

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 27, 2004

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 No. 1-15669

**Gentiva Health Services, Inc.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

36-4335801  
(I.R.S. Employer  
Identification No.)

3 Huntington Quadrangle, Suite 200S, Melville, NY 11747-4627  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (631) 501-7000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No \_\_\_

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes X No \_\_\_

The number of shares outstanding of the registrant's Common Stock, as of July 28, 2004, was 24,500,887.

## INDEX

### **PART I - FINANCIAL INFORMATION**

Page  
No.

Item 1.	Financial Statements	
	Consolidated Balance Sheets (Unaudited) – June 27, 2004 and December 28, 2003	3
	Consolidated Statements of Income (Unaudited) - Three and Six Months Ended June 27, 2004 and June 29, 2003	4
	Consolidated Statements of Cash Flows (Unaudited) – Six Months Ended June 27, 2004 and June 29, 2003	5
	Notes to Consolidated Financial Statements (Unaudited)	6-14
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	14-24
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	25
Item 4.	Controls and Procedures	25

### **PART II - OTHER INFORMATION**

Item 1.	Legal Proceedings	26
Item 2.	Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities	26
Item 3.	Defaults Upon Senior Securities	26
Item 4.	Submission of Matters to a Vote of Security Holders	26-27
Item 5.	Other Information	27
Item 6.	Exhibits and Reports on Form 8-K	28-29

### **SIGNATURES**

30

## PART I – FINANCIAL INFORMATION

### Item 1. Financial Statements

**Gentiva Health Services, Inc. and Subsidiaries**  
**Consolidated Balance Sheets**  
(In thousands, except share amounts)  
(Unaudited)

	June 27, 2004	December 28, 2003
<b>ASSETS</b>		
Current assets:		
Cash, cash equivalents and restricted cash	\$ 101,104	\$ 100,013
Short-term investments	10,000	10,000
Receivables, less allowance for doubtful accounts of \$8,340 and \$7,936 in 2004 and 2003, respectively	133,778	132,998
Deferred tax assets	23,210	26,464
Prepaid expenses and other current assets	7,890	6,524
Total current assets	275,982	275,999
Fixed assets, net	18,121	15,135
Deferred tax assets, net	23,631	28,025
Other assets	14,885	15,929
Total assets	\$ 332,619	\$ 335,088
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 12,205	\$ 16,079
Payroll and related taxes	13,845	12,932
Medicare liabilities	13,331	12,736
Cost of claims incurred but not reported	28,287	28,525
Obligations under insurance programs	36,583	37,200
Other accrued expenses	28,742	32,230
Total current liabilities	132,993	139,702
Other liabilities	20,375	18,207
Shareholders' equity:		
Common stock, \$.10 par value; authorized 100,000,000 shares; issued and outstanding 24,858,605 and 25,598,301 shares in 2004 and 2003, respectively	2,486	2,560
Additional paid-in capital	257,419	270,468
Accumulated deficit	(80,654)	(95,849)
Total shareholders' equity	179,251	177,179
Total liabilities and shareholders' equity	\$ 332,619	\$ 335,088

See notes to consolidated financial statements.

**Gentiva Health Services, Inc. and Subsidiaries**  
**Consolidated Statements of Income**  
(In thousands, except per share amounts)  
(Unaudited)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 27, 2004</b>	<b>June 29, 2003</b>	<b>June 27, 2004</b>	<b>June 29, 2003</b>
Net revenues	\$ 208,248	\$ 208,446	\$ 422,153	\$ 410,462
Cost of services sold	129,910	138,822	260,553	272,072
Gross profit	78,338	69,624	161,600	138,390
Selling, general and administrative expenses	(67,809)	(62,341)	(134,178)	(123,594)
Depreciation and amortization	(1,904)	(1,730)	(3,749)	(3,475)
Operating income	8,625	5,553	23,673	11,321
Gain on sale of Canadian investment	946	-	946	-
Interest income, net	208	139	290	182
Income before income taxes	9,779	5,692	24,909	11,503
Income tax expense	(3,814)	(445)	(9,714)	(1,055)
Net income	<u>\$ 5,965</u>	<u>\$ 5,247</u>	<u>\$ 15,195</u>	<u>\$ 10,448</u>
Net income per common share:				
Basic	<u>\$ 0.24</u>	<u>\$ 0.20</u>	<u>\$ 0.60</u>	<u>\$ 0.39</u>
Diluted	<u>\$ 0.22</u>	<u>\$ 0.19</u>	<u>\$ 0.56</u>	<u>\$ 0.38</u>
Weighted average shares outstanding:				
Basic	<u>25,068</u>	<u>26,530</u>	<u>25,305</u>	<u>26,613</u>
Diluted	<u>26,818</u>	<u>27,490</u>	<u>26,967</u>	<u>27,635</u>

See notes to consolidated financial statements.

**Gentiva Health Services, Inc. and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
(In thousands)  
(Unaudited)

	<b>Six Months Ended</b>	
	<b>June 27, 2004</b>	<b>June 29, 2003</b>
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 15,195	\$ 10,448
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	3,749	3,475
Provision for doubtful accounts	3,414	3,608
Gain on sale of Canadian investment	(946)	-
Deferred income tax expense	7,433	-
Changes in assets and liabilities, net of acquisitions / divestitures		
Accounts receivable	(4,194)	(11,569)
Prepaid expenses and other current assets	(1,616)	1,613
Current liabilities	(7,458)	6,358
Other, net	169	(1,200)
Net cash provided by operating activities	<u>15,746</u>	<u>12,733</u>
<b>INVESTING ACTIVITIES:</b>		
Purchase of fixed assets	(5,493)	(3,928)
Proceeds from sale of assets	4,123	200
Acquisition of businesses	-	(1,300)
Purchase of short-term investments	(10,000)	(14,900)
Maturities of short-term investments	10,000	10,035
Net cash used in investing activities	<u>(1,370)</u>	<u>(9,893)</u>
<b>FINANCING ACTIVITIES:</b>		
Proceeds from issuance of common stock	1,579	822
Repurchases of common stock	(14,702)	(7,857)
Repayment of capital lease obligations	(162)	-
Net cash used in financing activities	<u>(13,285)</u>	<u>(7,035)</u>
Net change in cash, cash equivalents and restricted cash	1,091	(4,195)
Cash, cash equivalents and restricted cash at beginning of period	100,013	101,241
Cash, cash equivalents and restricted cash at end of period	<u>\$ 101,104</u>	<u>\$ 97,046</u>
<b>Supplemental cash flow information</b>		
Income taxes paid, net of refunds	<u>\$ 3,534</u>	<u>\$ 744</u>
<b>Supplemental Schedule of Non-Cash Investing and Financing Activities</b>		
Fixed assets acquired under capital lease	<u>\$ 1,443</u>	<u>\$ -</u>

See notes to consolidated financial statements.

**Gentiva Health Services, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

1. Background and Basis of Presentation

Gentiva Health Services, Inc. (“Gentiva” or the “Company”) provides home health services throughout most of the United States principally through its Gentiva<sup>®</sup> Health Services and CareCentrix<sup>®</sup> brands.

The accompanying interim consolidated financial statements are unaudited, but have been prepared by Gentiva pursuant to the rules and regulations of the Securities and Exchange Commission and, in the opinion of management, include all adjustments necessary for a fair presentation of results of operations, financial position and cash flows for each period presented. Results for interim periods are not necessarily indicative of results for a full year. The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

2. Cash Equivalents, Restricted Cash and Short-term Investments

The Company considers all investments with an original maturity of three months or less on their acquisition date to be cash equivalents. Restricted cash of \$21.8 million at June 27, 2004 and December 28, 2003 represented segregated cash funds in a trust account designated as collateral under the Company’s insurance programs. Interest in the funds in the trust account accrues to the Company. The Company, at its option, may access the cash funds in the trust account by providing equivalent amounts of alternative security. The Company classifies investments with an original maturity of more than three months and less than one year on the acquisition date as short-term investments. Short-term investments are classified as “held to maturity” investments and are reported at amortized cost which approximates fair value.

