

LHC Group, Inc  
Form 10-K/A  
March 21, 2008

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-K/A  
Amendment No. 1**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 31, 2007**

**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: 0-8082**  
**LHC GROUP, INC.**  
*(Exact Name of Registrant as Specified in Charter)*

**Delaware**  
*(State or Other Jurisdiction of  
Incorporation or Organization)*

**71-0918189**  
*(I.R.S. Employer  
Identification No.)*

**420 West Pinhook Rd, Suite A**  
**Lafayette, Louisiana 70503**  
*(Address of principal executive offices)*  
**(337) 233-1307**

**(Registrant's telephone number, including area code)**  
**Securities registered pursuant to Section 12(b) of the Exchange Act:**

**Common Stock, par value \$.001 per share**  
**(Title of each class)**

**NASDAQ Global Select Market**  
**(Name of each exchange on which registered)**

**Securities registered pursuant to Section 12(g) of the Exchange Act:**  
**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting  
company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No   
As of December 31, 2007, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$368,067,910 based on the closing sale price as reported on the NASDAQ Global Select Market. For purposes of this determination shares beneficially owned by officers, directors and ten percent shareholders have been excluded, which does not constitute a determination that such persons are affiliates.

There were 18,085,329 shares of common stock, \$.01 par value, issued and outstanding as of March 5, 2008.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Annual Report to stockholders for the fiscal year ended December 31, 2007 are incorporated by reference in Part II of this Form 10-K. Portions of the Registrant's Proxy Statement for its 2008 Annual Meeting of Stockholders are incorporated by reference in Part III of this annual report on Form 10-K.

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**EXPLANATORY NOTE**

The Annual Report on Form 10-K for LHC Group, Inc. for the year ended December 31, 2007 is being amended to revised Part IV, Item 15. Due to a computational error, the Prepaid expenses, other assets amount in the Statement of Cash Flows was incorrectly listed as \$(772). The amount is actually \$(769). The amendment to Prepaid expenses, other assets will also change the subtotal in Net cash provided by operating activities. Net cash provided by operating activities amount in the Statement of Cash Flows was incorrectly listed as \$12,115. The amount is actually \$12,118 and the amendment to Item 15 below reflects the correction to these line items described above on page F-5.

In addition, in connection with filing of this Amendment No. 1 and pursuant to Rule 12b-15, certain certifications are attached as exhibits hereto. The remainder of the Form 10-K is unchanged and is not reproduced in this Amendment No. 1. This Amendment No. 1 has no effect on our consolidated financial positions or results of operations previously reported in Form 10-K. Except as set forth above, this Amendment No. 1 does not modify or update in any way the disclosures, including, without limitation, the financial statements, in the Form 10-K, and speaks of the original filing date of the Form 10-K and does not reflect events occurring after the original filing of the Form 10-K. Accordingly, this Amendment No. 1 should be read in conjunction with our Form 10-K.

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**PART IV**

**Item 15. Exhibits, Financial Statement Schedules**

(a) Documents to be filed with Form 10-K:

(1) Financial Statements

<u>Report of Independent Registered Public Accounting Firm</u>	F-1
<u>Consolidated Balance Sheets as of December 31, 2007 and 2006</u>	F-2
For each of the three years in the period ended December 31, 2007, 2006 and 2005:	
<u>Consolidated Statements of Income</u>	F-3
<u>Consolidated Statements of Changes in Stockholders' Equity</u>	F-4
<u>Consolidated Statements of Cash Flows</u>	F-5
<u>Notes to the Consolidated Financial Statements</u>	F-6
<u>EX-21.1 SUBSIDIARIES OF THE REGISTRANT</u>	
<u>EX-23.1 CONSENT OF ERNST &amp; YOUNG LLP</u>	
<u>EX-31.1 CERTIFICATION OF KEITH G. MYERS</u>	
<u>EX-31.2 CERTIFICATION OF PETER J. ROMAN</u>	
<u>EX-32.1 SECTION 906 CERTIFICATIONS OF THE CEO AND CFO</u>	

(2) Financial Statement Schedules

There are no financial statement schedules included in this report.

(3) Exhibits

The Exhibits are listed in the Index of Exhibits Required by Item 601 of Regulation S-K included herewith, which is incorporated by reference.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of LHC Group, Inc.

We have audited the accompanying consolidated balance sheets of LHC Group Inc. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of LHC Group, Inc. and subsidiaries at December 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2007 the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109*, and effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), LHC Group, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 14, 2008 expressed an adverse opinion thereon.

/s/ Ernst & Young LLP  
New Orleans, Louisiana  
March 14, 2008

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(Amounts in thousands, except share data)

	<b>As of December 31,</b>	
	<b>2007</b>	<b>2006</b>
<b>ASSETS</b>		
Current assets:		
Cash	\$ 1,155	\$ 26,877
Receivables:		
Patient accounts receivable, less allowance for uncollectible accounts of \$8,953 and \$5,769 at December 31, 2007 and 2006, respectively	70,033	50,029
Other receivables	2,425	3,401
Amounts due from governmental entities	1,459	2,518
	73,917	55,948
Deferred income taxes	2,946	1,935
Prepaid expenses and other current assets	4,423	4,120
Assets held for sale	556	1,171
Total current assets	82,997	90,051
Property, building and equipment, net	12,523	11,705
Goodwill	62,227	39,681
Intangible assets, net	14,055	8,262
Other assets	3,183	2,995
Total assets	\$ 174,985	\$ 152,694
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable and other accrued liabilities	\$ 6,103	\$ 5,903
Salaries, wages and benefits payable	11,303	10,572
Amounts due to governmental entities	3,162	3,223
Income taxes payable	863	1,219
Current portion of capital lease obligations	88	211
Current portion of long-term debt	433	428
Total current liabilities	21,952	21,556
Deferred income taxes	3,243	2,104
Capital lease obligations, less current portion	63	147
Long-term debt, less current portion	2,847	3,051
Minority interests subject to exchange contracts and/or put options	121	317
Other minority interests	3,388	3,630
Stockholders' equity:		
Common stock \$0.01 par value: 40,000,000 shares authorized; 20,725,713 and 20,682,317 shares issued and 17,775,284 and 17,732,258 shares outstanding at December 31, 2007 and 2006, respectively	177	177
	(2,866)	(2,856)

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Treasury stock 2,950,429 and 2,950,059 shares at cost at December 31, 2007 and 2006, respectively

Additional paid-in capital	81,983	80,273
Retained earnings	64,077	44,295
Total stockholders' equity	143,371	121,889
Total liabilities and stockholders' equity	\$ 174,985	\$ 152,694

See accompanying notes.

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(Amounts in thousands, except share and per share data)

	<b>For the Year Ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Net service revenue	\$ 298,031	\$ 218,535	\$ 155,687
Cost of service revenue	152,577	112,095	82,996
Gross margin	145,454	106,440	72,691
General and administrative expenses	106,795	71,115	46,519
Equity-based compensation expense(1)			3,856
Operating income	38,659	35,325	22,316
Interest expense	376	325	1,067
Non-operating (income) loss, including gain or loss on sales of assets	(1,073)	(2,033)	(574)
Income from continuing operations before income taxes and minority interest and cooperative endeavor allocations	39,356	37,033	21,823
Income tax expense	12,147	10,817	6,052
Minority interest and cooperative endeavor allocations	5,984	4,795	4,545
Income from continuing operations	21,225	21,421	11,226
Loss from discontinued operations (net of income tax benefit of \$239, \$897 and \$688 in 2007, 2006 and 2005, respectively)	(1,667)	(1,464)	(1,124)
Gain on sale of discontinued operations (net of income taxes of \$20 and \$390 in 2007 and 2006, respectively)	31	637	
Net income	19,589	20,594	10,102
Change in the redemption value of redeemable minority interests	193	1,163	(1,476)
Net income available to common stockholders	\$ 19,782	\$ 21,757	\$ 8,626
Earnings per share basic:			
Income from continuing operations	\$ 1.19	\$ 1.25	\$ 0.77
Loss from discontinued operations, net	(0.09)	(0.09)	(0.08)
Gain on sale of discontinued operations, net		0.04	
Net income	1.10	1.20	0.69
Change in the redemption value of redeemable minority interests	0.01	0.07	(0.10)
Net income available to common shareholders	\$ 1.11	\$ 1.27	\$ 0.59
Earnings per share diluted:			
Income from continuing operations	\$ 1.19	\$ 1.25	\$ 0.77

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Loss from discontinued operations, net	(0.09)	(0.09)	(0.08)
Gain on sale of discontinued operations, net		0.04	
Net income	1.10	1.20	0.69
Change in the redemption value of redeemable minority interests	0.01	0.07	(0.10)
Net income available to common shareholders	\$ 1.11	\$ 1.27	\$ 0.59
Weighted average shares outstanding:			
Basic	17,760,432	17,090,583	14,628,737
Diluted	17,827,444	17,104,660	14,684,639

(1) Equity-based compensation is allocated as follows:

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Cost of service revenue	\$	\$	\$ 565
General and administrative expenses			3,291
Total equity-based compensation expense	\$	\$	\$ 3,856

See accompanying notes.

