

Edgar Filing: CHEMED CORP - Form 10-Q

CHEMED CORP  
Form 10-Q  
November 01, 2006

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

X Quarterly Report Under Section 13 or 15 (d) of the Securities Exchange Act of 1934 For the Quarterly Period Ended September 30, 2006

----- Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 1-8351

CHEMED CORPORATION
(Exact name of registrant as specified in its charter)

Delaware 31-0791746
(State or other jurisdiction of incorporation or (IRS Employer Identification organization) No.)

2600 Chemed Center, 255 E. Fifth Street, Cincinnati, Ohio 45202
(Address of principal executive offices) (Zip code)

(513) 762-6900
(Registrant's telephone number, including area code)

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 periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No
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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer X Accelerated filer Non-accelerated filer
--- ----

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No X
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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class Amount Date

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Capital Stock  
\$1 Par Value

26,270,441 Shares

September 30, 2006

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1

CHEMED CORPORATION AND  
SUBSIDIARY COMPANIES

Index

PART I. FINANCIAL INFORMATION:

Item 1. Financial Statements

Unaudited Consolidated Balance Sheet -  
September 30, 2006 and December 31, 2005

Unaudited Consolidated Statement of Income -  
Three and nine months ended September 30, 2006 and 2005

Unaudited Consolidated Statement of Cash Flows -  
Nine months ended September 30, 2006 and 2005

Notes to Unaudited Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition and Results of  
Operations

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Item 4. Controls and Procedures

PART II. OTHER INFORMATION

Item 2.(e). Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Item 6. Exhibits

2

PART I. FINANCIAL INFORMATION  
Item 1. Financial Statements  
CHEMED CORPORATION, INC. AND SUBSIDIARY COMPANIES  
UNAUDITED CONSOLIDATED BALANCE SHEET  
(in thousands except share and per share data)

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	September 30, 2006	
	-----	-----
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 5,414	\$
Accounts receivable less allowances of \$10,016 (2005 - \$8,413)	104,240	
Inventories	6,381	
Current deferred income taxes	25,461	
Prepaid income taxes	5,642	
Prepaid expenses and other current assets	5,844	
	-----	-----
Total current assets	152,982	
Investments of deferred compensation plans held in trust	24,278	
Other investments	-	
Note receivable	12,500	
Properties and equipment, at cost, less accumulated depreciation of \$75,271 (2005 - \$66,655)	68,616	
Identifiable intangible assets less accumulated amortization of \$12,222 (2005 - \$9,612)	69,880	
Goodwill	434,066	
Other assets	19,459	
	-----	-----
Total Assets	\$ 781,781	\$
	=====	=====
<b>LIABILITIES</b>		
Current liabilities		
Accounts payable	\$ 45,745	\$
Current portion of long-term debt	207	
Income taxes	4,903	
Accrued insurance	41,368	
Accrued compensation	32,429	
Other current liabilities	27,460	
	-----	-----
Total current liabilities	152,112	
Deferred income taxes	20,570	
Long-term debt	165,796	
Deferred compensation liabilities	23,932	
Other liabilities	3,929	
	-----	-----
Total liabilities	366,339	
	-----	-----
<b>STOCKHOLDERS' EQUITY</b>		
Capital stock - authorized 80,000,000 shares \$1 par; issued 28,809,618 shares (2005 - 28,373,872 shares)	28,810	
Paid-in capital	250,373	
Retained earnings	199,467	
Treasury stock - 2,672,077 shares (2005 - 2,394,272 shares), at cost	(65,555)	
Deferred compensation payable in Company stock	2,402	
Notes receivable for shares sold	(55)	
	-----	-----
Total Stockholders' Equity	415,442	
	-----	-----
Total Liabilities and Stockholders' Equity	\$ 781,781	\$
	=====	=====

See accompanying notes to unaudited financial statements.

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3

CHEMED CORPORATION AND SUBSIDIARY COMPANIES  
 UNAUDITED CONSOLIDATED STATEMENT OF INCOME  
 (in thousands, except per share data)

	Three Months Ended September 30,		2004
	2006	2005	
Continuing Operations			
Service revenues and sales	\$ 253,202	\$ 233,328	\$ 7,000
Cost of services provided and goods sold (excluding depreciation)	187,190	165,229	5,000
Selling, general and administrative expenses	39,160	38,423	1,000
Depreciation	4,200	4,086	
Amortization	1,421	1,248	
Other expenses--net	2,692	(130)	
Total costs and expenses	234,663	208,856	6,000
Income from operations	18,539	24,472	
Interest expense	(4,081)	(5,147)	(1,000)
Loss from impairment of investment	(1,445)	-	
Loss on extinguishment of debt	-	-	
Other income--net	715	1,317	
Income before income taxes	13,728	20,642	
Income taxes	(3,541)	(6,010)	(1,000)
Income from continuing operations	10,187	14,632	
Discontinued operations, net of income taxes	(2,226)	-	
Net income	\$ 7,961	\$ 14,632	\$ 0.30
Earnings Per Share			
Income from continuing operations	\$ 0.39	\$ 0.57	\$ 0.30
Net income	\$ 0.30	\$ 0.57	\$ 0.30
Average number of share outstanding	26,190	25,719	
Diluted Earnings Per Share			
Income from continuing operations	\$ 0.38	\$ 0.55	\$ 0.30
Net income	\$ 0.30	\$ 0.55	\$ 0.30
Average number of share outstanding	26,633	26,401	
Cash Dividends Per Share	\$ 0.06	\$ 0.06	\$ 0.06

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See accompanying notes to unaudited financial statements.

4

### CHEMED CORPORATION AND SUBSIDIARY COMPANIES UNAUDITED CONSOLIDATED STATEMENT OF CASH FLOWS (in thousands)

		Nine Months E September 3
		2006
<hr/>		
Cash Flows from Operating Activities		
Net income	\$	33,018
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization		16,699
Provision for uncollectible accounts receivable		6,003
Losses on asset impairments		3,864
Discontinued operations		2,226
Amortization of debt issuance costs		1,325
Provision for deferred income taxes		(1,233)
Write off unamortized debt issuance costs		430
Noncash long-term incentive compensation		-
Changes in operating assets and liabilities, excluding amounts acquired in business combinations:		
Increase in accounts receivable		(17,545)
Decrease/(increase) in inventories		118
Decrease in prepaid expenses and other current assets		2,673
Decrease in accounts payable and other current liabilities		(16,147)
Increase in income taxes		10,636
Increase in other assets		(248)
Increase in other liabilities		2,403
Excess tax benefit on share-based compensation		(4,943)
Noncash expense of internally financed ESOP		-
Other sources		1,374
		<hr/>
Net cash provided by continuing operations		40,653
Net cash used by discontinued operations		-
		<hr/>
Net cash provided by operating activities		40,653
<hr/>		
Cash Flows from Investing Activities		
Capital expenditures		(16,207)
Net uses from disposals of discontinued operations		(3,360)
Business combinations, net of cash acquired		(1,489)
Proceeds from sales of property and equipment		287
Other uses		(553)
		<hr/>
Net cash used by investing activities		(21,322)
<hr/>		
Cash Flows from Financing Activities		
Repayment of long-term debt		(84,500)
Net increase in revolving line of credit		15,400
Purchases of treasury stock		(8,253)

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Excess tax benefit on share-based compensation	4,943
Dividends paid	(4,739)
Issuance of capital stock, net of issuance costs	3,854
Increase in cash overdraft payable	2,145
Debt issuance costs	(154)
Proceeds from issuance of long-term debt	-
Other sources	254
	-----
Net cash used by financing activities	(71,050)
	-----
Decrease in Cash and Cash Equivalents	(51,719)
Cash and cash equivalents at beginning of year	57,133
	-----
Cash and cash equivalents at end of period	\$ 5,414
	=====

See accompanying note to unaudited financial statements.

5

### CHEMED CORPORATION AND SUBSIDIARY COMPANIES Notes to Unaudited Financial Statements

#### 1. Basis of Presentation

As used herein, the terms "We," "Company" and "Chemed" refer to Chemed Corporation or Chemed Corporation and its consolidated subsidiaries.

We have prepared the accompanying unaudited consolidated financial statements of Chemed in accordance with Rule 10-01 of SEC Regulation S-X. Consequently, we have omitted certain disclosures required under generally accepted accounting principles in the United States for complete financial statements. However, in our opinion, the financial statements presented herein contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly our financial position, results of operations and cash flows. These financial statements are prepared on the same basis as and should be read in conjunction with the Consolidated Financial Statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2005. Certain 2005 amounts have been reclassified to conform with current period presentation in the balance sheet and statements of income and cash flows primarily related to the adoption of SFAS 123(R).

#### 2. Stock-Based Compensation

Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards No. 123, revised ("SFAS 123(R)") which establishes accounting for stock-based compensation for employees. Under SFAS 123(R), stock-based compensation cost is measured at the grant date, based on the fair value of the award and recognized as expense over the employee's requisite service period. We previously applied Accounting Principles Board Opinion No. 25 and provided the pro-forma disclosures required by Statement of Financial Accounting Standards No. 123. We elected to adopt the modified prospective transition method as provided by SFAS 123(R). Accordingly, we have not restated previously reported financial statement amounts. Other than the reclassifications noted above, there was no material impact on our financial position, results of operations or cash flows as a result of the adoption of SFAS 123(R).

