

**Thomson StreetEvents<sup>SM</sup>**



## Conference Call Transcript

GTIV - Q4 2004 Gentiva Health Services Earnings Conference Call

Event Date/Time: Feb. 17. 2005 / 10:00AM ET

Event Duration: N/A

## CORPORATE PARTICIPANTS

**Mary Morrissey-Gabriel***Gentiva Health Services - SVP of Sales***Ron Malone***Gentiva Health Services - CEO***John Potapchuk***Gentiva Health Services - CFO***Stephen Paige***Gentiva Health Services - SVP & General Counsel***Al Perry***Gentiva Health Services - President & COO*

## CONFERENCE CALL PARTICIPANTS

**Blake Goodner***Bridger Capital - Analyst***Eric Gommel***Legg Mason - Analyst***Sheryl Skolnick***Fulcrum Global Partners - Analyst***Tony Campbell***Knott Partners - Analyst***Larry Marsh***Lehman Brothers - Analyst***Evan Steen***EOS - Analyst***Josh Stewart***Sidotii & Co. - Analyst*

## PRESENTATION

**Operator**

Ladies and gentlemen, thank you very much for standing by, and welcome to the Gentiva Health Services fourth-quarter earnings conference call. At this point, all of your phone lines are muted or in a listen-only mode. However, later during the earnings release, there will be opportunities for your questions and those instructions will be given at that time. (Operator Instructions). As a reminder, today's call is being recorded for replay purposes and that information will be announced at the conclusion of our call.

Well, with that being said, let's get right to this fourth quarter's agenda, and here with our opening remarks is Gentiva Health Services Senior Vice President of Sales, Ms. Mary Morrissey-Gabriel. Please go ahead, ma'am.

**Mary Morrissey-Gabriel - Gentiva Health Services - SVP of Sales**

Thank you and good morning. Thank you for joining us this morning. I'm Mary Morrissey-Gabriel, Senior Vice President of Sales and marketing for Gentiva Health Services. And this is Gentiva's fourth-quarter and fiscal 2004 earnings call. We hope that each of you has had a chance to review the Company's fourth-quarter earnings report, which we released after close of market yesterday. In a moment, I will turn the call over to our Company's Chief Executive Officer, Ron Malone, for remarks on Gentiva's performance during the fourth quarter and to John Potapchuk, our Chief Financial Officer, for a closer look at our financial results and outlook. Also joining us for the call and the question-and-answer period are Al Perry, Gentiva's President and Chief Operating Officer and other key executives.

Let me remind participants on this morning's call that comments made by Gentiva executives other than historical information should be considered forward-looking and are subject to various risk factors and uncertainties. For example, our strategies and operations involve risks of competition, changing market conditions, changes in laws and regulations affecting our industry and numerous other factors discussed in our fourth-quarter earnings release and in our filings with the Securities and Exchange Commission. Accordingly, actual results may differ materially from those anticipated in any forward-looking projections or comments on this call today. Please refer to the forward-looking statement in our news release issued last evening as well as similar language in our most recent 10-K.

We are also operating under the Securities and Exchange Commission's Regulation FD. Our call this morning and comments within it will be consistent with our obligations under these SEC regulations. As such, we strongly encourage participants on this

call with questions to present them during today's question-and-answer period. Because, under Regulation FD, we have certain limitations on comments that can be made in individual inquiries. We are also mindful of Securities and Exchange Commission Regulation G. Regulation G requires public companies that disclose or release non-GAAP financial measures to include in that release or disclosure a presentation of the most directly comparable GAAP financial measure and a reconciliation of the disclosed non-GAAP financial measure to the most directly comparable GAAP financial measure. Because of this, we will not discuss non-GAAP financial measures on this call other than what is set forth in our earnings release.

I'd also like to mention that Gentiva continues to have a policy of being open and responsive to inquiries related to our Company. In the Investor Relations section of our Company Web site, [Gentiva.com](http://Gentiva.com), you will find our press releases, our investor presentations and many of our SEC filings. In accordance with Regulation G, a transcript of this call will be posted to the Web site and available for the next 12 months. Additionally, you may access our earnings call replay for the next seven days. We appreciate your continued interest in Gentiva Health Services.

Let me now turn the call over to Gentiva's Chief Executive Officer, Ron Malone, for comments on the Company's fourth-quarter and fiscal 2004 performance. Ron?

---

**Ron Malone - Gentiva Health Services - CEO**

Thanks, Mary. Good morning, everyone, and thanks for joining us. The fourth quarter was a good one. And as a result, we ended another year on a high note. We achieved our sixth consecutive quarter of double-digit Medicare revenue growth. We also reported an 11.7 percent increase in revenues from the Commercial Insurance and Other category, including a significant increase in revenues from our non-CIGNA managed care customers. Our specialty programs moved ahead full steam. These programs accounted for almost half of our Medicare growth in the quarter. We also continued with the launch of our Cardiopulmonary Program, which we announced in our last call. Our business in the Southeast recovered in the last two months of the quarter following some residual effects earlier in the quarter from the hurricanes.

As a result of our performance in all of the areas mentioned, we exceeded the revised net revenue and EPS outlook that we had discussed on our third-quarter conference call. We continue to work diligently to execute the key elements of our strategic plan and I'm very proud of the ways our people are responding with excellence and commitment to these goals. We have every reason to expect an even better 2005.

Here are some general highlights of the quarter, which as you may know, included 14 weeks instead of the usual 13 weeks. Our net revenues were over 225 million. This represented a 10.6 percent

increase over the same period of 2003. Our net income as reported was 6.9 million or 27 cents per diluted share compared to 41.8 million or \$1.53 per share in the fourth quarter of 2003. As you may recall, the 2003 results include a one-time tax benefit which John will discuss.

