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APRIA HEALTHCARE GROUP INC
Form 10-Q
May 15, 2001

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

FORM 10-Q

(Mark One)

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

For the period ended March 31, 2001

OR

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

Commission File Number: 1-14316

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

DELAWARE
(State or other jurisdiction of
incorporation or organization)

33-0488566
(I.R.S. Employer
Identification Number)

3560 HYLAND AVENUE, COSTA MESA, CA
(Address of principal executive offices)

92626
(Zip Code)

Registrant's telephone number, including area code: (714) 427-2000

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

Yes X No

There were 53,766,008 shares of common stock, \$.001 par value, outstanding at May 8, 2001.

APRIA HEALTHCARE GROUP INC.

FORM 10-Q

FOR THE PERIOD ENDED MARCH 31, 2001

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

APRIA HEALTHCARE GROUP INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS

(dollars in thousands)	MARCH 31, 2001	DECEMBER 31, 2000
	(unaudited)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 11,377	\$ 16,864
Accounts receivable, less allowance for doubtful accounts of \$36,716 and \$39,787 at March 31, 2001 and December 31, 2000, respectively...	155,216	145,518
Inventories	21,855	22,404
Deferred income taxes	33,400	33,067
Prepaid expenses and other current assets	8,332	8,617
TOTAL CURRENT ASSETS	230,180	226,470
PATIENT SERVICE EQUIPMENT, less accumulated depreciation of \$318,606 and \$310,741 at March 31, 2001 and December 31, 2000, respectively ...	140,035	134,812
PROPERTY, EQUIPMENT AND IMPROVEMENTS, NET	43,101	40,630

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DEFERRED INCOME TAXES	65,311	75,076
INTANGIBLE ASSETS, NET	161,356	137,928
OTHER ASSETS	1,643	1,687
	-----	-----
	\$ 641,626	\$ 616,603
	=====	=====

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES		
Accounts payable	\$ 49,392	\$ 54,250
Accrued payroll and related taxes and benefits	31,093	28,449
Accrued insurance	9,511	9,980
Income taxes payable	13,837	13,378
Other accrued liabilities	27,892	24,555
Current portion of long-term debt	8,956	1,999
	-----	-----
TOTAL CURRENT LIABILITIES	140,681	132,611
LONG-TERM DEBT, net of current portion	332,794	337,750
COMMITMENTS AND CONTINGENCIES (Note H)		
STOCKHOLDERS' EQUITY		
Preferred stock, \$.001 par value: 10,000,000 shares authorized; none issued	-	-
Common stock, \$.001 par value: 150,000,000 shares authorized; 53,602,825 and 53,153,890 shares issued at March 31, 2001 and December 31, 2000, respectively; 53,516,725 and 53,067,790 outstanding at March 31, 2001 and December 31, 2000, respectively...	54	53
Additional paid-in capital	348,453	343,621
Accumulated deficit	(179,395)	(196,471)
Treasury stock, at cost; 86,100 shares at March 31, 2001 and December 31, 2000, respectively	(961)	(961)
	-----	-----
	168,151	146,242
	-----	-----
	\$ 641,626	\$ 616,603
	=====	=====

See notes to condensed consolidated financial statements.

APRIA HEALTHCARE GROUP INC.

CONDENSED CONSOLIDATED INCOME STATEMENTS
(unaudited)

(dollars in thousands, except per share data)	THREE MONTHS ENDED	
	MARCH 31,	
	2001	2000
	-----	-----
Net revenues	\$271,354	\$250,722
Costs and expenses:		
Cost of net revenues:		

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Product and supply costs	51,927	49,446
Patient service equipment depreciation	20,964	18,853
Nursing services	354	453
Other	3,033	2,749
	-----	-----
	76,278	71,501
Selling, distribution and administrative	148,394	133,525
Provision for doubtful accounts	8,150	10,619
Amortization of intangible assets	2,836	2,440
	-----	-----
	235,658	218,085
	-----	-----
OPERATING INCOME	35,696	32,637
Interest expense, net	8,408	10,601
	-----	-----
INCOME BEFORE TAXES	27,288	22,036
Income tax expense	10,212	9,255
	-----	-----
NET INCOME	\$ 17,076	\$ 12,781
	=====	=====
Basic net income per common share	\$ 0.32	\$ 0.24
	=====	=====
Diluted net income per common share	\$ 0.31	\$ 0.24
	=====	=====

See notes to condensed consolidated financial statements.

APRIA HEALTHCARE GROUP INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	THREE MONTHS MARCH 3

(dollars in thousands)	2001

OPERATING ACTIVITIES	
Net income	\$ 17,076
Items included in net income not requiring cash:	
Provision for doubtful accounts	8,150
Depreciation and amortization	27,487
Amortization of deferred debt costs	617
Deferred income taxes and other	9,412
Changes in operating assets and liabilities, net of effects of acquisitions:	
Accounts receivable	(17,848)
Inventories	661
Prepaid expenses and other assets	373
Accounts payable	(4,857)
Accrued payroll and related taxes and benefits	2,644
Accrued expenses	1,466

NET CASH PROVIDED BY OPERATING ACTIVITIES	45,181

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INVESTING ACTIVITIES

Purchases of patient service equipment and property, equipment and improvements, net of effects of acquisitions	(30,029)
Proceeds from disposition of assets	41
Acquisitions and payments of contingent consideration	(25,299)

NET CASH USED IN INVESTING ACTIVITIES (55,287)

FINANCING ACTIVITIES

Proceeds from revolving credit facility	17,200
Payments on revolving credit facility	(17,200)
Payments on term loan	-
Payments on other long-term debt	(214)
Issuances of common stock	4,833

NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES 4,619

NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS (5,487)

Cash and cash equivalents at beginning of period 16,864

CASH AND CASH EQUIVALENTS AT END OF PERIOD \$ 11,377

See notes to condensed consolidated financial statements.

APRIA HEALTHCARE GROUP INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE A - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements include the accounts of Apria Healthcare Group Inc. ("Apria" or "the company") and its subsidiaries. Intercompany transactions and accounts have been eliminated.

In the opinion of management, all adjustments, consisting of normal recurring accruals necessary for a fair presentation of the results of operations for the interim periods presented, have been reflected herein. The unaudited results of operations for interim periods are not necessarily indicative of the results to be expected for the entire year. For further information, refer to the consolidated financial statements and footnotes thereto for the year ended December 31, 2000, included in the company's 2000 Form 10-K.

NOTE B - RECLASSIFICATIONS, ACCOUNTING ESTIMATES AND RECENT ACCOUNTING PRONOUNCEMENTS

Reclassifications: Certain amounts from prior periods have been reclassified to conform to the current year presentation.

Use of Accounting Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Recent Accounting Pronouncements: During the first quarter of 2001, Apria

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adopted Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities", which was amended by SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of SFAS No. 133" and further amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities". SFAS No. 133, as amended, establishes accounting and reporting standards for hedging activities and for derivative instruments, including certain derivative instruments embedded in other contracts. It requires that an entity recognize all derivatives as either assets or liabilities in the statements of financial position and measure those instruments at fair value. Changes in the fair value of derivatives must be recorded each period. SFAS No. 133 also requires formal documentation, designation at the time the hedge transaction is initiated and assessment of the effectiveness of the transactions that receive hedge accounting. At March 31, 2001, Apria had no derivative securities that require fair value measurement under SFAS No. 133. Accordingly, adoption of SFAS No. 133 did not have a material effect on the financial statements.

NOTE C - REVENUE RECOGNITION AND CONCENTRATION OF CREDIT RISK

Revenues are recognized on the date services and related products are provided to patients and are recorded at amounts estimated to be received under reimbursement arrangements with third-party payors, including private insurers, managed care organizations, Medicare and Medicaid.

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

Accounts receivable are reduced by an allowance for doubtful accounts which provides for those accounts from which payment is not expected to be received, although services were provided and revenue was earned.

Management performs various analyses to evaluate the net realizable value of accounts receivable. Specifically, management considers historical realization data, accounts receivable aging trends, operating statistics and relevant business conditions. Also, focused reviews of certain large and/or problematic payors are performed. Because of continuing changes in the healthcare industry and third-party reimbursement, it is possible that management's estimates could change in the near term, which could have an impact on operations and cash flows.

NOTE D - BUSINESS COMBINATIONS

Apria periodically makes acquisitions of complementary businesses in specific geographic markets. The transactions are accounted for as purchases and the results of operations of the acquired companies are included in the accompanying income statements from the date of acquisition. During the three-month period ended March 31, 2001, cash paid for acquisitions was \$25,299,000. For the acquisitions that closed during that same period, \$25,751,000 was allocated to intangible assets, which includes amounts not yet paid. Goodwill is being amortized over 20 years and covenants not to compete are being amortized over the life of the respective agreements.

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NOTE E - LONG-TERM DEBT

At March 31, 2001, total borrowings under the credit agreement were \$140,000,000, outstanding letters of credit totaled \$1,000,000 and credit available under the revolving facility was \$49,000,000. At March 31, 2001, Apria was in compliance with all of the financial covenants required by the credit agreement.

NOTE F - EQUITY

The change in stockholders' equity, other than from net income, is attributable to the exercise of stock options. For the three months ended March 31, 2001, proceeds from the exercise of stock options amounted to \$4,833,000.

NOTE G - INCOME TAXES

Income taxes for the three months ended March 31, 2001 and 2000 have been provided at the effective tax rate expected to be applicable for the year.

At December 31, 2000, Apria's federal net operating loss carryforwards ("NOLs") approximated \$173,000,000, which will begin expiring in varying amounts in the years 2003 through 2013. Additionally, the company has various state NOLs which began expiring in 1997 and an alternative minimum tax credit carryforward of approximately \$8,000,000. As a result of an ownership change in 1992, which met specified criteria of Section 382 of the Internal Revenue Code, future use of a portion of the federal and state NOLs generated prior to 1992 are each limited to approximately \$5,000,000 per year. Because of the annual limitation, approximately \$57,000,000 of each of Apria's federal and state NOLs may expire unused. The company excludes the \$57,000,000 of potentially expiring NOLs from its deferred tax assets. In 2001, for federal tax purposes, NOLs are being utilized to the extent of the company's federal taxable income.

NOTE H - COMMITMENTS AND CONTINGENCIES

Apria and certain of its present and former officers and/or directors are defendants in a class action lawsuit, In Re Apria Healthcare Group Securities Litigation, filed in the U.S. District Court for the Central District of California, Southern Division (Case No. SACV98-217 GLT). This case is a consolidation of three similar class actions filed in March and April, 1998. Pursuant to a court order dated May 27, 1998, the plaintiffs in the original three class actions filed a Consolidated Amended Class Action Complaint on August 6, 1998. The amended complaint purports to establish a class of plaintiff shareholders who purchased Apria's common stock between May 22, 1995 and January 20, 1998. No class has been certified at this time. The amended complaint alleges, among other things, that the defendants made false and/or misleading public statements regarding Apria and its financial condition in violation of federal securities laws. The amended complaint seeks compensatory and punitive damages as well as other relief.

Two similar class actions were filed during July, 1998 in Superior Court of California for the County of Orange: Schall v. Apria Healthcare Group Inc., et al. (Case No. 797060) and Thompson v. Apria Healthcare Group Inc., et al. (Case No. 797580). These two actions were consolidated by a court order dated October 22, 1998 (Master Case No. 797060). On June 14, 1999, the plaintiffs filed a Consolidated Amended Class Action Complaint asserting claims founded on state law and on Sections 11 and 12(2) of the 1933 Securities Act.

Apria believes that it has meritorious defenses to the plaintiffs' claims and it

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intends to vigorously defend itself in both the federal and state cases. In the opinion of Apria's management, the ultimate disposition of these class actions will not have a material adverse effect on the company's financial condition or results of operations.

Since mid-1998 Apria has received a number of subpoenas and document requests from U.S. Attorneys' offices and from the U.S. Department of Health and Human Services. The subpoenas and requests generally ask for documents, such as patient files, billing records and other documents relating to billing practices, related to the company's patients whose healthcare costs are paid by Medicare and other federal programs. Apria is cooperating with the government in connection with these investigations and is responding to the document requests and subpoenas. In July 1999 the company received notification that the U.S. Attorney's office in Sacramento closed its criminal investigation file relating to eight subpoenas that had been issued by that office.

In February 2001 the company was informed by the U.S. Attorney's office in Los Angeles that the billing investigation being conducted by that office is the result of qui tam litigation filed on behalf of the government against the company, and that the government is investigating certain allegations for the purpose of determining whether it will intervene in that litigation. The complaints in the litigation are under seal, however, and the government has not informed the company of either the identity of the court or courts where the proceedings are pending, the date or dates instituted, the identity of the plaintiffs, the factual bases alleged to underlie the proceedings, or the relief sought.

Apria has acknowledged that there may be errors and omissions in supporting documentation affecting a portion of its billings. If a judge, jury or administrative agency were to determine that such errors and omissions resulted in the submission of false claims to federal healthcare programs or significant overpayments by the government, Apria could face civil and administrative claims for refunds, sanctions and penalties for amounts that would be highly material to its business, results of operations and financial condition, including exclusion of Apria from participation in federal healthcare programs. Apria believes that the company would be in a position to assert numerous meritorious defenses in the event that the qui tam litigation proceeds or any other claims are asserted. However, no assurance can be provided as to the outcome of this litigation or whether any other claims will be asserted or as to the outcome of any other possible proceedings that may result from any such other claims. Management cannot estimate the range of possible loss of this litigation and therefore has not recorded any related accruals.

Apria is also engaged in the defense of certain claims and lawsuits arising out of the ordinary course and conduct of its business, the outcomes of which are not determinable at this time. Apria has insurance policies covering such potential losses where such coverage is cost effective. In the opinion of management, any liability that might be incurred by the company upon the resolution of these claims and lawsuits will not, in the aggregate, have a material adverse effect on Apria's financial condition or results of operations.

NOTE I - PER SHARE AMOUNTS

The following table sets forth the computation of basic and diluted per share amounts:

(in thousands, except per share data)

THREE

M

200

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NUMERATOR:

Net income	\$17,0
Numerator for basic per share amounts - income available to common stockholders	17,0
Numerator for diluted per share amounts - income available to common stockholders	17,0

DENOMINATOR:

Denominator for basic per share amounts - weighted average shares	\$53,3
Effect of dilutive securities:	
Employee stock options	2,0
Dilutive potential common shares	2,0
Denominator for diluted per share amounts - adjusted weighted average shares	55,4
=====	
Basic net income per common share	\$ 0.
=====	
Diluted net income per common share	\$ 0.
=====	
Employee stock options excluded from the computation of diluted per share amounts:	
Exercise price exceeds average market price of common stock	2,1
Average exercise price per share that exceeds average market price of common stock	\$ 26.

CAUTIONARY STATEMENT FOR PURPOSES OF THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995: Apria's business is subject to a number of risks, some of which are beyond the company's control. The company has described certain of those risks in its Form 10-K for the fiscal year ended December 31, 2000, as filed with the Securities and Exchange Commission on March 22, 2001. This report may be used for purposes of the Private Securities Litigation Reform Act of 1995 as a readily available document containing meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those projected in any forward-looking statements the company may make from time to time. Those risks include: whether the company will be able to resolve issues pertaining to the collectibility of its accounts receivable, healthcare reform and the effect of federal and state healthcare regulations, the ongoing government investigations regarding patients covered by Medicare and other federal programs, pricing pressures from large payors and changes in governmental reimbursement levels, the effectiveness of the company's operating systems and controls, and the successful implementation of the company's acquisition strategy.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

NET REVENUES. Net revenues were \$271.4 million in the first quarter of 2001, compared to \$250.7 million for the first quarter of 2000. The increase in

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net revenues is due to internal growth, new contracts with regional and national payors, the acquisition of complementary businesses and price increases in certain managed care contracts.