3. Medicare Revenues

Medicare revenues for the first six months of fiscal 2004 included approximately \$9 million received in settlement of the Company’s appeal filed with the U.S. Provider Reimbursement Review Board (“PRRB”) related to the reopening of all of its 1997 cost reports (see Note 9), net of a revenue adjustment of \$1 million to reflect an estimated repayment to Medicare in connection with services rendered to certain patients since the inception of the Prospective Payment Reimbursement System (“PPS”) in October 2000. In connection with the estimated repayment, the Centers for Medicare & Medicaid Services (“CMS”) has determined that home care providers should have received lower reimbursements for certain services rendered to beneficiaries discharged from inpatient hospitals within fourteen days immediately preceding admission to home healthcare.

4. Earnings Per Share

Basic and diluted earnings per share for each period presented have been computed by dividing net income by the weighted average number of shares outstanding for each respective period. The computations of the basic and diluted per share amounts were as follows (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	June 27, 2004	June 29, 2003	June 27, 2004	June 29, 2003
Net income	\$ 5,965	\$ 5,247	\$ 15,195	\$ 10,448
Basic weighted average common shares outstanding	25,068	26,530	25,305	26,613
Shares issuable upon the assumed exercise of stock options and in connection with the employee stock purchase plan using the treasury stock method	1,750	960	1,662	1,022
Diluted weighted average common shares outstanding	26,818	27,490	26,967	27,635
Net income per common share:				
Basic	\$ 0.24	\$ 0.20	\$ 0.60	\$ 0.39
Diluted	\$ 0.22	\$ 0.19	\$ 0.56	\$ 0.38

## 5. Disposition

On March 30, 2004, the Company sold its minority interest in a home care nursing services business in Canada. The business had been acquired as partial consideration for the sale of the Company's Canadian operations in the fourth quarter of fiscal 2000. In connection with the March 30, 2004 sale, the Company received cash proceeds of \$4.1 million and recorded a gain on sale of approximately \$0.9 million in the second quarter of fiscal 2004.

## 6. Revolving Credit Facility and Debt

The Company's credit facility, which was entered into on June 13, 2002, as amended, as described below, provides up to \$55 million in borrowings, including up to \$40 million which is available for letters of credit. The Company may borrow up to a maximum of 80 percent of the net amount of eligible accounts receivable, as defined, less any reasonable and customary reserves, as defined, required by the lender. Borrowing availability under the credit facility was reduced by \$10 million until such quarter in 2003 in which the trailing 12 month EBITDA, excluding certain restructuring costs and special charges, as defined, exceeded \$15 million. As of March 30, 2003, the trailing 12 month EBITDA threshold was achieved and the availability restriction lifted, effective June 1, 2003.

At the Company's option, the interest rate on borrowings under the credit facility was based on the London Interbank Offered Rates (LIBOR) plus 3.25 percent or the lender's prime rate plus 1.25 percent. In addition, the Company was required to pay a fee equal to 2.5 percent per annum of the aggregate face amount of outstanding letters of credit. Beginning in 2003, the applicable margins for the LIBOR borrowing, prime rate borrowing and letter of credit fees decreased by 0.25 percent to 3.0 percent, 1.0 percent, and 2.25 percent, respectively, provided that the Company's trailing 12 month EBITDA, excluding certain restructuring costs and special charges, as defined, was in excess of \$20 million. The Company was also subject to an unused line fee equal to 0.50 percent per annum of the average daily differ-

ence between the total revolving credit facility amount and the total outstanding borrowings and letters of credit. Beginning in 2003, the unused credit line fee decreased to 0.375 percent provided the minimum EBITDA target described above was achieved. The higher margins and fees are subject to reinstatement in the event that the Company's trailing 12 month EBITDA falls below \$20 million. The Company met this minimum EBITDA requirement as of March 30, 2003, with the rate reduction effective June 1, 2003, and continued to meet this requirement as of June 27, 2004.

The credit facility, which expires in June 2006, includes certain covenants requiring the Company to maintain a minimum tangible net worth of \$101.6 million, minimum EBITDA, as defined, and a minimum fixed charge coverage ratio, as defined. Other covenants in the credit facility include limitations on mergers, consolidations, acquisitions, indebtedness, liens, distributions including dividends, capital expenditures, stock repurchases and dispositions of assets and other limitations with respect to the Company's operations. On August 7, 2003 and on May 26, 2004, the Company's credit facility was amended to make covenants relating to acquisitions and stock repurchases less restrictive, provided that the Company maintains minimum excess aggregate liquidity, as defined, equal to at least \$60 million and to allow for the disposition of certain assets. As of June 27, 2004, the Company was in compliance with the covenants in the credit facility, as amended.

The credit facility further provides that if the agreement is terminated for any reason, the Company must pay an early termination fee equal to \$137,500 in the period from June 13, 2004 to June 12, 2005. There is no fee for termination of the facility subsequent to June 12, 2005. Loans under the credit facility are collateralized by all of the Company's tangible and intangible personal property, other than equipment.

Total outstanding letters of credit were approximately \$20.7 million as of June 27, 2004 and \$20.8 million at December 28, 2003. The letters of credit, which expire one year from date of issuance, were issued to guarantee payments under the Company's workers compensation program and for certain other commitments. There were no borrowings outstanding under the credit facility as of June 27, 2004.

During the first six months of fiscal 2004, the Company commenced implementation of a five-year capital lease for certain equipment. In connection with this lease, the Company recorded capital lease assets of approximately \$1.4 million in fixed assets, net, current obligation of capital leases of \$0.3 million in other accrued expenses and long-term capital lease obligations of \$1.1 million in other liabilities.

## 7. Shareholders' Equity

Changes in shareholders' equity for the six months ended June 27, 2004 were as follows (in thousands):

	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Accumulated Deficit</u>	<u>Total</u>
Balance at December 28, 2003	\$ 2,560	\$270,468	\$ (95,849)	\$ 177,179
Comprehensive income:				
Net income	-	-	15,195	15,195
Issuance of stock upon exercise of stock options and under stock plans for employees and directors (275,151 shares)	28	1,551	-	1,579
Repurchase of common stock at cost (1,014,847 shares)	(102)	(14,600)	-	(14,702)
Balance at June 27, 2004	<u>\$ 2,486</u>	<u>\$257,419</u>	<u>\$ (80,654)</u>	<u>\$ 179,251</u>

Comprehensive income amounted to \$6.0 million and \$5.2 million for the second quarter of fiscal 2004 and fiscal 2003, respectively, and \$15.2 million and \$10.4 million for the first six months of fiscal 2004 and fiscal 2003, respectively.