Net income as adjusted was \$4.8 million or 19 cents per share versus 4.2 million or 15 cents per share for the fourth quarter of 2003. Gross margins for the fourth quarter were up about 2 percentage points compared to the fourth quarter of 2003. We reported a 19 percent increase in pre-tax income excluding the special item. We continued to generate positive cash flow and we repurchased more than a half million shares of Gentiva common stock for about \$8.2 million and still ended the quarter with \$113 million in cash items and short-term investments.

Turning to the performance of our individual payer categories, let's first take a look at Medicare. Our Medicare revenues were up about 18 percent due to an increase in weekly admissions of approximately 10 percent, including important contributions from our expanding specialty programs; higher government reimbursement rates for this period versus the prior year, various ongoing operational and clinical process enhancements that we've discussed on past calls; and a good recovery from the hurricanes in the final two months of the quarter.

Last quarter, we talked about the valiant efforts of Gentiva people in serving patients during those storms. In the fourth quarter, the hard work and dedication of these same people enabled us not only to resume normal business operations but to continue execution of our growth strategies.

During 2005, we'll continue to focus on growth by increasing our sales force again this year to generate additional referrals. We're also continuing to focus on operational strategies which increase our capacity for turning those referrals into admissions. During the fourth quarter of 2004, specialty programs accounted for roughly half of our Medicare revenue growth. In 2005, we will continue the rollout and expansion of current specialty programs and explore opportunities to launch new programs to meet the emerging market needs.

We're also expanding our clinical outcomes measurement and reporting for these programs so we can continue to demonstrate their effectiveness to physicians, payers and referral sources.

Staying on the topic of specialty programs for a moment, I'm pleased to report that we ended the year with well over 100 locations across the country, the majority of which are orthopedic programs. We're seeing increased interest from physicians and referral sources in our Safe Strides program for people with balance problems and in our new Cardiopulmonary Program, which we're continuing to roll out.

Turning to our Medicaid and local government payer category, fourth-quarter revenues were essentially flat versus the prior year. We continue to limit our participation in certain low-margin hourly Medicaid and state and county programs. However, we also increased our skilled visits in some states within this payer category.

Before we leave the subject of government-reimbursed programs, I want to say that we remain active in Washington and in the states to promote awareness of the benefits of homecare and the importance of stable reimbursement. We're closely following the reactions to the recently released federal budget proposals and how they might impact various parts of the healthcare sector. While we do not agree with the recent MedPAC recommendations that could eliminate the increase in Medicare reimbursement for homecare in 2006, we will continue to work for fair reimbursement. We also support renewal of the 5 percent rural add-on set to expire at the end of next month.

Although we remain cautious about Medicaid, we're encouraged by recent comments from the new Health and Human Services Secretary, Mike Leavitt, that he and CMS Administrator, Mark McClellan, will focus on more Medicaid funding for home and community-based care. Their comments are consistent with our strong belief in the value that homecare brings to the community.

Turning to our Commercial Insurance and Other payer category, we were pleased to report a revenue increase of more than 11 percent for the quarter versus the same period of 2003, even after taking into account the essentially flat revenues generated by our CIGNA relationship. In addition to the extra week of activity, there were two major reasons for this increase -- the benefit of our five-year contract with TriWest that commenced in June of last year as well as increased business from our existing managed care customers.

Speaking of TriWest, all of the contract implementation phases are now completed, and we continue to focus on business development. Under this agreement, we are playing an important role in serving members of our nation's military, including veterans returning from overseas, and we are demonstrating how our CareCentrix model can expand its products and services to care for a large and geographically dispersed military population and their families. I am proud and pleased to report that since this relationship began, CareCentrix has been able to service virtually all TriWest referrals regardless of complexity or location.

I also want to highlight three ways that our current strategies are in line with emerging trends in healthcare. The combination of our long history in serving senior patients and our managed care experience give us an even stronger competitive advantage over other homecare companies. First, specialty programs such as our new Gentiva Cardiopulmonary Program can help payers improve the management of chronic diseases. Second, our CareCentrix managed care model and our more than 250 direct service delivery

units put us in a strong position to serve a growing number of adults and seniors enrolled in managed care, traditional Medicare and Medicare Advantage programs. And third, we are preparing for an emerging focus on pay-per-performance in homecare. For a number of years now, we have placed a very strong emphasis on clinical excellence, as evidenced by our approach to specialization, clinical protocols and outcomes measurement and reporting, a strategy that is clearly aligned with this new thinking. We believe quality matters, and we will continue to invest resources in monitoring quality and enhancing our performance.

We also continue to press forward with our strategy of recruiting and deploying more salaried clinicians to build a group of employees whose time is solely dedicated to Gentiva. This strategy promotes clinical excellence and allows us to achieve our capacity and productivity goals. In fact, we increased our number of full-time clinicians by over 30 percent between the fourth quarters of 2004 and 2003.

The ability to say yes to referral sources is a key differentiator in our industry. Once the patient is admitted, we can then use other differentiators to meet or exceed expectations. And technology will be one of those key differentiators. We have important deliverables in this area for 2005, including CRM, contact center modernization and an update of our CaseMatch scheduling application. Significant work is also underway on our new clinical management system. These initiatives were delayed in 2004 because of our need to focus on the necessary compliance work for Section 404 of the Sarbanes-Oxley Act. I'm pleased to note that we have not identified any material weaknesses or significant deficiencies in internal controls related to financial reporting, although the compliance work required under Section 404 of the Sarbanes-Oxley Act will not be complete until we file our annual report on Form 10-K in early March.

While we are pleased with this progress, it has come at the price of additional expense and the delay of several strategic initiatives as we deployed a significant part of the IT team for the application changes, documentation and testing of our systems as required by our 404 compliance work. We're committed to these strategic initiatives and we will keep you informed of our progress through this important area where we have high expectations.

