
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2011

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: 000-50940

ROTECH HEALTHCARE INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

030408870
(I.R.S. Employer
Identification No.)

2600 Technology Drive, Suite 300, Orlando, Florida
(Address of principal executive offices)

32804
(Zip Code)

(407) 822-4600
(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if smaller reporting company)

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

As of May 3, 2011, the registrant had 25,680,268 shares of common stock outstanding.

TABLE OF CONTENTS

	<u>Page No.</u>
PART I—FINANCIAL INFORMATION	
<u>Item 1—Financial Statements (unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets—March 31, 2011 and December 31, 2010</u>	3
<u>Condensed Consolidated Statements of Operations—Three months ended March 31, 2011 and 2010</u>	4
<u>Condensed Consolidated Statements of Cash Flows—Three months ended March 31, 2011 and 2010</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
<u>Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	12
<u>Item 3—Quantitative and Qualitative Disclosures About Market Risk</u>	26
<u>Item 4—Controls and Procedures</u>	26
PART II—OTHER INFORMATION	
<u>Item 1—Legal Proceedings</u>	26
<u>Item 1A—Risk Factors</u>	26
<u>Item 6—Exhibits</u>	28
<u>SIGNATURES</u>	29
<u>INDEX TO EXHIBITS</u>	30

PART I—FINANCIAL INFORMATION

Item 1—Financial Statements

ROTECH HEALTHCARE INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	<u>March 31,</u> <u>2011</u>	<u>December 31,</u> <u>2010</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 44,388	\$ 63,046
Accounts receivable, net	77,647	68,042
Other receivables	3,817	2,480
Income taxes receivable	121	111
Inventories	12,308	10,020
Prepaid expenses	4,677	3,390
Total current assets	<u>142,958</u>	<u>147,089</u>
Property and equipment, net	108,643	105,290
Intangible assets (less accumulated amortization of \$9,919 at March 31, 2011 and \$9,600 at December 31, 2010)	15,269	14,434
Restricted cash	8,765	12,927
Other assets, including debt issue costs	20,562	11,322
	<u>\$ 296,197</u>	<u>\$ 291,062</u>
Liabilities and Stockholders' Deficiency		
Current liabilities:		
Accounts payable	\$ 28,649	\$ 19,637
Accrued expenses and other current liabilities	15,075	14,237
Accrued interest	13,317	13,159
Deferred revenue	8,949	9,058
Current portion of long-term debt	415	502
Total current liabilities	<u>66,405</u>	<u>56,593</u>
Deferred tax liabilities, net	513	614
Other long-term liabilities	536	515
Long-term debt, less current portion	508,896	510,909
Series A convertible redeemable preferred stock, stated value \$20 per share, 1,000,000 shares authorized, 239,496 shares issued and outstanding at March 31, 2011 and December 31, 2010	5,222	5,116
Commitments and contingencies		
Stockholders' deficiency:		
Common stock, par value \$.0001 per share 50,000,000 shares authorized, 25,680,268 and 25,616,103 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively	3	3
Additional paid-in capital	507,069	506,960
Accumulated deficit	<u>(792,447)</u>	<u>(789,648)</u>
Total stockholders' deficiency	<u>(285,375)</u>	<u>(282,685)</u>
	<u>\$ 296,197</u>	<u>\$ 291,062</u>

See accompanying notes to unaudited condensed consolidated financial statements.

ROTECH HEALTHCARE INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)

	Three months ended	
	March 31,	
	2011	2010
Net revenues	\$ 121,506	\$ 123,366
Costs and expenses:		
Cost of net revenues	39,098	40,843
Selling, general and administrative	62,631	66,408
Provision for doubtful accounts	5,239	9,331
Depreciation and amortization	2,374	2,005
Total costs and expenses	<u>109,342</u>	<u>118,587</u>
Operating income	<u>12,164</u>	<u>4,779</u>
Other expense (income):		
Interest expense, net	14,567	11,124
Other (income) expense, net	(862)	13
Loss on debt extinguishment	1,216	—
Total other expense	<u>14,921</u>	<u>11,137</u>
Loss before income taxes	(2,757)	(6,358)
Income tax (benefit) expense	(64)	150
Net loss	<u>(2,693)</u>	<u>(6,508)</u>
Accrued dividends on convertible redeemable preferred stock	106	91
Net loss attributable to common stockholders	<u>\$ (2,799)</u>	<u>\$ (6,599)</u>
Net loss per common share:		
Basic and diluted	<u>\$ (0.11)</u>	<u>\$ (0.26)</u>
Weighted average shares outstanding:		
Basic and diluted	25,644,113	25,541,270

See accompanying notes to unaudited condensed consolidated financial statements.

ROTECH HEALTHCARE INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Three months ended	
	March 31,	
	2011	2010
Net loss	\$ (2,693)	\$ (6,508)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for doubtful accounts	5,239	9,331
Depreciation and amortization	16,024	15,892
Loss on debt extinguishment	1,216	—
Deferred income taxes	(101)	86
Other	(21)	102
Changes in operating assets and liabilities:		
Accounts receivable	(14,844)	(13,811)
Other receivables	(1,337)	(1,055)
Income taxes receivable	(10)	—
Inventories	(2,242)	2,393
Prepaid expenses	(1,286)	(197)
Other assets	(2,026)	92
Accounts payable and accrued expenses	5,050	(1,685)
Other long-term liabilities	21	20
Accrued interest	158	6,839
Deferred revenue	(109)	(218)
Net cash provided by operating activities	<u>3,039</u>	<u>11,281</u>
Cash flows from investing activities:		
Purchases of property and equipment	(12,878)	(11,222)
Identifiable intangible assets associated with equipment purchases	(263)	—
Cash paid for asset purchases	(2,486)	—
Withdrawals from restricted cash	4,162	—
Net cash used in investing activities	<u>(11,465)</u>	<u>(11,222)</u>
Cash flows from financing activities:		
Payments on capital leases	(145)	(75)
Payments of other liabilities	—	(175)
Proceeds from long-term borrowing	284,771	—
Retirement of long-term borrowing	(287,000)	—
Debt issue costs	(7,479)	—
Net proceeds from stock option exercise	56	—
Payments of dividends on Series A convertible redeemable preferred stock	(435)	—
Net cash used in financing activities	<u>(10,232)</u>	<u>(250)</u>
Decrease in cash and cash equivalents	(18,658)	(191)
Cash and cash equivalents, beginning of period	63,046	58,904
Cash and cash equivalents, end of period	<u>\$ 44,388</u>	<u>\$ 58,713</u>

See accompanying notes to unaudited condensed consolidated financial statements.

ROTECH HEALTHCARE INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(In thousands, except share and per share data)

(1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Rotech Healthcare Inc. and its subsidiaries and have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. In the opinion of management, all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results of operations for the interim periods presented have been reflected herein. Interim results are not necessarily indicative of results to be expected for the full year. The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make assumptions that affect the amounts reported in the financial statements and accompanying notes. In general, management's estimates are based upon historical experience and various other assumptions that we believe to be reasonable under the facts and circumstances. Actual results could differ from those estimates made by management. For further information, refer to the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2010. There have been no material changes to our significant accounting policies as disclosed in our consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2010.

The Company has evaluated significant events and transactions that occurred after March 31, 2011 through the date of filing this report on Form 10-Q.

As used in these notes, unless otherwise specified or the context otherwise requires, references to "the Company", "we", "our" and "us" refer to the business and operations of Rotech Healthcare Inc. and its subsidiaries.

For all periods presented herein, there were no differences between net income and comprehensive income.

(2) Liquidity

We completed a refinancing of our former 9.5% Senior Subordinated Notes due 2012 (the "Senior Subordinated Notes") in March 2011 with the issuance of \$290,000 in aggregate principal amount of 10.5% Senior Second Lien Notes due 2018 (the "Senior Second Lien Notes"). We completed a refinancing of our former payment-in-kind term loan facility (the "Senior Facility") in October 2010 with the issuance of \$230,000 in aggregate principal amount of 10.75% Senior Secured Notes due 2015 (the "Senior Secured Notes").

We are highly leveraged. As of March 31, 2011, we had \$509,311 of long-term debt outstanding. Our Senior Secured Notes (\$224,037) mature in October 2015 and our Senior Second Lien Notes (\$284,793) mature in March 2018. Although we are highly leveraged, management believes, based upon our current cash projections that our current cash balances, cash generated from our operations and available credit under our revolving credit facility will be sufficient to meet our working capital, capital expenditure and other cash obligations for the next twelve months.

(3) Earnings Per Common Share

Basic earnings per share (EPS) is computed by dividing net earnings available to common shareholders by the weighted average number of common shares outstanding for the periods. Diluted EPS reflects the potential dilution of securities that could share in the earnings and are based upon the weighted average number of common and common equivalent shares outstanding during the three months ended March 31, 2011 and 2010. Common equivalent shares related to employee stock options and the Series A convertible redeemable preferred stock ("Series A Preferred") on an "if converted" basis totaled 2,983,201 and 3,589,000 for the three months ended March 31, 2011 and 2010, respectively, are excluded from the computation of diluted EPS in periods where they have an anti-dilutive effect. We use the treasury stock method to compute the dilutive effects of common equivalent shares.

The reconciliations of net loss attributable to common shareholders and shares outstanding for purposes of calculating basic and diluted EPS for the three months ended March 31, 2011 and 2010 are as follows:

	<u>Net Loss (Numerator)</u>	<u>Shares (Denominator)</u>	<u>Per Share Amount</u>
For the Three Months Ended March 31, 2011:			
Basic and diluted EPS:			
Net loss	\$ (2,693)		
Accrued dividends on convertible redeemable preferred stock	<u>106</u>		
Net loss attributable to common stockholders	<u>\$ (2,799)</u>	<u>25,644,113</u>	<u>\$ (0.11)</u>
For the Three Months Ended March 31, 2010:			
Basic and diluted EPS:			
Net loss	\$ (6,508)		
Accrued dividends on convertible redeemable preferred stock	<u>91</u>		
Net loss attributable to common stockholders	<u>\$ (6,599)</u>	<u>25,541,270</u>	<u>\$ (0.26)</u>

Each share of our Series A Preferred has a stated value of \$20 and entitles the holder to an annual cumulative dividend equal to 9% of its stated value, payable semi-annually at the discretion of our board of directors in cash or in additional shares of Series A Preferred. In the event dividends are declared by our board of directors but not paid for six consecutive periods, the holders of the Series A Preferred are entitled to vote as a separate class to elect one director to serve on our board of directors. Effective December 5, 2003, our board of directors adopted a policy of declaring dividends to the holders of the Series A Preferred under the Rotech Healthcare Inc. Employees Plan on an annual basis, with each such declaration to be made at the meeting of the board of directors following the annual meeting of shareholders with respect to dividends payable for the preceding year. At the meeting of the board of directors held on June 22, 2010, dividends in the amount of \$435 were declared on our Series A Preferred and were paid in January 2011.

(4) Equipment and Asset Purchases

During the three months ended March 31, 2011 and 2010, we completed \$5,809 and \$282, respectively, of purchases of new and used rental equipment and inventory from competitors exiting the home health care market which represents a limited subset of the assets and activities used in operating their respective businesses ("Equipment Purchases"). The aggregate cost of these Equipment Purchases has been recorded as follows:

	<u>Three Months Ended March 31,</u>	
	<u>2011</u>	<u>2010</u>
Property and equipment	\$ 5,103	\$ 268
Inventory	443	14
Identifiable intangible assets	<u>263</u>	<u>—</u>
Total	<u>\$ 5,809</u>	<u>\$ 282</u>

During the three months ended March 31, 2011, we completed purchases of new and used rental equipment, inventory and other additional assets, including identifiable intangible assets, from competitors exiting the home health care market representing a business combination ("Asset Purchases") totaling \$3,173, the aggregate cost of which has been recorded as follows:

	<u>Three Months Ended March 31, 2011</u>
Property and equipment	\$ 2,193
Identifiable intangible assets	934
Inventory	<u>46</u>
Total	<u>\$ 3,173</u>

We did not have any Asset Purchases during the three months ended March 31, 2010. Pro forma results and other expanded disclosures required by the Financial Accounting Standards Board Accounting Standards Codification Topic 805, *Business Combinations*, have not been presented as these purchases individually and in the aggregate are not material.