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY**  
(Amounts in thousands, except share and per share data)

	Common Stock		Treasury		Additional Paid-In Capital	Retained Earnings	Total
	Amount	Issued Shares	Amount	Shares			
Balances at January 1, 2005	\$ 121	15,000,004	\$ (2,242)	2,914,850	\$ 4,421	\$ 14,051	\$ 16,351
Net income						10,102	10,102
Dividends to stockholders (\$0.009 per share)						(139)	(139)
Sale of 3,500,000 shares of common stock at the initial public offering price of \$14 per share, net of underwriting discount and offering costs of \$7,393	35	3,500,000			41,572		41,607
Issuance of common stock to two joint venture partners upon conversion of their equity interests into shares of common stock	5	518,036			7,247		7,252
Issuance of common stock upon conversion of outstanding KEEP units	5	481,680			5,239		5,244
Issuance of nonvested stock		8,167			117		117
Treasury shares redeemed for payment of income taxes			(614)	35,209			(614)
Recording minority interest in joint venture at redemption value						(1,476)	(1,476)
Balances at December 31, 2005	166	19,507,887	(2,856)	2,950,059	58,596	22,538	78,444
Net income						20,594	20,594
Sale of 1,150,000 shares of common	11	1,150,000			20,711		20,722

stock at \$19.25 per share, net of underwriting discount and offering costs of \$1,403								
Stock option compensation					128			128
Exercise of stock options	8,000				165			165
Nonvested stock compensation					484			484
Issuance of nonvested stock	1,167				23			23
Issuance of nonvested stock	8,167							
Issuance of common stock under Employee Stock Purchase Plan	7,096				166			166
Change in redemption value of redeemable minority interest						1,163		1,163
Balances at December 31, 2006	177	20,682,317	(2,856)	2,950,059	80,273	44,295		121,889
Net income						19,589		19,589
Exercise of stock options		527						
Nonvested stock compensation					1,125			1,125
Issuance of nonvested stock		25,976			62			62
Treasury shares redeemed to pay income tax			(10)	370				(10)
Excess tax benefit vesting of nonvested stock					104			104
Issuance of common stock under Employee Stock Purchase Plan		16,893			419			419
Change in redemption value of redeemable minority interest						193		193
Balances at December 31, 2007	\$ 177	20,725,713	\$ (2,866)	2,950,429	\$ 81,983	\$ 64,077		\$ 143,371

See accompanying notes.

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Amounts in thousands)

	<b>For the Year Ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
<b>Operating activities</b>			
Net income	\$ 19,589	\$ 20,594	\$ 10,102
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization expense	3,026	2,427	1,751
Provision for bad debts	13,817	4,778	3,188
Equity based compensation expense			3,856
Stock based compensation expense	1,187	635	177
Minority interest in earnings of subsidiaries	5,312	4,471	4,527
Deferred income taxes	127	(1,253)	673
Gain on divestitures and sale of assets		(979)	(211)
Changes in operating assets and liabilities, net of acquisitions:			
Receivables	(31,786)	(15,625)	(14,478)
Prepaid expenses, other assets	(769)	(1,466)	(196)
Accounts payable and accrued expenses	1,676	6,036	(2,509)
Net amounts due governmental entities	(61)	2,144	(105)
Net cash provided by operating activities	12,118	21,762	6,775
<b>Investing activities</b>			
Purchases of property, building and equipment	(3,346)	(3,938)	(2,134)
Proceeds from sale of property and equipment		7	
Proceeds from sale of entities		1,440	730
Cost of acquisitions, primarily goodwill, intangible assets and patient accounts receivable	(28,935)	(25,009)	(11,137)
Net cash used in investing activities	(32,281)	(27,500)	(12,541)
<b>Financing activities</b>			
Issuance of common stock, net of underwriting discounts of \$1,104 in 2006 and \$3,430 in 2005		21,033	45,570
Dividends paid			(227)
Principal payments on debt	(199)	(1,201)	(2,937)
Payments on capital leases	(207)	(389)	(1,105)
Proceeds from issuance of debt			24
Net (payments) proceeds from lines of credit and revolving debt arrangements			(14,288)
Offering costs incurred		(311)	(2,224)
Proceeds from exercise of stock options		135	
Proceeds from issuance of common stock under ESPP	419	140	
Minority interest contributions, net of (distributions)	(5,572)	(4,190)	(4,560)
Net cash provided by (used in) financing activities	(5,559)	15,217	20,253
Change in cash	(25,722)	9,479	14,487

Cash at beginning of period	26,877	17,398	2,911
Cash at end of period	\$ 1,155	\$ 26,877	\$ 17,398

**Supplemental disclosures of cash flow information**

Interest paid	\$ 376	\$ 342	\$ 1,068
Income taxes paid	\$ 12,052	\$ 9,370	\$ 5,821

**Supplemental disclosure of non-cash transactions:**

In the year ended December 31, 2006 the Company sold a clinic for promissory notes totaling \$946 and recognized a loss on the sale of \$28.

In the year ended December 31, 2005, the Company issued common stock valued at \$7,252 to two joint venture partners upon the acquisition of their minority interest. Additionally, the Company's stockholders' equity from the initial public offering was reduced by offering costs incurred by the Company of \$3,951. The Company financed the purchase of an airplane for \$3.0 million. The Company also financed the purchase of various types of insurance in the amount of \$2.2 million.

See accompanying notes.

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**1. Organization**

LHC Group, Inc. (Company) is a health care provider specializing in the post-acute continuum of care primarily for Medicare beneficiaries in non-urban markets in the United States. The Company provides home-based services, primarily through home nursing agencies and hospices and facility-based services, primarily through long-term acute care hospitals and outpatient rehabilitation clinics. The Company, through its wholly and majority-owned subsidiaries, equity joint ventures and controlled affiliate, currently operates in Louisiana, Mississippi, Arkansas, Alabama, Texas, West Virginia, Kentucky, Florida, Tennessee, Georgia, Ohio and Missouri.

The Company operated as Louisiana Health Care Group, Inc. (LHCG), until March 2001, when the shareholders of LHCG transferred to The Health Care Group, Inc. (THCG), all of the issued and outstanding shares of common stock of LHCG in exchange for shares in THCG. On January 1, 2003, the Company began operating as LHC Group, LLC, a Louisiana limited liability company. The THCG shareholders exchanged their shares for membership interests in the Company (units).

Prior to February 9, 2005, the Company operated under the terms of an operating agreement which provided that the Company did not have a finite life and that the members' personal liability was limited to his or her capital contribution. There was only one class of member interest.

***Plan of Merger and Recapitalization***

In January 2005, LHC Group, LLC established a wholly owned Delaware subsidiary, LHC Group, Inc. Effective February 9, 2005, LHC Group, LLC merged with and into LHC Group, Inc. In connection with the merger, each outstanding membership unit in LHC Group, LLC was converted into shares of the \$0.01 par value common stock of LHC Group, Inc. based on an exchange ratio of three-for-two. Each KEEP Unit was also converted during the initial public offering into shares of common stock of LHC Group, Inc. pursuant to the same three-for-two ratio. LHC Group, Inc. has 40,000,000 shares of \$0.01 par value common stock authorized and 5,000,000 shares of \$0.01 par value preferred stock authorized. All references to common stock, share and per share amounts have been retroactively restated to reflect the merger and recapitalization as if the merger and recapitalization had taken place as of the beginning of the earliest period presented.

As used herein, the Company includes LHC Group, Inc. and all predecessor entities.

***Initial Public Offering***

On June 9, 2005, the Company began its initial public offering of 4,800,000 shares of its common stock at a price of \$14.00 per share. The Company offered 3,500,000 shares along with 1,300,000 shares that were sold by certain stockholders of LHC Group. The Company received no proceeds from the sale of the shares by the selling stockholders. The shares began trading on the NASDAQ National Market under the symbol LHCG on June 9, 2005. The initial public offering was completed on June 14, 2005. The underwriters exercised an option to purchase an additional 720,000 shares from certain stockholders solely to cover over-allotments. The Company received \$45,570,000, net of underwriting discounts of \$3,430,000 in proceeds from the offering. The Company incurred approximately \$3,963,000 in costs related to the initial public offering through December 31, 2005. The shares are currently traded on the NASDAQ Global Select Market.

**2. Significant Accounting Policies*****Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported revenue and expenses during the reported period. Actual results could differ from those estimates.



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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Critical Accounting Policies***

The most critical accounting policies relate to the principles of consolidation, revenue recognition, accounts receivable and allowances for uncollectible accounts and accounting for goodwill and intangible assets.

***Principles of Consolidation***

The consolidated financial statements include all subsidiaries and entities controlled by the Company. Control is generally defined by the Company as ownership of a majority of the voting interest of an entity. The consolidated financial statements include entities in which the Company absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity.

All significant inter-company accounts and transactions have been eliminated in consolidation. Business combinations accounted for as purchases have been included in the consolidated financial statements from the respective dates of acquisition.

The following describes the Company's consolidation policy with respect to its various ventures excluding wholly owned subsidiaries:

***Equity Joint Ventures***

The Company's joint ventures are structured as limited liability companies in which the Company typically owns a majority equity interest ranging from 51 to 99 percent. Each member of all but one of the Company's equity joint ventures participates in profits and losses in proportion to their equity interests. The Company has one joint venture partner whose participation in losses is limited. The Company consolidates these entities as the Company absorbs a majority of the entities' expected losses, receives a majority of the entities' expected residual returns and generally has voting control over the entity.

