LEXINGTON HEALTHCARE GROUP INC
Form 10-Q
February 20, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

|X| Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For The Quarter Ended December 31, 2000

or

|_| Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For The Transition Period from ______to______

Commission File Number 0-22261

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

Delaware	06-1468252
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer identification No.)
1577 New Britain Avenue, Farmington, CT	06032
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: 860-674-2700

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

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: February 12, 2001 3,525,000 Shares of Common Stock outstanding

LEXINGTON HEALTHCARE GROUP, INC.
DECEMBER 31, 2000 FORM 10-Q
INDEX

LEXINGTON HEALTHCARE GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	December 31, 2000 (Unaudited)	June 30, 2000 (Audited)
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 1,302,000	$ 1,265,00
Accounts and notes receivable - net of allowance for doubtful accounts of $2,076,000 and $1,634,000, respectively	14,449,000	16,963,00
Inventories, prepaid expenses and other current assets	1,109,000	1,349,00
Total current assets	16,860,000	19,577,00
PROPERTY, EQUIPMENT & LEASEHOLD IMPROVEMENTS, net	5,629,000	4,477,00
OTHER ASSETS		
Security deposits - related parties	2,337,000	2,337,00
Residents' funds	364,000	370,00
Goodwill, net	1,831,000	1,886,00
Bed licenses, net	1,336,000	1,394,00
Other assets, net	783,000	917,00
	6,651,000	6,904,00
	$ 29,140,000	$ 30,958,00

LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIENCY)

CURRENT LIABILITIES		
Notes and capital leases payable (current portion)	$ 4,139,000	$ 4,296,00
Due to SunBridge - purchased receivables	2,078,000	2,094,00
Accounts payable and accrued expenses	13,918,000	14,423,00
Estimated third-party payor settlements	276,000	188,00
Income taxes payable	78,000	74,00
Total current liabilities	20,489,000	21,075,00
OTHER LIABILITIES		
Notes and capital leases payable (less current portion)	8,723,000	7,892,00
Residents' funds payable	364,000	370,00
Deferred rent	952,000	809,00
Other liabilities	120,000	120,00
	10,159,000	9,191,00
Total liabilities	30,648,000	30,266,00
COMMITMENTS AND CONTINGENCIES (Note F)		
MINORITY INTERESTS	565,000	565,00
STOCKHOLDERS' EQUITY (DEFICIENCY)		
Common stock, par value $.01 per share, authorized 15,000,000 shares, issued and outstanding 3,525,000 shares	35,000	35,00
Additional paid-in capital	5,556,000	5,556,00
Deficit	(7,664,000)	(5,464,00
Total stockholders' equity (deficiency)	(2,073,000)	127,00
	$ 29,140,000	$ 30,958,00

The accompanying notes are an integral part of these condensed consolidated financial statements.

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LEXINGTON HEALTHCARE GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Six Months Ended December 31,		
	2000	1999	
REVENUES			
Net patient service revenue	$ 34,772,000	$ 36,150,000	$
Management fee revenue	4,000	4,565,000	

Other revenue	83,000	136,000	
Total revenues	34,859,000	40,851,000	
EXPENSES			
Operating expenses:			
Salaries and benefits	28,220,000	29,719,000	
Food, medical and other supplies	1,888,000	4,201,000	
Other operating expenses	4,947,000	4,562,000	
Corporate, general and administrative expenses	1,242,000	1,681,000	
Interest expense	762,000	580,000	
Total expenses	37,059,000	40,743,000	
Income (loss) before income taxes and minority interest	(2,200,000)	108,000	
PROVISION FOR (BENEFIT FROM) INCOME TAXES	--	2,000	
MINORITY INTEREST IN INCOME OF CONSOLIDATED JOINT VENTURES	--	(101,000)	
Net income (loss)	$ (2,200,000)	$ 5,000	$
Basic earnings (loss) per share	$ (0.62)	$ 0.00	$
Weighted average number of shares outstanding	3,525,000	3,610,000	

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LEXINGTON HEALTHCARE GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED DECEMBER 31, 2000 AND 1999
(UNAUDITED)

