MANOR CARE INC
Form 10-Q
August 08, 2001

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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2001

OR

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

COMMISSION FILE NUMBER: 1-10858

MANOR CARE, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	34-1687107
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
333 N. SUMMIT STREET, TOLEDO, OHIO	43604-2617
(Address of principal executive offices)	(Zip Code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (419) 252-5500

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 X No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the close of business on July 31, 2001.

Common stock, $0.01 par value -- 103,106,251 shares

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

MANOR CARE, INC.
Consolidated Balance Sheets

	June 30, 2001	Decemb 200

	(Unaudited)	(Not
	(In thousands, except per	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 19,312	$ 2
Receivables, less allowances for doubtful accounts of $64,814 and $61,137, respectively	388,091	38
Receivable from sale of assets	1,766	
Prepaid expenses and other assets	26,870	2
Deferred income taxes	62,019	6
Total current assets	498,058	50
Property and equipment, net of accumulated depreciation of $701,250 and $646,478, respectively	1,568,990	1,57
Intangible assets, net of amortization	100,990	10
Other assets	181,984	17
Total assets	$ 2,350,022	$ 2,35
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 84,172	$ 9
Employee compensation and benefits	99,803	8
Accrued insurance liabilities	65,279	6
Income tax payable	26,157	2
Other accrued liabilities	53,371	4
Revolving loans		15
Long-term debt due within one year	5,480	
Total current liabilities	334,262	47
Long-term debt	711,237	64
Deferred income taxes	108,916	10
Other liabilities	133,936	12
Shareholders' equity:		
Preferred stock, $.01 par value, 5 million shares authorized		
Common stock, $.01 par value, 300 million shares authorized, 111.0 million shares issued	1,110	
Capital in excess of par value	316,416	33
Retained earnings	892,318	83
Other comprehensive income	(247)	
	1,209,597	1,17
Less treasury stock, at cost (8.0 and 8.4 million shares, respectively)	(147,926)	(16
Total shareholders' equity	1,061,671	1,01
Total liabilities and shareholders' equity	$ 2,350,022	$ 2,35

See notes to consolidated financial statements.

MANOR CARE, INC.
Consolidated Statements Of Operations
(Unaudited)

	Three Months Ended June 30		Six Mont
	2001	2000	2001
	(In thousands, except earnings		
Revenues	$ 663,336	$ 581,247	$ 1,301,5
Expenses:			
Operating	541,058	497,575	1,068,2
General and administrative	29,737	24,844	56,3
Depreciation and amortization	32,145	30,023	62,9
	602,940	552,442	1,187,5
Income before other income (expenses), income taxes and minority interest	60,396	28,805	113,9
Other income (expenses):			
Interest expense	(12,212)	(15,505)	(26,4
Impairment of investments		(20,000)	
Equity in earnings (losses) of affiliated companies	606	(115)	3
Interest income and other	33	755	1,1
Total other expenses, net	(11,573)	(34,865)	(24,9
Income (loss) before income taxes and minority interest	48,823	(6,060)	88,9
Income taxes (benefit)	18,611	(4,020)	33,7
Minority interest income		1,389	
Net income (loss)	$ 30,212	$ (3,429)	$ 55,1
Earnings per share:			
Basic	$ 0.30	$ (0.03)	$ 0.
Diluted	$ 0.29	$ (0.03)	$ 0.
Weighted average shares:			
Basic	102,265	102,276	102,2
Diluted	103,992	102,276	103,8

See notes to consolidated financial statements.

