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CHEMED CORP
Form 10-Q
November 01, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

Quarterly Report Under Section 13 or 15 (d) of the Securities
Exchange Act of 1934 For the Quarterly Period Ended September
X 30, 2007

Transition Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

Commission File Number: 1-8351

CHEMED CORPORATION
(Exact name of registrant as specified in its charter)

Delaware 31-0791746
(State or other jurisdiction of (IRS Employer Identification No.)
incorporation or organization)

2600 Chemed Center, 255 E. Fifth Street, 45202
Cincinnati, Ohio
(Address of principal executive offices) (Zip code)

(513) 762-6900
(Registrant's telephone number, including area code)

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 periods 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 by check mark whether the registrant is a large accelerated filer, an
accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the
Exchange Act).

Large Accelerated Non-accelerated
accelerated filer X filer filer

Indicate by check mark whether the registrant is a shell company (as defined in
Rule 12b-2 of the Exchange Act).

Yes No X

Indicate the number of shares outstanding of each of the issuer's classes of
common stock, as of the latest practicable date.

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| Class | Amount | Date |
|---------------|-------------------|--------------------|
| Capital Stock | 23,926,680 Shares | September 30, 2007 |
| \$1 Par Value | | |

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CHEMED CORPORATION AND SUBSIDIARY COMPANIES

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PART I. FINANCIAL INFORMATION Item 1. Financial Statements CHEMED CORPORATION AND SUBSIDIARY COMPANIES UNAUDITED CONSOLIDATED BALANCE SHEET (in thousands except share and per share data)

| | September 30, 2007 |
|---|-----------------------|
| ASSETS | |
| Current assets | |
| Cash and cash equivalents | \$ 16,730 |
| Accounts receivable less allowances of (2006 - \$10,180) | \$ 9,905 81,718 |

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| | |
|---|------------|
| Inventories | 6,824 |
| Current deferred income taxes | 20,344 |
| Current assets of discontinued operations | - |
| Prepaid expenses and other current assets | 6,983 |
| Total current assets | 132,599 |
| Investments of deferred compensation plans held in trust | 28,824 |
| Notes receivable | 14,701 |
| Properties and equipment, at cost, less accumulated depreciation of \$86,973 (2006 - \$77,107) | 73,285 |
| Identifiable intangible assets less accumulated amortization of \$16,235 (2006 - \$13,201) | 66,186 |
| Goodwill | 436,262 |
| Noncurrent assets of discontinued operations | - |
| Other assets | 16,382 |
| Total Assets | \$ 768,239 |
| ===== | |
| LIABILITIES | |
| Current liabilities | |
| Accounts payable | \$ 46,389 |
| Current portion of long-term debt | 10,161 |
| Income taxes | 9,854 |
| Accrued insurance | 37,725 |
| Accrued compensation | 37,147 |
| Current liabilities of discontinued operations | - |
| Other current liabilities | 20,972 |
| Total current liabilities | 162,248 |
| Deferred income taxes | 3,370 |
| Long-term debt | 224,735 |
| Deferred compensation liabilities | 28,407 |
| Other liabilities | 5,818 |
| Total Liabilities | 424,578 |
| ----- | |
| STOCKHOLDERS' EQUITY | |
| Capital stock - authorized 80,000,000 shares \$1 par; issued 29,205,791 shares (2006 - 28,849,918 shares) | 29,206 |
| Paid-in capital | 264,374 |
| Retained earnings | 259,578 |
| Treasury stock - 5,279,111 shares (2006 - 3,023,635 shares), at cost | (211,959) |
| Deferred compensation payable in Company stock | 2,462 |
| Total Stockholders' Equity | 343,661 |
| Total Liabilities and Stockholders' Equity | \$ 768,239 |
| ===== | |
| See accompanying notes to unaudited consolidated financial statements | |

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| | Three Months Ended September 30, | | Nine Months E |
|--|----------------------------------|------------|---------------|
| | 2007 | 2006 | 2007 |
| Continuing Operations | | | |
| Service revenues and sales | \$ 272,503 | \$ 253,695 | \$ 814,3 |
| Cost of services provided and goods sold (excluding depreciation) | 192,882 | 185,399 | 569,8 |
| Selling, general and administrative expenses | 42,526 | 39,139 | 136,6 |
| Depreciation | 5,220 | 4,171 | 14,8 |
| Amortization | 1,292 | 1,355 | 3,9 |
| Other operating expense/(income) | - | 272 | (1,1 |
| Total costs and expenses | 241,920 | 230,336 | 724,1 |
| Income from operations | 30,583 | 23,359 | 90,1 |
| Interest expense | (2,515) | (4,081) | (9,6 |
| Loss from impairment of investment | - | (1,445) | |
| Loss on extinguishment of debt | (83) | - | (13,7 |
| Other income--net | 11 | 715 | 3,0 |
| Income before income taxes | 27,996 | 18,548 | 69,7 |
| Income taxes | (11,080) | (5,673) | (27,1 |
| Income from continuing operations | 16,916 | 12,875 | 42,5 |
| Discontinued operations, net of income taxes | 1,201 | (4,914) | 1,2 |
| Net income | \$ 18,117 | \$ 7,961 | \$ 43,7 |
| Earnings Per Share | | | |
| Income from continuing operations | \$ 0.71 | \$ 0.49 | \$ 1. |
| Net income | \$ 0.76 | \$ 0.30 | \$ 1. |
| Average number of share outstanding | 23,933 | 26,190 | 24,7 |
| Diluted Earnings Per Share | | | |
| Income from continuing operations | \$ 0.69 | \$ 0.48 | \$ 1. |
| Net income | \$ 0.74 | \$ 0.30 | \$ 1. |
| Average number of share outstanding | 24,466 | 26,633 | 25,2 |
| Cash Dividends Per Share | \$ 0.06 | \$ 0.06 | \$ 0. |

See accompanying notes to unaudited consolidated financial statements

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CHEMED CORPORATION AND SUBSIDIARY COMPANIES UNAUDITED CONSOLIDATED STATEMENT OF CASH FLOWS (in thousands)

| | Nine Months Ended September 30, | |
|---|------------------------------------|-----------|
| | 2007 | 2006 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 43,771 | \$ 33,018 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 18,798 | 16,353 |
| Write off unamortized debt issuance costs | 7,235 | 430 |
| Noncash long-term incentive compensation | 6,154 | - |
| Provision for uncollectible accounts receivable | 6,025 | 5,938 |
| Provision for deferred income taxes | (1,388) | 2,896 |
| Discontinued operations | (1,201) | 5,445 |
| Amortization of debt issuance costs | 970 | 1,325 |
| Loss on asset impairment | - | 1,445 |
| Changes in operating assets and liabilities, excluding amounts acquired in business combinations: | | |
| Decrease/(increase) in accounts receivable | 4,819 | (20,256) |
| Decrease/(increase) in inventories | (246) | 118 |
| Decrease in prepaid expenses and other current assets | 2,964 | 2,673 |
| Decrease in accounts payable and other current liabilities | (9,896) | (21,323) |
| Increase in income taxes | 11,825 | 9,087 |
| Increase in other assets | (3,109) | (248) |
| Increase in other liabilities | 3,908 | 2,390 |
| Excess tax benefit on share-based compensation | (2,506) | (4,943) |
| Other sources | 2,020 | 1,373 |
| Net cash provided by continuing operations | 90,143 | 35,721 |
| Net cash provided by discontinued operations | - | 4,932 |
| Net cash provided by operating activities | 90,143 | 40,653 |
| Cash Flows from Investing Activities | | |
| Capital expenditures | (20,145) | (15,955) |
| Net uses from disposals of discontinued operations | (6,121) | (3,360) |
| Proceeds from sales of property and equipment | 3,072 | 287 |
| Business combinations, net of cash acquired | (1,079) | (1,489) |
| Other uses | (1,415) | (805) |
| Net cash used by investing activities | (25,688) | (21,322) |
| Cash Flows from Financing Activities | | |
| Proceeds from issuance of long-term debt | 300,000 | - |
| Repayment of long-term debt | (215,644) | (84,500) |
| Purchases of treasury stock | (130,873) | (8,253) |
| Purchases of note hedges | (55,093) | - |
| Proceeds from issuance of warrants | 27,614 | - |
| Debt issuance costs | (6,887) | (154) |
| Dividends paid | (4,441) | (4,739) |
| Increase in cash overdraft payable | 2,554 | 2,145 |
| Excess tax benefit on share-based compensation | 2,506 | 4,943 |
| Issuance of capital stock | 2,429 | 3,854 |
| Net increase in revolving line of credit | - | 15,400 |
| Other sources | 836 | 254 |

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| | | |
|--|-----------|----------|
| Net cash used by financing activities | (76,999) | (71,050) |
| Decrease in Cash and Cash Equivalents | (12,544) | (51,719) |
| Cash and cash equivalents at beginning of year | 29,274 | 57,133 |
| Cash and cash equivalents at end of period | \$ 16,730 | \$ 5,414 |

See accompanying notes to unaudited consolidated financial statements

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CHEMED CORPORATION AND SUBSIDIARY COMPANIES Notes to Unaudited Financial Statements

1. Basis of Presentation

As used herein, the terms "We," "Company" and "Chemed" refer to Chemed Corporation or Chemed Corporation and its consolidated subsidiaries.

We have prepared the accompanying unaudited consolidated financial statements of Chemed in accordance with Rule 10-01 of SEC Regulation S-X. Consequently, we have omitted certain disclosures required under generally accepted accounting principles in the United States for complete financial statements. However, in our opinion, the financial statements presented herein contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly our financial position, results of operations and cash flows. These financial statements are prepared on the same basis as and should be read in conjunction with the Consolidated Financial Statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2006. Certain 2006 amounts have been reclassified to conform with current period presentation in the balance sheet and statement of income primarily related to the presentation of the discontinued operations of our former Phoenix hospice program.

2. Refinancing Transactions

On May 2, 2007, we entered into a new senior secured credit facility with JPMorgan Chase Bank (the "2007 Facility") to replace our existing credit facility. The 2007 Facility includes a \$100 million term loan, a \$175 million revolving credit facility and a \$100 million expansion feature. The facility has a 5-year maturity with principal payments on the term loan due quarterly and on the revolving credit facility due at maturity. Interest is payable quarterly at a floating rate equal to our choice of various indices plus a specified margin based on our leverage ratio. The interest rate at the inception of the agreement is LIBOR plus 0.875%. In connection with replacing our existing credit facility, we wrote-off approximately \$2.3 million in deferred debt costs. The write-off of deferred debt costs has been recorded as loss on extinguishment of debt in the accompanying statement of income.

On May 4, 2007, we used the proceeds from the 2007 Facility to fund the redemption of our \$150 million, 8.75% Senior Notes due 2011. The redemption was made pursuant to the terms of the indenture at a price of 104.375% plus accrued but unpaid interest. In connection with the redemption, we wrote-off approximately \$4.8 million in deferred debt costs. The premium payment of \$6.6 million and the write-off of deferred debt costs have been recorded as loss on extinguishment of debt in the accompanying statement of income.