The Company's Board of Directors has authorized stock repurchase programs under which the Company could repurchase and formally retire up to an aggregate of 3,500,000 shares of its outstanding common stock. A summary of the shares repurchased under each program follows:

<u>Date Program Announced</u>	<u>Shares Authorized</u>	<u>Shares Repurchased as of June 27, 2004</u>	<u>Total Cost</u>	<u>Average Cost per Share</u>	<u>Program Completion Date</u>
May 16, 2003	1,000,000	1,000,000	\$ 9,082,353	\$ 9.08	July 23, 2003
August 7, 2003	1,500,000	1,453,311	\$ 20,043,169	\$ 13.79	July 8, 2004
May 26, 2004	1,000,000	-	\$ -	\$ -	
	<u>3,500,000</u>	<u>2,453,311</u>	<u>\$ 29,125,522</u>	<u>\$ 11.87</u>	

The repurchases will occur periodically in the open market or through privately negotiated transactions based on market conditions and other factors. During the second quarter and first six months of fiscal 2004, the Company repurchased 586,600 and 1,014,847 shares, respectively. As of June 27, 2004, the Company had remaining authorization to repurchase an aggregate of 1,046,689 shares of its outstanding common stock.

During the period from June 28, 2004 to July 28, 2004, the Company repurchased an additional 503,200 shares of stock at a cost of \$7.8 million, representing an average cost of \$15.42 per share.

## 8. Stock Options

The Company has chosen to adopt the disclosure only provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), as amended by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure – an amendment of FASB Statement No. 123" ("SFAS 148"), and continues to account for stock-based compensation using the intrinsic value

method prescribed in Accounting Principles Board (“APB”) Opinion No. 25, “Accounting for Stock Issued to Employees” (“APB 25”), and related interpretations. Under this approach, the imputed cost of stock option grants and discounts offered under the Company’s Employee Stock Purchase Plan (“ESPP”) is disclosed, based on the vesting provisions of the individual grants, but not charged to expense.

The weighted average fair values of the Company’s stock options granted during the first six months of fiscal 2004 and fiscal 2003, calculated using the Black-Scholes option-pricing model, and other assumptions are as follows:

	<b>Six Months Ended</b>	
	<b>June 27, 2004</b>	<b>June 29, 2003</b>
Risk-free interest rate	3.36%	3.60%
Expected volatility	60%	60%
Expected life	6 to 8 years	6 to 8 years
Contractual life	10 years	10 years
Expected dividend yield	0%	0%
Weighted average fair value of options granted	\$ 7.64	\$ 5.22

Pro forma compensation expense is calculated for the fair value of the employee’s purchase rights under the ESPP, using the Black-Scholes model. Assumptions for the first six months of fiscal 2004 and fiscal 2003 are as follows:

	<b>Six Months Ended</b>	
	<b>June 27, 2004</b>	<b>June 29, 2003</b>
Risk-free interest rate	1.02%	1.25%
Expected volatility	28%	32%
Expected life	0.5 years	0.5 years
Expected dividend yield	0%	0%

The following table presents net income and basic and diluted income per common share had the Company elected to recognize compensation cost based on the fair value at the grant dates for stock option awards and discounts for stock purchases under the Company’s ESPP, consistent with the method prescribed by SFAS 123, as amended by SFAS 148 (in thousands, except per share amounts):

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 27, 2004</b>	<b>June 29, 2003</b>	<b>June 27, 2004</b>	<b>June 29, 2003</b>
Net income - as reported	\$ 5,965	\$ 5,247	\$ 15,195	\$ 10,448
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of tax	(717)	(470)	(1,412)	(820)
Net income - pro forma	\$ 5,248	\$ 4,777	\$ 13,783	\$ 9,628
Basic income per share - as reported	\$ 0.24	\$ 0.20	\$ 0.60	\$ 0.39
Basic income per share - pro forma	\$ 0.21	\$ 0.18	\$ 0.54	\$ 0.36
Diluted income per share - as reported	\$ 0.22	\$ 0.19	\$ 0.56	\$ 0.38
Diluted income per share - pro forma	\$ 0.20	\$ 0.17	\$ 0.51	\$ 0.35

During the first six months of fiscal 2004, the Company granted 1,030,100 stock options to officers, directors and employees under its existing option plans at an average exercise price of \$12.94. At June 27, 2004, there were 3,522,984 options outstanding at a weighted average exercise price of \$8.15 per share.

## 9. Legal Matters

### **Litigation**

In addition to the matters referenced in this Note 9, the Company is party to certain legal actions arising in the ordinary course of business, including legal actions arising out of services rendered by its various operations, personal injury and employment disputes.

*Cooper v. Gentiva CareCentrix, Inc. t/a/d/b/a/ Gentiva Health Services*, U.S. District Court (W.D. Penn), Civil Action No. 01-0508. On January 2, 2002, this amended complaint was served on the Company alleging that the defendant submitted false claims to the government for payment in violation of the Federal False Claims Act, 31 U.S.C. 3729 et seq., and that the defendant had wrongfully terminated the plaintiff. The plaintiff claimed that infusion pumps delivered to patients did not supply the full amount of medication, allegedly resulting in substandard care. Based on a review of the court's docket sheet, the plaintiff filed a complaint under seal in March 2001. In October 2001, the United States government filed a notice with the court declining to intervene in this matter, and on October 24, 2001, the court ordered that the seal be lifted. The Company filed its responsive pleading on February 25, 2002, and discovery has commenced. The Company has denied the allegations of wrongdoing in the complaint and is defending itself vigorously in this matter. On May 19, 2003, the Company filed a motion for summary judgment on the issue of liability. On February 6, 2004, the court granted partial summary judgment for the Company, dismissing two of the three claims alleged under the False Claims Act and denying summary judgment for the Company on the wrongful termination claim. The parties are completing discovery; therefore, the Company cannot determine a range of damages, if any, at this time.

### **Government Matters**

#### **PRRB Appeal**

Prior to October 1, 2000, reimbursement of Medicare home care nursing services was based on reasonable, allowable costs incurred in providing services to eligible beneficiaries subject to both per visit and per beneficiary limits in accordance with the Interim Payment System established through the Balanced Budget Act of 1997. These costs were reported in annual cost reports, which were filed with the CMS, and were subject to audit by the fiscal intermediary engaged by CMS. In connection with the audit of the Company's 1997 cost reports, the Medicare fiscal intermediary made certain audit adjustments related to the methodology used by the Company to allocate a portion of its residual overhead costs. The Company filed cost reports for years subsequent to 1997 using the fiscal intermediary's methodology. The Company believed its methodology used to allocate such overhead costs was accurate and consistent with past practice accepted by the fiscal intermediary; as such, the Company filed appeals with the PRRB concerning this issue with respect to cost reports for the years 1997, 1998 and 1999. The Company's consolidated financial statements for the years 1997, 1998 and 1999 had reflected use of the methodology mandated by the fiscal intermediary.

In June 2003, the Company and its Medicare fiscal intermediary signed an Administrative Resolution relating to the issues covered by the appeals pending before the PRRB. Under the terms of the Administrative Resolution, the fiscal intermediary agreed to reopen and adjust the Company's cost reports for the years 1997, 1998 and 1999 using a modified version

of the methodology used by the Company prior to 1997. This modified methodology will also be applied to cost reports for the year 2000, which are currently under audit. The Administrative Resolution required that the process to (i) reopen all 1997 cost reports, (ii) determine the adjustments to allowable costs through the issuance of Notices of Program Reimbursement (“NPRs”) and (iii) make appropriate payments to the Company, be completed in early 2004. Cost reports relating to years subsequent to 1997 will be reopened after the process for the 1997 cost reports is completed.

On February 17, 2004, the fiscal intermediary notified the Company that it had completed the reopening of all 1997 cost reports and determined that the adjustment to allowable costs for that year was \$9.0 million. As of March 28, 2004, the Company had received the funds and recorded the adjustment of \$9.0 million as net revenues for the first quarter of fiscal 2004.