MANOR CARE, INC.
Consolidated Statements Of Cash Flows
(Unaudited)

	Six Months Ended	
	2001	
	In thousand	
OPERATING ACTIVITIES		
Net income (loss)	$ 55,195	$
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	62,984	
Impairment of investments		
Provision for bad debts	19,739	
Deferred income taxes		
Net gain on sale of assets	(643)	
Equity in earnings of affiliated companies	(309)	
Minority interest income		
Changes in assets and liabilities, excluding sold facilities and acquisitions:		
Receivables	(15,713)	
Prepaid expenses and other assets	(6,570)	
Liabilities	24,842	
Total adjustments	84,330	1
Net cash provided by operating activities	139,525	1
INVESTING ACTIVITIES		
Investment in property and equipment	(40,114)	(
Investment in systems development	(3,375)	
Acquisitions	(12,534)	(
Proceeds from sale of assets	3,790	
Consolidation of subsidiary		
Net cash used in investing activities	(52,233)	(
FINANCING ACTIVITIES		
Net repayments under bank credit agreements	(281,000)	(
Principal payments of long-term debt	(6,816)	
Proceeds from issuance of senior notes	200,000	
Payment of deferred financing costs	(3,316)	
Proceeds from stock options and common stock	1,997	
Purchase of common stock for treasury	(3,788)	
Net cash used in financing activities	(92,923)	(
Net increase (decrease) in cash and cash equivalents	(5,631)	
Cash and cash equivalents at beginning of period	24,943	
Cash and cash equivalents at end of period	$ 19,312	$

See notes to consolidated financial statements.

MANOR CARE, INC.
Notes To Consolidated Financial Statements
(Unaudited)

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management of Manor Care, Inc. (the Company), the interim data includes all adjustments necessary for a fair statement of the results of the interim periods and all such adjustments are of a normal recurring nature. Operating results for the six months ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001.

The balance sheet at December 31, 2000 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in Manor Care, Inc.'s annual report on Form 10-K/A for the year ended December 31, 2000.

At June 30, 2001, the Company operated 299 skilled nursing and 57 assisted living facilities, 91 outpatient therapy clinics, one acute care hospital and 81 home health offices.

NOTE 2 - DEBT

In March 2001 the Company issued $200 million of 8% Senior Notes due in 2008 that are guaranteed by substantially all of its subsidiaries. The net proceeds of $196.7 million from the Senior Notes were used to repay borrowings outstanding under the existing bank credit agreements. In May 2001, the Company registered identical Senior Notes with the Securities and Exchange Commission, which were exchanged for the Senior Notes issued in March. Debt consists of the following:

	June 30, 2001	December 31, 2000
	(In thousands)	
Five Year Agreement	$326,000	$452,000
364 Day Agreement (revolving loans)		155,000
8% Senior Notes	200,000	
7 1/2% Senior Notes, net of discount	149,705	149,675
Mortgages and other notes	35,667	42,456
Capital lease obligations	5,345	5,402
	716,717	804,533
Less:		
364 Day Agreement		155,000
Amounts due within one year	5,480	5,479
Long-term debt	$711,237	$644,054

NOTE 3 - CONTINGENCIES
One or more subsidiaries or affiliates of Manor Care of America, Inc. (MCA) have been identified as potentially responsible parties (PRPs) in a variety of actions (the Actions) relating to waste disposal sites which allegedly are subject to remedial action under the Comprehensive Environmental Response Compensation Liability Act, as amended, 42 U.S.C. Sections 9601 et seq. (CERCLA) and similar state laws. CERCLA imposes retroactive, strict joint and several liability on PRPs for the costs of hazardous waste clean-up. The Actions arise out of the alleged activities of Cenco, Incorporated and its subsidiary and affiliated companies (Cenco). Cenco was acquired in 1981 by a wholly owned subsidiary of MCA. The Actions allege that Cenco transported and/or generated hazardous substances that came to be located at the sites in question. Environmental proceedings such as the Actions may involve owners and/or operators of the hazardous waste site, multiple waste generators and multiple waste transportation disposal companies. Such proceedings involve efforts by governmental entities and/or private parties to allocate or recover site investigation and clean-up costs, which costs may be substantial. The potential liability exposure for currently pending environmental claims and litigation, without regard to insurance coverage, cannot be quantified with precision because of the inherent uncertainties of litigation in the Actions and the fact that the ultimate cost of the remedial actions for some of the waste disposal sites where MCA is alleged to be a potentially responsible party has not yet been quantified. Based upon its current assessment of the likely outcome of the Actions, the Company believes that its future environmental liabilities will be approximately $22.5 to $28.0 million. The Company has received or expects to receive between $18.0 million and $23.5 million of insurance proceeds, depending upon the ultimate liabilities, which will offset amounts due as a result of these exposures.