On May 8, 2007, we entered into a Purchase Agreement with J.P. Morgan

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Securities Inc. and Citigroup Global Markets Inc. (the "Initial Purchasers") for issuance and sale of \$180 million in aggregate principal amount of our 1.875% Senior Convertible Notes due 2014 (the "Notes"). On May 9, 2007, the Initial Purchasers exercised an over-allotment option to purchase an additional \$20 million in aggregate principal amount of Notes. On May 14, 2007 a total of \$200 million in aggregate principal amount of the Notes were sold to the Initial Purchasers at a price of \$1,000 per Note, less an underwriting fee of \$27.50 per Note. The Notes are to be resold by the Initial Purchasers pursuant to Rule 144A of the Securities Act of 1933, as amended (the "Securities Act").

We received approximately \$194 million in net proceeds from the sale of the Notes after paying underwriting fees, legal and other expenses. Proceeds from the offering were used to purchase treasury shares of our stock, as discussed further in Note 3 and to pay down a portion of the 2007 Facility. We will pay interest on the Notes on May 15 and November 15 of each year, beginning on November 15, 2007. The Notes will mature on May 15, 2014. The Notes are guaranteed on an unsecured senior basis by each of our subsidiaries that are a borrower or a guarantor under any senior credit facility, as defined in the Indenture. The Notes are convertible, under certain circumstances, into our Capital Stock at a conversion rate of 12.3874 shares per \$1,000 principal amount of Notes. This conversion rate is equivalent to an initial conversion price of approximately \$80.73 per share. Prior to March 1, 2014, holders may convert their Notes under certain circumstances. On and after March 1, 2014, the Notes will be convertible at any time prior to the close of business three days prior to the stated maturity date of the Notes. Upon conversion of a Note, if the conversion value is \$1,000 or less, holders will receive cash equal to the lesser of \$1,000 or the conversion value of the number of shares of our Capital Stock. If the conversion value exceeds \$1,000, in addition to this, holders will receive shares of our Capital Stock for the excess amount. The Indenture contains customary terms and covenants that upon certain events of default, including without limitation, failure to pay when due any principal amount, a fundamental change or certain cross defaults in other agreements or instruments, occurring and continuing; either the trustee or the holders of 25% in aggregate principal amount of the Notes may declare the principal of the Notes and any accrued and unpaid interest through the date of such declaration immediately due and payable. In the case of certain events of bankruptcy or insolvency relating to any significant subsidiary or to us, the principal amount of the Notes and accrued interest automatically becomes due and payable.

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Pursuant to the guidance in Emerging Issues Task Force ("EITF") 90-19, "Convertible Bonds with Issuer Option to Settle for Cash Upon Conversion", EITF 00-19 "Accounting for Derivative Instruments Indexed to, and Potentially Settled in a Company's Own Stock" and EITF 01-6 "The Meaning of Indexed to a Company's Own Stock", the Notes are accounted for as convertible debt in the accompanying consolidated balance sheet and the embedded options within the Notes have not been accounted for as separate derivatives.

We, our subsidiary guarantors and the Initial Purchasers also entered into a Registration Rights Agreement (the "RRA") dated May 14, 2007. Pursuant to the RRA, we agreed to, no later than the 120th day after May 14, 2007, file a shelf registration statement covering resale of the Notes and the Capital Stock issuable upon conversion pursuant to Rule 415 under the Securities Act. On August 17, 2007, we filed a shelf registration statement, that became immediately effective, to register the Notes and Capital Stock issuable upon conversion.

On May 8, 2007 we entered into a purchased call transaction and a warrant transaction (written call) with JPMorgan Chase, National Association and Citibank, N.A. (the "Counterparties"). The purchased call options cover

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approximately 2,477,000 shares of our Capital Stock, which under most circumstances represents the maximum number of shares of Capital Stock that underlie the Notes. Concurrently with entering into the purchased call options, we entered into warrant transactions with each of the Counterparties. Pursuant to the warrant transactions, we sold to the Counterparties warrants to purchase in the aggregate approximately 2,477,000 shares of Capital Stock. In most cases, the sold warrants may not be exercised prior to the maturity of the Notes.

The purchased call options and sold warrants are separate contracts with the Counterparties, are not part of the terms of the Notes and do not affect the rights of holders under the Notes. A holder of the Notes will not have any rights with respect to the purchased call options or the sold warrants. The purchased call options are expected to reduce the potential dilution upon conversion of the Notes if the market value per share of the Capital Stock at the time of exercise is greater than approximately \$80.73, which corresponds to the initial conversion price of the Notes. The sold warrants have an exercise price of \$105.44 and are expected to result in some dilution should the price of our Capital Stock exceed this exercise price. See Note 7 for further detail with respect to the potential impact of these transactions on our Earnings Per Share.

Our net cost for these transactions was approximately \$27.3 million. Pursuant to EITF 00-19 and EITF 01-6, the purchased call option and the sold warrants are accounted for as equity transactions. Therefore, our net cost was recorded as a decrease in shareholders' equity in the accompanying consolidated balance sheet.

Since May 2007, we have repaid \$65.5 million of the \$100 million term note under the 2007 Facility using cash on hand. Of the amount paid, \$60.5 million represents a prepayment. The following is a schedule by year of required long-term debt repayments as of September 30, 2007 (in thousands):

| | | |
|-----------------------|----|----------|
| September 2008 | \$ | 10,161 |
| September 2009 | | 10,059 |
| September 2010 | | 10,059 |
| September 2011 | | 4,559 |
| September 2012 | | 58 |
| Thereafter | | 200,000 |
| | | ----- |
| Total debt | | 234,896 |
| Less: Current portion | | (10,161) |
| | | ----- |
| Total long-term debt | \$ | 224,735 |
| | | ===== |

We are in compliance with all debt covenants as of September 30, 2007. We have issued \$30.1 million in standby letters of credit as of September 30, 2007, mainly for insurance purposes. Issued letters of credit reduce our available credit under the revolving credit agreement. As of September 30, 2007, we have approximately \$144.9 million of unused lines of credit available and eligible to be drawn down under our revolving credit facility, excluding the expansion feature.

3. Capital Stock Transactions

On April 26, 2007, our Board of Directors authorized a \$150 million stock repurchase program. For the nine months ended September 30, 2007 we repurchased 2.1 million shares at a weighted average cost of \$59.82 per share. For the nine months ended September 30, 2006 we repurchased 111,380 shares at a weighted average cost of \$37.30 per share.

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4. Revenue Recognition

Both the VITAS segment and Roto-Rooter segment recognize service revenues and sales when the earnings process has been completed. Generally, this occurs when services are provided or products are delivered. VITAS recognizes revenue at the estimated realizable amount due from third-party payers. Medicare payments are subject to certain caps, as described below.

We actively monitor each of our hospice programs, by provider number, as to their specific admission, discharge rate and median length of stay data in an attempt to determine whether they are likely to exceed the annual per-beneficiary Medicare cap ("Medicare cap"). Should we determine that revenues for a program are likely to exceed the Medicare cap based on projected trends, we attempt to institute corrective action to influence the patient mix or to increase patient admissions. However, should we project our corrective action will not prevent that program from exceeding its Medicare cap, we estimate the amount of revenue recognized during the period that will require repayment to the Federal government under the Medicare cap and record the amount as a reduction to patient revenue. The Medicare cap measurement period is from September 29 through September 28 of the following year for admissions and from November 1 through October 31 of the following year for revenue. As of the date of this filing, for the 2007 measurement period, no programs have a required Medicare billing reduction. Our current estimates for the projected full year 2007 measurement period anticipate no programs with a Medicare cap billing limitation. Therefore, no revenue reduction for Medicare cap has been recorded for the three or nine-month period ended September 30, 2007.

In October 2007, we received notification from the Federal government's fiscal intermediary regarding our Medicare cap liabilities related to the 2006 measurement period. The notification revealed that we were over accrued by \$1.2 million, consisting of an under accrual related to continuing operations of \$714,000 and an over accrual related to our discontinued Phoenix operation of \$1.9 million. Prior to this, we had \$9.5 million accrued for the 2006 measurement period related to 3 programs, including our discontinued Phoenix program. The difference between our estimates and the amount calculated by the Federal government's fiscal intermediary was primarily the result of allocations made for patients transferring between our hospice programs and other providers. We continue to believe that our estimation methodology provides a reasonable basis to record potential Medicare cap liabilities.

5. Segments

Service revenues and sales and aftertax earnings by business segment are as follows (in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|-----------------------------------|-------------------------------------|------------------|------------------------------------|------------------|
| | 2007 | 2006 | 2007 | 2006 |
| Service Revenues and Sales | | | | |
| VITAS | \$188,474 | \$175,289 | \$558,224 | \$512,873 |
| Roto-Rooter | 84,029 | 78,406 | 256,105 | 233,811 |
| Total | \$272,503 | \$253,695 | \$814,329 | \$746,684 |

Aftertax Earnings

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| | | | | |
|-------------------------|-----------|-----------|-----------|-----------|
| VITAS | \$ 13,921 | \$ 10,486 | \$ 43,062 | \$ 33,273 |
| Roto-Rooter | 8,942 | 8,509 | 29,123 | 22,713 |
| | ----- | ----- | ----- | ----- |
| Total | 22,863 | 18,995 | 72,185 | 55,986 |
| Corporate | (5,947) | (6,120) | (29,615) | (17,523) |
| Discontinued operations | 1,201 | (4,914) | 1,201 | (5,445) |
| | ----- | ----- | ----- | ----- |
| Net income | \$ 18,117 | \$ 7,961 | \$ 43,771 | \$ 33,018 |
| | ===== | ===== | ===== | ===== |

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6. Patient Care Notes Receivable

We have notes receivable of \$14.7 million from Patient Care, Inc. related to our sale of this subsidiary in 2002. In February 2007, the parties amended the terms of the promissory notes receivable. The amended notes are due October 2009. The interest on the notes receivable is the higher of Patient Care's current floating rate plus 2% or 11.5% per year. Interest payments are due quarterly. As of September 30, 2007, Patient Care is current on all interest payments related to these notes.