Although the Company believes that it will likely recover additional funds as a result of applying the modified methodology discussed above to cost reports subsequent to 1997, the settlement amounts cannot be specifically determined until the reopening or audit of each year’s cost reports is completed. The Company expects that the reopening of the 1998 cost reports will be completed during the second half of fiscal 2004. The reopening or audit of the cost reports for the years 1999 and 2000 is not expected to be completed before 2005. In view of changes in reimbursement and the Company’s operations in periods subsequent to 1997, it is likely that any future recoveries relating to any cost report year from 1998 to 2000 will be significantly less than the 1997 settlement.

### **Subpoena**

On April 17, 2003, the Company received a subpoena from the Department of Health and Human Services, Office of the Inspector General, Office of Investigations (“OIG”). The subpoena seeks information regarding the Company’s implementation of settlements and corporate integrity agreements entered into with the government, as well as the Company’s treatment on cost reports of employees engaged in sales and marketing efforts. With respect to the cost report issues, the government has preliminarily agreed to narrow the scope of production to the period from January 1, 1998 through September 30, 2000. On February 17, 2004, the Company received a subpoena from the U.S. Department of Justice (“DOJ”) seeking additional information related to the matters covered by the OIG subpoena. The Company has provided documents and other information requested by the OIG pursuant to its subpoena and similarly intends to cooperate fully with the DOJ subpoena, as well as any future OIG or DOJ information requests. To the Company’s knowledge, the government has not filed a complaint against the Company.

### **Indemnifications**

Gentiva became an independent, publicly owned company on March 15, 2000, when the common stock of the Company was issued to the stockholders of Olsten Corporation, a Delaware corporation (“Olsten”), the former parent corporation of the Company (the “Split-Off”). In connection with the Split-Off, the Company agreed to assume, to the extent permitted by law, and to indemnify Olsten for, the liabilities, if any, arising out of the home health services business.

In addition, the Company and Accredo Health, Incorporated (“Accredo”) agreed to indemnify each other for breaches of representations and warranties of such party or the non-fulfillment of any covenant or agreement of such party in connection with the sale of the Company’s Specialty Pharmaceutical Services (“SPS”) business to Accredo on June 13, 2002. The Company also agreed to indemnify Accredo for the retained liabilities and for tax liabilities and Accredo agreed to indemnify the Company for assumed liabilities and the operation of the SPS business after the closing of the acquisition. The representations and warranties generally survived for the period of two years after the closing of the acquisition, which period expired on June 13, 2004.

Certain representations and warranties, however, continue to survive, including the survival of representations and warranties related to health care compliance for three years after the closing of the acquisition and the survival of representations and warranties related to tax matters until thirty days after the expiration of the applicable statute of limitations period, including any extensions of the applicable period, subject to certain exceptions. Accredo and the Company generally may recover indemnification for a breach of a representation or warranty only to the extent a party’s claim exceeds \$1 million for any individual claim, or exceeds \$5 million in the aggregate, subject to certain conditions and only up to a maximum amount of \$100 million.

#### 10. Income Taxes

The Company recorded federal and state income taxes of approximately \$3.8 million for the second quarter ended June 27, 2004, of which \$1.6 million represented a current provision and \$2.2 million represented a deferred tax provision. For the six months ended June 27, 2004, the Company recorded a federal and state tax provision of \$9.7 million, representing a current provision of \$2.3 million and a deferred provision of \$7.4 million. The difference between the federal statutory income tax rate and the Company’s effective tax rate of 39 percent is due primarily to state taxes.

State income taxes and federal alternative minimum taxes of \$0.4 and \$1.1 million were recorded for the second quarter and first six months of fiscal 2003, respectively. The Company’s effective tax rates of approximately 7.8 percent for the second quarter and 9.2 percent for the first six months of fiscal 2003, were lower than the statutory income tax rate due to the impact of a valuation allowance offsetting the realization of tax benefits associated with the Company’s net operating loss carryforward and other deferred tax assets.

Deferred tax assets and deferred tax liabilities were as follows (in thousands):

	<u>June 27, 2004</u>	<u>December 28, 2003</u>
Deferred tax assets - current		
Reserves and allowances	\$ 20,516	\$ 21,290
Net operating loss and other carryforwards (Federal and state)	1,967	4,966
Other	727	208
Total current deferred tax assets	<u>23,210</u>	<u>26,464</u>
Deferred tax assets - non-current		
Amortization of intangible assets	27,444	29,085
Depreciation of fixed assets	(1,756)	23
Developed software	(1,667)	(1,083)
Other	(390)	-
Total non-current deferred tax assets (net)	<u>23,631</u>	<u>28,025</u>
Net deferred tax assets	<u>\$ 46,841</u>	<u>\$ 54,489</u>

As of June 27, 2004, the Company's tax credit carryforwards for income tax purposes were approximately \$2.0 million.

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

**Forward-looking Statements**

Certain statements contained in this Quarterly Report on Form 10-Q, including, without limitation, statements containing the words "believes," "anticipates," "intends," "expects," "assumes," "trends" and similar expressions, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based upon the Company's current plans, expectations and projections about future events. However, such statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following:

- general economic and business conditions;
- demographic changes;
- changes in, or failure to comply with, existing governmental regulations;
- legislative proposals for health care reform;
- changes in Medicare and Medicaid reimbursement levels;
- effects of competition in the markets in which the Company operates;
- liability and other claims asserted against the Company;
- ability to attract and retain qualified personnel;
- availability and terms of capital;
- loss of significant contracts or reduction in revenue associated with major payer sources;
- ability of customers to pay for services;

- a material shift in utilization within capitated agreements; and
- changes in estimates and judgments associated with critical accounting policies.

Forward-looking statements are found throughout “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere in this Quarterly Report on Form 10-Q. The reader should not place undue reliance on forward-looking statements, which speak only as of the date of this report. Except as required under the federal securities laws and the rules and regulations of the Securities and Exchange Commission (“SEC”), the Company does not have any intention or obligation to publicly release any revisions to forward-looking statements to reflect unforeseen or other events after the date of this report. The Company has provided a detailed discussion of risk factors in its 2003 Annual Report on Form 10-K and various filings with the SEC. The reader is encouraged to review these risk factors and filings.

The following discussion and analysis provides information which management believes is relevant to an assessment and understanding of the Company’s results of operations and financial position. This discussion and analysis should be read in conjunction with the Company’s consolidated financial statements and related notes included elsewhere in this report.

### General

The Company’s results of operations are impacted by various regulations and other matters that are implemented from time to time in its industry, some of which are described in the Company’s Annual Report on Form 10-K for the fiscal year ended December 28, 2003 and in other filings with the SEC.

For a discussion of the Company’s critical accounting policies, please refer to Note 2 of Notes to Consolidated Financial Statements in the Company’s 2003 Annual Report on Form 10-K.

### Overview

Gentiva is the nation’s largest provider of comprehensive home health services, based on the amount of revenues derived from the provision of skilled home nursing services to patients. The Company generates revenues and profits primarily by providing patients with direct home health care services, including specialty services and neuro-rehabilitation services; by delivering national, regional and local administrative services to managed care organizations and self-insured employers; and by providing home health care consulting services to independent and hospital-based home health agencies.

Gentiva’s direct home health services to patients include skilled nursing; physical, occupational, speech and neuro-rehabilitation therapy services; social work; nutrition; disease management education and help with daily living activities, as well as other therapies and services. The Company’s specialty services involve physical therapist-led orthopedic rehabilitation services for patients who have had joint replacements or other major orthopedic surgery, and therapies for patients with balance issues who are prone to injury or immobility as a result of falling. Gentiva is also piloting a similar specialty program for cardiopulmonary services and expects to launch this program during the second half of fiscal 2004. The Company’s

neuro-rehabilitation services, known as Rehab Without Walls<sup>®</sup>, provide home and community-based therapies for patients with traumatic brain injury, cerebrovascular accident injury and acquired brain injury, as well as a number of other complex rehabilitation cases.