We provide employees the opportunity to acquire our stock through a number of plans, as follows:

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- o We have nine stock incentive plans under which 10,700,000 shares can be issued to key employees through a grant of stock awards and/or options to purchase shares. The Compensation/Incentive Committee ("CIC") of the Board of Directors administers these plans. All options granted under these plans provide for a purchase price equal to the market value of the stock at the date of grant. The latest plan, covering a total of 3,000,000 shares, was adopted in May 2006. The plans are not qualified, restricted or incentive plans under the U.S. Internal Revenue Code. The terms of each plan differ slightly, however, stock options issued under the plans generally have a maximum term of 10 years. Under one plan, adopted in 1999, up to 500,000 shares may be issued to employees who are not our officers or directors.
  
- o In May 2002, our shareholders approved the adoption of the Executive Long-Term Incentive Plan ("LTIP") covering our officers and key employees. The LTIP is administered by the CIC. During June 2004, the CIC approved guidelines covering the establishment of a pool of 250,000 shares ("2004 LTIP Pool") to be distributed to eligible members of management upon attainment of the following hurdles during the period January 1, 2004 through December 31, 2007:
  - o 88,000 shares if our cumulative pro forma adjusted EBITDA (including the results of VITAS beginning January 1, 2004) reaches \$365 million within the four-year period.
  
  - o 88,000 shares if our stock price reaches the following hurdles during any 30 trading days out of any 60-trading-day period during the four-year period:

Stock Price Hurdle	Shares to be Issued
-----	-----
\$ 35.00	22,000
\$ 38.75	33,000
\$ 42.50	33,000
	-----
	88,000
	=====

6

- o 44,000 shares represent a retention element, subject to a four-year, time-based vesting.
  
- o 30,000 shares may be awarded at the discretion of the CIC. Through September 30, 2006, 18,000 shares have been issued from the discretionary pool.

The 88,000 shares tied to stock price hurdles were issued during the year ended December 31, 2005. On May 15,

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2006, the CIC approved additional price hurdles and associated shares to be issued under the LTIP pursuant to the 2006 Stock Incentive Plan, as follows:

Stock Price Hurdle	Shares to be Issued
-----	-----
\$ 62.00	20,000
\$ 68.00	30,000
\$ 75.00	30,000
	-----
	80,000
	=====

The stock price hurdles must be achieved during 30 trading days out of any 60 trading day period during the three years ending May 15, 2009. See Note 11 below for disclosure related to awards granted under the LTIP.

- o We maintain an Employee Stock Purchase Plan ("ESPP"). The ESPP allows eligible participants to purchase our shares through payroll deductions at current market value. We pay administrative and broker fees associated with the ESPP. Shares purchased for the ESPP are purchased on the open market and credited directly to participants' accounts. In accordance with the provisions of SFAS 123(R), the ESPP is non-compensatory.

For the three and nine months ended September 30, 2006, we recorded \$355,000 and \$960,000, respectively, in amortization expense in the accompanying statement of income for stock-based compensation expense related to the amortization of restricted stock awards previously granted. For the three and nine months ended September 30, 2006, we recorded \$597,000 and \$615,000, respectively, in selling, general and administrative expenses for stock-based compensation expense related to stock options granted. There were no capitalized stock-based compensation costs as of September 30, 2006. The pro-forma disclosure as required by SFAS No. 123 for the three and nine months ended September 30, 2005 is as follows (in thousands):

	Three Months	Nine Months
	-----	-----
Net income, as reported	\$ 14,632	\$ 31,633
Add: stock-based compensation expense included in net income as reported, net of income taxes	182	2,670
Deduct: total stock-based compensation determined under a fair value method, net of income taxes	(234)	(6,548)
	-----	-----
Pro-forma net income	\$ 14,580	\$ 27,755
	=====	=====
Earnings per share:		



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As reported	\$	0.57	\$	1.24
	=====		=====	
Pro-forma	\$	0.57	\$	1.09
	=====		=====	
Diluted earnings per share:				
As reported	\$	0.55	\$	1.21
	=====		=====	
Pro-forma	\$	0.55	\$	1.06
	=====		=====	

As of September 30, 2006, approximately \$2.9 million of total unrecognized compensation costs related to non-vested stock awards are expected to be recognized over a weighted average period of 2.8 years. As of September 30, 2006, approximately \$6.0 million of total unrecognized compensation costs related to non-vested stock options are expected to be recognized over a weighted average period of 2.75 years.

7

The following table summarizes stock option and award activity during the first nine months of 2006:

	Stock Options		Stock Awards	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Grant-Date Price
	-----	-----	-----	-----
Stock-based compensation shares:				
Outstanding at January 1, 2006	1,741,833	\$23.57	142,445	\$27.10
Granted	370,450	51.76	29,600	53.17
Exercised/Vested	(408,861)	20.99	(33,855)	36.53
Forfeited	(300)	51.76	(2,715)	30.32
	-----	-----	-----	-----
Outstanding at September 30, 2006	1,703,122	\$30.32	135,475	\$30.37
	=====	=====	=====	=====
Vested at September 30, 2006	1,332,972	\$24.36		
	=====	=====		

The weighted average contractual life of outstanding and exercisable options was 6.75 years at September 30, 2006.

The options outstanding at September 30, 2006, were in the following exercise price ranges:

	Weighted	
	Average	Aggregate
Number of	Exercise	Intrinsic

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Exercise Price Range	Options	Price	Value
\$16.10 to \$30.32	1,023,572	\$20.21	\$12,723,000
\$30.33 to \$51.76	679,550	\$45.54	\$ -

The total intrinsic value of stock options exercised during the nine month periods ended September 30, 2006 and 2005 was \$14.1 million and \$18.8 million, respectively. The total intrinsic value of stock options that are vested as of September 30, 2006 and 2005 was \$12.7 million and \$41.8 million, respectively. The total intrinsic value of stock awards vested during the nine month periods ended September 30, 2006 and 2005 was \$1.7 million and \$3.4 million, respectively. The total cash received from employees as a result of employee stock option exercises for the nine month periods ended September 30, 2006 and 2005 was \$3.8 million and \$10.0 million, respectively. In connection with these exercises, the tax benefits realized for the nine months ended September 30, 2006 and 2005 were \$4.9 million and \$6.6 million, respectively. We settle employee stock options with newly issued shares.

In connection with the adoption of SFAS 123(R) on January 1, 2006, we reassessed our valuation technique and related assumptions. We estimate the fair value of stock options using the Black-Scholes valuation model, consistent with the provisions of SFAS 123(R), the Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 107 and our prior period pro forma disclosure of net income including stock-based compensation expense. We granted 370,450 stock options on June 28, 2006 pursuant to the 2006 Stock Incentive Plan. For purposes of determining the key assumptions and the related fair value of the options granted, we analyzed the participants of the LTIP separately from the other stock option recipients.

8

Key input assumptions used to estimate the fair value of stock options granted on June 28, 2006 are as follows:

	LTIP Participants	All Others
Stock price on date of issuance	\$51.76	\$51.76
Grant date fair value per share	\$18.95	\$16.47
Number of options granted	262,750	107,700
Expected term (years)	6.0	4.5
Risk free rate of return	5.21 %	5.19 %
Volatility	28.0 %	28.9 %
Dividend yield	0.5 %	0.5 %
Forfeiture rate	- %	10.0 %

Volatility was determined using our historical stock price tracked over a period equal to the expected term of the option. We believe using the Black-Scholes model and the related assumptions are appropriate in estimating the fair value of our stock options granted. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by the option recipient. The ultimate value received by an employee for options granted is not necessarily indicative of the reasonableness of the estimate made by us in accordance with SFAS 123(R).

### 3. Capital Stock

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In July 2006, we announced a \$50 million on-going stock repurchase program. Our previous stock repurchase program approved in February 2000 had remaining authorization of \$8 million. For the three and nine months ended September 30, 2006, we repurchased 111,380 shares at a weighted average cost per share of \$37.30 under the February 2000 program.

On May 15, 2006, our shareholders approved an amendment to our Certificate of Incorporation increasing the number of authorized shares of capital stock from 40 million shares to 80 million shares.

On March 11, 2005, our Board of Directors approved a 2-for-1 stock split in the form of a 100% stock dividend to shareholders of record at the close of business on April 22, 2005. This stock split was paid May 11, 2005. Under Delaware law, the par value of the capital stock remains \$1 per share.

#### 4. Revenue Recognition

Both the VITAS segment and Roto-Rooter segment recognize service revenues and sales when the earnings process has been completed. Generally, this occurs when services are provided or products are delivered. VITAS recognizes revenue at the estimated realizable amount due from third-party payers. Medicare billings are subject to certain caps, as described further below.

We actively monitor each of our hospice programs, by provider number, as to their specific admission, discharge rate and median length of stay data in an attempt to determine whether revenues are likely to exceed the annual per-beneficiary Medicare cap ("Medicare Cap"). Should we determine that revenues for a program are likely to exceed the Medicare Cap based on projected trends, we attempt to institute corrective action to influence the patient mix or to increase patient admissions. However, should we project our corrective action will not prevent that program from exceeding its Medicare Cap, we estimate the amount of revenue recognized during the period that will require repayment to the US Federal government under the Medicare Cap and record the amount as a reduction to patient revenue.

