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FORM 10-Q
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

(MARK ONE)

/X/ QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 1998
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 NO. 1-6639

MAGELLAN HEALTH SERVICES, INC.
(Exact name of Registrant as specified in its charter)

DELAWARE	58-1076937
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3414 PEACHTREE ROAD, NE, SUITE 1400
ATLANTA, GEORGIA 30326
(Address of principal executive offices)
(Zip Code)

(404) 841-9200
(Registrant's telephone number, including area code)

NOT APPLICABLE

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

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 / /

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 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 / /

The number of shares of the Registrant's Common Stock outstanding as of April 30, 1998, was 31,509,504.
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FORM 10-Q
MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
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MAGELLAN HEALTH SERVICES, INC.
QUARTERLY REPORT UNDER SECTION 13 OR 15(D)
OF THE SECURITIES EXCHANGE ACT OF 1934

PART I--FINANCIAL INFORMATION

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)
(IN THOUSANDS)

	SEPTEMBER 30, 1997	MARCH 31, 1998
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 372,878	$ 160,986
Accounts receivable, net	107,998	181,622
Refundable income taxes	2,466	1,361
Other current assets	23,696	42,335
Total Current Assets	507,038	386,304
Assets restricted for settlement of unpaid claims and other long-term liabilities	87,532	69,226
Property and equipment:		
Land	11,667	11,477
Buildings and improvements	70,174	75,580
Equipment	63,719	131,013
	145,560	218,070
Accumulated depreciation	(37,038)	(46,169)
	108,522	171,901
Construction in progress	692	1,078
Total property and equipment	109,214	172,979
Deferred income taxes	1,158	75,651
Investment in CBHS	16,878	--
Other long-term assets	20,893	45,906
Goodwill, net	114,234	919,500
Other intangible assets, net	38,673	243,332
	$ 895,620	$ 1,912,898

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these balance sheets.

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	SEPTEMBER 30, 1997	MARCH 31, 1998
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 45,346	$ 42,478
Accrued liabilities	170,429	382,626
Current maturities of long-term debt and capital lease obligations	3,601	10,131
Total Current Liabilities	219,376	435,235
Long-term debt and capital lease obligations	391,693	1,208,715
Reserve for unpaid claims	49,113	36,642
Deferred credits and other long-term liabilities	16,110	19,710
Minority interest	61,078	30,619
Commitments and contingencies		
Stockholders' Equity:		
Preferred Stock, without par value Authorized--10,000 shares Issued and outstanding--none	--	--
Common Stock, par value $0.25 per share Authorized--80,000 shares Issued and outstanding--33,439 shares at September 30, 1997 and 33,625 shares at March 31, 1998	8,361	8,407
Other Stockholders' Equity		
Additional paid-in capital	340,645	351,858
Accumulated deficit	(129,955)	(157,634)
Warrants outstanding	25,050	25,050
Common Stock in Treasury, 4,424 shares at September 30, 1997 and 2,137 shares at March 31, 1998	(82,731)	(42,413)
Cumulative foreign currency adjustments	(3,120)	(3,291)
Total stockholders' equity	158,250	181,977
	$ 895,620	$ 1,912,898

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these balance sheets.

MAGELLAN HEALTH SERVICES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	FOR THE THREE MONTHS ENDED MARCH 31,		FOR THE SIX MONTHS ENDED MARCH 31,	
	1997	1998	1997	1998
Net revenue	$ 349,922	$ 372,223	$ 696,741	$ 588,320
Costs and expenses:				
Salaries, cost of care and other operating expenses	282,210	324,507	566,333	500,128
Bad debt expense	15,140	686	35,375	1,756
Depreciation and amortization	13,088	12,956	26,187	19,925
Interest, net	13,153	17,526	26,722	24,927
Stock option expense (credit)	829	420	1,433	(3,539)
Managed Care integration costs	--	11,074	--	11,074
Equity in loss of CBHS	--	5,575	--	17,063
Unusual Items	1,395	49	1,395	49
	325,815	372,793	657,445	571,383
Income (loss) before provision for income taxes, minority interest and extraordinary items	24,107	(570)	39,296	16,937
Provision for income taxes	9,643	630	15,718	7,633
Income (loss) before minority interest and extraordinary items	14,464	(1,200)	23,578	9,304
Minority interest	2,572	1,092	4,545	3,968
Income (loss) before extraordinary items	11,892	(2,292)	19,033	5,336
Extraordinary items--losses on early extinguishments of debt (net				

of income tax benefit of $1,967 in 1997 and $22,010 in 1998)...	--	(33,015)	(2,950)	(33,015)
Net income (loss)..	$ 11,892	$ (35,307)	$ 16,083	$ (27,679)
Average number of common shares outstanding--basic..............	28,726	31,012	28,657	29,995
Average number of common shares outstanding--diluted............	29,343	31,012	29,155	30,587
Income (loss) per common share--basic:				
Income (loss) before extraordinary items......................	$ 0.41	$ (0.07)	$ 0.66	$ 0.18
Extraordinary losses on early extinguishments of debt..........	$ --	$ (1.06)	$ (0.10)	$ (1.10)
Net income (loss)..	$ 0.41	$ (1.14)	$ 0.56	$ (0.92)
Income (loss) per common share--diluted:				
Income (loss) before extraordinary items......................	$ 0.41	$ (0.07)	$ 0.65	$ 0.17
Extraordinary losses on early extinguishments of debt..........	$ --	$ (1.06)	$ (0.10)	$ (1.08)
Net income (loss)..	$ 0.41	$ (1.14)	$ 0.55	$ (0.90)

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(IN THOUSANDS)

	FOR THE SIX MONTHS ENDED MARCH 31,	
	1997	1998
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)..	$ 16,083	$ (27,679)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization..	26,187	19,925
Equity in loss of CBHS...	--	17,063
Stock option expense (credit)..	1,433	(3,539)
Non-cash interest expense..	882	1,110
Loss (gain) on sale of assets..	(3,302)	49
Impairment of long-lived assets..	--	2,160
Extraordinary losses on early extinguishments of debt........................	4,917	55,025
Cash flows from changes in assets and liabilities, net of effects from sales and acquisitions of businesses:		
Accounts receivable, net..	(2,474)	(8,933)
Other assets..	(4,214)	(8,210)
Accounts payable and other accrued liabilities..........................	(30,981)	(25,475)
Reserve for unpaid claims...	(13,694)	(12,815)
Income taxes payable and deferred income taxes..........................	4,638	(23,275)
Other liabilities...	(15,154)	(4,126)
Minority interest, net of dividends paid................................	5,219	2,705
Other...	(1,063)	(1,026)
Total adjustments...	(27,606)	10,638
Net cash used in operating activities..............................	(11,523)	(17,041)
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures...	(14,373)	(13,467)
Acquisitions and investments in businesses, net of cash acquired.....................	(12,962)	(936,663)
Decrease in assets restricted for settlement of unpaid claims........................	8,626	18,007
Proceeds from sale of assets...	10,386	5,983
Crescent Transaction costs...	--	(5,865)
Net cash used in investing activities..............................	(8,323)	(932,005)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of debt, net of issuance costs................................	126,825	1,171,681
Payments on debt and capital lease obligations.......................................	(117,521)	(425,433)
Proceeds from exercise of stock options and warrants.................................	3,842	3,362
Purchases of treasury stock..	--	(12,456)

Net cash provided by financing activities	13,146	737,154
Net decrease in cash and cash equivalents	(6,700)	(211,892)
Cash and cash equivalents at beginning of period	120,945	372,878
Cash and cash equivalents at end of period	$ 114,245	$ 160,986

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 1998
(UNAUDITED)

NOTE A--BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments considered necessary for a fair presentation, have been included. These financial statements should be read in conjunction with the audited consolidated financial statements of the Company for the year ended September 30, 1997, included in the Company's Annual Report on Form 10-K.