(dollars in thousands)	THREE MONTHS ENDED MARCH 31,			
	2001		2000	
	\$	%	\$	%
Respiratory therapy	\$178,330	65.7%	\$163,263	65.1%
Infusion therapy	52,385	19.3%	46,751	18.6%
HME/other	40,639	15.0%	40,708	16.3%
Total net revenues	\$271,354	100.0%	\$250,722	100.0%
	=====	=====	=====	=====

Use of Estimates in Recording Net Revenues. Substantially all of Apria's revenues are reimbursed by third party payors, including Medicare, Medicaid and managed care organizations. Due to the nature of the industry and the reimbursement environment in which Apria operates, certain estimates are required in recording net revenues. Inherent in these estimates is the risk that they will have to be revised or updated as additional information becomes available.

Medicare Reimbursement Update. The Medicare, Medicaid and SCHIP Benefits Improvement and Protection Act of 2000 provides reinstatement of the Consumer Price Index-based reimbursement increase in 2001 for certain durable medical equipment products and services. The increase will be in effect July 1, 2001 through December 31, 2001 and will include a transitional allowance that will effectively compress a full year's Consumer Price Index update into six months.

GROSS MARGIN. Gross margins for the first quarter of 2001 were 71.9% compared to 71.5% for the same period last year. The improvement can be partially attributed to better utilization of inventory and patient service equipment and the increase in the share of higher-margin respiratory revenues to total net revenues.

SELLING, DISTRIBUTION AND ADMINISTRATIVE. Selling, distribution and administrative expense, as a percentage of net revenue, was 54.7% for the first quarter of 2001 versus 53.3% for the corresponding period in 2000. Expenses for the first quarter of 2001 reflect staffing and compensation increases effected during 2000, most notably in the functional areas of reimbursement and delivery. The investments made in the reimbursement area have contributed to improvements in cash collections and reductions in the provision for doubtful accounts. The additions in the delivery area were in support of business growth.

PROVISION FOR DOUBTFUL ACCOUNTS. The provision for doubtful accounts was 3.0% of net revenues for the first three months of 2001 compared to 4.2% for the corresponding period in 2000. The decrease is due to a reduction in the percentage of older accounts to total accounts receivable and a reduction in collection periods. See "Liquidity and Capital Resources - Accounts Receivable".

AMORTIZATION OF INTANGIBLE ASSETS. Amortization expense was \$2.8 million for the first quarter of 2001 compared to \$2.4 million in the corresponding period of 2000. The increase is directly attributable to intangible assets that were recorded in conjunction with acquisitions consummated after the first quarter of 2000.

INTEREST EXPENSE. Interest expense was \$8.4 million for the first quarter of 2001, down from \$10.6 million for the first quarter of 2000. The decrease is

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due to the reduction in long-term debt and a decrease in interest rates between the periods.

INCOME TAXES. Income taxes for the three months ended March 31, 2001 and 2000 have been provided at the effective tax rate expected to be applicable for the year.

At December 31, 2000, Apria's federal net operating loss carryforwards ("NOLs") approximated \$173 million, which will begin expiring in varying amounts in the years 2003 through 2013. Additionally, the company has various state NOLs which began expiring in 1997 and an alternative minimum tax credit carryforward of approximately \$8 million. As a result of an ownership change in 1992, which met specified criteria of Section 382 of the Internal Revenue Code, future use of a portion of the federal and state NOLs generated prior to 1992 are each limited to approximately \$5 million per year. Because of the annual limitation, approximately \$57 million of each of Apria's federal and state NOLs may expire unused. Apria excludes the \$57 million of potentially expiring NOLs from its deferred tax assets. In 2001, for federal tax purposes, NOLs are being utilized to the extent of the company's federal taxable income.