	2000
CASH FLOWS FROM OPERATING ACTIVITIES	
Net income (loss)	$(2,200,000)
Adjustments to reconcile net income (loss) to net cash provided by operating activities	912,000
Decrease in accounts receivable	2,072,000
Changes in other operating assets and liabilities	435,000
Minority interest in income of consolidated joint ventures	--
Decrease in accounts payable and accrued expenses	(505,000)
Net cash provided by operating activities	714,000
CASH FLOWS FROM INVESTING ACTIVITIES	
Note receivable - related party	--
Increase in security deposits - other	--
Acquisition of fixed assets	(364,000)

Net cash used in investing activities	(364,000)
CASH FLOWS FROM FINANCING ACTIVITIES	
Repayments of notes payable and capital lease obligations	(148,000)
Net repayments from line of credit	(165,000)
Net cash used in financing activities	(313,000)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	37,000
CASH AND CASH EQUIVALENTS, beginning of period	1,265,000
CASH AND CASH EQUIVALENTS, end of period	$ 1,302,000
NON-CASH INVESTING AND FINANCING ACTIVITIES:	
Certain assets acquired through assumption of mortgage note payable	$ 952,000
Equipment and leasehold improvements acquired through assumption of notes payable and capital leases	35,000
Receipt of treasury stock in satisfaction of note receivable - related party	--

LEXINGTON HEALTHCARE GROUP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Information with respect to December 31, 2000 and for the six months and three months ended December 31, 2000 and 1999 is unaudited)

NOTE A - THE COMPANY

The condensed consolidated financial statements include the accounts of Lexington Healthcare Group, Inc. and all of its wholly-owned subsidiaries: Balz Medical Services, Inc. ("BALZ"), Professional Relief Nurses, Inc. ("PRN"), Lexington Highgreen Holding, Inc., and LexiCore Rehab Services, LLC ("Lexicore"), collectively, the "Company", as well as the accounts of Lexicon Pharmacy Services, LLC ("Lexicon"), a 70% owned joint venture controlled by the Company. All material intercompany balances and transactions have been eliminated in consolidation.

The Company is a long-term and subacute care provider which operates eight nursing home facilities at December 31, 2000 with 1,063 beds licensed by the State of Connecticut. PRN provides health care services in the homes of its patients. Lexicore provides rehab services to patients in the Company's and other nursing homes.

BALZ provided medical supplies and durable medical equipment to nursing homes, but is now substantially inactive after selling its operating assets and business (exclusive of cash and accounts receivable) as of June 1, 2000. Lexicon ceased operations as of March 31, 2000. Once the remaining accounts receivable have been collected and all obligations paid, the members will terminate Lexicon.

NOTE B - BASIS OF PRESENTATION

The financial information included herein is unaudited and presented on a condensed basis; however, the information reflects all adjustments (consisting solely of normal recurring adjustments) that are, in the opinion of management, necessary to present fairly the financial position, results of operations, and cash flows for the interim periods presented although the results shown for the interim periods presented herein are not necessarily indicative of the results to be obtained for a full fiscal year. The condensed balance sheet data as of June 30, 2000 is derived from audited financial statements; certain line items have been combined or condensed in their presentation herein.

Inventories consisting of food, chemicals and medical and other supplies are valued at the lower of cost or market, with cost determined on a first-in, first-out (FIFO) basis.

NOTE C - ACQUISITIONS AND DISPOSITIONS OF BUSINESSES

MANAGEMENT OF SUN HOMES, ACQUISITION OF ADAMS AND HERITAGE AND TERMINATION OF MANAGEMENT AGREEMENT

On November 1, 1998 the Company began providing management services for four skilled nursing facilities in Connecticut under an interim Management Agreement with SunBridge Healthcare Corporation ("SunBridge"), a New Mexico corporation and nation-wide healthcare provider.

As consideration for the services provided under this Management Agreement, the Company was entitled to retain the excess of any revenues earned in the delivery of patient services over the expenses incurred during the term and was responsible for any excess of expenses incurred over revenues earned in the operation of the facilities during the term. Under the terms of the agreement SunBridge retained responsibility for all building lease costs. In addition, the Company purchased substantially all of SunBridge's accounts receivable for these facilities. As of December 31, 2000, the balance owed is presented as "Due to SunBridge - purchased receivables" in the accompanying condensed consolidated balance sheet.

