

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 SEPTEMBER 30, 1994

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 1-11353

NATIONAL HEALTH LABORATORIES HOLDINGS INC.

(Exact name of registrant as specified in its charter)

DELAWARE 13-3757370

(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

4225 EXECUTIVE SQUARE, SUITE 805 LA JOLLA, CALIFORNIA 92037

(Address of principal executive offices) (Zip code)

619-657-9382

(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 X No

The number of shares outstanding of the issuer's common stock is 84,760,067 shares as of October 31, 1994, of which 20,176,729 shares are held by an indirect wholly owned subsidiary of Mafco Holdings Inc.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS
(Dollars in Millions, except per share data)

	September 30, 1994	December 31, 1993
	----- (Unaudited)	-----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 19.6	\$ 12.3
Accounts receivable, net	214.4	119.0
Prepaid expenses and other	29.3	21.7
Deferred income taxes	20.6	21.6
Income taxes receivable	--	8.7
	-----	-----
Total current assets	283.9	183.3
Property, plant and equipment, net	138.7	100.1
Intangible assets, net	569.2	281.5
Other assets, net	26.2	20.6
	-----	-----
	\$1,018.0	\$ 585.5
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 50.0	\$ 36.9
Dividend payable	--	6.8
Accrued expenses and other	91.7	55.6
Current portion of long-term debt	35.0	--
Current portion of accrued settlement expenses	36.9	21.6
	-----	-----
Total current liabilities	213.6	120.9
Revolving credit facility	193.0	278.0
Long-term debt, less current portion	360.0	--
Capital lease obligation	9.8	9.7
Accrued settlement expenses, less current portion	--	11.5
Deferred income taxes	25.6	3.1
Other liabilities	60.2	21.5
Stockholders' equity:		
Preferred stock, \$0.10 par value; 10,000,000 shares authorized; none issued	--	--
Common stock, \$0.01 par value; 220,000,000 shares authorized; 84,755,692 and 99,354,492 shares issued at September 30, 1994 and December 31, 1993, respectively	0.8	1.0
Additional paid-in capital	153.4	226.3
Retained earnings	4.0	202.0
Minimum pension liability adjustment	(2.4)	(2.4)
Treasury stock, at cost; 14,603,800 shares of common stock at December 31, 1993	--	(286.1)
	-----	-----
Total stockholders' equity	155.8	140.8
	-----	-----
	\$1,018.0	\$ 585.5
	=====	=====

See notes to unaudited consolidated condensed financial statements.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF EARNINGS
(Dollars in Millions, except per share data)
(Unaudited)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	1994	1993	1994	1993
Net sales	\$ 637.6	\$ 591.6	\$ 248.7	\$ 194.8
Cost of sales	436.5	326.5	167.7	109.6
Gross profit	201.1	265.1	81.0	85.2
Selling, general and administrative expenses	105.6	90.4	41.1	29.3
Amortization of intangibles and other assets	11.9	6.4	5.4	2.2
Operating income	83.6	168.3	34.5	53.7
Other income (expenses):				
Litigation settlement and related expenses	(21.0)	--	(21.0)	--
Other gains and expenses, net	--	15.3	--	15.3
Investment income	0.7	1.0	0.2	0.3
Interest expense	(22.1)	(7.1)	(11.6)	(3.1)
	(42.4)	9.2	(32.4)	12.5
Earnings before income taxes	41.2	177.5	2.1	66.2
Provision for income taxes	18.8	72.5	1.9	28.0
Net earnings	\$ 22.4	\$ 105.0	\$ 0.2	\$ 38.2
Earnings per common share	\$ 0.26	\$ 1.16	\$ --	\$ 0.43
Dividends per common share	\$ 0.08	\$ 0.24	\$ --	\$ 0.08

See notes to unaudited consolidated condensed financial statements.

