
MANAGEMENT DISCUSSION SECTION

Operator: Good morning, my name is Lawrence and I'll be your conference operator today. At this time, I would like to welcome everyone to the Gentiva's Third Quarter 2006 Earnings Conference Call. [Operator Instructions] Thank you. It is now my pleasure to turn the floor over to your host, Mary Morrissey Gabriel. Ma'am, you may begin your conference.

Mary Morrissey Gabriel, Senior Vice President and Chief Marketing Officer

Thank you, Lawrence, and good morning everyone. Thank you for joining us today. I'm Mary Morrissey-Gabriel, Senior Vice President and Chief Marketing Officer of Gentiva Health Services, and this is Gentiva's Third Quarter 2006 Earnings Call. On the call today are Ron Malone, Gentiva's Chairman and CEO; John Potapchuk, our CFO; Tony Strange, the President of Gentiva Home Health; Bob Creamer, Senior Vice President of CareCentrix; and other key executives.

We hope that each of you has had a chance to review the Company's earnings script which we released after close of market yesterday. All statements made during this call relating to the future results and events are forward-looking statements that are based on our current expectations. Actual results could differ materially from those projected in the forward-looking statements because of a number of risks and uncertainties, which are discussed in our annual and quarterly SEC filings and in the cautionary statements contained in our press release and on our web site.

Our call today will be consistent with the SEC's Regulation FD, and we encourage participants to ask their questions during the call since we have certain limitations on comments that can be made in individual inquiries. Today's call also conforms to Regulation G regarding the reconciliation of GAAP and non-GAAP disclosure. As a result, we will not discuss non-GAAP financial measures on this call other than what is set forth in our press release. You may access a replay of this call on our web site for the next 7 days. A transcript of this call will be posted to our site within the next 36 hours and will be available for the next 12 months.

Following today's prepared remarks, we will open the call to questions. Please limit your initial comments to one question and one follow-up before leaving the queue so that we can accommodate as many callers as possible in the allotted time. Let me now turn the call over to Gentiva's Chief Executive Officer, Ron Malone, for comments on our third quarter activities.

Ron Malone, Chairman and Chief Executive Officer

Thanks, Mary. Good morning, everyone, and thanks for joining us. Gentiva's third quarter financial performance was largely a reflection of our focus on the Healthfield integration and our plans for 2007. As we continue to execute our strategies, we have more work ahead of us to fully reap the benefits of the integration and our other work. In commenting on our recent past performance, some of you have characterized 2006 as a year in which Gentiva is building for the future. We are making changes and investments for the right reasons and with the interests of patients and shareholders in mind.

Although some of these changes are having an effect on 2006, we think our focus on repositioning Gentiva will allow us to generate more positive results in 2007. Since the beginning of the year, we've made it clear that we're going to devote a significant portion of our resources to a careful and thoughtful integration. We also said it would take some time to realize all the opportunities behind this combination. We're working hard to capitalize on these opportunities and are beginning to see the impact of our work. The integration of Gentiva and Healthfield has gone very well. We have a high rate of retention of both employees and referral sources, and our overlapping markets are performing particularly well.

I am very proud of our work to combine our experiences and ensure that patients, referral sources and payers alike receive high-quality care and top-notch customer service. As our Company undergoes this transformation, we're addressing issues which I believe are typical for an integration of this size and scope. One issue is our need to accelerate growth -- in our case, Medicare -- so that we can return to double-digit organic growth in 2007. Another is the evaluation of each of our business lines to ensure that they're operating effectively and efficiently. Tony Strange will have more to say on these and other topics in just a moment.

I think it's worth discussing our progress in the last nine months. We have shifted our business mix toward Medicare and higher-margin commercial opportunities. Medicare is now approaching 48% of total Company revenues and company-wide gross margin, operating margin and EBITDA margin, were all up in the third quarter from the prior year period. We're making headway in the challenging process of renegotiating managed care contracts to achieve fair pricing as we shed some commercial business in Home Health. This is an area where we braced ourselves to make very tough decisions that we believe are in our long-term best interest.

We've deepened our Medicare penetration in the highly competitive southeastern region. We're continuing to build on our strong hospice platform, with expansions in Gentiva locations and other key markets. We've restructured CareCentrix and are gaining traction with our sales efforts. Bob Creamer will report on these successes in just a few minutes. And with all these changes still underway, our cash flow has remained strong. We are executing our strategy, we are paying down debt and we are focusing on our clinical leadership, which sets the pace for our industry. Our combination with Healthfield has already brought with it important benefits. So while we still have a lot of work ahead of us, we can be proud of what we've accomplished thus far. On that note, I'd like to turn the call over Tony Strange for additional commentary on the integration and other activities and the events in Home Health and related segments. Tony?

Tony Strange, Executive Vice President and President of Gentiva Home Health

Thanks, Ron, and good morning everyone. There are three things that I'd like to highlight about our performance in the third quarter. First, as Ron indicated, the Healthfield integration continues to go well and we've had a high retention rate of both employees and customers. Second, we continue to see strong Medicare growth in many parts of our businesses and we continue to focus on improved commercial pricing and redirecting capacity to Medicare and other more profitable business. The change in our mix is still having a short-term effect on the Medicare growth and we're concentrating on improved Medicare performance for 2007. And third, while it was a strong quarter for Hospice, we experienced a higher-than-normal discharge rate in the latter part of the third quarter that will have an effect on our fourth quarter results.

Before I get to a progress report on the integration, let me talk a little bit about Home Health and Hospice. Our Home Health segment revenues for the third quarter increased by almost \$55 million, or about 40%, compared to the prior-year period. Once again, the majority of the increase came from the addition of Healthfield and the growth of Medicare, including contributions from our Specialty programs. Our third quarter Medicare revenue doubled year-over-year. Organically, Medicare revenues increased by 7% in the third quarter. However, based on current trends, we expect to return to double-digit organic Medicare growth in 2007. And we'll accomplish this by one, investing in more street level sales resources; two, accelerating the expansion of our Specialty programs both at Healthfield and Gentiva locations; and concentrating on the successful implementation of local recruitment and retention strategies.