Effective September 1, 1999, the Company finalized agreements to acquire the operations of two of the managed facilities, Adams House and Heritage Heights. The related real property was leased with options to purchase which expire August 30, 2001; these facilities have a total of 240 skilled nursing beds. Management contracts covering the two other SunBridge facilities with a total of 239 skilled nursing beds were terminated as of August 31, 1999 and the operations of those facilities were returned to SunBridge. Under the terms of the management agreement, which terminated on August 31, 1999, the Company earned management fees of $4,422,000 and incurred costs and expenses of $4,407,000 during the two months ended August 31, 1999.

SALE OF BUSINESS

On June 14, 2000 BALZ sold its operating assets and business (exclusive of cash and accounts receivable) to an unrelated company, for $539,000 plus assumption of certain liabilities relating to financed equipment and leases. The agreement provided for a $40,000 cash payment at closing, a $260,000 note receivable requiring twelve equal monthly installments of principal and interest of $22,000 beginning July 1, 2000, and a payment of $239,000 for the book value of inventory due 90 days after closing.

As of December 31, 2000 the Company had received the payments due it under the note receivable, but had not received the payment for the book value of the inventory. However, the Company believes that its credit risk is minimal since it has the right to offset payables for goods purchased from the unrelated company in an amount sufficient to cover any unpaid amounts owing to the Company.

NOTE C - ACQUISITIONS AND DISPOSITIONS OF BUSINESSES (Continued)

SALE OF BUSINESS (Continued)

Prior to the sale of the business later in the fiscal year, BALZ had revenues of $1,699,000, expenses of $1,496,000 and net income of $203,000 during the six months ended December 31, 1999.

NOTE D - RENEGOTIATION OF RELATED PARTY OPERATING LEASE

The Company leases four of its nursing facilities (including certain equipment) under an operating lease with a partnership related through common ownership. The lease agreement, as amended, commenced on July 1, 1995 and is for an eighteen-year period, with renewal options for up to thirteen years. Annual rentals under the lease are currently $2.5 million.

The Company has renegotiated the required rent payments covering the period of October 1999 through February 2001 which will reduce the rent due during that period by approximately $800,000. However, recognition of that rent reduction has been accounted for by increasing deferred rent which equalizes the annual rent expense over the remaining fourteen-year term of the lease.

Rent expense charged to operations under this related party operating lease aggregated $1,224,000 and $1,237,000 for the six months ended December 31, 2000 and 1999, respectively.

NOTE E - THIRD-PARTY REVENUE ADJUSTMENTS AND SETTLEMENTS

Revenues are recognized at the time the service is provided to the patient. A substantial amount of the Company's revenues are billed to third party payors, i.e., Medicaid, Medicare and others under the provisions of reimbursement formulas and regulations in effect.

Patient service revenue is reported at the estimated net realizable amount from residents, third-party payors, and others for services rendered. Revenue received under cost reimbursement agreements is subject to audit and retroactive adjustment by third-party payors. Provisions for estimated adjustments have been reflected in patient service revenue. Differences between estimated adjustments and final settlements are recorded in the year of settlement.

The Company has recorded reductions in patient service revenue of $430,000 during the six months ended December 31, 2000 in connection with adjustments of 1997 and 1998 estimated Medicare settlements.

LEXINGTON HEALTHCARE GROUP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Information with respect to December 31, 2000 and for the six months and three months ended December 31, 2000 and 1999 is unaudited)

NOTE E - THIRD-PARTY REVENUE ADJUSTMENTS AND SETTLEMENTS (Continued)

Estimated third-party payor settlements payable represent management's best estimates of the amounts expected to be due and are based on anticipated results of ongoing negotiations, interpretation of applicable regulations and other assumptions. It is reasonably possible that the amounts the Company will ultimately be obligated to pay could differ materially in the near term.

NOTE F - COMMITMENTS AND CONTINGENCIES

GOVERNMENT INVESTIGATION

In October 1999, Federal officials (the "government") seized records and documents from the Company and subpoenaed current and former employees to provide testimony in connection with a grand jury investigation being conducted by the Office of the U.S. Attorney. The Company and certain members of present and former senior management have been named as targets of the government's investigation. However, the government has not provided the Company with any documentation from which it may determine the nature and scope of the investigation.