LIQUIDITY AND CAPITAL RESOURCES

CASH FLOW. Operating cash flow was \$45.2 million in the first quarter of 2001 compared with \$40.2 million for the corresponding period in 2000. The primary reason for the improvement is the increase in net income. The larger increase in accounts receivable in the first quarter of 2001 versus the same period in 2000 was offset by changes in other operating assets and liabilities. Cash used in investing activities was \$55.3 million and \$25.4 million in the first quarters of 2001 and 2000, respectively. The variance is due to an increase in business acquisitions and increases in patient service equipment purchases to support revenue growth.

ACCOUNTS RECEIVABLE. Accounts receivable before allowance for doubtful accounts was \$191.9 million at March 31, 2001 and \$185.3 million at December 31, 2000. The increase is due to continued quarter-over-quarter net revenue increases. Days sales outstanding (calculated as of each period-end by dividing accounts receivable, less allowance for doubtful accounts, by the 90-day rolling average of net revenues) were 51 days at both March 31, 2001 and December 31, 2000. Accounts aged in excess of 180 days as a percentage of total accounts receivable decreased to 21.6% at March 31, 2001 from 23.8% at December 31, 2000.

Evaluation of Net Realizable Value. Management performs various analyses to evaluate the net realizable value of accounts receivable. Specifically, management considers historical realization data, accounts receivable aging trends, operating statistics and relevant business conditions. Also, focused reviews of certain large and/or problematic payors are performed. Because of continuing changes in the healthcare industry and third-party reimbursement, it is possible that management's estimates could change in the near term, which could have an impact on operations and cash flows.

Unbilled Receivables. Included in accounts receivable are earned but unbilled receivables of \$23.2 million and \$17.9 million at March 31, 2001 and December 31, 2000, respectively. Delays between the date of service and billing can occur due to delays in obtaining certain required payor-specific documentation from internal and external sources. Earned but unbilled receivables are aged from date of service and are considered in Apria's analysis of historical performance and collectibility.

LONG-TERM DEBT. At March 31, 2001, total borrowings under the credit agreement were \$140.0 million (none of which was advanced from the revolving

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credit facility), outstanding letters of credit totaled \$1.0 million and credit available under the revolving facility was \$49.0 million. At March 31, 2001, Apria had \$120.4 million of its acquisition allotment (as defined by the credit agreement) remaining.

BUSINESS COMBINATIONS. Apria periodically makes acquisitions of complementary businesses in specific geographic markets. The transactions are accounted for as purchases and the results of operations of the acquired companies are included in the accompanying income statements from the date of acquisition. During the three-month period ended March 31, 2001, cash paid for acquisitions was \$25.3 million. For acquisitions that closed during the period, approximately \$25.8 million was allocated to intangible assets, which includes amounts not yet paid. Goodwill is being amortized over 20 years and covenants not to compete are being amortized over the life of the respective agreements.

OTHER. Apria's management believes that cash provided by operations together with cash invested in its money market account and amounts available under its existing credit facility will be sufficient to finance its current operations for at least the next year.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Apria does not currently utilize derivative financial instruments that expose the company to significant market risk. However, Apria is subject to interest rate changes on its variable rate term loan under the company's bank credit agreement that may affect the fair value of that debt and cash flow and earnings. Based on the term debt outstanding at March 31, 2001 and the current market perception, a 100 basis point change in the applicable interest rates would increase or decrease Apria's annual cash flow and pretax earnings by approximately \$1.4 million.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Apria and certain of its present and former officers and/or directors are defendants in a class action lawsuit, In Re Apria Healthcare Group Securities Litigation, filed in the U.S. District Court for the Central District of California, Southern Division (Case No. SACV98-217 GLT). This case is a consolidation of three similar class actions filed in March and April, 1998. Pursuant to a court order dated May 27, 1998, the plaintiffs in the original three class actions filed a Consolidated Amended Class Action Complaint on August 6, 1998. The amended complaint purports to establish a class of plaintiff shareholders who purchased Apria's common stock between May 22, 1995 and January 20, 1998. No class has been certified at this time. The amended complaint alleges, among other things, that the defendants made false and/or misleading public statements regarding Apria and its financial condition in violation of federal securities laws. The amended complaint seeks compensatory and punitive damages as well as other relief.