It's worth mentioning that many parts of our Home Health operations *are* continuing to produce strong Medicare growth today. The weakness that we're seeing is tied to specific areas and is partly reflective of our accelerating effort to achieve better commercial pricing in Home Health. We're

making good progress and will continue to adjust our commercial business to generate a fair return. Thus far we've exited about an additional \$5 million of Home Health commercial business for the quarter, bringing our total to about \$11 million in the first nine months of 2006.

Moving on to our Other Related Services segment, which includes hospice, respiratory, home medical equipment, pharmacy and healthcare consulting, revenues were about (\$)32 million in 2006 third quarter versus (\$)1.4 million reported in the prior-year period. The growth in this business segment was primarily due to the Healthfield acquisition and includes all payer categories. Businesses within this segment met or exceeded expectations for the third quarter. Our home medical equipment and respiratory division continues to experience good growth and we expect growth to continue as we move into the height of respiratory season this winter.

And Hospice continues to be an area of high interest and focus for our Company. We continue to evaluate potential opportunities for new Hospice operations which are complimentary to our Home Health footprint. Our start up operation in Greenville, South Carolina, became certified early in the fourth quarter and should begin contributing to results in this quarter and into 2007. During the quarter, as a part of our clinical review process, we've evaluated hospice patients to ensure that the most appropriate level of care is being provided in consultation with their physicians. As a result of this process, we've experienced a higher-than-normal discharge rate than is typical in a quarter. This drop in census, which we believe to be temporary, is expected to impact Hospice revenue during the fourth quarter. We see this as a short term development leading to a longer-term growth. This patient-centric approach has contributed to a strong relationship with hospice referral sources and differentiated our clinical leadership. As a byproduct, we've enhanced our ability to forecast any Medicare cap liabilities and to further ensure there continue to be no surprises related to cap adjustments.

Turning to integration matters, these are some of the things that we've accomplished since our last call. With our geographic structure now fully in place across six regions and with the complete integration of our sales structure, we are now focusing on the launch of new incentive programs next year. We've retained the key referral relationships that have defined our business in the two southeastern regions, particularly in those markets where Gentiva and Healthfield had overlapping operations. We've launched a new visual identity system and naming conventions to strengthen our local brand equity for all Gentiva Home Health operations. We continue to review our Home Health branches with a focus on the five key concepts: customer service, clinical excellence, census growth, cost control and cash collections. We call these the five Cs and they are helping our branches focus on exceptional patient care and improved financial performance. Each location also has a new key indicator reporting system for charting its results in a single dashboard as we identify local business opportunities and challenges.

On the clinical side, we've launched new patient care management protocols and have completed training of our people with the goal of ensuring each patient in each of our 400 locations receives the highest quality of care. We're also strengthening the regional clinical leadership and support teams and standardizing our approach to clinical performance improvement. These strategies position the Company to ensure that we are ready for performance-based reimbursement. We placed a strong emphasis on recruitment and retention and we are pleased to report that our clinician retention rates have improved year-over-year. We've integrated our employee benefit plans and are rolling out enhanced medical and other benefits that should yield improved performance in these areas. We've also integrated our other human resource policies and procedures and have continued to work on pay-per-visit compensation for full-time clinicians that we discussed on our last call. We've strengthened the leadership behind our recruiting and initiatives with a focus on increasing capacity.

On the technology front, we're integrating the health field business lines and corporate functions into the Gentiva infrastructure and back-office systems to achieve enterprise-wide consistency, as well as synergy savings. We've also continued to make progress on our LifeSmart Technologies

and integrated business platform encompassing both the clinical and the operating needs of the branch. LifeSmart Technologies includes our clinical management system and our ongoing pilot and introduction of point-of-care devices. We're making enhancements to our solution as a result of the insights we've gained from the pilot locations. We anticipate a company-wide rollout to begin in the second quarter of 2007.

Our Specialty area continues to be a focal point for Medicare growth. Year-to-date, we've opened 36 new Specialty locations, including a dozen markets served by Healthfield. As a result, we now operate over 180 Specialty locations across the United States. We've invested in -- and will continue to invest in -- the infrastructure to ensure that existing programs continue to grow, that we move forward with additional rollouts of Specialties in the Healthfield locations and that we continue to develop new and innovative programs for the future.

Before I close, I'd like to comment on two related government reimbursements. The first involves Wednesday's announcement by CMS that the home health market basket increase would be raised to 3.3% for fiscal year 2007. This is good news because it recognizes the growing importance of the Home Health industry in providing high quality, efficient, government-supported care to the aging population. However, we still need to see whether or not Congress is willing to let this increase stand, once it's back in session after Election Day. At this point, we've not included the increase in our 2007 preview. Our job right now is to continue to meet with legislators to stress the growing importance of homecare, and the need for a suitable reimbursement in 2007 and beyond. We are active in this area.

The second matter involves the growing shift of the Medicaid patients from institutions to homecare. At first glance, this would seem to be a real opportunity for Gentiva and others in the industry. However, we'll continue to approach Medicaid with the same caution and selectivity that we've used in the past. We need to be certain that additional Medicaid business meets our standards of profitability and makes the most out of our skilled nursing capabilities. I'm sure we'll have more to say about this on future calls.