9

During the three and nine month periods ended September 30, 2006, we recorded a pretax charge of \$5.5 million and \$7.8 million, respectively for Medicare Cap. The components of the pretax charge for the nine months ended September 30, 2006 are as follows (in thousands):

	Phoenix	All Other	Total
2006 Measurement Period	\$3,961	\$2,249	\$6,210
2005 Measurement Period	671	961	1,632
Total	\$4,632	\$3,210	\$7,842

The Phoenix program is discussed in further detail in Note 5 below. Charges for the 2005 measurement period relate to prior year billing limitations resulting from the fiscal intermediary reallocating admissions for deceased Medicaid patients who received hospice care from multiple providers. As of September 30, 2006 and December 31, 2005, respectively, we had \$9.7 million and \$2.4 million accrued in current liabilities in the accompanying balance sheet for the Medicare Cap.

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5. VITAS' Phoenix Program

On September 28, 2006, we announced our intention to exit the hospice market in Phoenix, Arizona. We have been successful in growing admissions of terminally ill patients who reside primarily in assisted living settings. Patients residing in these types of facilities tend to exit curative care and enter into hospice care relatively early in their terminal diagnosis. The current Medicare Cap limits payment for hospice care when a significant portion of the patient census enters into hospice early in their terminal diagnosis. Although we have, on average, relatively short average and median lengths of stay in the majority of our programs, all programs are measured separately and cannot be considered in the aggregate of programs under common control. Due to these billing limitations, the Phoenix program has had an operating loss through the first nine months of 2006. The operating results (unaudited) of the Phoenix program are as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Net revenue before Medicare cap	\$ 2,398	\$2,436	\$ 7,171	\$8,043
Medicare cap	(2,891)	-	(4,632)	-
Net revenue	(493)	2,436	2,539	8,043
Cost of services provided	(1,791)	(1,812)	(5,475)	(5,423)
Selling, general and administrative expenses	(22)	(23)	(65)	(75)
Depreciation	(28)	(9)	(80)	(15)
Amortization	(67)	-	(267)	-
Income (loss) before income taxes	(2,401)	592	(3,348)	2,530
Income tax benefit (provision)	1,068	(256)	1,484	(1,110)
Income (loss) from continuing operations	\$ (1,333)	\$ 336	\$ (1,864)	\$1,420
Impairment charge	\$ (2,419)	\$ -	\$ (2,419)	\$ -
Income tax benefit	1,064	-	1,064	-
Impairment charge, net of tax benefit	\$ (1,355)	\$ -	\$ (1,355)	\$ -

The operating results, balance sheet accounts and cash flows of the Phoenix program have been included in continuing operations for the three and nine months ended September 30, 2006 and 2005. We intend to either close or sell the Phoenix program by December 31, 2006. As a result of our announcement, we performed interim impairment tests of our long-lived assets of the Phoenix operation as of September 30, 2006 in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." An impairment charge of \$2.4 million was recorded for the referral network intangible asset and fixed assets during the third quarter of 2006. The impairment charge is included in income from operations in the accompanying statement of income.

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### 6. Segments

Service revenues and sales and aftertax earnings by business segment are as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
<u>Service Revenues and Sales</u>				
VITAS	\$174,795	\$160,408	\$515,411	\$460,146
Roto-Rooter	78,407	72,920	233,812	218,128
Total	\$253,202	\$233,328	\$749,223	\$678,274
<u>Aftertax Earnings</u>				
VITAS	\$ 7,798	\$ 11,663	\$ 30,054	\$ 31,876
Roto-Rooter	8,509	7,080	22,713	20,265
Total	16,307	18,743	52,767	52,141
Corporate	(6,120)	(4,111)	(17,523)	(18,493)
Discontinued operations	(2,226)	-	(2,226)	(2,015)
Net income	\$ 7,961	\$ 14,632	\$ 33,018	\$ 31,633

Historically, we have allocated stock-based compensation expense to the segment that employs its recipient. In connection with our adoption of SFAS 123(R), we re-assessed the classification within our business segments of stock-based compensation expense and determined that our chief decision maker analyzes stock-based compensation as a corporate expense. Accordingly, all stock-based compensation expense for 2006 and 2005 has been included as a corporate expense in the chart above.

### 7. Earnings per Share

Earnings per share are computed using the weighted average number of shares of capital stock outstanding. Earnings and diluted earnings per share for 2006 and 2005 are computed as follows (in thousands, except per share data):

	Income from Continuing Operations			Net Income		
	Income	Shares	Earnings per Share	Income	Shares	Earnings per Share
<u>For the Three Months Ended September 30,</u>						
2006						
Earnings	\$10,187	26,190	\$0.39	\$7,961	26,190	\$0.30
Dilutive stock options	-	393		-	393	
Nonvested stock awards	-	50		-	50	

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		-----	-----	-----	-----	-----
Diluted earnings	\$10,187	26,633	\$0.38	\$7,961	26,633	\$0.30
	=====	=====	=====	=====	=====	=====
2005						
Earnings	\$14,632	25,719	\$0.57	\$14,632	25,719	\$0.57
			=====			=====
Dilutive stock options	-	617		-	617	
Nonvested stock awards	-	65		-	65	
	-----	-----		-----	-----	
Diluted earnings	\$14,632	26,401	\$0.55	\$14,632	26,401	\$0.55
	=====	=====	=====	=====	=====	=====

11

For the Nine Months Ended September 30,	Income from Continuing Operations			Net Income		
	Income	Shares	Earnings per Share	Income	Shares	Earnings per Share
2006						
Earnings	\$35,244	26,147	\$1.35	\$33,018	26,147	\$1.26
			=====			=====
Dilutive stock options	-	546		-	546	
Nonvested stock awards	-	57		-	57	
	-----	-----		-----	-----	
Diluted earnings	\$35,244	26,750	\$1.32	\$33,018	26,750	\$1.23
	=====	=====	=====	=====	=====	=====
2005						
Earnings	\$33,648	25,453	\$1.32	\$31,633	25,453	\$1.24
			=====			=====
Dilutive stock options	-	676		-	676	
Impact of LTIP shares issued	-	12		-	12	
Nonvested stock awards	-	61		-	61	
	-----	-----		-----	-----	
Diluted earnings	\$33,648	26,202	\$1.28	\$31,633	26,202	\$1.21
	=====	=====	=====	=====	=====	=====

The EPS impact of discontinued operations was \$0.09 for the three and nine months ended September 30, 2006, respectively. The EPS impact of discontinued operations was zero and \$0.08 for the three and nine months ended September 30, 2005, respectively. The diluted EPS impact of discontinued operations was \$0.08 and \$0.09 for the three and nine months ended September 30, 2006, respectively. The diluted EPS impact of discontinued operations was zero and \$0.07 for the three and nine months ended September 30, 2005, respectively.

Excluded from diluted earnings per share were 372,150 and 128,807 stock options outstanding that were determined to be anti-dilutive for the three and nine months ended September 30, 2006, respectively. There were no anti-dilutive stock options outstanding for the comparable periods of 2005.

8. Other Expenses - Net

Other expenses - net, included in continuing operations, comprises the

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following (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Asset impairment related to selling or closing VITAS' Phoenix operation	\$2,419	\$ -	\$2,419	\$ -
Costs related to class action litigation	273	-	273	-
Adjustments to transaction-related costs of the VITAS acquisition	-	(130)	-	(801)
Total other expenses	\$2,692	\$(130)	\$2,692	\$(801)

12

9. Other Income -- Net

Other income - net, included in continuing operations, comprises the following (in thousands):

	Three Months Ended September 30,		Nine Month Septemb
	2006	2005	2006
Interest income	\$426	\$ 530	\$1,977
(Loss)/gain on trading investments of employee benefit trust	340	796	825
(Loss)/gain on disposal of property and equipment	(50)	(67)	(105)
Other - net	(1)	58	37
Total other income	\$715	\$1,317	\$2,734

10. Other Current Liabilities

Other current liabilities as of September 30, 2006 and December 31, 2005 consist of the following (in thousands):

	2006	2005
Accrued legal settlements	\$ 1,946	\$23,108
Accrued divestiture expenses	2,720	3,895
Accrued Medicare Cap estimate	9,728	2,410
Other	13,066	18,845
Total other current liabilities	\$27,460	\$48,258

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### 11. 2002 Executive Long-Term Incentive Plan

No performance targets under the LTIP were reached in the three or nine months ended September 30, 2006. As of September 30, 2006, no accrual was recorded for awards under the earnings component or the remaining market price component of the LTIP since no awards have been granted.

### 12. Long-term Debt and Extinguishment of Debt

On March 31, 2006, we repaid in full our \$84.4 million term loan with JPMorgan Chase Bank. The term loan was paid with a combination of cash on hand and a draw on our revolving credit facility. At that time, we also amended the \$175 million revolving credit facility with JPMorgan Chase Bank to reduce the commitment and annual fees and to reduce the floating interest rate by approximately 50 basis points. The interest rate of the amended revolving credit agreement is LIBOR plus 1.25%. The amended revolving credit facility also includes an "accordion" feature that allows us the opportunity to expand the facility by \$50 million. In connection with the repayment of the term loan, we recorded a write-off of unamortized debt issuance costs of \$430,000.

The following is a schedule by year of required long-term debt payments as of September 30, 2006 (in thousands):

September 2007	\$ 207
September 2008	208
September 2009	159
September 2010	15,429
September 2011	150,000
	-----
Total debt	166,003
Less: Current portion	(207)
	-----
Total long-term debt	\$165,796
	=====

13

We are in compliance with all debt covenants as of September 30, 2006. We have issued \$33.3 million in standby letters of credit as of September 30, 2006 mainly for insurance purposes. Issued letters of credit reduce our available credit under the revolving credit agreement. As of September 30, 2006, we have approximately \$126.3 million of unused lines of credit available and eligible to be drawn down under our revolving credit facility, excluding the accordion feature.