Gentiva's national, regional and local administrative services for managed care organizations and self-insured employers -- provided through its CareCentrix<sup>®</sup> business unit -- include central access, care coordination, utilization management and claims processing. The Company is capable of coordinating a wide range of home care services, including traditional home nursing, chronic and acute infusion therapies and durable medical and respiratory equipment, to member patients of these managed care organizations.

Consulting services to home health agencies are delivered primarily by the Company's Gentiva Consulting (formerly Gentiva Business Services) unit. These services include billing and collection activities, web-based caregiver training and credentialing, on-site agency support and consulting, operational support and individualized strategies for reduction of days sales outstanding.

The Company's services can be delivered across the United States 24 hours a day, 7 days a week. Direct home health services to patients are delivered through more than 350 owned and operated direct service delivery units in approximately 250 locations in 35 states. Administrative services for managed care organizations and self-insured employers are coordinated within four regional coordination centers. Home care services provided to member patients of these organizations are delivered through Company-owned and third-party credentialed provider locations covering the continental United States.

## Results of Operations

### *Net Revenues*

(Dollars in millions)

	<u>Second Quarter</u>			<u>Six Months</u>		
			<u>Percentage</u>			<u>Percentage</u>
	<u>2004</u>	<u>2003</u>	<u>Variance</u>	<u>2004</u>	<u>2003</u>	<u>Variance</u>
Medicare	\$ 53.8	\$ 42.0	28.3%	\$ 116.4	\$ 84.5	37.8%
Medicaid and other government	39.0	42.7	(8.7)	78.2	85.0	(8.0)
Commercial insurance and other	115.4	123.7	(6.7)	227.6	241.0	(5.6)
	<u>\$ 208.2</u>	<u>\$ 208.4</u>	<u>(0.1%)</u>	<u>\$ 422.2</u>	<u>\$ 410.5</u>	<u>2.9%</u>

For the quarter ended June 27, 2004 as compared to the quarter ended June 29, 2003, net revenues declined by \$0.2 million to \$208.2 million from \$208.4 million. Net revenues increased by \$11.7 million to \$422.2 million for the first six months of fiscal 2004 as compared to \$410.5 million for the first six months of fiscal 2003.

Medicare revenue growth, in the fiscal 2004 periods as compared to the fiscal 2003 periods, was driven by several factors including: (i) an increase in admissions of 13 percent for the second quarter and 17 percent for the first six months, (ii) growth in specialty services which generally generate a higher revenue per episode than other Medicare services, (iii) a 3.3 percent market basket rate increase that became effective for patients on service on or after October 1, 2003, which was adjusted downward by 0.8 percent to 2.5 percent effective April 1, 2004, (iv) a 5 percent rate increase effective April 1, 2004 for the rural add-on related

to home health services performed in specifically defined rural areas of the country, and (v) various operational and clinical process enhancements. The rate increases relating to the market basket change and rural add-on provision represented incremental revenue of \$1.3 million and \$2.7 million for the second quarter and first six months of fiscal 2004, respectively.

In addition, for the first six months of fiscal 2004, Medicare revenues were impacted by two special items which contributed \$8.0 million of the Medicare increase. The special items represented (i) approximately \$9 million received in settlement of the Company's appeal filed with the PRRB related to the reopening of all of its 1997 cost reports and (ii) a revenue adjustment of \$1.0 million to reflect the estimated repayment to Medicare in connection with services rendered to certain patients since the inception of the Prospective Payment Reimbursement System in October 2000. In connection with the estimated repayments, the CMS has recently determined that homecare providers should have received lower reimbursements for certain services rendered to beneficiaries discharged from inpatient hospitals within fourteen days immediately preceding admission to home healthcare.

Medicaid and other government revenue decreased, in the fiscal 2004 periods as compared to the fiscal 2003 periods, primarily due to a reduction in the Company's participation in certain low-margin, hourly Medicaid and state and county health programs. Revenues relating to hourly Medicaid and state and county programs decreased \$3.7 million and \$6.4 million for the second quarter and first six months of fiscal 2004, respectively, as compared to the corresponding periods of fiscal 2003.

Commercial insurance and other revenue decreased, in the fiscal 2004 periods as compared to the fiscal 2003 periods, due to a decline in revenue derived from CIGNA Health Corporation ("CIGNA") of \$9.9 million, or 12.8 percent, and \$22.2 million, or 14.4 percent, for the second quarter and first six months, respectively, related to a reduction in the number of enrolled CIGNA members in 2004, and lower revenue as well as related costs resulting from a change in the Company's delivery model of certain durable medical and respiratory equipment ("HME") products and services. The decline in CIGNA revenues was partially offset by an increase of \$1.5 million, or 3.2 percent, and \$8.7 million, or 10.0 percent, for the second quarter and first six months of fiscal 2004, respectively, in non-CIGNA, Commercial insurance and other revenue driven by unit volume and pricing increases from existing business as well as new contracts signed during the past year.

## ***Gross Profit***

(Dollars in millions)	<b>Second Quarter</b>			<b>Six Months</b>		
	<b><u>2004</u></b>	<b><u>2003</u></b>	<b><u>Variance</u></b>	<b><u>2004</u></b>	<b><u>2003</u></b>	<b><u>Variance</u></b>
Gross profit	\$ 78.3	\$ 69.6	\$ 8.7	\$ 161.6	\$ 138.4	\$ 23.2
As a percent of revenue	37.6%	33.4%	4.2%	38.3%	33.7%	4.6%

As a percent of revenues, gross profit margins were positively impacted by 1.2 percentage points for the first six months of fiscal 2004 due to the two special items discussed above. Approximately one-half of the increase in gross profit margins in the second quarter and one-half of the remaining increase for the first six months of fiscal 2004 was due to a favorable change in business mix in which volume growth of Medicare business more than offset the anticipated revenue loss in certain low-margin Medicaid and local government programs, as well as in the CIGNA business. The balance of the gross margin percentage increase resulted from improved rates in both Medicare and managed care contracts, reduced workers compensation expenses and growth in the Company's specialty programs.

## ***Selling, General and Administrative Expenses***

Selling, general and administrative expenses, including depreciation and amortization, increased \$5.6 million to \$69.7 million for the quarter ended June 27, 2004, as compared to \$64.1 million for the quarter ended June 29, 2003 and \$10.9 million to \$137.9 million for the six months ended June 27, 2004.

Approximately one-third of the increases in selling, general and administrative expenses, including depreciation and amortization, related to increases in field operating and administrative costs to service incremental revenues, including revenues from the Company's specialty programs. The remaining increases related to (i) increased sales and clinical care coordination expenses, (ii) incremental costs associated with both strategic and other information technology initiatives, (iii) costs associated with the reconfiguration of the Company's CareCentrix network of HME providers and (iv) various other costs.

## ***Gain on Sale of Canadian Investment***

On March 30, 2004, the Company sold its minority interest in a home care nursing services business in Canada. The business had been acquired as partial consideration for the sale of the Company's Canadian operations in the fourth quarter of fiscal 2000. In connection with the March 30, 2004 sale, the Company received cash proceeds of \$4.1 million and recorded a gain on sale of approximately \$0.9 million in the second quarter of fiscal 2004.