***License Leasing Arrangements***

The Company, through wholly owned subsidiaries, leases home health licenses necessary to operate certain of its home nursing agencies. As with wholly owned subsidiaries, the Company owns 100 percent of the equity of these entities and consolidates them based on such ownership as well as the Company's right to receive a majority of the entities' expected residual returns and the Company's obligation to absorb a majority of the entities' expected losses.

***Management Services***

The Company has various management services agreements under which the Company manages certain operations of agencies and facilities. The Company does not consolidate these agencies or facilities, as the Company does not have an ownership interest and does not have a right to receive a majority of the agencies' or facilities' expected residual returns or an obligation to absorb a majority of the agencies' or facilities' expected losses.

The following table summarizes the percentage of net service revenue earned by type of ownership or relationship the Company had with the operating entity:

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Wholly owned subsidiaries	46.4%	41.7%	36.0%
Equity joint ventures	43.7	46.3	49.7
License leasing arrangements	7.8	9.5	11.3
Management services	2.1	2.5	3.0
	100.0%	100.0%	100.0%

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

On October 1, 2007, we converted one of our license leasing arrangements to a joint venture. This will reduce the percentage of net revenue earned by license leasing arrangements and increase the percentage of net service revenue from joint ventures by approximately 8 percent in 2008.

**Revenue Recognition**

The Company reports net service revenue at the estimated net realizable amount due from Medicare, Medicaid, commercial insurance, managed care payors, patients and others for services rendered. Under Medicare, the Company's home nursing patients are classified into a group referred to as a home health resource group prior to the receipt of services. Based on this home health resource group the Company is entitled to receive a prospective Medicare payment for delivering care over a 60-day period referred to as an episode. Medicare adjusts these prospective payments based on a variety of factors, such as low utilization, patient transfers, changes in condition and the level of services provided. In calculating the Company's reported net service revenue from home nursing services, the Company adjusts the prospective Medicare payments by an estimate of the adjustments. The Company calculates the adjustments based on a historical average of these types of adjustments. For home nursing services, the Company recognizes revenue based on the number of days elapsed during the episode of care.

For the Company's long-term acute care hospitals, revenue is recognized as services are provided. Under Medicare, patients in the Company's long-term acute care facilities are classified into long-term diagnosis-related groups. Based on this classification, the Company is then entitled to receive a fixed payment from Medicare. This fixed payment is also subject to adjustment by Medicare due to factors such as short stays. In calculating reported net service revenue for services provided in the Company's long-term acute care hospitals, the Company reduces the prospective payment amounts by an estimate of the adjustments. The Company calculates the adjustment based on a historical average of these types of adjustments for claims paid.

For hospice services the Company is paid by Medicare under a per diem payment system. The Company receives one of four predetermined daily or hourly rates based upon the level of care the Company furnished. The Company records net service revenue from hospice services based on the daily or hourly rate. The Company recognizes revenue for hospice as services are provided.

Under Medicare the Company is reimbursed for rehabilitation services based on a fee schedule for services provided adjusted by the geographical area in which the facility is located. The Company recognizes revenue as these services are provided.

The Company's Medicaid reimbursement is based on a predetermined fee schedule applied to each service provided. Therefore, revenue is recognized for Medicaid services as services are provided based on this fee schedule. The Company's managed care payors reimburse the Company in a manner similar to either Medicare or Medicaid. Accordingly, the Company recognizes revenue from managed care payors in the same manner as the Company recognizes revenue from Medicare or Medicaid.

The Company records management services revenue as services are provided in accordance with the various management services agreements to which the Company is a party. The agreements generally call for the Company to provide billing, management and other consulting services suited to and designed for the efficient operation of the applicable home nursing agency or inpatient rehabilitation facility. The Company is responsible for the costs associated with the locations and personnel required for the provision of the services. The Company is generally compensated based on a percentage of net billings or an established base fee. In addition, for certain of the management agreements, the Company may earn incentive compensation.

Net service revenue was comprised of the following:

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Home-based services	81.9%	75.4%	67.8%
Facility-based services	18.1	24.6	32.2



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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table sets forth the percentage of net service revenue earned by category of payor:

Payor:	2007	2006	2005
Medicare	81.7%	82.6%	86.4%
Medicaid	5.5	5.7	4.9
Other	12.8	11.7	8.7
	100.0%	100.0%	100.0%

**Home-Based Services**

*Home Nursing Services.* The Company receives a standard prospective Medicare payment for delivering care. The base payment, established through federal legislation, is a flat rate that is adjusted upward or downward based upon differences in the expected resource needs of individual patients as indicated by clinical severity, functional severity and service utilization. The magnitude of the adjustment is determined by each patient's categorization into one of 80 payment groups, known as home health resource groups, and the costliness of care for patients in each group relative to the average patient. The Company's payment is also adjusted for differences in local prices using the hospital wage index. The Company performs payment variance analyses to verify the models utilized in projecting total net service revenue are accurately reflecting the payments to be received.

Medicare rates are subject to change. Due to the length of the Company's episodes of care, a situation may arise where Medicare rate changes affect prior period's net service revenue. In the event that Medicare rates experience change, the net effect of that change will be reflected in the current reporting period.

Final payments from Medicare may reflect one of five retroactive adjustments to ensure the adequacy and effectiveness of the total reimbursement: (a) an outlier payment if the patient's care was unusually costly; (b) a low utilization adjustment if the number of visits was fewer than five; (c) a partial payment if the patient transferred to another provider before completing the episode; (d) a change-in-condition adjustment if the patient's medical status changes significantly, resulting in the need for more or less care; or (e) a payment adjustment based upon the level of therapy services required in the population base. Management estimates the impact of these payment adjustments based on historical experience and records this estimate during the period the services are rendered.

*Hospice Services.* The Company's Medicare hospice reimbursement is based on an annually-updated prospective payment system. Hospice payments are also subject to two caps. One cap relates to individual programs receiving more than 20 percent of its total Medicare reimbursement from inpatient care services. The second cap relates to individual programs receiving reimbursements in excess of a cap amount, calculated by multiplying the number of beneficiaries during the period by a statutory amount that is indexed for inflation. The determination for each cap is made annually based on the 12-month period ending on October 31 of each year. This limit is computed on a program-by-program basis. We have not received notification that any of our hospices have exceeded the cap on inpatient care seniors during 2007. None of the Company's hospices exceeded either cap during the year ended December 31, 2006, or 2005.

**Facility-Based Services**

*Long-Term Acute Care Services.* The Company is reimbursed by Medicare for services provided under the long-term acute care hospital prospective payment system, which was implemented on October 1, 2002. Each patient is assigned a long-term care diagnosis-related group. The Company is paid a predetermined fixed amount applicable to that particular group. This payment is intended to reflect the average cost of treating a Medicare patient classified in that particular long-term care diagnosis-related group. For selected patients, the amount may be further adjusted based on length of stay and facility-specific costs, as well as in instances where a patient is discharged and subsequently readmitted, among other factors. Similar to other Medicare prospective payment systems, the rate is also adjusted for

geographic wage differences.

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Outpatient Rehabilitation Services.* Outpatient therapy services are reimbursed on a fee schedule, subject to annual limitations. Outpatient therapy providers receive a fixed fee for each procedure performed, adjusted by the geographical area in which the facility is located. The Company recognizes revenue as the services are provided. There are also annual per Medicare beneficiary caps that limit Medicare coverage for outpatient rehabilitation services.

***Accounts Receivable and Allowances for Uncollectible Accounts***

The Company reports accounts receivable net of estimated allowances for uncollectible accounts and adjustments. Accounts receivable are uncollateralized and primarily consist of amounts due from third-party payors and patients. To provide for accounts receivable that could become uncollectible in the future, the Company establishes an allowance for uncollectible accounts to reduce the carrying amount of such receivables to their estimated net realizable value. The credit risk for other concentrations of receivables is limited due to the significance of Medicare as the primary payor. The Company does not believe that there are any other significant concentrations of receivables from any particular payor that would subject it to any significant credit risk in the collection of accounts receivable.

The amount of the provision for bad debts is based upon the Company's assessment of historical and expected net collections, business and economic conditions and trends in government reimbursement. Uncollectible accounts are written off when the Company has determined the account will not be collected.

A portion of the estimated Medicare prospective payment system reimbursement from each submitted home nursing episode is received in the form of a request for accelerated payment (RAP). The Company submits a RAP for 60 percent of the estimated reimbursement for the initial episode at the start of care. The full amount of the episode is billed after the episode has been completed. The RAP received for that particular episode is deducted from the final payment. If the final bill is not submitted within the greater of 120 days from the start of the episode, or 60 days from the date the RAP was paid, any RAP's received for that episode will be recouped by Medicare from any other claims in process for that particular provider. The RAP and final payment must then be resubmitted. For any subsequent episodes of care contiguous with the first episode for a particular patient, the Company submits a RAP for 50 percent instead of 60 percent of the estimated reimbursement. The remaining 50 percent reimbursement is requested upon completion of the episode. The Company has earned net service revenue in excess of billings rendered to Medicare.

***Goodwill and Intangible Assets***

Goodwill and other intangible assets with indefinite lives are reviewed annually, or more frequently if circumstances indicate impairment may have occurred.

