

MATRIA HEALTHCARE INC  
Form 10-Q  
May 06, 2008

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED March 31, 2008

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission file number 0-20619

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

Delaware  
(State or other  
jurisdiction of  
incorporation or  
organization)

20-2091331  
(I.R.S. Employer  
Identification No.)

1850 Parkway Place  
Marietta, Georgia 30067  
(Address of principal  
executive offices)  
(Zip Code)

(770) 767-4500  
(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 period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined by Rule 12b-2 of the Exchange Act).

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

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The number of shares outstanding of the issuer's only class of common stock, \$.01 par value, as of May 1, 2008, was 21,526,924.

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MATRIA HEALTHCARE, INC.  
QUARTERLY REPORT ON FORM 10-Q  
MARCH 31, 2008

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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

Matria Healthcare, Inc. and Subsidiaries  
Consolidated Condensed Balance Sheets  
(Amounts in thousands, except per share amounts)  
(Unaudited)]

	March 31, 2008	December 31, 2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 23,070	\$ 19,501
Trade accounts receivable, less allowances of \$3,603 and \$4,559 at March 31, 2008 and December 31, 2007, respectively	46,591	45,968
Prepaid expenses and other current assets	10,803	11,479
Deferred income taxes	15,308	15,308
<b>Total current assets</b>	<b>95,772</b>	<b>92,256</b>
Property and equipment, net	40,027	40,013
Goodwill, net	494,895	494,718
Other intangibles, net	46,960	48,746
Other assets	9,791	10,505
	<b>\$ 687,445</b>	<b>\$ 686,238</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable, principally trade	\$ 8,882	\$ 8,365
Current installments of long-term debt	43,475	43,988
Unearned revenues	11,331	10,097
Accrued liabilities	17,499	19,584
<b>Total current liabilities</b>	<b>81,187</b>	<b>82,034</b>
Long-term debt, excluding current installments	242,828	238,688
Deferred income taxes	5,115	7,257
Other long-term liabilities	6,682	7,019
<b>Total liabilities</b>	<b>335,812</b>	<b>334,998</b>
Shareholders' equity:		
Preferred stock, \$.01 par value. Authorized 50,000 shares; none outstanding at March 31, 2008 and December 31, 2007	-	-
Common stock, \$.01 par value. Authorized 50,000 shares; issued and outstanding 21,498 and 21,420 at March 31, 2008 and December 31, 2007, respectively	215	214
Additional paid-in capital	433,390	430,531
Accumulated deficit	(76,133)	(76,389)
Accumulated other comprehensive earnings	(5,839)	(3,116)
<b>Total shareholders' equity</b>	<b>351,633</b>	<b>351,240</b>

\$ 687,445 \$ 686,238

See accompanying notes to consolidated condensed financial statements.

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Matria Healthcare, Inc. and Subsidiaries  
Consolidated Condensed Statements of Operations  
(Amounts in thousands, except per share amounts)  
(Unaudited)

	Three Months Ended March 31,	
	2008	2007
Revenues	\$ 79,512	\$ 86,024
Cost of revenues	25,593	26,493
Selling and administrative expenses	45,516	43,164
Provision for doubtful accounts	941	1,219
Amortization of intangible assets	1,786	1,786
Total costs and operating expenses	73,836	72,662
Operating earnings from continuing operations	5,676	13,362
Interest income	260	378
Interest expense	(5,615)	(5,648)
Other income, net	65	323
Earnings from continuing operations before income taxes	386	8,415
Income tax expense	(162)	(3,454)
Earnings from continuing operations	224	4,961
Earnings (loss) from discontinued operations	32	(154)
Net earnings	\$ 256	\$ 4,807
Net earnings per common share:		
Basic:		
Continuing operations	\$ 0.01	\$ 0.23
Discontinued operations	-	-
	\$ 0.01	\$ 0.23
Diluted:		
Continuing operations	\$ 0.01	\$ 0.23
Discontinued operations	-	(0.01)
	\$ 0.01	\$ 0.22
Weighted average shares outstanding:		
Basic	21,466	21,307
Diluted	21,968	21,828

See accompanying notes to consolidated condensed financial statements.



Matria Healthcare, Inc. and Subsidiaries  
Consolidated Condensed Statements of Cash Flows  
(Amounts in thousands)  
(Unaudited)

	Three Months Ended March 31,	
	2008	2007
<b>Cash Flows from Operating Activities:</b>		
Net earnings	\$ 256	\$ 4,807
Less earnings (loss) from discontinued operations, net of income taxes	32	(154)
Earnings from continuing operations	224	4,961
Adjustments to reconcile earnings from continuing operations to net cash provided by operating activities:		
Depreciation and amortization (including debt discount and expenses)	5,387	5,191
Provision for doubtful accounts	941	1,219
Deferred income taxes	79	1,547
Share-based compensation	1,839	2,709
Excess tax benefit - share-based compensation	-	(118)
Other	12	-
Changes in assets and liabilities:		
Trade accounts receivable	(1,564)	(3,234)
Prepaid expenses and other current assets	676	(690)
Noncurrent assets	(91)	(136)
Accounts payable	517	(4,863)
Accrued and other liabilities	(744)	(362)
Net cash provided by continuing operations	7,276	6,224
Net cash provided by (used in) discontinued operations	55	(519)
Net cash provided by operating activities	7,331	5,705
<b>Cash Flows from Investing Activities:</b>		
Purchases of property and equipment	(3,443)	(3,105)
Increase in restricted cash	-	(16)
Net cash used in investing activities	(3,443)	(3,121)
<b>Cash Flows from Financing Activities:</b>		
Principal repayments of debt	(1,339)	(1,383)
Proceeds from issuance of common stock	1,020	960
Excess tax benefit - share-based compensation	-	118
Net cash used in financing activities	(319)	(305)
Net increase in cash and cash equivalents	3,569	2,279
Cash and cash equivalents at beginning of year	19,501	19,839
Cash and cash equivalents at end of period	\$ 23,070	\$ 22,118
<b>Supplemental disclosure of cash paid for:</b>		
Interest	\$ 5,225	\$ 5,127
Income taxes	\$ 206	\$ 70



See accompanying notes to consolidated condensed financial statements.

Notes to Consolidated Condensed Financial Statements  
(Unaudited)

1. General

The consolidated condensed financial statements as of March 31, 2008, and for the three-month periods ended March 31, 2008 and 2007, respectively, are unaudited. The consolidated condensed balance sheet as of December 31, 2007, was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. In preparing financial statements, it is necessary for management to make assumptions and estimates affecting the amounts reported in the consolidated financial statements and related notes. These estimates and assumptions are developed based upon all information available. Actual results could differ from estimated amounts. In the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for fair presentation of the consolidated condensed financial position and results of operations for the periods presented have been included. The results for the three months ended March 31, 2008, are not necessarily indicative of the results that may be expected for the full year ending December 31, 2008.