The Company and Alterra Healthcare Corporation (Alterra) have jointly and severally guaranteed a development joint venture's revolving line of credit that had an outstanding balance and was capped at $57.0 million, which matured June 29, 2001. On July 2, 2001 the Company paid in full the revolving line of credit balance including accrued interest for a total of $57.7 million. As a result of the repayment, the Company has been assigned the full rights and privileges of the lenders including security interests in the 13 Alzhiemer's assisted living facilities. The Company will consolidate the results of these facilities in the third quarter that were previously recorded under the equity method. The Company intends to sell these facilities through the exercise of its rights as lienholders.

Legislation phased out interest deductions on certain policy loans related to corporate-owned life insurance (COLI) as of January 1, 1999. The Company has recorded a cumulative reduction to income tax expense of approximately $34.0 million resulting from interest deductions for tax periods prior to 1999. While the Internal Revenue Service (IRS) has not asserted any claim challenging the Company's COLI interest expense deductions, the IRS has challenged other taxpayers' COLI interest deductions and has prevailed in certain court decisions. Management understands that these decisions and the IRS's position are being subjected to extensive challenges in court. The Company intends to defend vigorously its right to deduct the entire amount of such interest payments, were the IRS to challenge these deductions.

The Company is party to various other legal matters arising in the ordinary course of business including patient care-related claims and litigation. The Company believes that the resolution of such matters will not result in liability materially in excess of accounting accruals established with respect to such matters.

NOTE 4 - EARNINGS PER SHARE
The calculation of earnings per share (EPS) is as follows:

	Three months ended June 30		Six months ended June 30	
	2001	2000	2001	2000
	(In thousands, except earnings per share)			
Numerator:				
Net income (loss) [income (loss) available to common shareholders]	$ 30,212	$ (3,429)	$ 55,195	$ (4,212)
Denominator:				
Denominator for basic EPS - weighted-average shares	102,265	102,276	102,209	102,297
Effect of dilutive securities:				
Stock options	1,459		1,413	
Non-vested restricted stock	268		254	
Denominator for diluted EPS - adjusted for weighted-average shares and assumed conversions	103,992	102,276	103,876	102,297
EPS:				
Basic	$ 0.30	$ (0.03)	$ 0.54	$ (0.04)
Diluted	$ 0.29	$ (0.03)	$ 0.53	$ (0.04)

Options to purchase 2.3 million shares of the Company's common stock at an average price of $34 were not included in the computation of diluted EPS for 2001 because the options' exercise prices were greater than the average market price of the common shares.

The dilutive effect of stock options would have been 442,000 shares and 587,000 shares for the three months and six months ended June 30, 2000, respectively. These shares were not included in the calculation because the effect would be anti-dilutive with a net loss.

NOTE 5 - SEGMENT INFORMATION
The Company provides a range of health care services. The Company has one reportable operating segment, long-term care, which includes the operation of skilled nursing and assisted living facilities. The "Other" category includes the non-reportable segments and corporate items not considered to be an operating segment. The revenues in the "Other" category include services for rehabilitation, home health and hospital care. Asset information, including capital expenditures, is not provided to the Company's chief operating decision maker. Operating performance represents revenues less operating expenses and does not include general and administrative expense,

depreciation and amortization, other income and expense items, and income taxes. See Management's Discussion and Analysis for a discussion of unusual expenses recorded in the first and second quarter of 2000.