## ***Interest Income, Net***

Net interest income was approximately \$0.2 million for the quarter ended June 27, 2004, and \$0.1 million for the quarter ended June 29, 2003. Net interest income included interest income of approximately \$0.5 million for the second quarter of fiscal 2004 and \$0.4 million for the second quarter of fiscal 2003, partially offset by fees relating to the revolving credit facility and outstanding letters of credit.

Net interest income was approximately \$0.3 million for the six months ended June 27, 2004 compared to \$0.2 million for the six months ended June 29, 2003. Net interest income for the first six months of fiscal years 2004 and 2003 represented interest income of \$0.8 million and \$0.7 million, respectively, partially offset by interest expense of \$0.5 million in both the fiscal 2004 and fiscal 2003 six month periods.

### ***Income Taxes***

The Company recorded federal and state income taxes of approximately \$3.8 million for the second quarter ended June 27, 2004, of which \$1.6 million represented a current provision and \$2.2 million represented a deferred tax provision. For the six months ended June 27, 2004, the Company recorded a federal and state tax provision of \$9.7 million, representing a current provision of \$2.3 million and a deferred provision of \$7.4 million. The difference between the federal statutory income tax rate and the Company's effective tax rate of 39 percent is due primarily to state taxes.

State income taxes and federal alternative minimum taxes of \$0.4 and \$1.1 million were recorded for the second quarter and first six months of fiscal 2003, respectively. The Company's effective tax rate of approximately 7.8 percent for the second quarter and 9.2 percent for the first six months of fiscal 2003 was lower than the statutory income tax rate due to the impact of a valuation allowance offsetting the realization of tax benefits associated with the net operating loss carryforward and other deferred tax assets.

### ***Net Income***

For the second quarter of fiscal 2004, net income was \$6.0 million, or \$0.22 per diluted share, compared with net income of \$5.2 million, or \$0.19 per diluted share, for the corresponding period of 2003.

For the first six months of fiscal 2004, net income was \$15.2 million, or \$0.56 per diluted share, compared with net income of \$10.4 million, or \$0.38 per diluted share for the first six months of fiscal 2003. Net income for the first six months of fiscal 2004 included two special items related to Medicare, noted in the Net Revenues section above, which had a net positive impact of \$4.9 million, or \$0.18 per diluted share.

Net income for both the second quarter and first six months of fiscal 2004 included a net gain of \$0.6 million, or \$0.02 per diluted share, on the sale of the Company's 19.9 percent interest in a Canadian home care company. See Note 5 to the Company's consolidated financial statements.

Net income for the second quarter and first six months of fiscal 2003 reflected the positive impact of lower effective tax rates of 7.8 percent and 9.2 percent, respectively.

## Liquidity and Capital Resources

### *Liquidity*

The Company's principal source of liquidity is the collection of its accounts receivable. For healthcare services, the Company grants credit without collateral to its patients, most of whom are insured under third party commercial or governmental payer arrangements. Net cash provided by operating activities for the six months ended June 27, 2004 was \$15.7 million. In addition, the Company received cash proceeds of \$4.1 million during the second quarter of 2004 in connection with the sale of the Company's investment in a Canadian home-care business. These cash resources were primarily used to fund capital expenditures of \$5.5 million and repurchase shares of the Company's common stock of \$14.7 million during the first six months of fiscal 2004.

Days Sales Outstanding ("DSO") as of June 27, 2004, decreased by 1 day to 58 days, from December 28, 2003. Working capital at June 27, 2004 was approximately \$143 million, an increase of \$7 million as compared to approximately \$136 million at December 28, 2003, primarily due to:

- a \$1 million increase in cash;
- a \$1 million increase in accounts receivable;
- a \$1 million increase in prepaid expenses and other assets; and
- a \$7 million decrease in current liabilities for accounts payable (\$4 million), obligations under insurance programs (\$1 million), other current liabilities (\$4 million), net of increases in payroll (\$1 million) and Medicare liabilities (\$1 million); offset by a \$3 million decrease in deferred tax assets.

The Company participates in the Medicare, Medicaid and other federal and state healthcare programs. Revenue mix by major payer classifications is as follows:

	Three Months Ended		Six Months Ended	
	June 27, 2004	June 29, 2003	June 27, 2004	June 29, 2003
Medicare	26%	20%	28%	21%
Medicaid and other government	19	21	19	21
Commercial insurance and other	55	59	53	58
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

On October 1, 2003, a 3.3 percent Medicare market basket rate increase became effective for patients on service on or after October 1, 2003. Effective April 1, 2004, this increase was reduced by 0.8 percent to 2.5 percent for open episodes of care on or after April 1, 2004. In addition, Medicare reimbursement was increased 5 percent for the rural add-on related to home health services performed in specifically defined rural areas of the country, effective April 1, 2004. These two reimbursement changes are not expected to have a material effect on Company results for the remainder of 2004.

There are certain standards and regulations that the Company must adhere to in order to continue to participate in these programs, including compliance with the Company's corporate integrity agreement. As part of these standards and regulations, the Company is subject to periodic audits, examinations and investigations conducted by, or at the direction of, gov-

ernmental investigatory and oversight agencies. Periodic and random audits conducted or directed by these agencies could result in a delay or adjustment to the amount of reimbursements received under these programs. Violation of the applicable federal and state health care regulations can result in the Company's exclusion from participating in these programs and can subject the Company to substantial civil and/or criminal penalties. The Company believes it is currently in compliance with these standards and regulations.

The Company is party to a contract with CIGNA, pursuant to which the Company provides or contracts with third party providers to provide home nursing services, acute and chronic infusion therapies, durable medical equipment and respiratory products and services to patients insured by CIGNA. For the second quarter and first six months of fiscal 2004, CIGNA accounted for approximately 32 percent and 31 percent of the Company's total net revenues, respectively, compared to approximately 37 percent and 38 percent for the second quarter and first six months of fiscal 2003, respectively. The Company extended its relationship with CIGNA by entering into a new national home health care contract, effective January 1, 2004. The term of the new contract extends to December 31, 2006, and automatically renews thereafter for additional one year terms unless terminated. Under the termination provisions, CIGNA has the right to terminate the agreement on December 31, 2005 if it provides 90 days advance written notice to the Company, and each party has the right to terminate at the end of each term thereafter by providing at least 90 days advance written notice prior to the start of the new term. If CIGNA chose to terminate or not renew the contract, or to significantly modify its use of the Company's services, there could be a material adverse effect on the Company's cash flow.

Net revenues generated under capitated agreements with managed care payers were approximately 12 percent of total net revenues for the second quarter and first six months of fiscal 2004, and 15 percent and 16 percent for the second quarter and first six months of fiscal 2003, respectively. Fee-for-service contracts with other commercial payers are traditionally one year in term and renewable automatically on an annual basis, unless terminated by either party.

The Company's credit facility, which was amended on August 7, 2003 and May 26, 2004 as described below, provides up to \$55 million in borrowings, including up to \$40 million which is available for letters of credit. The Company may borrow up to a maximum of 80 percent of the net amount of eligible accounts receivable, as defined, less any reasonable and customary reserves, as defined, required by the lender. Borrowing availability under the credit facility was reduced by \$10 million until such quarter in 2003 in which the trailing 12 month EBITDA, excluding certain restructuring costs and special charges recorded by the Company during fiscal 2002, as defined, exceeded \$15 million. As of March 30, 2003, the trailing 12 months EBITDA threshold was achieved and the availability restriction lifted, effective June 1, 2003.

