APRIA HEALTHCARE GROUP INC
Form 10-Q
May 01, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2012

or

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

For the transition period from to .

Commission file number 333-168159

APRIA HEALTHCARE GROUP INC.

(Exact name of Registrant as specified in its charter)

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

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

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

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

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

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

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

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

As of May 1, 2012, there were 100 shares of the issuer s common stock, par value $0.01 per share, issued and outstanding.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

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

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

As used in this report, unless otherwise noted or the context otherwise requires, references to Company, we, us, and our are to Apria Healthcare Group Inc., a Delaware corporation, and its subsidiaries; references to Apria and the Issuer are to Apria Healthcare Group Inc., exclusive of its subsidiaries; references to Merger Sub are to Sky Merger Sub Corporation, a Delaware corporation; references to Holdings are to Apria Holdings LLC, a Delaware limited liability company, exclusive of its subsidiaries; references to Sky LLC are to Sky Acquisition LLC , a Delaware limited liability company, exclusive of its subsidiaries; references to Blackstone and the Sponsor are to Blackstone Capital Partners V L.P.; references to the Investor Group are, collectively, to Blackstone and certain funds affiliated with Blackstone, Dr. Norman C. Payson and certain other members of our management; and references to home medical equipment, durable medical equipment and DME are used synonymously. On October 28, 2008, the Company was acquired by private investment funds affiliated with the Sponsor via a merger of the Merger Sub with and into Apria (the Merger), with Apria being the surviving corporation following the Merger. As a result of the Merger, the Investment Group beneficially owns all of Apria s issued and outstanding common stock. The term Successor refers to the Company following the Merger and the term Predecessor refers to the Company prior to the Merger.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

APRIA HEALTHCARE GROUP INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	March 31, 2012	December 31, 2011
	(in thousands, except share data)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 23,514	$ 29,096
Accounts receivable, less allowance for doubtful accounts of $50,858 and $53,934 at March 31, 2012 and December 31, 2011, respectively	362,479	337,212
Inventories	64,027	57,683
Deferred income taxes		168
Deferred expenses	3,430	3,681
Prepaid expenses and other current assets	25,165	23,927
TOTAL CURRENT ASSETS	478,615	451,767
PATIENT SERVICE EQUIPMENT, less accumulated depreciation of $173,323 and $176,526 at March 31, 2012 and December 31, 2011, respectively	174,503	166,769
PROPERTY, EQUIPMENT AND IMPROVEMENTS, NET	82,303	83,768
GOODWILL	258,725	258,725
INTANGIBLE ASSETS, NET	484,830	485,366
DEFERRED DEBT ISSUANCE COSTS, NET	41,185	44,636
OTHER ASSETS	10,332	8,997
TOTAL ASSETS	$ 1,530,493	$ 1,500,028
LIABILITIES AND STOCKHOLDERS DEFICIT		
CURRENT LIABILITIES		
Accounts payable	$ 146,466	$ 135,572
Accrued payroll and related taxes and benefits	71,679	69,217
Deferred income taxes	661	
Other accrued liabilities	93,685	67,114
Deferred revenue	27,336	28,649
Current portion of long-term debt	20,289	10,301
TOTAL CURRENT LIABILITIES	360,116	310,853
LONG-TERM DEBT, net of current portion	1,017,681	1,017,755
DEFERRED INCOME TAXES	199,534	200,225
INCOME TAXES PAYABLE AND OTHER NON-CURRENT LIABILITIES	51,630	50,795
TOTAL LIABILITIES	1,628,961	1,579,628
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS DEFICIT		
Common stock, $0.01 par value: 1,000 shares authorized; 100 shares issued at March 31, 2012 and December 31, 2011		
Additional paid-in capital	691,609	690,870

Accumulated deficit	(790,077)	(770,470)
TOTAL STOCKHOLDERS DEFICIT	(98,468)	(79,600)
	$ 1,530,493	$ 1,500,028

See notes to unaudited condensed consolidated financial statements.

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APRIA HEALTHCARE GROUP INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended March 31, 2012	2011
	(in thousands)	
Net revenues:		
Fee for service arrangements	$ 551,616	$ 495,684
Capitation	44,097	41,059
TOTAL NET REVENUES	595,713	536,743
Costs and expenses:		
Cost of net revenues:		
Product and supply costs	207,412	177,440
Patient service equipment depreciation	20,696	21,805
Home respiratory therapy services	7,289	5,973
Nursing services	11,223	9,931
Other	5,046	2,727
TOTAL COST OF NET REVENUES	251,666	217,876
Provision for doubtful accounts	11,858	20,264
Selling, distribution and administrative	317,422	296,628
Amortization of intangible assets	661	1,077
TOTAL COSTS AND EXPENSES	581,607	535,845
OPERATING INCOME	14,106	898
Interest expense	33,517	32,904
Interest income and other	(702)	(251)
LOSS BEFORE TAXES	(18,709)	(31,755)
Income tax expense (benefit)	898	(10,731)
NET LOSS	$ (19,607)	$ (21,024)

See notes to unaudited condensed consolidated financial statements.