7. Earnings per Share

Earnings per share are computed using the weighted average number of shares of capital stock outstanding. Earnings and diluted earnings per share for 2007 and 2006 are computed as follows (in thousands, except per share data):

| | Income from Continuing Operations | | | Net Income | |
|------------------------|-----------------------------------|--------|----------|------------|--------|
| | ----- | | | ----- | |
| | | | Earnings | | |
| For the Three Months | | | per | | |
| Ended September 30, | Income | Shares | Share | Income | Shares |
| ----- | ----- | ----- | ----- | ----- | ----- |
| 2007 | | | | | |
| Earnings | \$ 16,916 | 23,933 | \$ 0.71 | \$ 18,117 | |
| | | | ===== | | |
| Dilutive stock options | - | 462 | | - | |
| Nonvested stock awards | - | 71 | | - | |
| | | | ----- | | |
| Diluted earnings | \$ 16,916 | 24,466 | \$ 0.69 | \$ 18,117 | |
| | ===== | ===== | ===== | ===== | ===== |
| 2006 | | | | | |
| Earnings | \$ 12,875 | 26,190 | \$ 0.49 | \$ 7,961 | |
| | | | ===== | | |
| Dilutive stock options | - | 393 | | - | |
| Nonvested stock awards | - | 50 | | - | |
| | | | ----- | | |
| Diluted earnings | \$ 12,875 | 26,633 | \$ 0.48 | \$ 7,961 | |
| | ===== | ===== | ===== | ===== | ===== |
| | Income from Continuing Operations | | | Net Income | |
| | ----- | | | ----- | |
| | | | Earnings | | |
| For the Nine Months | | | per | | |
| Ended September 30, | Income | Shares | Share | Income | Shares |
| ----- | ----- | ----- | ----- | ----- | ----- |

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2007

| | | | | | | | |
|------------------------|----|--------|--------|----|-------|----|--------|
| Earnings | \$ | 42,570 | 24,711 | \$ | 1.72 | \$ | 43,771 |
| | | | | | ===== | | |
| Dilutive stock options | | - | 463 | | | | - |
| Nonvested stock awards | | - | 75 | | | | - |
| | | | | | ----- | | |
| Diluted earnings | \$ | 42,570 | 25,249 | \$ | 1.69 | \$ | 43,771 |
| | | | | | ===== | | |

2006

| | | | | | | | |
|------------------------|----|--------|--------|----|-------|----|--------|
| Earnings | \$ | 38,463 | 26,147 | \$ | 1.47 | \$ | 33,018 |
| | | | | | ===== | | |
| Dilutive stock options | | - | 546 | | | | - |
| Nonvested stock awards | | - | 57 | | | | - |
| | | | | | ----- | | |
| Diluted earnings | \$ | 38,463 | 26,750 | \$ | 1.44 | \$ | 33,018 |
| | | | | | ===== | | |

Diluted earnings per share may be impacted in future periods as the result of the issuance of our \$200 million Notes and related purchased call options and sold warrants, as described in Note 2 above. Under EITF 04-8 "The Effect of Contingently Convertible Instruments on Diluted Earnings per Share" and EITF 90-19, we will not include any shares related to the Notes in our calculation of diluted earnings per share until our average stock price for a quarter exceeds the conversion price of \$80.73. We would then include in our diluted earnings per share calculation those shares issuable using the treasury stock method. The amount of shares issuable is based upon the amount by which the average stock price for the quarter exceeds the conversion price. The purchased call option does not impact the calculation of diluted earnings per share as it is always anti-dilutive. The sold warrants become dilutive when our average stock price for a quarter exceeds the strike price of the warrant.

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The following table provides examples of how changes in our stock price impact the number of shares that would be included in our diluted earnings per share calculation. It also shows the impact on the number of shares issuable upon conversion of the Notes and settlement of the purchased call options and sold warrants:

| Share Price | Shares Underlying 1.875% Convertible Notes | Warrant Shares | Total Treasury Method Incremental Shares (a) | Shares Due to the Company under Notes Hedges | Shares Issuable upon Conversion |
|-------------|--|----------------|--|--|---------------------------------|
| \$ 80.73 | - | - | - | - | - |
| \$ 90.73 | 273,061 | - | 273,061 | (273,061) | - |
| \$ 100.73 | 491,905 | - | 491,905 | (491,905) | - |
| \$ 110.73 | 671,222 | 118,359 | 789,581 | (671,222) | - |
| \$ 120.73 | 820,833 | 313,764 | 1,134,597 | (820,833) | - |
| \$ 130.73 | 947,556 | 479,274 | 1,426,830 | (947,556) | - |

(a) Represents the number of incremental shares that must be included in the calculation of fully diluted shares under U.S. GAAP.

(b) Represents the number of incremental shares to be issued by the Company

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upon conversion of the 1.875% Convertible Notes, assuming concurrent settlement of the note hedges and warrants.

8. Other Operating Income

During the first quarter of 2007, we completed the sale of Roto-Rooter's call center building in Florida. The proceeds from the sale were approximately \$3.0 million, which resulted in a pretax gain of \$1.1 million. The gain was recorded in other income from operations in the accompanying consolidated statement of income.

9. Other Income -- Net

Other income -- net comprises the following (in thousands):

| | Three Months Ended September 30, | | Nine Months September | |
|--|-------------------------------------|--------|--------------------------|----|
| | 2007 | 2006 | 2007 | |
| Interest income | \$ 897 | \$ 426 | \$ 2,608 | \$ |
| (Loss)/gain on trading investments of employee benefit trust | (522) | 340 | 927 | |
| (Loss)/gain on disposal of property and equipment | (57) | (50) | (250) | |
| Other - net | (307) | (1) | (217) | |
| Total other income | \$ 11 | \$ 715 | \$ 3,068 | \$ |

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10. Other Current Liabilities

Other current liabilities as of September 30, 2007 and December 31, 2006 consist of the following (in thousands):

| | 2007 | 2006 |
|---------------------------------|-----------|-----------|
| Accrued legal settlements | \$ 618 | \$ 1,889 |
| Accrued divestiture expenses | 842 | 2,612 |
| Accrued Medicare Cap estimate | 8,279 | 3,373 |
| Other | 11,233 | 14,810 |
| Total other current liabilities | \$ 20,972 | \$ 22,684 |

Accrued Medicare cap as of September 30, 2007 includes \$4.7 million related to our Phoenix program that we sold in November 2006. This amount was recorded in current liabilities from discontinued operations as of December 31, 2006.

11. 2002 Executive Long-Term Incentive Plan

In February 2007, we met the cumulative earnings target specified in the LTIP and on March 9, 2007 the Compensation/Incentive Committee of the Board of Directors approved a stock grant of 100,000 shares and the related allocation to participants. The pre-tax cost of the stock grant was \$5.4 million and is included in selling, general and administrative expenses in

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the accompanying consolidated statement of income.

In May 2007, the Compensation/Incentive Committee of the Board of Directors approved a pool of shares to be awarded based on new earnings before interest, depreciation and amortization (EBITDA) targets. The participants of the LTIP may be awarded 80,000 shares of our capital stock if we attain adjusted EBITDA of either \$465 million for the three year period beginning January 1, 2007 or \$604 million for the four year period beginning January 1, 2007.

In June 2007, we met the \$62.00 per share stock price hurdle specified in the 2002 Long-Term Incentive Plan (LTIP) and on June 27, 2007 the Compensation/Incentive Committee of the Board of Directors approved a stock grant of 22,200 shares and the related allocation to participants. The pre-tax cost of the stock grant was \$1.6 million and is included in selling, general and administrative expenses in the accompanying statement of income.

12. Loans Receivable from Independent Contractors

The Roto-Rooter segment sublicenses with approximately sixty-one independent contractors to operate certain plumbing repair and drain cleaning businesses in lesser-populated areas of the United States and Canada. As of September 30, 2007, we had notes receivable from our independent contractors totaling \$1.6 million (December 31, 2006-\$1.9 million). In most cases these loans are fully or partially secured by equipment owned by the contractor. The interest rates on the loans range from 5% to 8% per annum and the remaining terms of the loans range from two months to 5 years at September 30, 2007. During the three and nine months ended September 30, 2007, we recorded revenues of \$5.3 million and \$16.2 million respectively (2006-\$4.5 million and \$14.1 million, respectively) and pretax profits of \$2.3 million and \$7.1 million, respectively (2006-\$1.7 million and \$5.5 million, respectively) from our independent contractors.

We have adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 46R "Consolidation of Variable Interest Entities--an interpretation of Accounting Research Bulletin No. 51 (revised)" ("FIN 46R") relative to our contractual relationships with the independent contractors. FIN 46R requires the primary beneficiary of a Variable Interest Entity ("VIE") to consolidate the accounts of the VIE. We have evaluated our relationships with our independent contractors based upon guidance provided in FIN 46R and have concluded that some of the contractors who have loans payable to us may be VIE's. We believe consolidation, if required, of the accounts of any VIE's for which we might be the primary beneficiary would not materially impact our financial position, results of operations or cash flows.

13. Pension and Retirement Plans

All of the Company's plans that provide retirement and similar benefits are defined contribution plans. Expenses for the Company's pension and profit-sharing plans, excess benefit plans and other similar plans were \$2.0 million and \$9.7 million for the three and nine months ended September 30, 2007, respectively. Expenses for the Company's pension and profit-sharing plans, excess benefit plans and other similar plans were \$2.6 million and \$7.5 million for the three and nine months ended September 30, 2006, respectively.

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14. Litigation

Like other large California employers, our VITAS subsidiary faces allegations of purported class-wide wage and hour violations. It was party to a class action lawsuit filed in the Superior Court of California, Los Angeles

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County, in April of 2004 by Ann Marie Costa, Ana Jimenez, Mariea Ruteaya and Gracetta Wilson ("Costa"). This case alleged failure to pay overtime wages for hours worked "off the clock" on administrative tasks, including voicemail retrieval, time entry, travel to and from work, and pager response. This case also alleged VITAS failed to provide meal and break periods to a purported class of California nurses, home health aides and licensed clinical social workers. The case also sought payment of penalties, interest, and Plaintiffs' attorney fees. VITAS contested these allegations. During 2006, we reached a tentative settlement and on June 26, 2006, the court granted final approval of the settlement (\$19.9 million).

VITAS is party to a class action lawsuit filed in the Superior Court of California, Los Angeles County, in September 2006 by Bernadette Santos, Keith Knoche and Joyce White ("Santos"). This case, filed by the Costa case Plaintiffs' counsel, makes similar allegations of failure to pay overtime and failure to provide meal and rest periods to a purported class of California admissions nurses, chaplains and sales representatives. The case likewise seeks payment of penalties, interest and Plaintiffs' attorney fees. VITAS contests these allegations. The lawsuit is in its early stage and we are unable to estimate our potential liability, if any, with respect to these allegations.

Regardless of outcome, defense of litigation adversely affects us through defense costs, diversion of our time and related publicity. In the normal course of business, we are a party to various claims and legal proceedings. We record a reserve for these matters when an adverse outcome is probable and the amount of the potential liability is reasonably estimable.