/TABLE

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Dollars in Millions)
(Unaudited)

	Nine Months Ended September 30,	
	1994	1993
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	\$ 22.4	\$ 105.0
Adjustments to reconcile net earnings to net cash flows provided by (used for) operating activities:	-----	-----
Depreciation and amortization	32.7	26.8
Provision for doubtful accounts, net	(1.2)	1.1
Litigation settlement and related expenses	21.0	--
Other gains and expenses, net	--	(15.3)
Change in assets and liabilities, net of effects of acquisitions:		
Increase in accounts receivable	(57.4)	(34.3)
Decrease (increase) in prepaid expenses and other	2.8	(1.7)
Decrease in deferred income taxes, net	9.1	14.8
Decrease in income taxes receivable	6.8	10.4
(Decrease) increase in accounts payable, accrued expenses and other	(9.2)	2.5
Payments for settlement and related expenses	(17.2)	(45.6)
Other, net	(3.7)	(5.0)
Net cash (used for) provided by operating activities	----- 6.1	----- 58.7
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(36.9)	(18.3)
Acquisitions of businesses	(252.6)	(45.4)
Restricted investments	--	0.8
Other gains and expenses, net	--	15.3
Net cash used for investing activities	----- (289.5)	----- (47.6)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from revolving credit facilities	283.0	263.0
Payments on revolving credit facilities	(368.0)	(139.0)
Proceeds from long-term debt	400.0	--
Payments on long-term debt	(5.0)	--
Deferred payments on acquisitions	(5.2)	(1.3)
Purchase of treasury stock	--	(125.5)
Dividends paid on common stock	(13.6)	(22.1)
Other	(0.5)	(0.9)
Net cash provided by (used for) financing activities	----- 290.7	----- (25.8)
Net increase (decrease) in cash and cash equivalents	7.3	(14.7)
Cash and cash equivalents at beginning of period	----- 12.3	----- 33.4
Cash and cash equivalents at end of period	\$ 19.6 =====	\$ 18.7 =====

See notes to unaudited consolidated condensed financial statements.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS, CONTINUED
(Dollars in Millions)
(Unaudited)

	Nine Months Ended September 30,	
	1994	1993
Supplemental schedule of cash flow information:		
Cash paid during the period for:		
Interest	\$ 21.4	\$ 5.9
Income taxes	9.5	54.4
Disclosure of non-cash financing and investing activities:		
Dividends declared and unpaid on common stock	\$ --	\$ 6.9
In connection with business acquisitions, liabilities were assumed as follows:		
Fair value of assets acquired	\$ 395.3	\$ 62.6
Cash paid, net of cash acquired	(252.6)	(45.4)
Liabilities assumed	\$ 142.7	\$ 17.2
	=====	=====

See notes to unaudited consolidated condensed financial statements.

/TABLE

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Dollars in Millions)

1. BASIS OF FINANCIAL STATEMENT PRESENTATION

The consolidated financial statements include the accounts of National Health Laboratories Holdings Inc. (the "Company") and its wholly owned subsidiaries after elimination of all material intercompany accounts and transactions. Approximately 24% of the outstanding common stock of the Company is owned by National Health Care Group, Inc. ("NHCG") which is an indirect wholly owned subsidiary of Mafco Holdings Inc. ("Mafco").

The accompanying consolidated condensed financial statements of the Company and its subsidiaries are unaudited. In the opinion of management, all adjustments (which include only normal recurring accruals) necessary for a fair statement of the results of operations have been made.

2. EARNINGS PER SHARE

Earnings per share are based upon the weighted average number of shares outstanding during the three and nine months ended September 30, 1994 of 84,754,089 shares and 84,752,194 shares, respectively, and the weighted average number of shares outstanding during the three and nine months ended September 30, 1993 of 88,575,433 shares and 90,871,612 shares, respectively. The change in the total number of shares outstanding resulted from the purchase and subsequent cancellation by the Company of a portion of its outstanding shares of common stock, net of additional shares issued upon the exercise of options pursuant to the Company's stock option plans.