At the Company's option, the interest rate on borrowings under the credit facility was based on the London Interbank Offered Rates (LIBOR) plus 3.25 percent or the lender's prime rate plus 1.25 percent. In addition, the Company was required to pay a fee equal to 2.5 percent per annum of the aggregate face amount of outstanding letters of credit. Beginning in 2003, the applicable margins for the LIBOR borrowing, prime rate borrowing and letter of credit fees decreased by 0.25 percent to 3.0 percent, 1.0 percent, and 2.25 percent, respectively, provided that the Company's trailing 12 month EBITDA, excluding certain restructur-

ing costs and special charges, as defined, was in excess of \$20 million. The Company was also subject to an unused line fee equal to 0.50 percent per annum of the average daily difference between the total revolving credit facility amount, as defined, and the total outstanding borrowings and letters of credit. Beginning in 2003, the unused credit line fee decreased to 0.375 percent provided the minimum EBITDA target described above was achieved.

The higher margins and fees are subject to reinstatement in the event that the Company's trailing 12 month EBITDA falls below \$20 million. The Company met this minimum EBITDA requirement as of March 30, 2003, with the rate reduction effective June 1, 2003, and continued to meet this requirement as of June 27, 2004.

Total outstanding letters of credit were \$20.7 million as of June 27, 2004. The letters of credit, which expire one year from date of issuance, were issued to guarantee payments under the Company's workers compensation program and for certain other commitments. As of June 27, 2004, there were no borrowings outstanding under the credit facility and the Company had borrowing capacity under the credit facility, after adjusting for outstanding letters of credit, of approximately \$34 million.

The credit facility, which expires in June 2006, includes certain covenants requiring the Company to maintain a minimum tangible net worth of \$101.6 million, minimum EBITDA, as defined, and a minimum fixed charge coverage ratio, as defined. Other covenants in the credit facility include limitations on mergers, consolidations, acquisitions, indebtedness, liens, distributions including dividends, capital expenditures, stock repurchases and dispositions of assets and other limitations with respect to the Company's operations. On August 7, 2003 and May 26, 2004, the credit facility was amended to make covenants relating to acquisitions and stock repurchases less restrictive, provided that the Company maintains minimum excess aggregate liquidity, as defined, equal to at least \$60 million and to allow for the disposition of certain assets. As of June 27, 2004, the Company was in compliance with the covenants in the credit facility, as amended.

The credit facility further provides that if the agreement is terminated for any reason, the Company must pay an early termination fee equal to \$137,500 in the period from June 13, 2004 to June 12, 2005. There is no fee for termination of the facility subsequent to June 12, 2005. Loans under the credit facility are collateralized by all of the Company's tangible and intangible personal property, other than equipment.

The credit facility includes provisions, which, if not complied with, could require early payment by the Company. These include customary default events, such as failure to comply with financial covenants, insolvency events, non-payment of scheduled payments, acceleration of other financial obligations and change in control provisions. In addition, these provisions include an account obligor, whose accounts are more than 25 percent of all accounts of the Company over the previous 12-month period, canceling or failing to renew its contract with the Company and ceasing to recognize the Company as an approved provider of health care services, or the Company revoking the lending agent's control over its governmental lockbox accounts. The Company does not have any trigger events in the credit facility that are tied to changes in its credit rating or stock price. As of June 27, 2004, the Company was in compliance with these provisions.

The Company may be subject to workers compensation claims and lawsuits alleging negligence or other similar legal claims. The Company maintains various insurance programs

to cover this risk but is substantially self-insured for most of these claims. The Company recognizes its obligations associated with these programs in the period the claim is incurred. The Company estimates the cost of both reported claims and claims incurred but not reported, up to specified deductible limits, based on its own specific historical claims experience and current enrollment statistics, industry statistics and other information. Such estimates and the resulting reserves are reviewed and updated periodically.

The Company is responsible for the cost of individual workers compensation claims and individual professional liability claims up to \$500,000 per incident which occurred prior to March 15, 2002 and \$1,000,000 per incident thereafter. The Company also maintains excess liability coverage relating to professional liability and casualty claims which provides insurance coverage for individual claims of up to \$25,000,000 in excess of the underlying coverage limits. Payments under the Company's workers compensation program are guaranteed by letters of credit and segregated restricted cash balances.

### ***Capital Expenditures***

The Company's capital expenditures for the six months ended June 27, 2004 were \$5.5 million, excluding equipment capitalized under capital lease obligations of \$1.4 million, as compared to \$3.9 million for the same period in fiscal 2003. The Company intends to make investments and other expenditures to, among other things, upgrade its computer technology and systems infrastructure and comply with regulatory changes in the industry. In this regard, management expects that capital expenditures for fiscal 2004 will range between \$9.0 million and \$12.0 million. Management expects that the Company's capital expenditure needs will be met through operating cash flow and available cash reserves.

### ***Cash Resources and Obligations***

The Company had cash, cash equivalents, restricted cash and short-term investments of approximately \$111.1 million as of June 27, 2004. The restricted cash relates to cash funds of \$21.8 million that have been segregated in a trust account to provide additional collateral under the Company's insurance programs. Interest on the funds in the trust account accrues to the Company. The Company, at its option, may access the cash funds in the trust account by providing equivalent amounts of alternative security, including letters of credit and surety bonds.

The Company anticipates that repayments to Medicare for partial episode payments and prior year cost report settlements will be made periodically through 2005. These amounts are reflected as Medicare liabilities in the accompanying consolidated balance sheets.

The Company's Board of Directors has authorized stock repurchase programs under which the Company could repurchase and formally retire up to an aggregate of 3,500,000 shares of its outstanding common stock. The repurchases occur periodically in the open market or through privately negotiated transactions based on market conditions and other factors. During the first six months of fiscal 2004, the Company repurchased 1,014,847 shares of its outstanding common stock at an average cost of \$14.49 per share and a total cost of approximately \$14.7 million. As of June 27, 2004, the Company had remaining authorization to repurchase an aggregate of 1,046,689 shares of its outstanding common stock. During the period from June 28, 2003 to July 28, 2004, the Company repurchased an additional 503,200

shares of common stock at a cost of \$7.8 million, representing an average cost of \$15.42 per share. See also Note 7 and Part II, Item 2, of this Form 10-Q.

***Contractual Obligations and Commercial Commitments***

At June 27, 2004, the Company had no long-term debt. During the first six months of fiscal 2004, the Company commenced implementation of a five-year capital lease for equipment. Under the terms of the lease, the Company capitalized the equipment at its fair market value of approximately \$1.4 million, which approximates the present value of the minimum lease payments. Future minimum rental commitments for all non-cancelable leases and purchase obligations at June 27, 2004, are as follows (in thousands):

<u>Contractual Obligations</u>	<u>Payment due by period</u>				
	<u>Total</u>	<u>Less than 1 year</u>	<u>1-3 years</u>	<u>4-5 years</u>	<u>More than 5 years</u>
Long-term debt obligations	\$ -	\$ -	\$ -	\$ -	\$ -
Capital lease obligations	1,283	268	577	438	-
Operating lease obligations	57,811	18,832	25,269	9,083	4,627
Purchase obligations	400	400	-	-	-
Total	<u>\$ 59,494</u>	<u>\$ 19,500</u>	<u>\$ 25,846</u>	<u>\$ 9,521</u>	<u>\$ 4,627</u>

The Company had total letters of credit outstanding under its credit facility of approximately \$20.7 million at June 27, 2004 and \$20.8 million at December 28, 2003. The letters of credit, which expire one year from the date of issuance, were issued to guarantee payments under the Company’s workers compensation program and for certain other commitments. The Company has the option to renew these letters of credit or set aside cash funds in a segregated account to satisfy the Company’s obligations, as further discussed above under the caption “Cash Resources and Obligations”.