The consolidated condensed financial statements 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, 2007. References herein to “we,” “us,” “our,” the “Company,” and “Matria” refer to Matria Healthcare, Inc. and its consolidated subsidiaries.

2. Recently Issued and Recently Adopted Accounting Standards

**Fair Value Measurements.** We adopted Statement of Financial Accounting Standards (“SFAS”) No. 157, Fair Value Measurements (“SFAS 157”), as of January 1, 2008. SFAS 157 defines fair value, establishes a methodology for measuring fair value, and expands the required disclosure for fair value measurements. On February 12, 2008, the FASB issued FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157, which amends SFAS 157 by delaying its effective date by one year for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. Therefore, the adoption of SFAS 157 on January 1, 2008, is limited to financial assets and liabilities. The initial adoption did not have a material impact on our financial position or results of operations. However, we are still in the process of evaluating this standard with respect to its effect on non-financial assets and liabilities, and we have not yet determined the impact that it will have on our financial statements upon full adoption on January 1, 2009. See Note 11 for additional information.

**Fair Value Option.** In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115 (“SFAS 159”). This standard permits entities to choose to measure many financial instruments and certain other items at fair value. Entities that elect the fair value option will report unrealized gains and losses in earnings at each subsequent reporting date. The fair value option may be elected on an instrument-by-instrument basis with a few exceptions. SFAS 159 also establishes presentation and disclosure requirements to facilitate comparisons between companies that choose different measurement attributes for similar assets and liabilities. We adopted SFAS 159 on January 1, 2008, and did not elect the fair value measurement for any of our financial assets or liabilities.

**Disclosures about Derivative Instruments.** In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133 (“SFAS 161”). SFAS 161 requires enhanced disclosure related to derivatives and hedging activities and thereby seeks to improve the transparency of financial reporting. Under SFAS 161, entities are required to provide enhanced disclosures relating to: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedge items are

accounted for under SFAS 133, Accounting for Derivative Instruments and Hedging Activities (“SFAS 133”), and its related interpretations; and (c) how derivative

instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS 161 must be applied prospectively to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under SFAS 133 and will be effective for all financial statements January 1, 2009. We are currently evaluating the impact on the disclosures for our derivative instruments and hedging activities.

### 3. Plan of Merger

On January 27, 2008, we entered into an Agreement and Plan of Merger (the "Merger Agreement") with Inverness Medical Innovations, Inc. ("Inverness"), pursuant to which Inverness will acquire Matria. Inverness is a global leader in rapid point-of-care diagnostics and the development of near-patient diagnosis, monitoring and health management, including disease management and wellness programs that enables individuals to take charge of improving their health and quality of life.

At the effective time of the merger, by virtue of the merger and without any action on the part of the holders of any capital stock of Matria, each share of common stock of Matria issued and outstanding immediately prior to the effective time will be converted into the right to receive: (i) a portion of a share of Inverness convertible preferred stock having a stated value of \$32.50 (the \$400 liquidation value of a share of Inverness convertible preferred stock multiplied by 0.08125, which is the exchange ratio of the issuance of Inverness convertible preferred stock in the merger), and (ii) \$6.50 in cash. The merger has been approved by the Boards of Directors of both companies. The completion of the merger is subject to obtaining the approval of Matria shareholders at a meeting scheduled on May 8, 2008. Matria and Inverness will continue to operate separately until the transaction closes. Inverness has filed a registration statement on Form S-4 with the SEC in connection with the proposed merger, which includes additional information related to the proposed merger and Matria's proxy statement and Inverness's prospectus for the proposed transaction.

### 4. Acquisition Contingent Consideration

In connection with our acquisition of Miavita LLC ("Miavita") on April 1, 2005, we were required to pay additional consideration in future periods, based upon a percentage of specified revenues pertaining to certain customer agreements. For the third earn-out period ended March 31, 2008, we accrued \$177,000, payable on May 15, 2008, for additional acquisition consideration and recorded the amount as a decrease to goodwill. Additional consideration payments will be payable in future periods through 2010, which we estimate to be less than \$250,000.

### 5. Comprehensive Earnings (Loss)

Comprehensive earnings generally include all changes in equity during a period except those resulting from investments by owners and distributions to owners. Comprehensive earnings consist of net earnings and net unrealized gains and losses on derivative instruments. Comprehensive earnings (loss) for the three-months ended March 31, 2008 and 2007, were \$(2.5) million and \$4.7 million, respectively.

### 6. Income Taxes

We adopted Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48") on January 1, 2007. As a result of implementing FIN 48, we derecognized \$524,000 in income tax benefits for certain tax positions for which there is uncertainty and recognized \$145,000 of related interest and penalties. These adjustments resulted in increases of \$669,000 to beginning Accumulated deficit and to Other long-term liabilities. As of March 31, 2008 and December 31, 2007, we had a liability of \$971,000 for tax benefits recognized which may not be sustained. We recognize interest and penalties related to unrecognized tax benefits in Interest expense and Selling and administrative expenses, respectively on the consolidated condensed statement of

operations. At March 31, 2008 and December 31, 2007, we accrued \$288,000 and \$213,000, respectively, for the payment of interest and

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penalties. These amounts are included in Other long-term liabilities on the consolidated condensed balance sheets.

## 7. Earnings Per Share

The computations for basic and diluted net earnings per common share are as follows (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2008	2007
Net earnings (loss) - basic and diluted:		
Continuing operations	\$ 224	\$ 4,961
Discontinued operations	32	(154)
Net earnings available to common shareholders	\$ 256	\$ 4,807
Shares:		
Weighted average common shares outstanding - basic	21,466	21,307
Dilutive effect of:		
Stock options and employee stock purchase plan	455	444
Unvested restricted stock awards	47	77
Weighted average common shares outstanding - diluted	21,968	21,828
Basic:		
Continuing operations	\$ 0.01	\$ 0.23
Discontinued operations	-	-
	\$ 0.01	\$ 0.23
Diluted:		
Continuing operations	\$ 0.01	\$ 0.23
Discontinued operations	-	(0.01)
	\$ 0.01	\$ 0.22

The calculation of diluted earnings per share excludes the antidilutive effect of 1.6 million shares of stock options and unvested restricted stock awards in both three-month periods ended March 31, 2008 and 2007.

## 8. Share -Based Compensation

Share-based compensation expense includes compensation expense, recognized over the applicable vesting periods, for the share-based awards granted after December 31, 2005, and for share-based awards granted prior to but not vested as of our adoption of FASB SFAS No. 123(revised 2004), Share-Based Payment.