On that note, I'd like to turn the call over to my colleague, Bob Creamer, to discuss the results for CareCentrix. Bob

Bob Creamer, Senior Vice President of Nursing Operations

Thanks, Tony, and good morning, everyone. We're pleased with CareCentrix' results for the quarter. While we experienced a 23% decline in net revenues, the increase was fully expected as a result of changes to commercial relationships over the past year. A reaction to those changes resulted in operating contribution declining at a lesser rate, about 10%, reflecting our achievements in controlling costs and streamlining our operations over the past several quarters.

During the third quarter, we also began to see results from our increased focused on four distinct streams of potential business: traditional commercial business, managed Medicaid, Medicare Advantage and certain specialized offerings. Among traditional commercial payers, we enhanced our long-standing relationship with Great West and returned as a network provider of home medical equipment and respiratory services after a two-year absence. We also continue to ramp-up our services for CIGNA in North Carolina, a territory that had previously been carved out of our national contract. That effort is accelerating this month. In managed Medicaid and Medicare Advantage, we're pleased to report that we've signed an agreement with a large health plan and are aggressively pursuing additional opportunities with others.

We believe strongly that we're an excellent partner for these types of plans as we can provide advanced Home Health utilization and guideline management for their high-use patient populations, thereby allowing health plans to focus their internal efforts on other components of their medical

spend. Among our business relationships, we've created something called the STAR Program, in which we have contracted with a number of national and regional infusion providers and have made them eligible to receive the highest priority status in our CareCentrix provider network. Our partnership with the providers will further enhance our patients' experience and position CareCentrix and these providers to capture additional, non-exclusive revenue through increased sales focus and coordination of effort.

We're also pleased to announce that CareCentrix has reached multiple agreements with specialty pharmaceutical providers and will expand our services to support the research, distribution and administration of their vital drugs. We feel confident that this new product line will yield numerous opportunities for us to leverage our vast network and to further differentiate us in the marketplace.

On the operations side, CareCentrix has made significant changes to the organization over the past 10 months. Operating expenses are down significantly, and operating margins are up. Our team has done a great job of managing these changes and streamlining the organization, while making investments to ensure that we're positioned for additional success in 2007. We hope we have more news to report in future quarters as we continue to take advantage of the progress we've made and capitalize on new business opportunities. With that, I'd like to turn the call over to our CFO, John Potapchuk, for additional comments on our financial performance and our 2006 outlook. John?

John Potapchuk, Senior Vice President and Chief Financial Officer

Thanks, Bob, and good morning to all of you. During the third quarter of 2006, we continued to see year-over-year changes in our payer mix to reflect the acquisition of The Healthfield Group earlier this year and our focus on Medicare. Medicare represented almost 48% of total third quarter net revenues, as compared to less than 31% of total net revenues in the same period last year. Within the Home Health segment, Medicare revenues increased from approximately 49% of the segment total in the third quarter of 2005 to nearly 62% of the segment total in this year's third quarter. Quarterly Medicaid and local government revenues were about 16% of total Company revenues this year and 17% last year. And Commercial Insurance and Other revenues, including revenues derived from CIGNA, were more than 36% of total Company revenues in the third quarter of 2006 versus more than 52% in the prior-year period.

Revenues from CIGNA remained at around 18% of total net revenues, about the same percentage as last quarter but well below the more than 29% of revenue reported in the third quarter of 2005. Gentiva's third quarter 2006 gross profit was almost (\$)38 million higher than the prior-year period, an increase of about 47%. As a percentage of net revenues, gross profit margin increased from 37% in the 2005 third quarter to about 41.5% in the current year's quarter. The increase in gross margin percentage is primarily attributable to these significant changes in our total Company business mix: first, the impact of the Healthfield acquisition and its addition of Medicare at a traditionally higher gross margin than our other business lines; also the organic revenue growth in Medicare, especially from our Specialty programs; our progress in shedding unprofitable commercial business within the Home Health segment; and less revenue in the lower gross margin CareCentrix business as compared to the third quarter of last year.

Selling, general and administrative expenses for Gentiva were about \$29 million higher in the 2006 third quarter versus the prior-year period, representing about a 40% increase. Approximately (\$)28 million of the increase was due to Healthfield's expenses in the current year's quarter. The remaining difference can be attributed to two other items, equity compensation expense resulting from the implementation of FAS 123(R) of (\$)1.2 million and restructuring and integration costs of about (\$)1.7 million, of which about (\$)600,000 is included in Home Health and about (\$)1.1 million is included in corporate expenses. These incremental costs were offset somewhat by cost reductions of nearly \$2 million in the CareCentrix unit.

For the 2006 third quarter, EBITDA excluding restructuring and integration cost, was about (\$19.5 million, or 6.8% of net revenues, compared to EBITDA of (\$9 million, or about 3.2% of net revenues, in the prior-year period. Although operating contribution margins in Home Health and CareCentrix declined somewhat between the second and third quarters of 2006 due to increases in certain direct costs, Home Health operating contribution margin increased by 330 basis points, from 9.3% to 12.6%, between the third quarters of 2005 and 2006, while CareCentrix margins increased by 120 basis points, from 7.5% to 8.7%, during the same period. Operating margin in the Other Related Services segment was 19.8% in the third quarter of 2006.

It's also important to note that excluding restructuring and integration cost, corporate expenses declined by about \$700,000 between the second and third quarters, as the Company continues to capture synergies resulting from the combination of Gentiva and Healthfield back-office functions. More synergies will be realized in the fourth quarter, as we have recently consolidated our general accounting function into one location, closed one of our Home Health billing centers and have taken other actions designed to improve our back-office efficiency. We continue to believe that cost synergies of about (\$3.5 million will be realized during 2006, with an annualized run-rate of about \$6 million by year end.

