MATRIA HEALTHCARE INC
Form 10-K
March 20, 2007

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 for the fiscal year ended December 31, 2006**

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from _________ to _________**

Commission File No. 0-20619

MATRIA HEALTHCARE, INC.
(Exact name of registrant as specified in its charter)

Delaware	**20-2091331**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
1850 Parkway Place	
Marietta, Georgia	**30067**
(Address of principal executive offices)	(Zip Code)

(770) 767-4500
Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:	Name of each exchange on which registered:
Common Stock, par value $0.01 per share	**The Nasdaq Stock Market, LLC**
(Title of each class)	

Securities registered pursuant to Section 12(g) of the Act: **None** (Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.
Yes o No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.
Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

As of June 30, 2006, the aggregate market value of common stock held by nonaffiliates was approximately $434,488,057, based upon the closing sale price for such date as reported on the Nasdaq Global Select Market. As of March 1, 2007, there were 21,533,273 shares of our common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the 2007 Annual Meeting of Shareholders are incorporated by reference into Part III.

MATRIA HEALTHCARE, INC.
2006 FORM 10-K ANNUAL REPORT
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PART I

Item 1. Business

General. Matria Healthcare, Inc. ("Matria" or the "Company") provides comprehensive, integrated programs and services focused on wellness, disease and condition management, productivity enhancement and informatics. This suite of services, which we call "Health Enhancement," is designed to reduce health-related costs and enhance the health and quality of life of the individuals we serve. Matria provides services to self-insured employers, private and government sponsored health plans, pharmaceutical companies and patients. Our employer clients are primarily Fortune 1000 companies that self-insure the medical benefits provided to their employees, dependents and retirees. Our health plan customers are regional and national health plans, as well as government-sponsored health plans, such as state Medicaid programs.

Our business strategy is described under "Management's Discussion & Analysis of Financial Condition and Results of Operations" in Item 7 of this Report.

Development of our Business. We were incorporated on December 28, 2004, in connection with our predecessor registrant's reorganization into a holding company structure. The predecessor registrant was incorporated on October 4, 1995 in connection with the merger of Tokos Medical Corporation and Healthdyne Maternity Management, effective March 8, 1996. Through that merger, Matria emerged as the country's premier provider of high-risk maternity management services. Subsequently, we decided to leverage the experience with patient assessment, education and patient monitoring we gained through our management of high-risk pregnancies by expanding our focus to include management of individuals with chronic diseases. In furtherance of that strategy, we launched our respiratory disease management program in 1998.

In 1999, we added diabetes disease management to our service offerings through an acquisition. At the same time, we acquired our former pharmacy and supplies business, as well as Facet Technologies, LLC ("Facet"), our diabetes product design, development and assembly business, and our foreign diabetes services business in Germany ("Dia Real"). In 2002, we continued to expand our disease management program offerings through internal development of programs for cardiac disease, depression and chronic pain and through the acquisition of Quality Oncology, Inc. ("Quality Oncology"), the nation's leading provider of cancer disease management services. In 2003, we launched an initiative to offer disease management services through pharmaceutical companies in support of complex drug therapies and began to offer disease management services for hepatitis C. Through a strategic acquisition in 2004, we expanded our services to include case management. We also divested our domestic pharmacy and supplies business in 2004. In 2005, we furthered our goal of offering the broadest spectrum of services in the industry across the full continuum of care through the acquisitions of Miavita, LLC ("Miavita"), a leading provider of on-line health and wellness programs, and WinningHabits, Inc. ("WinningHabits"), a premier provider of corporate wellness programs. We also launched our commercialized informatics business in 2005, which involves the aggregation and analysis of data to enable our customers to better manage health-related costs and further improve outcomes.

In December 2005, we signed a definitive merger agreement to acquire CorSolutions Medical, Inc. ("CorSolutions"), another leading provider of disease management and related services to employers, health plans and government-sponsored healthcare programs. At the same time, we made the strategic decision to divest Facet and Dia Real. With these strategic initiatives in place, we combined our operations under one reportable segment: Health Enhancement. We completed the acquisition of CorSolutions on January 19, 2006. On September 1, 2006, we completed the sale of Facet. We divested Dia Real on October 17, 2006. In September 2006, we invested in and formed a strategic alliance with privately-held Secured Independence, Inc. to address the needs of the long-term care insurance industry.

Our Business Today

Health Enhancement**.** With the completion of the acquisition of CorSolutions in January 2006, we have combined two of the leaders in our industry, and we believe that we have created the industry's

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most expansive health enhancement programs, services and capabilities across the full continuum of care. In the merger, we acquired an expanded product line, a significant presence in the health plan market, a talented group of employees, new expertise, valuable customer relationships and several new facilities. We expended substantial effort in 2006 to integrate CorSolutions, Miavita and WinningHabits with our legacy businesses.

Health enhancement involves multiple integrated programs and services that help participants change unhealthy lifestyles that lead to chronic diseases, improve self-care skills and compliance with plans of care and become better educated consumers of healthcare services. Our health enhancement business has 50 service centers that serve participants and patients throughout the United States.

Our on-line, interactive wellness programs address issues such as: smoking cessation, weight loss, exercise, healthier diet, stress relief, healthy aging and productivity enhancement. These programs are designed to help employees and health plan members live healthier and longer lives while reducing their healthcare costs and increasing their productivity.

Our disease and condition management programs focus on the most costly medical conditions, including, without limitation, diabetes, coronary artery disease, congestive heart failure, asthma, chronic obstructive pulmonary disease, depression, chronic pain, hepatitis C, cancer and high-risk pregnancies. With the acquisition of CorSolutions, we expanded our disease management offerings to include many less common chronic conditions. Also, with the acquisition of CorSolutions, we acquired greater expertise in the area of productivity enhancement, including an absence management program and the capability of integrating disease management programs with a customer's disability carriers.

We emphasize a multidisciplinary approach to care that involves our clinicians working with the physicians that are treating the participants in our programs to oversee adherence to evidenced-based standards of care prescribed by the physician. We focus on the management of participants between visits to their physician, the improvement of participants' compliance with their physicians' care plans and the avoidance of controllable and costly events, such as emergency room visits and hospital admissions. We believe that our programs, which were developed in accordance with national clinical standards, demonstrably reduce medical and healthcare-related costs and produce improved outcomes for our participants. Our disease and condition management services include, but are not limited to:

- Sophisticated data analysis to identify and preliminarily stratify individuals at risk for chronic diseases and high cost conditions;
- Administration of a multi-condition risk assessment, the results of which we use to build a detailed medical profile in our proprietary information systems;
- The use of predictive modeling to determine the probability that a given individual has a chronic condition or is at risk of a significant health event that will result in substantial healthcare costs in the near and longer-term future;
- Development of risk-specific care plans based on national clinical standards;
- Ongoing participant education, motivation and support;
- Monitoring of the participant's utilization of medication and supplies, the frequency of periodic laboratory testing and adherence to care plans;
- For some participants, biometric monitoring of weight, blood glucose, blood pressure and/or uterine activity; and

- Reporting of clinical and financial outcomes.

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Our customized educational materials encourage participants to make better lifestyle choices, empower participants through knowledge to make clinically supported decisions about their healthcare and help participants better manage their conditions. The Matria clinicians coach and motivate participants to develop self-care skills to manage their conditions, practice prevention, pursue a health conscious lifestyle, actively seek health and wellness knowledge and understand the financial and health impact of their lifestyle decisions.

People with chronic diseases and high-cost conditions face a myriad of medications, treatments, directives and precautions that are part of a plan of care, and thus, they typically need extra support. Our clinicians ensure this support is readily available and proactively provided. To properly manage one’s chronic disease, the individual must follow clinical parameters defined for the disease. Our nurses, with the aid of the Company’s technology, educate the participant on the management of these critical parameters. By combining the human touch of experienced clinicians with the power of Matria’s technology, the Company’s disease and condition management processes have been demonstrated to improve the participant’s course of treatment.

All of our programs are built on proprietary, sophisticated and advanced technology that enables us to ingest and analyze data from multiple sources, manage participant care and report clinical and financial outcomes. Increasingly, the market is recognizing the power of data as a tool in managing health care and optimizing clinical and financial outcomes. In 2005, we began to capitalize on our information systems technology and data analysis expertise by offering our informatics services as an adjunct to our wellness and disease and condition management services. We will continue to make substantial investments in our information systems.

Customers and Third-Party Payors. We market our health enhancement services to self-insured employers, health plans (both commercial and governmental), pharmaceutical companies and physicians, through our employee sales force and channel partners. In 2006, revenues from continuing operations were derived from the following types of customers and third-party payors: approximately 57% from health plans, 34% from employers, 7% from government payors and 2% from administrative services only (“ASO”) self-insured employer clients.

Billing and Revenue Recognition. Our services are paid for primarily on the basis of (i) monthly fees for each employee or member enrolled in a health plan, (ii) each member identified with a particular chronic disease or condition under contract, (iii) each member enrolled in our programs, (iv) fee-for-service or (iv) a fixed rate per case. Billings for certain services occur in advance of services being performed. Such amounts are recorded as “Unearned revenues” in the consolidated balance sheets. Such amounts are subsequently recognized as revenue as services are performed.

Some contracts provide that a portion of our fees are at-risk (i.e., refundable) if our programs do not achieve certain financial cost savings and clinical performance criteria. Revenues subject to refund are not recognized if (i) sufficient information is not available to calculate performance measurements; or (ii) interim performance measurements indicate that we are not meeting performance targets. If either of these two conditions exists, we record the amounts as unearned revenue, which is included in “Unearned revenues” in the consolidated balance sheets. These amounts are recognized as revenue when we establish that we have met the performance criteria. Often, recognition of these revenues occurs in periods subsequent to the recognition of the associated costs. Therefore, upon recognition, these revenues increase our operating profits on a dollar-for-dollar basis. If we do not meet performance criteria, we are contractually obligated to refund some or all of the at-risk fees. Historically, such refunds have been immaterial to our financial condition and results of operations.

Seasonality. Our high-risk pregnancy management services revenues tend to be seasonal. Revenues tend to decrease with the onset of the holiday season starting with Thanksgiving. As a result, first and fourth quarter revenues of each year tend to be lower than second and third quarter revenues.

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The other aspects of our health enhancement business currently do not reflect any significant degree of seasonality.