At March 31, 2008, total compensation cost related to unvested share-based awards granted to employees under stock option plans but not yet recognized, totaled \$14.5 million after estimating forfeitures and before income taxes. Of this amount, approximately \$6.3 million relates to shares of unvested restricted stock. The expense of all unvested share-based awards is expected to be recognized over an estimated weighted average period of 2.4 years. Our restricted stock awards are performance-based and service-based, and compensation expense for restricted stock awards is recognized using the tranche method (performance-based awards) or the straight line method (service-based awards) over the vesting period. The remaining unrecognized compensation expense for the performance-based

restricted stock awards may vary each reporting period based on changes in the expected achievement of performance measures.

The impact on our results of operations of recording share-based compensation for the three months

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ended March 31, 2008 and 2007, was as follows:

	Three Months Ended March 31,	
	2008	2007
Share-based compensation expense	\$ 1,839	\$ 2,709
Income tax benefit	(585)	(884)
Share-based compensation expense, net of income taxes	\$ 1,254	\$ 1,825
Effect on diluted earnings per share	\$ (0.06)	\$ (0.08)

## 9. Long-Term Debt

We have a \$485.0 million Credit Facility, as amended, with Bank of America, N.A., which matures in January 2012. Under the terms of the agreement, the amounts borrowed accrue interest at a variable spread over LIBOR, with the applicable spread determined by the Company's consolidated leverage ratio, as described in the credit agreement. Interest rates for the Credit Facility are reset quarterly. Amounts borrowed are fully and unconditionally guaranteed on a joint and several basis by substantially all of our subsidiaries. As of March 31, 2008, the outstanding balance under the Credit Facility was \$266.1 million, excluding the Revolving Credit Facility noted below.

Our Revolving Credit Facility provided that the amounts borrowed accrue interest at a variable spread over LIBOR or the prime rate, at our option, with the applicable spread determined by reference to our consolidated leverage ratio. On February 23, 2007, we entered into a third amendment to the Credit Facility, the terms of which increased our borrowing capacity under the Revolving Credit Facility from \$30.0 million to \$50.0 million. All other terms of the Credit Facility, as amended, remain unchanged. At March 31, 2008, there was \$10.0 million outstanding under the Revolving Credit Facility, and the available balance was \$38.9 million.

The Credit Facility contains, among other things, various representations, warranties and affirmative, negative and financial covenants customary for financings of this type. The negative covenants include, without limitation, certain limitations on transactions with affiliates, liens, making investments, the incurrence of debt, sales of assets, and changes in business. The financial covenants contained in the Credit Facility include a consolidated leverage ratio and a consolidated fixed charges coverage ratio. At March 31, 2008, we were in compliance with all covenants of the Credit Facility.

The weighted average interest rates, including amortization of debt discount and expense, on all outstanding indebtedness were 7.99% and 8.07% for the three-month periods ended March 31, 2008 and 2007, respectively.

## 10. Derivative Financial Instruments

In February and May 2006, we entered into two interest rate swap agreements, each with a notional amount of \$100.0 million, to hedge exposure to fluctuations in interest rates related to our Credit Facility. The agreements, which have two-year terms, have the economic effect of converting \$200.0 million of floating-rate debt under the Credit Facility to fixed-rate debt. In February 2008, we terminated the February 2006 swap according to the terms of the agreement. The provisions of the May 2006 agreement provide that we pay the bank a fixed base rate of 5.350%, and the bank will pay us a floating rate based on three-month LIBOR (2.703% at March 31, 2008). The variable rate is reset quarterly.



In August 2007, we entered into two additional interest rate swap agreements, each with a notional amount of \$100.0 million. The terms of these agreements are scheduled to become effective after the termination of the swaps noted above, in February and May 2008. The term of the February 2008 swap began

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as scheduled. These agreements also have two-year terms and have the economic effect of converting \$200.0 million of floating-rate debt to fixed-rate debt. We will pay the bank fixed base rates of 4.890% and 4.910%, respectively, under these swap arrangements, and the bank will pay us floating rates based on three-month LIBOR.

On the dates the interest rate swap derivative contracts were entered into, we designated the derivatives as hedges of the variability of cash flow to be paid ("cash flow" hedge). Under cash flow hedge accounting, changes in the fair value of a derivative that is qualified, designated and highly effective as a cash flow hedge are recorded in other comprehensive income until earnings are affected by the variability of cash flows. We reflected the interest rate swap agreements on the consolidated condensed balance sheets at fair value (liabilities of \$10.1 million and \$5.1 million at March 31, 2008, and December 31, 2007, respectively), which was based upon the estimated amount we would pay upon settlement of the agreements taking into account interest rates on those dates. For the three-month periods ended March 31, 2008 and 2007, we recognized net gains (losses) of \$(328,000) and \$79,000, respectively, from the cash flow hedges. These amounts are included in Interest expense in the consolidated condensed statements of operations.

## 11. Fair Value Measurement

In September 2006, the FASB issued SFAS 157. SFAS 157 does not require any new fair value measurements, rather, it defines fair value, establishes a framework for measuring fair value in accordance with existing GAAP, and expands disclosures about fair value measurements. Beginning January 1, 2008, assets and liabilities recorded at fair value in the consolidated condensed balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Level inputs, as defined by SFAS 157, are as follows:

### Level Input                      Input Definition

Level 1 Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.

Level 2 Inputs other than quoted prices included in Level 1 that are observable for the asset or liability through corroboration with market data at the measurement date.

Level 3 Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

As of March 31, 2008, our financial liabilities that are measured at fair value on a recurring basis are our derivative financial instruments, which consist of interest rate swaps. See Note 10 for further information about our derivative instruments and hedging activities. The fair values of the swap contracts are determined based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets. We have, therefore, categorized these swap contracts as Level 2.

The following table summarizes our fair value measurements at March 31, 2008, for financial liabilities measured at fair value on a recurring basis (in thousands):

	Level 1	Level 2	Level 3	Total
Fair value of interest rate swap agreements	\$ -	\$ 10,065	\$ -	\$ 10,065

## 12. Contingencies

In connection with our acquisition of CorSolutions, we are pursuing a claim for fraudulent misrepresentation, concealment and breach of contract before the American Arbitration Association in Chicago, Illinois, seeking damages in an unspecified amount. There is no assurance that we will prevail in this proceeding.