### 13. Loans Receivable from Independent Contractors

The Roto-Rooter segment sublicenses with approximately sixty independent contractors to operate certain plumbing repair and drain cleaning businesses in lesser-populated areas of the United States and Canada. As of September 30, 2006, we had notes receivable from independent contractors totaling \$2.2 million (December 31, 2005-\$2.6 million). In most cases these loans are fully or partially secured by equipment owned by the contractor. The interest rates on the loans range from 5% to 8% per annum and the remaining terms of the loans range from two months to 5.4 years at September 30, 2006. During the three months ended September 30, 2006, we recorded revenues of \$4.5 million (2005-\$4.3 million) and pretax profits of \$1.7 million (2005-\$1.6 million) from our independent contractors. During the nine months ended September 30, 2006, we recorded revenues of \$14.1 million (2005-\$13.3 million) and pretax profits of \$5.5 million (2005-\$4.6 million) from our independent contractors.

We have adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 46R "Consolidation of Variable Interest Entities--an interpretation of Accounting Research Bulletin No. 51 (revised)" ("FIN 46R")



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relative to our contractual relationships with the independent contractors. FIN 46R requires the primary beneficiary of a Variable Interest Entity ("VIE") to consolidate the accounts of the VIE. We have evaluated our relationships with our independent contractors based upon guidance provided in FIN 46R and have concluded that some of the contractors who have loans payable to us may be VIE's. We believe consolidation, if required, of the accounts of any VIE's for which we might be the primary beneficiary would not materially impact our financial position, results of operations or cash flows.

### 14. Pension and Retirement Plans

All of our plans that provide retirement and similar benefits are defined contribution plans. Expenses for our pension and profit-sharing plans, ESOP's, excess benefit plans and other similar plans are \$2.6 million and \$3.4 million for the three months ended September 30, 2006 and 2005, respectively. Expenses for our pension and profit-sharing plans, ESOP's, excess benefit plans and other similar plans are \$7.5 million and \$8.7 million for the nine months ended September 30, 2006 and 2005, respectively.

### 15. Litigation

We are party to a class action lawsuit filed in the Third Judicial Circuit Court of Madison County, Illinois in June of 2000 by Robert Harris, alleging certain Roto-Rooter plumbing was performed by unlicensed employees. We contested these allegations and believe them without merit. Plaintiff moved for certification of a class of customers in 32 states who allegedly paid for plumbing work performed by unlicensed employees. Plaintiff also moved for partial summary judgment on grounds the licensed apprentice plumber who installed his faucet did not work under the direct personal supervision of a licensed master plumber. On June 19, 2002, the trial judge certified an Illinois-only plaintiffs class and granted summary judgment for the named party Plaintiff on the issue of liability, finding violation of the Illinois Plumbing License Act and the Illinois Consumer Fraud Act through Roto-Rooter's representation of the licensed apprentice as a plumber. The court did not rule on certification of a class in the remaining 31 states. In December 2004, we reached a resolution of this matter with the Plaintiff. The court approved this settlement in July 2006. We accrued \$3.1 million in 2004 as the anticipated cost of settling this litigation.

Like other large California employers, our VITAS subsidiary faces allegations of purported class-wide wage and hour violations. It was party to a class action lawsuit filed in the Superior Court of California, Los Angeles County, in April of 2004 by Ann Marie Costa, Ana Jimenez, Mariea Ruteaya and Gracetta Wilson ("Costa"). This case alleged failure to pay overtime wages for hours worked "off the clock" on administrative tasks, including voicemail retrieval, time entry, travel to and from work, and pager response. This case also alleged VITAS failed to provide meal and break periods to a purported class of California nurses, home health aides and licensed clinical social workers. The case also sought payment of penalties, interest, and Plaintiffs' attorney fees. VITAS contested these allegations.

Plaintiff moved for class certification, and VITAS opposed this motion. We have reached an agreement with the Plaintiff class in order to avoid the uncertainty of litigation and the diversion of resources and personnel resulting from the litigation. In connection with our acquisition of VITAS in February 2004, we recorded a liability of \$2.3 million on VITAS' opening balance sheet for this case. At that time, this represented our best estimate of our exposure in the matter. As a result of the tentative resolution, we recorded a pretax charge of \$17.4 million (\$10.8 million aftertax) in the fourth quarter of 2005, representing the portion of this settlement not accounted for on Vitas' opening balance sheet. These amounts are inclusive of Plaintiffs' class attorneys' fees and the costs of settlement administration. On April 24, 2006, the court granted preliminary approval of the settlement and we funded \$15 million of the settlement in May 2006. On June 26, 2006, the court granted final approval of

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the settlement.

14

VITAS is party to a class action lawsuit filed in the Superior Court of California, Los Angeles County, in September 2006 by Bernadette Santos, Keith Knoche and Joyce White ("Santos"). This case, filed by the Costa case plaintiffs' counsel, makes similar allegations of failure to pay overtime and failure to provide meal and rest periods to a purported class of California admissions nurses, chaplains and sales representatives. The case likewise seeks payment of penalties, interest and plaintiffs' attorney fees. VITAS contests these allegations. The lawsuit is in its early stage and we are unable to estimate our potential liability, if any, with respect to these allegations. Regardless of outcome, defense of litigation adversely affects us through defense costs, diversion of our time and related publicity.

In the normal course of business, we are a party to various claims and legal proceedings. We record a reserve for these matters when an adverse outcome is probable and the amount of the potential liability is reasonably estimable.

### 16. OIG Investigation

On April 7, 2005, we announced the Office of Inspector General ("OIG") for the Department of Health and Human Services served VITAS with civil subpoenas relating to VITAS' alleged failure to appropriately bill Medicare and Medicaid for hospice services. As part of this investigation, the OIG selected medical records for 320 past and current patients from VITAS' three largest programs for review. It also sought policies and procedures dating back to 1998 covering admissions, certifications, recertifications and discharges. During the third quarter of 2005 and again in May 2006, the OIG requested additional information from us. A qui tam complaint has been filed in U.S. District Court for the Southern District of Florida. We are conferring with the U.S. Attorney regarding our defenses to the complaint allegations. The U.S. Attorney has not decided whether to intervene in the qui tam action. We have incurred pretax expense related to complying with OIG requests of \$344,000 for the quarter ended September 30, 2006 and \$818,000 for the nine months ended September 30, 2006.

The government continues to investigate the complaint's allegations, against which VITAS is presently defending. We are unable to predict the outcome of this matter or the impact, if any, that the investigation may have on the business, results of operations, liquidity or capital resources. Regardless of outcome, responding to the subpoenas can adversely affect us through defense costs, diversion of our time and related publicity.

### 17. Patient Care Settlement

On September 28, 2006, we announced a preliminary settlement in regard to litigation related to the 2002 divestiture of our Patient Care business segment. In connection with the sale of Patient Care in 2002, \$5.0 million of the cash purchase price was placed in escrow pending collection of third-party payer receivables on Patient Care's balance sheet at the sale date. As of that date, \$4.2 million had been returned and the remainder was being withheld pending the settlement of certain third-party payer claims. We have a long-term receivable due in October 2007 from Patient Care of \$12.5 million. We also had current accounts receivable from Patient Care for the post-closing balance sheet valuation and for expenses paid by us after closing on Patient Care's behalf of \$3.4 million. We were in litigation with Patient Care over the collection of these current amounts and their allegations that our acquisition of VITAS violated a non-compete covenant in the sales agreement. We also have a warrant to purchase 2% of Patient Care's common stock that we recorded as a \$1.4 million investment.

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We settled this case in October 2006. We agreed to forgive \$1.2 million of the current receivable related to the post-closing balance sheet valuation and convert the remaining amount into debt secured by a promissory note with the same terms as the \$12.5 million long-term receivable. We have incurred additional costs related to the settlement of \$1.1 million for additional insurance and legal costs related to workers' compensation claims incurred prior to the sale. An after tax charge of \$1.5 million has been recorded as discontinued operations in the accompanying unaudited consolidated statement of income for the three and nine months ended September 30, 2006. As a part of the settlement, we determined that the value of the warrants has been permanently impaired and have recorded a pretax impairment charge of \$1.4 million. This charge is included in income from continuing operations on the statement of income.

15

### 18. Related Party Agreements

In October 2004, VITAS entered into a pharmacy services agreement ("Agreement") with Omnicare, Inc. ("OCR") whereby OCR will provide specified pharmacy services for VITAS and its hospice patients in geographical areas served by both VITAS and OCR. The Agreement has an initial term of three years that renews automatically thereafter for one-year terms. Either party may cancel the Agreement at the end of any term by giving written notice at least 90 days prior to the end of said term. In June 2004, VITAS entered into a pharmacy services agreement with excelleRx. The agreement has a one-year term and automatically renews unless either party provides a 90-day written termination notice. Subsequent to June 2004, OCR acquired excelleRx. Under both agreements, VITAS made purchases of \$8.0 million and \$22.3 million for the three and nine month periods ended September 30, 2006 and has accounts payable of \$4.2 million at September 30, 2006. Mr. E. L. Hutton is non-executive Chairman and a director of the Company and OCR. Mr. Joel F. Gemunder, President and Chief Executive Officer of OCR, Mr. Charles H. Erhart, Jr. and Ms. Sandra Laney are directors of both OCR and the Company. Mr. Kevin J. McNamara, President, Chief Executive Officer and director of the Company, is a director emeritus of OCR. We believe that the terms of these agreements are no less favorable to VITAS than we could negotiate with an unrelated party.