Turning to other measures, the tax provision for the quarter was about 22.5% of pre-tax income, resulting in a year-to-date effective tax rate for reporting purposes of 36.5%. This year-to-date rate included a normalized rate of about 39% and an incremental 3.5% relating to the tax accounting treatment of certain stock-based compensation, offset somewhat by a 6% benefit resulting from the recognition of certain state net operating loss carryforwards and the expected reversal of tax reserves. However, our cash payment for taxes for the year-to-date period was only 10% of pre-tax income as we realized the benefits of net operating loss carryforwards and tax deductible goodwill and intangibles.

As we noted in the release, we reported diluted earnings per share of 19 cents for the third quarter of 2006 versus 17 cents in the prior-year period. If we excluded current period restructuring and integration costs, which had an impact of 4 cents per diluted share, third quarter 2006 earnings would have been 23 cents per diluted share. Third quarter 2006 earnings also included a charge of 4 cents per diluted share resulting from the implementation of FAS 123(R) and its impact on increasing the Company's effective tax rate. As a result, diluted EPS, adjusted to exclude these items, reflects an increase of 17 cents to 27 cents between the third quarters of 2005 and 2006.

We generated positive operating cash flow of more than \$11 million during the third quarter and over (\$45 million for the first nine months of 2006. Cash flow was positively affected by our operating earnings and strong cash collections throughout the organization. Net accounts receivable increased by (\$12.5 million during the third quarter and our Days Sales Outstanding, or DSO, increased from 55 days at the end of 2006 second quarter to 58 days as of October 1st. The increase in receivables and DSO was primarily attributable to a federally mandated hold on Medicare claims during the last nine days of the government's fiscal year. These funds, which represented about \$8 million, were released to the Company in early October.

It's also worth noting that during the quarter, we spent \$7 million on capital expenditures and \$7 million on voluntary debt prepayments relating to the original \$370 million term loan, which we finalized in connection with the Healthfield acquisition. Furthermore, during the first week of October, we made an additional voluntary debt prepayment of \$5 million, so that as of today our outstanding term loan amounts to (\$348 million. While the balance sheet has changed significantly since year-end 2005, we continue to maintain strong liquidity as evidenced by cash items and short term investments of (\$65.5 million at October 1st, 2006.

Before concluding my remarks, I want to make some comments about our financial outlook for 2006 and 2007. As we indicated in the news release, we have revised our 2006 revenue outlook in a range between (\$1.09 billion and (\$1.11 billion. This compares to the prior outlook in which we

indicated that revenue would be at the lower end of a range between (\$)1.12 billion and (\$)1.16 billion. The revised 2006 outlook recognizes that it's taking additional time for us to transition to an improved revenue mix in Home Health, as well as the impact of the temporary drop in Hospice census, as Tony mentioned earlier.

As we also noted in the release, we anticipate 2006 financial results to be at the lower end of previously announced ranges of 84 (cents) to 90 cents per diluted earnings per share and (\$)75 million to (\$)80 million in EBITDA. Our diluted EPS outlook includes a 14-cent-per-share charge relating to the implementation of FAS 123(R) and its impact on the Company's effective tax rate. The outlook excludes the Medicare special item recorded earlier this year, as well as restructuring and Healthfield integration cost, which are expected to range between 12 (cents) and 14 cents per diluted share for the full year. We also anticipate full year operating cash flow to be in excess of (\$)55 million, somewhat better than we had previously discussed.

Turning to a preview of 2007, we anticipate net revenues in a range between (\$)1.23 and (\$)1.27 billion. We expect to achieve double-digit growth rates for both Medicare revenues in Home Health and Hospice and revenues for CareCentrix. We believe EBITDA margins will improve in 2007, compared to the full year 2006. However, we've decided to provide a profitability outlook at a later date once we have better information on the 2007 Medicare Home Health reimbursement rates and various other factors, including our 2007 equity compensation expense.

Now, I'd like to turn the call back to Ron before we take your questions. Ron.

Ron Malone, Chairman and Chief Executive Officer

Thanks, John. That sums up our review of the quarter. Our work continues on these key priorities: the integration, a return to double-digit organic Medicare growth, Specialty program and Hospice expansion, fair returns from commercial relationships and new business for CareCentrix. We are keenly focused on improving performance and on profitable growth. With that, we'd be pleased to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator instructions] Your first question is coming from Eric Gommel of Stifel Nicolaus.

<Q – Eric Gommel>: Hi. Good morning. Could I just clarify on your, you said these preliminary estimates on '07 and things and going into 4Q '06, what kind of tax rate assumption were you saying for 4Q and maybe for beyond 4Q?

<A – John Potapchuk>: Eric, for the full year right now I mentioned we're at 36.5%. For the full year we expect to be between 38 (%) and 38.5% and in 2007, given a normalized rate of 39% and some charge associated with the stock compensation, we'd be somewhere around 41(%).

<Q – Eric Gommel>: Great and then just my, one question. I'm curious about the economics of Medicare Advantage versus sort of the traditional Medicare Home Health benefit. What are you seeing margin-wise and revenue per -- I guess per-episode, or is it more on a per-visit basis? I'd like you to give me your thoughts on that and what are the opportunities and the threats from Medicare Advantage? It sounds like you're making contracts with insurers but I'm curious if you could expand a little on that.

<A – Ron Malone>: Eric, this is Ron, good morning. We have, as you have, watched the growth of Medicare Advantage, particularly in certain geographies, and are optimistic that the managed care providers working in Medicare Advantage acknowledge the complexity of dealing with a Medicare aged patient, because we are seeing a rate differential between the normal commercial population and Medicare Advantage patient. We have, as we noted in the script and have talked about before, taken a very hard stance with our commercial business that is in the Home Health segment. When we talk about integration, you couldn't talk about the integration of our companies without talking about the concurrent transformation in that business, that commercial business. So we have, as we mentioned, shed some business; but we have also renegotiated some business to, in some cases, considerably higher rates, which we believe acknowledge the value of the business, what we're doing for those patients, as well as our cost to provide that service. The Medicare Advantage programs that we're dealing with right now are more likely to pay on a per-visit basis than they are on an episodic reimbursement like traditional Medicare. And really, the dynamics of dealing with each are really somewhat different. Tony, would you like to add anything?