The Company is cooperating fully with the government investigation, has provided all requested records and information, and management is confident that the Company has not committed any wrongdoings. In addition, the Company has established an independent committee of the Board of Directors to supervise its own investigation. The ultimate outcome of this uncertainty cannot presently be determined. Accordingly, no provision for any liability that may result has been made in the accompanying condensed consolidated financial statements. Since the inception of the government action through December 31, 2000 the Company has recorded charges to expense consisting primarily of legal fees of $388,000 relating to this matter.

OTHER CONTINGENCIES

The Company is involved in other legal proceedings and is subject to certain lawsuits and claims in the ordinary course of its business. Although the ultimate effect of these matters is often difficult to predict, management believes that their resolution will not have a material adverse effect on the Company's condensed consolidated financial statements.

LEXINGTON HEALTHCARE GROUP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Information with respect to December 31, 2000 and for the six months and three months ended December 31, 2000 and 1999 is unaudited)

NOTE G - RISKS AND UNCERTAINTIES

PATIENT SERVICE REVENUE

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any significant pending or threatened investigations involving allegations of potential wrongdoing, except for the investigation discussed in Note F.

Compliance with such laws and regulations are subject to government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in the Medicare and Medicaid programs and/or the reduction of funding levels could have an adverse impact on the Company.

LEGISLATION, REGULATIONS AND MARKET CONDITIONS

The Company is subject to extensive federal, state and local government regulation relating to licensure, conduct of operations, ownership of facilities, expansion of facilities and services and reimbursement for services. As such, in the ordinary course of business, the Company's operations are continuously subject to state and federal regulatory scrutiny, supervision and control. Such regulatory scrutiny often includes inquiries, investigations, examinations, audits, site visits and surveys, some of which may be non-routine. The Company believes that it is in substantial compliance with the applicable laws and regulations. However, if the Company is ever found to have engaged in improper practices, it could be subjected to civil, administrative or criminal fines, penalties or restitutionary relief which may have a material adverse impact on the Company's financial results and operations.

NOTE H - OPERATIONS

The Company reported a loss of $2,200,000 for the six months ended December 31, 2000 which includes a reduction of patient service revenue of $430,000 as discussed in Note E and a $450,000 increase to the provision for doubtful accounts as a result of estimated uncollectable trade accounts receivable from discontinued operations of subsidiaries. Management has prepared plans which contemplate a significant turnaround in ongoing operations and profitability and has plans to address the Company's equity capital and cash flow needs so that operations may continue in a normal manner.

NOTE H - OPERATIONS - (Continued)

Specifically, layoffs have been implemented, field and administrative positions were restructured to reduce costs, and cost monitoring has been tightened. Management is in the process of reviewing contracts for the outsourcing of the dietary, housekeeping and laundry, and maintenance departments to professional service firms. These contracts, when implemented, should generate positive cash flow of approximately $2,000,000 assuming sixty day payment terms which are currently being negotiated. The total anticipated contract costs should be equal to or less than the costs the Company is currently incurring for such services.

Management has implemented an aggressive marketing plan, which includes patient sharing arrangements with local hospitals, to improve the patient mix and generate revenue from higher rate paying sources and the facilities are undergoing a major redecoration program to attract more patients. Medicare consultants have been engaged to improve nursing diagnoses skills and patient admission procedures which should result in higher revenue and lower bad debt write-offs in the future.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis provides information which management believes is relevant to an assessment and understanding of the Company's consolidated results of operations and financial condition. The discussion should be read in conjunction with the condensed consolidated financial statements and notes thereto.

Overview

In the first six months of the fiscal year ending June 30, 2001, the Company continued to operate eight nursing homes, a home health agency and therapy company.

During the fiscal year ended June 30, 2000, the Company's operations were affected when the management contract for two nursing homes was terminated, when certain assets and the business of BALZ were sold, when the Company's joint venture pharmacy ceased operations, and when settlements were negotiated on employment agreements with two executives. The two remaining nursing homes under management contract were leased and are now operated by the Company. Further, the Company experienced a government investigation during the year ended June 30, 2000 which resulted in certain costs.