NOTE B--NATURE OF BUSINESS

The Company's 50% owned hospital business, Charter Behavioral Health Systems, LLC ("CBHS"), is seasonal in nature, with a reduced demand for certain services generally occurring in the first fiscal quarter around major holidays, such as Thanksgiving and Christmas, and during the summer months comprising the fourth fiscal quarter. The Company's businesses are also subject to general economic conditions and other factors. Accordingly, the results of operations for the interim periods are not necessarily indicative of the actual results expected for the year.

NOTE C--SUPPLEMENTAL CASH FLOW INFORMATION

Below is supplemental cash flow information related to the six months ended March 31, 1997 and 1998:

	FOR THE SIX MONTHS ENDED MARCH 31,	
	1997	1998
	(In thousands)	
Income taxes paid, net of refunds received	$ 9,064	$ 8,095
Interest paid, net of amounts capitalized	28,704	40,747
Non-cash transactions:		
Common Stock in Treasury issued in connection with the purchase of the remaining 39% interest in Green Spring Health Services, Inc	$ --	$ 63,496

Cash and cash equivalents at March 31, 1998 include approximately $57.6 million that is held for the payment of claims under the terms of certain behavioral managed care contracts and for regulatory purposes related to the payment of claims in certain jurisdictions.

NOTE D--LONG-TERM DEBT AND LEASES

Information with regard to the Company's long-term debt and capital lease obligations at September 30, 1997 and March 31, 1998 is as follows (in thousands):

	SEPTEMBER 30, 1997	MARCH 31, 1998
Credit Agreement due through 2002	$ --	$ --
New Credit Agreement:		
Revolving Facility (7.94% at March 31, 1998) due through 2004	--	30,000
Term Loan Facility (7.94% to 8.44% at March 31, 1998) due through 2006	--	550,000
11.25% Series A Senior Subordinated Notes	375,000	--
9.0% Senior Subordinated Notes due 2008	--	625,000
6.81% to 11.5% Mortgage and other notes payable through 2005	7,721	7,406
7.5% Swiss Bonds	6,443	--
3.65% Capital lease obligations due through 2014	6,438	6,440
	395,602	1,218,846
Less amounts due within one year	3,601	10,131
Less debt service funds	308	--
	$ 391,693	$ 1,208,715

In connection with the acquisition of Merit Behavioral Care Corporation ("Merit") on February 12, 1998, the Company (i) terminated its Credit Agreement; (ii) repaid all loans outstanding pursuant to Merit's existing credit agreement; (iii) completed a tender offer for its 11.25% Series A Senior Subordinated Notes due 2004 (the "Old Notes"); (iv) completed a tender offer for Merit's 11.50% Senior Subordinated Notes due 2005 (the "Merit Outstanding Notes"); (v) entered into a new senior secured bank credit agreement (the "New Credit Agreement") with the Chase Manhattan Bank and a syndicate of financial institutions, providing for Credit Facilities of up to $700 million, and (vi) issued $625 million in 9.0% Senior Subordinated Notes due 2008 (the "New Notes"). See Note H - --"Acquisitions--Merit Acquisition."

The Company recognized a net extraordinary loss from the early extinguishment of debt of approximately $33.0 million, net of income tax benefit, during the quarter and the six months ended March 31, 1998, to write off unamortized deferred financing costs related to terminating the Credit Agreement and extinguishing the Old Notes, to record the tender premium and related costs of extinguishing the Old Notes and to record the gain on extinguishment of the 7.5% Swiss Bonds.

The New Credit Agreement provides for a Term Loan Facility in an aggregate principal amount of $550 million, consisting of an approximately $183.3 million Tranche A Term Loan (the "Tranche A Term Loan"), an approximately $183.3 million Tranche B Term Loan (the "Tranche B Term Loan") and an approximately $183.3 million Tranche C Term Loan (the "Tranche C Term Loan"), and a Revolving Facility providing for revolving loans to the Company and the "Subsidiary Borrowers" (as defined therein) and the issuance of letters of credit for the account of the Company and the Subsidiary Borrowers in an aggregate principal amount (including the aggregate stated amount of letters of credit) of $150 million.