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APRIA HEALTHCARE GROUP INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
	(in thousands)	
OPERATING ACTIVITIES		
Net loss	$ (19,607)	$ (21,024)
Items included in net loss not requiring cash:		
Provision for doubtful accounts	11,858	20,264
Depreciation	28,705	31,121
Amortization of intangible assets	661	1,077
Amortization of deferred debt issuance costs	3,451	2,909
Deferred income taxes	137	(11,801)
Profit interest compensation	739	828
Loss on disposition of assets and other	5,597	3,624
Changes in operating assets and liabilities, exclusive of effects of acquisitions:		
Accounts receivable	(37,125)	(42,047)
Inventories	(6,344)	4,864
Prepaid expenses and other assets	(2,575)	(4,362)
Accounts payable, exclusive of book-cash overdraft	15,062	6,482
Accrued payroll and related taxes and benefits	2,462	4,742
Income taxes payable	260	274
Deferred revenue, net of related expenses	(1,062)	3,130
Accrued expenses	27,149	34,086
NET CASH PROVIDED BY OPERATING ACTIVITIES	29,368	34,167
INVESTING ACTIVITIES		
Purchases of patient service equipment and property, equipment and improvements, exclusive of effects of acquisitions	(44,783)	(34,089)
Proceeds from disposition of assets	13	7
Cash paid for acquisitions	(94)	(22,439)
NET CASH USED IN INVESTING ACTIVITIES	(44,864)	(56,521)
FINANCING ACTIVITIES		
Proceeds from ABL Facility	67,000	
Payments on ABL Facility	(57,000)	
Payments on other long-term debt	(86)	(400)
Cash paid on profit interest units		(1,000)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	9,914	(1,400)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(5,582)	(23,754)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	29,096	109,137
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 23,514	$ 85,383

SUPPLEMENTAL DISCLOSURES See Note 5 and Note 8 for a discussion of cash paid for interest and income taxes, respectively.

Purchases of patient service equipment and property, equipment and improvements exclude purchases that remain unpaid at the end of the respective quarter. Such amounts are then included in the following period s purchases when paid. Unpaid purchases were $15.0 million and $8.0 million at March 31, 2012 and March 31, 2011, respectively.

See notes to unaudited condensed consolidated financial statements.

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

In the opinion of management, all adjustments, consisting of normal recurring accruals necessary for a fair presentation of the results of operations for the interim periods presented, have been reflected herein. The unaudited results of operations for interim periods are not necessarily indicative of the results to be expected for the entire year. For further information, refer to the consolidated financial statements and notes thereto for the fiscal year ended December 31, 2011.

On October 28, 2008, the Company completed a merger (the Merger) with Sky Merger Sub Corporation (Merger Sub), a Delaware corporation and wholly-owned subsidiary of Sky Acquisition LLC, a Delaware limited liability company (Buyer or Sky LLC). Buyer is controlled by private investment funds affiliated with The Blackstone Group (Sponsor).

Company Background: Apria operates in the home healthcare segment of the healthcare industry, providing a variety of high-quality clinical patient care management programs, related products and supplies as prescribed by a physician and/or authorized by a case manager as part of a care plan. Essentially all products and services offered by the Company are provided through the Company s network of approximately 540 locations, which are located throughout the United States. We provide services and products in two operating segments and within these two operating segments there are four core service lines: home respiratory therapy, home medical equipment, home infusion therapy, including transparental nutrition services, and enteral nutrition services. Both segments provide products and services in the home setting to patients and are primarily paid for by a third-party payor, such as Medicare, Medicaid, managed care or other third-party insurer. Sales for both segments are primarily derived from referral sources such as hospital discharge planners, medical groups or independent physicians.

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

Revenue Recognition and Concentration of Credit Risk: Revenues are recognized under fee for service/product arrangements for equipment the Company rents to patients, sales of equipment, supplies, pharmaceuticals and other items the Company sells to patients and under capitation arrangements with third party payors for services and equipment the Company provides to the patients of these payors. Revenue generated from equipment that the Company rents to patients is recognized over the rental period, typically one month, and commences on delivery of the equipment to the patients. Revenue related to sales of equipment, supplies and pharmaceuticals is recognized on the date of delivery to the patients. Revenues derived from capitation arrangements were approximately 7% of total net revenues for the three months ended March 31, 2012 and 8% of total net revenues for the three months ended March 31, 2011. Capitation revenue is earned as a result of entering into a contract with a third party to provide its members certain services without regard to the actual services provided, therefore revenue is recognized in the period that the beneficiaries are entitled to health care services. All revenues are recorded at amounts estimated to be received under reimbursement arrangements with third-party payors, including private insurers, prepaid health plans, Medicare and Medicaid. Revenues reimbursed under arrangements with Medicare and Medicaid were approximately 24% and 6% of total net revenues for the three months ended March 31, 2012 and 23% and 7% for the three months ended March 31, 2011, no other third-party payor group represented more than 9% of the Company s revenues.

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

	Three Months Ended March 31,			
(dollars in millions)	**2012**		**2011**	
Rental	$ 166.6	30.2%	$ 152.8	30.8%
Sale	385.0	69.8	342.9	69.2
Total fee for service	$ 551.6	100.0%	$ 495.7	100.0%

In the Company s business, there are multiple services and products delivered to patients. These arrangements involve equipment that is rented and related supplies that may be sold that cannot be returned. In arrangements with multiple deliverables, revenue is recognized when each deliverable is provided to the patient. For example, revenues from equipment rental supplies sales are recognized upon of delivery of the products, as the supplies sold are considered a separate unit of accounting.