	Long-term Care	Other
		(In thousands)
Three months ended June 30, 2001		
Revenues from external customers	$563,041	$100,295
Intercompany revenues		9,357
Depreciation and amortization	29,100	3,045
Operating margin	109,080	13,198
Three months ended June 30, 2000		
Revenues from external customers	496,497	84,750
Intercompany revenues		6,992
Depreciation and amortization	28,321	1,702
Operating margin	89,157	(5,485)
Six months ended June 30, 2001		
Revenues from external customers	1,103,246	198,283
Intercompany revenues		18,392
Depreciation and amortization	57,025	5,959
Operating margin	205,428	27,846
Six months ended June 30, 2000		
Revenues from external customers	984,872	166,293
Intercompany revenues		13,400
Depreciation and amortization	54,363	5,335
Operating margin	145,966	4,250

NOTE 6 - COMPREHENSIVE INCOME

Comprehensive income represents the sum of net income (loss) plus other comprehensive income (loss). Comprehensive income was $30,221,000 and $54,948,000 for the three and six months ended June 30, 2001 and $(3,429,000) and $(4,212,000) for the three months and six months ended June 30, 2000. The other comprehensive loss of $256,000 in the first quarter of 2001 represents the after tax loss of the terminated treasury lock agreement that the Company entered into as a hedge of interest rates on the future issuance of the Senior Notes in March 2001.

NOTE 7 - NEW ACCOUNTING STANDARD

In July 2001, the Financial Accounting Standards Board issued Statement No. 142, "Goodwill and Other Intangible Assets" that the Company is required to adopt beginning January 1, 2002. Under this Statement, goodwill and indefinite lived intangible assets are no longer amortized but are reviewed annually, or more frequently if impairment indictors arise, for impairment. The Company's annual amortization of goodwill is $3.4 million.

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

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of Operations

RESULTS OF OPERATIONS

Revenues. Our revenues increased $82.1 million, or 14 percent, from the second quarter of 2000 to 2001. Revenues from skilled nursing and assisted living facilities increased $66.5 million, or 13 percent, due to increases in rates--$57.6 million, capacity--$5.8 million and occupancy--$3.1 million. Our revenues from the home health business increased $12.0 million primarily because of an increase in home health visits and hospice services.

Our revenues in the first half of 2001 increased $150.4 million, or 13 percent, compared with the first half of 2000. Revenues from skilled nursing and assisted living facilities increased $118.4 million, or 12 percent, due to increases in rates--$108.0 million, occupancy--$7.9 million and capacity--$2.5 million. Our revenues from the home health business increased $24.9 million primarily because of an increase in home health visits and hospice services.

Our rate increases for the skilled nursing and assisted living facilities relate to private pay, Medicaid and Medicare. The Medicare rate increase related to the positive effect of the Medicare, Medicaid and SCHIP Balanced Budget Refinement Act of 1999 with many of the provisions beginning April 1, 2000, as well as the Medicare, Medicaid and SCHIP Benefits Improvement and Protection Act of 2000 with many of the provisions beginning April 1, 2001.

Our occupancy levels were 86 percent for the second quarter and first half of 2000 compared with 87 percent for the second quarter and first half of 2001. When excluding start-up facilities, our occupancy levels were 87 percent for the second quarter and first half of 2000 compared with 88 percent for the second quarter and first half of 2001. Our occupancy levels for skilled nursing facilities were 87 percent for the second quarter and first half of 2000 compared with 88 percent for the second quarter and first half of 2001. The quality mix of revenue from Medicare, private pay and insured patients related to skilled nursing and assisted living facilities and rehabilitation operations increased from 67 percent for the second quarter and first half of 2000 to 68 percent for the second quarter and first half of 2001.

Our bed capacity increased between the first half of 2000 and 2001 primarily because we opened ten assisted living facilities with 612 beds.

Operating expenses. Our operating expenses increased $43.5 million, or 9 percent, from the second quarter of 2000 to 2001. During the second quarter of 2000, there were unusual operating expenses of $17.7 million that included $3.2 million for the terminated Company buy-out transaction costs and $14.5 million for the write off of amounts due from Genesis Health Ventures, Inc., Alterra Healthcare Corporation (Alterra) and our development joint venture with Alterra. When excluding these unusual expenses, operating expenses increased $61.2 million, or 13 percent.