Competition. Our health enhancement business is highly competitive. Our competitors and potential competitors include disease management companies, pharmaceutical companies, pharmacy benefit management companies, case management companies, health plans, healthcare providers and other organizations that provide services to health plans and self-insured employers. Certain of our competitors and potential competitors have significantly greater financial and sales resources than we do. We believe that our ability to offer customers an integrated health enhancement solution across a full continuum of care, our demonstrated clinical and financial outcomes capabilities and our highly regarded technology platforms will enable us to compete effectively. However, there can be no assurance that we will not encounter increased or more effective competition in the future, which would limit our ability to maintain or increase our business.

Research and Development. Program development and refinements from the health enhancement operations are a result of the cooperative efforts of the business's information technology, clinical, operating and marketing staff. The costs of these development activities are charged to earnings when incurred. However, we capitalize development costs incurred for internal use software under the provisions of the AICPA Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.*

Governmental Regulation. The healthcare business is subject to extensive and frequently changing federal, state and local regulations. Changes in applicable laws or any failure to comply with existing or future laws, regulations or standards could have a material adverse effect on our results of operations, financial condition, business and prospects. We believe our current arrangements and practices are in material compliance with applicable laws and regulations. There can be no assurance that we are in compliance with all applicable existing laws and regulations or that we will be able to comply with new laws or regulations.

Certain of our clinicians, such as nurses, must comply with individual licensing requirements. All of our clinicians who are subject to licensing requirements are licensed in the state in which they are physically present, such as the location of the call center from which they operate. In the future, multiple state licensing requirements for healthcare professionals who provide services telephonically over state lines may require us to license some of our clinicians in more than one state. New judicial decisions, agency interpretations or federal or state legislation or regulations could increase the requirement for multi-state licensing of a greater number of our clinical staff, which would increase our administrative costs.

Certain aspects of our health enhancement business are subject to unique licensing or permit requirements. For example, many states require our subsidiary providing high-risk pregnancy management services to be licensed as a home health agency and to have medical waste disposal permits. Also, many states require Quality Oncology, our cancer disease management subsidiary, to be licensed as a utilization review provider. We may also be required to obtain certification to participate in governmental payment programs, such as state Medicaid programs. Some states have established Certificate of Need ("CON") programs regulating the expansion of healthcare operations. The failure to obtain, renew or maintain any of the required licenses, certifications or CONs could adversely affect our business.

Some of the monitoring devices used by our subsidiary providing high-risk pregnancy management services in the provision of our services are classified as medical devices under the Federal Food, Drug and Cosmetic Act, or the FDC Act, and are subject to regulation by the Food and Drug Administration, or the FDA. In addition some of our services involve the use of drugs that are regulated by the FDA under the FDC Act. Although medical devices and drugs used by our subsidiary providing high-risk pregnancy management services are labeled for specific indications and cannot be

promoted for any other indications, the FDA allows physicians to prescribe drugs and medical devices for “off-label” indications under the “practice of medicine” doctrine. Negative publicity concerning the off-label use of drugs and devices may adversely affect the high-risk pregnancy management services component of our business. Our failure to comply with FDA requirements could result in FDA enforcement actions, which could include, but are not limited to, recalls, warning letters, fines, injunctions and criminal prosecution. Any such enforcement actions could have a material adverse effect on our business, financial condition and results of operations.

The Health Insurance Portability and Accountability Act of 1996, or HIPAA, governs electronic healthcare transactions and the privacy and security of medical records and other individually identifiable patient data. Any failure to comply with HIPAA could result in criminal penalties and civil sanctions.

Although a small component of our business relies on reimbursement by government payors, such as state Medicaid, that business is subject to particularly pervasive regulation by those agencies. These regulations impose stringent requirements for provider participation in those programs and for reimbursement of products and services. Additionally, we are subject to periodic audits or investigations by the Centers for Medicare and Medicaid Services, or CMS and/or its intermediaries, of our compliance with those requirements, and any deficiencies found may be extrapolated to cover a larger number of reimbursement claims. Additionally, many applicable laws and regulations are aimed at curtailing fraudulent and abusive practices in relation to those programs. These rules include the illegal remuneration provisions of the Social Security Act (sometimes referred to as the “Anti-Kickback” statute), which impose criminal and civil sanctions on persons who knowingly and willfully solicit, offer, receive or pay any remuneration, whether directly or indirectly, in return for, or to induce, the referral of a patient covered by a federal healthcare program to a particular provider of healthcare products or services. Related federal laws make it unlawful, in certain circumstances, for a physician to refer patients covered by federal healthcare programs to a healthcare entity with which the physician and/or the physician's family have a financial relationship. Additionally, a large number of states have laws similar to the federal laws aimed at curtailing fraud and abuse and physician “self-referrals.” These rules have been interpreted broadly such that any financial arrangement between a provider and potential referral source may be suspect. While we believe our business arrangements are in compliance with these laws and regulations, the government could take a contrary position or could investigate our practices.

In addition to the laws described above, the Federal False Claims Act imposes civil liability on individuals or entities that submit false or fraudulent claims for payment to the government. HIPAA created two new federal crimes: “Healthcare Fraud” and “False Statements Relating to Healthcare Matters.” The Healthcare Fraud statute prohibits knowingly and willfully executing a scheme or artifice to defraud any healthcare benefit program. The False Statements Relating to Healthcare Matters statute prohibits knowingly and willfully falsifying, concealing or covering up a material fact by any trick, scheme or device or making any materially false, fictitious or fraudulent statement in connection with the delivery of or payment for healthcare benefits, items or services. The Federal False Claims Act allows actions to be brought on the government's behalf by individuals under the Federal False Claims Act’s “*qui tam*” provision. Violation of these and other applicable rules can result in substantial fines and penalties, required repayment of monies previously recognized as income, as well as exclusion from future participation in government-sponsored healthcare programs.

There can be no assurance that we will not become the subject of a regulatory or other investigation or proceeding or that our interpretations of applicable laws and regulations will not be challenged. The defense of any such challenge could result in adverse publicity, substantial cost to us and diversion of management's time and attention. Thus, any such challenge could have a material adverse effect on our business, regardless of whether it ultimately is sustained.

The Medicare Prescription Drug Improvement and Modernization Act of 2003 (the "Act") provided funding for disease management demonstration programs to be implemented in targeted geographic areas across the country, and indicates that if the programs are successful, the programs will be expanded nationwide. The expansion of these programs could represent a significant opportunity for our disease and condition management business.

Employees. As of December 31, 2006, we employed a total of 1,704 regular full-time and 62 regular part-time employees in our continuing operations. Also, the health enhancement business employed an additional 836 part-time clinical employees to provide, among other things, patient training and back-up support on an "as needed" basis. None of these employees is represented by a union, and we consider our relationship with our employees to be good.

Discontinued Operations. On June 30, 2004, the Company completed the sale of substantially all of the assets, excluding trade and certain other receivables, of our former domestic direct-to-consumer pharmacy and supplies business. As a result of the sale and the discontinuance of the related lab business, the accompanying consolidated financial statements reflect the operations of these divisions as discontinued operations for all periods presented. In December 2005, we announced our strategic plan to divest Facet and Dia Real. As of December 31, 2005, we reported the assets and liabilities of Facet and Dia Real as assets held for sale and liabilities related to assets held for sale and other discontinued operations, respectively, and accordingly, reported their results of operations in discontinued operations for all periods presented. We completed the sale of Facet on September 1, 2006, and closed the sale of Dia Real on October 17, 2006.

Available Information.

The Company's Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), will be made available free of charge on or through our website at *www.matria.com* as soon as reasonably practicable after the reports are filed with, or furnished to, the Securities and Exchange Commission (the "SEC" or the "Commission"). Matria's Corporate Governance Guidelines and Code of Conduct were filed as exhibits to previous Exchange Act reports filed with the SEC and are available on our website. Any waivers of the Guidelines or Code will be disclosed in an SEC filing on Form 8-K.

Item 1A. Risk Factors.

Our business is subject to certain risks, including the risks described under the headings "Customers and Third-Party Payors," "Billing and Revenue Recognition," "Seasonality," "Competition," "Research and Development" and "Governmen Regulation" in Item 1, "Legal Proceedings" in Item 3, and those described below. Readers of this Annual Report on Form 10-K should take such risks into account in evaluating any investment decision involving our common stock. This Item 1A does not describe all risks applicable to our business and is intended only as a summary of certain material factors that affect our operations in the industries in which we operate. More detailed information concerning these and other risks is contained in other sections of this Annual Report on Form 10-K.

The health enhancement business is an evolving component of the overall healthcare industry.
Health enhancement and wellness services are relatively new components of the overall healthcare industry. Accordingly, some of our potential customers have not had significant experience in purchasing, evaluating or monitoring such services, which can result in a lengthy sales cycle. The success of our business plan relative to our disease and condition management and wellness services depends on a number of factors. These factors include:

- Our ability to differentiate our products and service offerings from those of our competitors;

- The extent and timing of the acceptance of our services as a replacement for, or supplement to, traditional managed care offerings;
- The effectiveness of our sales and marketing efforts;
- Our ability to implement new and additional services beneficial to health plans and employers;
- Our ability to effect and sufficiently communicate cost savings for health plans and employers through the use of our programs; and
- Our ability to improve patient compliance with the complex drug therapies offered by our pharmaceutical customers.

Since the disease and condition management and wellness businesses are continually evolving, we may not be able to anticipate and adapt to the developing market. Moreover, we cannot predict with certainty the future growth rate or the ultimate size of the market.

We are highly dependent on payments from our customers, which may implement cost reduction measures that adversely affect our business and operations.

Healthcare payors continue to face cost reduction pressures that may cause them to curtail their use of or reimbursement for health enhancement services, to negotiate reduced fees or other concessions or to delay payment. These financial pressures could have an adverse impact on our business.

Government regulations may adversely affect our business.

We are subject to extensive and frequently changing federal, state and local regulations. Changes in laws or regulations or new interpretations of existing laws or regulations can have a dramatic effect on operating methods, costs and reimbursement amounts provided by government and third-party payors. There can be no assurance that we are or have been in compliance with all applicable existing laws and regulations or that we will be able to comply with new laws or regulations. Changes in applicable laws or any failure to comply with existing or future laws, regulations or standards could have a material adverse effect on our results of operations, financial condition, business and prospects.

A portion of our disease management fees are contingent upon performance.

Some of our existing disease management agreements contain savings or other guarantees, which typically provide that we will repay all or some of our fees if the payor’s cost savings as a result of our disease management programs do not meet expectations or if other quality performance measures are not met. Some contracts also provide that we will receive bonus compensation by meeting certain performance criteria. There is no guarantee that we will accurately forecast cost savings and clinical outcome improvements under our disease management agreements or meet the performance criteria necessary to receive the designated bonus compensation or to avoid repayment of fees under the agreements. Additionally, untimely, incomplete or inaccurate data from our customers, or flawed analysis of such data, could have a material adverse impact on our ability to recognize revenues.

