,343) |

32

Table of Contents

**CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS**

**Six Months Ended June 30, 2013**

**(Unaudited)**

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries (in thousands) | Consolidating Adjustments | Consolidated |
|---|---|---|---|---|---|
| OPERATING ACTIVITIES | | | | | |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | $ 7,806 | $ 35,786 | $ 7 | $ (6,310) | $ 37,289 |
| INVESTING ACTIVITIES | | | | | |
| Purchases of patient service equipment and property, equipment and improvements | (10,142) | (60,302) | (6) | | (70,450) |
| Proceeds from sale of patient service equipment and other | 41 | 21,287 | | | 21,328 |
| NET CASH USED IN INVESTING ACTIVITIES | (10,101) | (39,015) | (6) | | (49,122) |
| FINANCING ACTIVITIES | | | | | |
| Proceeds from ABL Facility | 346,000 | | | | 346,000 |
| Payments on ABL Facility | (341,000) | | | | (341,000) |
| Payments on Series A-1 Notes | (700,000) | | | | (700,000) |
| Payments on Series A-2 Notes | (160,000) | | | | (160,000) |
| Proceeds from Senior Secured Term Loan | 900,000 | | | | 900,000 |
| Premium paid on early retirement of Series A-1 and A-2 Notes | (24,641) | | | | (24,641) |
| Debt issuance costs on Senior Secured Term Loan | (10,628) | | | | (10,628) |
| Payment of original issue discount associated with Senior Secured Term Loan | (9,000) | | | | (9,000) |
| Payments on other long-term debt | | (125) | | | (125) |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | 731 | (125) | | | 606 |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (1,564) | (3,354) | 1 | (6,310) | (11,227) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 23,457 | 3,354 | 269 | | 27,080 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $ 21,893 | $ | $ 270 | $ (6,310) | $ 15,853 |

Table of Contents

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**Six Months Ended June 30, 2012**

**(Unaudited)**

| | Issuer | Guarantor Subsidiaries | Non-Guarantor Subsidiaries (in thousands) | Consolidating Adjustments | Consolidated |
|---|---|---|---|---|---|
| OPERATING ACTIVITIES | | | | | |
| NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES | $ (72,894) | $ 56,348 | $ 135 | $ 14,932 | $ (1,479) |
| INVESTING ACTIVITIES | | | | | |
| Purchases of patient service equipment and property, equipment and improvements | (6,362) | (78,751) | | | (85,113) |
| Proceeds from disposition of assets | 15 | 23,096 | | | 23,111 |
| Cash paid for acquisitions | | (121) | | | (121) |
| NET CASH USED IN INVESTING ACTIVITIES | (6,347) | (55,776) | | | (62,123) |
| FINANCING ACTIVITIES | | | | | |
| Proceeds from ABL Facility | 209,000 | | | | 209,000 |
| Payments on ABL Facility | (150,000) | | | | (150,000) |
| Payments on other long-term debt | | (173) | | | (173) |
| Cash paid on profit interest | (82) | | | | (82) |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | 58,918 | (173) | | | 58,745 |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (20,323) | 399 | 135 | 14,932 | (4,857) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | | | | | |