

NEIGHBORCARE INC  
Form 10-K/A  
December 14, 2004

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-K/A**

**Amendment No. 1**

(Mark One)

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

**For the fiscal year ended September 30, 2004**

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: 000-33217**

**NEIGHBORCARE, INC.**

(Exact name of registrant as specified in its charter)

**Pennsylvania**

(State or other jurisdiction of incorporation or organization)

**601 East Pratt Street, 3rd Floor  
Baltimore, Maryland**

(Address of principal executive offices)

**06-1132947**

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

**21202**

(Zip code)

**(410) 528-7300**

(Registrant's telephone number, including area code)

**N/A**

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:

**NONE**

Securities registered pursuant to Section 12(g) of the Act:

**Common Stock, par value \$.02 per share  
Preferred Share Purchase Rights, no par value per share**

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

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

YES  NO

The aggregate market value of voting and non-voting common stock held by non-affiliates of the registrant is \$907,817,957 (1). As of December 1, 2004, 44,114,529 shares of the registrant's common stock were outstanding and 259,522 shares are to be issued in connection with the registrant's joint plan of reorganization confirmed by the Bankruptcy Court on September 20, 2001.

Indicate by check mark whether the registrant is an accelerated filer (as defined by Rule 12b-2 of the Act).

YES  NO

### APPLICABLE ONLY TO REGISTRANTS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court.

YES  NO

### DOCUMENTS INCORPORATED BY REFERENCE

NONE

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(1) The aggregate market value of the voting and non-voting common stock set forth above equals the number of shares of the registrant's common stock outstanding, reduced by the number of shares of common stock held by officers, directors and shareholders owning in excess of 10% of the registrant's common stock, multiplied by the last reported sale price for the registrant's common stock on the last business day of the registrant's most recently completed second fiscal quarter (i.e., March 31, 2004) (\$24.36). The information provided shall in no way be construed as an admission that any officer, director or 10% shareholder of the registrant may or may not be deemed an affiliate of the registrant or that he/it is the beneficial owner of the shares reported as being held by him/it, and any such inference is hereby disclaimed. The information provided herein is included solely for record keeping purposes of the Securities and Exchange Commission.

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### Explanatory Note

We are filing this Amendment No. 1 on Form 10-K/A to our Annual Report on Form 10-K for the fiscal year ended September 30, 2004, as filed with the Securities and Exchange Commission on December 10, 2004, to correct disclosure contained under Part III, Item 11 Executive Compensation Employment Agreements relating to compensation received by our chief executive officer, John J. Arlotta, under his employment agreement with respect to fiscal 2004. This Amendment No. 1 clarifies that Mr. Arlotta received no incentive (*i.e.*, performance) bonus under his employment agreement with respect to fiscal 2004. With the exception of this change, the below disclosure is identical to that contained in our Annual Report on Form 10-K for the fiscal year ended September 30, 2004 as filed on December 10, 2004.

### ITEM 11: EXECUTIVE COMPENSATION

#### Summary Compensation Table

The following table sets forth the compensation earned during each of the last three fiscal years by our current and former Chief Executive Officer and our five other most highly compensated executive officers, referred to as the Named Executive Officers, whose aggregate salaries and bonuses exceeded \$100,000 for services rendered in all capacities to us during fiscal 2004.

Name and Position	Fiscal Year	Annual Compensation			Long-term Compensation		
		Salary \$(1)	Bonus \$(2)	Other Annual Compensation \$(3)	Restricted Stock Awards \$(4)	Securities Underlying Options/ SARs	All Other Compensation \$(5)
John J. Arlotta Chairman, President and Chief Executive Officer	2004	\$ 850,000	\$ 130,000	\$ 102,184	\$ 6,077,521	1,000,000	\$ 76,570
	2003	163,462	850,000				29,005
Robert H. Fish Former Chief Executive Officer	2004	375,962	412,500		94,994	3,913	480
	2003	850,000	1,221,410	83,406		177,500	
	2002	274,615	70,833			25,000	
Robert A. Smith Senior Vice President and Chief Operating Officer	2004	350,000	405,900		822,150	87,500	1,708
	2003	360,768	75,250				2,000
	2002	310,003	60,000		304,950	50,000	1,700
John F. Gaither, Jr. Senior Vice President, General Counsel and Corporate Secretary	2004	280,000	10,000	9,750	623,750	150,000	
John L. Kordash Vice Chairman and Executive Vice President	2004	250,000	15,000	9,750	623,750	250,000	2,398
	2003	15,385					
Richard W. Sunderland, Jr. Former Chief Financial Officer	2004	230,769	314,300			75,000	79,607
	2003	244,808	69,375				
	2002	218,828	65,600		223,630		