(5) Intangible Assets

Intangible assets of a reporting unit will be tested for impairment if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount.

The following table reflects the components of intangible assets:

	March 31, 2011		December 31, 2010	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Intangible assets subject to amortization:				
Customer/physician relationship	\$ 12,000	\$ 5,400	\$ 12,000	\$ 5,250
Computer software	5,000	3,000	5,000	2,917
Other	6,188	1,519	5,034	1,433
Subtotal	23,188	9,919	22,034	9,600
Intangible assets not subject to amortization:				
Trade name	1,000	—	1,000	—
Medicare licenses	1,000	—	1,000	—
Subtotal	2,000	—	2,000	—
Total intangible assets	\$ 25,188	\$ 9,919	\$ 24,034	\$ 9,600

During 2011, we wrote off fully amortized intangibles in the amount of \$43. Amortization expense for the three months ended March 31, 2011 and 2010 was approximately \$362 and \$326, respectively. During 2011, we recorded \$1,197 of other intangibles subject to amortization which have a weighted average remaining life of 3.5 years.

Estimated amortization expense for each of the fiscal years ending December 31, is as follows:

	Amount
2011	\$1,547
2012	1,574
2013	1,571
2014	1,409
2015	1,250

(6) Segment Data

We operate in one reportable segment with three primary product lines: respiratory therapy equipment and services, durable medical equipment, and other products and services. The following table presents net revenues from distribution by each of our three primary product lines:

	Three Months Ended March 31,	
	2011	2010
Respiratory therapy equipment and services	\$106,056	\$106,660
Durable medical equipment	12,888	13,278
Other	2,562	3,428
Net revenue	\$121,506	\$123,366

(7) Other Commitments and Contingencies

We are subject to workers' compensation and employee health benefit claims, which are primarily self-insured. We do, however, maintain certain stop-loss and other insurance coverage which management believes to be appropriate.

Provisions for estimated settlements relating to workers' compensation are provided in the applicable period on a case-by-case basis. We review our estimated provisions on a quarterly basis and make changes when necessary. Differences between the amounts accrued and subsequent settlements are recorded in operations in the period of settlement. We estimate claim amounts incurred but not reported relating to health benefit plans in the applicable period and review such amounts on a quarterly basis.

We and our subsidiaries are parties to various legal proceedings in the ordinary course of business. For more information regarding our recent legal proceedings, see Note 8, "Certain Significant Risks and Uncertainties and Significant Events."

(8) Certain Significant Risks and Uncertainties and Significant Events

We and others in the health care business are subject to certain inherent risks, including the following:

- Substantial dependence on revenues derived from reimbursement by various federal health care programs (including Medicare) and State Medicaid programs which have been significantly reduced in recent years and which entail exposure to various health care fraud statutes;
- Inconsistent payment patterns from Centers for Medicare and Medicaid Services and its contractors or other third-party payors;
- Government regulations, government budgetary constraints and proposed legislative, reimbursement and regulatory changes; and
- Lawsuits alleging negligence in the provision of healthcare services and related claims.

Such inherent risks require the use of certain management estimates in the preparation of our financial statements and it is reasonably possible that changes in such estimates may occur.

We receive payment for a significant portion of services rendered to patients from the federal government under Medicare and other federally funded programs (including the Veterans Administration (VA)) and from the states under Medicaid. Revenue derived from Medicare, Medicaid and other federally funded programs represented 57.2% and 57.7% of our patient revenue for the three months ended March 31, 2011 and 2010, respectively.

(9) Debt

Our long-term debt consists of the following:

	<u>March 31, 2011</u>	<u>December 31, 2010</u>
Capital lease obligations with interest implied at fixed rates between 5.5% and 12.0%, due in equal monthly installments with terms expiring from July 2011 through November 2012, secured by equipment	\$ 481	\$ 629
10.75% Senior Secured Notes, due October 15, 2015, interest payable semi-annually on April 15 and October 15, net of \$5,963 and \$6,218 unamortized original issue discount at March 31, 2011 and December 31, 2010, respectively	224,037	223,782
10.5% Senior Second Lien Notes, due March 15, 2018, interest payable semi-annually on March 15 and September 15, net of \$5,207 unamortized original issue discount at March 31, 2011	284,793	—
9.5% Senior Subordinated Notes, due April 1, 2012, interest payable semi-annually on April 1 and October 1, fully satisfied March 17, 2011	—	287,000
Subtotal	<u>509,311</u>	<u>511,411</u>
Less current portion	415	502
Total long-term debt	<u>\$508,896</u>	<u>\$ 510,909</u>

On March 17, 2011, we issued \$290,000 in aggregate principal amount of Senior Second Lien Notes. The Senior Second Lien Notes were offered and sold in a private placement to Credit Suisse Securities (USA) LLC and Jefferies & Company, Inc. (the "Initial Purchasers") in reliance on the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"), and resold by the Initial Purchasers to qualified buyers pursuant to exemptions from registration provided by Rule 144A and Regulation S of the Securities Act. The Senior Second Lien Notes were also offered and sold to certain directors of the Company who are accredited investors as defined in Rule 501(a) under the Securities Act.

The Senior Second Lien Notes were issued at a discount of \$5,229 and we incurred transaction costs of approximately \$8,823. The discount and transaction costs associated with the Senior Second Lien Notes will be amortized as interest expense over the term of these notes. Interest will be payable semi-annually on March 15 and September 15 commencing on September 15, 2011. We used the proceeds from the offering of the Senior Second Lien Notes, together with \$24,485 of cash on hand, to repay all of our outstanding Senior Subordinated Notes and pay associated fees and expenses. In conjunction with the closing of the

Senior Second Lien Notes on March 17, 2011, we deposited \$301,920 with Bank of New York Mellon N.A., as trustee (the "Trustee"), to satisfy our obligation with respect to the Senior Subordinated Notes including the principal amount of \$287,000 and accrued interest through April 18, 2011 of \$14,920, of which \$1,288 is included in prepaid expenses in the accompanying condensed consolidated balance sheet as of March 31, 2011. We were legally released of our liability effective March 17, 2011. Upon completion of the 30-day notice period required under the indenture governing our Senior Subordinated Notes, on April 18, 2011, the Trustee redeemed and cancelled the Senior Subordinated Notes. As a result of the termination of the Senior Subordinated Notes we recorded a \$1,216 loss on extinguishment of debt related to unamortized debt issuance costs.

The Senior Second Lien Notes will mature on March 15, 2018. In connection with the issuance of the Senior Second Lien Notes, we entered into a registration rights agreement with the Initial Purchasers of the Senior Second Lien Notes, dated March 17, 2011 (the "Senior Second Lien Notes Registration Rights Agreement"). Pursuant to the Senior Second Lien Notes Registration Rights Agreement, we agreed to exchange the Senior Second Lien Notes for freely tradable notes with terms that are substantially identical to the Senior Second Lien Notes. We also agreed, in limited circumstances, to file a shelf registration statement with respect to the Senior Second Lien Notes.

The indenture governing the Senior Second Lien Notes contains covenants that limit our ability and the ability of our restricted subsidiaries to, among other things: sell assets; pay dividends or make other distributions or repurchase or redeem our stock; incur or guarantee additional indebtedness; incur certain liens; make loans and investments; enter into agreements restricting our subsidiaries' ability to pay dividends; consolidate, merge or sell all of substantially all of our assets, and enter into transactions with affiliates. The Senior Second Lien Notes are secured by a second priority security interest in substantially all of the Company's assets. The Senior Second Lien Notes are guaranteed by all of our wholly owned subsidiaries. Each guarantee is full and unconditional and joint and several. We hold all of our assets and conduct all of our operations through our wholly owned subsidiaries and we do not have independent assets and operations.

Additionally, on March 17, 2011 we entered into a credit agreement with Credit Suisse AG, as administrative agent, Credit Suisse Securities (USA) LLC and Jefferies Finance LLC, as joint bookrunners and joint lead arrangers and Jefferies Finance LLC, as documentation agent. The credit agreement provides for a revolving credit facility commitment of up to \$10,000 provided that the maximum outstanding aggregate principal balance at any one time does not exceed \$10,000 (the "Revolving Credit Facility"). The Revolving Credit Facility expires on March 17, 2012. There was no debt outstanding under the Revolving Credit Facility as of March 31, 2011.

The Revolving Credit Facility contains customary covenants similar to those in our indentures governing our Senior Secured Notes and Senior Second Lien Notes. The Revolving Credit Facility also includes a maximum leverage ratio above which level we would be precluded from making any additional draws. As of March 31, 2011, we were below the maximum leverage ratio threshold, as defined therein.

All borrowings under the Revolving Credit Facility are secured by a first priority security interest in substantially all of the Company's assets. The interest rate per annum applicable to the Revolving Credit Facility is adjusted LIBOR or, at our option, the alternate base rate, which is the higher of (a) the prime rate, (b) the federal funds effective rate plus 0.50%, and (c) the adjusted LIBOR plus 1.0% in each case, plus the applicable margin (as defined below). The applicable margin in the case of LIBOR advances is 5.0% and in the case of alternate base rate advances is 4.0%. The default rate on the Revolving Credit Facility is 2.0% above the otherwise applicable interest rate. We are also obligated to pay a commitment fee of 0.75% on the unused portion of our Revolving Credit Facility.

On October 6, 2010, we issued \$230,000 in aggregate principal amount of Senior Secured Notes. The Senior Secured Notes were offered and sold in a private placement to Credit Suisse Securities (USA) LLC (the "Initial Purchaser") in reliance on the exemption from registration provided by the Securities Act, and resold by the Initial Purchaser to qualified buyers pursuant to exemptions from registration provided by Rule 144A and Regulation S of the Securities Act.

The Senior Secured Notes were issued at a discount of \$6,465 and we incurred transaction costs of approximately \$7,983. The discount and transaction costs associated with the Senior Secured Notes will be amortized as interest expense over the term of those notes. Interest will be payable semi-annually on April 15 and October 15 commencing on April 15, 2011. We used the proceeds from the offering of the Senior Secured Notes, together with \$13,698 of cash on hand, to repay all of the outstanding indebtedness including accrued interest of \$2,761 under our former Senior Facility and pay associated fees and expenses. As a result of the termination of the Senior Facility dated March 30, 2007, we recorded a \$4,401 loss on extinguishment of debt related to unamortized debt issuance costs of \$2,143 and prepayment premiums of \$2,258.

The Senior Secured Notes will mature on October 15, 2015. In connection with the issuance of the Senior Secured Notes, we entered into a registration rights agreement with the Initial Purchaser of the Senior Secured Notes, dated October 6, 2010 (the "Senior Secured Notes Registration Rights Agreement"). Pursuant to the Senior Secured Notes Registration Rights Agreement, we agreed to exchange the Senior Secured Notes for freely tradable notes with terms that are substantially identical to the Senior Secured Notes. We also agreed, in limited circumstances, to file a shelf registration statement with respect to the Senior Secured Notes. On January 14, 2011, we completed the registered exchange offer with respect to the Senior Secured Notes.