15. OIG Investigation

In April 2005, the Office of Inspector General ("OIG") for the Department of Health and Human Services served VITAS with civil subpoenas relating to VITAS' alleged failure to appropriately bill Medicare and Medicaid for hospice services. As part of this investigation, the OIG selected medical records for 320 past and current patients from VITAS' three largest programs for review. It also sought policies and procedures dating back to 1998 covering admissions, certifications, recertifications and discharges. During the third quarter of 2005 and again in May 2006, the OIG requested additional information from us. The Court dismissed a related qui tam complaint filed in U.S. District Court for the Southern District of Florida with prejudice in July 2007. The plaintiffs are appealing this dismissal. Pretax expenses related to complying with OIG requests have been immaterial for the three and nine-month periods ended September 30, 2007. We incurred pretax expense related to complying with OIG requests and defending the litigation of \$344,000 and \$818,000 for the three and nine months ended September 30, 2006, respectively.

The government may continue to investigate the complaint's allegations. We are unable to predict the outcome of this matter or the impact, if any, that the investigation may have on our business, results of operations, liquidity or capital resources. Regardless of outcome, responding to the subpoenas and defending the litigation can adversely affect us through defense costs, diversion of our time and related publicity.

16. Related Party Agreement

In October 2004, VITAS entered into a pharmacy services agreement ("Agreement") with Omnicare, Inc. ("OCR") whereby OCR provides specified pharmacy services for VITAS and its hospice patients in geographical areas served by both VITAS and OCR. The Agreement has an initial term of three years that renews automatically for one-year terms. Either party may cancel the Agreement at the end of any term by giving written notice at least 90 days prior to the end of said term. In June 2004, VITAS entered into a pharmacy services agreement with excelleRx. The agreement has a one-year term

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and automatically renews unless either party provides a 90-day written termination notice. Subsequent to June 2004, OCR acquired excelleRx. Under both agreements, VITAS made purchases of \$8.6 million and \$25.1 million for the three and nine months ended September 30, 2007, respectively (2006 - \$8.0 million and \$22.3 million, respectively) and has accounts payable of \$912,000 at September 30, 2007.

Mr. E. L. Hutton is non-executive Chairman of the Board and a director of the Company and OCR. Mr. Joel F. Gemunder, President and Chief Executive Officer of OCR, Mr. Charles H. Erhart, Jr. and Ms. Sandra Laney are directors of both OCR and the Company. Mr. Kevin J. McNamara, President, Chief Executive Officer and a director of the Company, is a director emeritus of OCR. We believe that the terms of these agreements are no less favorable to VITAS than we could negotiate with an unrelated party.

17. Cash Overdrafts Payable

Included in accounts payable at September 30, 2007 is cash overdrafts payable of \$13.1 million (December 31, 2006 - \$10.6 million).

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18. Uncertain Tax Positions

On January 1, 2007, we adopted FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement 109", which prescribes a comprehensive model for how to recognize, measure, present and disclose in financial statements uncertain tax positions taken or expected to be taken on a tax return. Upon adoption of FIN 48, the financial statements reflect expected future tax consequences of such uncertain positions assuming the taxing authorities' full knowledge of the position and all relevant facts. FIN 48 also revises disclosure requirements and introduces an annual, tabular roll-forward of the unrecognized tax benefits.

The cumulative effect upon adoption of FIN 48 was to reduce our accrual for uncertain tax positions by approximately \$4.7 million, which has been recorded in retained earnings as of January 1, 2007 in the accompanying consolidated balance sheet. After adoption, we had approximately \$1.3 million in unrecognized tax benefits. The majority of this amount would affect our effective tax rate, if recognized in a future period. The years ended December 31, 2004 and forward remain open for review for Federal income tax purposes at Chemed and Roto-Rooter. For VITAS, fiscal years beginning after February 24, 2004 (the date of acquisition) remain open for review for Federal income tax purposes. The earliest open year relating to any of our material state jurisdictions is the fiscal year ended December 31, 2002. During the next twelve months, we anticipate that the net change in unrecognized tax benefits will be a decrease of approximately \$200,000 to \$250,000 due to normal quarterly provisions, releases upon expiration of certain statutes of limitation and the settlement of current audits.

As permitted by FIN 48, we reclassified interest related to our accrual for uncertain tax positions to separate interest accounts. We believe this change in accounting method is preferable as it more accurately classifies the impact of interest in our consolidated balance sheet and consolidated statement of income. As of September 30, 2007, we have approximately \$137,000 accrued in interest related to uncertain tax positions. These accruals are included in other current liabilities in the accompanying consolidated balance sheet. For the three and nine months ended September 30, 2007, we have recorded approximately \$1,000 and \$28,000, respectively for net interest expense related to uncertain tax positions in interest expense in the accompanying consolidated statement of income.

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19. Recent Accounting Statements

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"), which permits an entity to measure certain financial assets and financial liabilities at fair value. Entities that elect the fair value option will report unrealized gains and losses in earnings at each reporting date. The fair value option may be elected on an instrument-by-instrument basis, with a few exceptions, as long as it is applied to the entire instrument. The fair value election is irrevocable unless a new election date occurs. SFAS 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007. We believe there will be no impact on our financial condition and results of operations as a result of the adoption of SFAS 159.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("SFAS 157"), which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles (GAAP). It sets a common definition of fair value to be used throughout GAAP. The new standard is designed to make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently evaluating the impact SFAS 157 will have on our financial condition, results of operations and footnote disclosures.

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20. Guarantor Subsidiaries

Our 1.875% Notes are fully and unconditionally guaranteed on an unsecured, joint and severally liable basis by certain of our 100% owned subsidiaries. The following unaudited, condensed, consolidating financial data presents the composition of the parent company (Chemed), the guarantor subsidiaries and the non-guarantor subsidiaries as of September 30, 2007 and December 31, 2006 for the balance sheet, the three and nine months ended September 30, 2007 and 2006 for the income statement and the nine months ended September 30, 2007 and 2006 for the statement of cash flows (dollars in thousands):

Condensed Consolidating Balance Sheet

As of September 30, 2007

| ----- | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Co A |
|---|-----------|---------------------------|-------------------------------|---------|
| ----- | ----- | ----- | ----- | ----- |
| ASSETS | | | | |
| Cash and cash equivalents | \$ 15,694 | \$ (1,282) | \$ 2,318 | |
| Accounts receivable, less allowances | 878 | 80,272 | 568 | |
| Intercompany receivables | 22,050 | - | (3,756) | |
| Inventories | - | 6,174 | 650 | |
| Current deferred income taxes | (67) | 20,135 | 276 | |
| Prepaid expenses and other current assets | 1,100 | 5,801 | 82 | |
| | ----- | ----- | ----- | |
| Total current assets | 39,655 | 111,100 | 138 | |
| | ----- | ----- | ----- | |
| Investments of deferred compensation plans held in trust | - | - | 28,824 | |
| Note receivable | 14,701 | - | - | |
| Properties and equipment, at cost, less accumulated depreciation | 4,396 | 67,092 | 1,797 | |

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| | | | |
|--------------------------------|---------|---------|-------|
| Identifiable intangible assets | | | |
| less accumulated amortization | - | 66,185 | 1 |
| Goodwill | - | 431,570 | 4,692 |
| Other assets | 12,601 | 2,993 | 788 |
| Investments in subsidiaries | 497,376 | 10,839 | - |

| | | | |
|--------------|------------|------------|-----------|
| Total assets | \$ 568,729 | \$ 689,779 | \$ 36,240 |
|--------------|------------|------------|-----------|

LIABILITIES AND STOCKHOLDERS' EQUITY

| | | | |
|-----------------------------------|------------|-----------|--------|
| Accounts payable | \$ (1,603) | \$ 47,636 | \$ 356 |
| Intercompany payables | - | 14,691 | 3,603 |
| Current portion of long-term debt | 10,000 | 161 | - |
| Income taxes | 4,352 | 4,133 | 1,369 |
| Accrued insurance | 1,281 | 36,444 | - |
| Accrued salaries and wages | 2,778 | 33,726 | 643 |
| Other current liabilities | 3,181 | 17,620 | 171 |

| | | | |
|-----------------------------------|----------|---------|----------|
| Deferred income taxes | (23,088) | 36,479 | (10,021) |
| Long-term debt | 224,500 | 235 | - |
| Deferred compensation liabilities | - | - | 28,407 |
| Other liabilities | 3,667 | 1,978 | 173 |
| Stockholders' equity | 343,661 | 496,676 | 11,539 |

| | | | |
|--|------------|------------|-----------|
| Total Liabilities and Stockholders' Equity | \$ 568,729 | \$ 689,779 | \$ 36,240 |
|--|------------|------------|-----------|

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As of December 31, 2006

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Con Ad |
|---|-----------|---------------------------|-------------------------------|-----------|
| ASSETS | | | | |
| Cash and cash equivalents | \$ 25,258 | \$ (1,314) | \$ 5,330 | \$ |
| Accounts receivable, less allowances | 1,547 | 91,065 | 474 | |
| Intercompany receivables | 84,784 | - | - | |
| Inventories | - | 6,169 | 409 | |
| Current deferred income taxes | (117) | 17,591 | 315 | |
| Current assets of discontinued operations | - | 5,418 | - | |
| Prepaid expenses and other current assets | 809 | 9,087 | 72 | |
| Total current assets | 112,281 | 128,016 | 6,600 | |
| Investments of deferred compensation plans held in trust | 12,214 | 13,499 | - | |
| Note receivable | 14,701 | - | - | |
| Properties and equipment, at cost, less accumulated depreciation | 6,412 | 62,023 | 1,705 | |
| Identifiable intangible assets less accumulated amortization | - | 69,213 | 2 | |
| Goodwill | - | 430,671 | 4,379 | |
| Noncurrent assets of discontinued operations | - | 287 | - | |
| Other assets | 12,845 | 2,514 | 709 | |
| Investments in subsidiaries | 430,399 | 8,628 | - | |

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| | | | | |
|--|------------|------------|-----------|----|
| Total assets | \$ 588,852 | \$ 714,851 | \$ 13,395 | \$ |
| ===== | | | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | |
| Accounts payable | \$ (189) | \$ 49,502 | \$ 431 | \$ |
| Intercompany payables | - | 84,036 | 748 | |
| Current portion of long-term debt | - | 209 | - | |
| Income taxes | (5,906) | 11,680 | 991 | |
| Accrued insurance | 2,938 | 35,519 | - | |
| Accrued salaries and wages | 2,530 | 32,731 | 729 | |
| Current liabilities of discontinued operations | - | 12,215 | - | |
| Other current liabilities | 9,568 | 11,715 | 1,401 | |
| Deferred income taxes | (6,946) | 32,780 | 467 | |
| Long-term debt | 150,000 | 331 | - | |
| Deferred compensation liabilities | 12,247 | 13,267 | - | |
| Other liabilities | 3,249 | 467 | - | |
| Stockholders' equity | 421,361 | 430,399 | 8,628 | |
| Total Liabilities and Stockholders' Equity | \$ 588,852 | \$ 714,851 | \$ 13,395 | \$ |
| ===== | | | | |

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Condensed Consolidating Income Statement