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Richard W. Hunt Senior Vice President and Chief Financial Officer	2004	61,538			1,247,500		225
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(1) Includes compensation deferred under the 401(k) Retirement Plan, Non-Qualified Deferred Compensation Plan and other arrangements with us. Other payments made by us under the 401(k) Retirement Plan, Non-Qualified Deferred Compensation Plan and other arrangements with us are not included.

(2) Messrs. Arlotta, Fish, Gaither, Kordash and Sunderland received bonuses of \$130,000, \$200,000, \$10,000, \$15,000, and \$20,000, respectively, in connection with the spin-off of GHC in fiscal 2004. Mr. Fish received a pro rated performance bonus of \$212,500 in fiscal 2004. Messrs. Smith and Sunderland received employment contract payouts in fiscal 2004 of \$405,900 and \$294,300, respectively. Mr. Arlotta received a performance bonus of \$550,000 and a sign-on bonus of \$300,000 in fiscal 2003. Mr. Fish received a performance bonus of \$500,000 and a bonus of \$721,410 upon his appointment as chief executive officer in fiscal 2003. All other amounts reflect performance bonuses.

(3) Mr. Arlotta received compensation of approximately \$40,041 for housing expenses (\$16,041 of which represents a tax gross-up payment) and \$13,000 for automobile expenses in fiscal 2004. Mr. Arlotta also received \$49,143 in tax gross-up payments in relation to a company-sponsored

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life insurance plan in fiscal 2004. All remaining amounts in fiscal 2004 reflect compensation for automobile expenses. Mr. Fish received compensation of approximately \$62,206 for housing expenses and approximately \$15,200 for automobile expenses in fiscal 2003.

(4) Restricted stock grants in fiscal 2004 were authorized under our 2004 Performance Incentive Plan (the 2004 Plan ) on June 15, 2004. The restrictions vest at variable rates over a three-year term for each recipient. The market value of our common stock at September 30, 2004 was \$25.35 per share. The grants of restricted stock to Mr. Arlotta were committed in Mr. Arlotta's employment agreement but were not made until after our stockholders' approval on June 15, 2004 of the 2004 Plan. Restricted stock grants in fiscal 2002 and 2003 were authorized under our 2001 Stock Incentive Plan. See Benefit Plans 2001 Stock Incentive Plan. Of the shares granted to Mr. Arlotta, 64,678 vested immediately. As of September 30, 2004, Mr. Arlotta had 113,197 shares unvested at a value of \$2,869,543, Mr. Smith had 19,687 shares unvested at a value of \$499,065, Messrs. Gaither and Kordash had 25,000 shares unvested at a value of \$633,750, and Mr. Hunt had 37,500 shares unvested at a value of \$950,625.

(5) Includes severance pay, company-sponsored long-term disability and life insurance coverage. Mr. Arlotta received \$75,000 in relation to a company-sponsored life insurance plan and \$1,570 in imputed income from long-term disability/life insurance premiums in fiscal 2004. Payments to Messrs. Fish, Smith, Kordash and Hunt in fiscal 2004 reflect imputed income from long-term disability/life insurance premiums. Mr. Sunderland received severance payments in the aggregate amount of \$78,919 in fiscal 2004.

**Option/SAR Grants in Last Fiscal Year**

The following table sets forth certain information concerning stock options granted under the 2001 Stock Option Plan during fiscal 2004 to the Named Executive Officers:

Name	Individual Grants						Potential Realized Value at Assumed Annual Rates of Stock Price Appreciation for Option Terms			
	Number of Securities Underlying Options/SARs Granted (1)	Percent of Total Options/SARs Granted to Employees in Fiscal Year	Exercise Price per Share	Expiration Date	5%	10%				
John J. Arlotta	250,000	15.80%	21.50	12/9/2013	\$	3,380,309	\$	8,566,366		
	250,000	15.80%	19.55	12/9/2013	\$	3,073,722	\$	7,789,416		
	250,000	15.80%	18.79	12/9/2013	\$	2,954,233	\$	7,486,605		
	250,000	15.80%	20.12	12/9/2013	\$	3,163,240	\$	8,016,525		
Robert H. Fish	3,913	0.25%	15.47	10/1/2013	\$	38,070	\$	96,476		
Robert A. Smith	87,500	5.50%	21.50	12/9/2013	\$	1,183,108	\$	2,998,228		
John F. Gaither, Jr.	150,000	9.50%	21.50	12/9/2013	\$	2,028,185	\$	8,566,366		
John L. Kordash	250,000	15.80%	21.50	12/9/2013	\$	3,380,309	\$	5,139,819		
Richard W. Sunderland, Jr.	75,000	4.70%	21.50	12/9/2013	\$	1,014,093	\$	2,569,910		
Richard W. Hunt										

(1) Pursuant to Mr. Sunderland's separation agreement, 46,875 options granted under the 2001 Stock Option Plan were forfeited in connection with his resignation.



**Aggregate Option/SAR Exercises in Last Fiscal Year and Fiscal Year-End Option/SAR Values**

The following table sets forth certain information concerning the number and value of unexercised options to purchase shares of our common stock held at the end of fiscal 2004 by the Named Executive Officers:

Name	Shares Acquired on Exercise (#)	Value Realized (\$)	Number of Unexercised Securities Underlying Options/SARs Fiscal Year-End (#) Exercisable/ Unexercisable	Value of Unexercised In-the-Money Options/SARs at Fiscal Year-End (\$) Exercisable/ Unexercisable (1)
John J. Arlotta			421,875/578,125	2,026,250/3,088,594
Robert H. Fish	147,797	1,779,403	399,163/	4,932,794/
Robert A. Smith			38,281/49,219	147,382/189,493
John F. Gaither, Jr.			65,625/84,375	252,656/324,844
John L. Kordash			109,375/140,625	421,094/541,406
Richard W. Sunderland, Jr.			28,125/	108,281/
Richard W. Hunt			/	/

(1) Stock price at close of business on September 30, 2004 was \$25.35.

**Directors Compensation**

Each of our directors who is not our employee receives an annual fee of \$25,000 for serving as a director and cash compensation of \$1,500 for each in-person meeting of the Board of Directors or Board Committee attended and \$1,000 for each telephonic meeting of the Board of Directors or Board Committee attended. The chairman of our Audit and Compliance Committee receives an additional annual fee of \$10,000.

Each director also receives an annual award of restricted stock under our 2004 Performance Incentive Plan having a fair market value at the time of grant of \$95,000. Such shares are 100% vested on the date of the award but during the period commencing on the date of the award and terminating on the date the grantee no longer serves as a director, referred to as the restricted period, the shares may not be sold, assigned, exchanged, gifted, transferred, pledged, or otherwise encumbered by the grantee except as described below. If, during the restricted period, the fair market value of the shares is greater than \$285,000, the restrictions shall be lifted with respect to that number of the shares which represents the amount of the fair market value of the shares in excess of \$285,000, but the restrictions shall continue to apply during the restricted period to that portion of the shares with a fair market value of \$285,000. Upon a change of control, as defined in the plan, the shares shall be free of restrictions.

Effective June 15, 2004, each director was granted 3,033 shares of restricted stock valued at the closing market price of our common stock of \$31.32.

**Employment Agreements**

Effective July 7, 2003, we entered into an employment agreement with John J. Arlotta, our chairman, president and chief executive officer, as amended on December 9, 2003. The agreement currently expires on July 7, 2005, with automatic one-year renewals beginning on July 7, 2004 and each successive anniversary thereafter. The automatic extension of the agreement may be terminated with notice by either the affirmative vote of two-thirds of the non-management members of the Board of Directors or by Mr. Arlotta. Mr. Arlotta will receive an annual base salary of \$850,000, subject to annual reviews by the Compensation Committee of the Board of Directors commencing February 4, 2004. The agreement provided for an incentive bonus of not less than \$550,000, with a target bonus of 80% of his base salary, for fiscal 2003. Annually thereafter, the agreement provides that Mr. Arlotta will receive an incentive bonus equal to at least 100% of his base salary but only upon the Compensation Committee's certification that the applicable performance goals have been achieved. Mr. Arlotta received a signing bonus of \$300,000 and an

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incentive (*i.e.*, performance) bonus of \$550,000 in fiscal 2003 pursuant to the agreement. Mr. Arlotta received no incentive (*i.e.*, performance) bonus under his employment contract with respect to fiscal 2004.

Pursuant to the terms of the agreement, we granted to Mr. Arlotta options to purchase 1,000,000 shares of our Common Stock in increments of 250,000 shares on each of December 9, 2003, December 16, 2003, December 24, 2003 and January 5, 2004, of which 25% vests immediately upon the date of grant and the remainder vests in quarterly installments of 6.25% thereafter. Under the agreement, Mr. Arlotta also received a restricted stock award on January 15, 2004 with an aggregate value of \$4,000,000, rounded to the nearest whole share and based on the average closing price of our common stock for the thirty trading days immediately following the spin-off. On the date of the restricted stock award, 25% of the shares vested immediately, with vesting in equal quarterly installments thereafter such that the shares vest in full by July 7, 2006. In addition, Mr. Arlotta is entitled to participate in each employee benefit plan or perquisite applicable generally to our executive officers. Under the terms of the agreement, all equity-based compensation will fully vest automatically upon a change in control, any termination by us without cause or due to Mr. Arlotta's death or disability, each as defined in the agreement, any termination by Mr. Arlotta for good reason or our failure to automatically extend the term of the agreement.

The Board of Directors may terminate the employment agreement with Mr. Arlotta with or without cause, as defined in the agreement, by the affirmative vote of two-thirds of the non-management members of the Board of Directors. Mr. Arlotta may terminate his employment with us upon notice of the occurrence of certain events, including a change in control of NeighborCare. Upon termination of the employment agreement for any reason, Mr. Arlotta will be entitled to his accrued and unpaid base salary through the date of termination, any earned but unpaid bonus for any fiscal year ending prior to the date of termination, any benefits accrued and vested under the terms of our employee benefit plans and programs through the date of termination, all deferred compensation of any kind and the option to have assigned to him any assignable insurance policy relating to him. In addition upon death, we will pay Mr. Arlotta's estate a lump sum in cash equal to his base salary for the period from the date of death through the end of the term of the agreement, benefits as if his employment had terminated on the last day of the month and a pro rata bonus for the portion of the year of termination preceding the date of his death based upon an annual amount equal to 100% of his base salary. Also, all restricted stock, stock options and performance share awards will automatically vest as of the date of death.

If Mr. Arlotta's employment agreement is terminated by us without cause or due to his disability, each as defined in the agreement, or by Mr. Arlotta for good reason or following a change of control, each as defined in the agreement, or as a result of non-extension of the agreement, in addition to the foregoing, NeighborCare will:

pay him a pro rata bonus for the portion of the year in which the date of termination occurs preceding the date of termination based upon an annual amount equal to 100% of his base salary and a lump-sum cash payment equal to two times his highest base salary in the three years preceding termination plus two times his target bonus for the year of termination less any disability insurance benefits if applicable for the two-year period beginning with the date of termination;

continue to provide the health and life insurance benefits provided to him and his spouse and eligible dependents immediately prior to his date of termination for a period of two years following the date of termination; and

all restricted stock, stock option and performance share awards will fully vest and remain exercisable for two years following termination.

In addition, Mr. Arlotta is entitled to the above consideration in the event that he terminates the agreement because NeighborCare has engaged or has required that he engage in any activity which would cause him to violate covenants of his contained in a consulting agreement between him and his former employer, Caremark Rx, Inc.. On July 8, 2003, Caremark filed a complaint seeking to prohibit Mr. Arlotta's employment with NeighborCare pursuant to the terms of such consulting agreement. In December 2003, NeighborCare, Caremark and Mr. Arlotta entered into a Partial Release and Settlement Agreement pursuant to which Mr. Arlotta was permitted to accept continued employment with NeighborCare under certain conditions and Caremark was released of certain compensation obligations to Mr. Arlotta and the complaint was dismissed without prejudice.

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Mr. Arlotta's employment agreement contains confidentiality provisions that apply during and after the term of employment and non-competition provisions that limit him from competing with us for the term of employment and for a period of two years after, regardless of the reason for the termination of employment.

On each of July 28, 2003, September 10, 2003, November 24, 2003 and November 26, 2003, we entered into employment agreements with John L. Kordash, our executive vice president and assistant to the chief executive officer, John F. Gaither, Jr., our senior vice president, general counsel and secretary, Richard W. Sunderland, Jr., our former chief financial officer, and Robert A. Smith, our chief operating officer, respectively. Effective December 9, 2003, each of these agreements was amended and restated. Effective June 22, 2004, the agreements with Messrs. Kordash and Gaither were further amended. The agreements with Messrs. Kordash and Gaither expire on October 1, 2005. On May 7, 2004, the Company entered into a Separation Agreement with Richard W. Sunderland, Jr., and on August 27, 2004, Mr. Sunderland resigned as our chief financial officer. See Transition Agreements.

The agreement with Mr. Smith expires on December 1, 2005. The agreements provide that annual base salaries to be paid to Messrs. Kordash, Gaither, Sunderland and Smith are \$250,000, \$280,000, \$250,000 and \$350,000, respectively. In addition, the agreements with Messrs. Kordash and Gaither provided for an option grant on December 9, 2003 to purchase 250,000 and 150,000 shares, respectively, of our common stock at an exercise price of \$21.50, of which 25% vested immediately upon the date of grant and the remainder vests in quarterly installments of 6.25% thereafter. The agreements with Messrs. Sunderland and Smith provided for option grants by incorporation of prior letter agreements with us, as described below, at the same exercise price and vesting schedule described above. Under the terms of the agreements, all outstanding equity-based compensation shall automatically become fully vested upon any termination by us without cause or due to the executive's death or disability or the executive's termination for good reason, each as defined in the agreements; provided that the agreements with Messrs. Smith and Sunderland provide for less than full vesting upon termination on or before January 1, 2005 in certain instances.

The agreements with Messrs. Kordash, Gaither, Sunderland and Smith contain the following provisions that are substantially similar to those provisions contained in Mr. Arlotta's employment agreement discussed above: an automatic one-year extension, eligibility to participate in stock option, incentive compensation and other incentive plans, receipt of perquisites generally provided to our officers, termination of the agreement by us with or without cause and by the executive upon the occurrence of certain events and confidentiality and non-competition provisions. Each agreement also provides for severance compensation in the event of termination without cause or for good reason consisting of a pro rata bonus for the portion of the year in which the date of termination occurs, a lump-sum payment equal to the sum of the executive's average base salary and the average annual bonus earned under our incentive plans for the most recent two years, continuation of health and life insurance benefits for up to two years and vesting of previously granted stock options and restricted stock.

Effective June 22, 2004, we amended our agreements with Messrs. Kordash and Gaither to further provide (i) that resignation within ninety days following a change in control will constitute termination by the executive for good reason, (ii) for payment upon termination without cause, death or disability or termination by executive for good reason within two years of a change in control equal to two times his average annual base salary and average annual bonus under our incentive plans for the most recent two years, and (iii) for the automatic vesting of all equity-based compensation upon a change in control unless otherwise specifically provided by reference to the amended agreement in any plan or award thereunder or unless 75% of the incumbent directors (as defined in our 2004 Performance Incentive Plan) determine otherwise prior to such change in control.

In November 2003, in contemplation of the spin-off of GHC, we entered into letter agreements with Messrs. Smith and Sunderland which were incorporated by reference into each executive's amended and restated employment agreement described above. Under the letter agreements, each executive agreed to waive his right to a lump-sum payment and other benefits that the spin-off would likely have triggered under their employment agreements in exchange for continued employment until the spin-off. In addition, upon completion of the spin-off, we agreed to:



make a lump-sum payment to Messrs. Smith and Sunderland of \$405,900 and \$294,300, respectively, in settlement of amounts owing under prior employment agreements;

continue each executive's employment with the terms and conditions of the employment agreements described above;

grant a stock option to Messrs. Smith and Sunderland to purchase 87,500 and 75,000, respectively, shares of our Common Stock; and

on the six-month anniversary of the option grant, either grant an additional option to purchase the same amount of our Common Stock or grant shares of restricted stock having a value equivalent to the replaced options.

On June 29, 2004, we entered into an employment agreement with Richard W. Hunt, our senior vice president and chief financial officer. The agreement provides that Mr. Hunt's base salary for the initial one-year term of the agreement is \$250,000. The agreement also provides for the grant of 50,000 shares of our restricted stock, of which 12,500 vest 45 days after the grant date and the remaining amount vests in equal installments on each of the first three anniversaries of the effective date, provided that Mr. Hunt remains employed by us on each such date. In the event that a change of control, as defined in the agreement, occurs on or prior to December 31, 2004, 30,000 of such shares of restricted stock will immediately vest (inclusive of, and not in addition to, the 12,500 shares scheduled to vest 45 days after the grant date). In the event that a change of control occurs after December 31, 2004, all of such shares of restricted stock will vest in full.

The agreement with Mr. Hunt contains the following provisions that are substantially similar to those provisions contained in our agreements, as amended, with Messrs. Kordash and Gaither discussed above: an automatic one-year extension, eligibility to participate in equity and cash incentive compensation and other incentive plans, receipt of perquisites generally provided to our officers, termination of the agreement by us with or without cause and by Mr. Hunt upon the occurrence of certain events and confidentiality and non-competition provisions. The agreement also provides for severance compensation in the event of termination without cause or for good reason consisting of a pro rata bonus for the portion of the year in which the date of termination occurs, a lump-sum payment equal to the sum of Mr. Hunt's average base salary and the average annual bonus earned under our incentive plans for the most recent two years or, during the two-year period following a change of control as described above with respect to our agreements with Messrs. Kordash and Gaither, two times such sum, continuation of health and life insurance benefits for up to two years and, if but only if such termination occurs after the first anniversary of our agreement with Mr. Hunt, vesting of previously granted stock options and restricted stock.

### **Transition Agreements**

On December 1, 2003, in connection with the spin-off, Robert Fish resigned as our chairman and chief executive officer. Mr. Fish remained our employee for transitional purposes until his termination on February 28, 2004. Pursuant to the terms of Mr. Fish's employment agreement, upon his resignation Mr. Fish received \$766,500 in accrued and unpaid salary and bonuses through the date of termination and a continuation of health and insurance benefits for himself, his spouse and eligible dependents for a period of one year following the date of termination. Upon his resignation, all restricted stock awards made to Mr. Fish fully vested, and all vested stock options remained exercisable through the original terms with all rights. The employment agreement also contains provisions which restrict Mr. Fish from competing with NeighborCare for a period of one year after termination.

On December 9, 2003, we entered into an option cancellation agreement with Mr. Fish relating to options which vested upon the completion of the spin-off and Mr. Fish's termination of employment in connection with the spin-off. After the board of director's adjustment to the aggregate number and exercise price of all outstanding options to purchase our common stock in connection with the spin-off and as of the date of the agreement, Mr. Fish held options to purchase 430,470 shares of our common stock at an exercise price per share of \$10.86 and 352,203 shares at an exercise price of \$12.99, each of which expire on February 28, 2006. Under the option cancellation agreement, Mr. Fish surrendered to us options to purchase 282,673 shares of common stock at the exercise price of \$10.86 for the aggregate cash payment of \$2,580,108 less any applicable withholding taxes.

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On May 7, 2004, we entered into a Separation Agreement with Richard W. Sunderland, Jr., our chief financial officer. Under the agreement, effective August 27, 2004, Mr. Sunderland received incentive compensation of \$59,688 and will receive \$250,000 of severance through August 27, 2005. Additionally, Mr. Sunderland will continue to receive benefits through August 27, 2006.

## Benefit Plans

### *2004 Performance Incentive Plan*

On June 15, 2004, our shareholders approved our 2004 Performance Incentive Plan. The purposes of our 2004 Performance Incentive Plan are to attract and promote the long-term retention of our key employees, directors and certain other persons who are in a position to make significant contributions to our success, to reward our employees, directors and other persons for their contributions, to provide additional incentive to our employees, directors and other persons to continue making similar contributions and to further align the interests of our employees, directors and other persons with those of our shareholders. The 2004 Performance Incentive Plan was adopted to replace, on a prospective basis, our 2001 Stock Incentive Plan and 2001 Stock Option Plan, each as described below. See 2001 Stock Incentive Plan and 2001 Stock Option Plan.

The 2004 Performance Incentive Plan permits grants of incentive stock options, options not intended to qualify as incentive stock options, stock appreciation rights, restricted and unrestricted stock awards, restricted stock units, cash-based awards, including supplemental cash awards, and performance awards, and any combination thereof. Awards of restricted and unrestricted stock, restricted stock units and/or deferred stock may also be issued under the 2004 Performance Incentive Plan to participants in connection with management or employee purchase programs. Shares issuable under awards that terminate unexercised or otherwise terminate without an issuance of shares, shares issuable under awards that are payable in stock or cash but are paid in cash and shares issued but later forfeited will be available for future awards under the 2004 Performance Incentive Plan. If shares of our common stock are not issued because such shares instead are used to satisfy an applicable tax withholding requirement or other obligation to us in connection with the exercise of an award, then such shares will again be available for future issuance under the 2004 Performance Incentive Plan. In addition, if the exercise price of any award is satisfied by the tender of shares of our common stock (by actual delivery or attestation), only the number of shares of our common stock issued under the 2004 Performance Incentive Plan, net of any shares so tendered, will be deemed issued to the recipient.

Incentive stock options may be granted under the 2004 Performance Incentive Plan only to our employees. All of our current and future employees and other persons who, in the opinion of our Compensation Committee, are in a position to make significant contributions to our success, such as consultants and non-employee directors, are eligible to receive all other types of awards under the 2004 Performance Incentive Plan. Our Compensation Committee will determine the exercise price applicable to each stock option and stock appreciation right, which will not be less than the fair market value of our common stock at the time of the grant. In no case may our Compensation Committee amend an outstanding award, or cancel an outstanding award and issue a new award, for the sole purpose of reducing the exercise price thereunder.

The aggregate number of shares of our common stock for which awards may be granted under the 2004 Performance Incentive Plan is 5,000,000 shares, with an individual limit of 500,000 shares per fiscal year for each participant (excluding grants under any individual employment agreement as an inducement material to the individual's entering into an employment contract with us). Notwithstanding the foregoing, in the event of any stock dividend, stock split, combination or exchange of equity securities, merger, consolidation, recapitalization, reorganization, divestiture or other distribution (other than ordinary cash dividends) of assets to our shareholders, or any other event affecting our common stock that the Compensation Committee deems, in its sole discretion, to be similar circumstances, the aggregate number of shares of our common stock which may be issued under our 2004 Performance Incentive Plan shall be appropriately adjusted in a manner determined in the sole discretion of our Compensation Committee.

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The maximum aggregate amount that may be awarded in the form of a cash-based award, including a supplemental cash award, in any one fiscal year to a participant who is a covered employee as defined in Section 162(m) of the Internal Revenue Code of 1986, as amended, shall not exceed \$2,000,000 determined as of the date of vesting or payout, as applicable. The maximum aggregate amount that may be

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awarded in the form of a cash-based award, including a supplemental cash award, in any one fiscal year to a participant who is not a covered employee shall be determined by our Compensation Committee.

As of September 30, 2004, 416,946 shares of restricted stock have been issued to our employees, of which 145,304 were fully vested and 44,038 were surrendered to fulfill employee income tax obligations resulting from the grants, and 21,231 shares of restricted stock have been issued to members of our Board of Directors under the 2004 Performance Incentive Plan. Restrictions on grants to our employees typically vest ratably over three years from the date of grant such that the employee cannot sell or trade the restricted stock until it becomes vested. Restrictions on grants to our directors are described under Directors Compensation.

#### *2001 Stock Incentive Plan*

On October 2, 2001, our Board of Directors authorized the issuance of 750,000 shares of restricted common stock to certain of our senior officers. These shares vest and are issued quarterly over a five-year period, which commenced on February 28, 2002 and will generally end on October 1, 2006. In May 2003, the Company made an offer to employees who held shares of restricted common stock to accelerate the vesting of all such restricted shares in exchange for the tendering of any options to purchase common stock. At September 30, 2004, 625 shares of restricted common stock remain unvested and issuable through October 1, 2006. See 2001 Stock Option Plan. We will not make any future grants under the 2001 Stock Incentive Plan.

#### *2001 Stock Option Plan*

The purpose of our 2001 Stock Option Plan is to provide additional incentive to officers, other key employees, and directors of, and important consultants to us and each present or future parent or subsidiary corporation, by encouraging them to invest in shares of our common stock thereby acquire a proprietary interest in us and an increased personal interest in our continued success and progress.

The aggregate number of shares of our common stock that may be issued under our 2001 Stock Option Plan is 3,480,000. Notwithstanding the foregoing, in the event of any change in the outstanding shares of our common stock by reason of a stock dividend, stock split, combination of shares, recapitalization, merger, consolidation, transfer of assets, reorganization, conversion or what our compensation committee of the Board of Directors deems in its sole discretion to be similar circumstances, the aggregate number and kind of shares which may be issued under our 2001 Stock Option Plan shall be appropriately adjusted in a manner determined in the sole discretion of the compensation committee. Reacquired shares of our common stock, as well as unissued shares, may be used for the purpose of our 2001 Stock Option Plan. Our common stock subject to options which have terminated unexercised, either in whole or in part, shall be available for future options granted under our 2001 Stock Option Plan. As of September 30, 2004, 2,281,904 options are granted and outstanding, of which 1,632,287 are held by employees, 626,137 are held by current and former directors and 39,134 are held by a third party consultant. We will not make any future grants under the 2001 Stock Option Plan.