### 19. Cash Overdrafts Payable

Included in accounts payable at September 30, 2006 are cash overdrafts payable of \$10.2 million (December 31, 2005 - \$8.0 million).

### 20. Change in Accounting Principle

Effective September 30, 2006, we changed the date of our annual goodwill impairment analysis to October 1. Previously, we performed this annual goodwill impairment test on December 31. We believe this change in accounting principle is preferable because the new date coincides with the US federal government's fiscal year end of September 30 and therefore allows for a better estimation of the Medicare related cash flows of our VITAS business. Medicare pays in excess of 90% of VITAS' revenue. Of the total goodwill recorded as of September 30, 2006, approximately 75% is related to VITAS. Due to the Medicare Cap discussed above, October 1 is the date when cash flows from our hospice programs are most predictable. The change in accounting principle will have no effect on our consolidated financial statements.

### 21. Recent Accounting Statements

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in the Current Year Financial Statements" ("SAB 108"). Traditionally, there have been two widely recognized methods for quantifying the effects of financial statement misstatements. The first, called the "roll-over" method, focuses primarily on the income statement effect of a misstatement but

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its use can lead to the accumulation of misstatements on the balance sheet. The other method, referred to as the "iron curtain" method, focuses primarily on the balance sheet effect of a misstatement but its use can cause out-of-period adjustments in the income statement. We currently use the roll-over method.

SAB 108 requires companies to evaluate financial statement misstatements using both methods, referred to as the "dual approach." An issuer may either restate all periods presented as if the dual approach had always been used or record the cumulative effect of using the dual approach to assets and liabilities with an offsetting adjustment to the opening balance of retained earnings as of January 1, 2006. We believe there will be no material impact on our financial statements as a result of adopting SAB 108.

In September 2006, the FASB issued Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" ("SFAS 158"). The new standard will require employers to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare and other postretirement plans in their financial statements. Under past accounting standards, the funded status of an employer's postretirement benefit plan (i.e., the difference between the plan assets and obligations) was not always completely reported in the balance sheet. Employers reported an asset or liability that almost always differed from the plan's funded status because previous accounting standards allowed employers to delay recognition of certain changes in plan assets and obligations that affected the costs of providing such benefits. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006. We believe there will be no material impact on our financial statements as a result of adopting SFAS 158.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("SFAS 157"), which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles (GAAP). It sets a common definition of fair value to be used throughout GAAP. The new standard is designed to make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently evaluating the impact that SFAS 157 will have on our financial condition and results of operations.

In September 2006, the FASB issued a staff position related to the accounting for planned major maintenance activities. The staff position sets forth four alternative methods of accounting for planned major maintenance activities but disallowed the accrue-in-advance method. The accrue-in-advance method provides for estimating the cost of major maintenance activities and accruing that cost in advance of the maintenance being performed. The guidance is effective for the first fiscal year beginning after December 15, 2006. We are currently evaluating the impact that this staff position will have on accounting related to our transportation equipment.

In July 2006, the FASB issued Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement 109", which prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return. Upon adoption of FIN 48, the financial statements will reflect expected future tax consequences of such uncertain positions assuming the taxing authorities' full knowledge of the position and all relevant facts. FIN 48 also revises disclosure requirements and introduces an annual, tabular roll-forward of the unrecognized tax benefits.

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This interpretation is effective as of the beginning of fiscal years starting after December 15, 2006. We are currently evaluating the impact FIN 48 will have on our financial condition and results of operations.

In February 2006, the FASB issued Statement No. 155, "Accounting for Certain Hybrid Financial Instruments", which nullifies and amends various accounting guidance relating to accounting for derivative instruments and securitization transactions. In general, these changes will reduce the operational complexity associated with bifurcating embedded derivatives, and increase the number of beneficial interests in securitization transactions. This statement is effective for all financial instruments acquired or issued after the beginning of our first fiscal year that begins after September 15, 2006. Because we do not have any material derivative instruments or securitization transactions, we believe there will be no material impact on our financial condition, results of operations or cash flows upon adoption.

17

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### Executive Summary

We operate through two wholly owned subsidiaries, VITAS Healthcare Corporation and Roto-Rooter Group, Inc. VITAS focuses on hospice care that helps make terminally ill patients' final days as comfortable as possible. Through its team of doctors, nurses, home health aides, social workers, clergy and volunteers, VITAS provides direct medical services to patients, as well as spiritual and emotional counseling to both patients and their families. Roto-Rooter's services are focused on providing plumbing and drain cleaning services to both residential and commercial customers. Through its network of company-owned branches, independent contractors and franchisees, Roto-Rooter offers plumbing and drain cleaning service to over 90% of the U.S. population.

The following is a summary of the key operating results for the three and nine months ended September 30, 2006 and 2005 (in thousands except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Consolidated service revenues and sales	\$253,202	\$233,328	\$749,223	\$678,274
Consolidated income from continuing operations	\$ 10,187	\$ 14,632	\$ 35,244	\$ 33,648
Diluted EPS from continuing operations	\$ 0.38	\$ 0.55	\$ 1.32	\$ 1.28

The increase in consolidated service revenues and sales for the three months ended September 30, 2006 was driven by a 9% increase at VITAS and an 8% increase at Roto-Rooter. The increase at VITAS was primarily the result of a 9% increase in average daily census (ADC) from the third quarter of 2005. The decrease in revenue caused by the charge taken for the Medicare Cap of \$5.5 million offset the October 1, 2005 Medicare reimbursement rate increase of approximately 3%. The 8% increase at Roto-Rooter was driven primarily by a combination of job mix and price increases. Job count was essentially flat for

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the quarter. Consolidated income from continuing operations and diluted EPS from continuing operations decreased from the comparable three month period of 2005 due to the Medicare Cap charge, the impairment charge taken for VITAS' Phoenix program, the write-off of the Patient Care warrant and decreased margins at VITAS. As further shown in the results of operations section, consolidated income from continuing operations and diluted EPS from continuing operations include special items and adjustments that decreased aftertax earnings by \$1.2 million and increased aftertax earnings by \$1.7 million for the three months ended September 30, 2006 and 2005, respectively.

The increase in consolidated service revenues and sales for the nine months ended September 30, 2006 was driven by a 12% increase at VITAS and a 7% increase at Roto-Rooter. The increase at VITAS was primarily the result of a 10% increase in average daily census (ADC) from the first nine months of 2005 and the October 1, 2005 Medicare reimbursement rate increase of approximately 3%. The increase at VITAS was partially offset by a \$7.8 million reduction in revenue for Medicare Cap billing limitations. The increase at Roto-Rooter was driven primarily by a 1% increase in job count combined with an approximate 6% price increase. Consolidated income from continuing operations and diluted EPS from continuing operations increased as a result of the higher service revenues and sales, offset by the impairment charge taken for the Phoenix operation, the write-off of the Patient Care warrants and decreased margins at VITAS. As further shown in the results of operations section, consolidated income from continuing operations and diluted EPS from continuing operations include special items and adjustments that decreased aftertax earnings by \$1.8 million and \$1.3 million for the nine months ended September 30, 2006 and 2005, respectively.

Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards No. 123, revised ("SFAS 123(R)") which establishes accounting for stock-based compensation for employees. Under SFAS 123(R), stock-based compensation cost is measured at the grant date, based on the fair value of the award and recognized as expense over the employee's requisite service period. We previously applied Accounting Principles Board Opinion No. 25 and provided the pro-forma disclosures required by Statement of Financial Accounting Standards No. 123. We elected to adopt the modified prospective transition method as provided by SFAS 123(R). Accordingly, previously reported financial statement amounts have not been restated. We have determined that the Black-Scholes option pricing model to calculate the fair value of our stock options is appropriate in the circumstances. We also used the Black-Scholes model for purposes of the pro-forma disclosures under SFAS 123. There was no material impact on our financial position, results of operations or cash flows as a result of the adoption of SFAS 123(R).

18

Effective September 30, 2006, we changed the date of our annual goodwill impairment analysis to October 1. Previously, we performed this annual goodwill impairment test on December 31. We believe this change in accounting principle is preferable because the new date coincides with the US federal government's fiscal year end of September 30 and therefore allows for a better estimation of the Medicare related cash flows of our VITAS business. Medicare pays in excess of 90% of VITAS' revenue. Of the total goodwill recorded as of September 30, 2006, approximately 75% is related to VITAS. Due to the Medicare Cap discussed above, October 1 is the date when cash flows from our hospice programs are most predictable. The change in accounting principle will have no effect on our consolidated financial statements.

Financial Condition

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Liquidity and Capital Resources

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Significant changes in the balance sheet accounts from December 31, 2005 to September 30, 2006 include the following:

- o The \$51.7 million decline in cash and cash equivalents from \$57.1 million at December 31, 2005 to \$5.4 million at September 30, 2006 is primarily attributable to the use of \$69.1 million in cash to repay our \$84.4 million term note, the use of approximately \$20 million in cash to fund the Costa case settlement, the use of approximately \$8.3 million for purchases of treasury stock and the delay in the monthly U.S. federal government payment for VITAS services. The U.S. federal government generally pays VITAS in the same month hospice care was provided. The payment due September 29, 2006 of \$23.9 million was delayed until early October by the U.S. federal government due to its budgetary constraints. The cash uses were partially offset by cash provided by operations.
- o The decrease in other current liabilities of \$20.8 million is primarily attributable to our funding of the Costa settlement during the second and third quarter of 2006. The legal accrual for the Costa case of \$19.7 million at December 31, 2005 was classified in other current liabilities.
- o The reduction in long-term debt from \$234.1 million at December 31, 2005 to \$165.8 million at September 30, 2006 resulted from repayment of our \$84.4 million term loan with JPMorgan Chase in March 2006, partially offset by borrowings on our revolving line of credit to fund a portion of the repayment.