Our operating results have fluctuated in the past and could fluctuate in the future.

Our operating results have varied in the past and may fluctuate significantly in the future due to a variety of factors, many of which are outside of our control. These factors include, but are not limited to:

- the impact of substantial divestitures and acquisitions;

- the loss or addition of customers and referral sources;
- investments required to support growth and expansion;
- changes in the mix of our products and customers;
- changes in healthcare reimbursement policies and amounts;
- length of sales cycle and implementation process for new disease management customers;
- increases in costs of revenues and operating expenses;

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- recognition of deferred revenues and performance bonuses;
- incurrence of performance penalties;
- increases in selling, general and administrative expenses;
- increased or more effective competition; and
- regulatory changes.

In addition, revenues from our high-risk pregnancy management services are historically lower during the first and fourth calendar quarters than during the second and third calendar quarters. The seasonal variability of demand for these services significantly affects, and we believe will continue to affect, our quarterly operating results.

If our costs of providing products or services increase, we may not be able to pass these cost increases on to our customers.

In many of our markets, due to competitive pressures, we have very little control over the price at which we sell our products and services. If our costs increase, we may not be able to increase our prices, which would adversely affect results of operations. Accordingly, any increase in our costs could reduce our overall profit margin.

Recent and future acquisitions may cause integration problems, disrupt our business and strain our resources.

In 2005 and 2006, we made three strategic business acquisitions, and may continue with such acquisitions in the future. Our success will depend, to a certain extent, on the future performance of these acquired business entities. These acquisitions, either individually or as a whole, could divert management attention from other business concerns and expose us to unforeseen liabilities or risks associated with entering new markets and integrating these new entities. Further, the integration of these entities may cause us to lose key employees or key customers. Integrating newly acquired organizations and technologies could be expensive and time consuming and may strain our resources. Consequently, we may not be successful in integrating these acquired businesses or technologies and may not achieve anticipated revenue and cost benefits.

We may face costly litigation that could force us to pay damages and harm our reputation.

Like other participants in the healthcare market, we are subject to lawsuits alleging negligence, product liability or other similar legal theories, many of which involve large claims and significant defense costs. Any of these claims, whether with or without merit, could result in costly litigation, and divert the time, attention, and resources of our management. Although we currently maintain liability insurance intended to cover such claims, there can be no assurance that the coverage limits of such insurance policies will be adequate or that all such claims will be covered by insurance. In addition, these insurance policies must be renewed annually. Although we have been able to obtain liability insurance, such insurance may not be available in the future on acceptable terms, if at all. A successful claim in excess of the insurance coverage could have a material adverse effect on our results of operations or financial condition.

If we do not manage our growth successfully, our growth and profitability may slow, decline or stop.

If we do not manage our growth successfully, our growth and profitability may slow, decline or stop. We have expanded our operations rapidly and plan to continue to expand. This expansion has created significant demands on our administrative, operational and financial personnel and other resources. Additional expansion in existing or new markets could strain our resources and increase our need for capital. Our personnel, systems, procedures, controls and existing space may not be adequate to support further expansion. In addition, because our business strategy emphasizes growth, the failure to achieve our stated growth objectives or the growth expectations of investors could cause our stock price to decline.

Our data management and information technology systems are critical to maintaining and growing our business.

Our health enhancement services are dependent on the effective use of information technology. Although we believe that our systems provide us with a competitive advantage, we are exposed to technology failure or obsolescence. In addition, data acquisition, data quality control and data analysis, which are a cornerstone of our disease management programs, are intense and complex processes subject to error. Untimely, incomplete or inaccurate data, flawed analysis of such data or our inability to properly integrate, implement and update systems could have a material adverse impact on our business and results of operations.

We have recorded a significant amount of intangible assets, the value of which could become impaired.
Our acquisitions have resulted in the recognition of intangible assets, primarily goodwill. Goodwill, which represents the excess of cost over the fair value of net assets of businesses acquired, and other intangible assets was approximately $556.7 million, net of amortization, at December 31, 2006, representing approximately 78% of our total assets. On an ongoing basis, we will make an evaluation to determine whether events and circumstances indicate that all or a portion of the carrying value of intangible assets may no longer be recoverable, in which case a charge to earnings may be necessary. Any future determinations requiring an asset impairment of a significant portion of intangible assets could materially affect our results of operations for the period in which the adjustment occurs.

The competition for staff may cause us to restrict growth in certain areas or to realize increased labor costs in existing areas.

Our operations are dependent on the services provided by qualified management and staff, including nurses and other healthcare professionals, for which we compete with other health care providers. In addition, our opportunities for growth are limited by our ability to attract and retain such personnel. In certain markets, there is a shortage of nurses and other medical providers, thereby increasing competition and requiring us to improve working conditions, including wages and benefits, for such personnel. Our potential inability to maintain and grow an appropriate workforce may inhibit our expansion and could have a material adverse effect on our financial results.

We derive a significant portion of our revenues from health plan customers.

Although no customer accounts for more than 10% of our revenues, the recent expansion of our large health plan customer base in our disease management business has created greater revenue concentration. Consolidation in the health plan industry may cause us to lose business if one of our health plan customers is acquired by another health plan that has its own health enhancement solution. Loss of one or more of these customers or their inability or refusal to pay for our services, whatever the reason, could materially and adversely affect our results of operations, cash flows and financial condition. Additionally, a reduction in the number of covered lives enrolled with our health plan customers or a reduction in the scope of their programs could adversely affect our results of operations.

Our actual financial results might vary from our publicly disclosed forecasts.
Our actual financial results might vary from those anticipated by us, and these variations could be material. Our forecasts reflect numerous assumptions concerning our expected performance, as well as other factors, which are beyond our control, and which might not turn out to have been correct. Although we believe that the assumptions underlying the projections are reasonable, actual results could be materially different. Our financial results are subject to numerous risks and uncertainties, including those identified throughout these “Risk Factors” and elsewhere in this Annual Report on Form 10-K.

Our substantial leverage could materially adversely impact our financial condition.

As of December 31, 2006, our total outstanding long-term debt, including current installments, was approximately $280 million, and we had approximately $29 million of additional available borrowings under our credit facilities. Our substantial indebtedness could have a material adverse effect on our financial condition by, among other things:

- increasing our vulnerability to adverse economic conditions or increases in prevailing interest rates, particularly with respect to any of our borrowings at variable interest rates;

- limiting our ability to obtain any additional financing we may need to operate, develop and expand our business;

- requiring us to dedicate a substantial portion of any cash flow from operations to service our debt, which reduces the funds available for operations and future business opportunities; and

- potentially making us more highly leveraged than our competitors, which could potentially decrease our ability to compete in our industry.

Our ability to make interest payments and pay the principal amounts under our credit facilities will depend upon our future operating performance, which is subject to general economic and competitive conditions, and to financial, business and other factors, many of which we cannot control. If the cash flow from our operating activities is insufficient, we may take actions such as delaying or reducing capital expenditures, attempting to restructure or refinance our debt, selling assets or operations or seeking additional equity capital. In addition, the terms of our credit facilities may limit our ability to take several of these actions. Our failure to undertake any of these actions successfully could have a material adverse effect on our business, results of operations and financial condition.

Additionally, our credit facilities contain a number of affirmative, negative, and financial covenants, which limit our ability to take certain actions and require us to comply with specified financial ratios and other performance covenants. If we are unable to comply with our financial covenants or make required payments in the future, our lenders could pursue their contractual remedies, including requiring the immediate repayment in full of all amounts outstanding, if any. Additionally, we cannot be certain that, if the lenders demanded immediate repayment of any amounts outstanding, we would be able to secure adequate or timely replacement financing on acceptable terms or at all.

Forward-Looking Statements. This Annual Report on Form 10-K, including the information incorporated by reference herein, contains various forward-looking statements and information that are based on our beliefs and assumptions, as well as information currently available to us. From time to time, the Company and its officers, directors or employees may make other oral or written statements (including statements in press releases or other announcements) that contain forward-looking statements and information. Without limiting the generality of the foregoing, the words "believe," "anticipate," "estimate," "expect," "intend," "plan," "seek" and similar expressions, when usec Annual Report on Form 10-K and in such other statements, are intended to identify forward-looking statements, although some statements may use other phrasing. All statements that express expectations and projections with respect to future matters, including, without limitation, statements relating to growth, new lines of business and general optimism about future operating results, are forward-looking statements. All forward-looking statements and information in this Annual Report are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act, as amended, and are intended to be covered by the safe harbors created thereby. Such forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to differ materially from historical results or from any results expressed or implied by such forward-looking statements. Such factors include, without limitation, the risk factors set forth above under Item 1A, "Risk Factors."

These factors are not intended to be an all-encompassing list of risks and uncertainties that may affect the operations, performance, development and results of our business. Many of such factors are beyond the Company's ability to control or predict, and readers are cautioned not to put undue

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reliance on such forward-looking statements. In providing forward-looking statements, the Company expressly disclaims any obligation to update publicly or otherwise these statements, whether as a result of new information, future events or otherwise except to the extent required by law.

Item 1B. Unresolved Staff Comments.
Not applicable.

Item 2. Properties
Our principal executive and administrative offices are located at 1850 Parkway Place, Marietta, Georgia, and total approximately 91,000 square feet. The facility is leased through February 28, 2010.

In 2006, our wellness and disease management businesses had eight locations, with main care centers in Marietta, Georgia and Sunrise, Florida. The eight locations, which include the CorSolutions' locations described herein, total approximately 145,700 square feet and have lease terms expiring on various dates through June 2011. CorSolutions has four locations with its principal offices located in Rosemont, a suburb of Chicago, Illinois, and three call centers in Florida, Pennsylvania and Arizona. These facilities total approximately 77,000 square feet with lease terms expiring on various dates from 2009 to 2015. Our high-risk pregnancy management services are provided through a network of 37 patient service centers. These patient service centers are typically located in suburban office parks and range between 250 and 5,800 square feet of space, with an average of approximately 1,500 square feet. Total square footage for these facilities is approximately 54,000 square feet. These facilities are leased for terms expiring on various dates through 2008. Additionally, we lease approximately 10,400 square feet under a lease expiring September 2011 for this business's customer support center.

These facilities are generally in good condition, and we believe that they are adequate for and suitable to our requirements.