The indenture governing the Senior Secured Notes contains covenants that limit our ability and the ability of our restricted subsidiaries to, among other things: sell assets; pay dividends or make other distributions or repurchase or redeem our stock;

incur or guarantee additional indebtedness; incur certain liens; make loans and investments; enter into agreements restricting our subsidiaries' ability to pay dividends; consolidate, merge or sell all or substantially all of our assets, and enter into transactions with affiliates. The Senior Secured Notes are secured by a first priority security interest in substantially all of the Company's assets. The Senior Secured Notes are guaranteed by all of our wholly owned subsidiaries. Each guarantee is full and unconditional and joint and several. We hold all of our assets and conduct all of our operations through our wholly owned subsidiaries and we do not have independent assets and operations.

During the three months ended March 31, 2010 we paid \$3,528 of interest in cash under our former Senior Facility.

We have outstanding letters of credit totaling \$8,765 as of March 31, 2011 and December 31, 2010. Our letters of credit were cash collateralized at 100% and 105% of their face amount, as of March 31, 2011 and December 31, 2010, respectively. The cash collateral for these outstanding letters of credit is included in restricted cash on our accompanying consolidated balance sheet as of March 31, 2011 and December 31, 2010.

The fair values of our Senior Second Lien Notes at March 31, 2011 and our Senior Secured Notes at December 31, 2010 approximate their respective carrying values, because of the relatively short time period they have been outstanding. The fair value of our Senior Secured Notes at March 31, 2011 and our Senior Subordinated Notes at December 31, 2010 are based on quoted market prices. The estimated fair value of the Senior Secured Notes at March 31, 2011 was \$251,921. The estimated fair value of the Senior Subordinated Notes at December 31, 2010 was \$277,054.

(10) Income Taxes

We recorded a net tax benefit of \$64 and a net tax expense of \$150 for the three months ended March 31, 2011 and 2010, respectively. The current period tax benefit is primarily the result of a decrease of \$101 in our liabilities recorded for uncertain tax positions and a current state tax expense of \$37. We have provided a full valuation allowance against our remaining net deferred tax assets as of March 31, 2011 because management's judgment is that it is more likely than not that the net deferred tax assets resulting from the net loss for the quarter ended March 31, 2011 will not be realized, based on a cumulative book losses.

At March 31, 2011, we had available federal net operating loss (NOL) carryforwards of approximately \$184,663 net of the de-recognition recorded as a result of the change in ownership interest under Section 382 of the Internal Revenue Code that occurred on December 31, 2006. These remaining NOLs fully expire in 2031. NOL carryforwards and credits are subject to review and possible other adjustments by the Internal Revenue Service and may be further limited by the occurrence of certain events, including other significant changes in ownership interests. The effect of an ownership change is the imposition of an annual limitation on the use of the NOL carryforwards attributable to periods before the change.

We recorded a liability of \$447 and \$525 for unrecognized tax benefits related to various federal and state income tax matters as of March 31, 2011 and December 31, 2010, respectively. If recognized, all of these amounts would impact our effective tax rate. There is no difference between the total amount of unrecognized tax benefit and the amount that would impact the effective tax rate based on the current valuation of the deferred tax assets. We do not expect that the amounts of unrecognized tax benefits will change significantly within the next 12 months.

We are currently open to audit under the statute of limitations by the Internal Revenue Service for all years ended December 31, 2002 to present. However, we are only open to additional tax assessments under the Internal Revenue Code statute of limitations for the years ended December 31, 2007 to present. The IRS commenced examinations of the Company's U.S. income tax return for 2008 in the third quarter of 2010 and for 2009 in the first quarter of 2011. As of March 31, 2011, the IRS has not proposed any adjustments although these examinations are still ongoing. Our state income tax returns are open to audit and additional tax assessments under the various state statutes of limitations for the years ended December 31, 2002 to present.

There is \$66 and \$89 of accrued interest related to uncertain tax positions as of March 31, 2011 and December 31, 2010, respectively. No penalties have been accrued. We account for interest and penalties related to uncertain tax positions as part of our provision for federal and state income taxes.

(11) Supplemental Cash Flow and Non-cash Investing and Financing Information

	Three months ended	
	March 31,	
	2011	2010
Cash payments for:		
Interest	\$14,915	\$3,562
Income taxes paid	48	65
Non-cash investing and financing activities:		
Property and equipment unpaid and included in accounts payable	6,544	3,818
Purchase price payable for asset purchases included in accounts payable	687	
Accrued debt issue costs	1,608	—

(12) Subsequent Events

On May 2, 2011, we received a termination notice from Humana exercising their right to terminate our existing national fee for service contracts with them effective October 31, 2011. We do not expect this termination to have a material effect during the year ended December 31, 2011. The associated contracts contributed an estimated \$4,000 in operating income for the year ended December 31, 2010.

Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and the notes thereto included elsewhere in this Quarterly Report on Form 10-Q and our consolidated financial statements for the year ended December 31, 2010 and the notes thereto included in our Annual Report on Form 10-K previously filed with the Securities and Exchange Commission. As used herein, unless otherwise specified or the context otherwise requires, references to the “Company”, “we”, “our” and “us” refer to the business and operations of Rotech Healthcare Inc. and its subsidiaries.

Introduction

Background

We are one of the largest providers of home medical equipment and related products and services in the United States, with a comprehensive offering of respiratory therapy and durable home medical equipment and related services. We provide home medical equipment and related products and services principally to older patients with breathing disorders, such as chronic obstructive pulmonary diseases (COPD), which include chronic bronchitis, emphysema, obstructive sleep apnea and other cardiopulmonary disorders. We provide equipment and services in 48 states through approximately 425 operating locations located primarily in non-urban markets.

Our revenues are principally derived from respiratory equipment rental and related services, which accounted for 87.3% and 86.5% of net revenues for the three months ended March 31, 2011 and 2010, respectively. Revenues from respiratory equipment rental and related services include rental of oxygen concentrators, liquid oxygen systems, portable oxygen systems, ventilator therapy systems, nebulizer equipment and sleep disorder breathing therapy systems, and the sale of nebulizer medications. We also generate revenues through the rental and sale of durable medical equipment, which accounted for 10.6% and 10.8% of net revenues for the three months ended March 31, 2011 and 2010, respectively. Revenues from durable medical equipment include rental and sale of hospital beds, wheelchairs, walkers, patient aids and ancillary supplies. We derive our revenues principally from reimbursement by third-party payors, including Medicare, Medicaid, the Veterans Administration (VA) and private insurers.

We are focused on specific initiatives to continue the growth in patient and product counts experienced over the past three years. We continue to further develop our sales and operational training programs, and have introduced new incentive programs that we believe will better equip and motivate our sales force, and ultimately drive additional growth. During 2010, we substantially completed development of a new order intake system that will streamline our order intake processes and eliminate many of our current, paper-based processes; we will be implementing this system in our operating locations during 2011.

Executive Summary

We face significant financial and Medicare reimbursement related challenges that continue to negatively affect our financial position. We anticipate that we will continue to face such challenges in both the near and long-term future. Most of these difficulties result from our highly leveraged capital structure, while others are the result of significant Medicare reimbursement reductions applicable to our industry, as well as current conditions in the capital markets.

In light of these challenges, our operational focus is on reducing our cost structure while maintaining internal growth and seeking opportunities to gain market share through selective equipment and asset purchases from competitors exiting the home medical equipment market. In particular:

- During the first three months of 2011, we purchased \$9.0 million of new and used rental equipment, inventory and certain identifiable intangible assets from competitors exiting the home medical equipment market. Some of the equipment purchased in these transactions is currently on rent and located in a patient’s home. We believe that we will be successful in identifying additional equipment and asset purchase opportunities and that we will be able to successfully transition and retain a high percentage of the associated patients onto service with our Company. During the three months ended March 31, 2011, we have recognized approximately \$4.9 million of revenues associated with patients transitioned onto service with our Company through equipment and asset purchases.
- During the first three months of 2010, we purchased \$0.3 million of new and used rental equipment and inventory from competitors exiting the home medical equipment market. Some of the equipment purchased in these transactions is currently on rent and located in patients’ homes. During the three months ended March 31, 2010, we have recognized approximately \$4.5 million of revenues associated with patients transitioned onto service with our Company through equipment purchases.
- During 2010, we implemented several new initiatives intended to streamline our workflows and further leverage new internally developed systems and system enhancements. These reductions, in addition to other cost saving initiatives, decreased our selling, general and administrative expenses as a percentage of net revenue to 51.5% for the three months ended March 31, 2011 as compared to 53.8% for the three months ended March 31, 2010.

These strategic and operational initiatives were implemented in order to improve our financial performance and thereby best position us to complete the refinancing of our 2011-2012 debt maturities and provide adequate cash flow to service our outstanding

long-term debt and fund our strategic growth initiatives. Our 2011 financial plans call for continued improvements in financial performance compared to 2010.

We currently intend, between the date of this report and the end of 2011, to file an application to list our common shares on the NASDAQ Stock Market, subject to our meeting the associated listing requirements. Upon such filing, our listing application will be subject to review and approval by NASDAQ's Listing Qualifications department for compliance with all NASDAQ Stock Market standards. There can be no assurance of when or if our common shares will be listed on the NASDAQ Stock Market or another stock exchange.

Reimbursement by Third Party Payors

We derive substantially all of our revenues from reimbursement by third-party payors, including Medicare, Medicaid, the VA and private insurers. Revenue derived from Medicare, Medicaid and other federally funded programs represented 57.2% and 57.7% of our patient revenue for the three months ended March 31, 2011 and 2010, respectively. Our business has been, and may continue to be, significantly impacted by changes mandated by Medicare legislation.

Under existing Medicare laws and regulations, the sale and rental of our products generally are reimbursed by the Medicare program according to prescribed fee schedule amounts calculated using statutorily-prescribed formulas. Significant legislation affecting home medical equipment (HME) reimbursement has been signed into law, including the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Affordability Reconciliation Act (collectively, the "PPACA"), Medicare Improvement for Patients and Providers Act of 2008 (MIPPA), Medicare, Medicaid and State Children's Health Insurance Program Extension Act of 2007 ("SCHIP Extension Act"), the Deficit Reduction Act of 2005 (DRA) and the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA), contain provisions that negatively impact reimbursement for the primary HME products that we provide. The PPACA, MIPPA, the SCHIP Extension Act, DRA and MMA provisions (each of which is discussed in more detail below), when fully implemented, could have a material adverse effect on our financial condition, revenues, profit margins, profitability, operating cash flows and results of operations.

- The PPACA includes, among other things, annual, non-deductible fees on any entity that manufactures or imports certain prescription drugs and biologics, beginning in 2011; a deductible excise tax on any entity that manufactures or imports medical devices offered for sale in the United States, with limited exceptions, beginning in 2013; new face to face encounter requirements for HME and home health services; and a requirement that by 2016, the competitive bidding process must be nationalized or prices in non-competitive bidding areas must be adjusted to match competitive bidding prices.
- MIPPA retroactively delayed the implementation of competitive bidding for eighteen months and decreased the 2009 schedule payment amounts by 9.5% for product categories included in competitive bidding.
- The SCHIP Extension Act reduced Medicare reimbursement amounts for covered Medicare Part B drugs, including inhalation drugs that we provide, which went into effect April 1, 2008.
- The DRA capped the Medicare rental period for oxygen equipment at 36 months of continuous use, after which time title of the equipment would transfer to the beneficiary. For purposes of this cap, the DRA provided for a new 36-month rental period that began January 1, 2006 for all oxygen equipment. With the passage of MIPPA, transfer of title of oxygen equipment at the end of the 36-month rental cap was repealed, although the rental cap remained in place.
- The MMA significantly reduced reimbursement for inhalation drug therapies beginning in 2005, reduced payment amounts for five categories of HME, including oxygen, beginning in 2005, froze payment amounts for other covered HME items through 2007, established a competitive bidding program for HME, and implemented quality standards and accreditation requirements for HME suppliers.