And, speaking of high expectations, we recently launched a long-term branding initiative to achieve consistent brand behaviors and high performance throughout our Company. We call it "Caring the Gentiva Way." It's designed to strengthen our Gentiva and CareCentrix brand and further articulate the differences between our Company and other homecare companies in the marketplace. The idea for "Caring the Gentiva Way" was born about a year ago, and it has involved a good deal of research. We've talked with external and internal audiences, including patients, referral sources, members of the investment community and employees in order to gain an understanding of the baseline perceptions of Gentiva and the value we deliver and how we deliver against their expectations.

We also conducted an extensive internal opinion survey to better understand the ideas, needs, and concerns of our own people. While we think our Company does an excellent job today, we learned a lot about how we can improve and deliver to each audience an experience that is always consistent, exceptional and memorable, an experience that further differentiates us and strengthens our leadership position in homecare. When we say that Gentiva and CareCentrix are the best at what they do, we back those words up with actions and we deliver. Over the next few months, we will be training all employees on our new brand behaviors, which we believe will be a key driver in achieving a true high-performance culture.

Before I conclude my remarks, I also want to say that we're pleased with our overall performance for fiscal 2004. Net revenues rose 3.9 percent for the year versus the prior period and increased 10.2 percent, excluding revenue from CIGNA. Net income as adjusted reached 69 cents per diluted share versus 52 cents for the prior year. We reported cash flow from operating activities of \$34.9 million. We repurchased over 2.5 million shares of Gentiva common stock at a total cost of \$38.4 million. We ended the year with over \$100 million in cash items and short-term investments. And we made good progress on our overall strategic initiatives.

With that, I'd now like to turn the call over to our CFO, John Potapchuk, for a discussion of our financial performance and our outlook for 2005. John?

---

**John Potapchuk - Gentiva Health Services - CFO**

Thanks, Ron, and welcome, everyone. I am pleased to share with you more detail on our strong fourth-quarter and year-to-date financial performance along with our 2005 outlook.

But, before I do that, I'd like to briefly review several items that affect our presentation format and the comparability of the Company's results for the 2004 and 2003 periods. The first relates to settlement of our appeals relating to the methodology used for determining Medicare reimbursements in our 1997 and 1998 cost reports. These settlements contributed about \$300,000 to fourth quarter 2004 revenues and pretax income and about 10.4 million to our full-year results. The agreed-upon methodology will also be applied to cost reports covering the years 1999 and 2000. We expect cost reports for the 1999 year to be reopened and completed during 2005. It is likely that our future recoveries of funds relating to this appeal will be significantly less than the 1997 settlement of 9 million but greater than the 1998 settlement of 1.4 million. The time frame for resolving all items relating to the year 2000 cost reports cannot be determined at this time.

The second item relates to a \$1 million revenue adjustment representing an estimated repayment to Medicare that we recorded in the first quarter of 2004. The third item involves the pre-tax gain of over \$900,000 relating to the sale of a 19.9 percent interest in a

Canada-based company which was recorded in the second quarter of 2004.

And the final two items affecting comparability relate to our tax rates. In 2003, we recognized a portion of a valuation allowance to offset deferred taxes during interim periods, and we reversed the remaining valuation allowance and increased income at the end of fiscal 2003. In 2004, during the second half of the year, we recognized the benefit of certain state net operating loss carryforwards, which resulted in an effective tax rate of 34.1 percent for the full year. Because of these items, we also disclosed net income as adjusted in our earnings release and reconciled such amounts to the reported GAAP presentation. We believe the "as adjusted" presentation is useful to investors since it reflects the Company's operating performance in a consistent manner, excluding the special items that I just mentioned and using an annual effective tax rate of 39 percent, which is the Company's expected normalized rate for reporting purposes.

I'd now like to turn to some of the financial performance measures. As Ron mentioned, we reported revenue growth in two areas in both the fourth quarter and for the full year. Medicare and our non-CIGNA Commercial Insurance and Other. This resulted in the following changes in our payer mix for fiscal 2004 excluding special items. Medicare represented 26.1 percent of our total net revenues for fiscal 2004, up more than 4 percentage points from fiscal 2003. Medicaid and local government payers represented 18.5 percent of total net revenues, a decrease of more than 1.5 percentage points from fiscal 2003. Revenues from CIGNA Healthcare represented 31.1 percent of total net revenues, a decrease of nearly 5 percentage points from the prior year. And, Commercial Insurance and Other category, excluding revenues from CIGNA, represented 24.3 percent of total net revenues, an increase of almost 2.5 percentage points compared to fiscal 2003.

Turning to other financial measures, our gross profit in the fourth quarter of 2004 was approximately 12.4 million higher than the corresponding period of 2003. As a percentage of net revenues, gross profit margin increased about 2 percentage points from 36.5 percent in the fourth quarter of 2003 to 38.5 percent in the fourth quarter of 2004.

We had two major drivers behind gross profit improvement for the quarter. The first was CareCentrix. As we benefited from the reconfiguration of our HME provider network earlier this year and from the addition of new contracts, such as TriWest. The second was a favorable change in our business mix, as our increased Medicare business and revenue growth from our higher margin specialty programs more than offset the anticipated revenue loss from reduced participation in certain low-margin, hourly Medicaid and local government programs. We also had contributions to gross margin improvement from positive changes in Medicare reimbursement rates between the 2003 and 2004 periods and lower workers' compensation expense.

For the full year, gross profit as a percentage of net revenues increased 3.7 percentage points from 34.6 percent in fiscal 2003 to 38.3 percent in fiscal 2004. The increase was driven by the same factors that affected the fourth quarter, as well as the Medicare settlements that I discussed earlier.

Selling, general and administrative expenses of 76.9 million for the fourth quarter of 2004 increased nearly \$11 million compared with the fourth quarter of 2003. And SG&A expenses of 278.3 million for the full year 2004 increased about 26 million compared to fiscal 2003. About \$5 million of the increase for both the fourth quarter and the full year related to the impact of the extra week of activity in the 2004 periods. More than half of the remaining increase resulted from incremental field operating and administrative costs to service increased Medicare volume and higher selling and clinical care coordination expenses. In addition, SG&A expense in the fourth quarter of 2004 included a charge of 1.4 million relating to the write-down of software which we determined had limited future value to Gentiva. The remaining increases in SG&A expenses during both the fourth quarter and full year 2004 resulted from incremental costs associated with the implementation of Sarbanes-Oxley requirements, ongoing IT initiatives, field development training and costs associated with the reconfiguration of the CareCentrix HME provider network.