On April 1, 2003, we extended an offer to our employees, including executive officers except for our then chief executive officer, to tender all options to purchase shares of our common stock, par value \$.02 per share, outstanding under its 2001 Stock Option Plan, for the following consideration: (a) for those holders of options who had received awards of more than 2,000 restricted shares of common stock under our 2001 Stock Incentive Plan, the acceleration of vesting of all such restricted shares plus a cash payment of \$2.50 per share underlying the option for options that had an exercise price below \$20.00 per share, and (b) with respect to those holders of options who had not received awards of more than 2,000 restricted shares, (i) for those options that had an exercise price of at least \$20.00 per share, a cash payment of \$2.00 per share underlying the option, and (ii) for those options that had an exercise price below \$20.00 per share, a cash payment of \$2.50 per share

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subject to the option. The offer expired on May 12, 2003. We accepted for exchange and cancellation options to purchase 1,724,000 shares of our common stock, which represented all of the eligible outstanding options properly tendered for exchange by eligible option holders, on May 13, 2003. All eligible options held by our employees were tendered on the offer, with the exception of options to purchase 35,000 shares.

See Transition Agreements.

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*Non-Qualified Deferred Compensation Plan*

On April 1, 2001, we adopted a Non-Qualified Deferred Compensation Plan. Beginning January 1, 2002, eligible employees (i.e., in calendar 2004, employees whose base salary meets or exceeds \$90,000) were permitted to defer up to 50% of their base salary and up to 90% of their incentive compensation bonus each year on a pre-tax basis under the NeighborCare Non-Qualified Deferred Compensation Plan. Participants are able to select from several fund choices and their Deferred Compensation Plan account increases or decreases in value in accordance with the performance of the funds selected. The Non-Qualified Deferred Compensation Plan is administered by a trustee.

*Retirement Plan*

On January 1, 1989, we adopted an employee Retirement Plan that consists of a 401(k) component and a profit sharing component. Our retirement plan is a 401(k)/cash or deferred arrangement covering all of our employees (other than certain employees covered by a collective bargaining agreement) who have completed at least 500 hours of service during the six-month period beginning on his or her commencement date or who has completed at least 1,000 hours of service in the first year of employment or any subsequent calendar year. Under the 401(k) component, each employee may elect to contribute a portion of his or her current compensation up to the lesser of the maximum permitted by the Internal Revenue Code or 50% (or, in the case of a highly compensated employee, a maximum of 6% (4% for plan years ending prior to January 1, 2004)) of such employee's annual compensation. We may make a matching contribution each year as determined by the Board of Directors. The Board of Directors may establish this contribution at any level each year, or may omit such contribution entirely. Under the profit sharing component of the Retirement Plan, we may make an additional employer contribution as determined by the Board of Directors each year. The Board of Directors may establish this contribution at any level each year, or may omit such contribution entirely.

**Compensation Committee Interlocks and Insider Participation**

The Compensation Committee was comprised of Messrs. Gerbino and LaNasa until the consummation of the spin-off of GHC on December 1, 2003, at which time Mr. LaNasa resigned from our Board of Directors and Messrs. Dondero, Bloem and Dalton were appointed as the members of our Compensation Committee.

No person who served as a member of our Compensation Committee during fiscal 2004 is currently nor was during or prior to fiscal 2004 an officer or employee of the Company or, except as described in Item 13, Certain Relationships and Related Transactions, below, engaged in certain transactions with us required to be disclosed by regulations of the Securities and Exchange Commission. Additionally, there were no compensation committee interlocks during fiscal 2004, which generally means that none of our executive officers served as a director or member of the compensation committee of another entity, one of whose executive officers served as a director or member of our Compensation Committee.

See Item 13 Certain Relationships and Related Transactions.

**SIGNATURE**

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the Registrant has duly caused this Amendment No. 1 to the Annual Report on Form 10-K/A to be signed on its behalf on December 14, 2004 by the undersigned thereunto duly authorized.

NeighborCare, Inc.

By: /s/RICHARD W. HUNT  
Richard W. Hunt  
Senior Vice President and Chief Financial Officer

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