We cannot predict the impact that any federal legislation enacted in the future will have on our financial condition, revenues, profit margins, profitability, operating cash flows and results of operations.

Further, changes in the law or new interpretations of existing laws could have a dramatic effect on permissible activities, the relative costs associated with doing business and the amount of reimbursement by government and other third-party payors. Reimbursement from Medicare and other government programs is subject to federal and state statutory and regulatory requirements, administrative rulings, interpretations of policy, implementation of reimbursement procedures, renewal of VA contracts, retroactive payment adjustments and governmental funding restrictions. Our levels of revenue and profitability, like those of other health care companies, are affected by the continuing efforts of government payors to contain or reduce the costs of health care, including competitive bidding initiatives, measures that impose quality standards as a prerequisite to payment, policies reducing certain HME payment rates and restricting coverage and payment for inhalation drugs, and refinements to payments for oxygen and oxygen equipment.

(1) **Competitive Bidding Program for HME.** On April 2, 2007, the Centers for Medicare & Medicaid Services (CMS), the agency responsible for administering the Medicare program, issued its final rule implementing a competitive bidding program for certain HME products under Medicare Part B. This nationwide competitive bidding program is designed to replace the existing fee schedule payment methodology. Under the competitive bidding program, suppliers compete for the right to provide items to beneficiaries in a defined geographic region. CMS selects contract suppliers that agree to receive as payment

the “single payment amount” calculated by CMS after bids are submitted. Round one of the competitive bidding program began on July 1, 2008 in ten high-population competitive bidding areas (CBAs). As a winning bidder in nine of the ten CBAs, we signed contracts with CMS to become a contracted supplier for the Round 1 contract period of July 1, 2008 though June 30, 2011. The competitive bidding program was scheduled to expand to 70 additional CBAs for a total of 80 CBAs in 2009 and additional areas thereafter.

However, on July 15, 2008, the United States Congress, following an override of a Presidential veto, enacted MIPPA. MIPPA retroactively delays the implementation of competitive bidding for eighteen months, and terminates all existing contracts previously awarded. MIPPA includes a 9.5% nationwide reduction in reimbursement effective January 1, 2009 for the product categories included in competitive bidding, as a budget-neutrality offset for the eighteen month delay.

On January 16, 2009, CMS published an interim final rule with comment period (IFC) addressing the MIPPA provisions that affect round one of the competitive bidding program. This IFC announced the delay of round one of the program from 2007 to 2009. The Round 1 competition, also known as the Round 1 rebid, occurs in the same CBAs as the 2007 Round 1 bidding, excluding Puerto Rico. The product categories for 2009 are the same as those selected for the 2007 Round 1 bidding, with the exception of negative pressure wound therapy and Group 3 complex rehabilitative wheelchairs. The IFC also announced the delay of Round 2 of the program from 2009 to 2011, the national mail order program until after 2010 and competition in additional areas, other than mail order, until after 2011. We submitted our bids for each of the respective CBAs and product categories prior to the deadline. As in the 2007 Round 1 program, suppliers were required to meet all applicable eligibility, financial, quality and accreditation standards. The MIPPA changes that were addressed in this IFC did not alter the fundamental requirements of the final regulation for the competitive bidding program published on April 10, 2007.

On July 2, 2010 CMS announced the single payment amount for each of the respective Round 1 rebid CBAs and product categories and began offering contracts to certain bidders in the CBAs. We were awarded and have accepted 17 contracts as follows:

- 6 CBAs for oxygen supplies and equipment;
- 6 CBAs for enteral nutrients, equipment and supplies;
- 3 CBAs for continuous positive airway pressure, respiratory assist devices and related supplies and accessories; and
- 2 CBAs for standard power wheelchairs, scooter and related accessories

CMS announced the participating providers in November 2010. The contracts became effective January 1, 2011 and have a term of three years. The average reduction from current Medicare payment rates in this round of competitive bidding across the CBAs was 32%. Suppliers that were not contracted by CMS may continue to provide certain capped rental and oxygen equipment for those beneficiaries that were patients at the time the program began and are known as “grandfathered suppliers”. In the CBAs and product categories where we are not a contracted supplier, we continue to service our Medicare patients as a grandfathered supplier under applicable guidelines. Based upon CMS released information, it appears that approximately 70% of existing providers across the Round 1 Rebid CBAs were not awarded competitive bidding contracts and are therefore not able to provide competitive bid products to new Medicare patients during the term of these contracts in the respective CBAs. Although we do not have specific market share data relative to the 70% of providers not awarded competitive bidding contracts, we do expect that contracted providers within these CBAs will experience significant volume increases once the competitive bidding contracts became effective on January 1, 2011. The application of the new competitive bid rates in the Round 1 Rebid CBAs reduced our net revenue by approximately \$0.7 million for the three months ended March 31, 2011. We have experienced volume increases in the CBAs where we were awarded contracts, which we attribute to an increase in market share, during the three months ended March 31, 2011, and we believe that these volume increases will more than offset the reductions in reimbursement over time.

(2) Certain Clinical Conditions, Accreditation Requirements and Quality Standards. The MMA required establishment and implementation of new clinical conditions of coverage for HME products and quality standards for HME suppliers. Some clinical conditions have been implemented, such as the requirement for a face-to-face visit by treating physicians for beneficiaries seeking power mobility devices. CMS published its quality standards and criteria for accrediting organizations for HME suppliers in 2006 and revised some of these standards in October 2008. As an entity that bills Medicare and receives payment from the program, we are subject to these standards. We have revised our policies and procedures to ensure compliance in all material respects with the quality standards. These standards, which are applied by independent accreditation organizations, include business-related standards, such as financial and human resources management requirements, which would be applicable to all HME suppliers, and product-specific quality standards, which focus on product specialization and service standards. The product specific standards address several of our products, including oxygen and oxygen equipment, CPAP and power and manual wheelchairs and other mobility equipment.

Currently, all of our operating centers are accredited by the Joint Commission (formerly referred to as the Joint Commission on Accreditation of Healthcare Organizations). The Joint Commission is a CMS recognized accrediting organization. Round 1 rebid competitive bid suppliers were required to be accredited by September 30, 2009.

On January 2, 2009, CMS published its final rule on surety bond requirements for HME suppliers, effective March 3, 2009. For each National Provider Identifier (NPI) number subject to Medicare billing privileges, suppliers must obtain a surety bond in the amount of \$50,000. Each of our 425 operating locations is required to have its own NPI number. There may be an upward adjustment for suppliers that have had adverse legal actions imposed on them in the past. HME suppliers already enrolled in Medicare were required to obtain a surety bond by October 2, 2009, and newly enrolled suppliers or those changing ownership were subject to the provisions of the new rule on May 4, 2009. We maintain surety bonds covering all of our NPI numbers at each of our operating locations.

(3) Reduction in Payments for HME and Inhalation Drugs. The MMA changes also included a reduction in reimbursement rates beginning in January 2005 for oxygen equipment and certain other items of home medical equipment (including wheelchairs, nebulizers, hospital beds and air mattresses) based on the percentage difference between the amount of payment otherwise determined for 2002 and the 2002 median reimbursement amount under the Federal Employee Health Benefits Program (FEHBP) as determined by the Office of the Inspector General of the Department of Health and Human Services (OIG). The FEHBP adjusted payments remained “frozen” through 2008. With limited exceptions, items that were not included in competitive bidding received a 5% update for 2009. As discussed above, for 2009, MIPPA included a 9.5% nationwide reduction in reimbursement for the product categories included in competitive bidding, as a budget-neutrality offset for the eighteen month delay.

The MMA also revised the payment methodology for certain drugs, including inhalation drugs dispensed through nebulizers. Historically, prescription drug coverage under Medicare has been limited to drugs furnished incident to a physician’s services and certain self-administered drugs, including inhalation drug therapies. Prior to MMA, Medicare reimbursement for covered drugs, including the inhalation drugs that we provide, was limited to 95 percent of the published average wholesale price (AWP) for the drug. MMA established new payment limits and procedures for drugs reimbursed under Medicare Part B. Beginning in 2005, inhalation drugs furnished to Medicare beneficiaries are reimbursed at 106 percent of the volume-weighted average selling price (ASP) of the drug, as determined from data provided each quarter by drug manufacturers under a specific formula described in MMA. Implementation of the ASP-based reimbursement formula resulted in a significant reduction in payment rates for inhalation drugs. Given the overall reduction in payment for inhalation drugs dispensed through nebulizers, CMS established a dispensing fee for inhalation drugs shipped to a beneficiary beginning in 2005. The current dispensing fee is \$57 for the first 30-day period in which a Medicare beneficiary uses inhalation drugs and \$33 for each subsequent 30-day period. The dispensing fee for a 90-day supply of inhalation drugs is \$66. This dispensing fee has remained unchanged since 2006. Future changes from quarterly updates to ASP pricing, as well as any future dispensing fee reductions or eliminations, if they occur, could have a material adverse effect on our financial condition, revenues, profit margins, profitability, operating cash flows and results of operations.

Furthermore, because the ASP amounts vary from quarter to quarter, changes in market forces influence the Medicare payment rate. In late 2006, the US Food and Drug Administration approved a first-time generic formulation for DuoNeb. The introduction of this generic product into the market has contributed to the reduction of the ASP for DuoNeb from \$1.079 in the fourth quarter of 2007 to \$0.200 in the second quarter of 2011. The impact of this reduction to our profit margins, profitability, operating cash flows and results of operations was partially mitigated through the dispensing of generic DuoNeb and changes in nebulizer product mix.

(4) Reductions in Payments for Oxygen and Oxygen Equipment. The DRA which was signed into law on February 8, 2006, made certain changes to the way Medicare Part B pays for certain of our HME products, including oxygen and oxygen equipment. For oxygen equipment, prior to the DRA, Medicare made monthly rental payments indefinitely, provided medical need continued. The DRA capped the Medicare rental period for oxygen equipment at 36 months of continuous use, after which time ownership of the equipment would transfer to the beneficiary. For purposes of this cap, the DRA provides for a new 36-month rental period that began January 1, 2006 for all oxygen equipment. In addition to the changes in the duration of the rental period for capped rental items and oxygen equipment, the DRA permitted payments for servicing and maintenance of the products after ownership transfers to the beneficiary.

On November 1, 2006, CMS released a final rule to implement the DRA changes, which went into effect January 1, 2007. Under the rule, CMS clarified the DRA’s 36-month rental cap on oxygen equipment. CMS also revised categories and payment amounts for the oxygen equipment and contents during the rental period and for oxygen contents after equipment ownership by the beneficiary as described below. With the passage of MIPPA on July 15, 2008, transfer of title to oxygen equipment at the end of the 36-month rental cap was repealed, although the rental cap remained in place. Effective January 1, 2009, after the 36th continuous month during which payment is made for the oxygen equipment, the equipment is to continue to be furnished during any period of medical need for the remainder of the reasonable useful lifetime of the equipment. The reasonable useful lifetime for stationary or portable oxygen equipment begins when the oxygen equipment is first delivered to the beneficiary and continues until the point at which the stationary or portable oxygen equipment has been used by the beneficiary on a continuous basis for five years (60 months) provided there are no breaks in service due to medical necessity. Computation of the reasonable useful lifetime is not based on the age of the equipment. During the capped rental period from months 37 through 60 of

continuous use, payment is made only for oxygen contents and for certain reasonable and necessary maintenance and servicing (for parts and labor not covered by the supplier's or manufacturer's warranty) (discussed in more detail below).