In addition, we are subject to various legal claims and actions incidental to our business and the businesses of our predecessors, including product liability claims and professional liability claims. We maintain insurance, including insurance covering professional and product liability claims, with customary deductible amounts. There can be no assurance, however, that (i) additional suits will not be filed against us in the future, (ii) our prior experience with respect to the disposition of litigation is representative of the results that will occur in pending or future cases or (iii) adequate insurance coverage will be available at acceptable prices for incidents arising or claims made in the future. There are no other pending legal or governmental proceedings to which we are a party that we believe would, if adversely resolved, have a material adverse effect on us.

### 13. Supplemental Disclosures Regarding Revenue

Our revenues are generated from the following sources: our disease and condition management services, our wellness programs and our maternity management services. The following table summarizes our revenues for these services and programs (amounts in thousands):

	Three Months Ended March 31,	
	2008	2007
Disease and Condition Management	\$ 46,158	\$ 52,758
Wellness	6,149	6,829
Maternity Management	27,205	26,437
Total Revenues	\$ 79,512	\$ 86,024

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

The following discussion and analysis should be read in conjunction with the other financial information in this Report and the consolidated financial statements and related notes and other financial information in our Annual Report on Form 10-K for the year ended December 31, 2007, as filed with the Securities and Exchange Commission (the "Commission" or "SEC"). The discussion contains forward-looking statements that involve risks and uncertainties. Actual results could differ materially from those anticipated in the forward-looking statements as a result of a variety of factors, including those discussed in "Risk Factors" in the Annual Report. The historical results of operations are not necessarily indicative of future results.

### Executive Overview

We are a leading provider of comprehensive, integrated programs and services focused on wellness, disease and condition management, productivity enhancement and informatics. This suite of services, which we call "Health Enhancement," is designed to reduce health-related costs and enhance the health and quality of life of the individuals we serve. We provide services to self-insured employers, private and government-sponsored health plans, pharmaceutical companies and patients. Our employer clients are primarily Fortune 1000 companies that self-insure the medical benefits provided to their employees, dependents and retirees. Our health plan customers are regional and national health plans, as well as government-sponsored health plans, such as state Medicaid programs.

Our online, interactive wellness programs address issues such as: smoking cessation, weight loss, exercise, healthier diet, stress relief, healthy aging, and productivity enhancement. These programs are designed to help employees and health plan members live healthier and longer lives while reducing their healthcare costs and increasing their productivity.

Our disease and condition management programs focus on the most costly medical conditions including, without limitation, diabetes, cardiovascular diseases, respiratory disorders, depression, chronic pain, hepatitis C, cancer and high-risk pregnancies. We assist individuals to better manage their conditions by increasing their knowledge about their illnesses or conditions, potential complications and the importance of medication and treatment plan compliance. Depending on acuity, our specialized nurses proactively contact patients to monitor their progress and ensure they are following the plan of care set by their physician.

### Plan of Merger

On January 27, 2008, we entered into an Agreement and Plan of Merger (the "Merger Agreement") with Inverness Medical Innovations, Inc. ("Inverness"), pursuant to which Inverness will acquire Matria. Inverness is a global leader in rapid point-of-care diagnostics and the development of near-patient diagnosis, monitoring and health management, including disease management and wellness programs that enables individuals to take charge of improving their health and quality of life.

At the effective time of the merger, by virtue of the merger and without any action on the part of the holders of any capital stock of Matria, each share of common stock of Matria issued and outstanding immediately prior to the effective time will be converted into the right to receive: (i) a portion of a share of Inverness convertible preferred stock having a stated value of \$32.50 (the \$400 liquidation value of a share of Inverness convertible preferred stock multiplied by 0.08125, which is the exchange ratio of the issuance of Inverness convertible preferred stock in the merger), and (ii) \$6.50 in cash. The merger has been approved by the Boards of Directors of both companies. The completion of the merger is subject to obtaining the approval of Matria shareholders at a meeting scheduled on May 8, 2008. Matria and Inverness will continue to operate separately until the transaction closes. Inverness has filed a registration statement on Form S-4 with the SEC in connection with



the proposed merger, which includes additional information related to the proposed merger and Matria's proxy statement and Inverness's prospectus for the proposed transaction.

## Results of Operations

Three Months Ended March 31, 2008, Compared to Three Months Ended March 31, 2007

The following table summarizes key components in our financial statements for continuing operations for the three-month periods ended March 31, 2008 and 2007, respectively, expressed as a percentage of revenues. An explanation of the results follows the table.

	Three Months Ended March 31,	
	2008	2007
Revenues	100.0%	100.0%
Cost of revenues	32.2%	30.8%
Gross margin	67.8%	69.2%
Selling and administrative expenses	57.2%	50.2%
Provision for doubtful accounts	1.2%	1.4%
Amortization of intangible assets	2.2%	2.1%
Operating earnings	7.1%	15.5%
Interest expense, net	6.7%	6.1%
Other income, net	0.1%	0.4%
Earnings from continuing operation before income taxes	0.5%	9.8%
Income tax expense	0.2%	4.0%
Earnings from continuing operations	0.3%	5.8%

Note: Totals may not foot due to rounding.

Our first quarter 2008 revenues were \$79.5 million, a decrease of \$6.5 million, or 7.6%, from \$86.0 million in the comparable period in 2007. Disease and condition management revenues decreased \$6.6 million, or 12.5%, and wellness program revenues decreased \$681,000, or 10.0%, in the first three months of 2008 compared to 2007. These decreases were largely due to (i) the loss of one of our large health plan accounts and (ii) the loss of several smaller accounts resulting from increased competition for our Administrative Services Only, or ASO, customers. These decreases were partially offset by increases from the implementation of new and expanded disease management and wellness contracts. Additionally, our maternity management program revenues increased \$768,000, or 2.9%, to \$27.2 million for the quarter ended March 31, 2008, primarily due to an increase in census and patient days for certain preterm labor management services, as well as higher revenues from our MaternaLink® services.

Cost of revenues consists primarily of clinical labor and supplies related to the provision of services. Cost of revenues as a percentage of revenues increased to 32.2% for the three-month period ended March 31, 2008, from 30.8% in 2007. This increase was primarily due to the decrease in our high-margin disease management and wellness revenues. Cost as a percentage of revenues for our maternity management services decreased due to the availability of a lower cost generic drug for Zofran, which is used for nausea and vomiting in our maternity management services, and due to a reduction in costs as a result of the implementation of cost reduction initiatives.