<A – Tony Strange>: I concur with everything that Ron just said. While it's certainly not the norm, we have been successful in negotiating a few of the Medicare Advantage plans on an episodic payment plan. Something that more mirrors PPS but like Ron said, to-date most of these plans are wanting to pay on a per-visit methodology and we're treating that like we would treat any other managed care contract. It's got to be profitable. We've got to be able to negotiate and do this on a profitable basis or if not, we're going to say no.

<A – Ron Malone>: I frankly believe as the Medicare Advantage plans themselves mature, they'll realize not only the importance of allowing us to help them control utilization and hospitalization and I think also they'll certainly come to understand better what CareCentrix can offer them. Thank you, Eric.

<Q – Eric Gommel>: Thanks.

Operator: Your next question is coming from David MacDonald of SunTrust.

<Q – David MacDonald>: Good morning, guys. A couple questions. One, John I think you mentioned that, sequentially, the margins were down in the Home Health area and it sounds like you guys walked away from about (\$)5 million of what I would expect was pretty low margin business, so it seems a little counterintuitive. I was wondering if you could give us a sense of what's

going on on the cost side there. And how to knock those costs out on a go-forward basis? And then, second question is with regards to guidance. When you look at the implicit guidance, just in terms of full year and what you've done year-to-date, it looks like you guys are expecting some decent sequential growth into 4Q. Is most of that, what sounds like (\$)2 million of synergies that will come in the fourth quarter? And a little more color on what we should expect in terms of organic growth and acceleration?

<A – John Potapchuk>: Yes, David, you broke up a little bit, but I think I caught most of that. In terms of the margins on the Home Health side in the third quarter, when I mentioned the increases in direct costs, part of that is associated with kind of what I'll call maybe a seasonally adjusted caregiver cost. When you think about the fact that we do have certain productive caregivers, it's a period of time of higher PTO and less demand sequentially. That had some impact in terms of that cost. There were also some, a little bit higher worker's comp costs, than what we had included in the prior quarter. So that's really the component on the Home Health side that broke those margins down by around 50 or 60 basis points in total. Certainly we expect that to reverse itself in the fourth quarter during a period of higher demand.

<A – Tony Strange>: And, David, this is Tony, before John answers the second part of your question. When you think, if you think about this business with capacity issues, and there is a finite amount of capacity, and you begin to shift your mix where you may have a resource today taking care of revenue that's at a low-margin percent, and when you turn that off you don't necessarily get rid of that resource but you have to redeploy that resource on more profitable business. Unfortunately you can't time that to where it's moment by moment. You're basically taking this resource and then reallocating it to a revenue dollar that is going to be much more profitable.

<Q – David MacDonald>: Is it fair to say this is more of a timing dislocation issue where you've got some clinicians where the right decision is to walk away from some very skinny margin business, but until you are able to redeploy that into some higher-margin Medicare there is going to be some dislocations?

<A – Ron Malone>: I think so. While I don't want to jump out on a limb here, if you looked at our current activity going into the fourth quarter I think you'll begin to see that replacement beginning to happen. In certain markets across the country, we are beginning to get back to that much stronger Medicare growth as I look at our current snapshot of where we are in the fourth quarter. I kind of jumped in here. John was going to answer the second part of the question.

<A – John Potapchuk>: No. That's great. David, if I caught the question, it was really associated with fourth quarter and the increases and you're right. The increase in just the momentum on synergies certainly has some impact on that on the positive side. We also have some positives associated with Home Health as we continued to change that mix. As we've said, getting away from the lower seasonal third quarter, that had some positive impact. Due to the lower census count in Hospice, there will be a short term dip in Hospice. This quarter, we did have a benefit on those tax adjustments and they won't reoccur. The combination of all of that gives you a number roughly about 23 cents or so associated with the fourth quarter.

<Q – David MacDonald>: Okay.

<A – Ron Malone>: Thank you, David.

Operator: Your next question is coming from Brian Tanquilut of Jefferies & Company.

<Q – Brian Tanquilut>: Hey, good morning, guys. I just wanted to ask John, just a housekeeping question first. What's internal growth rate in Medicare admissions this quarter and what's your rural penetration rate in Home Health?

<A – John Potapchuk>: In terms of growth rate what we mentioned in our remarks and given the fact that we've got multiple systems on Healthfield, what I've tried to do is, I think Tony may have mentioned it, kind of on a same-store basis on existing branch offices the growth rate in Medicare revenue was 7%. Brian, the second part of your question?

<Q – Brian Tanquilut>: The rural penetration in Medicare home nursing?

<A – Ron Malone>: Are you saying rural?

<Q – Brian Tanquilut>: Yes, rural.

<A – John Potapchuk>: Oh, okay the rural – if you look at our total Medicare revenue it's somewhere around a 15(%) to 17% of services are performed in designated rural markets.

<Q – Brian Tanquilut>: Got you. And then, Ron, last question. In the past you have talked about how the Healthfield integration will take between 24 to 36 months. Now we are 10 months into it. I was just wondering what else is left to be done in terms of integrating Healthfield? You mentioned that the sales force integration is pretty much completed. What else is there at this time?

<A – Ron Malone>: Great question, Brian. I am very pleased with how the integration has proceeded. The things that we have left to do under the broad term of integration would really relate to things that are constrained by systems integration. It will take us some time to continue to wean off those back-office systems and bring ourselves into one. For one thing, for instance, we mentioned the new Life Smart Technologies. What we would try to avoid doing is two changes in systems for any branch. So we'll sequence those branches in to try to get them on that one system so that we can subsequently feed the revenue into one system, which in turn will facilitate the contraction of our back-office billing system network and help us get closer to our synergies.