- *Payment for Rental Period.* The 2011 and 2010 rate for stationary oxygen equipment is \$173.31 and \$173.17, respectively. The 2011 and 2010 monthly portable oxygen add-on amount is \$28.74 and \$28.77, respectively. The 2011 monthly payment for oxygen-generating portable oxygen equipment remains unchanged at \$51.63 from 2010. The oxygen-generating portable oxygen equipment payments were unaffected by MIPPA.
- *Payment for Contents after 36-Month Rental Cap.* Payment is based on the type of equipment owned and whether it is oxygen-generating. Previously, CMS paid a combined average monthly payment amount of \$154.90 for furnishing oxygen contents for stationary and portable systems after the 36 month rental cap. This amount included payment for both stationary contents and portable contents. CMS split this payment into a separate monthly payment amount for stationary oxygen content of \$77.45 and a separate monthly payment amount for portable oxygen content of \$77.45. This payment amount is for oxygen contents for equipment that is not oxygen-generating. If the beneficiary uses both stationary and portable equipment that is not oxygen-generating, the monthly payment amount for oxygen contents is \$154.90. For stationary or portable oxygen equipment that is oxygen-generating, there will be no monthly payment for contents.

In its November 1, 2006 final rule, CMS also acknowledged certain other payments after the 36-month rental cap, including payment for supplies such as tubing and masks. In addition, CMS detailed several requirements regarding a supplier's responsibility to maintain and service capped rental items and provided for a general maintenance and servicing payment for certain oxygen-generating equipment beginning six months after the 36-month rental cap. On October 30, 2008, CMS issued new oxygen payment rules and supplier responsibilities to address changes to the transfer of title under MIPPA. In the final rule, CMS determined that for liquid or gaseous oxygen (stationary or portable), after the 36-month rental cap, there will be no additional Medicare payment for the maintenance and servicing of such equipment for the remainder of the useful lifetime of the equipment. CMS also determined that for 2009 only, Medicare will pay for in-home, maintenance and servicing visits for oxygen concentrators and transfilling equipment every six months, beginning six months after the end of the 36-month rental cap. This payment will be made if the supplier visits the beneficiary's home, performs any necessary maintenance and servicing, and inspects the equipment to ensure that it will function safely for the next six months. In its final CY 2010 rule, CMS stated that it will continue to pay for such in-home maintenance and servicing visits every six months until medical necessity ends or the beneficiary elects to obtain new equipment. Beginning July 1, 2010, the payment rate is capped at 10% of the cost of acquiring a stationary oxygen concentrator increased by the consumer price index, or \$66 for calendar year 2010. On February 5, 2010, CMS issued program instructions on this new provision.

Finally, CMS clarified that though it retains title to the equipment, a supplier is required to continue to furnish needed oxygen equipment and contents for liquid or gaseous equipment after the 36-month rental cap until the end of the equipment's reasonable useful lifetime. CMS determined the reasonable useful lifetime for oxygen equipment to be five years provided there are no breaks in service due to medical necessity, computed based on the date the equipment is delivered to the beneficiary. On January 27, 2009, CMS posted further instructions on the implementation of the 36-month rental cap, including guidance on payment for oxygen contents after month 36 and the replacement of oxygen equipment that has been in continuous use by the patient for the equipment's reasonable useful lifetime (as defined above). In accordance with these instructions, and consistent with the final rule published on October 30, 2008, suppliers may bill for oxygen contents on a monthly basis after the 36-month rental cap, and the supplier can deliver up to a maximum of three months of oxygen contents at one time. Additionally, in accordance with these instructions, and consistent with the final rule published on October 30, 2008, we now provide replacement equipment to our patients that exceed five years of continuous use.

The ongoing financial impact of the 36-month rental cap will depend upon a number of variables, including, (i) the number of Medicare oxygen customers reaching 36 months of continuous service, (ii) the number of patients receiving oxygen contents beyond the 36-month rental period and the coverage and billing requirements established by CMS for suppliers to receive payment for such oxygen contents, (iii) the mortality rates of patients on service beyond 36 months, (iv) the incidence of patients with equipment deemed to be beyond its reasonable useful life that may be eligible for new equipment and therefore a new rental episode and the coverage and billing requirements established by CMS for suppliers to receive payment for a new rental period, (v) any breaks in continuous use due to medical necessity, and (vi) payment amounts established by CMS to reimburse suppliers for maintenance of oxygen equipment. We cannot predict the impact that any future rulemaking by CMS will have on our business. If payment amounts for oxygen equipment and contents are further reduced in the future, this could have a material adverse effect on our financial condition, revenues, profit margins, profitability, operating cash flows and results of operations.

CMS also has authority to make other adjustments to reimbursement for HME. With the passage of the Balanced Budget Act of 1997, CMS may determine to increase or reduce the reimbursement for HME, including oxygen, by up to 15% each year under an inherent reasonableness procedure. The regulation implementing the inherent reasonableness authority establishes a process for adjusting payments for certain items and services covered by Medicare Part B when the existing payment amount is determined to be grossly excessive or deficient. The regulation lists factors that may be used by CMS and its Medicare contractors to determine whether an existing reimbursement rate is grossly excessive or deficient and to determine what a realistic and equitable payment

amount is. Also, under the regulation, CMS and its contractors will not consider a payment amount to be grossly excessive or deficient and make an adjustment if they determine that an overall payment adjustment of less than 15% is necessary to produce a realistic and equitable payment amount. The implementation of the inherent reasonableness procedure itself does not trigger payment adjustments for any items or services and to date, no payment adjustments have occurred or been proposed under this inherent reasonableness procedure.

Though the inherent reasonableness authority has not been exercised, in past years, CMS historically has reduced the published Medicare reimbursement rates for HME to an amount based on the payment amount for the least costly alternative (LCA) treatment that met the Medicare beneficiary's medical needs. LCA determinations have been applied to particular products and services by CMS and its contractors through the notice and comment process used in establishing local coverage policies for HME. With respect to LCA policies, on October 16, 2008, a U.S. District Court in the District of Columbia held that CMS did not have the authority to implement LCA determinations in setting payment amounts for an inhalation drug. This decision was upheld by the U.S. Court of Appeals and, as a result, CMS and its contractors withdrew their LCA policy for the inhalation drug. In addition, CMS instructed its contractors that they may no longer apply LCA policies to any HME. Effective February 4, 2011, all coverage policies have been revised to eliminate their LCA provisions.

Results of Operations

The following table shows our results of operations for the three months ended March 31, 2011 and 2010 (in thousands).

	Three months ended March 31,	
	2011	2010
Net revenues	\$121,506	\$123,366
Costs and expenses:		
Cost of net revenues	39,098	40,843
Selling, general and administrative	62,631	66,408
Provision for doubtful accounts	5,239	9,331
Depreciation and amortization	2,374	2,005
Total costs and expenses	<u>109,342</u>	<u>118,587</u>
Operating income	12,164	4,779
Other expense (income):		
Interest expense, net	14,567	11,124
Other (income) expense, net	(862)	13
Loss on debt extinguishment	1,216	—
Total other expense	<u>14,921</u>	<u>11,137</u>
Loss before income taxes	(2,757)	(6,358)
Income tax (benefit) expense	(64)	150
Net loss	(2,693)	(6,508)
Accrued dividends on convertible redeemable preferred stock	106	91
Net loss attributable to common stockholders	<u>\$ (2,799)</u>	<u>\$ (6,599)</u>

The following table shows our results of operations as a percentage of our net revenues for the three months ended March 31, 2011 and 2010.

	Three months ended March 31,	
	2011	2010
Net revenues	100.0%	100.0%
Costs and expenses:		
Cost of net revenues	32.2%	33.1%
Selling, general and administrative	51.5%	53.8%
Provision for doubtful accounts	4.3%	7.6%
Depreciation and amortization	2.0%	1.6%
Total costs and expenses	<u>90.0%</u>	<u>96.1%</u>
Operating income	10.0%	3.9%
Other expense (income):		
Interest expense, net	12.0%	9.0%
Other (income) expense, net	-0.7%	0.0%
Loss on debt extinguishment	1.0%	0.0%
Total other expense	<u>12.3%</u>	<u>9.0%</u>
Loss before income taxes	-2.3%	-5.1%
Income tax (benefit) expense	-0.1%	0.1%
Net loss	-2.2%	-5.2%
Accrued dividends on convertible redeemable preferred stock	0.1%	0.1%
Net loss attributable to common stockholders	<u>-2.3%</u>	<u>-5.3%</u>

Three months ended March 31, 2011 as compared to the three months ended March 31, 2010

Total net revenues for the three months ended March 31, 2011 were \$121.5 million as compared to \$123.4 million for the comparable period in 2010. This decrease of \$1.9 million from the comparable period in 2010 is primarily attributable to a \$1.9 million reduction in nebulizer medication reimbursement and volume, \$1.1 million reduction in non-patient service revenue and approximately \$0.7 million reduction from competitive bidding. These decreases were primarily offset by organic growth in our core oxygen and CPAP product lines which increased \$1.4 million and approximately \$0.4 million associated with patients transitioned onto service with us through equipment purchases for the three months ended March 31, 2011 from the comparable period in 2010.

Cost of net revenues totaled \$39.1 million for the three months ended March 31, 2011, a decrease of \$1.7 million, or 4.3%, from the comparable period in 2010. Cost of net revenues for the three months ended March 31, 2011 and 2010 was comprised as follows:

	Three months ended March 31,	
	2011	2010
Cost of net revenues (in thousands):		
Product and supply costs	\$24,227	\$25,652
Patient service equipment depreciation	12,716	13,140
Operating costs	2,155	2,051
	<u>\$39,098</u>	<u>\$40,843</u>

The decrease in product and supply costs is consistent with reduced volume in our nebulizer medication business partially offset by increases in CPAP supply expense associated with the growth in our CPAP programs. Cost of net revenues as a percentage of net revenue was 32.2% for the three months ended March 31, 2011, as compared to 33.1% for the comparable period in 2010.

Selling, general and administrative expenses for the three months ended March 31, 2011 totaled \$62.6 million, a decrease of \$3.8 million, or 5.7%, from the comparable period in 2010. The decrease in selling, general and administrative expenses was primarily attributable to a \$1.3 million reduction in fleet costs associated with the buy-out of our vehicle leases during 2010, a \$1.1 million decrease in insurance costs as a result of lower claims incurrence and design changes to our health insurance plans, and a \$0.9 million decrease in telecom expenses associated with an excise tax refund (\$0.6 million, net of associated fees) and renegotiated telecom contracts. These decreases were partially offset by increased fuel costs as a result of higher gas prices. Selling, general and administrative expenses as a percentage of net revenues were 51.5% for the three months ended March 31, 2011 compared to 53.8% for the three months ended March 31, 2010.

The provision for doubtful accounts for the three months ended March 31, 2011 totaled \$5.2 million, compared to \$9.3 million for the same period in 2010. During 2009, we transitioned all patient-related collection activities to a third-party vendor. We experienced extended delays and implementation issues associated with this transition. During the quarter ended March 31, 2010, we completed the initial collection phases associated with the early patient balances most impacted by these transition issues and have determined that an additional provision for doubtful accounts in the amount of \$5.0 million was required to allow for a lower percentage of collection on patient receivables resulting from these transition issues. Management believes that these transition issues have been fully resolved and the increased provision for doubtful accounts recorded during the three months ended March 31, 2010 is not indicative of expected future rates of patient collections. As a percentage of net revenue, excluding the \$5.0 million additional provision for the three months ended March 31, 2010, the provision for doubtful accounts increased from 3.5% for the three months ended March 31, 2010 to 4.3% for the three months ended March 31, 2011. This increase is attributable to the factors described below under the heading "Liquidity and Capital Resources."

Depreciation and amortization for the three months ended March 31, 2011 totaled \$2.4 million, an increase of \$0.4 million from the comparable period in 2010. This increase was mainly the result of purchased vehicles, including those acquired in conjunction with certain equipment and asset purchase transactions. Depreciation and amortization as a percentage of net revenue increased to 2.0% as compared to 1.6% for the comparable period in 2010.