3. LITIGATION SETTLEMENT

The Company approved a proposed settlement of previously disclosed shareholder class and derivative litigation. In connection with the settlement, the Company took a pre-tax special charge of \$15.0 and a \$6.0 charge for expenses related to the settled litigation. Insurance payments and payments from other defendants amount to \$55.0 plus expenses. As previously disclosed, the litigation consisted of two consolidated class action suits and a consolidated shareholder derivative action brought in federal and state courts in San Diego, California. The proposed settlement involves no admission of wrongdoing and is subject to execution of a definitive agreement and court approval.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Dollars in Millions, except per share data)

4. ACQUISITION OF ALLIED CLINICAL LABORATORIES, INC.

On May 3, 1994, the Company entered into a definitive agreement to acquire Allied Clinical Laboratories, Inc. ("Allied"). Pursuant to the agreement, on May 9, 1994, a subsidiary of the Company commenced a cash tender offer for all shares of Allied common stock for \$23 per share. The agreement provided that any shares not tendered and purchased in the offer were to be exchanged for \$23 per share in cash in a second-step merger. In connection with the Company's acquisition of Allied, the Company and Allied became aware that the nature of the possible problems associated with billing practices of Allied's Cincinnati, Ohio clinical laboratory, concerning which Allied had received a subpoena on April 5, 1994 from the Office of Inspector General of the Department of Health and Human Services (the "OIG") requiring Allied to produce certain documents and information regarding the Medicare billing practices of such laboratories with respect to certain cancer screening tests, may have been both different and greater than previously perceived by the Company and Allied. As a result, on June 7, 1994, the Company entered into an agreement whereby the price payable in such cash tender offer and such second-step merger was reduced from \$23 per share to \$21.50 per share, or an aggregate of approximately \$12.6. The Company and Allied are continuing to investigate these possible problems and have communicated with the OIG regarding its subpoena, and they intend to cooperate fully with the OIG's investigation. However, in the opinion of management, the ultimate disposition of these matters is not likely to have a material adverse effect on the financial position or results of operations of the Company.

A subsidiary of the Company acquired Allied as a wholly owned subsidiary on June 23, 1994, for approximately \$191.5 in cash plus the assumption of \$24.0 of Allied indebtedness and the recognition of approximately \$19.9 of Allied net liabilities (the "Allied Acquisition"). The Allied Acquisition was accounted for using the purchase method of accounting; as such, Allied's assets and liabilities were recorded at their estimated fair values on the date of acquisition. The purchase price exceeded the fair value of acquired net tangible assets by approximately \$235.4, which consists of goodwill and the right to the Allied name of \$182.6 and other intangible assets of \$52.8. These items are being amortized over periods between 25 and 40 years on a straight-line basis. The allocation of the purchase price will be finalized during the fourth quarter of 1994 upon completion of asset valuations. Allied's results of operations have been included in the Company's results of operations beginning June 23, 1994.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Dollars in Millions, except per share data)

4. ACQUISITION OF ALLIED CLINICAL LABORATORIES, INC. - Continued

The following table provides unaudited pro forma operating results of the Company giving effect to the Allied Acquisition as if it had been completed at the beginning of the periods presented. The pro forma information has been prepared for comparative purposes only and does not purport to be indicative of future operating results.

	Nine Months Ended September 30,	
	1994	1993
Net sales	\$ 727.9	\$ 710.7
Net earnings	19.0	99.5
Earnings per common share	\$ 0.22	\$ 1.09

5. CORPORATE REORGANIZATION

On June 7, 1994, the stockholders of National Health Laboratories Incorporated ("NHLI") approved a proposed corporate reorganization of NHLI, as a result of which National Health Laboratories Holdings Inc., a Delaware corporation, now owns, through NHL Intermediate Holdings Corp. I, a Delaware corporation and a wholly owned subsidiary of the Company ("Intermediate Holdings I"), and NHL Intermediate Holdings Corp. II, a Delaware corporation and a wholly owned subsidiary of Intermediate Holdings I ("Intermediate Holdings II"), all the outstanding capital stock of NHLI.

In connection with the corporate reorganization on June 7, 1994, all of the 14,603,800 treasury shares held by NHLI were cancelled. As a result, the \$286.1 value assigned to such treasury shares was eliminated with corresponding decreases in the par value, additional paid-in capital and retained earnings accounts of \$0.2, \$72.3 and \$213.6, respectively.