Selling and administrative expenses increased \$2.4 million, or 5.5%, to \$45.5 million for the quarter ended March 31, 2008, from \$43.2 million in 2007. We incurred approximately \$1.8 million of legal, accounting and financial advisor

expenses related to our pending acquisition by Inverness. Additionally, our costs for salaries and other personnel-related expenses increased \$1.8 million due primarily to severance payable to certain senior-level management. These increases were partially offset by a reduction of \$870,000 for share-based compensation expense due the exclusion of expense for certain performance-based restricted stock awards. Because expense for restricted stock awards is recognized using the tranche method



(performance-based awards) or the straight line method (service-based awards) over the vesting period, our recognition of compensation expense for the performance-based restricted stock awards may vary each reporting period based on changes in the expected achievement of performance measures. Selling and administrative expenses as a percentage of revenues increased to 57.2% in the first quarter of 2008 from 50.2% in the same period of 2007.

The provision for doubtful accounts as a percentage of revenues was 1.2% for the three-month period ended March 31, 2008, compared to 1.4% in 2007. The provision, which is recorded primarily for our maternity management program revenues, is adjusted periodically based upon our quarterly evaluation of historical collection experience, recoveries of amounts previously provided, industry reimbursement trends and other relevant factors.

We recorded \$1.8 million expense in both three-month periods of 2008 and 2007 from the amortization of intangible assets. The amortization expense results from our acquisitions of CorSolutions in 2006, and WinningHabits and Miavita in 2005.

Interest expense remained stable at \$5.6 million for both quarters ended March 31, 2008 and 2007. The weighted average interest rates, including amortization of debt discount and expense, on all outstanding indebtedness were 7.99% and 8.07% for the quarters ended March 31, 2008 and 2007, respectively.

Income tax expense was \$162,000 and \$3.5 million for the three months ended March 31, 2008 and 2007, respectively. Our effective income tax rates were 42.0% in 2008 and 41.0% in 2007. The effective income tax rate is higher than the statutory federal tax rate due to state income taxes and certain non-deductible expenses for tax purposes. Cash outflows for income taxes for continuing and discontinued operations in 2008 and 2007 were \$206,000 and \$70,000, respectively, comprised of federal alternative minimum taxes and state income taxes. As of December 31, 2007, our remaining net operating loss carryforwards were \$49.4 million, which we expect will be available to offset future taxable income, subject to certain limitations. We expect to use approximately \$21.6 million of our net operating loss carryforwards in 2008.

Discontinued operations include the operations of Facet Technologies LLC (“Facet”) and our foreign diabetes service operations in Germany (“Dia Real”), which we sold in the third and fourth quarters of 2006, respectively.

## Liquidity and Capital Resources

### Operating Activities

As of March 31, 2008, we had cash and cash equivalents of \$23.1 million. In the first three months of 2008, operating activities from continuing operations provided \$7.3 million of cash, compared with \$6.2 million provided in the comparable period of 2007. This increase was due primarily to decreases in accounts payable in the first three months of 2007, as well as the change in accounts receivable, which used \$1.6 million of cash in the first quarter of 2008 compared to a use of \$3.2 million in the same period of 2007. Our days’ sales outstanding, or DSO, decreased to 53 days at March 31, 2008, from 58 days at March 31, 2007. Our DSO at December 31, 2007, was 47 days.

Net cash provided by (used in) discontinued operations was \$55,000 and \$(519,000) for the three-month periods ended March 31, 2008 and 2007, respectively, driven primarily by the payment of certain expenses related to the sale of Facet and Dia Real in 2007.

#### Investing Activities

Net cash used in investing activities totaled \$3.4 million and \$3.1 million for the three months ended March 31, 2008 and 2007, respectively, which is attributable to capital expenditures for the replacement and enhancement of computer information systems. We expect to expend a total of approximately \$12.0 million for capital items in 2008, including capital expenditures made in the first three months.

#### Financing Activities

Net cash used in financing activities was \$319,000 and \$305,000 for the three months ended March 31, 2008 and 2007, respectively. We repaid \$1.3 million and \$1.4 million of short-term indebtedness and capital lease obligations during the three-month periods ended March 31, 2008 and 2007, respectively. We received \$1.0 million and \$960,000 from participants under our stock purchase and stock option plans in the 2008 and 2007 periods, respectively.

We have a Credit Facility, as amended, with Bank of America, N.A., which matures in January 2012. Under the terms of the agreement, the amounts borrowed accrue interest at a variable spread over LIBOR, with the applicable spread determined by the Company's consolidated leverage ratio, as described in the agreement. Interest rates for the Credit Facility are reset quarterly. Amounts borrowed are fully and unconditionally guaranteed on a joint and several basis by substantially all of our subsidiaries. As of March 31, 2008, the outstanding balance under the Credit Facility was \$266.1 million, excluding the Revolving Credit Facility noted below.

Our Revolving Credit Facility provide that amounts borrowed accrue interest at a variable spread over LIBOR or the prime rate, at our option, with the applicable spread determined by reference to our consolidated leverage ratio. On February 23, 2007, we entered into a third amendment to the Credit Facility, the terms of which increased our borrowing capacity under the Revolving Credit Facility from \$30.0 million to \$50.0 million. All other terms of the Credit Facility, as amended, remain unchanged. At March 31, 2008, there was \$10.0 million outstanding under the Revolving Credit Facility, and the available balance was \$38.9 million.

The Credit Facility contains, among other things, various representations, warranties and affirmative, negative and financial covenants customary for financings of this type. The negative covenants include, without limitation, certain limitations on transactions with affiliates, liens, making investments, the incurrence of debt, sales of assets, and changes in business. The financial covenants contained in the Credit Facility include a consolidated leverage ratio and a consolidated fixed charges coverage ratio. At March 31, 2008, we were in compliance with all covenants of the Credit Facility.

In February and May 2006, we entered into two interest rate swap agreements, each with a notional amount of \$100.0 million, to hedge exposure to fluctuations in interest rates related to our Credit Facility. The agreements, which have two-year terms, have the economic effect of converting \$200.0 million of floating-rate debt under the Credit Facility to fixed-rate debt. In February 2008, we terminated the February 2006 swap according to the terms of the agreement. The provisions of the May 2006 agreement provide that we pay the bank fixed base rate of 5.350%, and the bank will pay us a floating rate based on three-month LIBOR (2.703% at March 31, 2008). The variable rate is reset quarterly.

In August 2007, we entered into two additional interest rate swap agreements, each with a notional amount of \$100.0 million. The terms of these agreements are scheduled to become effective after the termination of the swaps noted above, in February and May 2008. The term of the February 2008 swap began as scheduled. These agreements also have two-year terms and have the economic effect of converting \$200.0 million of floating-rate debt to fixed-rate debt. We will pay the bank fixed base rates of 4.890% and 4.910%,

respectively, under these swap arrangements, and the bank will pay us floating rates based on three-month LIBOR.