For the nine months ended September 30, 2007

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Con Ad |
|--|-----------|---------------------------|-------------------------------|-----------|
| ----- | | | | |
| Continuing Operations | | | | |
| Net sales and service revenues | \$ - | \$ 795,912 | \$ 18,417 | \$ |
| ----- | | | | |
| Cost of services provided and goods sold | - | 560,630 | 9,215 | |
| Selling, general and administrative expenses | 14,513 | 119,397 | 2,776 | |
| Depreciation | 366 | 14,075 | 456 | |
| Amortization | 871 | 3,028 | 2 | |
| Other operating income | (1,138) | - | - | |
| Total costs and expenses | 14,612 | 697,130 | 12,449 | |
| Income/ (loss) from operations | (14,612) | 98,782 | 5,968 | |
| Interest expense | (9,065) | (365) | (227) | |
| Loss on extinguishment of debt | (13,798) | - | - | |
| Other income - net | 12,436 | (8,885) | (483) | |
| Income/ (loss) before income taxes | (25,039) | 89,532 | 5,258 | |
| Income tax (provision)/benefit | 9,439 | (34,182) | (2,438) | |
| Equity in net income of subsidiaries | 59,371 | 2,988 | - | |
| Income from continuing operations | 43,771 | 58,338 | 2,820 | |
| Discontinued Operations | - | 1,201 | - | |
| Net Income | \$ 43,771 | \$ 59,539 | \$ 2,820 | \$ |
| ===== | | | | |

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For the nine months ended September 30, 2006

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Con Ad |
|--|-----------|---------------------------|-------------------------------|-----------|
| Continuing Operations | | | | |
| Net sales and service revenues | \$ - | \$ 731,406 | \$ 15,278 | \$ |
| Cost of services provided and goods sold | - | 532,921 | 7,616 | |
| Selling, general and administrative expenses | 8,095 | 105,178 | 2,941 | |
| Depreciation | 361 | 11,585 | 439 | |
| Amortization | 960 | 3,006 | 2 | |
| Other operating expenses | - | 272 | - | |
| Total costs and expenses | 9,416 | 652,962 | 10,998 | |
| Income/ (loss) from operations | (9,416) | 78,444 | 4,280 | |
| Interest expense | (13,290) | (418) | (18) | |
| Loss on extinguishment of debt | (430) | - | - | |
| Investment impairment charge | (1,445) | - | - | |
| Other income - net | 15,925 | (13,209) | 18 | |
| Income/ (loss) before income taxes | (8,656) | 64,817 | 4,280 | |
| Income tax (provision)/benefit | 3,516 | (23,676) | (1,818) | |
| Equity in net income of subsidiaries | 40,384 | 2,462 | - | |
| Income from continuing operations | 35,244 | 43,603 | 2,462 | |
| Discontinued Operations | (2,226) | (3,219) | - | |
| Net income | \$ 33,018 | \$ 40,384 | \$ 2,462 | \$ |

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For the three months ended September 30, 2007

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries |
|--|---------|---------------------------|-------------------------------|
| Continuing Operations | | | |
| Net sales and service revenues | \$ - | \$ 266,382 | \$ 6,121 |
| Cost of services provided and goods sold | - | 189,854 | 3,028 |
| Selling, general and administrative expenses | 4,155 | 37,755 | 616 |
| Depreciation | 123 | 4,940 | 157 |
| Amortization | 282 | 1,008 | 2 |
| Total costs and expenses | 4,560 | 233,557 | 3,803 |
| Income/ (loss) from operations | (4,560) | 32,825 | 2,318 |
| Interest expense | (2,169) | (120) | (226) |
| Loss on extinguishment of debt | (83) | - | - |
| Other income - net | 2,838 | (2,258) | (569) |
| Income/ (loss) before income taxes | (3,974) | 30,447 | 1,523 |
| Income tax (provision)/benefit | 1,570 | (11,749) | (901) |

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| | | | |
|--------------------------------------|-----------|-----------|--------|
| Equity in net income of subsidiaries | 20,521 | 790 | - |
| Income from continuing operations | 18,117 | 19,488 | 622 |
| Discontinued Operations | - | 1,201 | - |
| Net Income | \$ 18,117 | \$ 20,689 | \$ 622 |

For the three months ended September 30, 2006

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries |
|--|----------|---------------------------|-------------------------------|
| Continuing Operations | | | |
| Net sales and service revenues | \$ - | \$ 248,512 | \$ 5,183 |
| Cost of services provided and goods sold | - | 182,793 | 2,606 |
| Selling, general and administrative expenses | 3,026 | 35,126 | 987 |
| Depreciation | 113 | 3,903 | 155 |
| Amortization | 355 | 1,000 | - |
| Other operating expenses | - | 272 | - |
| Total costs and expenses | 3,494 | 223,094 | 3,748 |
| Income/ (loss) from operations | (3,494) | 25,418 | 1,435 |
| Interest expense | (3,996) | (85) | - |
| Investment impairment charge | (1,445) | - | - |
| Other income - net | 5,121 | (4,396) | (10) |
| Income/ (loss) before income taxes | (3,814) | 20,937 | 1,425 |
| Income tax (provision)/benefit | 1,665 | (6,733) | (605) |
| Equity in net income of subsidiaries | 12,336 | 820 | - |
| Income from continuing operations | 10,187 | 15,024 | 820 |
| Discontinued Operations | (2,226) | (2,688) | - |
| Net income | \$ 7,961 | \$ 12,336 | \$ 820 |

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Condensed Consolidating Statement of Cash Flows

For the nine months ended September 30, 2007

| | Parent | Guarantor Subsidiaries | No S |
|---|----------|---------------------------|---------|
| Cash Flow from Operating Activities: | | | |
| Net cash provided by operating activities | \$ 4,819 | \$ 83,915 | \$ |
| Cash Flow from Investing Activities: | | | |
| Capital expenditures | (175) | (19,469) | |
| Business combinations, net of cash acquired | - | (1,079) | |
| Net payments from sale of discontinued operations | (2,382) | (3,739) | |
| Proceeds from sale of property and equipment | 2,964 | 83 | |

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| | | | |
|---|-----------|------------|----|
| Other uses - net | (680) | (721) | |
| Net cash used by investing activities | (273) | (24,925) | |
| Cash Flow from Financing Activities: | | | |
| Increase/(decrease) in cash overdrafts payable | (352) | 2,906 | |
| Change in intercompany accounts | 66,460 | (63,165) | |
| Dividends (paid to)/received from shareholders | (4,441) | 1,446 | |
| Purchases of treasury stock | (130,873) | - | |
| Proceeds from exercise of stock options | 2,429 | - | |
| Realized excess tax benefit on share based compensation | 2,506 | - | |
| Purchase of note hedges | (55,093) | - | |
| Proceeds from issuance of warrants | 27,614 | - | |
| Proceeds from issuance of long-term debt | 300,000 | - | |
| Debt issuance costs | (6,887) | - | |
| Repayment of long-term debt | (215,500) | (144) | |
| Other sources and uses - net | 27 | (1) | |
| Net cash used by financing activities | (14,110) | (58,958) | |
| Net increase/(decrease) in cash and cash equivalents | (9,564) | 32 | |
| Cash and cash equivalents at beginning of period | 25,258 | (1,314) | |
| Cash and cash equivalents at end of period | \$ 15,694 | \$ (1,282) | \$ |

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For the nine months ended September 30, 2006

| | Parent | Guarantor Subsidiaries | Non Su |
|---|-------------|---------------------------|-----------|
| Cash Flow from Operating Activities: | | | |
| Net cash provided/(used) by operating activities | \$ (14,107) | \$ 52,297 | \$ |
| Cash Flow from Investing Activities: | | | |
| Capital expenditures | (128) | (15,215) | |
| Business combinations, net of cash acquired | - | (1,489) | |
| Net payments from sale of discontinued operations | (3,360) | - | |
| Proceeds from sale of property and equipment | 42 | 222 | |
| Other uses - net | (524) | (281) | |
| Net cash used by investing activities | (3,970) | (16,763) | |
| Cash Flow from Financing Activities: | | | |
| Increase/(decrease) in cash overdrafts payable | (139) | 2,284 | |
| Change in intercompany accounts | 38,715 | (37,564) | |
| Dividends paid to shareholders | (4,739) | - | |
| Purchases of treasury stock | (8,253) | - | |
| Proceeds from exercise of stock options | 3,854 | - | |
| Realized excess tax benefit on share based compensation | 4,943 | - | |
| Net increase in revolving credit facility | 15,400 | - | |
| Debt issuance costs | (154) | - | |

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| | | | |
|--|----------|------------|-------|
| Repayment of long-term debt | (84,363) | (137) | |
| Other sources - net | 47 | 207 | |
| | ----- | ----- | ----- |
| Net cash used by financing activities | (34,689) | (35,210) | |
| | ----- | ----- | ----- |
| Net increase/(decrease) in cash and cash equivalents | (52,766) | 324 | |
| Cash and cash equivalents at beginning of period | 54,871 | (1,419) | |
| | ----- | ----- | ----- |
| Cash and cash equivalents at end of period | \$ 2,105 | \$ (1,095) | \$ |
| | ===== | ===== | ===== |

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

Executive Summary

We operate through our two wholly owned subsidiaries, VITAS Healthcare Corporation and Roto-Rooter Group, Inc. VITAS focuses on hospice care that helps make terminally ill patients' final days as comfortable as possible. Through its team of doctors, nurses, home health aides, social workers, clergy and volunteers, VITAS provides direct medical services to patients, as well as spiritual and emotional counseling to both patients and their families. Roto-Rooter's services are focused on providing plumbing and drain cleaning services to both residential and commercial customers. Through its network of company-owned branches, independent contractors and franchisees, Roto-Rooter offers plumbing and drain cleaning service to over 90% of the U.S. population.

The following is a summary of the key operating results for the three and nine months ended September 30, 2007 and 2006 (in thousands except per share amounts):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------|------------------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| | ----- | ----- | ----- | ----- |
| Consolidated service revenues and sales | \$ 272,503 | \$ 253,695 | \$ 814,329 | \$ 746,684 |
| Consolidated income from continuing operations | \$ 16,916 | \$ 12,875 | \$ 42,570 | \$ 38,463 |
| Diluted EPS from continuing operations | \$ 0.69 | \$ 0.48 | \$ 1.69 | \$ 1.44 |

For the three months ended September 30, 2007 compared to 2006, the increase in consolidated service revenues and sales was driven by a 7.5% increase at VITAS and a 7.2% increase at Roto-Rooter. The increase at VITAS was primarily the result of a 4.6% increase in average daily census (ADC) from the third quarter of 2006 and the October 1, 2006 Medicare reimbursement rate increase. The increase at Roto-Rooter was driven primarily by increases due to price and job mix changes. Job count was essentially unchanged for the three months ended September 30, 2007 compared to 2006.