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

Accounts Receivable: Included in accounts receivable are earned but unbilled receivables of $60.7 million and $63.4 million at March 31, 2012 and December 31, 2011, respectively. Delays ranging from a day up to several weeks between the date of service and billing can occur due to delays in obtaining certain required payor-specific documentation from internal and external sources. Unbilled receivables can also be impacted by the transition of patients during the integration of acquisitions and overall revenue growth. Earned but unbilled receivables are aged from date of service and are considered in the analysis of historical performance and collectability.

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

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

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

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

Inventories: Inventories are stated at the lower of cost (first-in, first-out method) or market and consist primarily of pharmaceuticals and items used in conjunction with patient service equipment. Inventories are reduced by a reserve for slow moving or obsolete inventory.

Patient Service Equipment: Patient service equipment is stated at cost less depreciation and consists of medical equipment rented to patients on a month-to-month basis. Depreciation is provided using the straight-line method over the estimated useful lives of the equipment, which range from one to ten years. During the fourth quarter of 2011, the Company recorded a $45.5 million impairment of patient service equipment within the home respiratory/home medical equipment reporting unit.

APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Property, Equipment and Improvements: Property, equipment and improvements are stated at cost less depreciation. Depreciation is provided using the straight-line method over the estimated useful lives of the assets. During the fourth quarter of 2011, the Company recorded a $12.1 million impairment of property, equipment and improvements within the home respiratory/home medical equipment reporting unit.

Capitalized Software: Included in property, equipment and improvements are costs related to internally developed and purchased software that are capitalized and amortized over periods that the assets are expected to provide benefit. Capitalized costs include direct costs of materials and services incurred in developing or obtaining internal-use software and payroll and benefit costs for employees directly involved in the development of internal-use software. Additions to capitalized internally developed software totaled $2.1 million for the three months ended March 31, 2012 and $2.3 million for the three months ended March 31, 2011.

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

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

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

During the fourth quarter of 2011, the Company recorded the following impairments of its goodwill and long-lived assets:

(in millions)	Home Infusion Therapy	Home Respiratory Therapy and Home Medical Equipment	Total
Goodwill	$	$ 509.9	$ 509.9
Trade Name	3.6	56.4	60.0
Patient Service Equipment		45.5	45.5
Capitated Relationships		30.4	30.4
Property, Equipment and Improvements		12.1	12.1

$	3.6	$	654.3	$ 657.9

Additionally, the Company recorded a tax benefit relating the goodwill, intangible and long-lived assets impairment of $166.9 million.

There were no indicators of impairment related to the Company s goodwill, intangibles and long-lived assets as of March 31, 2012.

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

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

Fair Value of Financial Instruments: The carrying value of debt approximates fair value because the underlying instruments are variable notes that reprice frequently. The fair values of cash and cash equivalents, short-term investments and the Series A-1 Notes and Series A-2 Notes are determined based upon Level 1 inputs, consisting of quoted prices in active markets for identical items. The fair value of the Series A-1 Notes and Series A-2 Notes was $733.3 million and $317.5 million at March 31, 2012, respectively. The carrying amounts of cash and cash equivalents, accounts receivable, trade payables and accrued expenses approximate fair value due to their short maturity.

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

Home Respiratory Therapy Expenses: Home respiratory therapy expenses presented within cost of total net revenues are comprised primarily of employee salary and benefit costs or contract fees paid to respiratory therapists and other related professionals who are deployed to service a patient. Home respiratory therapy personnel are also engaged in a number of administrative and marketing tasks, and accordingly, these costs are classified within selling, distribution and administrative expenses and amounted to $10.0 million and $10.4 million in the three months ended March 31, 2012 and March 31, 2011, respectively.

Distribution Expenses: Distribution expenses are included in selling, distribution and administrative expenses and totaled $49.9 million and $45.6 million in the three months ended March 31, 2012 and March 31, 2011, respectively. Such expense represents the cost incurred to coordinate and deliver products and services to the patients. Included in distribution expenses are leasing, maintenance, licensing and fuel costs for the vehicle fleet; salaries and other costs related to drivers and dispatch personnel; and amounts paid to courier and other outside shipping vendors. Such expenses fall within the definition of shipping and handling costs and are classified within selling and administrative expenses and may not be comparable to other companies.

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

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

(in thousands)	**March 31, 2012**	**December 31, 2011**
Workers compensation	$ 6,394	$ 6,464
Professional and general liability/vehicle	3,300	3,134
Medical insurance	6,281	7,152

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

(in thousands)	**March 31, 2012**	**December 31, 2011**
Workers compensation	$ 18,478	$ 18,466
Professional and general liability/vehicle	7,999	7,822

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

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

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

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

In September 2011, the FASB issued guidance on testing goodwill for impairment. The new guidance provides an entity the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity determines that this is the case, it is required to perform the currently prescribed two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized for that reporting unit (if any). If an entity determines that the fair value of a reporting unit is greater than its carrying amount, the two-step goodwill impairment test is not required. The new guidance is effective for fiscal years beginning after December 31, 2011.