Item 3. Legal Proceedings
Pursuant to the merger agreement under which we acquired CorSolutions, we are pursuing a claim before a contractually-designated settlement accountant for certain post-closing adjustments including a $4 million claim relating to a liability resulting from CorSolutions' pre-closing performance under a customer contract. We are also pursuing a related claim for fraudulent misrepresentation and concealment before the American Arbitration Association in Chicago, Illinois, seeking damages in an unspecified amount exceeding $4 million. There is no assurance that we will prevail in either of these proceedings.

In addition, we are subject to various legal claims and actions incidental to our business and the businesses of our predecessors, including product liability claims and professional liability claims. We maintain insurance, including insurance covering professional and product liability claims, with customary deductible amounts. There can be no assurance, however, that (i) additional suits will not be filed against us in the future, (ii) our prior experience with respect to the disposition of litigation is representative of the results that will occur in pending or future cases or (iii) adequate insurance coverage will be available at acceptable prices for incidents arising or claims made in the future. There are no other pending legal or governmental proceedings to which we are a party that we believe would, if adversely resolved, have a material adverse effect on us.

Item 4. Submission of Matters to a Vote of Security Holders
Not applicable.

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Special Item. Executive Officers of the Company

The following sets forth certain information with respect to the executive officers of the Company:

Name	Age	Position with the Company
Parker H. Petit	67	Chairman of the Board and Chief Executive Officer
Richard M. Hassett, M.D.	51	President and Chief Operating Officer
Yvonne V. Scoggins	57	Senior Vice President - Business Analysis
Roberta L. McCaw	51	Senior Vice President, General Counsel and Secretary
Thornton A. Kuntz, Jr.	53	Senior Vice President and Chief Administrative Officer
Jeffrey L. Hinton	43	Senior Vice President and Chief Financial Officer

The executive officers of the Company are elected annually and serve at the pleasure of the Board of Directors.

Mr. Petit has served as Chairman of the Board of the Company since the formation of the Company through the merger of Healthdyne Maternity Management, a division of Healthdyne, Inc. ("Healthdyne") and Tokos Medical Corporation on March 8, 1996 and as Chief Executive Officer since October 5, 2000, and as President and Chief Executive Officer from October 5, 2000, to February 22, 2003. Mr. Petit was the founder of Healthdyne and served as its Chairman of the Board of Directors and Chief Executive Officer from 1970 until 1996. Mr. Petit is also a director of Intelligent Systems Corporation and Logility, Inc.

Dr. Hassett has been a member of the Board of Directors since May 31, 2006, and has been President and Chief Operating Officer since November 7, 2005. He previously served as Executive Vice President and Chief Strategic Officer of the Company from November 14, 2004 to November 6, 2005. From August 2002 to April 2004, Dr. Hassett was Chief Executive Officer and served on the board of Coordinated Care Solutions, a provider of medical care management services, and from September 2000 to July 2002, he was President and Chief Executive Officer and served on the board of Vivra Asthma & Allergy, Inc., a specialty disease management company. Dr. Hassett previously held executive positions with Accordant Health Services, a healthcare services and technology company from 1997 to August 2000, last serving as Executive Vice President and Chief Medical Officer and as a member of the board.

Ms. Scoggins has served as Senior Vice President - Business Analysis since October 20, 2006, and previously was appointed Senior Vice President - Corporate Finance of the Company from February 22, 2006 to October 20, 2006. She previously served as Vice President - Corporate Finance from July 22, 2004 to February 21, 2006. She was Vice President - Financial Planning and Analysis from February 28, 2001, to July 22, 2004, and previously was Vice President, Treasurer and Chief Accounting Officer of the Company from December 15, 1997, to February 28, 2001, and also Vice President and Controller from March 8, 1996, to December 15, 1997. Prior thereto, she was Vice President and Controller of Healthdyne from May 1995 to March 8, 1996; Vice President - Planning and Analysis of Healthdyne from May 1993 to May 1995; and Vice President and Chief Financial Officer of Home Nutritional Services, Inc., a former majority owned subsidiary of Healthdyne, from February 1990 to April 1993.

Ms. McCaw was appointed Senior Vice President, General Counsel and Secretary of the Company on February 22, 2006. She previously served as Vice President - Legal, General Counsel and Secretary from April 23, 1998 to February 21, 2006. She was Assistant General Counsel and Assistant Secretary of the Company from December 15, 1997 to April 23, 1998, and Assistant General Counsel from July 1996 to December 1997. Prior thereto, Ms. McCaw was a partner at Tyler, Cooper & Alcorn, a Connecticut-based law firm, from January 1990 to July 1996.

Mr. Kuntz was appointed Senior Vice President and Chief Administrative Officer of the Company on February 22, 2006. He previously served as Vice President - Administration from February 24, 1998 to February 21, 2006, and Vice President - Human Resources of the Company from March 8, 1996 to February

24, 1998. Prior thereto, he served as Vice President - Administration of Healthdyne from August 1992 to March 1996.

Mr. Hinton was appointed Senior Vice President and Chief Financial Officer of the Company on March 20, 2006. From 2004 to March 2006, Mr. Hinton was Vice President, Internal Controls of HealthSouth Corporation. He was Strategic Financial Consultant for Synavant, Inc. from 2002 to 2003. Mr. Hinton held Chief Financial Officer positions with various public and private companies, including SURGICOE Corporation from 2000 to 2002, Wise Business Forms, Inc. from 1997 to 2000, and Notify MD from 1996 to 1997.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a) Market Information. Matria's common stock is listed on the Nasdaq Global Select Market ("NASDAQ") under the symbol "MATR."

The following table sets forth, for the calendar quarters indicated, the high and low sales prices of Matria's common stock as quoted on NASDAQ from January 1, 2005, through December 31, 2006, as adjusted to reflect the three-for-two stock split effective February 4, 2005:

Quarter	Low	High
2005		
First	$ 24.31	$ 32.01
Second	25.23	33.00
Third	31.88	39.61
Fourth	30.23	42.16
2006		
First	$ 32.70	$ 45.00
Second	19.77	38.21
Third	21.00	27.98
Fourth	25.10	30.41

(b) Holders. The approximate number of stockholders of the Company as of March 1, 2007, was 1,750 holders of record and approximately 6,900 beneficial holders.

(c) Dividends. Matria has not paid any cash dividends with respect to its common stock and does not intend to declare any dividends in the near future. The Company's credit facilities contain covenants restricting the payment of dividends on and repurchases of the Company's common stock.

(d) Purchases of Equity Securities. During the fourth quarter of 2006, Matria did not repurchase any of its outstanding equity securities.

Item 6. Selected Financial Data

The following table sets forth selected consolidated financial data with respect to the Company's operations. The data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes thereto. The statement of operations data for each of the five years ended December 31, 2006, and the related balance sheet data have been derived from the audited consolidated financial statements (in thousands, except per share data).

	Years Ended December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
Consolidated statements of operations data: (1)					
Revenues from continuing operations	$ 336,139	$ 179,231	$ 145,087	$ 123,196	$ 106,044
Earnings (loss) from continuing operations	18,475	4,014	(20,077) (2)	(8,505)	(26,425) (3)
Earnings (loss) from continuing operations per share:					
Basic	$ 0.88	$ 0.21	($1.29)	($0.56)	($1.89)
Diluted	0.85	0.20	(1.29)	(0.56)	(1.89)

	December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
Consolidated balance sheet data:					
Total assets	$ 711,373	$ 323,207	$ 307,392	$ 333,482	$ 291,407
Long-term debt, excluding current installments	275,938	2,099	85,751	121,005	118,215

(1) Consolidated statements of operations data includes the results from the following acquisitions: CorSolutions Medical, Inc. effective January 1, 2006; WinningHabits, Inc. effective October 1, 2005; Miavita LLC effective April 1, 2005; and Quality Oncology, Inc. effective October 1, 2002.
(2) Other expense for 2004 included a $22,886 charge resulting from the retirement of $120 million in aggregate principal amount of the Company's 11% Senior Notes. See Notes to Consolidated Financial Statements included herein.
(3) In 2002, the Company recorded a charge of $14,247 in connection with the termination and restructuring of its split-dollar life insurance plan.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the consolidated financial statements and related notes and other financial information appearing elsewhere in this Annual Report. The discussion contains forward-looking statements that involve risks and uncertainties. Actual results could differ materially from those anticipated in the forward-looking statements as a result of a variety of factors, including those discussed in "Risk Factors" in this Annual Report. The historical results of operations are not necessarily indicative of future results.

Executive Overview

We are a leading provider of comprehensive, integrated programs and services focused on wellness, disease and condition management, productivity enhancement and informatics. This suite of services, which we call "Health Enhancement," is designed to reduce health related costs and enhance the health and quality of life of the individuals we serve. We are dedicated to developing better educated, motivated and self-enabled healthcare consumers and supporting clinicians in managing the care of their patients. We provide services to self-insured employers, private and government sponsored health plans, pharmaceutical companies and patients. Our employer clients are primarily Fortune 1000 companies that self-insure the medical benefits provided to their employees, dependents and retirees. Our health plan customers are regional and national health plans, as well as government-sponsored health plans, such as state Medicaid programs.

Our on-line, interactive wellness programs address issues such as: smoking cessation, weight loss, exercise, healthier diet, stress relief, healthy aging, and productivity enhancement. These programs are designed to help employees and health plan members live healthier and longer lives while reducing their healthcare costs and increasing their productivity.

Our disease and condition management programs focus on the most costly medical conditions including, without limitation, diabetes, cardiovascular diseases, respiratory disorders, depression, musculoskeletal and chronic pain, hepatitis C, cancer and high-risk pregnancies. We assist individuals to better manage their conditions by increasing their knowledge about their illnesses or conditions, potential complications and the importance of medication and treatment plan compliance. Depending on acuity, our specialized nurses proactively contact participants to monitor their progress and ensure they are following the plan of care set by their physician.

Acquisitions and Dispositions

On January 19, 2006, we completed the acquisition of CorSolutions Medical, Inc. ("CorSolutions"), a disease management, health and wellness and productivity enhancement organization. The results of CorSolutions' operations are included in our results of operations effective January 1, 2006.

On October 1, 2005, we completed the acquisition of WinningHabits, Inc., a premier provider of corporate wellness programs. On April 1, 2005, we completed the acquisition of the business and assets of Miavita LLC, a leading provider of on-line health and wellness programs. Results of operations of these businesses were included in the results of operations from the respective acquisition dates.

During the third and fourth quarters of 2006, we completed the divestitures of Facet Technologies LLC ("Facet") and our foreign diabetes service operations in Germany ("Dia Real"), respectively. We made the strategic decision to divest Facet and Dia Real in the fourth quarter of 2005. In the accompanying consolidated financial statements, their assets and liabilities were reclassified as "Assets held for sale" and "Liabilities related to assets held for sale and other discontinued operations," respectively, on the December 31, 2005, consolidated balance sheet, and their results of operations are included in discontinued operations for all periods presented.