Net interest expense for the three months ended March 31, 2011 totaled \$14.6 million, an increase of \$3.4 million from the comparable period in 2010. This increase is primarily the result of the refinancing of the payment-in-kind term loan facility (the "Senior Facility") in October 2010 with our 10.75% Senior Secured Notes due 2015 (the "Senior Secured Notes"). The Senior Secured Notes bear interest at 10.75% while the Senior Facility had an average variable interest rate of 6.25%.

Other income, net for the three months ended March 31, 2011 totaled \$0.9 million. This amount included cash received from the sale of certain assets associated with a former acquisition.

As a result of the redemption of the 9.5% Senior Subordinated Notes due 2012 (the "Senior Subordinated Notes"), we recorded a \$1.2 million loss on extinguishment of debt related to unamortized debt issuance costs.

Non-GAAP Financial Measure

We present Adjusted EBITDA as a supplemental measure of our performance that is not required by, or presented in accordance with, generally accepted accounting principles (GAAP) in the United States of America. We define Adjusted EBITDA as net earnings (loss) adjusted for (i) income tax expense (benefit), (ii) interest expense and (iii) depreciation and amortization, as further adjusted to eliminate the impact of certain items, consistent with definitions provided under our former Senior Facility, that we do not consider indicative of our ongoing operating performance. These further adjustments are itemized below. You are encouraged to evaluate these adjustments and the reasons we consider them appropriate for supplemental analysis. We believe Adjusted EBITDA assists investors and securities analysts in comparing our performance across reporting periods on a consistent basis by excluding certain items, consistent with definitions provided under our former Senior Facility, that we do not believe are indicative of our core operating performance. However, there may be additional items which are non-recurring as set forth above in Management's Discussion and Analysis of Financial Condition and Results of Operations. We use Adjusted EBITDA to evaluate the effectiveness of our business strategies. In evaluating Adjusted EBITDA, you should be aware that in the future we may incur expenses that are the same as or similar to some of the adjustments in this presentation. Our presentation of Adjusted EBITDA should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items.

The following table is a reconciliation of Adjusted EBITDA to net loss (in thousands):

	Three months ended March 31,	
	2011	2010
Adjusted EBITDA:		
Net loss	\$ (2,693)	\$ (6,508)
Income tax (benefit) expense	(64)	150
Interest expense	14,718	11,163
Depreciation and amortization, including patient service equipment depreciation	15,090	15,146
Accounts receivable adjustment ⁽¹⁾	—	5,000
Non-cash equity-based compensation expense	33	87
Restructuring expense ⁽²⁾	6	66
Settlement costs ⁽³⁾	18	21
Loss on extinguishment of debt ⁽⁴⁾	1,216	
	<u>\$28,324</u>	<u>\$25,125</u>

(1) Accounts receivable adjustments associated with specific collection issues that are not considered indicative of our ongoing operation performance. During 2009, we transitioned all patient-related collection activities to a third-party vendor. We experienced extended delays and implementation issues associated with this transition. During the quarter ended March 31, 2010, we completed the initial collection phases associated with the early patient balances most impacted by these transition issues and determined that an additional provision for doubtful accounts in the amount of \$5.0 million was required to allow for a lower percentage of collection on patient receivables resulting from these transition issues. Management believes that these transition issues have been fully resolved and the increased provision for doubtful accounts recorded during the three months ended March 31, 2010 is not indicative of expected future rates of patient collections.

(2) Restructuring related costs generally consist of severance and location closure costs.

(3) Settlement costs incurred outside our ordinary course of business which we do not believe reflect the current and ongoing cash charges related to our operating cost structure.

(4) We redeemed our 9.5% Senior Subordinated Notes due April 2012 on March 17, 2011, and recorded a \$1.2 million loss on extinguishment of debt related to unamortized debt issuance costs.

Adjusted EBITDA should not be considered as a measure of financial performance under GAAP, and the items excluded from EBITDA are significant components in understanding and assessing financial performance. Adjusted EBITDA has limitations as an analytical tool. Some of these limitations are:

- Adjusted EBITDA does not reflect our cash expenditures, future requirements for capital expenditures or contractual commitments;
- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA does not reflect significant interest expense, or the cash requirements necessary to service interest or principal payments on our debts;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;
- non-cash compensation is and will remain a key element of our overall long-term incentive compensation package, although we exclude it as an expense when evaluating our ongoing operating performance for a particular period;

- Adjusted EBITDA does not reflect the impact of certain cash charges resulting from matters we consider not to be indicative of our ongoing operations; and
- other companies in our industry may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure.

Because of these limitations, Adjusted EBITDA should not be considered in isolation or as a substitute for performance measures calculated in accordance with GAAP. We compensate for these limitations by relying primarily on our GAAP results and using Adjusted EBITDA only supplementally.

Liquidity and Capital Resources

Net cash provided by operating activities was \$3.0 million for the three months ended March 31, 2011, as compared to \$11.3 million for the same period in 2010. Cash flows and cash on hand were sufficient to fund operations, capital expenditures and required repayments of debt during the quarter ended March 31, 2011. Based on current conditions, we believe that the cash generated from our operations and cash balances will be sufficient to meet our working capital, capital expenditure and other cash needs during the next twelve months, including payment of interest amounts on our Senior Secured Notes and Senior Second Lien Notes when due.

Accounts receivable before allowance for doubtful accounts increased to \$87.3 million at March 31, 2011 from \$78.5 million at December 31, 2010. Allowances for contractual adjustments and doubtful accounts as a percentage of accounts receivable totaled 29.4% and 31.6% as of March 31, 2011 and December 31, 2010, respectively. Days sales outstanding (DSO) in accounts receivable (calculated as of each period end by dividing net accounts receivable by the 90-day rolling average of net revenue) were 57.5 days at March 31, 2011, compared to 49.5 days at December 31, 2010 and 52.7 days at March 31, 2010. There are several factors that continue to impact our DSO, including, but not limited to:

- Lengthened initial collection cycles for patients transitioned onto service with us through equipment purchases. When we purchase equipment from competitors and transition their patients onto service with us, we are required to obtain revised paperwork from the patient's physician, which requires additional resources and time to obtain and thereby extends the collection cycle during the transition period.
- Managed care business. As a result of our increases in managed care volumes, we have experienced increases in our DSO as a result of comparatively longer collections cycles from managed care payors, as well as increased patient copayment obligations which likewise have a longer collection cycle.
- More stringent patient collection standards. We have implemented more stringent collection standards with respect to balances due from patients including enhanced internal collection efforts and utilization of a third-party collection resource. While these changes have increased our DSO, we believe that our efforts will ultimately result in greater collection of amounts due from patients.
- During Q1 2011, we completed significant updates to our internal billing systems in preparation for the implementation of our new order intake system that will streamline our order intake processes and eliminate many of our current, paper-based processes. As a result of these updates, we experienced a temporary delay in claims transmission which contributed to our increased DSO as of March 31, 2011. These issues have been addressed and we do not expect that this temporary delay will negatively impact the overall collectability of the associated claims.

In addition, we typically experience an increase in DSO during the first quarter of the year due to the longer collection cycle on deductibles due from patients.

During 2009, we transitioned all patient-related collection activities to a third-party vendor. We experienced extended delays and implementation issues associated with this transition. During the quarter ended March 31, 2010, we completed the initial collection phases associated with the early patient balances most impacted by these transition issues and determined that an additional provision for doubtful accounts in the amount of \$5.0 million was required to allow for a lower percentage of collection on patient receivables resulting from these transition issues. Management believes that these transition issues have been fully resolved and the increased provision for doubtful accounts recorded during the three months ended March 31, 2010 is not indicative of expected future rates of patient collections.

The following table sets forth the percentage breakdown of our accounts receivable by payor and aging category as of March 31, 2011 and December 31, 2010:

March 31, 2011

<u>Accounts receivable by payor and aging category:</u>	<u>Government</u>	<u>Managed Care and Other</u>	<u>Patient Responsibility</u>	<u>Total</u>
Aged 0-90 days	39%	20%	12%	71%
Aged 91-180 days	5%	3%	7%	15%
Aged 181-360 days	3%	3%	6%	12%
Aged over 360 days	1%	1%	0%	2%
Total	48%	27%	25%	100%

December 31, 2010

<u>Accounts receivable by payor and aging category:</u>	<u>Government</u>	<u>Managed Care and Other</u>	<u>Patient Responsibility</u>	<u>Total</u>
Aged 0-90 days	38%	21%	8%	67%
Aged 91-180 days	5%	5%	7%	17%
Aged 181-360 days	4%	4%	7%	15%
Aged over 360 days	0%	1%	0%	1%
Total	47%	31%	22%	100%

Included in accounts receivable are earned but unbilled receivables of \$20.7 million at March 31, 2011 and \$18.9 million at December 31, 2010. These amounts include \$4.7 million at March 31, 2011 and \$3.6 million at December 31, 2010 of receivables for which a prior authorization is required but has not yet been received. Delays, ranging from a day to several weeks, between the date of service and billing can occur due to delays in obtaining certain required payor-specific documentation from internal and external sources. In addition to the aforementioned delays, we are required to obtain revised documentation for patients transitioned onto service with us through equipment purchases which results in increased initial billing cycles for these patients. Earned but unbilled receivables are aged from the date of service and are considered in our analysis of historical performance and collectibility.

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

Management performs analyses to evaluate the net realizable value of accounts receivable. Specifically, management considers historical realization data, accounts receivable aging trends, other operating trends and relevant business conditions. Because of continuing changes in the health care industry and third-party reimbursement, it is possible that management's estimates could change, which could have an impact on financial condition, revenues, profit margins, profitability, operating cash flows and results of operations.

We derive a significant portion of our revenues from the Medicare and Medicaid programs and from managed care health plans. Payments for services rendered to patients covered by these programs may be less than billed charges. Revenue is recognized at net realizable amounts estimated to be paid by customers and third-party payors. Our billing system contains payor-specific price tables that reflect the fee schedule amounts in effect or contractually agreed upon by various government and commercial payors for each item of equipment or supply provided to a customer. For Medicare and Medicaid revenues, as well as most other managed care and private payors, final payment is subject to administrative review and audit. Management makes estimated provisions for adjustments, which may result from administrative review and audit, based upon historical experience. Management closely monitors its historical collection rates as well as changes in applicable laws, rules and regulations and contract terms to help assure that provisions are made using the most accurate information management believes to be available. However, due to the complexities involved in these estimations, actual payments we receive could be different from the amounts we estimate and record.

Collection of receivables from third-party payors and patients is our primary source of cash and is critical to our operating performance. We manage billing and collection of accounts receivable through our own billing and collection centers. In addition, we utilize third-party collection resources to manage collection of amounts due from patients. Our primary collection risks relate to patient accounts for which the primary insurance payor has paid, but patient responsibility amounts (generally deductibles and co-

payments) remain outstanding. We record bad debt expense based on a percentage of revenue using historical Company-specific data. The percentage and amounts used to record bad debt expense and the allowance for doubtful accounts are supported by various methods including current and historical cash collections, bad debt write-offs, and aging of accounts receivable. Accounts are written off against the allowance when all collection efforts (including payor appeals processes) have been exhausted. We routinely review accounts receivable balances in conjunction with our historical contractual adjustment and bad debt rates and other economic conditions which might ultimately affect the collectibility of patient accounts when we consider the adequacy of the amounts we record as provision for doubtful accounts. Significant changes in payor mix, business office operations, economic conditions or trends in federal and state governmental health care coverage could affect our collection of accounts receivable, cash flows and results of operations. Further, even if our billing procedures comply with all third-party payor requirements, some of our payors may experience financial difficulties, may delay payments or may otherwise not pay accounts receivable when due, which would result in increased write-offs or provisions for doubtful accounts. We have also experienced increases in pre-payment and post-payment audits by governmental and private payors. With respect to claims subject to pre-payment reviews, we may be required to obtain certain payor-specific documentation from physicians and other health care providers before submitting claims for reimbursement, thereby delaying payments for such claims. With respect to post-payment reviews, we may be subject to such documentation requests after claims are paid, which may result in requests for refunds if the payor determines that the claims information we provide is inadequate. In addition, we periodically experience inconsistent payment patterns from CMS and its contractors and other third-party payors. If we are unable to collect our accounts receivable on a timely basis or significant overpayments are assessed, our revenues, profitability and cash flow likely will significantly decline.