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 2 RECENT DEVELOPMENTS

Realignment of Management: On March 14, 2012, the Company announced the realignment of management responsibilities for its operating segments. In connection with these changes, Daniel E. Greenleaf was promoted to Chief Executive Officer of Coram, Inc., the principal operating subsidiary of our Home Infusion Therapy Segment. In connection with this appointment, Mr. Greenleaf no longer serves as the Chief Operating Officer of the Home Respiratory/Home Medical Equipment Segment.

In addition, Daniel J. Starck was named Chief Executive Officer of Apria Healthcare, Inc., the principal operating subsidiary for the Home Respiratory Therapy/Home Medical Equipment Segment. Mr. Starck joins Apria from CorVel Corporation, where he served as Chief Executive Officer since 2007. Norman C. Payson, M.D. will continue to serve as the Company s Executive Chairman and Chief Executive Officer of the parent company, overseeing both operating segments.

NOTE 3 BUSINESS COMBINATIONS

The Company periodically acquires complementary businesses in specific geographic markets. The results of operations of the acquired companies are included in the accompanying condensed consolidated statements of operations from the dates of acquisition. On March 4, 2011, the Company completed its previously announced asset acquisition of Praxair, Inc. s (NYSE: PX) and Praxair Healthcare Services, Inc. s (collectively, Praxair) United States homecare business.

During the three months ended March 31, 2012 and 2011, the Company purchased certain assets and businesses for total consideration of $0.1 million and $22.4 million, respectively. The 2011 total is comprised primarily of the asset acquisition of Praxair, Inc. s U.S. homecare business.

NOTE 4 GOODWILL AND INTANGIBLE ASSETS

Changes in goodwill by segment are as follows:

(in thousands)	Home Infusion Therapy	Home Respiratory Therapy and Home Medical Equipment	Total
Balance, December 31, 2011	$ 258,725	$	$ 258,725
Acquisitions			
Balance, March 31, 2012	$ 258,725	$	$ 258,725

During the fourth quarter of 2011, the Company recorded an impairment of the entire carrying value of goodwill related to the home respiratory/home medical equipment reporting unit of $509.9 million.

Intangible assets consist of the following:

		March 31, 2012			December 31, 2011			
(dollars in thousands)	Average Life in Years	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Impairment Charge	Net Book Value

Intangible assets subject to amortization:								
Capitated relationships	20.0	$ 4,400	$ (1,182)	$ 3,218	$ 40,000	$ (6,333)	$ (30,400)	$ 3,267
Payor relationships	20.0	11,000	(1,879)	9,121	11,000	(1,742)		9,258
Net favorable leasehold interest	3.5	3,210	(3,133)	77	3,210	(2,904)		306
Customer list	1.1	1,247	(833)	414	1,123	(588)		535
Subtotal		19,857	(7,027)	12,830	55,333	(11,567)	(30,400)	13,366
Intangible assets not subject to amortization:								
Trade names		465,000		465,000	525,000		(60,000)	465,000
Accreditations with commissions		7,000		7,000	7,000			7,000
Subtotal		472,000		472,000	532,000		(60,000)	472,000
Total		$ 491,857	$ (7,027)	$ 484,830	$ 587,333	$ (11,567)	$ (90,400)	$ 485,366

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Amortization expense amounted to $0.7 million and $1.1 million for the three months ended March 31, 2012 and 2011, respectively. Estimated amortization expense for each of the fiscal years ending December 31 is presented below:

Year Ending December 31,	(in thousands)
2012	$ 1,710
2013	744
2014	744
2015	744
2016	744
Thereafter	8,805

NOTE 5 LONG-TERM DEBT

Series A-1 Notes and Series A-2 Notes. Series A-1 Notes and Series A-2 Notes were issued by the Company in May 2009 and August 2009, respectively. The Series A-1 Notes and the Series A-2 Notes bear interest at a rate equal to 11.25% per annum and 12.375% per annum, respectively. The indenture governing the Series A-1 Notes and the Series A-2 Notes, among other restrictions, limits the Company s ability and the ability of its restricted subsidiaries to:

incur additional debt;

pay dividends and make other distributions;

make certain investments;

repurchase our stock;

incur certain liens;

enter into transactions with affiliates;

merge or consolidate;

enter into agreements that restrict the ability of our subsidiaries to make dividends or other payments to us; and transfer or sell assets.

Subject to certain exceptions, the indenture governing the Series A-1 Notes and the Series A-2 Notes permits Apria and its restricted subsidiaries to incur additional indebtedness, including senior indebtedness and secured indebtedness. The Series A-1 Notes are entitled to a priority of payment over the Series A-2 Notes in certain circumstances, including upon any acceleration of the obligations under the Series A-1 Notes, the Series A-2 Notes or any bankruptcy or insolvency event or default with respect to Apria or any guarantor of the Series A-1 Notes and the Series A-2 Notes.