On June 30, 2004, we completed the sale of substantially all of the assets, excluding trade and certain other receivables, of our domestic direct-to-consumer pharmacy and supplies business. As a result of the sale of the domestic pharmacy and supplies business and the discontinuance of the lab business, the accompanying consolidated financial statements reflect the operations of these divisions as discontinued operations in 2004 and 2005.

Financial and Performance Highlights of 2006

For the year ended December 31, 2006, we reported $336.1 million in net revenues, a growth of 87.5% over the year ended December 31, 2005. We also reported $18.5 million of earnings from continuing operations, compared to earnings from continuing operations of $4.0 million for the year ended December 31, 2005. Our diluted earnings per share from continuing operations increased to $0.85 per common share, compared to $0.20 per common share in 2005.

During 2006, we also had the following financial and performance highlights. These accomplishments should be considered in conjunction with our discussion of operating results, liquidity and capital resources.

- Completed the acquisition of CorSolutions, and integrated this business' operations and the operations of Miavita and WinningHabits, capturing significant synergies and operating efficiencies made available through the combination of the companies;

- Completed the divestitures of our non-core businesses, Facet and Dia Real, establishing the Company as a pure play in the wellness and disease management market;

- Accomplished our goal of reducing acquisition indebtedness by $175 million, leaving us with approximately $277 million of acquisition debt remaining at December 31, 2006;

- Refinanced our $65 million Second Lien Credit Facility, producing interest savings in 2006 and beyond; and

- Invested in and formed a strategic alliance with Secured Independence, Inc. to address the needs of the long-term care insurance market for seniors.

Business Strategy

Our goal is to position ourselves as an industry leader in the health enhancement market. We seek to achieve this goal by pursuing the following strategies:

Capitalize on our Position as a Pure Play in the Health Enhancement Market. We believe our extensive experience, scalable, established infrastructure and demonstrated clinical and financial outcomes will provide us a significant competitive advantage as we seek to capitalize on the growing market for health enhancement. Including our predecessor organizations, we have more than 15 years of experience in providing disease management and related services. Our established infrastructure includes our proprietary informatics technology platform, care center operations located throughout the United States and a national network of skilled multi-disciplinary clinicians.

Leverage Our Information Technology. We will continue to make significant investments in our information technology systems in order to better identify participants for intervention and improve treatment plans for these identified participants by reducing variations in care by consistent applications of national criteria and standards of care. We expect to leverage this technology through the expansion of our informatics business.

Further Penetrate All Key Segments of the Growing Health Enhancement Market. We intend to expand our customer base within the employer, health plan, state and federal governments, and pharmaceutical markets. We believe there is a significant opportunity to expand our health enhancement business by cross-selling other products and services to existing customers as they realize the cost savings and superior clinical outcomes that our programs provide.

Results of Operations

The following table summarizes key components in our financial statements for continuing operations expressed as a percentage of revenues.

	Years Ended December 31,		
	2006	**2005**	**2004**
Revenues	100.0%	100.0%	100.0%
Cost of revenues	32.7%	40.7%	44.8%
Gross margin	67.3%	59.3%	55.2%
Selling and administrative expenses	47.3%	52.6%	54.7%
Provision for doubtful accounts	1.2%	1.9%	1.7%
Amortization of intangible assets	2.1%	0.2%	0.0%
Operating earnings (loss)	16.6%	4.5%	-1.1%
Interest expense, net	7.7%	0.9%	6.6%
Other income, net	0.4%	0.1%	0.5%
Loss on retirement of Senior Notes	0.0%	0.0%	15.8%
Earnings (loss) from continuing operations before income taxes	9.3%	3.8%	-23.0%
Income tax expense (benefit)	3.8%	1.5%	-9.2%
Earnings (loss) from continuing operations	5.5%	2.2%	-13.8%

2006 Compared to 2005

Revenues from continuing operations increased by $156.9 million, or 87.5%, to $336.1 million for the year ended December 31, 2006, from $179.2 million in 2005. This increase was due primarily to our acquisitions of CorSolutions effective January 1, 2006, Winning Habits on October 1, 2005, and Miavita on April 1, 2005. Revenues from these acquired businesses contributed $135.9 million, or 86.6%, to the 2006 increase. Also contributing to the revenue growth was the addition of new and expanded accounts that were implemented in 2005 and 2006. Excluding maternity management program revenues, disease and condition management program revenues, including wellness program revenues, increased $151.2 million, or 195.4%, to $228.6 million for the year ended December 31, 2006. Wellness program revenues were $19.4 million for the year ended December 31, 2006, compared to $4.9 million in 2005. Maternity management program revenues increased $5.7 million, or 5.6%, to $107.5 million for the year ended December 31, 2006. This increase was due to an increase in the days of service and an increase in the portion of our maternity management programs generating revenues as a result of electronic identification of potential patients.

Cost of revenues consists primarily of clinical labor and supplies related to the provision of services. Cost of revenues as a percentage of revenues decreased to 32.7% for the year ended December 31, 2006, from 40.7% in 2005. This decrease was primarily due to the growth in the disease management and wellness program revenues and improved margins from these programs resulting from the leveraging impact of higher revenues.

Selling and administrative expenses increased $64.7 million to $159.0 million for the year ended December 31, 2006, compared to $94.3 million in 2005. We incurred increased costs as a result of our 2005 and 2006 acquisitions, primarily for salaries and other personnel-related expenses and increased depreciation and amortization expenses related to our technology investments. Also included in our 2006 expense is approximately $7.0 million of share-based compensation associated with the adoption of Statement of Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 123(R), *Share-Based Payment* ("SFAS 123(R)"). As a percentage of revenues, selling and administrative expenses decreased to 47.3% in 2006, compared to 52.6% in 2005, primarily due to the leveraging impact of higher revenues and the synergies realized from the integration of the CorSolutions acquisition in 2006.

The provision for doubtful accounts as a percentage of revenues was 1.2% in 2006 compared to 1.9% in 2005. The provision, which is recorded primarily for our maternity management program revenues, is adjusted periodically based upon our quarterly evaluation of historical collection experience, recoveries of amounts previously provided, industry reimbursement trends and other relevant factors. The percentage decrease results from an increase in the portion of revenues from our non-maternity management program sources.

We recorded $7.1 million and $365,000 of expense in 2006 and 2005, respectively, from the amortization of intangible assets. The increase in amortization expense resulted primarily from our 2006 acquisition of CorSolutions.

Interest expense, net, increased to $26.0 million in 2006 from $1.6 million in 2005. This increase was primarily the result of the new credit facilities we entered into in January 2006 in conjunction with our acquisition of CorSolutions (discussed below under “Liquidity and Capital Resources - Financing Activities”). In 2006, we allocated $9.8 million of interest expense and amortization expense of deferred financing fees related to the new credit facilities to discontinued operations in accordance with Emerging Issues Task Force (“EITF”) Issue 87-24, *Allocation of Interest to Discontinued Operations*. EITF Issue 87-24 states that interest on debt that must be repaid when the disposal of discontinued operations occurs should be allocated to discontinued operations. In accordance with the terms of the new credit facilities, we used the net proceeds from the sales of Facet in the third quarter of 2006 and Dia Real in the fourth quarter of 2006 to repay a portion of the outstanding indebtedness. The weighted average interest rates, including amortization of debt discount and expense and net gains from interest rate swap transactions, on all outstanding indebtedness were 9.29% and 6.80% for years ended December 31, 2006 and 2005, respectively.

Other income (expense), net, increased to $1.3 million in 2006 from $226,000 in 2005. In 2006, we recorded a $741,000 gain from the settlement of the forward exchange agreement we entered into with a bank to eliminate the potential impact of foreign exchange fluctuations on the U.S. dollar equivalent of the expected euro proceeds from the sale of Dia Real. Under the terms of the agreement, we sold €26.0 million at the forward rate and received approximately $33.4 million on the settlement date. We reported the forward exchange agreement at fair value until settled in October 2006. Other income also includes collections of notes and receivables that were previously written-off, royalties and other miscellaneous items in both periods and favorable currency adjustments on a euro-denominated receivable in 2005.

Income tax expense for the years ended December 31, 2006, reflects a higher effective tax rate than the statutory federal tax rate due to state income taxes and certain non-deductible expenses for tax purposes. Cash outflows for income taxes for continuing and discontinued operations in 2006 and 2005 were $6.7 million and $4.0 million, respectively, comprised of foreign, federal alternative minimum taxes and state income taxes. As of December 31, 2006, our remaining net operating loss carryforwards of $67.0 million, the tax effect of which is reflected on the balance sheet as a deferred tax asset, will be available to offset future taxable income.

On September 1, 2006, we completed the sale of Facet for net cash proceeds of $121.9 million and recorded a gain on the sale of $26.6 million, or $23.9 million, net of income taxes. We wrote-off $76.2 million of goodwill and recorded $541,000 for unamortized share-based compensation expense resulting from the accelerated vesting of options granted to the Facet employees. On October 17, 2006, we completed the sale of Dia Real for net cash proceeds of $33.3 million. The gain on the sale was $9.1 million, or $5.0 million net of income taxes, and included charges of $3.6 million for net goodwill and intangibles and $67,000 for unamortized share-based compensation. The net proceeds from these sales were used to repay a portion of the outstanding indebtedness under our First Lien Credit Facility (see below).

Earnings from discontinued operations include the operations of Facet, Dia Real and our domestic direct to consumer pharmacy and supplies business (sold on June 30, 2004). Earnings from discontinued operations were $5.3 million, net of tax, in 2006 compared to $9.9 million in 2005. Discontinued operations in 2006 include a pre-tax expense of

$9.8 million for the allocation of interest and deferred financing fees to Facet and Dia Real related to the new credit facilities as described above; $1.1 million of this amount was charged to

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the gain on disposal of discontinued operations. In 2005, we recorded a $10 million pre-tax charge for the settlement of the *qui tam* claims related to our pharmacy and supplies business. The purchaser of the pharmacy and supplies business did not assume the liability for these claims. Our earnings from discontinued operations in 2005 also include a $2 million charge for the write-off of the remaining accounts receivable of our pharmacy and supplies business, which we retained after the sale. The collection efforts for these receivables were outsourced to a third party in the first quarter of 2005.