On the dates the interest rate swap derivative contracts were entered into, we designated the derivatives as hedges of the variability of cash flow to be paid (“cash flow” hedge). Under cash flow hedge accounting, changes in the fair value of a derivative that is qualified, designated and highly effective as a cash flow hedge are recorded in other comprehensive income until earnings are affected by the variability of cash flows. We reflected the interest rate swap agreements on the consolidated condensed balance sheets at fair value (liabilities of \$10.1 million and \$5.1 million at March 31, 2008, and December 31, 2007, respectively), which was based upon the estimated amount we would pay upon settlement of the agreements taking into account interest rates on those dates. For the three-month periods ended March 31, 2008 and 2007, we recognized net gains (losses) of \$(328,000) and \$79,000, respectively, from the cash flow hedges. These amounts are included in Interest expense in the consolidated condensed statements of operations.

We believe that our cash, other liquid assets, operating cash flows, Credit Facility and alternative financing, taken together, will provide adequate resources to fund ongoing operating requirements, planned capital expenditures and contractual obligations through at least the next twelve months. However, we may not be able to remain in compliance with the financial covenants as defined by the terms of the Credit Facility due to costs incurred related to the pending acquisition by Inverness or due to other business risks as discussed in the “Risk Factors” in Item 1A of the Company’s Annual Report on Form 10-K for the year ended December 31, 2007. If the pending acquisition does not close within the timeframe expected, we may be required to seek a waiver from the bank, restructure the financial covenants in the Credit Facility, obtain alternative financing or raise additional equity. Although we believe we would be able to resolve any noncompliance, we cannot assure you that we would be successful in our efforts to do so.

#### Contractual Obligations, Commitments and Off-Balance Sheet Arrangements

We have various contractual obligations that are recorded as liabilities in our consolidated condensed financial statements. Certain other items, such as operating lease obligations, are not recognized as liabilities in our consolidated condensed financial statements but are required to be disclosed. The following sets forth our future minimum payments required under our contractual obligations as of March 31, 2008 (in thousands):

	Total	Payments Due by Year			
		Less than 1 Year	1 - 3 Years	3 - 5 Years	More than 5 Years
Long-term debt obligations	(1) \$ 319,743	\$ 26,961	\$ 110,406	\$ 182,376	\$ -
Capital lease obligations	7	7	-	-	-
Operating lease obligations	21,248	7,806	8,804	2,439	2,199
Other long-term obligations	5,013	2,768	2,245	-	-
	\$ 346,011	\$ 37,542	\$ 121,455	\$ 184,815	\$ 2,199

(1) Includes projected interest payments.

Scheduled principal and interest payments of \$12.5 million and \$10.2 million, respectively, under the Credit Facility and Revolving Credit Facility are payable in the remaining nine months of 2008. We intend to make voluntary, unscheduled payments of \$30.0 million in 2008. Capital expenditures of approximately \$12.0 million, including capital expenditures made in the first three months, are estimated in 2008 as we continue to enhance our computer information systems.

As of March 31, 2008, we did not have any significant off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K, except for our indemnification obligations related to potential



breaches of the representations and warranties contained in the definitive agreement to sell Facet and Dia Real, which obligations are capped at \$12.5 million and \$9.9 million, respectively.

#### Other Factors Affecting Liquidity

In connection with our acquisition of Miavita LLC, we will be required to pay additional earn-out consideration in future periods through 2010, based upon specified revenues pertaining to certain customer agreements. In accordance with SFAS No. 141, Business Combinations, we accrue contingent consideration obligations upon attainment of the objectives. Additionally, any such payments would result in increases in goodwill.

At March 31, 2008, we computed the additional consideration payable pursuant to the 2007 earn-out period to be \$177,000, which is payable on May 15, 2008. This amount was recorded as an increase to Goodwill and to Accrued liabilities on the consolidated condensed balance sheet. We estimate the additional consideration payable for the remaining periods to be less than \$250,000.

#### Uncertainties

We are subject to various legal claims and actions incidental to our business and the businesses of our predecessors, including product liability claims and professional liability claims. We maintain insurance, including insurance covering professional and product liability claims, with customary deductible amounts. There can be no assurance, however, that (i) lawsuits will not be filed against us in the future, (ii) our prior experience with respect to the disposition of litigation is representative of the results that will occur in pending or future cases or (iii) adequate insurance coverage will be available at acceptable prices, if at all, for incidents arising or claims made in the future. There are no pending legal or governmental proceedings to which we are a party that we believe would, if adversely resolved, have a material adverse effect on our financial position or results of operations. For a discussion of other risks and uncertainties that may affect our business, see "Risk Factors" in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2007.

#### Critical Accounting Policies and Estimates

Critical accounting policies are those policies that require management to make the most challenging, subjective or complex judgments, often because they must estimate the effect of matters that are inherently uncertain and may change in subsequent periods. Critical accounting policies involve judgments and uncertainties that are sufficiently sensitive to result in materially different results under different assumptions and conditions. We believe our most critical accounting policies are described below:

**Revenue Recognition and Allowances for Uncollectible Accounts.** Our services are provided telephonically and through home-based nursing services through care centers located throughout the United States. In addition, our services are provided through access to our online health and wellness based tools. Revenues are recognized as the related services are rendered and are net of contractual allowances and related discounts.

Our services are paid for primarily on the basis of (i) monthly fees for each employee or member enrolled in a health plan, (ii) each member identified with a particular chronic disease or condition under contract, (iii) each member enrolled in our programs, (iv) fee-for-service, or (v) a fixed rate per case. Billings for certain services occur in advance of services being performed. Such amounts are recorded as Unearned revenues in the consolidated condensed balance sheets. Such amounts are subsequently recognized as revenue as services are performed.

Some contracts provide that a portion of our fees are at-risk (i.e., refundable) if our programs do not achieve certain financial cost savings and clinical performance criteria. Revenues subject to refund are not recognized if (i) sufficient information is not available to calculate performance measurements, or (ii) interim performance measurements indicate that we are not meeting performance targets. If either of these two conditions exists, we record the amounts as Unearned revenues in the consolidated condensed balance sheets. If we do not meet performance targets by the end of the operations period under the contract, we are contractually obligated to refund some or all of the at-risk fees. Historically, such adjustments have been immaterial to our financial condition and results of operations.

A significant portion of our revenues is billed to third-party reimbursement sources. Therefore, the collectibility of all of our accounts receivable varies based on payor mix, general economic conditions and other factors. A provision for doubtful accounts is made for revenues estimated to be uncollectible and is adjusted periodically based upon our evaluation of current industry conditions, historical collection experience, recoveries of amounts previously provided, industry reimbursement trends and other relevant factors which, in the opinion of management, deserve recognition in estimating the allowance for uncollectible accounts. The evaluation is performed at each reporting period for each operating unit with an overall assessment at the consolidated level. The evaluation of the monthly estimates of revenues estimated to be uncollectible has not resulted in material adjustments in any recent period; however, special charges have resulted from certain specific circumstances affecting collectibility. While estimates and judgments are involved and factors impacting collectibility may change, management believes adequate provision has been made for any adjustments that may result from final determination of amounts to be collected.