Because of continuing changes in the health care industry and third-party reimbursement, it is possible that management's estimates could change, which could have an impact on revenues, profit margins, profitability, operating cash flows and results of operations. Our future liquidity may be materially adversely impacted by health care reform.

Net cash used in investing activities was \$11.5 million for the three months ended March 31, 2011 as compared to \$11.2 million for the same period in 2010. We currently have no contractual commitments for capital expenditures over the next twelve months other than to acquire equipment as needed to supply our patients. Our business requires us to make significant capital expenditures relating to the purchase and maintenance of the medical equipment used in our business. Cash paid for capital expenditures totaled approximately \$12.9 million for the three months ended March 31, 2011 as compared to \$11.2 million for the same period in 2010, including \$4.1 million and \$0.3 million paid for equipment purchases from competitors exiting the home health care market, respectively. Some of the equipment purchased in these transactions is currently on rent and located in a patient's home. As such, we have the opportunity to transition such patients onto service with our Company. We also paid \$2.5 million for the three months ended March 31, 2011 for asset purchases from competitors. These increases in cash used in investing activities were partially offset by a \$4.2 million reduction in our surety bond and letter of credit collateral included in restricted cash.

On March 17, 2011, we issued \$290.0 million in aggregate principal amount of 10.5% Senior Second Lien Notes due 2018 (the "Senior Second Lien Notes") pursuant to an indenture (the "Indenture") among ourselves, the Subsidiary Guarantors and The Bank of New York Mellon Trust Company, N.A., as trustee (in such capacity, the "Trustee"). The Senior Second Lien Notes were offered and sold in a private placement to Credit Suisse Securities (USA) LLC and Jefferies & Company (the "Initial Purchasers") in reliance on the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"), and resold by the Initial Purchasers to qualified buyers pursuant to exemptions from registration provided by Rule 144A and Regulation S of the Securities Act. The Senior Second Lien Notes were also offered and sold to certain directors of the Company who are accredited investors as defined in Rule 501(a) under the Securities Act.

The Senior Second Lien Notes were issued at a discount of \$5.2 million and we incurred transaction costs of approximately \$8.8 million. The discount and transaction costs associated with the Senior Second Lien Notes will be amortized as interest expense over the term of those notes. Interest will be payable semi-annually on March 15 and September 15 commencing on September 15, 2011. We used the proceeds from the offering of the Senior Second Lien Notes, together with \$24.5 million of cash on hand, to repay all of our outstanding Senior Subordinated Notes and pay associated fees and expenses. In conjunction with the closing of the Senior Second Lien Notes on March 17, 2011, we deposited \$301.9 million with Bank of New York Mellon N.A., as trustee (the "Trustee"), to satisfy our obligation with respect to the Senior Subordinated Notes including the principal amount of \$287.0 million and accrued interest through April 18, 2011 of \$14.9 million, of which \$1.3 million is included in prepaid expenses in the accompanying condensed consolidated balance sheet as of March 31, 2011. We were legally released of our liability effective March 17, 2011. Upon completion of the 30-day notice period required under the indenture governing our Senior Subordinated Notes, on April 18, 2011, the Trustee redeemed and cancelled the Senior Subordinated Notes. As a result of the termination of the Senior Subordinated Notes we recorded a \$1.2 million loss on extinguishment of debt related to unamortized debt issuance costs.

The Senior Second Lien Notes will mature on March 15, 2018. In connection with the issuance of the Senior Second Lien Notes, we entered into a registration rights agreement with the Initial Purchasers of the Senior Second Lien Notes, dated March 17, 2011 (the "Senior Second Lien Notes Registration Rights Agreement"). Pursuant to the Senior Second Lien Notes Registration Rights Agreement, we agreed to exchange the Senior Second Lien Notes for freely tradable notes with terms that are substantially identical to

the Senior Second Lien Notes. We also agreed, in limited circumstances, to file a shelf registration statement with respect to the Senior Second Lien Notes.

The indenture governing the Senior Second Lien Notes contains covenants that limit our ability and the ability of our restricted subsidiaries to, among other things: sell assets; pay dividends or make other distributions or repurchase or redeem our stock; incur or guarantee additional indebtedness; incur certain liens; make loans and investments; enter into agreements restricting our subsidiaries' ability to pay dividends; consolidate, merge or sell all or substantially all of our assets, and enter into transactions with affiliates. The Senior Second Lien Notes are secured by a second priority security interest in substantially all of the Company's assets. The Senior Second Lien Notes are guaranteed by all of our wholly owned subsidiaries. Each guarantee is full and unconditional and joint and several. We hold all of our assets and conduct all of our operations through our wholly owned subsidiaries and we do not have independent assets and operations.

Additionally, on March 17, 2011 we entered into a credit agreement with Credit Suisse AG, as administrative agent, Credit Suisse Securities (USA) LLC and Jefferies Finance LLC, as joint bookrunners and joint lead arrangers and Jefferies Finance LLC, as documentation agent. The credit agreement provides for a revolving credit facility commitment of up to \$10.0 million provided that the maximum outstanding aggregate principal balance at any one time does not exceed \$10.0 million (the "Revolving Credit Facility"). The Revolving Credit Facility expires on March 17, 2012. There was no debt outstanding under the Revolving Credit Facility as of March 31, 2011.

The Revolving Credit Facility contains customary covenants similar to those in our indentures governing our Senior Secured Notes and Senior Second Lien Notes. The Revolving Credit Facility also includes a maximum leverage ratio above which level we would be precluded from making any additional draws. As of March 31, 2011, we were below the maximum leverage ratio threshold, as defined therein.

All borrowings under the Revolving Credit Facility are secured by a first priority security interest in substantially all of the Company's assets. The interest rate per annum applicable to the Revolving Credit Facility is adjusted LIBOR or, at our option, the alternate base rate, which is the higher of (a) the prime rate, (b) the federal funds effective rate plus 0.50%, and (c) the adjusted LIBOR plus 1.0% in each case, plus the applicable margin (as defined below). The applicable margin in the case of LIBOR advances is 5.0% and in the case of alternate base rate advances is 4.0%. The default rate on the Revolving Credit Facility is 2.0% above the otherwise applicable interest rate. We are also obligated to pay a commitment fee of 0.75% on the unused portion of our Revolving Credit Facility.

On October 6, 2010, we issued \$230.0 million in aggregate principal amount of 10.75% Senior Secured Notes due 2015 (the "Senior Secured Notes") pursuant to an indenture (the "Indenture") among ourselves, the Subsidiary Guarantors and The Bank of New York Mellon Trust Company, N.A., as trustee (in such capacity, the "Trustee"). The Senior Secured Notes were offered and sold in a private placement to Credit Suisse Securities (USA) LLC (the "Initial Purchaser") in reliance on the exemption from registration provided by the Securities Act, and resold by the Initial Purchaser to qualified buyers pursuant to exemptions from registration provided by Rule 144A and Regulation S of the Securities Act.

The Senior Secured Notes were issued at a discount of \$6.5 million and we incurred transaction costs of approximately \$7.9 million. The discount and transaction costs associated with the Senior Secured Notes will be amortized as interest expense over the term of those notes. Interest will be payable semi-annually on April 15 and October 15 commencing on April 15, 2011. We used the proceeds from the offering of the Senior Secured Notes, together with \$13.7 million of cash on hand, to repay all of the outstanding indebtedness including accrued interest of \$2.8 million under our former Senior Facility and pay associated fees and expenses. As a result of the termination of the Senior Facility dated March 30, 2007, we recorded a \$4.4 million loss on extinguishment of debt related to unamortized debt issuance costs of \$2.1 million and prepayment premiums of \$2.3 million.

The Senior Secured Notes will mature on October 15, 2015. In connection with the issuance of the Senior Secured Notes, we entered into a registration rights agreement with the Initial Purchaser of the Senior Secured Notes, dated October 6, 2010 (the "Senior Secured Notes Registration Rights Agreement"). Pursuant to the Senior Secured Notes Registration Rights Agreement, we agreed to exchange the Senior Secured Notes for freely tradable notes with terms that are substantially identical to the Senior Secured Notes. We also agreed, in limited circumstances, to file a shelf registration statement with respect to the Senior Secured Notes. On January 14, 2011, we completed the registered exchange offer with respect to the Senior Secured Notes.

The indenture governing the Senior Secured Notes contains covenants that limit our ability and the ability of our restricted subsidiaries to, among other things: sell assets; pay dividends or make other distributions or repurchase or redeem our stock; incur or guarantee additional indebtedness; incur certain liens; make loans and investments; enter into agreements restricting our subsidiaries' ability to pay dividends; consolidate, merge or sell all or substantially all of our assets, and enter into transactions with affiliates. The Senior Secured Notes are secured by a first priority security interest in substantially all of the Company's assets. The Senior Secured Notes are guaranteed by all of our wholly owned subsidiaries. Each guarantee is full and unconditional and joint and several. We hold all of our assets and conduct all of our operations through our wholly owned subsidiaries and we do not have independent assets and operations.

We have outstanding letters of credit totaling \$8.8 million as of March 31, 2011 and December 31, 2010. Our letters of credit were cash collateralized at 100% and 105% of their face amount, as of March 31, 2011 and December 31, 2010, respectively. The cash collateral for these outstanding letters of credit is included in restricted cash on our consolidated balance sheet as of March 31, 2011 and December 31, 2010.

Cash flows provided by financing activities primarily relate to our debt facilities and outstanding debt, which are as follows:

- \$224.0 million in aggregate principal amount of Senior Secured Notes, the proceeds of which were used to repay our Senior Facility. The notes mature on October 15, 2015. Interest of 10.75% is payable semi-annually in arrears on April 15 and October 15 of each year. Accrued interest on the Senior Secured Notes totaled \$12.0 million and \$6.2 million at March 31, 2011 and December 31, 2010, respectively.
- \$284.8 million aggregate principal amount of Senior Second Lien Notes, the proceeds of which were used to repay our Senior Subordinated Notes. The notes mature on March 15, 2018. Interest of 10.5% is payable semi-annually in arrears on March 15 and September 15 of each year. Accrued interest on the Senior Second Lien Notes totaled \$1.3 million at March 31, 2011.

The Company, either directly or through a subsidiary, may from time to time seek to purchase or retire our outstanding indebtedness through cash purchases, in the open market, privately negotiated transactions or otherwise. We will evaluate any such transactions in light of then-existing market conditions, taking into account contractual restrictions, our current liquidity and prospects for future access to capital. The amounts involved may be material.

Our working capital requirements relate primarily to the working capital needed for general corporate purposes. Our business requires us to make significant capital expenditures relating to the purchase and maintenance of the medical equipment used in our business. Based on current conditions, we believe that the cash generated from our operations and cash balances will be sufficient to meet our working capital, capital expenditure and other cash needs during the next twelve months.

Off-balance Sheet Arrangements

We do not have off-balance sheet arrangements (as that term is defined in Item 303(a)(4)(ii) of Regulation S-K) that have or are reasonably likely to have a current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Critical Accounting Policies

Refer to Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," as presented in our Annual Report on Form 10-K for the year ended December 31, 2010 regarding our critical accounting policies.