2005 Compared to 2004

Revenues from continuing operations increased by $34.1 million, or 23.5%, to $179.2 million for the year ended December 31, 2005, from $145.1 million in 2004. Disease and condition management program revenues, excluding maternity management program revenues, and wellness program revenues increased $25.0 million, or 47.7%, to $77.4 million for the year ended December 31, 2005. Revenues from disease management and wellness programs increased due to new and expanded accounts implemented in 2004 and 2005. In 2005, we added wellness programs to our health enhancement services through the acquisition of Miavita on April 1, 2005, and Winning Habits on October 1, 2005. Revenue from these wellness programs were $4.9 million for the year ended December 31, 2005. Maternity management program revenues increased $9.1 million, or 9.8%, to $101.8 million for the year ended December 31, 2005. This increase was due to an increase in the days of service, the addition of new programs that are beginning to generate revenue growth, as well as a shift in mix of services offered to therapies with a higher average revenue amount per day.

Cost of revenues as a percentage of revenues decreased to 40.7% for the year ended December 31, 2005, from 44.8% in 2004. This decrease was primarily due to the growth in the disease and condition management and wellness program revenues and improved margins from these programs resulting from the leveraging impact of higher revenues.

Selling and administrative expenses increased $15.0 million to $94.3 million in 2005, compared to $79.3 million in 2004. We incurred increased costs for salaries and other personnel related expenses and increased depreciation and amortization expenses related to our technology investments. As a percentage of revenues, selling and administrative expenses decreased to 52.6% in 2005, compared to 54.7% in 2004. The decrease in this percentage was primarily due to higher revenues in 2005.

The provision for doubtful accounts as a percentage of revenues was 1.9% for the year ended December 31, 2005, compared to 1.7% for the year ended December 31, 2004. The provision is adjusted periodically based upon our quarterly evaluation of historical collection experience, recoveries of amounts previously provided, industry reimbursement trends, audit activity and other relevant factors.

Interest expense, net, decreased by $8.0 million, or 83.5%, in 2005, compared to 2004. This decrease was primarily the result of the retirement of substantially all of the 11% Senior Notes in June 2004 (discussed below under "Liquidity and Capital Resources - Financing Activities") partially offset by interest due to the issuance of the 4.875% convertible senior subordinated notes in May 2004. In May 2005, all of the Company's 4.875% convertible senior subordinated notes were converted into common stock of the Company. The weighted average interest rates, including amortization of debt discount and expense and net gains from terminated interest rate swap transactions, on all outstanding indebtedness were 6.80% and 8.62% for the years ended December 31, 2005 and 2004, respectively.

Other income, net, included income of $226,000 for 2005, compared to $681,000 for 2004. Other income includes collections of notes and receivables that were previously written-off, royalties and other miscellaneous items and favorable currency adjustments on a euro-denominated receivable in 2005.

On March 29, 2004, we commenced a tender offer for all of our unsecured 11% Senior Notes, which had an aggregate principal amount of $122 million. We received valid tenders from holders of $120 million in aggregate principal amount of the 11% Senior Notes. On June 30, 2004, we completed the repurchase of the 11% Senior Notes tendered in the tender offer with proceeds from the issuance of our 4.875% convertible senior subordinated notes and with the proceeds from the sale of assets of the pharmacy and supplies business. The repurchase of substantially all of the 11% Senior Notes resulted in a loss of $22.9 million, or $14.1 million, net of taxes.

Income tax expense for the year ended December 31, 2005, reflected a higher effective tax rate than the statutory federal tax rate due to state and foreign income taxes and certain non-deductible expenses for tax purposes. Cash outflows for income taxes in 2005 and 2004, were $4.0 million and $7.7 million, respectively, comprised of foreign, federal alternative minimum taxes and state income taxes.

Earnings from discontinued operations of $9.9 million, net of tax, in 2005 includes a $10 million pre-tax charge for the settlement of the *qui tam* claims and a $2 million pre-tax charge for the write-off of the remaining accounts receivable of the pharmacy and supplies business described above. In 2004, we recorded a gain on the sale of the pharmacy and supplies business of $30.9 million, net of income taxes of $20.9 million. Goodwill of $16.3 million was charged against the gain. Also in connection with the sale, in 2004 we increased the allowance for doubtful accounts for the retained receivables by $11.9 million to provide for the estimated effects of the sale of the business and 2005 outsourcing of the collection effort to a third party could have on collections.

Liquidity and Capital Resources

Operating Activities

As of December 31, 2006, we had cash and cash equivalents of $19.8 million. Net cash provided by (used in) continuing operations was $27.4 million in 2006 compared to $5.0 million in 2005 and $(3.6) million in 2004. This increase in cash from operations was due primarily to an increase in earnings from continuing operations and increases in non-cash charges for depreciation and amortization, deferred income taxes and share-based compensation. The increase in 2006 was partially offset by decreases in accounts payable and in accrued and other liabilities relating primarily to the payment of transaction-related expenses incurred in the CorSolutions acquisition.

Cash flows from discontinued operations were $(3.1) million, $20.0 million and $13.7 million for the years ended December 31, 2006, 2005 and 2004, respectively. In 2006, cash flows used in discontinued operations included a $10.0 million settlement payment, net of $150,000 insurance reimbursement, for the two *qui tam* actions filed against the Company and its former subsidiary, Diabetes Self Care, Inc. This charge was included in earnings from discontinued operations for the year ended December 31, 2005. The 2006 period also reflects the allocation of $9.8 million in interest expense (before taxes) discussed above.

Our accounts receivable days' sales outstanding, or DSO, were 54 days and 63 days at December 31, 2006 and 2005, respectively. The decrease is due to a lower DSO from our disease management and wellness businesses.

Investing Activities

Net cash provided by (used in) investing activities totaled $(299.4) million in 2006, $(28.9) million in 2005, and $67.8 million in 2004. The increase in net cash used in investing activities is driven primarily by our acquisition and divestiture activities. The results of operations of our acquired businesses have been included in our consolidated statements of operations since their respective acquisition dates.

On January 19, 2006, we completed the acquisition of CorSolutions for a cash payment of $434.7 million, net of cash acquired. Also in 2006, we successfully completed the divestitures of Facet on September 1, 2006, for cash proceeds of $119.8 million, net of transaction costs, and Dia Real on October 19, 2006, for cash proceeds of $30.5 million, net of transaction costs.

In 2005, cash used in investing activities included $19.7 million for the acquisition of two businesses. On April 1, 2005, we acquired the business and assets of Miavita for a net cash payment of $4.8 million, with additional amounts to be paid in 2006 and 2007 under an earn-out agreement. In May 2006, we paid $1.7 million of additional consideration for the first earn-out period of this acquisition as a result of certain operating milestones being achieved. The payment was recorded as additional goodwill. On October 1, 2005, we acquired the business of WinningHabits for a net cash payment of $14.9 million, with additional amounts to be paid in 2007 under an earn-out agreement. As of December 31, 2006, the estimated additional earn-out consideration to be paid under these agreements was approximately $54.2 million.

Continuing operations' capital expenditures of $13.1 million in 2006, $11.1 million in 2005, and $8.6 million in 2004 relate primarily to the replacement and enhancement of computer information systems and to the replacement of medical devices used in our maternity management programs. Discontinued operations' capital expenditures of $379,000 in 2006, $1.5 million in 2005, and $1.6 million in 2004 relate primarily to purchases of machinery and equipment and computer information systems.

On June 30, 2004, we completed the sale of substantially all of the assets, excluding trade and certain other receivables, of our direct-to-consumer pharmacy and supplies business. At the closing, we received cash proceeds, net of transaction costs, of approximately $101.1 million. We used approximately $20.5 million of the proceeds received from the sale to satisfy the earn-out payment owed to the sellers of Quality Oncology and approximately $53 million to complete the funding of our tender offer for our 11% Senior Notes.

Restricted cash increased to $1.4 million in 2006 from $550,000 in 2005. We have restricted funds for amounts held in escrow related to customer contracts and as collateral for insurance policies. Generally, such funds are held in interest-bearing investment accounts or certificates of deposit.

Financing Activities

Net cash provided by (used in) financing activities was $271.7 million, $(8.2) million and $(49.1) million for 2006, 2005 and 2004, respectively.

On January 19, 2006, we funded the acquisition of CorSolutions with the proceeds from term loans and revolving credit loans pursuant to a credit agreement and a second lien term loan facility with Bank of America, N.A., as administrative and collateral agent (the "New Credit Facilities"). The New Credit Facilities, as amended, provide for borrowings of up to an aggregate of $485 million and were divided between a First Lien Credit Facility and a Second Lien Credit Facility. The New Credit Facilities replaced our previous revolving credit facility, which was terminated on January 13, 2006. There were no amounts outstanding under the revolving credit facility at the time of termination.

At December 31, 2006, the New Credit Facilities consisted of the following:

Loan		**Outstanding Balance at December 31, 2006**	**Interest**	**Variable Interest Rate at December 31, 2006**	**Maturity Date**
First Lien Credit Facility					
Term Loan B Facility	$	277.2 million	LIBOR plus 2.00%	7.36% to 7.37%	January 19, 2012
Term Loan C Facility (a)	$	--	-	-	January 19, 2007
Revolving Credit Facility	$	--	-	-	January 19, 2011

Second Lien Credit Facility

Term Loan Facility (b)	$	--	LIBOR plus 6.75%	-	January 19, 2012

(a) We used the net proceeds from the sales of Facet and Dia Real and operating cash flows to prepay the outstanding indebtedness under the Term Loan C Facility.
(b) On November 6, 2006, we amended the terms of the New Credit Facilities and prepaid the Second Lien Credit Facility with proceeds from the First Lien Credit Facility.

Amounts borrowed under the Term Loan B Facility and the Term Loan C Facility accrue interest at a variable spread over LIBOR, with the applicable spread determined by the Company's consolidated leverage ratio, as described in the applicable credit agreement. Interest rates for these facilities, as well as for the Term Loan Facility, are reset quarterly. Amounts borrowed under the New Credit Facilities are fully and unconditionally guaranteed on a joint and several basis by substantially all of our subsidiaries. Amounts borrowed under the First Lien Credit Facility are secured by a first priority lien on substantially all of our assets and the assets of our subsidiary guarantors.

The New Credit Facilities also provide for a Revolving Credit Facility. Amounts borrowed under the Revolving Credit Facility accrue interest at a variable spread over LIBOR or the prime rate, at our option, with the applicable spread determined by reference to our consolidated leverage ratio, as described in the credit agreement. At December 31, 2006, there were no amounts outstanding under the Revolving Credit Facility, and the available balance was $28.5 million.