The long term care industry has experienced many changes in recent years including the implementation of the Balanced Budget Act of 1997 ("BBA") which resulted in a new Medicare Prospective Payment System (known as PPS). Under PPS, Medicare revenues are substantially less than those earned under the former cost-based reimbursement system. Some of the Company's Medicare rate cuts were restored in October 1999 and April 2000; in addition, a 4% federal rate increase became effective October 1, 2000.

In Connecticut, multiple long term care entities have undergone financial reorganization in 1999 and 2000 due to reduced occupancy and PPS-related revenue reductions and increasing cost pressures (including union costs), and have experienced considerable losses in the market value of their own securities.

The Company believes its continued emphasis on cost controls and development of ancillary businesses remains the most appropriate strategy. Further, the Company is encouraged by the above-noted Medicare rate increases and recently proposed legislation to fund staffing increases for nursing homes, although it cannot be estimated what effect, if any, this proposed legislation may have on the Company's revenues in the near term.

The Company continues to believe that the demand for long-term care and specialty medical services will increase substantially over the next decade due primarily to favorable demographic trends, advances in medical technology and emphasis on healthcare cost containment. At the same time, government restrictions and high construction and start-up costs are expected to limit the supply of long-term care facilities and home care agencies. In addition, the Company anticipates that recent trends toward industry consolidation will continue.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview (Continued)

The Company's operating strategy is to increase nursing home profitability levels through aggressive marketing and by offering rehabilitation therapies and other specialized services; by adhering to strict cost standards at the Facility level while providing effective patient care and containing corporate overhead expenses; and by increasing marketing of rehabilitative services and nursing services to affiliated and non-affiliated nursing homes as well as to patients at home.

By concentrating its facilities and ancillary service operations within a selected geographic region, the Company's strategy is to achieve operating efficiencies through economies of scale, reduced corporate overhead, more effective management supervision and financial controls. In addition, the Company believes that geographic concentration also enhances the Company's ability to establish more effective relationships with referral sources and regulatory authorities in the states where the Company operates.

Results of Operations
Six months ended December 31, 2000 ("2000 period") vs. six
months ended December 31, 1999 ("1999 period")

Revenues in the 2000 period decreased form the 1999 period by $5,992,000 or by 15% largely as a result of the termination of the management agreement for two nursing homes, the sale of the assets and the business of BALZ, and the termination of Lexicon's operations.

The Company had a net loss of $2,200,000 or (.62) per share for the 2000 period and net income of $5,000 or (.00) per share for the 1999 period. The increase in losses is due primarily to a $430,000 reduction in patient service revenue resulting from adjustments to 1997 and 1998 Medicare settlements, a $450,000 increase to the provision for doubtful accounts as a result of estimated uncollectable trade accounts receivable from discontinued operations of subsidiaries, and reductions in net revenue from Medicare under the prospective payment systems (PPS).

Three months ended December 31, 2000 ("2000 period") vs. three months ended December 31, 1999 ("1999 period")

Revenues in the 2000 period declined from the 1999 period by $1,944,000 or by 10% largely as a result of the sale of the assets and the business of BALZ and the termination of Lexicon's operations.

The Company had a net loss of $1,238,000 or (.35) per share for the 2000 period and a net loss of $27,000 or (.01) per share for the 1999 period. The increase in losses is primarily due to a $450,000 increase in the provision for doubtful accounts as a result of estimated uncollectible trade accounts receivable from discontinued operations of subsidiaries in the 2000 period, and higher payroll and benefits.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Liquidity and Capital Resources

The Company has primarily financed its operations through operating revenues, borrowings from banks, the prior operator of certain of the facilities and other private lenders including stockholders, by financing its accounts receivable, through a public offering of its common stock, and through the sale of bed licenses.

During the six months ended December 31, 2000,the Company expended approximately $1,316,000 in capital improvements to its owned and its leased facilities of which $987,000 was funded by the mortgagor, banks or capital lease financing.

At December 31, 2000, the Company had a working capital deficit of $3,629,000 as compared to a working capital deficit of $1,498,000 at June 30, 2000. The increase in the working capital deficit is due primarily to the $2,200,000 operating loss reported for the 2000 period.

In December 1998, the Company entered into a financing agreement with a healthcare lender for up to $4,500,000, subsequently increased to $6,000,000, which is secured by its accounts receivable and certain other assets. As of December 31, 2000, $3,890,000 was borrowed under this agreement. The Company has increased its utilization of this line of credit to finance working capital needs as a result of payback of Medicare and Medicaid settlements, costs of the government investigation, and operating losses.