I think the field-level integration is really, for the most part, done. We have our branding conventions rolled out. We have the management teams in place and I have visited, I think now, Tony, I'm afraid to know, several dozen branches. I think the teams are working together very well, and evidenced by what I mentioned, was very good performance in the overlapping markets. I think most of it is really systems-related. I think the thing not to underestimate is the fact that we've gone through this change in business mix concurrent with the integration. We have put together some branches, closed some branches, shut down business and we are focused on getting the whole system operating where we believe that it can. I think that certainly you have been willing to sort of bite a stick and take the pain associated with shedding that revenue, holding our powder and letting those branches grow back into the Medicare mix that we look for. As Tony mentioned just a few minutes ago, our recent trends would indicate that in many of those markets that performance is starting to turn.

<A – Tony Strange>: And, Brian, this is Tony. If there are some field operators on this call and we state things like, the heavy lifting is done, they may say, well, gosh, it still seems like we're working hard. I guess where I'm at is kind of where Ron said. If you look at the risk associated with doing an integration of this magnitude, where you've got two companies that have been in roughly 15 or 16 overlapping markets and have been slugging it out now for the better part of a decade and all of a sudden Ron and Tony walks in and say, by the way you are all going to start working together week after next. The risk associated with spillage, I think we are beyond that risk. To Ron's point is that when you look out in the field and talk about overlapping fields and talk about overlapping markets and talk about how we are going to integrate our sales resources and those things, I am very, very, very proud of our field operators and at the thoughtfulness that they've taken to the approach to this integration.

To Ron's point, the bulk of the work is still on some of the systems-related issues. I have to brag on our IS folks for just a little bit. Even though we are still operating, as Ron mentioned, on multiple

systems, we have implemented the key indicator reporting system where we have a single look at a market, whether or not the information is coming out of a legacy Healthfield system or a legacy Gentiva system. We've done a lot of work related to our clinical integration. Those folks we're investing in the clinical infrastructure in the field, that's going extremely well. The other thing that I'm really proud about is that one of the things that Gentiva brought of extreme value to Healthfield was the Specialty programs. In the third quarter, we've rolled out roughly about 12 different Specialties across the Healthfield locations which you don't see those results in our third quarter results, and those are very strong Medicare drivers.

<Q – Brian Tanquilut>: I guess the 24 to 36 months, we're still on track for completing integration around that timeframe?

<A – John Potapchuk>: I would probably categorize being probably ahead of time.

<Q – Brian Tanquilut>: Thank you.

<A – Ron Malone>: Thank you, Brian.

Operator: Our next question is coming from John Ransom from Raymond James.

<Q – John Ransom>: Hi. Good morning. How many of the nurses and clinical staff are on a per-episode type of compensation structure versus a salary type structure and where do you think that might be two or three quarters since? Thanks.

<A – John Potapchuk>: John, just in terms of the raw numbers of caregivers, the vast majority of caregivers are on kind of a per-visit payment scale, somewhere close to 85(%) to 90%, but in the, I know we have talked on past calls, that I'll say in the legacy Gentiva locations, roughly half of the visits were performed by that group versus our benefited full-time caregivers. Now we're going through the pay-per-visit system where we will have more flexibility, if you will, and really the onus on managing that will be on the caregiver level.

<A – Ron Malone>: Well, I think two additional thoughts. Good morning, John, it's Ron. Two additional thoughts I would add. One is that we certainly didn't want to lose good productive clinicians in a change; and secondly, we felt like we needed to have our 2007 benefit structure ready before we could aggressively convert offices and go about to recruiting. We are now in the process of our enrollment. The single benefit structure from combined Company has been extraordinarily well received. We've put in place really a high-touch rollout of that; and, frankly, I think that is really helping in our overall retention rates. You'll see us in the next few quarters be more aggressive about how we approach that, the use of PRN versus salaried staff if that's the differentiation we're making.

<A – Tony Strange>: John, this is Tony and I'm not trying to ask your question for you so just bear with me. I took from your question that you might have been asking about how are we coming with the rollout of pay per-visit methodology since our last call and as I mentioned to you on our last call that we were developing a pay-per visit strategy for Gentiva. Most of the employees that came over from Healthfield were already on a pay per-visit structure. The beta of that, which we did in August, went very well. We've now converted about nine offices to a pay per-visit structure in the legacy Gentiva locations without really any hiccups along the way. So as time goes on through this integration process, more and more of these offices will be converted on a pay per-visit.

<Q – John Ransom>: I remember a meeting in April where we talked about the majority of the branches that mattered, quote unquote, would be converted by the end of the calendar year. Are we still looking at that? Or has that been pushed back a little back?

<A – Tony Strange>: When you said the majority of the branches that mattered, I don't recall specifically that conversation, but if branches have a cost-per-visit issue, where they're experiencing extremely high costs, those are the branches that we're looking at converting first.

<Q – John Ransom>: No, yes, that's what I meant. Right.

<A – Tony Strange>: Yes.

<A – Ron Malone>: The majority of the salaried full-time, the salaried full-time clinicians, field clinicians in the Gentiva legacy branches are highly productive. I mean it really is, it's more about how we're going to manage that for the future.

<Q – John Ransom>: Okay.

<A – Ron Malone>: I think it's a real opportunity. Thank you, John.

<Q – John Ransom>: And I guess my other question if I remember looking at my notes, Healthfield was generating roughly (\$50 million of EBITDA when it was acquired and just looking at the year-over-year EBITDA growth and I know there's seasonality, but it looks like there's about (\$10.5 million of EBITDA growth year-over-year. Should we take this to mean if we were, I know we're one company but is Healthfield generating a little less than that now? Or is Gentiva generating less EBITDA because of the reduced revenues out of CareCentrix? Or how should we be looking at that or am I just mixing apples and oranges? Thanks.