In November 2006, we amended the terms of the New Credit Facilities. Under the amended agreement, the First Lien Credit Facility was increased by $65.0 million, the proceeds of which were used to prepay the Second Lien Credit Facility. Borrowings under the First Lien Credit Facility bore interest at LIBOR plus 2.00%, a 475 basis point reduction from the Second Lien Credit Facility. All the other terms and conditions of the Credit Agreement (other than those relating to the increased amount of the First Lien Credit Facility and those that are no longer applicable because they relate solely to the Second Lien Credit Facility) remain unchanged. We incurred fees and expenses of approximately $1.7 million, which were recorded as deferred financing costs and are being amortized over the term of the First Lien Credit Facility (January 2012). On February 23, 2007, we entered into a third amendment to the New Credit Facilities, the terms of which increased our borrowing capacity under the Revolving Credit Facility from $30.0 million to $50.0 million. All other terms of the New Credit Facilities, as amended, remain unchanged.

The New Credit Facilities contain, among other things, various representations, warranties and affirmative, negative and financial covenants customary for financings of this type. The negative covenants include, without limitation, certain limitations on transactions with affiliates, liens, making investments, the incurrence of debt, sales of assets, and changes in business. The financial covenants contained in the New Credit Facilities include a consolidated leverage ratio and a consolidated fixed charges coverage ratio. At December 31, 2006, we were in compliance with all covenants of the New Credit Facilities.

During the third and fourth quarters of 2006, we made prepayments of $175.0 million toward the reduction of the First Lien Credit Facility. Of this amount, $115.0 million and $30.0 million were paid from proceeds from the Facet and Dia Real divestitures, respectively, and $30.0 million was paid from our operating cash flows. As of December 31, 2006, the outstanding balance under the New Credit Facilities was $277.2 million.

In February and May 2006, we entered into two interest rate swap agreements totaling $200 million notional amount to hedge our exposure to fluctuations in interest rates related to the New Credit Facilities. The swap agreements had the economic effect of converting $200 million of our floating rate debt under the New Credit Facilities to fixed rate debt. Under the terms of the agreements, we will pay the bank fixed base rates of 5.065% and 5.350%, respectively, and the bank will pay us floating rates based on three-month LIBOR (5.371% and 5.364%, respectively, at December 31, 2006). We reflected the interest rate swap agreements on the consolidated balance sheet at a fair value of $62,000 at December 31, 2006, which was based upon the estimated amount we would pay upon settlement of the agreements, taking into account interest rates at December 31, 2006. For the year ended December 31, 2006, we recognized a net gain of $79,000 from the cash flow hedges, which is included in "Interest expense" in the consolidated statements of operations.

In September 2006, we entered into a forward exchange agreement with a bank to eliminate the potential impact of foreign exchange fluctuations on the U.S. dollar equivalent of the expected euro proceeds from the sale of Dia Real. Under the terms of the agreement, we agreed to sell €26.0 million at the forward rate (1.2837) and receive approximately $33.4 million on the settlement date. We reported the forward exchange agreement at fair value on our consolidated balance sheet until it was settled in October 2006.

In 2004, we completed the sale of $86.3 million in aggregate principal amount of 4.875% convertible senior subordinated notes due 2024. We received proceeds, net of discount, of $83.2 million from the issuance of the convertible senior subordinated notes. We used the proceeds and proceeds from the sale of substantially all of the assets of our direct-to-consumer pharmacy and supplies business to fund the repurchase of $120 million in aggregate principal amount of 11% Senior Notes, which had an aggregate principal amount of $122 million, tendered in a tender offer. This repurchase resulted in a net cash payment of $136.5 million. In June 2004, we recorded a charge of $22.9 million, or $14.1 million, net of taxes, related to the repurchase of substantially all of the 11% Senior Notes.

On April 27, 2005, we issued a notice of our intention to redeem our $86.3 million in aggregate principal amount of 4.875% convertible senior subordinated notes on May 27, 2005. In response to the redemption notice, all noteholders converted their notes into shares of the Company's common stock prior to the redemption date, and the Company issued approximately 4.4 million shares of common stock ($19.61 per share). In addition, the redemption also required us to make a "make-whole payment" equal to the present value, as of the redemption date, of all remaining scheduled interest payments on the notes through May 1, 2009. We paid the noteholders the "make-whole payment" totaling $15.5 million ($3.52 per share), which included $294,000 of accrued but unpaid interest. The "make-whole payment," excluding the accrued but unpaid interest, was accounted for in accordance with SFAS No. 84, *Induced Conversion of Convertible Debt*. Since the conversion was pursuant to the original conversion terms and no inducement was made to the noteholders, no loss was recognized with respect to the "make-whole payment," excluding the accrued but unpaid interest, or the shares issued.

Proceeds received from participants under our stock purchase and stock option plans totaled $6.0 million, $7.3 million, and $6.6 million in 2006, 2005 and 2004, respectively.

We believe that our cash, other liquid assets, operating cash flows and New Credit Facilities, taken together, will provide adequate resources to fund ongoing operating requirements, planned capital expenditures and contractual obligations through the remainder of 2007.

Contractual Obligations, Commitments and Off-Balance Sheet Arrangements

We have various contractual obligations that are appropriately recorded as liabilities in our consolidated financial statements. Certain other items, such as operating lease obligations, are not recognized as liabilities in our consolidated financial statements but are required to be disclosed. The following sets forth our future minimum payments required under contractual obligations as of December 31, 2006 (in thousands):

	Payments Due by Year				
	Total	**2007**	**2008-2009**	**2010-2011**	**Thereafter**
Long-term debt obligations (1)	$ 279,957	$ 4,069	$ 8,600	$ 238,791	$ 28,497
Capital lease obligations	144	127	17	-	-
Operating lease obligations	31,450	8,539	14,427	5,011	3,473
Other long-term obligations	6,981	3,343	2,606	1,032	-
Acquisition obligations (2)	54,223	54,223	-	-	-
	$ 372,755	$ 70,301	$ 25,650	$ 244,834	$ 31,970

(1) Does not include the interest expense associated with the long-term debt obligations.
(2) Discussed above under "Liquidity and Capital Resources - Investing Activities" and below under "Other Factors Affecting Liquidity."

Principal and interest payments of $3.3 million and $21.9 million, respectively, under the New Credit Facilities are payable in 2007. Capital expenditures of approximately $19 million are estimated in 2007 as we continue to enhance our computer information systems.

We have restricted funds of $1.4 million as of December 31, 2006, which represent amounts held in escrow related to customer contracts. Funds are held in interest-bearing investment accounts.

As of December 31, 2006, we did not have any significant off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K, except for our indemnification obligations related to potential breaches of the representations and warranties contained in the definitive agreements to sell Facet and Dia Real, which obligations are capped at $12.5 million and $9.9 million, respectively.

Other Factors Affecting Liquidity

In connection with our acquisitions of WinningHabits and Miavita, we are required to pay additional consideration in future periods, based upon the attainment of defined operating objectives of these businesses. In accordance with SFAS No. 141, *Business Combinations*, we accrue contingent consideration obligations upon attainment of the objectives. Additionally, any such payments result in increases in goodwill.

We currently estimate that the additional consideration pursuant to the terms of our earn-out agreement for the WinningHabits acquisition is $32.2 million. The estimated additional consideration, which is included in “Acquisition contingent consideration” on the consolidated balance sheet, is based on the attainment of the operating objectives for the year ended December 31, 2006, and is subject to final audit. The final amount for WinningHabits will be payable in 2007.

Also included in “Acquisition contingent consideration" is $22.0 million of earn-out consideration for the second earn-out period ending March 31, 2007, for the Miavita acquisition. On November 6, 2006, we entered into a Settlement Agreement and Release with the seller that effectively amends the terms of the original acquisition agreement to fix the amount payable for the second earn-out period at $20 million plus 3.575 times net revenues from certain new customers between November 6, 2006, and March 31, 2007, provided that no payment is payable in respect of the second earn-out period unless payments received from such new customers between November 6, 2006, and May 1, 2007, are at least $500,000.

Goodwill was increased by $55.9 million at December 31, 2006, for the consideration paid during 2006 and the estimated additional consideration payable under the earn-out agreements described above.

Uncertainties

Pursuant to the merger agreement under which we acquired CorSolutions, we are pursuing a claim before a contractually-designated settlement accountant for certain post-closing adjustments including a $4 million claim relating to a liability resulting from CorSolutions’ pre-closing performance under a customer contract. We are also pursuing a related claim for fraudulent misrepresentation and concealment before the American Arbitration Association in Chicago, Illinois, seeking damages in an unspecified amount exceeding $4 million. There is no assurance that we will prevail in either of these proceedings.

We are subject to various legal claims and actions incidental to our business and the businesses of our predecessors, including product liability claims and professional liability claims. We maintain insurance, including insurance covering professional and product liability claims, with customary deductible amounts. There can be no assurance, however, that (i) lawsuits will not be filed against us in the future, (ii) our prior experience with respect to the disposition of litigation is representative of the results that will occur in pending or future cases or (iii) adequate insurance coverage will be available at acceptable prices, if at all, for incidents arising or claims made in the future. There are no pending legal or governmental proceedings to which we are a party that we believe would, if adversely resolved, have a material adverse effect on us. For a discussion of other risks and uncertainties that may affect our business, see “Risk Factors” in Item 1A of this Annual Report on Form 10-K.

Critical Accounting Policies and Estimates

Critical accounting policies are those policies that require management to make the most challenging, subjective or complex judgments, often because they must estimate the effect of matters that are inherently uncertain and may change in subsequent periods. Critical accounting policies involve judgments and uncertainties that are sufficiently sensitive to result in materially different results under different assumptions and conditions. We believe our most critical accounting policies are described below.

Revenue Recognition and Allowances for Uncollectible Accounts. Our services are provided telephonically and, in some cases, in a patient's home from care centers located throughout the United States. In addition, our services are provided through access to our online health and wellness based tools. Revenues are recognized as the related services are rendered and are net of contractual allowances and related discounts.

Our services are paid for primarily on the basis of (i) monthly fees for each employee or member enrolled in a health plan, (ii) each member identified with a particular chronic disease or condition under contract, (iii) each member enrolled in our programs, (iv) fee-for-service, or (v) a fixed rate per case. Billings for certain services occur in advance of services being performed. Such amounts are recorded as "Unearned revenues" in the consolidated balance sheets. Such amounts are subsequently recognized as revenue as services are performed.

Some contracts provide that a portion of our fees are at-risk (i.e., refundable) if our programs do not achieve certain financial cost savings and clinical performance criteria. Revenues subject to refund are not recognized if (i) sufficient information is not available to calculate performance measurements, or (ii) interim performance measurements indicate that we are not meeting performance targets. If either of these two conditions exists, we record the amounts as "Unearned revenues" in the consolidated balance sheets. If we do not meet performance levels by the end of the operations period under the contract, we are contractually obligated to refund some or all of the at-risk fees.