NOTE D--LONG-TERM DEBT AND LEASES (CONTINUED)

The Tranche A Term Loan and the Revolving Facility mature on February 12, 2004. The Tranche B Term Loan matures on February 12, 2005 and the Tranche C Term Loan matures on February 12, 2006. The Tranche A Term Loan amortizes in installments in each fiscal year in amounts equal to $16.5 million in 1999, $28.0 million in 2000, $34.5 million in 2001, $45.0 million in 2002, $48.0 million in 2003 and $11.3 million in 2004. The Tranche B Term Loan amortizes in installments in amounts equal to $1.7 million in 1999, $2.2 million in each of 2000 through 2002, $41.8 million in 2003, $103.4 million in 2004 and $29.8 million in 2005. The Tranche C Term Loan amortizes in installments in each fiscal year in amounts equal to $1.7 million in 1999, $2.2 million in each of 2000 through 2003, $41.8 million in 2004, $101.9 million in 2005 and $29.1 million in 2006. In addition, the Credit Facilities are subject to mandatory prepayment and reductions (to be applied first to the Term Loan Facility) in an amount equal to (a) 100% of the net proceeds of certain offerings of equity securities by the Company or any of its subsidiaries, (b) 100% of the net proceeds of certain debt issues of the Company or any of its subsidiaries, (c) 75% of the Company's excess cash flow, as defined, and (d) 100% of the net proceeds of certain asset sales or other dispositions of property of the Company and its subsidiaries, in each case subject to certain limited exceptions.

The New Credit Agreement contains a number of covenants that, among other things restrict the ability of the Company and its subsidiaries to dispose of assets, incur additional indebtedness, incur or guarantee obligations, prepay other indebtedness or amend other debt instruments (including the Indenture for the New Notes), pay dividends, create liens on assets, make investments, make loans or advances, redeem or repurchase common stock, make acquisitions, engage in mergers or consolidations, change the business conducted by the Company and its subsidiaries and make capital expenditures. In addition, the New Credit Agreement requires the Company to comply with specified financial ratios and facts, including minimum coverage ratios, maximum leverage ratios, maximum senior debt ratios, minimum "EBITDA" (as defined in the New Credit Agreement) and minimum net worth tests.

At the Company's election, the interest rates per annum applicable to the loans under the New Credit Agreement are a fluctuating rate of interest measured by reference to either (a) an adjusted London inter-bank offered rate ("LIBOR") plus a borrowing margin or (b) an alternate base rate ("ABR") (equal to the higher of the Chase Manhattan Bank's published prime rate or the Federal Funds effective rate plus 1/2 of 1%) plus a borrowing margin. The borrowing margins applicable to the Tranche A Term Loan and loans under the Revolving Facility are currently 1.25% for ABR loans and 2.25% for LIBOR loans, and are subject to reduction if the Company's financial results satisfy certain leverage tests. The borrowing margins applicable to the Tranche B Term Loan and the Tranche C Term Loan are 1.50% and 1.75%, respectively, for ABR loans and 2.50% and 2.75%, respectively, for LIBOR loans, and are not subject to reduction. Amounts outstanding under the credit facilities not paid when due bear interest at a default rate equal to 2.00% above the rates otherwise applicable to each of the loans under the Term Loan Facility and the Revolving Facility.

The obligations of the Company and the Subsidiary Borrowers under the New Credit Agreement are unconditionally and irrevocably guaranteed by, subject to certain exceptions, each wholly owned domestic subsidiary and, subject to certain exceptions, each foreign subsidiary of the Company. In addition, the Credit Facilities and the guarantees are secured by security interests in and pledges of or liens on substantially all the material tangible and intangible assets of the guarantors, subject to certain exceptions.

NOTE D--LONG-TERM DEBT AND LEASES (CONTINUED)

The New Notes are general unsecured senior subordinated obligations of the Company. The New Notes are limited in aggregate principal amount to $625 million and will mature on February 15, 2008. Interest on the New Notes will accrue at the rate of 9.0% per annum and will be payable semi-annually on each February 15 and August 15, commencing on August 15, 1998, to the holders of record on the immediately preceding February 1 and August 1, whether or not a business day.