6. LONG-TERM DEBT

On June 21, 1994, Intermediate Holdings II entered into a credit agreement dated as of such date (the "Credit Agreement"), with the banks named therein (the "Banks"), Citicorp USA, Inc., as administrative agent (the "Bank Agent"), and certain co-agents named therein, which made available to Intermediate Holdings II a term loan facility of \$400.0 (the "Term Facility") and a revolving credit facility of \$350.0 (the "Revolving Credit Facility" and, together with the Term Facility, the "Bank Facility"). The Bank Facility provided funds for the acquisition of Allied, for the refinancing of certain existing debt of Allied and NHLI, to pay related fees and expenses and for general corporate purposes of Intermediate Holdings II and its subsidiaries, in each case subject to the terms and conditions set forth therein.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Dollars in Millions)

6. LONG-TERM DEBT - Continued

The Credit Agreement provides that the Banks and the Bank Agent will receive from Intermediate Holdings II customary facility and administrative agent fees, respectively. Intermediate Holdings II will pay a commitment fee on the average daily unused portion of the Bank Facility of 0.5% per annum, subject to a reduction to 0.375% per annum if certain financial tests are met. Availability of funds under the Bank Facility is conditioned on certain customary conditions, and the Credit Agreement contains customary representations, warranties and events of default. The Credit Agreement also requires the Company to maintain certain financial ratios and tests, including minimum debt service coverage ratios and net worth tests.

The Revolving Credit Facility matures in June 1999, with semi-annual reductions of availability of \$50.0, commencing in December 1997. The Term Facility matures in December 2000, with repayments in each quarter prior to maturity based on a specified amortization schedule. The Bank Facility bears interest, at the option of Intermediate Holdings II, at (i) Citibank, N.A.'s Base Rate (as defined in the Credit Agreement), plus a margin of up to 0.75% per annum, based upon the Company's financial performance or (ii) the Eurodollar rate for one, two, three or six month interest periods (as selected by Intermediate Holdings II), plus a margin varying between 1.25% and 2.00% per annum based upon the Company's financial performance.

The Bank Facility is guaranteed by Intermediate Holdings I and certain subsidiaries of Intermediate Holdings II and is secured by pledges of stock and other assets of Intermediate Holdings II and its subsidiaries.

On June 21, 1994, \$400.0 available under the Term Facility was borrowed by Intermediate Holdings II and loaned to NHLI and was used by NHLI to repay in full its existing revolving credit facilities and for working capital and general corporate purposes. On June 23, 1994, Intermediate Holdings II borrowed \$185.0 of the amount available under the Revolving Credit Facility to consummate the Allied Acquisition.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollars in Millions)

RESULTS OF OPERATIONS

Nine Months Ended September 30, 1994 compared with Nine Months

Ended September 30, 1993

Net sales for the nine months ended September 30, 1994 were \$637.6, an increase of 7.8% from \$591.6 reported in the comparable 1993 period. Net sales from the inclusion of Allied since June 23, 1994 increased net sales by approximately \$52.7 or 8.9%. Growth in new accounts and numerous acquisitions of small clinical laboratory companies increased net sales by approximately 9.7% and 11.9%, respectively. A price increase, effective on April 1, 1994, increased net sales by approximately 1.7% for the nine months ended September 30, 1994. However, a reduction in Medicare fee schedules from 88% to 84% of the national limitation amounts on January 1, 1994, plus changes in reimbursement policies of various third party payors, reduced net sales by approximately 3.6%. Other factors, in order of decreasing magnitude, comprised the remaining reduction in net sales: declines in the level of HDL and ferritin testing, lower utilization of laboratory testing, price erosion in the industry as a whole and severe weather in the first quarter of 1994.

Cost of sales, which primarily includes laboratory and distribution costs, increased to \$436.5 for the nine months ended September 30, 1994 from \$326.5 in the corresponding 1993 period. Of the \$110.0 increase, approximately \$49.2 was the result of higher testing volume, approximately \$6.3 was due to an increase in phlebotomy staffing to improve client service and meet competitive demand and approximately \$34.3 was due to the inclusion of the cost of sales of Allied. The remaining increase resulted mainly from higher compensation and insurance expenses. Cost of sales as a percent of net sales was 68.5% for the nine months ended September 30, 1994 and 55.2% in the corresponding 1993 period. The increase in the cost of sales percentage primarily resulted from a reduction in net sales due to a reduction in Medicare fee schedules, pricing pressures and utilization declines, each of which provided little corresponding reduction in costs.