<A – Tony Strange>: Yes it's really a mixture now. I think we've said on other calls, John, that as time moves on the, it's more, clearly more difficult to see exactly what the old Healthfield, if you will, was really doing. The only comment I can make is just given the 23% reduction in revenue on CareCentrix and you could look at it from the notes – there is a decrease year-over-year in the CareCentrix operating contribution margin of a couple million dollars.

<Q – John Ransom>: Okay.

<A – Tony Strange>: Other than that, John, I can't comment.

<Q – John Ransom>: Okay, and then I guess my last question, I mean last quarter you guys talked about well organic Medicare revenue growth was a little disappointing but we'll have it back by next quarter. And now this quarter you're saying that's going to take longer. I guess I'm just struggling to understand exactly what changed between the last prediction and kind of where you are now? Thanks.

<A – Ron Malone>: I think the difficulty – the issue is the word you just used, prediction. I think what we have told you during this call is that recent trends and by that I mean the trends we saw in October, are indicative of higher run-rate in Medicare and it's probably just fair to say it took us longer. I don't think we spoke, I think we talked about our expectations but we could not speak with certainty, John, about how long it would take some of these branches that were shedding commercial business to settle back into Medicare. If I remember correctly, I mentioned that we know that we would likely also shed, at least temporarily, some referral sources in that situation. We might be taking, for instance in a given office, we might get in a month 30 very low margin commercial referrals and 5 or 6 Medicare.

<Q – John Ransom>: Right.

<A – Ron Malone>: We shut down that commercial – that physician's office may well turn to somebody else with that Medicare. We will endure that because I want to assure you in this process, we are not shedding desirable commercial business. And so I think it's just really a matter

of uncertain timeline. I think I'll just reiterate Tony's note of earlier that recent trends would indicate that some of those branches are starting to turn the corner and settle back into that Medicare, more in line with our expectations. I think the other point I would add is it's probably taken us a little longer in my view and Tony you can comment, to get traction of moving those Specialties into Healthfield and we thought we linked Medicare with some of that growth as well.

<A – Tony Strange>: I agree with that it's the, I am pleased that we've expanded Specialties across 12 of the Healthfield 120 some-odd locations thus far, due to some integration and timing and not wanting to throw too much at the field at one time, I would like for that to be a little bit further along; but that's where a lot of our Medicare growth is going to come from.

<Q – John Ransom>: On the Specialty side?

<A – Ron Malone>: Yes.

<Q – John Ransom>: Okay, so that's really the answer then, it's just a delay in getting Specialty rolled out because you didn't want to overwhelm the field staff relative to maybe some initial talks.

<A – Ron Malone>: That and the patience in markets, even where they had Specialties, Gentiva markets, where we shed the commercial business, not to just cut the branch to the bone but to give them time.

<Q – John Ransom>: Right.

<A – Ron Malone>: I think I mentioned earlier, if they show us that they can't grow back into the Medicare, we'll have to adjust the whole cost structure, but we wanted to have the patience to do that because we know the business is there.

<Q – John Ransom>: So if we look sequentially, last year your earnings dropped about a penny sequentially second to third quarter. This quarter they dropped 3 cents. That difference would be more on the CareCentrix side than Healthfield? Is that fair to say? It's just hard to analyze your numbers given all these moving parts so I'm just trying to figure out what the shortfall is, why it's there and what's not? Is it CareCentrix, do you think? Is that a fair way to look at it? It was more difficult sequentially this time than last year?

<A – Tony Strange>: Well that's some of it, but, John, I was thrown by your comment sequentially drop of 3 cents.

<Q – John Ransom>: Yes, fully tax diluted EPS at a normalized tax rate dropped from 21 (cents) to 18 cents June to September, last year 18 (cents) to 17 (cents) so there's a little more pressure this year and I wondered if it was just because of the CareCentrix or if it was because of Healthfield costs or just what's changed? I guess our expectation was that second quarter of Healthfield would be better than first quarter of Healthfield and that the improvements would kind of overwhelm some of the seasonal, normal seasonal factors. So, just surprised at the drop sequentially in the earnings on a fully tax basis. I'm just trying to figure that out.

<A – Tony Strange>: I guess the comment I could make – clearly when you look at the pure numbers, and it's a comparison on CareCentrix, that's a piece of it.

<Q – John Ransom>: Okay.

<A – Tony Strange>: I think I'll also mention, John, that in terms of our internal projections, there was a, we recognized the seasonality of the business in the third quarter in both the former Healthfield and the former Gentiva side. The revenue number that we reported in Home Health, relative to our internal projections, was within a few million dollars of that.

<Q – John Ransom>: Right.

<A – Tony Strange>: I'd say, kind of a long way of saying that you look to CareCentrix, that's really the more significant piece of it.

<Q – John Ransom>: Okay. Thank you.

<A>: Thank you, John.

Operator: Your next question is coming from Matthew Ripperger of Citigroup.

<Q – Jie Bao>: Hi. Thanks. This is Jie Bao for Matt Ripperger. My first question is your fiscal year '07 guidance also assumes a double-digit growth in the CareCentrix business. Can you just comment on what's the driver there?

<A – Bob Creamer>: Good morning, this is Bob. It's a number of things, I've mentioned. We've seen a tremendous amount of interest, in particular managed Medicaid and the Medicare Advantage plans, and those were rather long sales cycles because of what's at stake to make that change for a health plan. So we see the effort we've made in the last six months really starting to pay off. We've signed one agreement recently, and we're hoping to close a few others over the next few months. So it's really that interest in that space, and we also have some other opportunities, on the specialty pharmaceutical side we're picking up some business as well.