The New Notes are not redeemable at the option of the Company prior to February 15, 2003. The New Notes will be redeemable at the option of the Company on or after such date, in whole or in part, at the redemption prices (expressed as a percentage of the principal amount) set forth below, plus accrued and unpaid interest, during the twelve-month period beginning on February 15 of the years indicated below:

YEAR	REDEMPTION PRICES
2003	104.5%
2004	103.0%
2005	101.5%
2006 and thereafter	100.0%

In addition, at any time and from time to time prior to February 15, 2001, the Company may, at its option, redeem up to 35% of the original aggregate principal amount of New Notes at a redemption price (expressed as a percentage of the principal amount) of 109%, plus accrued and unpaid interest with the net cash proceeds of one or more equity offerings; provided that at least 65% of the original aggregate principal amount of New Notes remains outstanding immediately after the occurrence of such redemption and that such redemption occurs within 60 days of the date of the closing of any such equity offering.

The Indenture for the New Notes limits, among other things: (i) the incurrence of additional indebtedness by the Company and its Restricted Subsidiaries (as defined); (ii) the payment of dividends on, and redemption or repurchase of, capital stock of the Company and its Restricted Subsidiaries and the redemption of certain Subordinated Obligations of the Company; (iii) certain other restricted payments, including investments; (iv) sales of assets; (v) certain transactions with affiliates; (vi) the creation of liens; and (vii) consolidations, mergers and transfers of all or substantially all the Company's assets. The Indenture on the New Notes also prohibits certain restrictions on distributions from Restricted Subsidiaries. However, all such limitations and prohibitions are subject to certain qualifications and exceptions.

NOTE E--ACCRUED LIABILITIES

Accrued liabilities consist of the following (in thousands):

	SEPTEMBER 30, 1997	MARCH 31, 1998
Salaries, wages and other benefits	$ 21,647	$ 21,153
Amounts due health insurance programs	14,126	9,775
Medical claims payable	36,508	196,575
Interest	19,739	9,537
Crescent Transactions	14,648	7,719
Other	63,761	137,867
	$ 170,429	$ 382,626

NOTE F--INCOME PER COMMON SHARE

The Company adopted Statement of Financial Accounting Standards No. 128,

"Earnings per Share" ("FAS 128"), effective October 1, 1997. Income per common share for the three months and the six months ended March 31, 1997 have been restated to conform to FAS 128 as required. The effect of adopting FAS 128 was not material.

The following table presents the components of weighted average common shares outstanding-- diluted (in thousands):

	Three Months Ended March 31,		Six Months Ended March 31,	
	1997	1998	1997	1998
Weighted average common shares outstanding--basic..........	28,726	31,012	28,657	29,995
Common stock equivalents--stock options....................	600	0	481	575
Common stock equivalents--warrants.........................	17	0	17	17
Weighted average common shares outstanding--diluted........	29,343	31,012	29,155	30,587

Common stock equivalents of approximately 452,000 were excluded from the income per common share calculation for the three months ended March 31, 1998 due to their anti-dilutive nature as a result of the Company's loss for such period.

NOTE G--INVESTMENT IN CBHS

The Company became a 50% owner of CBHS upon consummation of the Crescent Transactions (as defined) on June 17, 1997, which are further described in the Company's Annual Report on Form 10-K for the year ended September 30, 1997. The Company accounts for its investment in CBHS using the equity method.