**Goodwill and Identifiable Intangible Assets.** Goodwill represents the excess of cost over fair value of net assets acquired. Goodwill arising from business combinations is accounted for under the provisions of SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets, and is not amortized. Our identifiable intangible assets are amortized over their respective estimated useful lives. As of March 31, 2008, we reported goodwill and identifiable intangible assets at net carrying amounts of \$494.9 million and \$47.0 million, respectively. The total of \$541.9 million represents approximately 79% of our total assets as of March 31, 2008.

We review goodwill and identifiable intangibles for impairment annually as of December 31 and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. In testing for impairment, we compare the book value of net assets to the fair value of the related reporting units that have goodwill and indefinite life intangibles assigned to them. If the fair value is determined to be less than book value, a second step is performed to compute the amount of impairment. We estimate the fair values of the reporting units based upon earnings multiples for similar precedent transactions as well as the present value of estimated future free cash flows. The approach utilized is dependent on a number of factors, including estimates of future revenues and operating costs, appropriate discount rates and other variables. We base our estimates on assumptions that we believe to be reasonable, but which are unpredictable and inherently uncertain. Therefore, future impairments could result if actual results differ from those estimates. Based on our evaluation, we concluded that no impairment of recorded goodwill and intangibles existed at December 31, 2007.

**Accounting for Income Taxes.** We account for income taxes using an asset and liability approach. Deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities and net operating loss and tax credit carryforwards. Additionally, the effect on deferred taxes of a change in tax rates is recognized in earnings in the period that includes the enactment date.

We adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (“FIN 48”) on January 1, 2007. As a result of the implementation, we recognized a liability of \$524,000 for tax benefits recognized which may not be sustained and \$144,000 of related interest and penalties, which increased our Accumulated deficit at January 1, 2007. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

As of December 31, 2007, our remaining net operating loss carryforwards of \$49.4 million, the tax effect of which is reflected as an asset on the balance sheet in Deferred income taxes, will be available to offset future taxable income liabilities, subject to certain limitations. Based on projections of taxable income in 2008 and future years, we believe that it is more likely than not that we will fully realize the value of the recorded deferred income tax assets. The amount of the deferred tax asset considered realizable, however, could be reduced if estimates of future taxable income during the carryforward period are reduced.

**Share-Based Compensation.** On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (“SFAS 123R”). SFAS 123R establishes standards for the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for either equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise’s equity instruments or that may be settled by the issuance of such equity instruments. SFAS 123R eliminates the ability to account for share-based compensation transactions, as we formerly did, using the intrinsic value method as prescribed by Accounting Principles Board, (“APB”), Opinion No. 25, Accounting for Stock Issued to Employees, and generally requires that such transactions be accounted for using a fair-value-based method. Changes in assumptions as to the employee forfeitures assumptions, expected stock option exercise terms and volatility could have a significant impact on the stock compensation fair value determinations. Additionally, our restricted stock awards are performance-based and service-based. Expense for restricted stock awards is recognized using the tranche method (performance-based awards) or the straight line method (service-based awards) over the vesting period. The remaining unrecognized compensation costs for the performance-based restricted stock awards may vary each reporting period based on changes in the expected achievement of performance measures.

The above listing is not intended to be a comprehensive list of all of our accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States, with no need for management’s judgment in their application. There are also areas in which management’s judgment in selecting any available alternative would not produce a materially different result. See the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2007, which contain additional accounting policies and other disclosures required by accounting principles generally accepted in the United States.

Our senior management has discussed the development and selection of our critical accounting estimates, and this disclosure, with the Audit Committee of our Board of Directors.

#### Recently Issued and Recently Adopted Accounting Standards

**Fair Value Measurements.** We adopted Statement of Financial Accounting Standards (“SFAS”) No. 157, Fair Value Measurements (“SFAS 157”), as of January 1, 2008. SFAS 157 defines fair value, establishes a methodology for measuring fair value, and expands the required disclosure for fair value measurements. On February 12, 2008, the FASB issued FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157, which amends SFAS 157 by delaying its effective date by one year for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in





the financial statements on a recurring basis. Therefore, the adoption of SFAS 157 on January 1, 2008, is limited to financial assets and liabilities. The initial adoption did not have a material impact on our financial position or results of operations. However, we are still in the process of evaluating this standard with respect to its effect on non-financial assets and liabilities, and we have not yet determined the impact that it will have on our financial statements upon full adoption on January 1, 2009. See Note 11 of the Notes to Consolidated Condensed Financial Statements for additional information.

**Fair Value Option.** In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115 (“SFAS 159”). This standard permits entities to choose to measure many financial instruments and certain other items at fair value. Entities that elect the fair value option will report unrealized gains and losses in earnings at each subsequent reporting date. The fair value option may be elected on an instrument-by-instrument basis with a few exceptions. SFAS 159 also establishes presentation and disclosure requirements to facilitate comparisons between companies that choose different measurement attributes for similar assets and liabilities. We adopted SFAS 159 on January 1, 2008, and did not elect the fair value measurement for any of our financial assets or liabilities.

**Disclosures about Derivative Instruments.** In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133 (“SFAS 161”). SFAS 161 requires enhanced disclosure related to derivatives and hedging activities and thereby seeks to improve the transparency of financial reporting. Under SFAS 161, entities are required to provide enhanced disclosures relating to: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedge items are accounted for under SFAS 133, Accounting for Derivative Instruments and Hedging Activities (“SFAS 133”), and its related interpretations; and (c) how derivative instruments and related hedged items affect an entity’s financial position, financial performance and cash flows. SFAS 161 must be applied prospectively to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items accounted for under SFAS 133 and will be effective for all financial statements January 1, 2009. We are currently evaluating the impact on the disclosures for our derivative instruments and hedging activities.

Our Annual Report on Form 10-K for the year ended December 31, 2007, as filed with the Commission, also contains a discussion of recently issued accounting standards and the expected impact on our financial statements.