For the nine months ended September 30, 2007 compared to 2006, the increase in consolidated service revenues and sales was driven by an 8.8% increase at VITAS and a 9.5% increase at Roto-Rooter. The increase at VITAS was

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primarily the result of a 6.9% increase in average daily census (ADC) from the first nine months of 2006 and the October 1, 2006 Medicare reimbursement rate increase. The increase at Roto-Rooter was driven primarily by a 1.2% increase in job count combined with an approximate 8% increase due to price and job mix changes.

In October 2007, we received notification from the Federal government's fiscal intermediary regarding our Medicare cap liabilities related to the 2006 measurement period. The notification revealed that we were over accrued by \$1.2 million, consisting of an under accrual related to continuing operations of \$714,000 and an over accrual related to our discontinued Phoenix operation of \$1.9 million. Prior to this, we had \$9.5 million accrued for the 2006 measurement period related to 3 programs, including our discontinued Phoenix program. The difference between our estimates and the amount calculated by the Federal government's fiscal intermediary was primarily the result of allocations made for patients transferring between our hospice programs and other providers. We continue to believe that our estimation methodology provides a reasonable basis to record potential Medicare cap liabilities.

Financial Condition

Liquidity and Capital Resources

Significant changes in the balance sheet accounts from December 31, 2006 to September 30, 2007 include the following:

- o The decrease in accounts receivable from \$93.1 million at December 31, 2006 to \$81.7 million at September 30, 2007 is due mainly to the timing of payments received from Medicare.
- o The increase in current portion of long-term debt and long-term debt is the result of our refinancing transactions described in detail below.
- o The decrease in long-term deferred income taxes of \$22.9 million relates mainly to the treatment of the premium payment made in conjunction with our purchased call options described below.
- o The increase in treasury stock of \$133.9 million relates mainly to our share repurchase program.

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Net cash provided by continuing operations increased \$54.4 million from a source of cash by continuing operations of \$35.7 million for the first nine months of 2006, to a source of cash of \$90.1 million for the first nine months of 2007, due primarily to higher net income and the timing of cash collections and payments in accounts receivable and accounts payable.

On May 2, 2007, we entered into a new senior secured credit facility with JPMorgan Chase Bank (the "2007 Facility") to replace our existing credit facility. The 2007 Facility includes a \$100 million term loan, a \$175 million revolving credit facility and a \$100 million expansion feature. The facility has a 5-year maturity with principal payments on the term loan due quarterly and on the revolving credit facility due at maturity. Interest is payable quarterly at a floating rate equal to our choice of various indices plus a specified margin based on our leverage ratio. The interest rate at the inception of the agreement is LIBOR plus 0.875%. In connection with replacing our existing credit facility, we wrote-off approximately \$2.3 million in deferred debt costs. The write-off of deferred debt costs has been recorded as loss on extinguishment of debt in the accompanying statement of income.

On May 4, 2007, we used the proceeds from the 2007 Facility to fund the redemption of our \$150 million, 8.75% Senior Notes due 2011. The redemption was made pursuant to the terms of the indenture at a price of 104.375% plus accrued but unpaid interest. In connection with the redemption, we wrote-off

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approximately \$4.8 million in deferred debt costs. The premium payment of \$6.6 million and the write-off of deferred debt costs have been recorded as loss on extinguishment of debt in the accompanying statement of income.

On May 8, 2007, we entered into a Purchase Agreement with J.P. Morgan Securities Inc. and Citigroup Global Markets Inc. (the "Initial Purchasers") for issuance and sale of \$180 million in aggregate principal amount of our 1.875% Senior Convertible Notes due 2014 (the "Notes"). On May 9, 2007, the Initial Purchasers exercised an over-allotment option to purchase an additional \$20 million in aggregate principal amount of Notes. On May 14, 2007 a total of \$200 million in aggregate principal amount of the Notes were sold to the Initial Purchasers at a price of \$1,000 per Note, less an underwriting fee of \$27.50 per Note. The Notes are to be resold by the Initial Purchasers pursuant to Rule 144A of the Securities Act of 1933, as amended (the "Securities Act").

We received approximately \$194 million in net proceeds from the sale of the Notes after paying underwriting fees, legal and other expenses. Proceeds from the offering were used to purchase treasury shares of our stock and to pay down a portion of the 2007 Facility. We will pay interest on the Notes on May 15 and November 15 of each year, beginning on November 15, 2007. The Notes will mature on May 15, 2014. The Notes are guaranteed on an unsecured senior basis by each of our subsidiaries that are a borrower or a guarantor under any senior credit facility, as defined in the Indenture. The Notes are convertible, under certain circumstances, into our Capital Stock at a conversion rate of 12.3874 shares per \$1,000 principal amount of Notes. This conversion rate is equivalent to an initial conversion price of approximately \$80.73 per share. Prior to March 1, 2014, holders may convert their Notes under certain circumstances. On and after March 1, 2014, the Notes will be convertible at any time prior to the close of business three days prior to the stated maturity date of the Notes. Upon conversion of a Note, if the conversion value is \$1,000 or less, holders will receive cash equal to the lesser of \$1,000 or the conversion value of the number of shares of our Capital Stock. If the conversion value exceeds \$1,000, in addition to this, holders will receive shares of our Capital Stock for the excess amount. The Indenture contains customary terms and covenants that upon certain events of default, including without limitation, failure to pay when due any principal amount, a fundamental change or certain cross defaults in other agreements or instruments, occurring and continuing; either the trustee or the holders of 25% in aggregate principal amount of the Notes may declare the principal of the Notes and any accrued and unpaid interest through the date of such declaration immediately due and payable. In the case of certain events of bankruptcy or insolvency relating to any significant subsidiary or to us, the principal amount of the Notes and accrued interest automatically becomes due and payable.

Pursuant to the guidance in Emerging Issues Task Force ("EITF") 90-19, "Convertible Bonds with Issuer Option to Settle for Cash Upon Conversion", EITF 00-19 "Accounting for Derivative Instruments Indexed to, and Potentially Settled in a Company's Own Stock" and EITF 01-6 "The Meaning of Indexed to a Company's Own Stock", the Notes are accounted for as convertible debt in the accompanying consolidated balance sheet and the embedded options within the Notes have not been accounted for as separate derivatives.

We, our subsidiary guarantors and the Initial Purchasers also entered into a Registration Rights Agreement (the "RRA") dated May 14, 2007. Pursuant to the RRA, we agreed to, no later than the 120th day after May 14, 2007, file a shelf registration statement covering resale of the Notes and the Capital Stock issuable upon conversion pursuant to Rule 415 under the Securities Act. On August 17, 2007, we filed a shelf registration statement, that became immediately effective, to register the Notes and Capital Stock issuable upon conversion.

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On May 8, 2007 we entered into a purchased call transaction and a warrant transaction (written call) with JPMorgan Chase, National Association and Citibank, N.A. (the "Counterparties"). The purchased call options cover approximately 2,477,000 shares of our Capital Stock, which under most circumstances represents the maximum number of shares of Capital Stock that underlie the Notes. Concurrently with entering into the purchased call options, we entered into warrant transactions with each of the Counterparties. Pursuant to the warrant transactions, we sold to the Counterparties warrants to purchase in the aggregate approximately 2,477,000 shares of Capital Stock. In most cases, the sold warrants may not be exercised prior to the maturity of the Notes.

The purchased call options and sold warrants are separate contracts with the Counterparties, are not part of the terms of the Notes and do not affect the rights of holders under the Notes. A holder of the Notes will not have any rights with respect to the purchased call options or the sold warrants. The purchased call options are expected to reduce the potential dilution upon conversion of the Notes if the market value per share of the Capital Stock at the time of exercise is greater than approximately \$80.73, which corresponds to the initial conversion price of the Notes. The sold warrants have an exercise price of \$105.44 and are expected to result in some dilution should the price of our Capital Stock exceed this exercise price.

Our net cost for these transactions was approximately \$27.3 million. Pursuant to EITF 00-19 and EITF 01-6, the purchased call option and the sold warrants are accounted for as equity transactions. Therefore, our net cost was recorded as a decrease in shareholders' equity in the accompanying consolidated balance sheet.

Since May 2007, we have repaid \$65.5 million of the \$100 million term note under the 2007 Facility using cash on-hand. Of the amount paid, \$60.5 million represents a prepayment. The following is a schedule by year of required long-term debt repayments as of September 30, 2007 (in thousands):

| | |
|-----------------------|------------|
| September 2008 | \$ 10,161 |
| September 2009 | 10,059 |
| September 2010 | 10,059 |
| September 2011 | 4,559 |
| September 2012 | 58 |
| Thereafter | 200,000 |
| | ----- |
| Total debt | 234,896 |
| Less: Current portion | (10,161) |
| | ----- |
| Total long-term debt | \$ 224,735 |
| | ===== |

We are in compliance with all debt covenants as of September 30, 2007. We have issued \$30.1 million in standby letters of credit as of September 30, 2007 mainly for insurance purposes. Issued letters of credit reduce our available credit under the revolving credit agreement. As of September 30, 2007, we have approximately \$144.9 million of unused lines of credit available and eligible to be drawn down under our revolving credit facility, excluding the expansion feature.

Commitments and Contingencies

Collectively, the terms of our credit agreements provide that we are required to meet various financial covenants, to be tested quarterly. We are in compliance with all financial and other debt covenants as of September 30, 2007

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and anticipate remaining in compliance throughout 2007.

Like other large California employers, our VITAS subsidiary faces allegations of purported class-wide wage and hour violations. It was party to a class action lawsuit filed in the Superior Court of California, Los Angeles County, in April of 2004 by Ann Marie Costa, Ana Jimenez, Mariea Ruteaya and Gracetta Wilson ("Costa"). This case alleged failure to pay overtime wages for hours worked "off the clock" on administrative tasks, including voicemail retrieval, time entry, travel to and from work, and pager response. This case also alleged VITAS failed to provide meal and break periods to a purported class of California nurses, home health aides and licensed clinical social workers. The case also sought payment of penalties, interest, and Plaintiffs' attorney fees. VITAS contested these allegations. During 2006 we reached a tentative settlement and on June 26, 2006, the court granted final approval of the settlement (\$19.9 million).

VITAS is party to a class action lawsuit filed in the Superior Court of California, Los Angeles County, in September 2006 by Bernadette Santos, Keith Knoche and Joyce White ("Santos"). This case, filed by the Costa case Plaintiffs' counsel, makes similar allegations of failure to pay overtime and failure to provide meal and rest periods to a purported class of California admissions nurses, chaplains and sales representatives. The case likewise seeks payment of penalties, interest and Plaintiffs' attorney fees. VITAS contests these allegations. The lawsuit is in its early stage and we are unable to estimate our potential liability, if any, with respect to these allegations.

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Regardless of outcome, defense of litigation adversely affects us through defense costs, diversion of our time and related publicity. In the normal course of business, we are a party to various claims and legal proceedings. We record a reserve for these matters when an adverse outcome is probable and the amount of the potential liability is reasonably estimable.