Selling, general and administrative expenses increased to \$105.6 for the nine months ended September 30, 1994 from \$90.4 in the same period in 1993. Approximately \$12.7 of the increase was due to the inclusion of the selling, general and administrative expenses of Allied since June 23, 1994. The remaining increase was primarily due to expansion of data processing and billing departments due to increased volume and to improve customer service. As a percentage of net sales, selling, general and administrative expenses was 16.6% and 15.3% for the nine months ended September 30, 1994 and 1993, respectively. The increase in the selling, general and administrative percentage primarily resulted from a reduction in net sales as discussed above.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollars in Millions, except per share data)

RESULTS OF OPERATIONS - Continued

Nine Months Ended September 30, 1994 compared with Nine Months

Ended September 30, 1993

Management expects net sales to continue to grow through strategic acquisitions and the addition of new accounts, although there can be no assurance that the Company will experience such growth. Reductions in Medicare fee schedules, pursuant to the Omnibus Budget Reconciliation Act of 1993 ("OBRA '93"), to 80% of the median fee amounts, effective January 1, 1995, followed by an additional reduction to 76% of such amounts on January 1, 1996 are expected to negatively impact net sales, cost of sales as a percentage of net sales and selling, general and administrative expenses as a percentage of net sales in the future. Management does not expect increases in cost of sales as a percentage of net sales and selling, general and administrative expenses as a percentage of net sales of the magnitude experienced in the nine months ended September 30, 1994. Management cannot predict if price erosion or utilization declines will continue or what their ultimate effect on net sales or results of operations will be. It is the objective of management to partially offset the increases in cost of sales as a percentage of net sales and selling, general and administrative expenses as a percentage of net sales through comprehensive cost reduction programs at each of the Company's regional laboratories, although there can be no assurance of the success of such programs.

The increase in amortization of intangibles and other assets to \$11.9 for the nine months ended September 30, 1994 from \$6.4 in the corresponding period in 1993 primarily resulted from the acquisition of Allied in June 1994 and numerous small laboratory companies during both 1994 and 1993.

The Company approved a proposed settlement of previously disclosed shareholder class and derivative litigation. In 1994 in connection with the settlement, the Company took a pre-tax special charge of \$15.0 and a \$6.0 charge for expenses related to the settled litigation. Insurance payments and payments from other defendants amount to \$55.0 plus expenses. As previously disclosed, the litigation consisted of two consolidated class action suits and a consolidated shareholder derivative action brought in federal and state courts in San Diego, California. The proposed settlement involves no admission of wrongdoing and is subject to execution of a definitive agreement and court approval.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollars in Millions)

RESULTS OF OPERATIONS - Continued

Nine Months Ended September 30, 1994 compared with Nine Months

Ended September 30, 1993

Other gains and expenses in 1993 included expense reimbursement and termination fees of \$21.6 received in connection with the Company's attempt to purchase Damon Corporation less related expenses and the write-off of certain bank financing costs aggregating \$6.3, resulting in a one-time pre-tax gain of \$15.3.

Interest expense was \$22.1 for the nine months ended September 30, 1994 compared with \$7.1 for the same period in 1993. The change resulted primarily from increased borrowings used to finance repurchases by the Company of its common stock in 1993 and to finance the acquisition of Allied in June 1994 and numerous small laboratory companies during both 1994 and 1993. Higher average interest rates also contributed to the increase in interest expense.