Operating expenses from skilled nursing and assisted living facilities increased $46.6 million, or 11 percent from the second quarter of 2000 to 2001. These increases primarily related to labor costs, including temporary staffing, of $29.3 million; ancillary costs, excluding internal labor costs, of $6.4 million; and general and professional liability costs of $4.9 million. Ancillary costs, which include various types of therapies, medical supplies and prescription drugs, increased as a result of the more medically complex patients. Operating expenses increased $10.0 million from our home health business due to an increase in services and $1.3 million from our transcription business due to an increase in capacity.

Operating expenses for the first half of 2001 increased $67.3 million, or 7 percent, from the first half of 2000. Operating expenses from skilled nursing and assisted living facilities increased $58.9 million, as discussed below. Operating expenses increased $17.0 million from our home health business and $3.0 million from our transcription business, which were partially offset by the decrease of $17.7 million of unusual expenses recorded in the second quarter of 2000, as discussed previously.

In the first quarter of 2000, we recorded an additional $33.6 million of general and professional liability expense related to a change in estimate incorporating industry experience for claims originating in policy years 1994 through 1999. When excluding this additional expense, operating expenses for the skilled nursing and assisted living facilities increased $92.5 million, or 11 percent, from the first half of 2000 to 2001. We attribute the largest portion of this operating expense increase to labor costs and temporary staffing of $58.9 million. Ancillary costs, excluding internal labor costs, increased $11.2 million and general and professional liability expense increased $8.8 million in the first half of 2001 compared with the first half of 2000.

General and professional liability costs for the long-term care industry, especially in the state of Florida, have become increasingly expensive. Industry sources report the average cost of a claim in Florida in 2000 was three times higher than the rest of the country and industry providers in the state experienced four times the number of claims compared to the national average. The long-term care industry received minor assistance with the passage of a measure of tort reform in Florida in May 2001. The industry did not benefit from previously passed tort reform in Florida as did other health care providers, and this new legislation still will not put the industry on the same judicial footing as these providers. However, it is hoped that the legislation that was passed, which includes caps on punitive damages, limits to add-on legal fees, tougher rules of evidence and a reduced statute of limitations, will be the first step when fully implemented in October 2001 in reducing the long-term care industry's current litigation burden.

General and administrative expenses. Our general and administrative expenses, which approximated 4 percent of revenues, increased $4.9 million and $6.1 million from the second quarter and first half of 2000 to 2001, respectively, because of deferred compensation plans, stock appreciation rights and general cost increases.

Depreciation and amortization. Amortization increased $0.9 million and $2.2 million from the second quarter and first half of 2000 to 2001 primarily due to computer software amortization.

Interest expense. When excluding capitalized interest, our interest expense in the second quarter and first half of 2001 decreased $3.8 million and $4.6 million compared with the same periods in 2000 because of lower debt levels and interest rates.

Impairment of investments. Because of Genesis' bankruptcy filing on June 22, 2000, we reduced the carrying value of our Genesis preferred stock investment by $19.0 million to zero and wrote off a separate Genesis-related investment of $1.0 million in the second quarter of 2000.

Equity in earnings (losses) of affiliated companies. During the second quarter and first half of 2001, we recorded equity losses of $1.9 million and $3.1 million, respectively, related to our development joint venture with Alterra. For the same periods in 2000, we recorded equity losses of $0.2 million and $0.3 million, respectively. We and Alterra jointly and severally guaranteed a development joint venture's revolving line of credit that had an outstanding balance and was capped at $57.0 million, which matured June 29, 2001. On July 2, 2001 we paid in full the revolving line of credit balance including accrued interest for a total of $57.7 million. As a result of the repayment, we have been assigned the full rights and privileges of the lenders including security interests in the 13 Alzhiemer's assisted living facilities. We will consolidate the results of these facilities in the third quarter and classify them as held for sale. The facilities' operating income is currently at break even.