## Forward-Looking Information

This Form 10-Q, including the information incorporated by reference herein, contains various forward-looking statements and information that are based on our beliefs and assumptions, as well as information currently available to us. From time to time, the Company and its officers, directors or employees may make other oral or written statements (including statements in press releases or other announcements) that contain forward-looking statements and information. Without limiting the generality of the foregoing, the words “believe,” “anticipate,” “estimate,” “expect,” “intend,” “plan,” “seek” and similar expressions, when used in this Form 10-Q and in such other statements, are intended to identify forward-looking statements, although some statements may use other phrasing. All statements that express expectations and projections with respect to future matters, including, without limitation, statements relating to growth, new lines of business and general optimism about future operating results, are forward-looking statements. All forward-looking statements and information in this Quarterly Report are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act, as amended, and are intended to be covered by the safe harbors created thereby. Such forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to differ materially from historical results or from any results expressed or implied by such forward-looking statements. Such factors include, without limitation:

- (i) Changes in reimbursement rates, policies or payment practices by third-party payors, whether initiated by the payor or legislatively mandated, or uncollectible accounts in excess of current estimates;
  - (ii) The loss of major payors or customers;
  - (iii) Impairment of the Company’s rights in intellectual property;
  - (iv) Increased or more effective competition;
- (v) New technologies that render obsolete or non-competitive products and services offered by the Company;
- (vi) Changes in or new interpretations of laws or regulations applicable to the Company, its customers or referral sources or failure to comply with existing laws and regulations;
  - (vii) Increased exposure to professional negligence liability;
- (viii) Difficulties in successfully integrating recently acquired businesses into the Company’s operations and uncertainties related to the future performance of such businesses;
  - (ix) Changes in company-wide or business unit strategies;
  - (x) The effectiveness of the Company’s advertising, marketing and promotional programs;
- (xi) Market acceptance of the Company’s wellness and disease and condition management programs and the Company’s ability to sign and implement new wellness and disease and condition management contracts;
  - (xii) Inability to successfully manage the Company’s growth;
  - (xiii) Acquisitions that strain the Company’s financial and operational resources;
  - (xiv) Inability to forecast accurately or effect cost savings and clinical outcomes improvements or penalties for failure to meet the clinical or cost savings performance criteria under the Company’s disease management contracts or inability to reach agreement with the Company’s disease management customers with respect to the same;
- (xv) Inability of the Company’s disease management customers to provide timely and accurate data that is essential to the operation and measurement of the Company’s performance under its disease management contracts;
  - (xvi) Increases in interest rates;
- (xvii) Changes in the number of covered lives enrolled in the health plans with which the Company has agreements for payment;
- (xviii) The availability of adequate financing and cash flows to fund the Company’s capital and other anticipated expenditures;
  - (xix) Higher than anticipated costs of doing business that cannot be passed on to customers;

- (xx) Pricing pressures;
- (xxi) Information technology failures or obsolescence or the inability to effectively integrate new technologies;
- (xxii) The outcome of legal proceedings or investigations involving the Company, and the adequacy of insurance coverage in the event of an adverse judgment;
- (xxiii) Competition for staff;
- (xxiv) Changes in estimated payments of earn-out consideration;
- (xxv) Delay or failure to consummate the Company's proposed merger with Inverness; and
- (xxvi) The risk factors discussed from time to time in the Company's SEC reports, including but not limited to, the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

These factors are not intended to be an all-encompassing list of risks and uncertainties that may affect the operations, performance, development and results of our business. Many of such factors are beyond the Company's ability to control or predict, and readers are cautioned not to put undue reliance on such forward-looking statements. In providing forward-looking statements, the Company expressly disclaims any obligation to update these statements publicly or otherwise, whether as a result of new information, future events or otherwise, except as may be required by law.

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

We are exposed to market risk from changes in interest rates on long-term debt.

Our primary interest rate risk relates to the Credit Facility and our interest rate swap facilities. In February and May 2006, we entered into two interest rate swap agreements, each with a notional amount of \$100.0 million, to hedge exposure to fluctuations in interest rates related to our Credit Facility. The agreements, which have two-year terms, have the economic effect of converting \$200.0 million of floating-rate debt under the Credit Facility to fixed-rate debt. In February 2008, we terminated the February 2006 swap according to the terms of the agreement. The provisions of the May 2006 agreement provide that we pay the bank fixed base rate of 5.350%, and the bank will pay us a floating rate based on three-month LIBOR (2.703% at March 31, 2008). In August 2007, we entered into two additional interest rate swap agreements, each with a notional amount of \$100.0 million. These agreements also have two-year terms and have the economic effect of converting \$200.0 million of floating-rate debt to fixed-rate debt. We will pay the bank fixed base rates of 4.890% and 4.910%, respectively, under these swap arrangements, and the bank will pay us floating rates based on three-month LIBOR. Based upon the total amount of debt outstanding at March 31, 2008, not covered by interest rate swaps, a hypothetical two percentage point increase in the interest rates for a duration of one year would result in additional interest expense of approximately \$1.5 million.

### Item 4. Controls and Procedures

#### (a) Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer and our Chief Financial Officer have evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of March 31, 2008. No process, no matter how well designed and operated, can provide absolute assurance that the objectives of the process are met in all cases. However, our disclosure controls and procedures are designed to provide reasonable assurance that the certifying officers will be alerted on a timely basis to material information relating to the Company, including the Company's consolidated subsidiaries, required to be included in our reports filed or submitted under the Exchange Act.



Based on such evaluation, such officers have concluded that our disclosure controls and procedures were effective as of March 31, 2008, to provide reasonable assurance that the objectives of the disclosure controls and procedures were met.

(b) Changes in Internal Control Over Financial Reporting

During the three months ended March 31, 2008, there were no significant changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 1A. Risk Factors

As of the date of the report, there have been no material changes to the risk factors included in Item 1A to our Annual Report on Form 10-K for the year ended December 31, 2007.

Item 6. Exhibits

Exhibit Number	Description
10.1	Third Amendment to Lease Agreement dated November 24, 2004, between Atlanta Parkway Investment Group, Inc. and Matria Healthcare, Inc.
10.2	Fourth Amendment to Lease Agreement dated December 29, 2006, between NM Owner LLC and Matria Healthcare, Inc.
*10.3	Severance, Release and Restrictive Covenant Agreement dated February 26, 2008, between Matria Healthcare, Inc. and Richard M. Hassett, MD.
31.1	Rule 13a-14(a)/15d-14(a) Certification by Parker H. Petit
31.2	Rule 13a-14(a)/15d-14(a) Certification by Jeffrey L. Hinton
32.1	Section 1350 Certification by Parker H. Petit
32.2	Section 1350 Certification by Jeffrey L. Hinton

\* Management contract or compensatory plan or arrangement.

SIGNATURES

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

MATRIA HEALTHCARE, INC.

May 6, 2008

By: /s/ Parker H. Petit  
Parker H. Petit  
Chairman of the Board and  
Chief Executive Officer

/s/ Jeffrey L. Hinton  
Jeffrey L. Hinton  
Senior Vice President and  
Chief Financial Officer