NOTE G--INVESTMENT IN CBHS (CONTINUED)

A summary of financial information for CBHS is as follows (in thousands):

	SEPTEMBER 30, 1997	MARCH 31, 1998
Current assets...	$ 148,537	$ 147,700
Property and equipment, net..	18,424	17,815
Other noncurrent assets..	8,633	8,294
Total Assets...	$ 175,594	$ 173,809
Current liabilities..	$ 68,497	$ 90,066
Long-term debt...	65,860	65,831
Other noncurrent liabilities...	7,481	23,138
Members' capital (deficiency)..	33,756	(5,226)
Total Liabilities and Members' Capital...................................	$ 175,594	$ 173,809

THREE MONTHS ENDED	SIX MONTHS ENDED

	MARCH 31, 1998	MARCH 31, 1998
Net revenue	$ 187,384	$ 365,442
Operating expenses	200,278	399,942
Interest, net	1,305	2,675
Net loss before preferred member distribution	$ (14,199)	$ (37,175)
Cash used in operating activities		$ (9,517)
Magallan's portion of net loss	(7,100)	(18,588)
Intercompany loss elimination(1)	1,525	1,525
Magellan equity loss	$ (5,575)	$ (17,063)

NOTE G--INVESTMENT IN CBHS (CONTINUED)

The Company's transactions with CBHS and related balances are as follows (in thousands):

	THREE MONTHS ENDED MARCH 31, 1998	SIX MONTHS ENDED MARCH 31, 1998
Franchise Fee revenue(1)	$ 16,525	$ 36,100
Costs:		
Accounts receivable collection fees	$ 560	$ 1,614
Hospital-based joint venture management fees	1,853	3,483

	SEPTEMBER 30, 1997	MARCH 31, 1998
Due (to) from CBHS, net (2)	$ (5,090)	$ 1,789
Franchise fees receivable (3)	$ --	$ 10,000
Prepaid CHARTER call center management fees	$ --	$ 4,921

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(1) Based on the terms of the CBHS Transactions (as defined), the Franchise Fees were reduced to $5.0 million per month from approximately $6.5 million per month, effective February 1, 1998, through the consummation date of the CBHS Transactions. In the event that the CBHS Transactions are not consummated, no adjustment will be made to the Franchise Fees. The Company's Franchise Fee revenue for the quarter and the six months ended March 31, 1998, reflects the reduced Franchise Fee revenue, since February 1, 1998, while CBHS recorded Franchise Fee expense of approximately $6.5 million per month in its financial statements. Accordingly, the Company has eliminated the intercompany loss for the proportionate share of the difference between Franchise Fee revenue and expense reflected in the Company's financial statements and CBHS' financial statements.

(2) The nature of hospital accounts receivable billing and collection processes have resulted in the Company and CBHS receiving remittances from payors which belong to the other party. Additionally, the Company and CBHS have established a settlement and allocation process for the accounts receivable

related to those patients who were not yet discharged from their treatment on June 16, 1997. In an effort to settle these amounts on a timely basis, and in light of CBHS start up operations and cash flow requirements, the Company made advances to CBHS periodically during the three months and the six months ending March 31, 1998, most of which have been repaid by CBHS. Such advances, net of all settlement activity and certain other amounts due to CBHS for certain shared services and related matters, resulted in the amount shown above as due from CBHS. In addition, the Company has recorded equity in loss of CBHS in excess of its investment balance of approximately $0.2 million, which has been applied against the advances.

(3) CBHS did not pay its Franchise Fee obligation for February 1998 and March 1998. CBHS will be required to pay all Franchise Fees and other amounts due to the Company within six months of consummating the CBHS Transactions.

NOTE G--INVESTMENT IN CBHS (CONTINUED)