We were a 50 percent owner in a partnership that sold its only nursing home in June 2001. During the second quarter of 2001, we reversed $1.5 million of previously recorded losses for this partnership. These losses were booked in excess of our investment because we had guaranteed the partnership's debt, which was paid off with the sale of the nursing home.

Our share of a pharmacy partnership's earnings increased $0.6 million and $1.1 million for the second quarter and first half of 2001 compared to 2000, respectively.

Minority interest income. The minority interest income for the second quarter and first half of 2000 represented the minority owners' share of In Home Health, Inc.'s (IHHI) net income for those periods. In December 2000, we purchased the remaining shares of IHHI to increase our ownership to 100 percent.

LIQUIDITY AND CAPITAL RESOURCES

During the first half of 2001, we satisfied our cash requirements from cash generated from operating activities. Cash flows from operating activities were $139.5 million for the first half of 2001, an increase of $24.8 million from the first half of 2000. Our operating cash flows increased because of an increase in net income. We used the cash principally for capital expenditures, to acquire businesses and to repay debt. Expenditures for property and equipment of $40.1 million in the first half of 2001 included $11.1 million to construct new facilities.

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In March 2001 we issued $200 million of 8% Senior Notes due in 2008. We used the net proceeds of $196.7 million from the Senior Notes to repay borrowings outstanding under our existing bank credit agreements. Immediately following the repayment of borrowings under the credit agreements, we reduced the commitment under the 364-day agreement from $200 million to $50 million. Effective August 1, 2001, we canceled the remaining $50 million commitment. At June 30, 2001, outstanding borrowings totaled $326.0 million under the five year agreement. We had no outstanding borrowings under the 364-day agreement.

As discussed previously, we paid in full a development joint venture's revolving line of credit balance including accrued interest for a total of $57.7 million on July 2, 2001. At July 31, 2001, outstanding borrowings totaled $381.0 million under the five year agreement. After consideration of usage for letters of credit, we had $88.8 million remaining credit available under the five year agreement on July 31, 2001.

On February 8, 2000, our board of directors authorized us to spend up to $100 million to purchase our common stock through December 31, 2001. We purchased

186,000 shares for $3.8 million in the first half of 2001. We may use the shares for internal stock option and 401(k) match programs and for other uses, such as possible future acquisitions.

We believe that our cash flow from operations will be sufficient to cover debt payments, future capital expenditures and operating needs. It is likely that we will pursue growth from acquisitions, partnerships and other ventures that would be funded from excess cash from operations, credit available under the bank credit agreement and other financing arrangements that are normally available in the marketplace.

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS
This report may include forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. We identify forward-looking statements in this report by using words or phrases such as "anticipate," "believe," "estimate," "expect," "intend," "may be," "objective," "plan," "predict," "project," and "will be" and similar words or phrases, or the negative thereof.

These forward-looking statements are subject to numerous assumptions, risks and uncertainties. Factors which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by us in those statements include, among others: changes in Medicare, Medicaid and certain private payors' reimbursement levels; existing government regulations, including applicable health care, tax and health and safety regulations, and changes in, or the failure to comply with, governmental regulations or the interpretations thereof; legislative proposals for health care reform; competition and general economic and business conditions; the ability to attract and retain qualified personnel; changes in current trends in the cost and volume of general and professional liability claims and other litigation.

Although we believe the expectations reflected in our forward-looking statements are based upon reasonable assumptions, we can give no assurance that we will attain these expectations or that any deviations will not be material. Except as otherwise required by the federal securities laws, we disclaim any obligations or undertaking to publicly release any updates or revisions to any forward-looking statement contained in this report to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See the discussion of our market risk in our Form 10-K/A for the year ended December 31, 2000. There are no changes in debt instruments since year end other than the $200 million, 8% Senior Notes issued in March 2001. The Senior Notes are due in 2008 and the carrying value approximated fair value.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

Since May of 1999, we and other related persons and entities have been parties to several actions by or against Genesis Health Ventures, Inc. and its subsidiary, NeighborCare Pharmacy Services, Inc. On or about June 22, 2000, Genesis and NeighborCare filed voluntary petitions for bankruptcy under Chapter