Pre-tax income as a percentage of net revenues was 3.6 percent in the fourth quarter of 2004, excluding the impact of the final portion of the 1998 Medicare settlement. This compares to 3.4 percent in the fourth quarter of 2003. For fiscal year 2004, the pre-tax margin, excluding all special items, was 3.6 percent versus 2.9 percent for the comparable period of 2003.

We continue to be pleased with the strength of the Company's balance sheet. At year-end 2004, net accounts receivable declined by \$1 million from the end of 2003 and our days-sales-outstanding, or DSO, at January 2nd, 2005 was 57 days, a decrease of two days from the end of the third quarter of 2004 and year-end 2003. Cash items and short-term investments were 113 million at year-end 2004 compared to 117 million at December 28th, 2003. It is useful to note that the 2003 year-end amount reflects a reclassification of book overdrafts from cash to accounts payable to conform to the presentation format adopted for year-end 2004.

As Ron indicated in the news release, we repurchased over 526,000 shares of common stock in the fourth quarter of 2004 at a cost of about 8.2 million for an average cost per share of \$15.65. From May 2003, when we began our first share repurchase program, through the end of fiscal 2004, we have repurchased nearly 4 million shares in the open market at an average cost of about \$13.23 per share, and shares outstanding have declined by more than 11 percent during that period. As of the end of the fourth quarter of 2004, the Company had remaining authorization to repurchase about half a million shares of its common stock.

It is also interesting to note that during this same time period, the period from May 2003 to December 2004, Gentiva used cash of nearly 53 million for share repurchases and 19 million for capital expenditures, and yet, cash items and short-term investments have remained above \$100 million at each interim and year-end reporting period.

Before I move on and discuss our 2005 outlook, I want to make note of an item that will not appear in our 10-K but relates to a news story on insulin pumps that appeared last November. Gentiva, CIGNA, and Dana Diabecare were recently named in a lawsuit generally alleging that the three companies improperly denied a patient a medically necessary insulin infusion pump and violated the patient's right of privacy. While it is our policy not to comment on pending litigation, we can tell you that no allegations have been made to indicate that this patient or any other patient was in any way harmed. We intend to mount a vigorous defense against the suit because in our view, it is without merit.

Now, I'd like to turn to our financial outlook for 2005, which we are updating from the preliminary outlook which we discussed on our third-quarter conference call. We are reaffirming our outlook for full year net revenues in a range of 870 million to 890 million. We are changing our outlook for 2005 net income to a range of 72 cents to 80 cents per diluted share, including an expense to earnings of between 6 cents and 8 cents per share resulting from the implementation of new accounting rules related to equity-based compensation. We expect to adopt the provisions of Financial Accounting Standards Board Statement No. 123[R] "Share-Based Payment," on a modified prospective basis beginning in the third quarter of fiscal 2005. Our earlier 2005 outlook reflected a range of 78 cents to 85 cents per diluted share without the equity compensation charge. This updated 2005 financial outlook excludes the impact of any special items or potential acquisitions and reflects estimated average diluted outstanding shares of 26.2 million.

Our 2005 financial outlook also reflects depreciation and amortization of between \$7.5 and \$8.5 million, capital expenditures of between \$12 million and \$14 million and cash flow from operating activities of between 26 million and 30 million. That completes our financial discussion.

Now, I'd like to turn the call back to Ron to discuss our 2005 initiatives. Ron?

---

**Ron Malone - Gentiva Health Services - CEO**

Thanks, John. While we were pleased with our 2004 performance, we're excited by the opportunities for an even stronger 2005. About a month ago, I had a chance to stand in front of both the field and corporate leadership of the Company and share with them our vision and strategic plan. We left that meeting with a clear commitment to the following priorities.

We will continue our focus on profitable growth led by our ongoing expansion in specialty programs. We will work to create a more diversified business portfolio. We will continue to evaluate accretive acquisition opportunities that are complementary to our business. We will continue our investments in new technologies that contribute to productivity and clinical excellence. We'll remain focused on the recruitment, retention and productivity of clinical associates to increase our capacity for referrals. We will build brand equity along with a high-performance culture with clear accountabilities based on the tenets of "Caring the Gentiva Way" and we will work to create solutions, quality clinical outcomes and superior service experiences that meet the needs of all who have a high stake in high-quality health care and in our success.

As we wrap up our discussion of the past quarter and fiscal year, we remain focused on these priorities and look forward to discussing our results on the next call. With that, we are now pleased to take your questions.

## QUESTION AND ANSWER

**Operator**

(Operator Instructions). Eric Gommel, Legg Mason.

**Eric Gommel - Legg Mason - Analyst**

Did I hear you correctly? You said you won't be disclosing the lawsuit in the 10-K?

**John Potapchuk - Gentiva Health Services - CFO**

That's correct, Eric.

**Eric Gommel - Legg Mason - Analyst**

And why is that?

**Ron Malone - Gentiva Health Services - CEO**

I'll ask our General Counsel, Steve Paige to comment on that.

**Stephen Paige - Gentiva Health Services - SVP & General Counsel**

Eric, as you know from our previous calls, and as John just stated, it's our policy not to comment on pending litigation. But I can tell you we do not believe the case has merit and we intend to vigorously defend it. We've made an analysis of the case and based upon that, we're not going to be including it in our 10-K.

**Operator**

Sheryl Skolnick, Fulcrum Global.