The provision for income taxes as a percentage of earnings before income taxes was 45.6% and 40.8% for the nine months ended September 30, 1994 and 1993, respectively. The change was mainly due to a higher effective tax rate for both federal and state income taxes because of the impact of permanent differences on lower pre-tax income in the third quarter of 1994.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollars in Millions)

RESULTS OF OPERATIONS - Continued

Three Months Ended September 30, 1994 compared with Three Months

Ended September 30, 1993

Net sales for the three months ended September 30, 1994 were \$248.7, an increase of 27.7% from \$194.8 reported in the comparable 1993 period. Net sales from the inclusion of Allied increased net sales by approximately \$48.3 or 24.8%. Growth in new accounts and numerous acquisitions of small clinical laboratory companies increased net sales by approximately 9.0% and 12.3%, respectively. A price increase, effective on April 1, 1994, increased net sales by approximately 2.5% for the three months ended September 30, 1994. However, a reduction in Medicare fee schedules from 88% to 84% of the national limitation amounts on January 1, 1994, plus changes in reimbursement policies of various third party payors, reduced net sales by approximately 2.2%. The remaining reduction in net sales was due to declines in the level of HDL and ferritin testing, and, to a lesser extent, lower utilization of laboratory testing.

Cost of sales, which primarily includes laboratory and distribution costs, increased to \$167.7 for the three months ended September 30, 1994 from \$109.6 in the corresponding 1993 period. Of the \$58.1 increase, approximately \$16.3 was the result of higher testing volume, approximately \$1.0 was due to an increase in phlebotomy staffing to improve client service and meet competitive demand and approximately \$31.7 was due to the inclusion of the cost of sales of Allied. The remaining increase resulted mainly from higher compensation and insurance expenses. Cost of sales as a percent of net sales was 67.4% for the three months ended September 30, 1994 and 56.3% in the corresponding 1993 period. The increase in the cost of sales percentage primarily resulted from a reduction in net sales due to a reduction in Medicare fee schedules, pricing pressures and utilization declines, each of which provided little corresponding reduction in costs.

Selling, general and administrative expenses increased to \$41.1 for the three months ended September 30, 1994 from \$29.3 in the same period in 1993. Approximately \$11.6 of the increase was due to the inclusion of the selling, general and administrative expenses of Allied. As a percentage of net sales, selling, general and administrative expenses was 16.5% and 15.0% for the three months ended September 30, 1994 and 1993, respectively. The increase in the selling, general and administrative percentage primarily resulted from a reduction in net sales as discussed above.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollars in Millions, except per share data)

RESULTS OF OPERATIONS - Continued

Three Months Ended September 30, 1994 compared with Three Months

Ended September 30, 1993

Management expects net sales to continue to grow through strategic acquisitions and the addition of new accounts, although there can be no assurance that the Company will experience such growth. Reductions in Medicare fee schedules, pursuant to OBRA '93, to 80% of the median fee amounts, effective January 1, 1995, followed by an additional reduction to 76% of such amounts on January 1, 1996 are expected to negatively impact net sales, cost of sales as a percentage of net sales and selling, general and administrative expenses as a percentage of net sales in the future. Management does not expect increases in cost of sales as a percentage of net sales and selling, general and administrative expenses as a percentage of net sales of the magnitude experienced in the three months ended September 30, 1994 compared to the same 1993 period. Management cannot predict if price erosion or utilization declines will continue or what their ultimate effect on net sales or results of operations will be. It is the objective of management to partially offset the increases in cost of sales as a percentage of net sales and selling, general and administrative expenses as a percentage of net sales through comprehensive cost reduction programs at each of the Company's regional laboratories, although there can be no assurance of the success of such programs.

The increase in amortization of intangibles and other assets to \$5.4 for the three months ended September 30, 1994 from \$2.2 in the corresponding period in 1993 primarily resulted from the acquisition of Allied in June 1994 and numerous small laboratory companies during both 1994 and 1993.

The Company approved a proposed settlement of previously disclosed shareholder class and derivative litigation. In 1994 in connection with the settlement, the Company took a pre-tax special charge of \$15.0 and a \$6.0 charge for expenses related to the settled litigation. Insurance payments and payments from other defendants amount to \$55.0 plus expenses. As previously disclosed, the litigation consisted of two consolidated class action suits and a consolidated shareholder derivative action brought in federal and state courts in San Diego, California. The proposed settlement involves no admission of wrongdoing and is subject to execution of a definitive agreement and court approval.