11 of the Bankruptcy Code, which effectively stayed the actions to the extent they had not been stayed already. The status of the various Genesis/NeighborCare lawsuits is as follows:

First Action. On May 7, 1999, Genesis filed suit in federal district court in Delaware against us, our wholly owned subsidiary, Manor Care of America, Inc., formerly known as Manor Care, Inc., or MCA, our Chief Executive Officer, Paul A. Ormond, and our Chairman, Stewart Bainum, Jr. The complaint alleges that the defendants fraudulently induced Genesis to acquire, in August 1998, all of the outstanding stock of Vitalink Pharmacy Services, Inc., an approximately 50 percent-owned subsidiary of MCA. The complaint further alleges that the defendants' alleged conduct constituted violations of Section 10(b) of the Securities Exchange Act of 1934, and constituted common law fraudulent misrepresentation and negligent misrepresentation. The suit also alleges that our ownership in a partnership known as Heartland Healthcare Services violates a non-compete provision signed by MCA. The suit seeks compensatory and punitive damages in excess of $100 million and preliminary and permanent injunctive relief enforcing the covenant not to compete.

On June 29, 1999, the defendants moved to dismiss or, in the alternative, to stay the lawsuit in its entirety. On March 22, 2000, the court granted the defendants' motion to stay the action in its entirety pending the arbitration discussed below, but denied the motion with respect to the alternative request to dismiss the action. We intend to vigorously defend the lawsuit. Although the ultimate outcome of the case is uncertain, management believes that it is not likely to have a material adverse effect on our financial condition.

Second Action. On August 27, 1999, MCA filed a separate action in federal district court in Delaware against Genesis concerning Genesis's 1998 acquisition of Vitalink. MCA's lawsuit charges that Genesis violated Section 11 and Section 12 of the Securities Act of 1933, when Genesis issued approximately $293 million of Genesis Preferred Stock to MCA for MCA's interest in Vitalink. The suit alleges that Genesis misrepresented and/or omitted material facts. MCA seeks, among other things, compensatory damages and recission, which would void MCA's purchase of the Genesis Preferred Stock and require Genesis to return to MCA the consideration that it paid at the time of the Vitalink sale.

On November 23, 1999, Genesis moved to dismiss the lawsuit in its entirety. On or about January 18, 2000, Genesis moved to consolidate MCA's lawsuit with the suit that Genesis had filed in Delaware district court on May 7, 1999. On or about September 29, 2000, the court granted in part and denied in part Genesis' motion to dismiss and also denied Genesis' motion to consolidate the lawsuits. On October 6, 2000, MCA advised the court by letter that the automatic stay in bankruptcy--a provision of the bankruptcy laws that prevents creditors from taking collection and other actions against a bankrupt debtor outside of the bankruptcy courts--had stayed MCA's lawsuit. However, pursuant to 11 U.S.C. Section 108(c), MCA reserved any and all rights it may have concerning the September 29, 2000 order and the MCA litigation, including the right to seek clarification and reconsideration of the order, following termination or expiration of the automatic stay. We intend to vigorously prosecute this lawsuit following relief from the bankruptcy stay.

Third Action. Additionally, on May 7, 1999, NeighborCare instituted a lawsuit in the Circuit Court for Baltimore City, Maryland against us, MCA and ManorCare Health Services, Inc. seeking damages, preliminary and permanent injunctive relief, and a declaratory judgment related to allegations that the defendants had improperly sought to terminate certain Master Service Agreements between Vitalink, now known as NeighborCare, and ManorCare Health Services, Inc.

NeighborCare also instituted arbitration proceedings against the same defendants. These proceedings seek substantially the same relief as sought in the Maryland action with respect to one of the Master Service Agreements at issue in the Maryland action and also certain additional permanent relief with respect to that contract. On May 13, 1999, NeighborCare and the defendants agreed:

- to consolidate the Maryland action into the arbitration;
- to dismiss the Maryland action with prejudice as to jurisdiction and without prejudice as to the merits; and
- to stay termination of the agreements at issue until a decision can be reached in the arbitration.