**Sheryl Skolnick - Fulcrum Global Partners - Analyst**

Thank you very much for disclosing that. I would imagine at this point, given the status of the case, there's nothing material really being alleged and I'm not at all surprised that it wouldn't be in the K. But on the other hand, you've done the right thing and I appreciate it, at least in my view.

My question is, however, related to the CareCentrix network as it pertains to the Dana Diabecare situation. And I'm wondering if based on what appears to be bona fide information that Dana was a very small company with a rather colorful past and that was not part of your process of credentialing to determine whether it was or

it wasn't of a colorful past, are you changing that process to include more due diligence on the vendors as you grow the CareCentrix business?

**Ron Malone - Gentiva Health Services - CEO**

As we move forward, we will look carefully at all vendors in the CareCentrix network. And I couldn't possibly comment on your comments about a colorful past because we're not aware of that. Do you have a follow-up question?

**Sheryl Skolnick - Fulcrum Global Partners - Analyst**

Well, I guess what I'm looking for here is a notion of whether or not you're going to change your procedures for admitting vendors into the network or if you're not.

**Ron Malone - Gentiva Health Services - CEO**

Well, we seek to learn from everything that happens here every day. We will evaluate future companies that wish or we wish to have them join the network. We believe our credentialing process is very sound. In the case of larger vendors to the organization, we very well may conduct on-site visits to affirm our comfort in their delivery systems. But that wouldn't be a significant change from our past pattern.

**Operator**

Tony Campbell, Knott Partners.

**Tony Campbell - Knott Partners - Analyst**

Boy, I'm not usually this far up in the queue. But anyway, you've taken a couple of days off DSOs. How hard do you think it is to get to 50 days? And when do you think you can get there? And then I have a follow-up question if I might.

**John Potapchuk - Gentiva Health Services - CFO**

Tony, we're continually striving to improve. And you can see we've done that. I mean I can think back three or four years when all those DSOs were at 85. But, it does become a point where you really have to measure the incremental costs associated with bringing those days down. That being said, I have challenged our group in our financial service unit to say over time, kind of best in class, you know we'd like to get into the low 50s. But I don't have a specific time frame for when that might be.

**Tony Campbell - Knott Partners - Analyst**

Okay. And then on -- are you going to increase the authorization for repurchase?

**Ron Malone - Gentiva Health Services - CEO**

We will be working with our Board on what is the best use of our cash and we still are strong believers in our Company and its future.

**Operator**

Larry Marsh, Lehman Brothers.

**Larry Marsh - Lehman Brothers - Analyst**

Let's see, a question I wanted to address. You're guiding to cash flow from ops of 26 to 30. You just did almost 35 this past year and your CapEx looks to be about the same as you had last year. Why are you guiding to a big drop in cash flow from ops?

**John Potapchuk - Gentiva Health Services - CFO**

Yes, Larry, a couple of things -- keep in mind that 35 million in operating cash flow for this year included those special items, or a number of those special items. If you take out the Medicare settlement, there's some tax payment associated with that and we did make some payments back on -- you may recall about a year or so ago we took a charge on PEPs -- made some payment back on that. There's about \$6 to \$8 million of that \$35 million relating to those special items. So, if you dial that out, you're in the \$27 to \$29 million range. You look at 2005 now -- we may need some additional funds to continue to grow the business. And right now the expectation would be that our cash payment of taxes will be somewhat higher than it was in '04.

**Larry Marsh - Lehman Brothers - Analyst**

Okay. But did you have any NOL benefit in '04?

**John Potapchuk - Gentiva Health Services - CFO**

Well in '04, our overall cash taxes were in the neighborhood of \$4 million. We expect to be somewhat higher than that. Keep in mind that state NOL benefit, we're recognizing that net of a valuation allowance. But the actual benefit of that is scheduled out for periods from now through I think like 2013. So, it's not on the cash basis that you get the entire benefit in '04. It goes out over a period of time.

**Larry Marsh - Lehman Brothers - Analyst**

Okay. So do you have any sense of what your expected cash tax payments are going to be this year?

**John Potapchuk - Gentiva Health Services - CFO**

Yes, I think there are a number of things that move around there. But as some guidance there, if our reported tax rate is going to be about 39 percent, we would expect the cash tax payment at this point to be somewhere between like 20 to 25 percent.

**Larry Marsh - Lehman Brothers - Analyst**

25 percent?

**John Potapchuk - Gentiva Health Services - CFO**

Between 20 and 25.

**Larry Marsh - Lehman Brothers - Analyst**

Okay. So you would expect about 8 to 9 million cash taxes?

**John Potapchuk - Gentiva Health Services - CFO**

Yes, somewhere like that, right.

**Larry Marsh - Lehman Brothers - Analyst**

Secondly, just elaborate a little bit on the draft -- the booked overdraft cash in accounts payable reclass.

**John Potapchuk - Gentiva Health Services - CFO**

Sure. What we've tried to do with the cash balance we have is obviously to maximize the return on our cash resources. So, in that regard, what we do is we keep our cash and our cash equivalents in an interest-bearing account that's separate from our master operating account. And then we transfer funds into the operating account to cover check clearings. There's no right of offset with respect to those two separate accounts. And the master account from day-to-day operations, it shows up in a book overdraft position as of the balance sheet date. So, in looking at some technical accounting bulletins, it suggests that the better presentation is to present the book overdrafts as an accounts payable rather than showing it as a reduction of cash. And we've adopted that presentation this year end and reclassified the prior year to be consistent.

**Larry Marsh - Lehman Brothers - Analyst**

Okay. Thank you. And just I wanted to address the CIGNA business. You said it was roughly flat from last year. Are you breaking out any revenue contribution from CIGNA in the fourth quarter comparable to what you did for the full year?

**John Potapchuk - Gentiva Health Services - CFO**

When you say revenue contribution, Larry, we said it's 31.1 percent. Well, I'm sorry, 31.1 percent for the full year. I'm sorry, you're asking about the quarter. Bear with me one second.