Components of the Company's home nursing operating segment are generally represented by individual subsidiaries or joint ventures with individual licenses to conduct specific operations within geographic markets as limited by the terms of each license. Components of the Company's facility-based services are represented by individual operating entities. Management aggregates the components of these two segments into two reporting units for purposes of evaluating impairment.

The Company estimates the fair value of its identified reporting units and compares those estimates against the related carrying value. For each of the reporting units, the estimated fair value is determined based on a formula that considers 75 percent of the estimated value based on a multiple of earnings before interest, taxes, depreciation and amortization and 25 percent of the estimated value using recent sales of comparable facilities.

Included in intangible assets, net are other intangible assets such as licenses to operate home-based and/or facility-based services and trade names. The Company has valued these intangible assets separately from goodwill for each acquisition completed since January 1, 2006. The Company has concluded that these licenses and trade names have indefinite lives, as management has determined that there are no legal, regulatory, contractual, economic or other factors that would limit the useful life of these intangible assets and the Company intends to renew and operate the licenses and use these trade names indefinitely. Prior to January 1, 2006, the Company elected to record

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

the fair value of indefinite-lived licenses and trade names together with goodwill as a single asset for financial reporting purposes.

***Other Significant Accounting Policies****Due to/from Governmental Entities*

Prior to October 1, 2000, the Company recorded Medicare home nursing services revenues at the lower of actual costs, the per visit cost limit, or a per beneficiary cost limit on an individual provider basis. Additionally, the Company's long-term acute care hospitals are reimbursed for certain activities based on tentative rates. Final reimbursement is determined based on submission of annual cost reports and audits by the fiscal intermediary. Adjustments are accrued on an estimated basis in the period the related services were rendered and further adjusted as final settlements are determined. These adjustments are accounted for as changes in estimates. There have been no significant changes in estimates during the years ended December 31, 2007 and 2006.

*Property, Building and Equipment*

Property, building and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the individual assets, generally ranging from three to ten years and up to 39 years on buildings. Depreciation expense for the years ended December 31, 2007, 2006 and 2005 was \$3.0 million, \$2.4 million and \$1.8 million, respectively.

Capital leases, primarily consisting of transportation equipment, are included in equipment. Capital leases are recorded at the present value of the future rentals at lease inception and are amortized over the shorter of the applicable lease term or the useful life of the equipment. Amortization of assets under the capital lease obligations is included in depreciation and amortization expense.

*Long-Lived Assets*

The Company reviews the recoverability of long-lived assets whenever events or circumstances occur which indicate recorded costs may not be recoverable. If the expected future cash flows (undiscounted) are less than the carrying amount of such assets, the Company recognizes an impairment loss for the difference between the carrying amount of the assets and their estimated fair value.

*Income Taxes*

The Company accounts for income taxes using the liability method. Under the liability method, deferred taxes are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax laws that will be in effect when the differences are expected to reverse. Management provides a valuation allowance for any net deferred tax assets when it is more likely than not that a portion of such net deferred tax assets will not be recovered.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an *Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. We were required to record the impact, if any, of adopting FIN 48 as an adjustment to the January 1, 2007 beginning balance of retained earnings rather than our consolidated statement of income. The adoption of FIN 48 had no effect on the Company's retained earnings. The Company recognizes interest and penalties related to uncertain tax positions in interest expense and general and administrative expenses, respectively.

*Minority Interest*

The interest held by third parties in subsidiaries owned or controlled by the Company is reported on the consolidated balance sheets as minority interest. Minority interest reported in the consolidated statements of income reflects the respective interests in the income or loss before income taxes of the subsidiaries attributable to the other parties, the effect of which is removed from the Company's consolidated results of operations.

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Two of the Company's home health agencies have agreements with third parties that allow the third parties to be paid or recover a fee based on the profits or losses of the respective agencies. The Company accrues for the settlement of the third party's profits or losses during the period the amounts are earned. Under the agreements, the Company has incurred net amounts due to the third parties of \$289,000, \$246,000 and \$316,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

For agreements where the third party is a health care institution, the agreements typically require the Company to lease building and equipment and receive housekeeping and maintenance from the health care institutions. Ancillary services related to these arrangements are also typically provided by the health care institution.

*Minority Interest Subject to Exchange Contracts and/or Put Options*

During 2004, in conjunction with the acquisition/sale of joint venture interests, the Company entered into agreements with minority interest holders in three of its majority owned subsidiaries that allowed these minority interest holders to put their minority interests to the Company. Only one of these agreements remains as of December 31, 2007. The put option allows the minority interest holder to exchange their minority interest for cash based on EBITDA and the Company's stock price. As of March 5, 2008, approximately 76.5 percent of the minority interest holders have converted their minority interests to cash.

The above put/redemption options and exchange agreements have been presented in the historical financial statements under the guidance in Accounting Series Release (ASR) No. 268 and EITF Topic D-98, which generally require a public company's stock subject to redemption requirements that are outside the control of the issuer to be excluded from the caption "stockholders' equity" and presented separately in the issuer's balance sheet. Under EITF Topic D-98, once it becomes probable that the minority interest would become redeemable, the minority interest should be adjusted to its current redemption amount, marked to market.

In connection with the partial redemption of certain minority interest in the year ended December 31, 2006, the Company decreased minority interest by approximately \$1,039,000 and increased retained earnings by the same amount. Simultaneously, The Company recorded goodwill of \$979,000 to represent the value of the minority interest redeemed. Also for the year ended December 31, 2006, the Company recorded a mark to market benefit of \$124,000.

There were no redemptions in the year ended December 31, 2007. In the year ended December 31, 2007, the Company recorded a mark-to-market benefit of \$193,000 for these redeemable minority interests. Included in minority interests subject to exchange contracts and/or put options liability at December 30, 2007 and 2006 is \$121,000 and \$317,000, respectively, related to these redeemable minority interests.

*Equity-Based Compensation Expense*

During 2003, the Company began sponsoring a Key Employee Equity Participation (KEEP) Plan whereby certain individuals were granted participation equity units (KEEP Units). The KEEP Plan was terminated in conjunction with the initial public offering when the outstanding units were converted to 481,680 shares of common stock. The KEEP Plan functioned as a stock appreciation rights plan whereby an individual was entitled to receive, on a per KEEP Unit basis, the increase in estimated fair value of the Company's common stock from the date of grant until the date that the employee dies, retires, or is terminated for other than cause. Accordingly, the KEEP Units were subject to variable accounting until such time as the obligation to the employee was settled. The Company had a call right, under which, it could purchase all or a portion of the KEEP Units. The individuals receiving KEEP Units vested in those rights in a graded manner over a five-year period and, accordingly, the Company recorded compensation expense for the vested portion of the KEEP Units. The KEEP Units had no exercise price.

Compensation expense and a corresponding increase in paid-in capital, was also recognized each period for any change in value associated with certain KEEP Units that were held by an officer of the Company.

In conjunction with the initial public offering, the outstanding KEEP Units were converted to common stock. In conjunction with this conversion, the Company incurred a charge to equity based compensation of approximately



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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

\$3.0 million. For the year ended December 31, 2005, the Company recorded approximately \$3.9 million in equity based compensation related to the KEEP Units. There was no equity based compensation related to the KEEP units recorded for the year ended December 31, 2007 or 2006.

*Stock-based Compensation*

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 123(R) (revised 2004), *Share-Based Payment*, a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*, on January 1, 2006 using the modified prospective method. This method requires compensation cost to be recognized beginning with the effective date (a) based on the requirements of SFAS No. 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123(R) that remain unvested on the effective date. Under this method, prior periods are not restated to reflect the impact of adopting the new standard.

Prior to adopting SFAS No. 123R, the Company accounted for issuances of restricted stock and stock option grants in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* and related interpretations (APB 25). Accordingly, the Company did not recognize compensation cost in the Consolidated Statements of Income for years prior to adoption of SFAS No. 123R in connection with the issuance of the stock options, as the options granted had an exercise price equal to the market value of the Company's common stock on the date of grant. The Company recorded compensation cost in connection with the issuance of restricted stock.

The following pro forma information illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to options granted in 2005. For purposes of this pro forma disclosure, the value of the options is estimated using the Black-Scholes option pricing formula and amortized to expense over the options' vesting period (in thousands, except per share amounts):

	<b>2005</b>
Net income, as reported	\$ 10,102
Redeemable minority interests	(1,476)
Net income available to common stockholders, as reported	8,626
Adjustments:	
Stock-based compensation expense included in reported net income	
Stock-based compensation expense determined under fair value method	(53)
Pro forma income available to common stockholders	\$ 8,573
Net income per common share:	
As reported:	
Basic	\$ 0.69
Diluted	\$ 0.69
Pro Forma:	
Basic	\$ 0.69
Diluted	\$ 0.68
Net income available to common stockholders per common share:	
As reported:	
Basic	\$ 0.59
Diluted	\$ 0.59
Pro Forma:	
Basic	\$ 0.59

Diluted

\$ 0.58

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Black-Scholes option pricing model assumptions:

	<b>December 31, 2005</b>
Risk free interest rate	3.72-4.54%
Expected life (years)	5
Volatility	41.62-43.50
Expected annual dividend yield	
<i>Earnings Per Share</i>	

Basic per share information is computed by dividing the item by the weighted-average number of shares outstanding during the period. Diluted per share information is computed by dividing the item by the weighted-average number of shares outstanding plus dilutive potential shares.