We have issued \$33.3 million in standby letters of credit as of September 30, 2006 mainly for insurance purposes. Issued letters of credit reduce our available credit under the revolving credit agreement. As of September 30, 2006, we have approximately \$126.3 million of unused lines of credit available and eligible to be drawn down under our revolving credit facility, excluding the accordion feature. We believe our liquidity and sources of capital are satisfactory for our needs in the foreseeable future.

### Commitments and Contingencies

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Collectively, the terms of our credit agreements provide that we are required to meet various financial covenants, to be tested quarterly. We are in compliance with all financial and other debt covenants as of September 30, 2006 and anticipate remaining in compliance throughout 2006.

We are party to a class action lawsuit filed in the Third Judicial Circuit Court of Madison County, Illinois in June of 2000 by Robert Harris, alleging certain Roto-Rooter plumbing was performed by unlicensed employees. We contested these allegations and believe them without merit. Plaintiff moved for certification of a class of customers in 32 states who allegedly paid for plumbing work performed by unlicensed employees. Plaintiff also moved for partial summary judgment on grounds the licensed apprentice plumber who installed his faucet did not work under the direct personal supervision of a licensed master plumber. On June 19, 2002, the trial judge certified an Illinois-only plaintiffs class and granted summary judgment for the named party Plaintiff on the issue of liability, finding violation of the Illinois Plumbing License Act and the Illinois Consumer Fraud Act through Roto-Rooter's representation of the licensed apprentice as a plumber. The court did not rule on certification of a class in the remaining 31 states. In December 2004, we reached a resolution of this matter with the Plaintiff. The court approved this settlement in July 2006. We accrued \$3.1 million in 2004 as the anticipated cost of settling this litigation.

Like other large California employers, our VITAS subsidiary faces

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allegations of purported class-wide wage and hour violations. It was party to a class action lawsuit filed in the Superior Court of California, Los Angeles County, in April of 2004 by Ann Marie Costa, Ana Jimenez, Mariea Ruteaya and Gracetta Wilson ("Costa"). This case alleged failure to pay overtime wages for hours worked "off the clock" on administrative tasks, including voicemail retrieval, time entry, travel to and from work, and pager response. This case also alleged VITAS failed to provide meal and break periods to a purported class of California nurses, home health aides and licensed clinical social workers. The case also sought payment of penalties, interest, and Plaintiffs' attorney fees. VITAS contested these allegations.

19

Plaintiff moved for class certification, and VITAS opposed this motion. We have reached an agreement with the Plaintiff class in order to avoid the uncertainty of litigation and the diversion of resources and personnel resulting from the litigation. In connection with our acquisition of VITAS in February 2004, we recorded a liability of \$2.3 million on VITAS' opening balance sheet for this case. At that time, this represented our best estimate of our exposure in the matter. As a result of the tentative resolution, we recorded a pretax charge of \$17.4 million (\$10.8 million aftertax) in the fourth quarter of 2005, representing the portion of this settlement not accounted for on Vitas' opening balance sheet. These amounts are inclusive of Plaintiffs' class attorneys' fees and the costs of settlement administration. On April 24, 2006, the court granted preliminary approval of the settlement and we funded \$15 million of the settlement in May 2006. On June 26, 2006, the court granted final approval of the settlement.

VITAS is party to a class action lawsuit filed in the Superior Court of California, Los Angeles County, in September 2006 by Bernadette Santos, Keith Knoche and Joyce White ("Santos"). This case, filed by the Costa case plaintiffs' counsel, makes similar allegations of failure to pay overtime and failure to provide meal and rest periods to a purported class of California admissions nurses, chaplains and sales representatives. The case likewise seeks payment of penalties, interest and plaintiffs' attorney fees. VITAS contests these allegations. The lawsuit is in its early stage and we are unable to estimate our potential liability, if any, with respect to these allegations. Regardless of outcome, defense of litigation adversely affects us through defense costs, diversion of our time and related publicity.

On April 7, 2005, we announced the Office of Inspector General ("OIG") for the Department of Health and Human Services served VITAS with civil subpoenas relating to VITAS' alleged failure to appropriately bill Medicare and Medicaid for hospice services. As part of this investigation, the OIG selected medical records for 320 past and current patients from VITAS' three largest programs for review. It also sought policies and procedures dating back to 1998 covering admissions, certifications, recertifications and discharges. During the third quarter of 2005 and again in May 2006, the OIG requested additional information from us. A qui tam complaint has been filed in U.S. District Court for the Southern District of Florida. We are conferring with the U.S. Attorney regarding our defenses to the complaint allegations. The U.S. Attorney has not decided whether to intervene in the qui tam action. We have incurred pretax expense related to complying with OIG requests of \$344,000 for the quarter ended September 30, 2006 and \$818,000 for the nine months ended September 30, 2006.

The government continues to investigate the complaint's allegations, against which VITAS is presently defending. We are unable to predict the outcome of this matter or the impact, if any, that the investigation may have on the business, results of operations, liquidity or capital resources. Regardless of outcome, responding to the subpoenas can adversely affect us through defense costs, diversion of our time and related publicity.



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### Results of Operations

#### Third Quarter 2006 versus Third Quarter 2005-Consolidated Results

Our service revenues and sales for the third quarter of 2006 increased 8.5% versus the third quarter of 2005. Of this increase, \$14.4 million was attributable to VITAS and \$5.5 million was attributable to Roto-Rooter, as follows (dollars in thousands):

	Increase/(Decrease)	
	Amount	Percent
VITAS		
Routine Homecare	\$16,309	14.6%
Continuous Care	3,012	11.1%
General Inpatient	569	2.7%
Less: Medicare Cap	(5,503)	-
Roto-Rooter		
Plumbing	2,556	8.5%
Drain Cleaning	2,722	8.5%
Other	209	1.9%
	-----	
Total	\$19,874	8.5%
	=====	

20

The increase in VITAS' revenues for the third quarter of 2006 versus the third quarter of 2005 is attributable to increases in ADC of 9.9% and 7.0%, respectively, for routine homecare and continuous care. General inpatient ADC was unchanged between periods. ADC is a key measure we use to monitor volume growth in our hospice business. Changes in total program admissions and average length of stay for our patients are the main drivers of changes in ADC. The remainder of the revenue increase is due primarily to the annual increase in Medicare reimbursement rates in the fourth quarter of 2005. In excess of 90% of VITAS' revenues for both periods were from Medicare and Medicaid. The increase in VITAS revenue was partially offset by a reduction of \$5.5 million for Medicare Cap including \$2.9 million for the Phoenix program. The revenue reduction is the result of three programs reaching the Medicare Cap revenue limitation during the third quarter of 2006, including the Phoenix program.

The increase in the plumbing revenues for the third quarter of 2006 versus 2005 comprises a 0.4% decrease in the number of jobs performed and an 8.9% increase in the average price per job. The increase in drain cleaning revenues for the third quarter of 2006 versus 2005 comprised a 0.4% decrease in the number of jobs and an 8.9% increase in the average price per job. The increase in other revenues is attributable primarily to increased revenue from independent contractor operations.

The consolidated gross margin was 26.1% in the third quarter of 2006 as compared with 29.1% in the third quarter of 2005. On a segment basis, VITAS' gross margin was 17.4% in the third quarter of 2006 and 21.7% in the third quarter of 2005. The decrease in VITAS' gross margin in the third quarter of 2006 is primarily attributable to the \$5.5 million reduction in revenue related to Medicare Cap billing limitations. This represents a decrease in VITAS margin of 3.1%. The remaining margin decrease is primarily the result of increased manpower and labor capacity relative to ADC. Given the inherent difficulty in hiring and retaining qualified healthcare professionals, management continued to build manpower in anticipation of an increase in admissions and overall census

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in the majority of its programs in the fourth quarter of 2006. Roto-Rooter segment's gross margin was 45.4% in the third quarter of 2006 and 45.7% in the third quarter of 2005.

Selling, general and administrative expenses ("SG&A") for the third quarter of 2006 were \$39.2 million, an increase of \$737,000 (1.9%) versus the third quarter of 2005. The increase is largely due to higher revenues by both segments which increase certain variable selling costs.

Other expenses - net, included in income from operations, include an impairment charge of \$2.4 million related to our intention to close or sell VITAS' Phoenix program by December 31, 2006. As a result of our announcement, we performed interim impairment tests of our long-lived assets of the Phoenix operation as of September 30, 2006 in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The impairment charge was recorded for the referral network intangible asset and fixed assets.

Income from operations decreased \$6.0 million from \$24.5 million in the third quarter of 2005 to \$18.5 million in the third quarter of 2006. The decrease is attributable to the decrease in gross margin and the Phoenix impairment charge.

Interest expense, substantially all of which is incurred at Corporate, declined from \$5.1 million in the third quarter of 2005 to \$4.1 million in the third quarter of 2006. This decline is due primarily to the reduction of outstanding debt balances.

As part of our Patient Care settlement, we determined that the value of the warrant has been permanently impaired and have recorded a pretax impairment charge of \$1.4 million. This charge is included in income from continuing operations on the statement of income.

Our effective income tax rate decreased from 29.1% in the third quarter of 2005 to 25.8% in the third quarter of 2006. The decrease relates to adjustments made upon expiration of certain statutes of limitations.