**Larry Marsh - Lehman Brothers - Analyst**

Sure.

**John Potapchuk - Gentiva Health Services - CFO**

Yes, CIGNA is 30.4 percent for the quarter.

**Larry Marsh - Lehman Brothers - Analyst**

Okay. And I guess just a question here. It looks like your -- I don't know what sort of contribution TriCare may have had in that segment in the quarter -- I don't know if you are quantifying that. But would you say that excluding TriCare, it looks like your managed care revenues grew a good bit in the quarter? And why would that be the case?

**John Potapchuk - Gentiva Health Services - CFO**

Managed care revenues excluding CIGNA did grow significantly in the quarter. If you adjust out for the extra week, somewhere near the 20 percent mark. A significant piece of that is TriWest. But also we're continuing to grow our other managed care contracts.

**Larry Marsh - Lehman Brothers - Analyst**

Okay, all right. So is it just -- then I'll shut up -- is it fair to say that in your guidance for next year you would anticipate a further moderation in reported revenues from the CIGNA relationship? And remind us again when that current contract is set to renew or expire?

**John Potapchuk - Gentiva Health Services - CFO**

Yes, we expect -- as you know, we had showed a decrease this year. But, now on a comparable basis, we expect CIGNA to be flattish, maybe down a couple of percentage points. I would think as you roll in as a percentage of our revenue, it's likely to be slightly under 30 percent. But, hopefully that answers your question. On the contract renewal, again, if you recall beginning in

'04, we signed a contract with CIGNA for a three-year duration, meaning through '06. Although we have disclosed in our K that there is the option or the opportunity, if you will, 90 days prior to, you know, CIGNA can give notice 90 days prior to the end of '05.

**Larry Marsh - Lehman Brothers - Analyst**

Okay. And I'll shut up -- has there been any comments from CIGNA since the publicity around this one subcontractor issue? Or have you gotten any feedback from them to suggest they continue to be pleased at your relationship?

**Ron Malone - Gentiva Health Services - CEO**

I'll ask Al Perry, our President, to comment on that.

**Al Perry - Gentiva Health Services - President & COO**

Certainly, every indication is that our relationship has remained very strong, as strong as it has ever been. So, we're continuing to move forward with other initiatives with CIGNA. And I certainly don't see anything that would suggest that there is an issue between our organizations.

**Ron Malone - Gentiva Health Services - CEO**

In fact, I work, Larry -- we're working very closely with them to add value to that relationship.

**Operator**

(Operator Instructions). Evan Steen with EOS.

**Evan Steen - EOS - Analyst**

Nice quarter and nice year. Most of my questions have been answered. But could you actually on the option expense just sort of give me some clarity on how that's going to run through the P&L? The shares outstanding obviously are going up. So, and there's going to be expense. But could you just give me a little bit more clarity on how you get to that 6 to 8 cents?

**John Potapchuk - Gentiva Health Services - CFO**

What you have to do, Evan -- and thanks for the comment -- that will show up as a, really included in SG&A expense over the, beginning in the third quarter of this year. And, what we have done is look at the value of each option, both the legacy options that we have and any new option that would be granted in 2004. And those need to be expensed over the vesting period of the option. And so, there's a continuing expense from prior-year options also. There's

also a piece relating to our employee stock purchase plan that will be included in that expense number. And again, that goes through SG&A. It's not really going to affect the shares outstanding because again in calculating diluted shares today, under a treasury stock method format, those shares are already reflected in the denominator.

**Evan Steen - EOS - Analyst**

Okay, I got confused I guess because your share count average for the end of the quarter was 25 -- what was it 487 or so?

**John Potapchuk - Gentiva Health Services - CFO**

Yes.

**Evan Steen - EOS - Analyst**

And you gave us guidance of 26.2. My assumption is you're going to be buying back some more shares. So, I was a bit confused.

**John Potapchuk - Gentiva Health Services - CFO**

Well what's reflected in our outlook today is the fact that we have a half a million shares that are authorized to be repurchased. So continuing the repurchase program there. But other assumptions that are reflected in the share count -- we issue -- if you look at our footnotes when the K comes out, we issue shares on the employee stock purchase plan two times a year. So that adds to the count. There are some assumptions regarding options being exercised. And as those options are exercised, the share count is an incremental increase in the share count. And then if there's a change in the share price, that also would add to the diluted share count under the treasury stock method. So, there's a whole series of assumptions that go into that.

**Evan Steen - EOS - Analyst**

Lastly, could you guys just comment on two things. One, any more managed care projects that you can talk about that are in the works? I know these things take a long time. And I don't know what sort of the pipeline looks like. And then two, any new geographies that you guys are thinking about expanding into that you're not currently in.

**Ron Malone - Gentiva Health Services - CEO**

Evan, this is Ron. First of all, on new geographies, we do plan some de novo openings this year. Really those mostly allow us to expand into territories we currently operate. We have also said that as we evaluate acquisition opportunities, we would be more

focused in areas where we either did not operate or where we felt like we had quite low market penetration and a smart acquisition might allow us to really expand our presence in a market. So, we're continually mindful of that -- that's on the core nursing side.

On the managed care opportunities, there's nothing we can make specific comment on this time. We do feel good about our offering. We have invested more in that managed care team to take that message out to prospective customers. And we do feel like that message is received very positively. So, we have a good pipeline and you're certainly right. They do take quite a long time and it's not entirely predictable when they might come in. But we are very active in that area.

---

**Evan Steen - EOS - Analyst**

Okay. And then last question. The board meeting for potential reauthorization is -- the next one is when?

---

**Ron Malone - Gentiva Health Services - CEO**

Well, the next board meeting is next week.

---

**Operator**

Josh Stewart, Sidoti & Co.

---

**Josh Stewart - Sidoti & Co. - Analyst**

First, a quick review. Did I hear correctly that you gave some guidance for the share count in '05?