Management has prepared plans, as discussed in Note H, which contemplate a significant turnaround in ongoing operations and profitability and has plans to address the Company's equity capital and cash flow needs so that operations may continue in a normal manner.

Inflation has not had, nor is it expected to have, a material impact on the operations and financial condition of the Company.

Forward Looking Statements

This quarterly report contains certain forward-looking statements regarding the Company, its business prospects and results of operations that are subject to certain risks and uncertainties posed by many factors and events that could cause the Company's actual business, prospects and results of operations to differ materially from those that may be anticipated by such forward-looking statements.

Factors that may affect such forward-looking statements include, without limitations: the Company's ability to successfully and timely develop and finance new projects, the impact of competition on the Company's revenues, and changes in reimbursement rates, patient mix, and demand for the Company's services.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward Looking Statements (Continued)

When used, words such as "believes," "anticipates," "expects," "intends" and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. The Company undertakes no obligation to revise any forward-looking statements in order to reflect events or circumstances that may subsequently arise.

Readers are urged to carefully review and consider the various disclosures made by the Company in this report, news releases, and other reports filed with the Securities and Exchange Commission that attempt to advise interested parties of the risks and factors that may affect the Company's business.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

In October 1999, Federal officials (the "government") seized records and documents from the Company and subpoenaed current and former employees to provide testimony in connection with a grand jury investigation being conducted by the Office of the U.S. Attorney. The Company and certain members of present and former senior management have been named as targets of the government's investigation. However, the government has not provided the Company with any documentation from which it may determine the nature and scope of the investigation.

The Company is cooperating fully with the government investigation, has provided all requested records and information, and management is confident that the Company has not committed any wrongdoings. In addition, the Company has established an independent committee of the Board of Directors to supervise its own investigation. The ultimate outcome of this uncertainty cannot presently be determined. Accordingly, no provision for any liability that may result has been made in the accompanying condensed consolidated financial statements. Since inception through December 31, 2000 the Company has incurred expenses of $388,000 relating to this matter.

The independent committee of the Board of Directors approved a formal Corporate Compliance Plan which was submitted to the Connecticut Department of Social Services in February 2000. The following actions have been taken in support of that plan:

o An experienced operations executive was named Corporate Compliance Officer

o An 800 "hot line" phone number to report questions or problems has been set up and communicated to employees and others

o A Management Compliance Committee has held seven monthly meetings, resulting in a number of formal policies being written and distributed including a Corporate Compliance Handbook for employees which includes disciplinary guidelines, an offense detection plan, and corrective action initiatives

o Corporate compliance training for employees has been conducted Written policies and procedures have been prepared relating to State of CT reimbursement (including related party transactions and cost report preparation); training was completed before preparing the 2000 cost reports

o Quarterly audits of management costs, related party transactions and rent payments have been completed and submitted to the State of Connecticut

The Company has received notice of lawsuits initiated against it in April 2000 concerning four nursing homes which it was managing for SunBridge Healthcare Corporation; the claims are being made by affiliates of SunBridge for therapy and pharmacy services rendered. The total claimed is $1.2 million of which $1.1 million is reflected by invoices recorded on the Company's books. The Company believes that the claim includes overbillings, payments and credits not applied, and amounts charged in excess of contract rates. The Company settled a portion of the lawsuit for $212,000 payable over ten months. This amount represents invoices previously recorded on the Company's books. The Company intends to vigorously contest the lawsuits as it works out arrangements to pay appropriate charges.

The Company is involved in other legal proceedings and is subject to certain lawsuits and claims in the ordinary course of its business. Although the ultimate effect of these matters is often difficult to predict, management believes that their resolution will not have a material adverse effect on the Company.

Item 2. Change in Securities

NONE

Item 3. Defaults Upon Senior Securities

NONE

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

NONE

Item 5. Other Information

NONE.

Item 6. Exhibits and Reports on Form 8-K

NONE.

SIGNATURES

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

/s/

(Barry Feldscher, Chief Operating Officer)
(Duly Authorized Officer)

Date ------------------------------ /s/

(Chief Financial Officer)
(Principal Financial Officer)