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

Series A-1 Notes	**Percentage**
November 1, 2011	105.625%
November 1, 2012	102.813%
November 1, 2013 and thereafter	100.000%

Series A-2 Notes	**Percentage**
November 1, 2011	106.188%
November 1, 2012	103.094%
November 1, 2013 and thereafter	100.000%

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

The ABL Facility provides for revolving credit financing of up to $250.0 million, subject to borrowing base availability, with a maturity of the earlier of (a) five years and (b) 90 days prior to the earliest maturity of our outstanding

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Series A-1 Notes and Series A-2 Notes, and includes both a letter of credit and swingline loan sub-facility. The borrowing base at any time is equal to the sum (subject to certain reserves and other adjustments) of (i) 85% of eligible receivables, (ii) the least of (a) 85% of eligible self-pay accounts, (b) 10% of the borrowing base, (c) $25,000,000 and (d) the aggregate amount of self-pay accounts collected within the previous 90 days, (iii) the lesser of (a) 85% of eligible accounts invoiced but unpaid for more than 180 days but less than 360 days and (b) 10% of eligible accounts invoiced but unpaid for 180 days or less and (iv) the lesser of (a) 85% of the net orderly liquidation value of eligible inventory and (b) $35.0 million.

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

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

As of March 31, 2012, there was $20.0 million outstanding under the ABL Facility, outstanding letters of credit totaled $21.1 million and additional availability under the ABL Facility, subject to the borrowing base, was $208.9 million. As of March 31, 2012, the available borrowing base did not constrain our ability to borrow the entire $208.9 million available borrowing capacity under our ABL Facility. At March 31, 2012, we were in compliance with all of the financial covenants required by the credit agreement governing the ABL Facility. As of April 30, 2012 there was approximately $68 million outstanding under the ABL Facility.

Interest paid on debt totaled $0.6 million and $0.5 million for the three months ended March 31, 2012 and 2011, respectively. Interest expense for the three months ended March 31, 2012 and 2011 was $33.5 million and $32.9 million, respectively.

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

NOTE 6 STOCKHOLDERS EQUITY

For the three months ended March 31, 2012, changes to stockholders equity were comprised of the following amounts (in thousands):

Net loss	$ (19,607)
Profit interest compensation	739
	$ (18,868)

NOTE 7 PROFIT INTEREST UNITS

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

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

BP Holdings granted the Company s Chief Executive Officer 38,697,318 Class B units, all of which are subject to vesting terms based on either (i) continued service to BP Holdings or its subsidiaries and/or (ii) performance/ market conditions.

Time-Vesting Units. The portion of the Class B units that vest based on continued service represent 80% of the total Class B units. These units vest over four years starting on October 28, 2008 based on continued service, but will become fully vested on an accelerated basis either (x) upon a change in control while the Company s Chief Executive Officer continues to provide services to BP Holdings or its subsidiaries or (y) if affiliates of the Sponsor receive cash proceeds in respect to 50% of their units in BP Holdings equal to at least 200% of their aggregate capital contributions in respect of such units while the Company s Chief Executive Officer continues to provide services to BP Holdings or its subsidiaries. In addition, if the Company s Chief Executive Officer s services are terminated (a) by the Company without cause or (b) by the Chief Executive Officer as a result of constructive termination, an additional number of these time-vesting Class B units will vest equal to the number that would have vested over the 24-month period following the applicable termination date. Any of these time-vested Class B units that are unvested on termination of the executive s services will be forfeited.

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

Assumptions used were as follows:

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

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

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following table summarizes activity for profit interest units for the period December 31, 2011 to March 31, 2012:

	Class B Units
Balance at December 31, 2011	38,697,318
Granted	
Forfeited	
Exercised	
Balance at March 31, 2012	38,697,318
Vested units at March 31, 2012	25,153,257

There is no stated contractual life for the B units.

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

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

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

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

Assumptions used were as follows:

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

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

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

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following table summarizes activity for profit interest units for the period December 31, 2011 to March 31, 2012:

	Class A-2 Units	Class B Units	Class C Units
Balance at December 31, 2011	500,000	6,675,287	2,225,096
Granted			
Forfeited			
Exercised			
Balance at March 31, 2012	500,000	6,675,287	2,225,096
Vested units at March 31, 2012		3,114,822	

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

Sky LLC (and following our reorganization in March 2010, Apria Holdings LLC) granted certain management employees 50,603,082 Class B units and 17,351,412 Class C units, all of which are subject to vesting terms based on either (i) continued service to Sky LLC or its subsidiaries or (ii) performance/market conditions.

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

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

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

Assumptions used were as follows for the 2012 grants:

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

Assumptions used were as follows for the 2011 grants:

Expected Asset Volatility (1)	25.0%

Risk Free Interest Rate (2)	2.01%
Expected Life (3)	5.0 years

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

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following table summarizes activity for profit interest units for the period December 31, 2011 to March 31, 2012:

	Class A-2 Units	Class B Units	Class C Units
Balance at December 31, 2011	1,075,000	37,736,224	13,433,309
Granted			
Forfeited		(2,525,000)	(841,667)
Exercised			
Balance at March 31, 2012	1,075,000	35,211,224	12,591,642
Vested units at March 31, 2012		10,917,285	

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

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

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

Performance-Vesting Units. The remaining portion of the Class B units vest based on performance/market conditions. These units are divided into two categories, with vesting in each category based on the Company s achievement of EBITDA (as defined in the Company s credit agreement) targets and return on the investment of the Sponsor (defined as Blackstone Capital Partners V L.P. and its affiliates). The first category of the target-based Class B Units will vest if either of the following conditions is satisfied while Mr. Zafirovski continues to serve as a director (or within 24 months after termination by the Company of his service on the Board of Directors without cause): (1) the Company achieves a specified EBITDA target for each of fiscal year 2012 and fiscal year 2013; or (2) the Sponsor achieves a specified return on investment on or prior to December 31, 2014.