---

**John Potapchuk - Gentiva Health Services - CFO**

Yes. Average diluted shares of 26.2 million.

---

**Josh Stewart - Sidoti & Co. - Analyst**

Okay, for the full year?

---

**John Potapchuk - Gentiva Health Services - CFO**

Right.

---

**Josh Stewart - Sidoti & Co. - Analyst**

And then, the other question is I just wanted to get some sort of grasp on the sustainability of your strength in the non-CIGNA commercial revenue sector. Was there anything at all one-time about the jump in the quarter? I mean, by my model, it's mid to

high 20 percent range year-over-year growth in that segment. So, I was just wondering if you could comment -- is there anything one-time and is this sustainable in '05?

---

**John Potapchuk - Gentiva Health Services - CFO**

Well, Josh, a couple of things. I mean, we do have, obviously, the extra week of activity in the fourth quarter that contributes to that and we do have -- the TriWest contract began implementation in June 1. And that was being implemented over a -- really over 21 states over a period through the end of the year. So, there's a little bit of gyrations that that implementation period is going -- went on through the rest of this year. I'm confident we're going to continue to grow that non-Medicare managed care business. But I'm not at this point getting into the details of taking the percentage.

---

**Ron Malone - Gentiva Health Services - CEO**

I do believe that while we stated, Josh, that we have gone through all the implementation phases, we do believe that we're now focused in a phase of developing the full potential of TriWest. We do think it has considerably more potential than we have yet seen. And then of course as I mentioned, we have a very active pipeline of new prospects as well.

---

**Josh Stewart - Sidoti & Co. - Analyst**

Could you comment about what the extra potential in TriWest contract is exactly?

---

**Ron Malone - Gentiva Health Services - CEO**

We have not broken out the individual accounts other than CIGNA as of this point. We do believe it can be -- we could see considerable growth in the full year.

---

**Josh Stewart - Sidoti & Co. - Analyst**

Okay. And is that from more specialty programs?

---

**Ron Malone - Gentiva Health Services - CEO**

Well, I was making a comment specifically about TriWest. We do believe that we will see considerably more revenue this year, and we can mine additional opportunities there. However, we do believe that we would expect to see continued good performance in the growth of our Medicare business. And bear in mind that all of our specialty business is not Medicare. There are also other payers because our referring physicians really would expect us to accept a pretty broad range of patients that fall into the category of need, both adult and older adult, you know there are both those that are

qualified as Medicare beneficiaries and those that are under managed care. But we believe we'll continue to see growth in that area. We're very pleased that we established this a couple of years ago as a real cornerstone of our growth strategy. And we're very pleased with what we see there, both from a growth opportunity point of view, ability to enhance our mix but also from the clinical point of view in terms of our delivering outcomes.

---

**Operator**

Blake Goodner, Bridger Capital.

---

**Blake Goodner - Bridger Capital - Analyst**

I hopped on the call a little bit late. So, hopefully I'm not asking questions that were already answered. But could you just I guess reiterate the Medicare admission growth in the quarter? I missed that.

---

**John Potapchuk - Gentiva Health Services - CFO**

The Medicare admission growth was 10 percent.

---

**Blake Goodner - Bridger Capital - Analyst**

Okay, great. And then secondly, could you provide us -- I know you've done this historically at the end of your full years; but could you provide us with the revenue per episode that you experienced in the fourth quarter and the full year?

---

**Ron Malone - Gentiva Health Services - CEO**

We have not, Blake, and we don't disclose our Medicare operating metrics.

---

**Blake Goodner - Bridger Capital - Analyst**

Okay. And I guess my last question would just be in terms of the acquisition environment, I know there's been a lot of talk about your uses of cash and what you're going to be doing with that. Could you just give me a little more feedback in terms of what you're seeing in terms of multiples being paid for different acquisitions? It looks like some of your competitors are doing acquisitions and it looks like the multiples are creeping up a little bit. There was a large deal just done in South Carolina, I believe. So could you just perhaps comment on the state of the acquisition environment and the multiples that people are paying out there and your interest? Thanks.

---

**Ron Malone - Gentiva Health Services - CEO**

I believe that the multiples -- and I'll ask John to comment as well -- the multiples have moved up over the past couple of years. We see particularly the higher multiple expectations being in business that's highly concentrated -- the larger business is more highly concentrated in Medicare. It seems to bear the highest multiple expectation. As we're looking at these, we look, as I mentioned a bit earlier, we look at the real estate, where they operate and the degree of integration required. Given our footprint and the fact that we've been pretty successful over the past six quarters in growing our Medicare, we're very, very careful not to do something that would disrupt that growth in a particular area. You may know that we have concentrations of business for instance in Florida. So, clearly the integration of a large business in Florida would be more problematic to us than it would be to an acquirer with no presence. So, we're pretty careful about that. And then maybe John, you'd like to comment on what you see in the multiples as well?

---

**John Potapchuk - Gentiva Health Services - CFO**

Yes, to dovetail with your point, a couple of years ago, we were looking at multiples that were more in the let's say 3 to 5 times EBITDA range. And now we're looking at 5 plus, again, depending on a lot of different situations. So, I think over the last couple of years, it certainly has crept up.

---

**Blake Goodner - Bridger Capital - Analyst**

Okay. And then if I might ask just one other question. In terms of again, push back to the Medicare admission growth, it looks like you had a strong Medicare quarter at 10 percent. What would you say that the industry is growing -- what is the industry growth rate as we look out over the next year and where would you expect to come out? Is the 10 percent level sustainable? Or are we going to see it gravitate up a little bit or down a little bit? Just a little color there. Thanks.

---

**Ron Malone - Gentiva Health Services - CEO**

Well, okay. We're certainly going to work hard to sustain our growth rate. For 2005, we believe we have a pretty stable reimbursement platform to work with at this juncture. The only piece that's a bit up in the air is the rural add-on. We have not included that in our outlook.