Other gains and expenses in 1993 included expense reimbursement and termination fees of \$21.6 received in connection with the Company's attempt to purchase Damon Corporation less related expenses and the write-off of certain bank financing costs aggregating \$6.3, resulting in a one-time pre-tax gain of \$15.3.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollars in Millions)

RESULTS OF OPERATIONS - Continued

Three Months Ended September 30, 1994 compared with Three Months

Ended September 30, 1993

Interest expense was \$11.6 for the three months ended September 30, 1994 compared with \$3.1 for the same period in 1993. The change resulted primarily from increased borrowings used to finance repurchases by the Company of its common stock during 1993 and to finance the acquisition of Allied in June 1994 and numerous small laboratory companies during both 1994 and 1993. Higher average interest rates also contributed to the increase interest expense.

The provision for income taxes as percentage of earnings before income taxes was 90.5% and 42.3% for the three months ended September 30, 1994 and 1993, respectively. The change was mainly due to the impact of permanent differences on lower pre-tax income in the third quarter of 1994.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollars in Millions, except per share data)

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

For the nine months ended September 30, 1994 and 1993, net cash provided by operating activities (after payment of settlement and related expenses of \$17.2 and \$45.6 in 1994 and 1993, respectively) was \$6.1 and \$58.7, respectively. Cash used for capital expenditures was \$36.9 and \$18.3 for the nine months ended September 30, 1994 and 1993, respectively. The Company expects capital expenditures to be approximately \$50.0 in 1994 to accommodate expected growth, to further automate laboratory processes, improve efficiency and integrate the Company and Allied.

On May 3, 1994, the Company entered into a definitive agreement to acquire Allied. Pursuant to the agreement, on May 9, 1994, a subsidiary of the Company commenced a cash tender offer for all shares of Allied common stock for \$23 per share. The agreement provided that any shares not tendered and purchased in the offer were to be exchanged for \$23 per share in cash in a second-step merger. On June 7, 1994, the Company entered into an agreement whereby the price payable in such cash tender offer and such second-step merger was reduced to \$21.50 per share, or an aggregate of approximately \$12.6. A subsidiary of the Company acquired Allied as a wholly owned subsidiary on June 23, 1994, for approximately \$191.5 in cash plus the assumption of \$24.0 of Allied indebtedness and the recognition of approximately \$19.9 of Allied net liabilities.

The Company acquired nine small laboratory companies during the nine months ended September 30, 1994 for an aggregate amount of \$44.2 in cash and the recognition of \$26.9 of liabilities. During the corresponding period in 1993, the Company acquired nineteen laboratory companies for a total of \$45.4 in cash and the recognition of \$17.2 of liabilities.

On June 21, 1994, Intermediate Holdings II entered into the Credit Agreement dated as of such date, with the banks named therein, Citicorp USA, Inc., as administrative agent, and certain co-agents named therein, which made available to Intermediate Holdings II the Term Facility of \$400.0 and the Revolving Credit Facility of \$350.0. The Bank Facility provided funds for the acquisition of Allied, for the refinancing of certain existing debt of Allied and NHLI, to pay related fees and expenses and for general corporate purposes of Intermediate Holdings II and its subsidiaries, in each case subject to the terms and conditions set forth therein.

The Credit Agreement provides that the Banks and the Bank Agent will receive from Intermediate Holdings II customary facility and administrative agent fees, respectively. Intermediate Holdings II will pay a commitment fee on the average daily unused portion of the Bank Facility of 0.5% per annum, subject to a reduction to

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollars in Millions)

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES - Continued

0.375% per annum if certain financial tests are met. Availability of funds under the Bank Facility is conditioned on certain customary conditions, and the Credit Agreement contains customary representations, warranties and events of default. The Credit Agreement also requires the Company to maintain certain financial ratios and tests, including minimum debt service coverage ratios and net worth tests.