The Company has no other off-balance sheet arrangements and has not entered into any transactions involving unconsolidated, limited purpose entities or commodity contracts.

Management expects that the Company’s working capital needs for fiscal 2004 will be met through operating cash flow and its existing cash balances. The Company may also consider other alternative uses of cash including, among other things, acquisitions, additional share repurchases and cash dividends. These uses of cash would require the approval of the Company’s Board of Directors and may require the approval of its lender. If cash flows from operations, cash resources or availability under the credit facility fall below expectations, the Company may be forced to delay planned capital expenditures, reduce operating expenses, seek additional financing or consider alternatives designed to enhance liquidity.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Generally, the fair market value of fixed rate debt will increase as interest rates fall and decrease as interest rates rise. The Company had no interest rate exposure on fixed rate debt or other market risk at June 27, 2004.

Item 4. Controls and Procedures

***Evaluation of disclosure controls and procedures.***

The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934, as amended ("Exchange Act") Rule 13a-15(e)) as of the end of the period covered by this report. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are adequate and effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within required time periods.

***Changes in internal control over financial reporting.***

As required by the Exchange Act Rule 13a-15(d), the Company's Chief Executive Officer and Chief Financial Officer evaluated the Company's internal control over financial reporting to determine whether any change occurred during the quarter ended June 27, 2004 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. Based on that evaluation, there has been no such change during such quarter.

## PART II - OTHER INFORMATION

Item 1. Legal Proceedings

See Note 9 to the consolidated financial statements included in this report for a description of legal matters and pending legal proceedings, which description is incorporated herein by reference.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

(e) Issuer Purchases of Equity Securities (1)

<u>Period</u>	<u>(a) Total Number of Shares Purchased</u>	<u>(b) Average Price Paid per Share</u>	<u>(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>(d) Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs</u>
April (3/29/04 - 4/25/04)	60,000	\$ 15.61	60,000	573,289
May (4/26/04 - 5/23/04)	425,600	\$ 14.88	425,600	147,689
June (5/24/04 - 6/27/04)	101,000	\$ 15.85	101,000	1,046,689
Total	<u>586,600</u>	<u>\$ 15.12</u>	<u>586,600</u>	

(1) On August 7, 2003, the Company announced that its Board of Directors had authorized the repurchase of up to 1,500,000 shares of its outstanding common stock. By the end of the period covered by the table, 1,453,311 of such shares had been repurchased. On May 26, 2004, the Company announced that its Board of Directors had authorized the repurchase of up to 1,000,000 additional shares of its outstanding common stock.

Item 3. Defaults Upon Senior Securities

None.

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

(a) The Annual Meeting of Shareholders was held on May 14, 2004.

(c) i) The following individuals were elected as Class I directors by votes as follows:

<u>Name</u>	<u>Votes FOR</u>	<u>Votes WITHHELD</u>
Victor F. Ganzi	21,256,760	548,622
Josh S. Weston	19,742,515	2,062,907
Gail R. Wilensky	21,594,731	210,691

- ii) The proposal to ratify and approve the appointment of Pricewaterhouse-Coopers LLP as independent auditors of the Company for 2004 was approved by votes as follows:

FOR:	21,245,654
AGAINST:	535,175
ABSTAIN:	24,593
BROKER NONVOTES:	0

- iii) The proposal to approve the Company's 2004 Equity Incentive Plan was approved by votes as follows:

FOR:	11,222,140
AGAINST:	4,902,148
ABSTAIN:	318,668
BROKER NONVOTES:	5,362,466

Item 5. Other Information

- (a) In connection with a July 19, 1999 settlement with various government agencies, Olsten executed a corporate integrity agreement with the Office of Inspector General of the Department of Health and Human Services, which will remain in effect until August 18, 2004. The corporate integrity agreement applies to the Company's businesses that bill the federal government health programs directly for services, such as its nursing brand (but excludes the SPS business), and focuses on issues and training related to cost report preparation, contracting, medical necessity and billing of claims. Under the corporate integrity agreement, the Company is required, for example, to maintain a corporate compliance officer to develop and implement compliance programs, to retain an independent review organization to perform annual reviews and to maintain a compliance program and reporting systems, as well as to provide certain training to employees.

The Company's compliance program is required to be implemented for all newly established or acquired business units if their type of business is covered by the corporate integrity agreement. Reports under the corporate integrity agreement are to be filed annually with the Department of Health and Human Services, Office of Inspector General. After the corporate integrity agreement expires, the Company is to file a final annual report with the government. The Company believes it is in compliance with the corporate integrity agreement and has timely filed all required reports. If the Company fails to comply with the terms of its corporate integrity agreement, the Company will be subject to penalties.

Item 6. Exhibits and Reports on Form 8-K

(a)	<u>Exhibit Number</u>	<u>Description</u>
	3.1	Restated Certificate of Incorporation of Company. (1)
	3.2	Certificate of Correction to Certificate of Incorporation, filed with the Delaware Secretary of State on July 1, 2002. (2)
	3.3	Restated By-Laws of Company. (2)
	4.1	Specimen of common stock. (4)
	4.2	Form of Certificate of Designation of Series A Junior Participating Preferred Stock. (1)
	4.3	Form of Certificate of Designation of Series A Cumulative Non-Voting Redeemable Preferred Stock. (3)
	10.1	Company's 2004 Equity Incentive Plan. (5) +
	10.2	Fourth Amendment dated May 26, 2004 to Loan and Security Agreement dated June 13, 2002, by and between Fleet Capital Corporation, as Administrative Agent on behalf of lenders named therein, Fleet Securities, Inc., as Arranger, Gentiva Health Services, Inc., Gentiva Health Services Holding Corp. and the subsidiaries named therein. *
	31.1	Certification of Chief Executive Officer dated August 4, 2004 pursuant to Rule 13a-14(a).*
	31.2	Certification of Chief Financial Officer dated August 4, 2004 pursuant to Rule 13a-14(a).*
	32.1	Certification of Chief Executive Officer dated August 4, 2004 pursuant to 18 U.S.C. Section 1350.*
	32.2	Certification of Chief Financial Officer dated August 4, 2004 pursuant to 18 U.S.C. Section 1350.*

---

(1) Incorporated herein by reference to Amendment No. 2 to the Registration Statement of Company on Form S-4 dated January 19, 2000 (File No. 333-88663).

(2) Incorporated herein by reference to Form 10-Q of Company for the quarterly period ended June 30, 2002.

(3) Incorporated herein by reference to Amendment No. 3 to the Registration Statement of Company on Form S-4 dated February 4, 2000 (File No. 333-88663).

- (4) Incorporated herein by reference to Amendment No. 4 to the Registration Statement of Company on Form S-4 dated February 9, 2000 (File No. 333-88663).
- (5) Incorporated herein by reference to Appendix B to the Definitive Proxy Statement on Schedule 14A of Company dated April 8, 2004.

\* Filed herewith.

+ Management contract or compensatory plan or arrangement.

(b) Reports on Form 8-K

On April 29, 2004, the Company furnished a report on Form 8-K (i) furnishing in Item 7 as an exhibit a press release covering the Company's 2004 first quarter consolidated earnings and (ii) reporting in Item 12 the issuance of the Company's press release on the subject of its 2004 first quarter consolidated earnings.

## SIGNATURES

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

GENTIVA HEALTH SERVICES, INC.

(Registrant)

Date: August 4, 2004

/s/ Ronald A. Malone

Ronald A. Malone

Chairman and Chief Executive Officer

Date: August 4, 2004

/s/ John R. Potapchuk

John R. Potapchuk

Senior Vice President and  
Chief Financial Officer