NeighborCare has since dismissed the Maryland action and consolidated certain of those claims into the arbitration by filing an amended demand for arbitration. On June 15, 1999, the defendants filed an answer and counterclaim, denying the material allegations in the amended

demand. They subsequently moved to dismiss three of the six claims alleged in the amended demand. On or about May 17, 2000, the arbitrator, in response to the defendants' motion, dismissed two of NeighborCare's six claims.

On or about May 23, 2000, based upon NeighborCare's representation that it would likely file for bankruptcy before it could complete the arbitration hearing set for the weeks of June 12 and July 3, 2000, the Arbitrator vacated the hearing dates. NeighborCare's June 22, 2000 bankruptcy effectively stayed the matter. The defendants then asked the bankruptcy court to enforce the arbitration clause and relieve them from the automatic stay to the extent necessary to complete the arbitration. NeighborCare, in turn, opposed this motion and filed its own motion to assume the Master Service Agreements in the bankruptcy.

On or about February 6, 2001, the bankruptcy court issued an opinion finding in favor of the defendants' motion and deferring consideration of NeighborCare's motion to assume the Master Service Agreements until the arbitration is complete. No order was entered. Shortly thereafter, the defendants tendered a proposed order to the bankruptcy court, which granted the defendants' motion in accordance with the opinion. On or about February 22, 2001, NeighborCare moved the bankruptcy court to reconsider the February 6, 2001 opinion. Following briefing and a hearing on NeighborCare's motion to reconsider, the Court entered an order on March 20, 2001 denying the motion to reconsider, affirming and incorporating the February 6, 2001 opinion and granting relief from the automatic stay to permit the arbitration to proceed to final judgment in accordance with that Opinion. Hearing in the arbitration was rescheduled and began July 30, 2001. The defendants intend to vigorously defend the arbitration demand and to vigorously prosecute their counterclaim at the arbitration. Although we cannot predict the ultimate outcome of the arbitration, management believes that it is not likely to have a material adverse effect on our financial condition.

Additional NeighborCare Complaint. On July 26, 1999, NeighborCare filed an additional complaint in the Circuit Court for Baltimore County, Maryland against Omnicare, Inc. and Heartland Healthcare Services, Inc. seeking injunctive relief and compensatory and punitive damages. Heartland Healthcare Services, Inc. is a partnership between us and subsidiaries of Omnicare. The complaint includes counts for tortious interference with Vitalink's purported contractual rights under the Master Service Agreements. On October 4, 1999, the defendants moved to dismiss or, in the alternative, to stay the lawsuit in its entirety. On November 12, 1999, the court stayed the matter pending the arbitration. Although we cannot predict the ultimate outcome of the case, management believes that it is not likely to have a material adverse effect on our financial condition.

Fourth Action. On December 22, 1999, MCA filed suit in federal court in Toledo, Ohio against Genesis; Cypress Group, L.L.C.; TPG Partners II, L.P.; and Nazem, Inc. The complaint alleges that the issuance by Genesis of its Series H and Series I Preferred Stock violated the terms of the Series G Preferred Stock and the terms of a rights agreement entered into between Genesis and MCA in connection with the Vitalink transaction. On February 29,

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2000, the defendants moved to dismiss the case. That motion was pending before the court as of the time the matter was automatically stayed by Genesis' June 22, 2000 bankruptcy filing.

See Note 3 - Contingencies in the notes to the consolidated financial statements for a discussion of litigation related to environmental matters and patient-care related claims.

Item 2. Changes in Securities.

None

Item 3. Defaults Upon Senior Securities.

None

Item 4. Submission of Matters to a Vote of Security Holders.

None

Item 5. Other Information.

None

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits
None

(b) Reports on Form 8-K
None

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Manor Care, Inc.
(Registrant)

Date August 8, 2001

By /s/ Geoffrey G. Meyers

Geoffrey G. Meyers, Executive Vice President
and Chief Financial Officer