21

Income from continuing operations decreased \$4.4 million or 30% in the third quarter of 2006 as compared to the third quarter of 2005. Income from continuing operations for both periods included the following aftertax special items/adjustments that increased/(reduced) aftertax earnings (in thousands):

	Three Months Ended September 30,	
	2006	2005
Asset impairment charges related to selling or closing VITAS' Phoenix operation	\$(1,355)	\$ -
Loss from impairment of investment	(918)	-
Stock option expense	(379)	-
Legal expenses of OIG investigation	(213)	(192)
Costs related to class action litigation	(169)	-
Tax adjustments upon expiration of certain statutes	1,791	1,787

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Adjustments to transaction costs	-	130
	-----	-----
	\$ (1,243)	\$1,725
	=====	=====

In addition, VITAS' Phoenix program recorded an aftertax operating loss of \$2.7 million in the third quarter of 2006 including the impairment charge, as compared to aftertax operating income of \$337,000 for the comparable period of 2005.

Discontinued operations in the third quarter of 2006 include aftertax charges related to the settlement of certain items related to our sale of Patient Care in 2002 and additional charges related to environmental costs in connection with DuBois Chemical which we sold in 1991.

### Third quarter 2006 versus Third quarter 2005-Segment Results

The change in net income for the third quarter of 2006 versus the third quarter of 2005 is due to (dollars in thousands):

	Net Income Increase/ (Decrease)	
	Amount	Percent
VITAS	\$ (3,865)	-33.1%
Roto-Rooter	1,429	20.2%
Corporate	(2,009)	-48.9%
Discontinued operations	(2,226)	-
	-----	
	\$ (6,671)	-45.6%
	=====	

22

### First Nine Months of 2006 versus First Nine Months of 2005-Consolidated Results

Our service revenues and sales for the first nine months of 2006 increased 10.5% versus the first nine months of 2005. Of this increase, \$55.2 million was attributable to VITAS and \$15.7 million was attributable to Roto-Rooter, as follows (dollars in thousands):

	Increase/ (Decrease)	
	Amount	Percent
VITAS		
Routine Homecare	\$47,447	14.9%
Continuous Care	12,182	15.7%
General Inpatient	3,479	5.5%
Less: Medicare Cap	(7,843)	-
Roto-Rooter		
Plumbing	5,784	6.6%
Drain Cleaning	8,671	8.9%
Other	1,229	3.7%
	-----	

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Total	\$70,949	10.5%
	=====	

The increase in VITAS' revenues for the first nine months of 2006 versus the first nine months of 2005 is attributable to increases in ADC of 10.1%, 10.2% and 2.2%, respectively, for routine homecare, continuous care and general inpatient. ADC is a key measure we use to monitor volume growth in our hospice business. Changes in total program admissions and average length of stay for our patients are the main drivers of changes in ADC. The remainder of the revenue increase is due primarily to the annual increase in Medicare reimbursement rates in the fourth quarter of 2005. In excess of 90% of VITAS' revenues for both periods were from Medicare and Medicaid. The increase in VITAS revenue was partially offset by a reduction of \$7.8 million for Medicare Cap including \$4.6 million for the Phoenix program. The revenue reduction is the result of three programs reaching the Medicare Cap revenue limitation during the first nine months of 2006.

The increase in the plumbing revenues for the first nine months of 2006 versus 2005 comprises a 0.4% increase in the number of jobs performed and a 6.2% increase in the average price per job. The increase in drain cleaning revenues for the first nine months of 2006 versus 2005 comprised a 0.9% increase in the number of jobs and a 8.0% increase in the average price per job. The average price per job for both plumbing and drain cleaning was positively impacted by the continued shift to commercial jobs. Overall, the number of commercial jobs increased 1.3% while the number of residential jobs increased 0.5%. This is a favorable shift in job mix since a commercial job averaged approximately 33% more revenue per job through the first nine months of 2006 than a residential job. The increase in other revenues is attributable primarily to increased revenue from the independent contractor operations.

The consolidated gross margin was 27.1% in the first nine months of 2006 as compared with 29.3% in the first nine months of 2005. On a segment basis, VITAS' gross margin was 18.8% in the first nine months of 2006 and 21.4% in the first nine months of 2005. The decrease in VITAS' gross margin in 2006 is primarily attributable to the \$7.8 million reduction in revenue for the Medicare Cap billing limitation and excess patient care capacity experienced in the first and third quarter of 2006. Roto-Rooter segment's gross margin was 45.4% in the first nine months of 2006 and 46.1% in the first nine months of 2005. The decrease in Roto-Rooter's gross margin in 2006 is primarily attributable to a benefit realized in the first quarter of 2005 of \$1.6 million (pretax) related to prior period casualty insurance claims.

Selling, general and administrative expenses ("SG&A") for the first nine months of 2006 were \$116.3 million, an increase of \$1.3 million (1.1%) versus the first nine months of 2005. The increase is largely due to higher revenues by both segments which increase certain variable selling costs, such as commissions.

Other expenses - net, included income from operations, include an impairment charge of \$2.4 million related to our intention to close or sell VITAS' Phoenix program by December 31, 2006. As a result of our announcement, we performed interim impairment tests of our long-lived assets of the Phoenix operation as of September 30, 2006 in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The impairment charge was recorded for the referral network intangible asset and fixed assets.

Income from operations decreased \$1.7 million from \$69.2 million in the

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first nine months of 2005 to \$67.5 million in the first nine months of 2006. The decrease in the consolidated gross margin and the Phoenix impairment charge caused the decrease.

Interest expense, substantially all of which is incurred at Corporate, declined from \$16.0 million in the first nine months of 2005 to \$13.7 million in the first nine months of 2006. This decline is due primarily to the reduction in debt outstanding that occurred as a result of the February 2005 and 2006 refinancings, as well as subsequent debt payments.

We tentatively settled our litigation with Patient Care in the third quarter of 2006. As part of the settlement, we determined that the value of the warrant has been permanently impaired and recorded a pretax impairment charge of \$1.4 million. This charge is included in income from continuing operations on the statement of income.

Loss on extinguishment of debt decreased from \$4.0 million in the first nine months of 2005 to \$430,000 in the first nine months of 2006. The 2005 loss on extinguishment relates to the refinancing in February 2005. The loss on extinguishment in 2006 relates to the early repayment of our \$84.4 million term loan in March 2006.

Our effective income tax rate increased from 35.1% in the first nine months of 2005 to 35.5% in the first nine months of 2006.

Income from continuing operations increased \$1.6 million or 4.7% in the first nine months of 2006 as compared to the first nine months of 2005. Income from continuing operations for both periods included the following aftertax special items/adjustments that increased/(reduced) aftertax earnings (in thousands):

	Nine Months Ended September 30,	
	2006	2005
Asset impairment charges related to selling or closing VITAS' Phoenix operation	\$ (1,355)	\$ -
Loss from impairment of investment	(918)	-
Legal expenses of OIG investigation	(507)	(352)
Stock option expense	(391)	(137)
Loss on extinguishment of debt	(273)	(2,523)
Costs related to class action litigation	(169)	-
Tax adjustments upon expiration of certain statutes	1,791	1,787
LTIP	-	(1,847)
Adjustments to transaction costs	-	801
Favorable adjustment for insurance	-	1,014
	\$ (1,822)	\$ (1,257)
	=====	=====

In addition, VITAS' Phoenix program recorded an aftertax operating loss of \$3.2 million in the first nine months of 2006 including the impairment charge, as compared to aftertax operating income of \$1.4 million for the comparable period of 2005.

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First Nine Months of 2006 versus First Nine Months of 2005—Segment Results

The change in net income for the first nine months of 2006 versus the first nine months of 2005 is due to (dollars in thousands):

	Net Income Increase/(Decrease)	
	Amount	Percent
VITAS	\$ (1,822)	-5.7%
Roto-Rooter	2,448	12.1%
Corporate	970	5.2%
Discontinued operations	(211)	-10.5%
	<u>\$1,385</u>	<u>4.4%</u>

The following chart updates historical unaudited financial and operating data of VITAS, acquired in February 2004 (dollars in thousands, except dollars per patient day):

25

CHEMED CORPORATION AND SUBSIDIARY COMPANIES  
OPERATING STATISTICS FOR VITAS SEGMENT  
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2006 AND 2005  
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
OPERATING STATISTICS				
Net revenue (\$000) (a)				
Homecare	\$128,268	\$111,959	\$366,888	\$319,441
Inpatient	21,890	21,321	66,779	63,300
Continuous care	30,140	27,128	89,587	77,405
	<u>\$180,298</u>	<u>\$160,408</u>	<u>\$523,254</u>	<u>\$460,146</u>
Total before Medicare cap allowance				
Medicare cap allowance	(5,503)	-	(7,843)	-
	<u>\$174,795</u>	<u>\$160,408</u>	<u>\$515,411</u>	<u>\$460,146</u>
Net revenue as a percent of total before Medicare cap allowance				
Homecare	71.2	% 69.8	% 70.1	% 69.4
Inpatient	12.1	13.3	12.8	13.8
Continuous care	16.7	16.9	17.1	16.8
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Total before Medicare cap allowance	100.0	100.0	100.0	100.0