Two similar class actions were filed during July, 1998 in Superior Court of California for the County of Orange: Schall v. Apria Healthcare Group Inc., et al. (Case No. 797060) and Thompson v. Apria Healthcare Group Inc., et al. (Case No. 797580). These two actions were consolidated by a court order dated October 22, 1998 (Master Case No. 797060). On June 14, 1999, the plaintiffs filed a

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Consolidated Amended Class Action Complaint asserting claims founded on state law and on Sections 11 and 12(2) of the 1933 Securities Act.

Apria believes that it has meritorious defenses to the plaintiffs' claims and it intends to vigorously defend itself in both the federal and state cases. In the opinion of Apria's management, the ultimate disposition of these class actions will not have a material adverse effect on the company's financial condition or results of operations.

Since mid-1998 Apria has received a number of subpoenas and document requests from U.S. Attorneys' offices and from the U.S. Department of Health and Human Services. The subpoenas and requests generally ask for documents, such as patient files, billing records and other documents relating to billing practices, related to the company's patients whose healthcare costs are paid by Medicare and other federal programs. Apria is cooperating with the government in connection with these investigations and is responding to the document requests and subpoenas. In July 1999 the company received notification that the U.S. Attorney's office in Sacramento closed its criminal investigation file relating to eight subpoenas that had been issued by that office.

In February 2001 the company was informed by the U.S. Attorney's office in Los Angeles that the billing investigation being conducted by that office is the result of qui tam litigation filed on behalf of the government against the company, and that the government is investigating certain allegations for the purpose of determining whether it will intervene in that litigation. The complaints in the litigation are under seal, however, and the government has not informed the company of either the identity of the court or courts where the proceedings are pending, the date or dates instituted, the identity of the plaintiffs, the factual bases alleged to underlie the proceedings, or the relief sought.

Apria has acknowledged that there may be errors and omissions in supporting documentation affecting a portion of its billings. If a judge, jury or administrative agency were to determine that such errors and omissions resulted in the submission of false claims to federal healthcare programs or significant overpayments by the government, Apria could face civil and administrative claims for refunds, sanctions and penalties for amounts that would be highly material to its business, results of operations and financial condition, including exclusion of Apria from participation in federal healthcare programs. Apria believes that the company would be in a position to assert numerous meritorious defenses in the event that the qui tam litigation proceeds or any other claims are asserted. However, no assurance can be provided as to the outcome of this litigation or whether any other claims will be asserted or as to the outcome of any other possible proceedings that may result from any such other claims.

Apria is also engaged in the defense of certain claims and lawsuits arising out of the ordinary course and conduct of its business, the outcomes of which are not determinable at this time. Apria has insurance policies covering such potential losses where such coverage is cost effective. In the opinion of management, any liability that might be incurred by the company upon the resolution of these claims and lawsuits will not, in the aggregate, have a material adverse effect on Apria's financial condition or results of operations.

ITEMS 2-5. NOT APPLICABLE

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

Exhibit Number -----	Reference -----
10.1	Amendment No. 1 to the 1998 Nonqualified Stock Incentive Plan, dated January 31, 2001. Incorporated by reference to Annual Report on Form 10-K for the year ended December 31, 2000.

(b) Reports on Form 8-K:

No reports on Form 8-K were filed during the quarter for which this report is filed.

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.

APRIA HEALTHCARE GROUP INC.

Registrant

May 15, 2001

/s/ JOHN C. MANEY

John C. Maney
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)