The second category of the target-based Class B Units will vest if both of the following conditions are satisfied while Mr. Zafirovski continues to serve as a director (or within 24 months after a termination by the Company of his service on the Board of Directors without cause): (1) the Company achieves a more challenging specified EBITDA target for either fiscal year 2012 or fiscal year 2013 (such year of achievement, the Subject Year); and (2) one of the following conditions is satisfied: (a) the Company achieves a more challenging specified EBITDA target for the fiscal year immediately succeeding the Subject Year; or (b) the Sponsor achieves a specified return on investment on or prior to December 31, 2014. The Company believes that the targets set for the target based Class B Units are reasonable, although neither automatically nor easily achieved.

The Class B units acquired by Mr. Zafirovski are similar to the other Class B units, except that the Class B units acquired by Mr. Zafirovski contain the following different economic terms than Holdings normal Class B Units: Mr. Zafirovski s special Class B Units will not entitle him to receive any value per unit unless and until the value attributable to a regular Class B unit in Holdings exceeds $0.63 per unit, at which point Mr. Zafirovski s special Class B Units will become entitled to receive $0.63 per unit and thereafter, will become entitled to receive the same amount as regular Class B Units.

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Assumptions used were as follows for the 2011 grants:

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

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

The following table summarizes activity for profit interest units for the period December 31, 2011 to March 31, 2012:

	Class A-2 Units	Class B Units
Balance at December 31, 2011	1,000,000	5,030,651
Granted		
Forfeited		
Exercised		
Balance at March 31, 2012	1,000,000	5,030,651
Vested units at March 31, 2012		

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

Expense recorded related to profit interest units was $0.7 million and $0.8 million in the three months ended March 31, 2012 and 2011, respectively. As of March 31, 2012, total unrecognized profit interest compensation cost related to unvested profit interest units was $4.6 million, which is expected to be expensed over a weighted average period of 3.7 years.

NOTE 8 INCOME TAXES

The Company s effective tax rate was (4.8)% for the three months ended March 31, 2012, compared to 33.8% for the three months ended March 31, 2011. For the three months ended March 31, 2012, our effective tax rate differed from federal and state statutory rates primarily due to the accrual of a valuation allowance against substantially all of our net deferred tax assets. For the three months ended March 31, 2011, our effective tax rate differed from federal and state statutory rates primarily due to the tax rate impact of non-deductible equity compensation and certain discrete items.

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

For the three-year period ended December 31, 2011, the Company sustained a cumulative book loss, after adjusting for non-recurring items. Therefore, the Company accrued a valuation allowance of $224.5 million at December 31, 2011, since the Company determined that it is more likely than not that substantially all of the Company s net deferred tax assets will not be realized. The Company utilized all available information (including cumulative consolidated three-year loss information) to determine the necessity and amount of its valuation allowance at December 31, 2011. The Company intends to maintain its valuation allowance until sufficient positive evidence exists to support the reversal of all or a portion of its valuation allowance.

The Company increased its valuation allowance by $7.3 million to $231.8 million at March 31, 2012 from $224.5 million at December 31, 2011 to offset corresponding increases in its net deferred tax assets for the three months ended March 31, 2012.

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

As of March 31, 2012, it is reasonably possible that unrecognized tax benefits could decrease by $3.0 million within the 12-month rolling period ending March 31, 2013. This decrease primarily relates to the timing uncertainty for when certain deductions should be recognized for tax return purposes, allocation of expenses between affiliates, and state tax uncertainties. Ultimate realization of this decrease is dependent upon the occurrence of certain events (including the completion of audits by tax agencies and expiration of statutes of limitations).

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

For the three months ended March 31, 2012, no other material changes occurred with respect to the Company s tax uncertainties and the other four disclosure categories.

As of March 31, 2012, federal net operating loss (NOLs) carryforwards of approximately $371.3 million were available to offset future federal taxable income. Such NOLs will expire at various times and in varying amounts during the Company s calendar 2015 through 2032 tax years. A significant portion of these NOLS are subject to an annual utilization limitation as required by Section 382 of the Internal Revenue Code of 1986, as amended.

The Company files federal and state income tax returns in jurisdictions with varying statutes of limitations expiration dates. The Company s calendar 2008 through 2012 tax years generally remain subject to examination by tax authorities. The Internal Revenue Service is auditing the Company s calendar 2009 Federal income tax return. Additionally, certain state tax agencies are currently examining the tax years 2005 and forward.

Net income tax payments made (and refunds received) for the three-month period ended March 31, 2012 and 2011 amounted to $0.3 million and $(0.6) million, respectively.

NOTE 9 COMMITMENTS AND CONTINGENCIES

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

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

Supplier Concentration: Currently, approximately 61.4% of purchases for patient service equipment and supplies are from five vendors. Although there are a limited number of suppliers, management believes that other vendors could provide similar products on comparable terms. However, a change in suppliers could cause delays in service delivery and possible losses in revenue, which could adversely affect the Company s financial condition or operating results.