In 2006, revenues from continuing operations were derived from the following types of customers and third-party payors: approximately 57% from health plans, 34% from employers, 7% from government payors and 2% from administrative services only ("ASO") self-insured employer clients.

A significant portion of our revenues is billed to third-party reimbursement sources. Therefore, the collectibility of all of our accounts receivable varies based on payor mix, general economic conditions and other factors. A provision for doubtful accounts is made for revenues estimated to be uncollectible and is adjusted periodically based upon our evaluation of current industry conditions, historical collection experience, recoveries of amounts previously provided, industry reimbursement trends and other relevant factors which, in the opinion of management, deserve recognition in estimating the allowance for uncollectible accounts. The evaluation is performed at each reporting period for each operating unit with an overall assessment at the consolidated level. While estimates and judgments are involved and factors impacting collectibility may change, management believes adequate provision has been made for any adjustments that may result from final determination of amounts to be collected.

Goodwill and Identifiable Intangible Assets. Goodwill represents the excess of cost over fair value of identifiable net assets acquired. Goodwill arising from business combinations is accounted for under the provision of SFAS No. 141, *Business Combinations*, and SFAS No. 142, *Goodwill and Other Intangible Assets*, and is not amortized. Our identifiable intangible assets are amortized over their respective estimated useful lives. As of December 31, 2006, we reported goodwill and identifiable intangible assets at net carrying amounts of $500.8 million and $55.9 million, respectively. The total of $556.7 million represents approximately 78% of our total assets as of December 31, 2006.

We review goodwill and identifiable intangibles for impairment annually as of December 31 and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. In testing

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for impairment, we compare the book value of net assets to the fair value of the related reporting units that have goodwill and indefinite life intangibles assigned to them. If the fair value is determined to be less than book value, a second step is performed to compute the amount of impairment. We estimate the fair values of the reporting units based upon earnings multiples for similar precedent transactions as well as the present value of estimated future free cash flows. The approach utilized is dependent on a number of factors, including estimates of future revenues and operating costs, appropriate discount rates and other variables. We base our estimates on assumptions that we believe to be reasonable, but which are unpredictable and inherently uncertain. Therefore, future impairments could result if actual results differ from those estimates. Based on our evaluation, we concluded that no impairment of recorded goodwill and intangibles existed at December 31, 2006.

Accounting for Income Taxes. We account for income taxes using an asset and liability approach. Deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities and net operating loss and tax credit carryforwards. Additionally, the effect on deferred taxes of a change in tax rates is recognized in earnings in the period that includes the enactment date.

The income tax expense (benefit) for continuing operations was $12.8 million, $2.7 million, and $(13.3) million for the years ended December 31, 2006, 2005 and 2004, respectively. Reflected in each year were various non-deductible permanent differences between tax and financial reporting. As of December 31, 2006, our remaining net operating loss carryforwards of $67.0 million, the tax effect of which is reflected as an asset on the balance sheet in the "Deferred income taxes," will be available to offset future taxable income liabilities. Based on projections of taxable income in 2007 and future years, we believe that it is more likely than not that we will fully realize the value of the recorded deferred income tax assets. The amount of the deferred tax asset considered realizable, however, could be reduced if estimates of future taxable income during the carryforward period are reduced.

Share-Based Compensation. On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* ("SFAS 123(R)"). SFAS 123(R) establishes standards for the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for either equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. SFAS 123(R) eliminates the ability to account for share-based compensation transactions, as we formerly did, using the intrinsic value method as prescribed by Accounting Principles Board, ("APB"), Opinion No. 25, *Accounting for Stock Issued to Employees*, and generally requires that such transactions be accounted for using a fair-value-based method. Changes in assumptions as to the employee forfeitures assumptions, exercise dates and volatility could have a significant impact on the stock compensation fair value determinations.

The above listing is not intended to be a comprehensive list of all of our accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by generally accepted accounting principles, with no need for management's judgment in their application. There are also areas in which management's judgment in selecting any available alternative would not produce a materially different result. See the Notes to Consolidated Financial Statements in this Annual Report on Form 10-K, which contain additional accounting policies and other disclosures required by generally accepted accounting principles.

Our senior management has discussed the development and selection of our critical accounting estimates, and this disclosure, with the Audit Committee of our Board of Directors.

Recently Issued and Recently Adopted Accounting Standards

Accounting for Uncertainty in Income Taxes. In June 2006, the FASB published Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (“FIN 48”). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The effective date of this interpretation is January 1, 2007, the first fiscal year beginning after December 15, 2006. We are currently evaluating the provisions of FIN 48 to determine its impact, if any, on our financial statements but presently anticipate that its adoption will not have a material impact on our results of operations and financial position.

Fair Value Measurements. In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"), which defines fair value, establishes framework for measuring fair value in GAAP and expands disclosures about fair value measurements. SFAS 157 will be effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently evaluating the requirements of this new standard and have not concluded our analysis on the impact, if any, on our results of operations and financial position.

Prior Year Misstatements. In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ("SAB No. 108"). SAB No. 108 addresses quantifying the financial statement effects of misstatements, specifically, how the effects of prior year uncorrected errors must be considered in quantifying misstatements in current year financials. Under the provisions of SAB No. 108, a reporting entity must quantify and evaluate errors using a balance sheet approach and an income statement approach. After considering all relevant quantitative and qualitative factors, if either approach results in a misstatement that is material, a reporting entity's financial statements must be adjusted. SAB No. 108 is effective for fiscal years ending after November 15, 2006.

We adopted the provisions of SAB No. 108 in the fourth quarter of 2006 and recorded a cumulative effect adjustment of $813,000, net of income taxes of $518,000, to our January 1, 2006 consolidated balance sheet. We identified two uncorrected misstatements for consideration under SAB 108, each of which was considered immaterial to our results of operations in any reporting period when using only the income statement approach we historically used to assess the materiality of unrecorded errors:

1. An unrecorded liability for drugs and supplies from a major vendor, which is included in "Accounts payable" on the consolidated balance sheets, resulted from an accumulation of unrecorded costs over several periods prior to 2003. This misstatement was identified in 2003 The amount required at January 1, 2006, to correct the liability balance would result in a $600,000 charge to our results of operations in 2006.

2. During 2006, we discovered that our medical device inventory, which is included in "Property and equipment" on the consolidated balance sheets, was overstated due to improper recording of disposed and lost medical devices and the related depreciation expense. The misstatement originated in 2003 and accumulated over subsequent periods. The amount required to correct the medical device inventory balance at January 1, 2006, would result in a $731,000 charge to our results of operations in 2006.

Under the balance sheet approach and the income statement approach, or the dual approach, we determined that correcting the above misstatements would be material to our 2006 financial statements and recorded a cumulative effect adjustment to our January 1, 2006, consolidated balance sheet upon our initial application of SAB 108.

Item 7A. Quantitative and Qualitative Disclosure about Market Risk

We are exposed to market risk from changes in interest rates on long-term debt.

Our primary interest rate risk relates to the New Credit Facilities and our interest rate swap facilities. In February 2006 and May 2006, we entered into interest rate swap agreements with notional amounts totaling $200 million with a bank under which we will pay the bank fixed base rates of interest of 5.065% and 5.350%, respectively, and the bank will pay us floating rates based on three-month LIBOR (5.371% and 5.364%, respectively, at December 31, 2006). The agreements, which have a two-year term, have the economic effect of converting a portion of our floating rate debt to fixed rate debt. Based upon the total amount outstanding at December 31, 2006, not covered by interest rate swaps, a hypothetical two percentage point increase in the interest rates for a duration of one year would result in additional interest expense of approximately $2 million.

Item 8. Financial Statements and Supplementary Data

Our consolidated financial statements are included as pages F-1 through F-30 of this Annual Report on Form 10-K:

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of December 31, 2006. No process, no matter how well designed and operated, can provide absolute assurance that the objectives of the process are met in all cases. However, our disclosure controls and procedures are designed to provide reasonable assurance that the certifying officers will be alerted on a timely basis to material information relating to the Company (including the Company's consolidated subsidiaries) required to be included in our reports filed or submitted under the Exchange Act.

Based on such evaluation, such officers have concluded that our disclosure controls and procedures were effective as of December 31, 2006, to provide reasonable assurance that the objectives of the disclosure controls and procedures were met.

Management's Report on Internal Control Over Financial Reporting and Report of Independent Registered Public Accounting Firm

"Report of Independent Registered Public Accounting Firm" on management's assessment of internal controls and "Management's Report on Internal Control Over Financial Reporting" are included on pages F-2 and F-3 of this Annual Report on Form 10-K.

Changes in Internal Control over Financial Reporting

On January 19, 2006, the Company completed the acquisition of CorSolutions Medical, Inc. The Company is now in the process of integrating the CorSolutions operations. The Company has extended its Section 404 compliance program under the Sarbanes-Oxley Act of 2002 and the applicable rules and regulations under such Act to include CorSolutions. See Note 2 to the Notes to Consolidated Financial Statements included on page F-8 of this Annual Report on Form 10-K for a discussion of the acquisition and related financial data.

Except for the CorSolutions acquisition, Messrs. Petit and Hinton have concluded that there have been no significant changes in the Company's internal control over financial reporting during the period ended December 31, 2006, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers of the Registrant and Corporate Governance.

Except as set forth below, information required by this item will be included under the captions "Election of Directors," "Corporate Governance and Nominating Committee," "Board Committees, Attendance and Communications with Board of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's Proxy Statement for the 2007 Annual Meeting of Stockholders to be held on June 5, 2007, to be filed with the Commission and incorporated by reference herein. Additional information relating to the executive officers of the Company is included as a Special Item in Part I of this Annual Report on Form 10-K.

Information relating to the Company's Corporate Governance Guidelines and Code of Conduct is included under the caption "Available Information" in Part I, Item 1 of this Annual Report on Form 10-K.

Item 11. Executive Compensation.

Information required by this item will be contained under the captions "Compensation Committee Interlocks and Insider Participation," "Executive Compensation" and "Compensation Committee Report" in the Company's Proxy Statement for the 2007 Annual Meeting of Stockholders to be held on June 5, 2007, to be filed with the Commission and incorporated by reference herein.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Except as set forth below, information required by this item will be contained under the caption "Security Ownership of Certain Beneficial Owners and Management" in the Company's Proxy Statement for the 2007 Annual Meeting of Stockholders to be held on June 5, 2007, to be filed with the Commission and incorporated by reference herein.

For purposes of determining the aggregate market value of the Company's c