Yes, I think the specialty programs and the amount of focus we have on quality growth will -- and we're pretty optimistic that we can sustain a reasonable growth rate. And we believe we're growing certainly in line if not ahead in many markets of the general industry.

You know, when you look at particularly Medicare projections for growth, those have been somewhat problematic over the last few years. So, I'm not so sure that we can put a lot into that. And there

are parts of the industry we really don't touch. We're very, very focused though on delivering the specialty programs because we believe strongly that allows us to improve our messaging to our referral sources, the amount -- the outcomes feedback. It allows our salespeople to focus. It allows us to attract and put to work clinicians who are able to practice in a more specific area, which we believe will enhance not only retention but productivity over the long run. So, we're certainly committed to continue to grow that specialty program. So much so that I would say that there will be markets in coming years where virtually all of our business in that market would be flowing through various specialty programs. We think it's a much higher quality approach to our business. But, thank you for your questions.

---

**Operator**

Eric Gommel, Legg Mason.

---

**Eric Gommel - Legg Mason - Analyst**

Yes, just a follow-up on gross profit margin. Can you remind us or give us some perspective on how gross margins relate Medicare versus managed care versus Medicaid. I think in the past, you've talked about some ranges for those different business lines. I wonder if you could give me just an idea of how those compare. And I guess interpreting what you were saying earlier on the call that the managed care business you are in is -- the gross margins are actually better than previous contracts. Is that a safe assumption?

---

**Ron Malone - Gentiva Health Services - CEO**

Well, what we can say is we did improve our managed care margins during the year. We are very focused on doing smart contracting at the front end of the process. Because as we looked back -- you know, looking back over five, six, seven years in the business, our analysis would indicate that in order to sustain the activity, we need to contract wisely upfront. And in order by the way to make sure -- I think that this was reflective of what I refer to as small contracting is reflected in our DSOs as well.

Let me go back to your question around the relative margins. As it relates to managed care, we will often see two margins within managed care. That within our CareCentrix business as well as that portion where we are the direct provider of services. Those margins in the CareCentrix, where we are applying essentially an administrative charge there are among the lower margins. But our operating costs are also correspondingly lower in that business. As you may know, we operate four call centers for regional care centers to support that business.

In Medicaid, the margins are very broad from perhaps as low as 20 percent gross margin to as high as perhaps in the 50s or

approaching 60. And you really have to know the particular program and the particular state you're talking about and that's why we're so careful. As we mentioned in our script, while we have decreased some hourly cases, we have increased the number of skilled visits we're delivering in Medicaid. So, what you see there is some transition in that business. While revenues are still down slightly in the business, we have a more favorable mix. And we have said before that we believe that a well-managed Medicare-certified agency would be operating with gross margins in the 50s as a percent of revenue at this juncture. Operating costs being typically higher with a Medicare certified agency. Is there anything to add, John?

---

**John Potapchuk - Gentiva Health Services - CFO**

No, I think you touched on that pretty well. Absolutely. But also within that Medicare, as you say, running in the 50s, what we're seeing as we're focusing more on the specialty programs, those specialty programs do come in even somewhat higher margin than your typical Medicare.

---

**Ron Malone - Gentiva Health Services - CEO**

I think as we really focus our attention on disease states, we operate more efficiently almost all the way around. And the way we recruit and deal with our clinicians, our productivity, the development of our care protocol, I think is again I would say in our opinion is a high-quality approach to delivering care.

---

**Operator**

Thank you very much, Mr. Gommel. Ladies and gentlemen, thank you very much for the interest shown in today's call. However, with time now for one more question, our final question comes from Larry Marsh, a follow-up once again from Lehman Brothers.

---

**Larry Marsh - Lehman Brothers - Analyst**

I just wanted to understand -- you said there was a 1.4 million software write-down in the fourth quarter. And do you quantify about how much you spent incrementally for Sarbanes-Oxley this past year?

---

**John Potapchuk - Gentiva Health Services - CFO**

Yes. Sarbanes-Oxley, between the accounting fees and some consulting fees, we're talking about a number of between half a million and a million from our standpoint. In terms of the write-down, we had purchased some software and then with that, conducted a proof of concept in connection with the clinical management system. And what that work did is helped us really define our long-term direction. But, we also recognized, and

certainly with the help of our new IT leadership team, that the initial approach to the project wouldn't be the right solution to Gentiva. So, rather than spending a whole lot of incremental dollars on what we viewed as really the wrong solution at that time, we took a conservative approach and we wrote off the investment in fourth quarter. Larry, if you recall though in Ron's remarks, we did indicate and absolutely true, we are committed to that initiative. And over future quarters, we'll keep you informed of our progress as we continue the development of that new clinical management system.

---

**Ron Malone - Gentiva Health Services - CEO**

I would add two points, Larry. First, the Sarbanes costs that John referenced were really external costs. There were tremendous internal resources dedicated to that effort as well. And we certainly recognize that. And as it relates to the software, we have a lot of confidence in the team we've developed in IT. We've really strengthened the applications development part of our organization. And we're very focused on delivering a solution that works as a smart use of our money. We thank you very much for the questions.

In fact, I'd like to thank each of you this morning for your participation and your continued interest in Gentiva Health Services. We will continue to keep you informed of our progress and look forward to speaking with all of you again on our first-quarter earnings call.

---

**Operator**

And thank you very much, sir. Ladies and gentlemen, your host is making today's conference available for digitized replay for one week starting at 1:30 PM Eastern standard time February 17th all the way through 11:59 PM February the 24th. To access AT&T's Executive Replay Service, please dial 320-365-3844. At the voice prompt, enter today's conference ID of 769380. And that does conclude our earnings call for this quarter. Thank you very much for your participation as well as for using AT&T's Executive Teleconference Service. You may now disconnect.

**DISCLAIMER**

Thomson Financial reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON FINANCIAL OR THE APPLICABLE COMPANY OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

© 2005, Thomson StreetEvents All Rights Reserved.