The following table sets forth shares used in the computation of basic and diluted per share information for the years ended December 31, 2007, 2006 and 2005.

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Weighted average number of shares outstanding for basic per share calculation	17,760,432	17,090,583	14,628,737
Effect of dilutive potential shares:			
Options	6,461	2,399	790
Restricted stock	60,551	11,678	1,112
KEEP Units			54,000
Adjusted weighted average shares for diluted per share calculation	17,827,444	17,104,660	14,684,639

*Recently Issued Accounting Pronouncements*

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosure requirements about fair value measurements. SFAS 157 is effective in our fiscal year ended December 31, 2008. The adoption of SFAS No. 157 is not expected to have a material effect on the Company's consolidated financial position or results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment to SFAS 115* (SFAS 159). SFAS 159 allows the measurement of many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis under a fair value option. SFAS 159 is effective in our fiscal year ended December 31, 2008. The adoption of SFAS No. 159 is not expected to have a material effect on the Company's consolidated financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations* (SFAS 141R). SFAS 141R changes the accounting for business combinations. Under SFAS 141R, an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS 141R will change the accounting treatment and disclosure for certain specific items in a business combination. For instance, acquisition-related costs, with the exception of debt or equity issuance costs, are to be recorded in the period that the costs are incurred and the services are received. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after January 1, 2009. We expect SFAS 141R will have an impact on accounting for business combinations once adopted but the effect is dependent upon acquisitions at that time.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an Amendment of ARB No. 51* (SFAS 160). SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is



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effective for our fiscal year ending December 31, 2009. We have not completed our evaluation of the potential impact, if any, of the adoption of SFAS 160 on our consolidated financial position, results of operations and cash flows.

**3. Acquisitions and Divestitures**

The purchase price of the following acquisitions was determined based on the Company's analysis of comparable acquisitions and target market's potential cash flows. Goodwill generated from the acquisitions was recognized based on the expected contributions of each acquisition to the overall corporate strategy. The Company expects the goodwill recognized in connection with the acquisition of existing operations to be fully tax deductible. Operations of the entities acquired in 2007, 2006 and 2005 are not considered material to the consolidated statements of income.

***2007 Acquisitions***

During the year ended December 31, 2007, the Company acquired the existing operations of 11 locations and a majority ownership interest in the existing operations of 12 locations for \$26.0 million in cash, and \$2.4 million in acquisition costs. Goodwill of \$21.9 million and other intangibles of \$5.8 million were assigned to the home based services segment. Certain 2007 acquisitions are accounted for based on preliminary purchase price allocations. The Company expects to finalize these allocations in 2008 and any changes are not expected to be significant to the company's consolidated balance sheet.

***2007 Divestitures***

During the year ended December 31, 2007, the Company sold its critical access hospital for \$180,000 and recognized a gain of \$31,000, net of tax of \$20,000, on the sale of this hospital. There was no goodwill related to this hospital. Additionally, the Company closed a home health pharmacy location in the year ended December 31, 2007. The assets related to the home health pharmacy are classified as assets held for sale on the consolidated balance sheet. The Company retired goodwill of \$48,000 related to the termination of its private duty business.

In 2007, the Company reclassified the operations of one long-term acute care hospital out of discontinued operations as the Company no longer holds the assets for sale. The facility had previously been identified as held for sale and accounted for in discontinued operations throughout the year ended December 31, 2006. Goodwill of \$402,000 and other assets related to this hospital were classified as assets held for sale at December 31, 2006. The operating results for the year ended December 31, 2006, previously disclosed in discontinued operations, have been reclassified to continuing operations in the consolidated statement of income.

***2006 Acquisitions***

During the year ended December 31, 2006, the Company acquired the existing operations of seven entities, including assets of \$2.2 million, primarily patient accounts receivable, the minority interest in one of its joint ventures and a license which was being leased for \$22.1 million in cash and \$1.4 million in acquisition costs. Goodwill of \$13.7 million and other intangibles of \$8.1 million were assigned to the home based services segment.

In conjunction with certain minority interest holders redeeming their interests in St. Landry, \$979,000 of goodwill was recognized in the facility based services segment.

***2006 Divestitures***

During the year ended December 31, 2006, the Company sold one of its long-term acute care hospitals for \$1.2 million and recognized a gain of \$958,000 on the sale of this hospital. In conjunction with this transaction, the Company allocated and retired \$155,000 of goodwill related to this hospital. The Company also sold a clinic for promissory notes totaling \$946,000 and recognized a loss on the sale of \$28,000. Goodwill of \$891,000 was retired in conjunction with the sale of the clinic. Additionally, the Company closed one location of another clinic and terminated virtually all of its private duty business. Finally, the Company sold one of its home health agencies for \$240,000 and retired goodwill of \$50,000. The Company recognized a gain of \$98,000 on the sale of this agency. The Company has identified one long-term acute care hospital and one pharmacy operation as held for sale as of

**Table of Contents****LHC GROUP, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

December 31, 2006. Goodwill of \$402,000 and other assets related to these operations are classified as assets held for sale on the consolidated balance sheet.

**2005 Acquisitions**

During the year ended December 31, 2005, the Company acquired the existing operations of seven entities for \$9.5 million in cash and a promissory note for \$250,000 to be paid over five years. The Company also obtained the right to appoint a majority of the members of the Board of Directors of a non profit critical access hospital which was in arrears in payment of a promissory note of approximately \$2.1 million to the Company. Goodwill of \$10.1 million was assigned to the home based services segment.

In conjunction with the initial public offering, the Company issued 518,036 shares of common stock to two of its joint ventures. The Company accrued a cash payment of \$2.2 million related to one of the acquisitions as of June 30, 2005 of which the entire amount has been paid as of December 31, 2005. This transaction resulted in the recording of goodwill of \$8.5 million, which is deductible for income tax purposes, in the home-based services segment and \$872,000 in the facility-based services segment.

In conjunction with certain minority interest holders redeeming their interests in St. Landry, \$214,000 of goodwill was recognized in the facility based services segment.

**2005 Divestitures**

The Company sold a minority interest in an extended care operation and in a pharmacy operation which was wholly-owned, during 2005. The Company received \$873,000 in cash and recognized a gain on these sales of \$526,000. The Company retained majority interests in both operations.

In 2005, the Company executed a rescission of the sale of the pharmacy operation resulting in a loss on the complete transaction of approximately \$8,000. There was no goodwill recognized in the transaction.

The following table summarizes the operating results of the divestitures described above which have been presented as loss from discontinued operations in the accompanying consolidated statements of income:

	<b>2007</b>	<b>2006</b>	<b>2005</b>
		<b>(In thousands)</b>	
Net service revenue	\$ 2,979	\$ 5,261	\$ 6,863
Costs, expenses and minority interest and cooperative endeavor allocations	4,885	7,622	8,675
Loss from discontinued operations before income taxes	(1,906)	(2,361)	(1,812)
Income taxes	239	897	688
Loss from discontinued operations	\$ (1,667)	\$ (1,464)	\$ (1,124)

The following table summarizes the changes in goodwill by segment:

	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>	
Home-based services segment:		
Balances at beginning of period	\$ 35,740	\$ 21,692
Goodwill acquired during the period from acquisitions	22,192	13,603
Goodwill retired during the period	(48)	(50)
Goodwill acquired during the period from purchase of minority interest		495
Balance at end of period	\$ 57,884	\$ 35,740

Facility-based services segment:

Balance at beginning of period

\$ 3,941

\$ 4,411

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>	
Goodwill retired during the period		(1,046)
Goodwill classified (to) from held for sale during the period	402	(402)
Goodwill acquired during the period from redemption of minority interest		978
Balance at end of period	\$ 4,343	\$ 3,941

The above transactions were considered to be immaterial individually and in the aggregate. Accordingly, no supplemental pro forma information is required.

**4. Income taxes**

Significant components of the Company's deferred tax assets and liabilities were as follows:

	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>	
Deferred tax liabilities:		
Amortization of intangible assets	\$ (2,166)	\$ (842)
Tax in excess of book depreciation	(1,563)	(1,407)
Prepaid expenses	(1,095)	(931)
Non-accrual experience accounting method	(861)	(633)
Conversion from cash basis accounting	(11)	(61)
Deferred tax liabilities	(5,696)	(3,874)
Deferred tax assets:		
Allowance for uncollectible accounts	3,392	2,045
Accrued employee benefits	1,005	791
Stock compensation	495	181
NOL carry forward	505	
Accrued self-insurance	508	688
Valuation allowance	(505)	
Deferred tax assets	5,400	3,705
Net deferred tax liability	\$ (296)	\$ (169)

The components of the Company's income tax expense (benefit) from continuing operations were as follows:

	<b>2007</b>	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>		
Current:			
Federal	\$ 10,542	\$ 10,139	\$ 4,604
State	1,478	1,931	775
	12,020	12,070	5,379



Deferred:			
Federal	111	(1,053)	580
State	16	(200)	93
	127	(1,253)	673
Total provision for income taxes	\$ 12,147	\$ 10,817	\$ 6,052

A reconciliation of the differences between income taxes from continuing operations computed at the federal statutory rate and provisions for income taxes for each period are as follows:

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	2007	2006	2005
	(In thousands)		
Income taxes computed at federal statutory tax rate	\$ 11,680	\$ 11,283	\$ 6,047
State income taxes, net of federal benefit	1,001	967	516
Gulf Opportunity Act tax credit	(662)	(1,027)	(164)
Nondeductible expenses	128	54	73
Tax exempt proceeds from life insurance		(380)	
Tax exempt interest income		(80)	(78)
Tax benefit on compensation charge			(342)
Total provision for income taxes	\$ 12,147	\$ 10,817	\$ 6,052

**5. Credit Arrangements****Long-Term Debt**

Long-term debt consisted of the following:

	December 31,	
	2007	2006
	(In thousands)	
Notes payable:		
Due in yearly installments of \$50,000 through August 2010 at 6.25%	150	190
Due in monthly installments of \$20,565 through October 2015 at LIBOR plus 2.25% (6.71% at December 31, 2007)	2,870	2,898
Due in monthly installments of \$12,500 through November 2009 at 3.08%	260	391
	3,280	3,479
Less current portion of long-term debt	433	428
	\$ 2,847	\$ 3,051

In August 2005, the Company entered into a promissory note with the seller of A-1 Nursing Registry, Inc. ( A-1 ) in conjunction with the purchase of the assets of A-1. The principal amount of the note is \$250,000 and it bears interest at 6.25 percent.