In April 2005, the Office of Inspector General ("OIG") for the Department of Health and Human Services served VITAS with civil subpoenas relating to VITAS' alleged failure to appropriately bill Medicare and Medicaid for hospice services. As part of this investigation, the OIG selected medical records for 320 past and current patients from VITAS' three largest programs for review. It also sought policies and procedures dating back to 1998 covering admissions, certifications, recertifications and discharges. During the third quarter of 2005 and again in May 2006, the OIG requested additional information from us. The Court dismissed a related qui tam complaint filed in U.S. District Court for the Southern District of Florida with prejudice in July 2007. The plaintiffs are appealing this dismissal. Pretax expenses incurred related to complying with OIG requests have been immaterial for the three and nine-month periods ended September 30, 2007. We incurred pretax expense related to complying with OIG requests and defending the litigation of \$344,000 and \$818,000 for the three and nine months ended September 30, 2006, respectively.

The government may continue to investigate the complaint's allegations. We are unable to predict the outcome of this matter or the impact, if any, that the investigation may have on our business, results of operations, liquidity or capital resources. Regardless of outcome, responding to the subpoenas and defending the litigation can adversely affect us through defense costs, diversion of our time and related publicity.

Results of Operations

Three -months ended September 30, 2007 versus 2006-Consolidated Results

Our service revenues and sales for the third quarter of 2007 increased 7.4%

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versus revenues for the third quarter of 2006. Of this increase, \$13.2 million was attributable to VITAS and \$5.6 million was attributable to Roto-Rooter, as follows (dollars in thousands):

| | Increase/(Decrease) | |
|-------------------|---------------------|---------|
| | Amount | Percent |
| VITAS | | |
| Routine homecare | \$ 11,476 | 9.1% |
| Continuous care | (1,219) | -4.0% |
| General inpatient | 1,031 | 4.7% |
| Medicare cap | 1,897 | 72.7% |
| Roto-Rooter | | |
| Plumbing | 2,636 | 8.1% |
| Drain cleaning | 1,324 | 3.8% |
| Other | 1,663 | 15.1% |
| Total | \$ 18,808 | 7.4% |

The increase in VITAS' revenues for the third quarter of 2007 versus the third quarter of 2006 is attributable to an increase in ADC of 5.4% for routine homecare and a 3.2% increase in general inpatient care offset by a 7.6% decline in continuous care. ADC is a key measure we use to monitor volume growth in our hospice business. Changes in total program admissions and average length of stay for our patients are the main drivers of changes in ADC. The remainder of the revenue increase is due primarily to the annual increase in Medicare reimbursement rates in the fourth quarter of 2006. In excess of 90% of VITAS' revenues for the period were from Medicare and Medicaid. We recorded a \$714,000 reduction in revenue in September 2007 related to Medicare cap billing limitations for the 2006 measurement period for 3 programs. The adjustment for the 2006 measurement period was due to the normal allocation of transferred patients performed by the Federal government's fiscal intermediary. We did not record any Medicare cap billing limitations related to the 2007 measurement period. We recorded a Medicare cap billing limitation for the three months ended September 30, 2006 of \$2.6 million.

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The increase in the plumbing revenues for the third quarter of 2007 versus 2006 comprises a 6.1% increase in the number of jobs performed and a 2.0% increase caused by increased prices and job mix. The increase in drain cleaning revenues for the third quarter of 2007 versus 2006 comprised a 3.2% decline in the number of jobs offset by a 7.0% increase caused by increased prices and job mix. The increase in other revenues is attributable primarily to increased revenue from the independent contractor operations.

The consolidated gross margin was 29.2% in the third quarter of 2007 as compared with 26.9% in the third quarter of 2006. On a segment basis, VITAS' gross margin was 21.4% in the third quarter of 2007 and 18.6% in the third quarter of 2006. The increase in VITAS' gross margin in 2007 is attributable to a reduction in the Medicare cap expense in 2007 of \$1.9 million, a reclassification of approximately \$1.0 million of costs from cost of revenue to central support in 2007, as well as excess patient care capacity in the prior year period. We corrected our excess capacity during the later part of the second quarter and early part of the third quarter in 2006. The Roto-Rooter segment's gross margin was 46.8% in the third quarter of 2007 and 45.4% in the third quarter of 2006. The increase in Roto-Rooter's gross margin in 2007 is primarily attributable to price increases and better retention of service

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technicians, which enhances overall productivity of our workforce as well as reduces our workers' compensation costs.

Selling, general and administrative expenses ("SG&A") for the third quarter of 2007 were \$42.5 million, an increase of \$3.4 million (8.7%) versus the third quarter of 2006. The increase is due to higher revenue, which increase our variable selling expenses as well as the reclassification of approximately \$1.0 million of costs from cost of revenue to SG&A at our VITAS subsidiary.

Income from operations increased \$7.2 million from \$23.4 million in the third quarter of 2006 to \$30.6 million in the third quarter of 2007. The increase is primarily the result of the increase in sales and gross margin.

Interest expense, substantially all of which is incurred at Corporate, declined from \$4.1 million in the third quarter of 2006 to \$2.5 million in the third quarter of 2007. This decline is due primarily to the refinancing transactions in May 2007, discussed above.

Other income-net decreased from \$715,000 in the third quarter of 2006 to \$11,000 in the third quarter of 2007. The decrease is attributable to market losses from investments held in our deferred compensation benefit trusts.

Our effective income tax rate was 30.6% in the third quarter of 2006 compared to 39.6% in the third quarter of 2007. The increase in the effective income tax rate is due to a \$1.8 million reduction in our tax provision in 2006 related to the expiration of certain statutes of limitations. No significant adjustment was required in 2007.

Income from continuing operations increased \$4.0 million or 31.4% in the third quarter of 2007 as compared to the third quarter of 2006 due mainly to the sales and gross margin increases as discussed above. The \$1.2 million gain from discontinued operations in the third quarter of 2007 relates to VITAS' Phoenix, AZ program that we sold in November 2006. We received notification from the Federal government's fiscal intermediary that we were over accrued with respect to the Medicare cap by approximately \$1.9 million on a pretax basis. The loss from discontinued operations in 2006 also results from the Phoenix, AZ program. Income from continuing operations and net income for both periods included the following aftertax special items/adjustments that (increased)/reduced aftertax earnings (in thousands):

| | Three Months Ended September 30, | |
|---|-------------------------------------|----------|
| | 2007 | 2006 |
| Stock option expense | \$ 1,011 | \$ 379 |
| Loss on extinguishment of debt | 52 | - |
| Legal expenses of OIG investigation | 30 | 213 |
| Loss from impairment of investment | - | 918 |
| Costs related to class action litigation | - | 169 |
| Tax adjustments upon expiration of certain statutes | - | (1,791) |
| | \$ 1,093 | \$ (112) |

Three-months ended September 30, 2007 versus 2006-Segment Results

The change in aftertax earnings for the third quarter of 2007 versus the third quarter of 2006 is due to (in thousands):

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| | Net Income Increase/ (Decrease) | |
|-------------------------|------------------------------------|---------|
| | Amount | Percent |
| VITAS | \$ 3,435 | 32.8% |
| Roto-Rooter | 433 | 5.1% |
| Corporate | 173 | 2.8% |
| Discontinued operations | 6,115 | 124.4% |
| | | |
| | \$ 10,156 | 127.6% |

Nine-months ended September 30, 2007 versus 2006-Consolidated Results

Our service revenues and sales for the first nine months of 2007 increased 9.1% versus revenues for the first nine months of 2006. Of this increase, \$45.3 million was attributable to VITAS and \$22.3 million was attributable to Roto-Rooter, as follows (in thousands):

| | Increase/ (Decrease) | |
|-------------------|----------------------|---------|
| | Amount | Percent |
| VITAS | | |
| Routine homecare | \$ 43,818 | 12.2% |
| Continuous care | (3,937) | -4.4% |
| General inpatient | 2,502 | 3.8% |
| Medicare cap | 2,968 | 92.0% |
| Roto-Rooter | | |
| Plumbing | 12,669 | 13.6% |
| Drain cleaning | 5,787 | 5.4% |
| Other | 3,838 | 11.3% |
| | | |
| Total | \$ 67,645 | 9.1% |

The increase in VITAS' revenues for the first nine months of 2007 versus the first nine months of 2006 is attributable to an increase in ADC of 8.0% for routine homecare and 1.5% for general inpatient care offset by a 7.2% decline in continuous care. ADC is a key measure we use to monitor volume growth in our hospice business. Changes in total program admissions and average length of stay for our patients are the main drivers of changes in ADC. The remainder of the revenue increase is due primarily to the annual increase in Medicare reimbursement rates in the fourth quarter of 2006. We recorded a \$714,000 reduction in revenue in September 2007 related to Medicare cap billing limitations for the 2006 measurement period for 3 programs. The adjustment for the 2006 measurement period was due to the normal allocation of transferred patients performed by the Federal government's fiscal intermediary. We did not record any Medicare cap billing limitations related to the 2007 measurement period. We recorded a Medicare cap billing limitation for the nine months ended September 30, 2006 of \$3.2 million.

The increase in the plumbing revenues for the first nine months of 2007 versus 2006 comprises an 8.2% increase in the number of jobs performed and a 5.4% increase due to increased price and job mix. The increase in drain cleaning revenues for the first nine months of 2007 versus 2006 comprised a 1.6% decline in the number of jobs offset by a 7.0% increase due to increased price and job mix. The increase in other revenues is attributable primarily to increased

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revenue from the independent contractor operations.

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The consolidated gross margin was 30.0% in the first nine months of 2007 as compared with 27.6% in the first nine months of 2006. On a segment basis, VITAS' gross margin was 22.1% in the first nine months of 2007 and 19.5% in the first nine months of 2006. The increase in VITAS' gross margin in 2007 is primarily attributable to \$3.0 million less in Medicare cap billing reductions in 2007 as well as excess patient care capacity in the prior year period. We corrected our excess capacity during the later part of the second quarter and early part of the third quarter in 2006. The Roto-Rooter segment's gross margin was 47.3% in the first nine months of 2007 as compared to 45.4% in the first nine months of 2006. The increase in Roto-Rooter's gross margin in 2007 is primarily attributable to price increases and better retention of service technicians, which enhances overall productivity of our workforce as well as reduces our workers' compensation costs.

SG&A for the first nine months of 2007 were \$136.7 million, an increase of \$20.5 million (17.6%) versus the first nine months of 2006. The increase is largely due to increased revenue which increases our variable selling expenses as well as 2007 expenses of \$7.1 million related to the LTIP and \$3.0 million related to stock option grants made in May 2007 and June 2006. LTIP and stock option expense recorded in the first nine months of 2006 was approximately \$615,000.

Income from operations increased \$16.8 million from \$73.3 million in the first nine months of 2006 to \$90.1 million in the first nine months of 2007. The increase is primarily the result of the increase in sales and gross margin.