Forward-Looking Statements

This report contains certain statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and the provisions of section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act) and section 27A of the Securities Act of 1933, as amended. These forward-looking statements include all statements regarding the intent, belief or current expectations regarding the matters discussed in this report and all statements which are not statements of historical fact. Words such as "expects," "anticipates," "intends," "plans," "believes," "estimates," "projects," "may," "will," "could," "should", "would", variations of such words and similar expressions are intended to identify such forward-looking statements. These forward-looking statements involve known and unknown risks, uncertainties, contingencies and other factors that could cause results, performance or achievements to differ materially from those stated in this report. The following are some but not all of such risks, uncertainties, contingencies, assumptions and other factors, many of which are beyond our control, that could cause results, performance or achievements to differ materially from those anticipated: general economic, financial and business conditions; setting of new reimbursement rates and other changes in reimbursement policies, the timing of reimbursements and other legislative initiatives aimed at reducing health care costs associated with Medicare and Medicaid; issues relating to reimbursement by government and third-party payors for our products and services generally; the impact of competitive bidding on Medicare volume in the impacted competitive bidding areas; the costs associated with government regulation of the health care industry; health care reform and the effect of changes in federal and state health care regulations generally; whether we will be subject to additional regulatory restrictions or penalties; issues relating to our ability to maintain effective internal control over financial reporting and disclosure controls and procedures; compliance with federal and state regulatory agencies, as well as accreditation standards and confidentiality requirements with respect to patient information; the effects of competition, industry consolidation and referral sources; recruiting, hiring and retaining qualified employees and directors; compliance with various settlement agreements and corporate compliance programs; the costs and effects of legal proceedings; our ability to meet our working capital, capital expenditures and other liquidity needs; our ability to maintain compliance with the covenants contained in our indentures for our senior secured notes and our senior second lien notes; our ability to successfully transition and retain patients associated with equipment and asset purchases; our ability to maintain current levels of collectibility on our accounts receivable; the risks and uncertainties discussed under the heading "Certain Significant Risks and Uncertainties and Significant Events" in Note 8 of the Financial Statements in Part I, Item 1 of this Form 10-Q and other factors described in our filings with the Securities and Exchange Commission. Readers should refer to the discussion under "Risk Factors" in Item 1A contained in our Annual Report on Form 10-K for the year ended December 31, 2010 for a description of additional risks and uncertainties. Should one or more of these risks or uncertainties materialize or should underlying assumptions

prove incorrect, our actual results, performance or achievements could differ materially from those expressed in, or implied by, such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date thereof. When you consider these forward-looking statements, you should keep in mind these risk factors and other cautionary statements in this report. We do not undertake any obligation to release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Item 3—Quantitative and Qualitative Disclosures About Market Risk

We are a smaller reporting company as defined by Rule 12b-2 of the Securities Exchange Act of 1934 and are not required to provide the information required by this Item.

Item 4—Controls and Procedures

Disclosure Controls and Procedures

As required by Rule 13a-15(d) of the Exchange Act, our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our principal executive officer and principal financial officer have concluded, as of the end of such period, that our disclosure controls and procedures are effective.

Internal Control over Financial Reporting

As required by Rule 13a-15(d) of the Exchange Act, our management with the participation of our principal executive officer and principal financial officer, evaluates our internal control over financial reporting on a regular basis. If we identify a problem in our internal control over financial reporting during the course of our evaluations, we consider what revision, improvement and/or correction to make in order to ensure that our internal controls are effective. Our management recognizes that any set of controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Accordingly, we intend to continue to refine our internal control over financial reporting on an ongoing basis as we deem appropriate with a view towards making improvements.

We made no changes during the first quarter of fiscal year 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1—Legal Proceedings

Information required for Part II, Item 1 is incorporated herein by reference to the discussion under the heading “Certain Significant Risks and Uncertainties and Significant Events” in Note 8 of the Financial Statements in Part I, Item 1 of this Form 10-Q. See also Part I, Item 3 “Legal Proceedings” of our 2010 Annual Report on Form 10-K, filed February 28, 2011.

Item 1A—Risk Factors

There have been no material changes from the risk factors previously disclosed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2010, except for the following:

Our indebtedness could limit our ability to plan for or respond to changes in our business, and we may be unable to generate sufficient cash flow to satisfy significant debt service obligations.

As of March 31, 2011, our total consolidated long-term debt (including current maturities) of \$509.3 million exceeds our total assets. The degree to which we are leveraged continues to have substantial negative consequences, because:

- a substantial portion of our cash flow from operations is required to be dedicated to interest payments and therefore is not available for operations, working capital, capital expenditures, expansion, acquisitions, or general corporate or other purposes;
- we are more highly leveraged than our major national competitors, which places us at a disadvantage in terms of our ability to capitalize on business opportunities and to react to competitive pressures and changes in our industry as compared to our competitors; and
- it makes us more vulnerable in the event of a downturn in our business, our industry, or the economy in general.

The degree to which we are leveraged may also have substantial future negative consequences, because:

- it could affect our ability to satisfy our obligations under our 10.75% Senior Secured Notes due 2015 (the “Senior Secured Notes”) and our 10.5% Senior Second Lien Notes due 2018 (the “Senior Second Lien Notes”), including our ability to make interest payments thereunder when due and payable;
- our ability to finance and consummate transactions that may be critical to our strategic and financial condition could be limited;
- our ability to obtain additional financing in the future may be impaired; and
- our flexibility in planning for, or reacting to, changes in our business and industry may be limited.

If we are unable to make payments on or refinance our debt or obtain new financing when needed, we would have to consider other options, such as:

- sales of assets;
- sales of equity;
- negotiations with holders of our debt to restructure the applicable debt; and/or
- seeking protection from our creditors through bankruptcy.

Although the indentures related to our Senior Secured Notes and Senior Second Lien Notes limit our ability to incur additional debt, these limitations are subject to a number of exceptions and, under certain circumstances, we may be able to incur a significant amount of additional debt. The incurrence of such additional debt could increase the risks described above.

Our failure to comply with the covenants contained in our Senior Secured Notes and Senior Second Lien Notes would likely have a material adverse effect on our operating results and financial condition, including the possibility that we may not be able to make payments on the Senior Secured Notes and Senior Second Lien Notes.

Our indentures for our Senior Secured Notes and Senior Second Lien Notes contain covenants limiting our ability and the ability of our restricted subsidiaries to, among other things: sell assets; pay dividends or make other distributions or repurchase or redeem our stock; issue certain preferred shares; incur or guarantee additional indebtedness; incur certain liens; make loans and investments; enter into agreements restricting our subsidiaries’ ability to pay dividends; consolidate, merge, sell or otherwise dispose of all or substantially all of our assets, and enter into transactions with affiliates. Any of these restrictions could limit our ability to plan for or react to market conditions or meet extraordinary capital needs and could otherwise restrict corporate activities.

Our ability to comply with these covenants may be affected by events beyond our control, and an adverse development affecting our business could require us to seek waivers or amendments of covenants, alternative or additional sources of financing or reductions in expenditures. We cannot assure you that such waivers, amendments or alternative or additional financings could be obtained on acceptable terms or at all. In addition, the holders of the Senior Secured Notes and Senior Second Lien Notes will have no control over any waivers or amendments with respect to any debt outstanding other than the Senior Secured Notes and Senior Second Lien Notes. Therefore, we cannot assure you that even if the holders of the Senior Secured Notes and Senior Second Lien Notes agree to waive or amend the covenants contained in the indenture relating to the Senior Secured Notes and Senior Second Lien Notes, that the holders of our other debt, including the Senior Secured Notes, will agree to do the same with respect to our debt instruments held by them.

Failure to comply with the covenants in our indentures could, under certain circumstances, result in declarations that all outstanding borrowings, together with accrued interest and other fees, be immediately due and payable, lenders could elect to exercise control over our cash through their rights under applicable deposit account control agreements, and foreclosure proceedings could be instituted against those assets that secure our Senior Secured Notes and Senior Second Lien Notes. If our debt were accelerated upon an event of default, our assets and cash flow would be insufficient to fully repay our outstanding borrowings.

Servicing our indebtedness will require a significant amount of cash. Our ability to generate sufficient cash depends on numerous factors beyond our control, and we may be unable to generate sufficient cash flow to service our debt obligations.

Our ability to make payments on or to refinance our indebtedness will depend on our ability to generate cash in the future. This to a certain extent, is subject to general economic, political, financial, competitive, legislative, regulatory and other factors that are beyond our control.

To service our indebtedness, we expended approximately \$14.9 million during the three months ended March 31, 2011 and \$35.6 million during the year ended December 31, 2010. We cannot assure you that our business will generate cash flow from operations in

an amount sufficient to enable us to pay our indebtedness or to fund our other liquidity needs. If our cash flows and capital resources are insufficient to allow us to make scheduled payments on our indebtedness, we may need to reduce or delay capital expenditures, sell assets, seek additional capital or restructure or refinance all or a portion of our indebtedness on or before maturity. We cannot assure you that we will be able to refinance any of our indebtedness on commercially reasonable terms, or at all, or that these measures would satisfy our scheduled debt service obligations. If we are unable to generate sufficient cash flow or refinance our debt on favorable terms, it could have a material adverse effect on our financial condition, the value of the Senior Secured Notes and Senior Second Lien Notes and our ability to make any required cash payments under our indebtedness, including the Senior Secured Notes and Senior Second Lien Notes.

Item 6—Exhibits

(a) Exhibits:

- 10.1 Indenture, dated March 17, 2011, by and among the Company, the guarantors party thereto, and The Bank of New York Mellon Trust Company, N.A., including the form of Notes (incorporated by reference to our Current Report on Form 8-K filed with the Securities and Exchange Commission on March 18, 2011).
- 10.2 Registration Rights Agreement, dated March 17, 2011, by and among the Company, the guarantors party thereto and Credit Suisse (USA) LLC and Jefferies & Company, Inc. (incorporated by reference to our Current Report on Form 8-K filed with the Securities and Exchange Commission on March 18, 2011).
- 31.1 Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit Index

<u>Exhibit No.</u>	<u>Description</u>
10.1	Indenture, dated March 17, 2011, by and among the Company, the guarantors party thereto, and The Bank of New York Mellon Trust Company, N.A., including the form of Notes (incorporated by reference to our Current Report on Form 8-K filed with the Securities and Exchange Commission on March 18, 2011).
10.2	Registration Rights Agreement, dated March 17, 2011, by and among the Company, the guarantors party thereto and Credit Suisse (USA) LLC and Jefferies & Company, Inc. (incorporated by reference to our Current Report on Form 8-K filed with the Securities and Exchange Commission on March 18, 2011).
31.1	Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

CERTIFICATION

I, Philip L. Carter, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended March 31, 2011 of Rotech Healthcare Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 6, 2011

/s/ PHILIP L. CARTER

Philip L. Carter
President and Chief Executive Officer

CERTIFICATION

I, Steven P. Alsene, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended March 31, 2011 of Rotech Healthcare Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 6, 2011

/s/ STEVEN P. ALSENE

Steven P. Alsene
Chief Financial Officer

**Certification Pursuant to
18 U.S.C. Section 1350,
as Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report on Form 10-Q of Rotech Healthcare Inc. (the "Company") for the quarterly period ended March 31, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Philip L. Carter, as President and Chief Executive Officer of the Company, and Steven P. Alsene, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of each such officer's knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ PHILIP L. CARTER

Name: Philip L. Carter
Title: **President and Chief Executive Officer**
Date: **May 6, 2011**

/s/ STEVEN P. ALSENE

Name: Steven P. Alsene
Title: **Chief Financial Officer**
Date: **May 6, 2011**

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.