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Medicare cap allowance	(3.1)	-	(1.5)	-
Total	96.9	% 100.0	% 98.5	% 100.0 %
Average daily census ("ADC") (days)				
Homecare	6,670	5,972	6,419	5,719
Nursing home	3,590	3,366	3,484	3,276
Routine homecare	10,260	9,338	9,903	8,995
Inpatient	401	404	413	404
Continuous care	552	517	553	502
Total	11,213	10,259	10,869	9,901
Total Admissions	12,753	12,375	39,718	37,969
Total Discharges	12,621	12,025	38,640	36,766
Average length of stay (days)	71.0	66.5	70.5	66.8
Median length of stay (days)	14.0	13.0	13.0	12.0
ADC by major diagnosis				
Neurological	33.6	% 32.1 %	33.4	% 32.0 %
Cancer	20.1	21.3	20.1	21.4
Cardio	14.7	14.9	14.9	15.1
Respiratory	6.9	7.1	7.1	7.1
Other	24.7	24.6	24.5	24.4
Total	100.0	% 100.0 %	100.0	% 100.0 %
Admissions by major diagnosis				
Neurological	19.3	% 18.0 %	19.9	% 18.8 %
Cancer	37.0	38.3	35.4	36.6
Cardio	12.4	12.4	13.2	13.5
Respiratory	6.7	6.3	7.2	7.2
Other	24.6	25.0	24.3	23.9
Total	100.0	% 100.0 %	100.0	% 100.0 %
Direct patient care margins (b)				
Routine homecare	49.1	% 50.4 %	48.8	% 49.9 %
Inpatient	16.5	21.3	20.2	22.4
Continuous care	17.5	18.1	18.7	18.4
Homecare margin drivers (dollars per patient day)				
Labor costs	\$ 48.21	\$45.04	\$ 49.15	\$45.58
Drug costs	8.46	7.66	8.12	7.71
Home medical equipment	5.66	5.45	5.58	5.48
Medical supplies	2.21	2.23	2.15	2.18
Inpatient margin drivers (dollars per patient day)				
Labor costs	\$ 269.72	\$242.70	\$ 257.82	\$240.61
Continuous care margin drivers (dollars per patient day)				
Labor costs	\$ 467.65	\$447.99	\$ 461.89	\$441.83
Bad debt expense as a percent of revenues				
Accounts receivable -- days of revenue outstanding	0.9 %	0.9 %	0.9 %	0.9 %
	42.1	42.1	N/A	N/A

(a) VITAS has 6 large (greater than 450 ADC), 15 medium (greater than 200 but less than 450 ADC) and 21 small (less than 200 ADC) hospice programs. There are three programs with estimated Medicare Cap billing limitations for the

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2006 measurement period. There is one other program with Medicare Cap cushion of less than 10% for the 2006 measurement period. No other programs have an estimated Medicare Cap cushion of less than 10% for the 2006 measurement period

- (b) Amounts exclude indirect patient care and administrative costs, as well as Medicare Cap billing limitation.

26

### Recent Accounting Statements

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In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in the Current Year Financial Statements" ("SAB 108"). Traditionally, there have been two widely recognized methods for quantifying the effects of financial statement misstatements. The first, called the "roll-over" method, focuses primarily on the income statement effect of a misstatement but its use can lead to the accumulation of misstatements on the balance sheet. The other method, referred to as the "iron curtain" method, focuses primarily on the balance sheet effect of a misstatement but its use can cause out-of-period adjustments in the income statement. We currently use the roll-over method.

SAB 108 requires companies to evaluate financial statement misstatements using both methods, referred to as the "dual approach." An issuer may either restate all periods presented as if the dual approach had always been used or record the cumulative effect of using the dual approach to assets and liabilities with an offsetting adjustment to the opening balance of retained earnings as of January 1, 2006. We believe there will be no material impact on our financial statements as a result of adopting SAB 108.

In September 2006, the FASB issued Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" ("SFAS 158"). The new standard will require employers to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare and other postretirement plans in their financial statements. Under past accounting standards, the funded status of an employer's postretirement benefit plan (i.e., the difference between the plan assets and obligations) was not always completely reported in the balance sheet. Employers reported an asset or liability that almost always differed from the plan's funded status because previous accounting standards allowed employers to delay recognition of certain changes in plan assets and obligations that affected the costs of providing such benefits. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006. We believe there will be no material impact on our financial statements as a result of adopting SFAS 158.

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("SFAS 157"), which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles (GAAP). It sets a common definition of fair value to be used throughout GAAP. The new standard is designed to make the measurement of fair value more consistent and comparable and improve disclosures about those measures. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently evaluating the impact that SFAS 157 will have on our financial condition and results of operations.



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In September 2006, the FASB issued a staff position related to the accounting for planned major maintenance activities. The staff position sets forth four alternative methods of accounting for planned major maintenance activities but disallowed the accrue-in-advance method. The accrue-in-advance method provides for estimating the cost of major maintenance activities and accruing that cost in advance of the maintenance being performed. The guidance is effective for the first fiscal year beginning after December 15, 2006. We are currently evaluating the impact that this staff position will have on accounting related to our transportation equipment.

In July 2006, the FASB issued Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement 109", which prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return. Upon adoption of FIN 48, the financial statements will reflect expected future tax consequences of such uncertain positions assuming the taxing authorities' full knowledge of the position and all relevant facts. FIN 48 also revises disclosure requirements and introduces an annual, tabular roll-forward of the unrecognized tax benefits. This interpretation is effective as of the beginning of fiscal years starting after December 15, 2006. We are currently evaluating the impact FIN 48 will have on our financial condition and results of operations.

In February 2006, the FASB issued Statement No. 155, "Accounting for Certain Hybrid Financial Instruments", which nullifies and amends various accounting guidance relating to accounting for derivative instruments and securitization transactions. In general, these changes will reduce the operational complexity associated with bifurcating embedded derivatives, and increase the number of beneficial interests in securitization transactions. This statement is effective for all financial instruments acquired or issued after the beginning of our first fiscal year that begins after September 15, 2006. Because we do not have any material derivative instruments or securitization transactions, we believe there will be no material impact on our financial condition, results of operations or cash flows upon adoption.

27

Safe Harbor Statement under the Private Securities Litigation Reform Act of  
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1995 Regarding Forward-Looking Information  
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In addition to historical information, this report contains forward-looking statements and performance trends that are based upon assumptions subject to certain known and unknown risks, uncertainties, contingencies and other factors. Variances in any or all of the risks, uncertainties, contingencies, and other factors from our assumptions could cause actual results to differ materially from these forward-looking statements and trends. Our ability to deal with the unknown outcomes of these events, many of which are beyond our control, may affect the reliability of projections and other financial matters.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our primary market risk exposure relates to interest rate risk exposure through variable interest rate borrowings. At September 30, 2006, we had a total of \$15.4 million of variable rate debt outstanding. Should the interest rate on this debt increase 100 basis points, our annual interest expense would increase \$154,000. The quoted market value of our 8.75% fixed rate senior notes on September 30, 2006 is \$156 million (carrying value is \$150 million). We estimate that the fair value of the remainder of our long-term debt approximates its book value at September 30, 2006.

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### Item 4. Controls and Procedures

We carried out an evaluation, under the supervision of our President and Chief Executive Officer and with the participation of the Vice President and Chief Financial Officer and the Vice President and Controller, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the President and Chief Executive Officer, Vice President and Chief Financial Officer and Vice President and Controller have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report. There has been no change in our internal control over financial reporting that occurred during the quarter covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II OTHER INFORMATION

### Item 2(e). Purchases of Equity Securities by the Issuer and Affiliated Purchasers

In July 2006, we announced a \$50 million on-going stock repurchase program. Our previous stock repurchase program authorized in February 2000 had remaining authorization of \$8.5 million. The following table shows the repurchase activity related to the programs for the three months ended September 30, 2006:

	Total Number of Shares Repurchased	Weighted Average Price Paid Per Share	Cumulative Shares Repurchased Under the Program	Dollar Amount Remaining Under The Program
February 2000 Program (a)				
July 1 through July 31, 2006	-	\$ -	42,349	\$8,498,717
August 1 through August 31, 2006	111,380	\$37.30	153,729	\$4,344,488
September 1 through September 30, 2006	-	\$ -	153,729	\$4,344,488
Third Quarter Total - February 2000 Program	111,380	\$37.30		

(a) No shares had been purchased under the February 2000 program since June 2001. \$10 million was originally authorized under this program with no expiration date.

### July 2006 Program

We have not repurchased any shares to date under this program. \$50 million remains authorized under this program with no expiration date.

28

### Item 6. Exhibits

Exhibit No.	Description
18.1	PricewaterhouseCoopers LLP preferability letter regarding

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change in accounting principle

- 31.1 Certification by Kevin J. McNamara pursuant to Rule 13a-14(a)/15d-14(a) of the Exchange Act of 1934.
- 31.2 Certification by David P. Williams pursuant to Rule 13a-14(a)/15d-14(a) of the Exchange Act of 1934.
- 31.3 Certification by Arthur V. Tucker, Jr. pursuant to Rule 13a-14(a)/15d-14(a) of the Exchange Act of 1934.
- 32.1 Certification by Kevin J. McNamara pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification by David P. Williams pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.3 Certification by Arthur V. Tucker, Jr. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

29

SIGNATURES

Pursuant to the requirements 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.

Chemed Corporation

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(Registrant)

Dated: November 1, 2006 By: Kevin J. McNamara  
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Kevin J. McNamara  
(President and Chief Executive Officer)

Dated: November 1, 2006 By: David P. Williams  
-----  
David P. Williams  
(Vice President and Chief Financial Officer)

Dated: November 1, 2006 By: Arthur V. Tucker, Jr.  
-----  
Arthur V. Tucker, Jr.  
(Vice President and Controller)

30