In August 2005, the Company entered into a promissory note with Bancorp Equipment Finance, Inc. to purchase an airplane, for a principal amount of \$2,975,000 with interest on any outstanding principal balance at the one month LIBOR rate plus 2.25 percent (6.71 percent at December 31, 2007). The note is collateralized by the airplane and is payable in 119 monthly installments of \$20,565 followed by one balloon installment in the amount of \$1,920,565. On February 28, 2008, the Company sold this airplane to a third party for \$3,050,000 in cash and paid off the promissory note in full.

On February 20, 2008, the Company entered into a Loan Agreement with Capital One, National Association for a term note in the amount of \$5,050,000 for the purchase of a 1999 Cessna 560 aircraft. The term note is payable in 84 monthly installments of principal plus interest commencing on March 6, 2008 and ending with the final payment on February 6, 2015. The term note will bear the interest at the LIBOR Rate (adjusted monthly) plus the Applicable Margin of 1.9 percent.

Certain of the Company's loan agreements contain restrictive covenants, including limitations on indebtedness and the maintenance of certain financial ratios. At December 31, 2007 and December 31, 2006, the Company was in

compliance with all covenants.

The scheduled principal payments on long-term debt are as follows for each of the next five years following December 31, 2007 (in thousands):

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

2008	\$ 433
2009	420
2010	297
2011	247
2012	247
Thereafter	1,636
	\$ 3,280

**Other Credit Arrangements**

On February 20, 2008, the Company terminated the credit facility agreement with GMAC (Former Credit Facility) and entered into a new credit facility agreement with Capital One, National Association (New Credit Facility). Under the terms of the Former Credit Facility, which was in effect at December 31, 2007, the Company was able to be advanced funds up to a defined limit of eligible accounts receivable not to exceed the borrowing limit. At December 31, 2007 the borrowing limit was \$22,500,000 and no amounts were outstanding. Interest accrues on any outstanding amounts at a varying rate and was based on the Wells Fargo Bank, N.A. prime rate plus 1.5 percent (9.02 percent at December 31, 2007). The annual facility fee was 0.5 percent of the total availability. The Former Credit Facility was due to expire on April 15, 2010.

On February 20, 2008, the Company entered into the New Credit Facility, which was amended on March 6, 2008 to include an additional lender, First Tennessee Bank, N.A., to increase the line of credit and to amend the Eurodollar Margin for each Eurodollar Loan (as those terms are defined in the New Credit Facility) issued under the New Credit Facility. The New Credit Facility is unsecured, has a term of two years and provides for a line of credit of \$37.5 million (with a letter of credit sub-limit equal to \$2.0 million). Upon written notice by the Company to the Agent, the Agent will endeavor to obtain additional lending commitments from other financial institutions to increase the line of credit to \$50.0 million. The annual facility fee is 0.125 percent of the total availability. The interest rate for borrowings under the New Credit Agreement is a function of the prime rate (Base Rate) or the eurodollar rate (Eurodollar), as elected by the Company, plus the applicable margin as set forth below:

<b>Leverage Ratio</b>	<b>Eurodollar Margin</b>	<b>Base Rate Margin</b>
< 1.00:1.00	1.75%	(0.25)%
≥ 1.00:1.00 < 1.50:1.00	2.00%	0%
≥ 1.50:1.00 < 2.00:1.00	2.25%	0%
≥ 2.00:1.00	2.50%	0%

**6. Stockholders Equity****Public Offering**

On July 19, 2006, the Company closed its follow-on public offering of 4,000,000 shares of common stock at a price of \$19.25 per share. Of the 4,000,000 shares of common stock offered, 1,000,000 shares were offered by the Company, with the remaining 3,000,000 shares of common stock sold by the selling stockholders identified in the prospectus supplement. The underwriters exercised an over-allotment of an additional 600,000 shares, 150,000 of which were sold by the Company. The additional net cash provided to the Company from this offering after deducting expenses and underwriting discounts and commissions amounted to approximately \$20.7 million.

**Share Based Compensation**

On January 20, 2005, the board of directors and stockholders of the Company approved the 2005 Long-Term Incentive Plan (the Incentive Plan). The Incentive Plan provides for 1,000,000 shares of common stock that may be issued or transferred pursuant to awards made under the plan. A variety of discretionary awards for employees,

officers, directors and consultants are authorized under the Incentive Plan, including incentive or non-qualified statutory stock options and restricted stock. All awards must be evidenced by a written award certificate which will include the provisions specified by the compensation committee of the board of directors. The compensation

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

committee will determine the exercise price for non-statutory stock options. The exercise price for any option cannot be less than the fair market value of our common stock as of the date of grant.

Also on January 20, 2005, the 2005 Director Compensation Plan was adopted. The shares issued under the 2005 Director Compensation Plan are issued from the 1,000,000 shares reserved for issuance under the Incentive Plan. In 2005, 13,500 stock options were granted at the fair market value of the underlying stock with a weighted average option price of \$14.45. These options vested immediately and have a contractual life of 10 years. The weighted average exercise price ranges between \$14.00 and \$17.05. All 13,500 options were exercisable at December 31, 2005.

Additionally, the independent directors were granted initial restricted stock awards under the Director Compensation Plan. During 2005, 24,500 units were granted at an average market value at the date of the award of \$14.44.

The Company accounted for these issuances of restricted stock and stock option grants in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations (APB 25). Accordingly, the Company did not recognize compensation cost in connection with the issuance of the stock options, as the options granted had an exercise price equal to the market value of the Company's common stock on the date of grant. During the year ended December 31, 2005, the Company did recognize compensation cost in connection with the issuance of restricted stock in the amount of \$177,000.

**Stock Options**

The Company uses the Black-Scholes option pricing model to estimate the fair value of each option on the grant date and uses the following weighted-average assumptions:

	<b>Year Ended December 31, 2006</b>
Risk free interest rate	5.03%
Expected life (years)	5
Expected volatility	38.39
Expected annual dividend yield	

The following table represents stock options activity for the year ended December 31, 2007:

	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term</b>	<b>Aggregate Intrinsic Value</b>
Options exercisable at January 1, 2007	21,000	17.44		
Options granted				
Options exercised	2,000	19.75		
Options forfeited or expired				
Options outstanding at December 31, 2007	19,000	17.20	8.0 years	
Options exercisable at December 31, 2007	19,000	17.20	8.0 years	\$ 147,895

The weighted average grant date fair value of options granted during the year 2006 was \$8.26. There were no options granted during 2007. The total intrinsic value of options exercised during the year ended December 31, 2007 and 2006 was \$14,120 and \$29,800, respectively. No options were exercised in the year ended December 31, 2005. The Company has recorded \$134,000 in compensation expense related to stock option grants in the year ended December 31, 2006. The pro forma expense for the same period in 2005 was \$53,000. No compensation expense related to stock option grants was recorded in the year ended December 31, 2007. All options are fully vested and exercisable at December 31, 2007.



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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Nonvested Stock***

During 2007 and 2006, respectively, 16,100 and 3,500 nonvested shares of stock were granted to our independent directors under the 2005 Director Compensation Plan. One third of these shares vested immediately and the remaining vest over the two year period following the grant date. During 2007, 181,071 nonvested shares were granted to employees pursuant to the 2005 Long-Term Incentive Plan. These shares vest over a five year period. The fair value of nonvested shares is determined based on the closing trading price of the Company's shares on the grant date. The weighted average grant date fair values of nonvested shares granted during the years ended December 31, 2007 and 2006 were \$27.83 and \$18.66, respectively. The following table represents the nonvested stock activity for the year ended December 31, 2007:

	<b>Number of Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
Nonvested shares outstanding at December 31, 2006	86,719	18.29
Granted	197,171	27.83
Vested	(25,607)	18.03
Forfeited	(39,951)	27.35
Nonvested shares outstanding at December 31, 2007	218,332	24.03

As of December 31, 2007, there was \$1.7 million of total unrecognized compensation cost related to nonvested shares granted. That cost is expected to be recognized over the weighted average period of 3.9 years. The total fair value of shares vested in the years ended December 31, 2007 and 2006 were \$468,361 and \$141,294, respectively. The Company records compensation expense related to nonvested share awards at the grant date for shares that are awarded fully vested and over the vesting term on a straight line basis for shares that vest over time. The Company has recorded \$1.2 million and \$445,000 in compensation expense related to nonvested stock grants in the years ended December 31, 2007 and 2006 respectively.