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

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

NOTE 10 SEGMENTS

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

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

	Net Revenues Three Months Ended March 31,	
(in thousands)	**2012**	**2011**
Operating Segment		
Home Respiratory Therapy and Home Medical Equipment	$ 301,904	$ 276,061
Home Infusion Therapy	293,809	260,682
Total	$ 595,713	$ 536,743

	EBIT Three Months Ended March 31,	
(in thousands)	**2012**	**2011**
Operating Segment		
Home Respiratory Therapy and Home Medical Equipment	$ (5,399)	$ (17,662)
Home Infusion Therapy	19,505	18,410
Total	$ 14,106	$ 748

	Depreciation and Amortization Three Months Ended March 31,	
(in thousands)	**2012**	**2011**
Operating Segment		
Home Respiratory Therapy and Home Medical Equipment	$ 24,992	$ 28,151
Home Infusion Therapy	4,374	4,047
Total	$ 29,366	$ 32,198

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

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

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

	Three Months Ended March 31, 2012			Three Months Ended March 31, 2011		
(in thousands)	**Home Respiratory Therapy and Home Medical Equipment**	**Home Infusion Therapy**	**Total**	**Home Respiratory Therapy and Home Medical Equipment**	**Home Infusion Therapy**	**Total**

Net loss			$ (19,607)			$ (21,024)
Interest expense, net (a)			32,815			32,503
Income tax expense (benefit)			898			(10,731)
EBIT	$ (5,399)	$ 19,505	$ 14,106	$ (17,662)	$ 18,410	$ 748

(a) Reflects $33.5 million of interest expense, net of $0.7 million of interest income for the three months ended March 31, 2012. Reflects $32.9 million of interest expense, net of $0.4 million of interest income for the three months ended March 31, 2011.

The Company allocates certain corporate expenses that are not directly attributable to a product line based upon segment headcount. For the three months ended March 31, 2012, the corporate costs allocated to the home respiratory therapy/home medical equipment segment were $33.8 million and the corporate costs allocated to the home infusion therapy segment were $16.4 million. For the three months ended March 31, 2011, the corporate costs allocated to the home respiratory therapy/home medical equipment segment were $41.4 million and the corporate costs allocated to the home infusion therapy segment were $15.7 million.

NOTE 11 CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

Transaction and Management Fee Agreement: In connection with the Merger, Merger Sub entered into a transaction and management fee agreement with Blackstone Management Partners V L.L.C. (BMP). The Company succeeded to and assumed the rights and obligations of Merger Sub pursuant to the transaction and management fee agreement upon the closing of the Merger. Under the transaction and management fee agreement, Merger Sub agreed to pay BMP, at the closing of the Merger, an $18.7 million transaction fee in consideration for BMP undertaking financial and structural analysis, due

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

diligence and other assistance in connection with the Merger. In addition the Company agreed to reimburse BMP for any out-of-pocket expenses incurred by BMP and its affiliates in connection with the Merger and the provision of services under the transaction and management fee agreement.

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

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

Intelenet Agreement: In May 2009, the Company entered into the Master Service Agreement (Intelenet Agreement) with Intelenet Global Services Private Limited (Intelenet), an Indian company affiliated with the Sponsor, regarding the outsourcing of certain functions relating to billing, collections and other administrative and clerical services. In 2010, the Company modified the Intelenet Agreement to limit the services provided by Intelenet. On May 31, 2011, it was announced that an affiliate of the Sponsor, along with other shareholders of Intelenet, agreed to sell Intelenet to Serco Group PLC, an international services company. The transaction closed in July 2011, but the affiliate of the Sponsor may receive additional payments based on Intelenet s performance through 2013. During the three months ended March 31, 2012, the Company paid approximately $4.1 million to Intelenet.

Equity Healthcare Agreement: Effective as of January 1, 2010, the Company entered into an employer health program agreement with Equity Healthcare LLC (Equity Healthcare), an affiliate of the Sponsor, pursuant to which Equity Healthcare will provide to the Company certain negotiating, monitoring and other services in connection with our health benefit plans. In consideration for Equity Healthcare s services, the Company pays Equity Healthcare a fee of $2 per participating employee per month. As of March 31, 2012, the Company had approximately 8,700 employees enrolled in Equity Healthcare health benefit plans.

NOTE 12 FINANCIAL GUARANTEES

The Company conducts substantially all of its business through its subsidiaries. Substantially all of the Company s wholly-owned subsidiaries (the Guarantors) fully and unconditionally guarantee the Series A-1 Notes and Series A-2 Notes on a senior secured basis. The Guarantors also guarantee the Company s ABL Facility. See also Note 5 Long-Term Debt.

The following condensed consolidated financial statements quantify the financial position as of March 31, 2012 and December 31, 2011, the operations for the three months ended March 31, 2012 and 2011, and the cash flows for the three months ended March 31, 2012 and 2011. These condensed consolidated financial statements present financial information for the parent issuer, the guarantor subsidiaries, the non-guarantor subsidiaries and consolidating adjustments, consisting of the entries that eliminate the investment in subsidiaries and intercompany balances and transactions.