Interest expense, substantially all of which is incurred at Corporate, declined from \$13.7 million in the first nine months of 2006 to \$9.7 million in the first nine months of 2007. This decline is due to the reduction in debt outstanding that occurred in February 2006 when we refinanced and repaid a significant portion of our debt as well as the refinancing transactions in May 2007, discussed above. The loss on extinguishment of debt is also the result of the May 2007 refinancing transactions.

Our effective income tax rate was 39.0% for the first nine months of 2007 as compared to 36.4% for the same period of 2006. The increase in the effective income tax rate is due mainly to a \$1.8 million reduction in our tax provision in 2006 related to the expiration of certain statutes of limitations. No significant adjustment was required in 2007.

Income from continuing operations increased \$4.1 million or 10.7% in the first nine months of 2007 as compared to the first nine months of 2006. Increased income from continuing operations was due to increases in sales and gross margin in 2007, which was offset by the \$13.8 million loss on extinguishment of debt. The \$1.2 million gain from discontinued operations in the third quarter of 2007 relates to VITAS' Phoenix, AZ program that we sold in November 2006. We received notification from the Federal government's fiscal intermediary that we were over accrued with respect to the Medicare cap by approximately \$1.9 million on a pretax basis. The loss from discontinued operations in 2006 also results from the Phoenix, AZ program. Income from continuing operations and net income for both periods included the following aftertax special items/adjustments that (increased)/reduced aftertax earnings (in thousands):

Nine Months Ended
September 30,

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| | 2007 | 2006 |
|---|------------------|---------------|
| Loss on extinguishment of debt | \$ 8,778 | \$ 273 |
| Long-term incentive compensation award | 4,427 | - |
| Stock option expense | 1,952 | 391 |
| Legal expenses of OIG investigation | 117 | 507 |
| Loss from impairment of investment | - | 918 |
| Costs related to class action litigation | - | 169 |
| Tax adjustments upon expiration of certain statutes | - | (1,791) |
| Gain on sale of Florida call center | (724) | - |
| Other | (296) | - |
| | <u>\$ 14,254</u> | <u>\$ 467</u> |

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Nine-months ended September 30, 2007 versus 2006-Segment Results

The change in aftertax earnings for the first nine months of 2007 versus the first nine months of 2006 is due to (in thousands):

| | Net Income Increase/(Decrease) | |
|-------------------------|-----------------------------------|--------------|
| | Amount | Percent |
| VITAS | \$ 9,789 | 29.4% |
| Roto-Rooter | 6,410 | 28.2% |
| Corporate | (12,092) | -69.0% |
| Discontinued operations | 6,646 | 122.1% |
| | <u>\$ 10,753</u> | <u>32.6%</u> |

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The following chart updates historical unaudited financial and operating data of VITAS: (dollars in thousands, except dollars per patient day)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------------------|-------------------------------------|------------|------------------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| OPERATING STATISTICS | | | | |
| Net revenue (a) | | | | |
| Homecare | \$ 137,406 | \$ 125,930 | \$ 403,748 | \$ 359,930 |
| Inpatient | 22,861 | 21,830 | 69,068 | 66,566 |
| Continuous care | 28,921 | 30,140 | 85,650 | 89,587 |
| Total before Medicare cap allowance | 189,188 | 177,900 | 558,466 | 516,083 |
| Medicare cap allowance | (714) | (2,611) | (242) | (3,210) |

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| | | | | |
|--|------------|------------|------------|------------|
| Total | \$ 188,474 | \$ 175,289 | \$ 558,224 | \$ 512,873 |
| | ===== | ===== | ===== | ===== |
| Net revenue as a percent of total before | | | | |
| Medicare cap allowance | | | | |
| Homecare | 72.6% | 70.8% | 72.3% | 69.7% |
| Inpatient | 12.1 | 12.3 | 12.4 | 12.9 |
| Continuous care | 15.3 | 16.9 | 15.3 | 17.4 |
| | ----- | ----- | ----- | ----- |
| Total before Medicare cap allowance | 100.0 | 100.0 | 100.0 | 100.0 |
| Medicare cap allowance | (0.4) | (1.5) | (0.0) | (0.6) |
| | ----- | ----- | ----- | ----- |
| Total | 99.6% | 98.5% | 100.0% | 99.4% |
| | ===== | ===== | ===== | ===== |
| Average daily census ("ADC") (days) | | | | |
| Homecare | 7,039 | 6,480 | 6,914 | 6,231 |
| Nursing home | 3,567 | 3,587 | 3,572 | 3,479 |
| | ----- | ----- | ----- | ----- |
| Routine homecare | 10,606 | 10,067 | 10,486 | 9,710 |
| Inpatient | 412 | 400 | 417 | 411 |
| Continuous care | 511 | 553 | 512 | 553 |
| | ----- | ----- | ----- | ----- |
| Total | 11,529 | 11,020 | 11,415 | 10,674 |
| | ===== | ===== | ===== | ===== |
| Total admissions | 13,436 | 12,686 | 41,204 | 39,446 |
| Total discharges | 13,403 | 12,524 | 40,823 | 38,352 |
| Average length of stay (days) | 76.7 | 71.0 | 76.7 | 70.5 |
| Median length of stay (days) | 14.0 | 14.0 | 13.0 | 13.0 |
| ADC by major diagnosis | | | | |
| Neurological | 32.8% | 33.6% | 33.1% | 33.4% |
| Cancer | 20.3 | 20.1 | 19.9 | 20.1 |
| Cardio | 14.2 | 14.7 | 14.5 | 14.9 |
| Respiratory | 6.8 | 6.9 | 6.9 | 7.1 |
| Other | 25.9 | 24.7 | 25.6 | 24.5 |
| | ----- | ----- | ----- | ----- |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| | ===== | ===== | ===== | ===== |
| Admissions by major diagnosis | | | | |
| Neurological | 18.2% | 19.3% | 18.5% | 19.9% |
| Cancer | 37.5 | 37.0 | 35.9 | 35.4 |
| Cardio | 12.1 | 12.4 | 12.8 | 13.2 |
| Respiratory | 7.1 | 6.7 | 7.6 | 7.2 |
| Other | 25.1 | 24.6 | 25.2 | 24.3 |
| | ----- | ----- | ----- | ----- |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| | ===== | ===== | ===== | ===== |
| Direct patient care margins (b) | | | | |
| Routine homecare | 51.0% | 49.1% | 50.9% | 48.8% |
| Inpatient | 15.9 | 16.5 | 18.3 | 20.2 |
| Continuous care | 16.9 | 17.5 | 18.2 | 18.7 |
| Homecare margin drivers | | | | |
| (dollars per patient day) | | | | |
| Labor costs | \$ 48.86 | \$ 48.28 | \$ 48.98 | \$ 49.25 |
| Drug costs | 7.88 | 8.46 | 7.95 | 8.10 |
| Home medical equipment | 5.65 | 5.66 | 5.73 | 5.57 |
| Medical supplies | 2.22 | 2.21 | 2.16 | 2.14 |
| Inpatient margin drivers | | | | |
| (dollars per patient day) | | | | |
| Labor costs | \$ 274.64 | \$ 269.72 | \$ 263.11 | \$ 258.48 |
| Continuous care margin drivers | | | | |

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| | | | | |
|--|-----------|-----------|-----------|-----------|
| (dollars per patient day) | | | | |
| Labor costs | \$ 490.94 | \$ 467.64 | \$ 479.83 | \$ 461.89 |
| Bad debt expense as a percent of revenues | 0.9% | 0.9% | 0.9% | 0.9% |
| Accounts receivable -- days of revenue outstanding | 39.6 | 42.1 | N.A. | N.A. |

(a) VITAS has 6 large (greater than 450 ADC), 15 medium (greater than 200 but less than 450 ADC) and 22 small (less than 200 ADC) hospice programs. There are two programs with Medicare cap of less than 10% for the 2007 measurement period.

(b) Amounts exclude indirect patient care and administrative costs, as well as Medicare cap limitation.

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Recent Accounting Statements

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"), which permits an entity to measure certain financial assets and financial liabilities at fair value. Entities that elect the fair value option will report unrealized gains and losses in earnings at each reporting date. The fair value option may be elected on an instrument-by-instrument basis, with a few exceptions, as long as it is applied to the entire instrument. The fair value election is irrevocable unless a new election date occurs. SFAS 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007. We believe there will be no impact on our financial condition and results of operations as a result of the adoption of SFAS 159.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("SFAS 157"), which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles (GAAP). It sets a common definition of fair value to be used throughout GAAP. The new standard is designed to make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently evaluating the impact SFAS 157 will have on our financial condition, results of operations and footnote disclosures.

Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995

Regarding Forward-Looking Information

In addition to historical information, this report contains forward-looking statements and performance trends that are based upon assumptions subject to certain known and unknown risks, uncertainties, contingencies and other factors. Variances in any or all of the risks, uncertainties, contingencies, and other factors from our assumptions could cause actual results to differ materially from these forward-looking statements and trends. Our ability to deal with the unknown outcomes of these events, many of which are beyond our control, may affect the reliability of projections and other financial matters.

Item 3. Quantitative and Qualitative Disclosures about Market Risk Our primary

market risk exposure relates to interest rate risk exposure through variable interest rate borrowings. At September 30, 2007, we had \$34.9 million of variable rate debt outstanding. A 1% change in the interest rate on our variable interest rate borrowings would have a \$349,000 full-year impact on our

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interest expense. At September 30, 2007, we believe the fair value of our Senior Convertible Notes approximates \$196.7 million.

Item 4. Controls and Procedures

We carried out an evaluation, under the supervision of our President and Chief Executive Officer and with the participation of the Vice President and Chief Financial Officer and the Vice President and Controller, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the President and Chief Executive Officer, Vice President and Chief Financial Officer and Vice President and Controller have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report. There has been no change in our internal control over financial reporting that occurred during the quarter covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

Item 6. Exhibits

| Exhibit No. | Description |
|-------------|--|
| 31.1 | Certification by Kevin J. McNamara pursuant to Rule 13a-14(a)/15d-14(a) of the Exchange Act of 1934. |
| 31.2 | Certification by David P. Williams pursuant to Rule 13a-14(a)/15d-14(a) of the Exchange Act of 1934. |
| 31.3 | Certification by Arthur V. Tucker, Jr. pursuant to Rule 13a-14(a)/15d-14(a) of the Exchange Act of 1934. |
| 32.1 | Certification by Kevin J. McNamara pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification by David P. Williams pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.3 | Certification by Arthur V. Tucker, Jr. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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SIGNATURES

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

Chemed Corporation

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(Registrant)

Dated: November 1, 2007

By: Kevin J. McNamara

Kevin J. McNamara
(President and Chief
Executive Officer)

Dated: November 1, 2007

By: David P. Williams

David P. Williams
(Vice President and Chief
Financial Officer)

Dated: November 1, 2007

By: Arthur V. Tucker, Jr.

Arthur V. Tucker, Jr.
(Vice President and
Controller)