***Employee Stock Purchase Plan***

The Company has a plan whereby eligible employees may purchase the Company's common stock at 95 percent of the market price on the last day of the calendar quarter. There are 250,000 shares reserved for the plan. The Company issued 16,893 shares of common stock under the plan at a weighted average per share price of \$24.76 during the year ended December 31, 2007. At December 31, 2007 there were 226,011 shares available for future issuance.

***Treasury Stock***

In conjunction with the conversion of the KEEP units to common stock during the initial public offering and the vesting of the nonvested shares of stock, the recipients incurred withholding tax liabilities. The Company allowed the holders to turn in shares of common stock at December 30, 2005 to satisfy those tax obligations. The Company redeemed 371 and 35,209 shares of common stock related to these tax obligations at December 30, 2007 and 2005, respectively.

**7. Related Party Transactions*****Employee Receivables***

As a result of Hurricanes Katrina and Rita, the Company established a loan fund to allow affected employees to borrow up to six months of their salary to aid in their recovery from the hurricanes. The loan agreements bear interest of 3.5 percent. The employees began payment on the loans one year after the date of the loan agreement through payroll deductions. As of December 31, 2007 and 2006, these loans totaled \$245,000 and \$363,000, respectively and are included in other assets on the consolidated balance sheet.



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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**8. Leases**

Occasionally, the Company enters into lease agreements with third parties through wholly owned subsidiaries for a Medicare and a Medicaid license and the associated provider number to provide home health or hospice services. The Company entered into such an agreement in 2003. Effective October 1, 2007, the Company converted this lease into a joint venture.

In 2005, the Company entered into two leases, one to provide home health services and the other to provide hospice services. The initial terms of these leases expire in 2010.

In 2007, the Company entered into two leases to provide home health and hospice services. The initial terms of these leases expire in 2017.

Expense related to these leases was \$738,000 in 2007, \$525,000 in 2006 and \$436,000 in 2005. Payments due under these leases are \$222,000 in 2008. These payments do not include payments for the licenses granted in 2005 as these are dependent on net quarterly profits and are each capped at \$160,000 per year.

The Company leases office space and equipment at its various locations. Total rental expense was approximately \$8.1 million in 2007, \$7.6 million in 2006 and \$5.4 million in 2005. Future minimum rental commitments under non-cancelable operating leases, are as follows for the periods ending December 31 (in thousands):

2008	\$ 6,519
2009	3,523
2010	1,902
2011	1,119
2012	955
Thereafter	1,616
	\$ 15,634

As of December 31, 2007, future minimum payments by year and in the aggregate, under non-cancelable capital leases with initial terms of one year or more, consisted of the following (in thousands):

2008	\$ 88
2009	63
2010	
2011	
2012	
Thereafter	
Total minimum lease payments	151
Current portion of capital lease obligations	88
Capital lease obligations, long-term	\$ 63

The cost of assets held under capital leases was \$456,000 and \$1,070,000 at December 31, 2007 and 2006, respectively. The related accumulated amortization was \$456,000 and \$603,000 at December 31, 2007 and 2006, respectively.

**9. Employee Benefit Plan**

The Company sponsors a profit-sharing 401(k) plan that covers substantially all eligible full-time employees. The plan allows participants to contribute up to 15 percent of their compensation and allows discretionary Company contributions as determined by the Company's board of directors. Effective January 1, 2006, the Company

implemented a discretionary match of up to 2 percent of participating employee contributions. The employer contribution will vest 20 percent after two years and 20 percent each additional year until it is fully vested in year six. At December 31, 2007 and December 31, 2006, \$215,000 and \$693,000 related to this match is included in salaries, wages and benefits payable.

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**10. Commitments and Contingencies*****Contingencies***

The terms of one joint venture operating agreement grants a buy/sell option that would require the Company to either purchase or sell the existing membership interest in the joint venture within 30 days of the receipt of the notice to exercise the provision (See Note 2). Either the Company or its joint venture partner has the right to exercise the buy/sell option. The party receiving the exercise notice has the right to either purchase the interests held by the other party, sell its interests to the other party or dissolve the partnership. The purchase price formula for the interests is set forth in the joint venture agreement and is typically based on a multiple of the earnings before income taxes, depreciation and amortization of the joint venture. Total revenue earned by the Company from this joint venture was \$13.6 million, \$13.9 million and \$13.7 million for the year ended December 31, 2007, 2006 and 2005, respectively. As of December 31, 2007, approximately 76.5 percent of the minority interest holders have converted their minority interests to cash.

The Company is involved in various legal proceedings arising in the ordinary course of business. Although the results of litigation cannot be predicted with certainty, management believes the outcome of pending litigation will not have a material adverse effect, after considering the effect of the Company's insurance coverage, on the Company's consolidated financial statements.

***Compliance***

The laws and regulations governing the Company's operations, along with the terms of participation in various government programs, regulate how the Company does business, the services offered and interactions with patients and the public. These laws and regulations and their interpretations, are subject to frequent change. Changes in existing laws or regulations, or their interpretations, or the enactment of new laws or regulations could materially and adversely affect the Company's operations and financial condition.

The Company is subject to various routine and non-routine governmental reviews, audits and investigations. In recent years, federal and state civil and criminal enforcement agencies have heightened and coordinated their oversight efforts related to the health care industry, including with respect to referral practices, cost reporting, billing practices, joint ventures and other financial relationships among health care providers. Violation of the laws governing the Company's operations, or changes in the interpretation of those laws, could result in the imposition of fines, civil or criminal penalties, the termination of the Company's rights to participate in federal and state-sponsored programs and the suspension or revocation of the Company's licenses.

If the Company's long-term acute care hospitals fail to meet or maintain the standards for Medicare certification as long-term acute care hospitals, such as average minimum length of patient stay, they will receive payments under the prospective payment system applicable to general acute care hospitals rather than payment under the system applicable to long-term acute care hospitals. Payments at rates applicable to general acute care hospitals would likely result in the Company receiving less Medicare reimbursement than currently received for patient services. Moreover, all but one of the Company's long-term acute care hospitals are subject to additional Medicare criteria because they operate as separate hospitals located in space leased from and located in, a general acute care hospital, known as a host hospital. This is known as a "hospital within a hospital" model. These additional criteria include requirements concerning financial and operational separateness from the host hospital.

The Company anticipates there may be changes to the standard episode-of-care payment from Medicare in the future. Due to the uncertainty of the revised payment amount, the Company cannot estimate the impact that changes in the payment rate, if any, will have on its future financial statements.

The Company believes that it is in material compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties and exclusion from the Medicare program.



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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**11. Concentration of Risk**

The Company's Louisiana facilities accounted for approximately 50.9 percent, 64.1 percent and 78.6 percent of net service revenue during the years ended December 31, 2007, 2006 and 2005, respectively. Any material change in the current economic or competitive conditions in Louisiana could have a disproportionate effect on the Company's overall business results.

**12. Segment Information**

The Company's segments consist of (a) home-based services and (b) facility-based services. Home-based services include home nursing services and hospice services. Facility-based services include long-term acute care services and outpatient rehabilitation services. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

	<b>Year Ended December 31, 2007</b>		
	<b>Home-Based Services</b>	<b>Facility-Based Services</b>	<b>Total</b>
		<b>(In thousands)</b>	
Net service revenue	\$244,107	\$ 53,924	\$298,031
Cost of service revenue	118,451	34,126	152,577
General and administrative expenses	88,532	18,263	106,795
Operating income	37,124	1,535	38,659
Interest expense	250	126	376
Non operating (income) loss, including gain on sale of assets	(746)	(327)	(1,073)
Income from continuing operations before income taxes and minority interest and cooperative endeavor allocations	37,620	1,736	39,356
Minority interest and cooperative endeavor allocations	5,177	807	5,984
Income from continuing operations before income taxes	32,443	929	33,372
Total assets	151,540	23,445	174,985

	<b>Year Ended December 31, 2006</b>		
	<b>Home-Based Services</b>	<b>Facility-Based Services</b>	<b>Total</b>
		<b>(In thousands)</b>	
Net service revenue	\$164,701	\$ 53,834	\$218,535
Cost of service revenue	79,070	33,025	112,095
General and administrative expenses	55,700	15,415	71,115
Operating income	29,931	5,394	35,325
Interest expense	210	115	325
Non operating (income) loss, including gain on sale of assets	(1,404)	(629)	(2,033)
Income from continuing operations before income taxes and minority interest and cooperative endeavor allocations	31,125	5,908	37,033
Minority interest and cooperative endeavor allocations	3,075	1,720	4,795
Income from continuing operations before income taxes	28,050	4,188	32,238
Total assets	117,585	35,109	152,694

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Year Ended December 31, 2005		
	Home-Based Services	Facility-Based Services (In thousands)	Total
Net service revenue	\$ 105,588	\$ 50,099	\$ 155,687
Cost of service revenue	51,255	31,741	82,996
General and administrative expenses	33,650	12,869	46,519
Equity-based compensation expense	2,699	1,157	3,856
Operating income	17,984	4,332	22,316
Interest expense	690	377	1,067
Non operating (income) loss, including gain on sale of assets	(132)	(442)	(574)
Income from continuing operations before income taxes and minority interest and cooperative endeavor allocations	17,426	4,397	21,823
Minority interest and cooperative endeavor allocations	3,142	1,403	4,545
Income from continuing operations before income taxes	14,284	2,994	17,278
Total assets	70,889	33,729	104,618

**13. Fair Value of Financial Instruments**

The carrying amounts of the Company's cash, receivables, accounts payable and accrued liabilities approximate their fair values because of their short maturity.