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following condensed financial statements reflect an allocation of consolidated valuation allowance between the parent issuer and guarantor subsidiaries. Such allocation may not be reflective of the amount of valuation allowance which would be accrued if separate financial statements were prepared because certain guarantor subsidiaries have not sustained a cumulative three-year loss.

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

CONDENSED CONSOLIDATED BALANCE SHEETS

March 31, 2012

(Unaudited)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (in thousands)	Consolidating Adjustments	Consolidated
ASSETS					
CURRENT ASSETS					
Cash and cash equivalents	$ 32,828	$	$ 404	$ (9,718)	$ 23,514
Accounts receivable less allowance for doubtful accounts		361,289	1,190		362,479
Inventories, net		63,730	297		64,027
Deferred income taxes					
Deferred expenses		3,430			3,430
Intercompany	225,553	731,388		(956,941)	
Prepaid expenses and other current assets	1,025	24,128	12		25,165
Intercompany loan	360,000			(360,000)	
TOTAL CURRENT ASSETS	619,406	1,183,965	1,903	(1,326,659)	478,615
PATIENT SERVICE EQUIPMENT, less accumulated depreciation		174,498	5		174,503
PROPERTY, EQUIPMENT AND IMPROVEMENTS, NET	37,549	44,524	230		82,303
GOODWILL		258,725			258,725
INTANGIBLE ASSETS, NET	400,000	84,830			484,830
DEFERRED DEBT ISSUANCE COSTS, NET	41,185				41,185
INVESTMENT IN SUBSIDIARIES	(225,050)	806		224,244	
Intercompany Loan	350,000			(350,000)	
OTHER ASSETS	5,313	5,019			10,332
TOTAL ASSETS	$ 1,228,403	$ 1,752,367	$ 2,138	$ (1,452,415)	$ 1,530,493
LIABILITIES AND STOCKHOLDERS (DEFICIT) EQUITY					
CURRENT LIABILITIES					
Accounts payable	$ 11,168	$ 144,785	$ 231	$ (9,718)	$ 146,466
Accrued payroll and related taxes and benefits	6,365	65,130	184		71,679
Deferred income taxes current	2,449	(1,788)			661
Other accrued liabilities	49,578	43,190	917		93,685
Deferred revenue		27,336			27,336
Intercompany	61,787	895,154		(956,941)	
Current portion of long-term debt	20,000	360,289		(360,000)	20,289
TOTAL CURRENT LIABILITIES	151,347	1,534,096	1,332	(1,326,659)	360,116
LONG-TERM DEBT, net of current portion	1,017,500	181			1,017,681

DEFERRED INCOME TAXES	149,152	50,382			199,534
Intercompany long-term		350,000		(350,000)	
INCOME TAXES PAYABLE & OTHER NON-CURRENT LIABILITIES	8,872	42,758			51,630
TOTAL LIABILITIES	1,326,871	1,977,417	1,332	(1,676,659)	1,628,961
COMMITMENTS AND CONTINGENCIES					
STOCKHOLDERS (DEFICIT) EQUITY					
Additional paid-in capital	691,609	513,613		(513,613)	691,609
(Accumulated deficit) retained earnings	(790,077)	(738,663)	806	737,857	(790,077)
TOTAL STOCKHOLDERS (DEFICIT) EQUITY	(98,468)	(225,050)	806	224,244	(98,468)
	$ 1,228,403	$ 1,752,367	$ 2,138	$ (1,452,415)	$ 1,530,493

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APRIA HEALTHCARE GROUP INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

CONDENSED CONSOLIDATED BALANCE SHEETS

December 31, 2011

(Unaudited)

	Issuer	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
			(in thousands)		
ASSETS					
CURRENT ASSETS					
Cash and cash equivalents	$ 43,552	$	$ 475	$ (14,931)	$ 29,096
Accounts receivable less allowance for doubtful accounts		336,396	816		337,212
Inventories		57,384	299		57,683
Deferred income taxes	443	(275)			168
Deferred expenses		3,681			3,681
Intercompany	340,259	515,672		(855,931)	
Prepaid expenses and other current assets	1,262	22,653	12		23,927
Intercompany loan	710,000			(710,000)	
TOTAL CURRENT ASSETS	1,095,516	935,511	1,602	(1,580,862)	451,767
PATIENT SERVICE EQUIPMENT, less accumulated depreciation		166,764	5		166,769
PROPERTY, EQUIPMENT AND IMPROVEMENTS, NET	43,760	39,761	247		83,768
GOODWILL		258,725			258,725
INTANGIBLE ASSETS, NET	400,000	85,366			485,366
DEFERRED DEBT ISSUANCE COSTS, NET	44,636				44,636
INVESTMENT IN SUBSIDIARIES	(203,080)	641		202,439	
OTHER ASSETS	4,116	4,881			8,997
TOTAL ASSETS	$ 1,384,948	$ 1,491,649	$ 1,854	$ (1,378,423)	$ 1,500,028
LIABILITIES AND STOCKHOLDERS EQUITY					
CURRENT LIABILITIES					
Accounts payable	$ 8,768	$ 141,491	$ 244	$ (14,931)	$ 135,572
Accrued payroll and related taxes and benefits	14,614	54,420	183		69,217
Other accrued liabilities	20,103	46,225	786		67,114
Deferred revenue		28,649			