The Revolving Credit Facility matures in June 1999, with semi-annual reductions of availability of \$50.0, commencing in December 1997. The Term Facility matures in December 2000, with repayments in each quarter prior to maturity based on a specified amortization schedule. The Bank Facility bears interest, at the option of Intermediate Holdings II, at (i) Citibank, N.A.'s Base Rate (as defined in the Credit Agreement), plus a margin of up to 0.75% per annum, based upon variations in certain financial tests or (ii) the Eurodollar rate for one, two, three or six month interest periods (as selected by Intermediate Holdings II), plus a margin varying between 1.25% and 2.00% per annum based upon the Company's financial performance.

The Bank Facility is guaranteed by Intermediate Holdings I and certain subsidiaries of Intermediate Holdings II and is secured by pledges of stock and other assets of Intermediate Holdings II and its subsidiaries.

On June 21, 1994, \$400.0 available under the Term Facility was borrowed by Intermediate Holdings II and loaned to NHLI and was used by NHLI to repay in full its existing revolving credit facilities and for working capital and general corporate purposes. On June 23, 1994, Intermediate Holdings II borrowed \$185.0 of the amount available under the Revolving Credit Facility to consummate the Allied acquisition.

In connection with the Allied Acquisition, the Company announced that it terminated its 10 million share repurchase program, under which 7,795,800 common shares had been repurchased, and established a new \$50.0 stock repurchase program through which the Company will acquire additional shares of the Company's common stock from time to time in the open market. As of September 30, 1994, there were no stock repurchases under the new stock repurchase program.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollars in Millions)

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES - Continued

During the nine months ended September 30, 1993, the Company purchased 7,582,700 of its outstanding shares of common stock for an aggregate amount of \$125.5. The purchase was financed by borrowings under the revolving credit facilities in existence at such time and cash on hand. In connection with the corporate reorganization on June 7, 1994, all of the 14,603,800 treasury shares held by NHLI were cancelled. As a result, the \$286.1 value assigned to such treasury shares was eliminated with corresponding decreases in the par value, additional paid-in capital and retained earnings accounts of \$0.2, \$72.3 and \$213.6, respectively.

The Company announced, also in connection with the Allied Acquisition, that it is discontinuing its dividend payments for the foreseeable future in order to increase its flexibility with respect to both its acquisition strategy and stock repurchase plan.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Company has been cooperating fully with the government to resolve its concerns with regard to the matters described under "Legal Proceedings" in the Form 10-Q for the six months ended June 30, 1994.

The Company approved a proposed settlement of previously disclosed shareholder class and derivative litigation. In connection with the settlement, the Company took a pre-tax special charge of \$15.0 million and a \$6.0 million charge for expenses related to the settled litigation. Insurance payments and payments from other defendants amount to \$55.0 million plus expenses. As previously disclosed, the litigation consisted of two consolidated class action suits and a consolidated shareholder derivative action brought in federal and state courts in San Diego, California. The proposed settlement involves no admission of wrongdoing and is subject to execution of a definitive agreement and court approval.

NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES

PART II - OTHER INFORMATION, Continued

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

27 - Financial Data Schedule
(electronically filed version only)

(b) Reports on Form 8-K

A report on Form 8-K dated June 23, 1994 was filed on July 7, 1994 in connection with the Allied Acquisition. The Form 8-K incorporated by reference the historical financial statements included in Allied's Annual Report on Form 10-K for the year ended December 31, 1993 and Allied's Quarterly Report on Form 10-Q for the quarter ended March 31, 1994. The Form 8-K also included unaudited pro forma financial data of the Company.

S I G N A T U R E S

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

NATIONAL HEALTH LABORATORIES HOLDINGS INC.
Registrant

By:/s/ David C. Flaugh

David C. Flaugh
Senior Executive Vice
President and Chief Operating
Officer (Acting Principal
Financial and Accounting
Officer)

Date: November 14, 1994

INDEX TO EXHIBITS

Exhibit No.

27 Financial Data Schedule (electronically
filed version only)

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES CONSOLIDATED CONDENSED BALANCE SHEETS AND STATEMENT OF EARNINGS AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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NATIONAL HEALTH LABORATORIES HOLDINGS INC. AND SUBSIDIARIES
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	SEP-30-1994	
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1,018,000		
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		41,200
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