CBHS TRANSACTIONS. On March 3, 1998, the Company and certain of its wholly owned subsidiaries entered into definitive agreements with Crescent Operating, Inc. ("COI") and CBHS pursuant to which the Company will, among other things, sell the Company's franchise operations, certain domestic provider operations and certain other assets and operations. The definitive agreements include: (i) an equity purchase agreement between the Company and COI (the "Equity Purchase Agreement"); (ii) a purchase agreement between the Company, certain of its wholly owned subsidiaries and CBHS (the "Purchase Agreement"); and (iii) a support agreement between the Company and COI (the "Support Agreement"). Pursuant to the Equity Purchase Agreement, the Company agreed to sell to COI the Company's common and preferred equity interest in CBHS. Pursuant to the Purchase Agreement, the Company and certain of its wholly owned subsidiaries agreed to sell to CBHS: (i) Charter Advantage, LLC, the entity that conducts the Company's franchise operations; (ii) Charter System, LLC, which owns the intellectual property comprising the "CHARTER" system of behavioral healthcare; (iii) Group Practice Affiliates, Inc., the Company's physician practice management business; (iv) certain behavioral staff model operations; (v) the Company's Puerto Rican provider management business; (vi) Golden Isle Assurance Company, Ltd., one of the Company's captive insurance companies; and (vii) Strategic Advantage, Inc., which owns certain intellectual property used by the Company to monitor clinical results. The obligations of CBHS and the Company to consummate the transactions contemplated by the Purchase Agreement are also subject to, among other things, the execution of either (i) a Joint Venture Purchase Agreement pursuant to which the Company will sell to CBHS, for no additional consideration, its interest in six hospital-based joint ventures that are managed by CBHS on behalf of the Company (the "Joint Ventures") or (ii) amendments to the services agreement between the Company and certain subsidiaries of CBHS relating to the Joint Ventures pursuant to which the Company will transfer to CBHS all rights to receive certain distributions with respect to the Joint Ventures and pursuant to which CBHS would assume all obligations of the Company with respect to the Joint Ventures arising after consummation of the CBHS Transactions.

Among other things, the Support Agreement obligates COI to provide CBHS assistance in obtaining financing for its payment obligation under the Purchase Agreement, including its agreement to: (i) provide assistance in the preparation of any offering documents required in connection with CBHS's efforts to obtain financing; (ii) reimburse CBHS for all expenses incurred in connection with obtaining financing, whether or not the CBHS Transactions are consummated; and (iii) purchase up to $25.0 million of CBHS securities, if necessary, to permit CBHS to obtain the required financing. The Support Agreement also obligates COI, under certain circumstances, to pay the Company a termination fee equal to $2.5 million in cash and the number of shares of COI common stock obtained by dividing $2.5 million by the average closing price of a share of COI common stock for the five trading days prior to the termination of the Purchase Agreement and for the five trading days after the termination of the Purchase Agreement (the "Termination Fee"), if the CBHS Transactions are not consummated as a result of the failure of CBHS to obtain sufficient financing for its payment obligations under the Purchase Agreement.

Upon consummation of the CBHS Transactions, the Company will receive $280.0

million in cash, pursuant to the Purchase Agreement and, pursuant to the Equity Purchase Agreement, the number of shares of COI common stock obtained by dividing $30.0 million by the average closing price of a share of COI common stock for the ten trading days preceding consummation of the CBHS Transactions. The Company expects to use the cash proceeds, after transaction costs of approximately $8.0 million, to repay indebtedness outstanding under the Term Loan Facility. The CBHS Transactions are expected to close in

NOTE G--INVESTMENT IN CBHS (CONTINUED)
the fourth quarter of fiscal 1998. There can be no assurance that the Company will consummate the CBHS Transactions.

The obligations of the Company and CBHS to consummate the transactions contemplated by the Equity Purchase Agreement and the Support Agreement are conditioned upon the execution and delivery of a services purchase agreement (the "Services Purchase Agreement"). It is expected that the Services Purchase Agreement would obligate the Company to purchase from CBHS a designated minimum amount of behavioral healthcare services for gate-kept risk-based covered lives if CBHS meets certain standards required of it pursuant to the Provider Services Agreement (as defined). If the CBHS Transactions are consummated, the Company also expects to enter into a provider services agreement (the "Provider Services Agreement") with CBHS pursuant to which the Company would grant CBHS status as a national preferred provider of behavioral healthcare services to the Company for ten years provided that CBHS complies during the term of the Provider Services Agreement with enhanced clinical, quality assurance, reporting and customer service standards in addition to the standards currently required of other providers of such services to the Company.