The carrying amount of the Company's lines of credit and capital lease obligations approximate their fair values because the interest rates are considered to be at market rates. The carry value of the Company's long-term debt equals its fair value based on a variable interest rate.

**14. Allowance for Uncollectible Accounts and Property, Building and Equipment**

The following table summarizes the activity and ending balances in the allowance for uncollectible accounts:

	Beginning	Additions		End of
	of Year Balance	and Expenses	Deductions	Year Balance
	(In thousands)			
Year ended December 31:				
2007	\$5,769	\$ 13,817	\$10,633	\$8,953
2006	2,544	4,778	1,553	5,769
2005	1,168	3,188	1,812	2,544

The following table describes the components of property, building and equipment:

	December 31,	
	2007	2006
	(In thousands)	
Land	\$ 135	\$ 135
Building and improvements	3,079	2,891
Transportation equipment	3,434	3,480
Furniture and other equipment	13,661	10,321
	20,309	16,827
Less accumulated depreciation and amortization	7,786	5,122

\$ 12,523

\$ 11,705

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**LHC GROUP, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**15. Unaudited Summarized Quarterly Financial Information**

	<b>First Quarter 2007</b>	<b>Second Quarter 2007</b>	<b>Third Quarter 2007</b>	<b>Fourth Quarter 2007</b>
	<b>(In thousands)</b>			
Net service revenue	\$ 68,727	\$ 70,564	\$ 77,495	\$ 81,245
Gross margin	34,111	34,483	37,516	39,344
Net income	5,786	5,038	6,025	2,740
Net income available to common stockholders	5,820	5,160	6,082	2,720
Basic earnings per share				
Net income	\$ 0.33	\$ 0.28	\$ 0.34	\$ 0.15
Net income available to common shareholders	\$ 0.33	\$ 0.29	\$ 0.34	\$ 0.15
Diluted earnings per share				
Net income	\$ 0.33	\$ 0.28	\$ 0.34	\$ 0.15
Net income available to common shareholders	\$ 0.33	\$ 0.29	\$ 0.34	\$ 0.15
Weighted average shares outstanding				
Basic	17,748,369	17,754,632	17,766,612	17,773,116
Diluted	17,807,338	17,798,952	17,794,072	17,817,777

In the fourth quarter of 2007, the Company recorded an adjustment to increase its allowance for uncollectible accounts \$3.9 million and reduce net income available to common shareholders \$2.5 million (\$0.14 per share).

	<b>First Quarter 2006</b>	<b>Second Quarter 2006</b>	<b>Third Quarter 2006</b>	<b>Fourth Quarter 2006</b>
	<b>(In thousands)</b>			
Net service revenue	\$ 45,281	\$ 49,968	\$ 58,626	\$ 64,660
Gross margin	21,264	24,870	28,458	31,848
Net income	4,136	4,256	5,271	6,931
Net income available to common stockholders	4,979	4,428	5,199	7,151
Basic earnings per share				
Net income	\$ 0.26	\$ 0.26	\$ 0.30	\$ 0.39
Net income available to common shareholders	\$ 0.31	\$ 0.27	\$ 0.30	\$ 0.40
Diluted earnings per share				
Net income	\$ 0.26	\$ 0.26	\$ 0.30	\$ 0.39
Net income available to common shareholders	\$ 0.31	\$ 0.27	\$ 0.30	\$ 0.40
Weighted average shares outstanding				
Basic	16,557,828	16,561,398	17,557,576	17,730,698
Diluted	16,563,368	16,576,068	17,574,541	17,751,390

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15 (d) of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**LHC GROUP, INC.**

/s/ Keith G. Myers  
Keith G. Myers  
President and Chief Executive Officer

Date March 21, 2008

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EXHIBIT INDEX

<b>Exhibit Number</b>	<b>Description of Exhibits</b>
2.1	Asset purchase Agreement, dated June 19, 2006, by and among the Registrant, The Lifeline Health Group, Inc. and various subsidiaries of The Lifeline Health Group, Inc. (previously filed as Exhibit 2.1 to the Form 8-K on June 19, 2006).
3.1	Certificate of Incorporation of LHC Group, Inc. (previously filed as an exhibit to the Form S-1/A (File No. 333-120792) on February 14, 2005).
3.2	Bylaws of LHC Group, Inc. (previously filed as an exhibit to the Form S-1/A (File No. 333-120792) on May 9, 2005)
3.3	Amendment to LHC Group, Inc. Bylaws (previously filed as Exhibit 3.1 to the Form 8-K on January 4, 2008).
3.4	Certificate of Designations (previously filed as Exhibit B to Exhibit 4.1 to the Form 8-A12B on March 11, 2008).
4.1	Specimen Stock Certificate of LHC's Common Stock, par value \$0.01 per share (previously filed as an exhibit to the Form S-1/A (File No. 333-120792) on February 14, 2005).
4.2	Reference is made to Exhibits 3.1 and 3.2 (previously filed as an exhibit to the Form S-1/A (File No. 333-120792) on February 14, 2005 and May 9, 2005, respectively).
4.3	Stockholder Protection Rights Agreement by and between LHC Group, Inc. and Computershare Trust Company, N.A., as rights agent (previously filed as Exhibit 4.1 to the Form 8-A12B on March 11, 2008).
10.1	LHC 2003 Key Employee Equity Participation Plan (previously filed as an exhibit to the Form S-1/A (File No. 333-120792) on November 26, 2004).
10.2	LHC Group, Inc. 2005 Long-Term Incentive Plan (previously filed as an exhibit to the Form S-1/A (File No. 333-120792) on February 14, 2005).
10.3	Form of Award under LHC Group, Inc. 2005 Director Compensation Plan. (previously filed as an exhibit to the Form S-1/A (File No. 333-120792) on February 14, 2005).
10.4	Form of Indemnity Agreement between LHC Group and directors and certain officers (previously filed as an exhibit to the Form S-1/A (File No. 333-120792) on February 14, 2005).
10.5	LHC Group, Inc. 2005 Director Compensation Plan (previously filed as an exhibit to the Form S-1/A (File No. 333-120792) on February 14, 2005).
10.6	Amendment to LHC Group, Inc. 2005 Director Compensation Plan (previously filed as Exhibit 99.1 to the Form 8-K on June 12, 2006).

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- 10.7 LHC Group, Inc. 2006 Employee Stock Purchase Plan (previously filed as Exhibit 99.2 to the Form 8-K on June 12, 2006).
  - 10.8 Severance and Consulting Agreement by and between LHC Group, Inc. and Barry E. Stewart, dated August 15, 2007 (previously filed as Exhibit 10.1 to the Form 8-K on August 15, 2007).
  - 10.9 Employment Agreement by and between LHC Group, Inc. and Don Stelly, dated October 22, 2007 (previously filed as Exhibit 10.1 to the Form 8-K on October 30, 2007).
  - 10.10 Employment Agreement between LHC Group, Inc. and Keith G. Myers dated January 1, 2008 (previously filed as Exhibit 10.1 to the Form 8-K on January 4, 2008 ).
  - 10.11 Employment Agreement between LHC Group, Inc. and John L. Indest dated January 1, 2008 (previously filed as Exhibit 10.2 to the Form 8-K on January 4, 2008).
  - 10.12 Employment Agreement by and between LHC Group, Inc. and Peter Roman, dated January 1, 2008 (previously filed as Exhibit 10.3 to the Form 8-K on January 4, 2008).
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<b>Exhibit Number</b>	<b>Description of Exhibits</b>
10.13	Employment Agreement between LHC Group, Inc. and Daryl Doise dated January 1, 2008 (previously filed as Exhibit 10.4 to the Form 8-K on January 4, 2008).
10.14	Loan Agreement by and between LHC Group, Inc., Palmetto Express, L.L.C. and Capital One, National Association dated February 6, 2008 (previously filed as Exhibit 10.1 to the Form 8-K on February 13, 2008).
10.15	Credit Agreement by and between LHC Group, Inc. and Capital One, National Association dated February 20, 2008 (previously filed as Exhibit 10.1 to the Form 8-K dated February 20, 2008 on February 25, 2008).
10.16	First Amendment to Credit Agreement by and between LHC Group, Inc., Capital One, National Association and First Tennessee Bank, N.A. dated March 6, 2008 (previously filed as Exhibit 10.1 to the Form 8-K on March 10, 2008).
21.1	Subsidiaries of the Registrant.
23.1	Consent of Ernst & Young LLP.
31.1	Certification of Keith G. Myers, Chief Executive Officer pursuant to Rule 13a- 14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Peter J. Roman, Chief Financial Officer pursuant to Rule 13a- 14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* This exhibit is furnished to the SEC as an accompanying document and is not deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that Section, and the document will

not be deemed  
incorporated by  
reference into  
any filing under  
the Securities  
Act of 1933.