<Q – Jie Bao>: Okay, and the restructuring cost savings in that segment of the business, is that already completed or do you see more savings going forward?

<A – Bob Creamer>: Most of that effort took place really in the first half of the year, so actually we've kind of right-sized that organization and made the change in the people and the processes. And actually now, because we're bringing on some new business, have actually started to add back some staff to be able to handle that new business, and we're done with the restructuring.

<Q – Jie Bao>: Okay. And the (\$)1.7 million restructuring charges related to the Healthfield acquisition, what type of costs are they exactly?

<A – Bob Creamer>: Jie, there's some severance involved in there, there's some lease cost, I mentioned that as an example we had closed the Home Health billing center and there's some incremental travel costs as we were going through integration efforts both in accounting and some IT. That's the majority of it.

<Q – Jie Bao>: Okay and just lastly, just want to make sure. The revenue guidance for next year does not include the 3.3% Medicare rate increase? Correct?

<A – Bob Creamer>: That's absolutely correct.

<A – Ron Malone>: That is correct.

<Q – Jie Bao>: Okay, and can you comment on the likelihood that will be intact the next year?

<A – Tony Strange>: Well I can't, this is Tony. I can't comment on any certainty. I can tell you that at this point in the game last year, the rate increase was in and it took an Act of Congress to take it out, which did occur. Today the rate increase is there. There is an announcement from CMS, there's a 3.3% market basket update. However, it will take an Act of Congress to take that away. However, that could still happen and I'm no more certain about that than I am the outcome of the election next week.

<Q – Jie Bao>: Right. Okay. Thanks.

Operator: Thank you. Your next question is coming from Doug Tsao of Lehman Brothers.

<Q – Doug Tsao>: Hi. Thanks a lot, guys. I was wondering John if you could just sort of walk us through again the items that affected the tax rate this quarter and whether any of – you spoke about sort of NOLs, sort of go-forward and valuation reserves – if any of those might affect taxes in future quarters?

<A – John Potapchuk>: Yes, Doug, I mentioned that the impact year-to-date was about 6% and really what it is as you go through a process of filing returns and there are positions for which you have some tax reserves for, and when statute of limitations expires, and/or the audits are completed, we would have the ability, provided there was not an assessment, to reverse those reserves. I think what maybe is important to note and that's what happened in the third quarter, what's important to note is historically – say years ago – what companies would do would be to estimate those reversals of tax reserves and put them into their annual effective rate and use that rate each quarter. There are some recent interpretations in the accounting industry and it's called IN48, interpretation number 48, that really requires you to look on a quarter-by-quarter basis. So when you think about the fact that returns are filed in September, statute of limitations would generally expire three years down the road and, therefore, you have that knowledge in the third quarter that you can reverse some of that. You have to reverse the whole thing. So that's in essence what happened. So to your other question, as we'll continue to look at our tax reserves, there may be some things in the third quarter of next year that we would have. That's kind of the way the process is going to work.

<Q – Doug Tsao>: I guess my question is I'm trying to figure out what I should see as your normalized tax rate. Should I see it as the 40% rate that we've typically seen or now it looks like we are going to be at a 37(%), 38% rate?

<A – John Potapchuk >: As I mentioned earlier to Eric, I think for this year, for the full year, we'll be up at about 38% when you dial in the fourth quarter results. For next year we are looking at something around a 41% rate. That would include normalized rate of 39(%), some additional rate due to the stock option accounting and then what might happen with respect to tax reserves down the road is really not clear at this time. That could have a tendency to bring that rate down somewhat.

<Q – Doug Tsao>: Okay. And then on your comment on expectations for next year, you say that you expect to see some increase in EBITDA margins. My question is, from what levels do you expect to see an increase? Is that from the as-reported rates or margin or from the margin excluding the integration cost?

<A – John Potapchuk>: From the margin excluding the integration cost. And I think while we haven't given bottom line guidance at this point, when you think about the fact that we'll have a full year of Healthfield, former Healthfield results in next year and they had operated, because of their Medicare mix, at a higher EBITDA margin. When you think about the fact that we're in the process of changing our mix to higher-margin business and when you think about the fact that we have a full year of synergies that we've been working on this year, those three things all add to improving margins down the road.

<Q – Doug Tsao>: Okay. When I think about your revenue guidance for next year, it sounds like you are not assuming an increase to reimbursement rates. My question is, what are your expectations for further reductions in your commercial business as you continue paring unprofitable contracts?

<A – John Potapchuk>: At this point if you do the math and think about the double-digit growth in Medicare Home Health, Hospice and CareCentrix, what that suggests is that there will still be some reduction, single-digit reductions in our non-Medicare Home Health business.

<Q – Doug Tsao>: Okay. What is your assumption for organic Medicare growth next year?

<A – John Potapchuk>: We said double-digits and at this stage we are looking at, I'd say, 12(%) to 15%.

<Q – Doug Tsao>: And what would that be versus when I think about what you've done this year, what would your organic Medicare increases have been on a volume basis?

<A – John Potapchuk>: I should say Doug; we're making that comparison relative to current run-rates and so, as a benchmark this quarter we were at 7%; last quarter we said same-store was about 10%.

<Q – Doug Tsao>: So you are looking for an acceleration next year?

<A – John Potapchuk>: Absolutely.

<Q – Doug Tsao>: Okay. Thank you, guys.

Operator: Thank you. I want to turn the call back over to management for any closing remarks.

Ron Malone, Chairman and Chief Executive Officer

Thank you. I'd like to thank each of you for participating this morning and for your continued interest in our Company. We are highly optimistic about the future of Gentiva and we hope to share additional information about our progress with you on our next call.

Operator: Thank you. This concludes today's Gentiva's Third Quarter 2006 Earnings Call.

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