NOTE H--ACQUISITIONS

ALLIED HEALTH GROUP, INC. ACQUISITION. On December 5, 1997, the Company purchased the assets of Allied Health Group, Inc. and certain affiliates ("Allied"). Allied provides specialty risk-based products and administrative services to a variety of insurance companies and other customers for its 3.7 million members. Allied has over 80 physician networks across the eastern United States. Allied's networks include physicians specializing in cardiology, oncology and diabetes. The Company paid $70 million for Allied, of which $50 million was paid to the sellers at closing with the remaining $20 million placed in escrow.

The Company funded the acquisition of Allied with cash on hand and has accounted for the acquisition of Allied using the purchase method of accounting. The escrowed amount of the purchase price is payable in one-third increments if Allied achieves specified earnings targets during each of the three years following the closing. Additionally, the purchase price may be increased during the three year period by up to $40 million if Allied's performance exceeds specified earnings targets. The maximum purchase price payable is $110 million.

The preliminary allocation of the Allied purchase price to goodwill and identifiable intangible assets was based on the Company's preliminary valuations, which are subject to change upon receiving independent appraisals of identifiable intangible assets. The Company expects the Allied purchase price allocation to be finalized by September 30, 1998.

HAI ACQUISITION. On December 4, 1997, the Company acquired the outstanding common stock of Human Affairs International, Incorporated ("HAI"), a wholly-owned subsidiary of Aetna Insurance Company of Connecticut and a unit of Aetna U.S. Healthcare ("Aetna"), for approximately $122.1 million. HAI provides managed care services to approximately 16.3 million covered lives, primarily through employee assistance programs and other managed behavioral healthcare plans. The Company funded the acquisition of HAI with cash on hand and has accounted for the acquisition of HAI using the purchase method of accounting.

NOTE H--ACQUISITIONS (CONTINUED)

The Company may be required to make additional contingent payments of up to $300 million to Aetna (the "Contingent Payments") over the five-year period (each year a "Contract Year") subsequent to closing. The amount and timing of the Contingent Payments will depend upon HAI's receipt of additional covered lives as computed under two separate calculations. Under the first calculation, the Company may be required to pay up to $25 million per year for each of five years following the acquisition based on the net annual growth in the number of lives covered in specified HAI products. Under the second calculation, the Company may be required to pay up to $35 million per Contract Year, based on the net cumulative increase in lives covered by certain other HAI products.

The preliminary allocation of the HAI purchase price to goodwill and identifiable intangible assets was based on the Company's preliminary valuations, which are subject to change upon receiving independent appraisals of identifiable intangible assets. The Company expects the HAI purchase price allocation to be finalized by September 30, 1998.

MERIT ACQUISITION. On February 12, 1998, the Company acquired all of the outstanding stock of Merit for approximately $448.9 million in cash plus the repayment of Merit's debt. The Company refinanced its $375 million 11.25% Series A Senior Subordinated Notes as part of the Merit acquisition. The Company accounted for the Merit acquisition using the purchase method of accounting. Merit provides managed care services to approximately 21.6 million covered lives across all segments of the healthcare industry, including HMOs, Blue Cross/Blue Shield organizations and other insurance companies, corporations and labor unions, federal, state and local government agencies, and various state Medicaid programs.

The following table sets forth the sources and uses of funds for the Merit acquisition and related transactions (the "Transactions") at closing (in thousands):

SOURCES:	
Cash and cash equivalents	$ 59,290
New Credit Agreement:	
Revolving Facility (1)	20,000
Term Loan Facility	550,000
The New Notes	625,000
Total sources	$1,254,290
USES:	
Cash paid to Merit Shareholders	$ 448,867
Repayment of Merit existing credit agreement (2)	196,357
Purchase of the Old Notes (3)	432,102
Purchase of Merit Outstanding Notes (4)	121,651
Transaction costs (5)	55,313
Total uses	$1,254,290

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(1) The Revolving Facility provides for borrowings of up to $150.0 million. The Company had $112.5 million available for borrowing pursuant to the Revolving Facility after consummating the Transactions, excluding approximately $17.5 million of availability reserved for certain letters of credit.

NOTE H--ACQUISITIONS (CONTINUED)

(2) Includes principal amount of $193.6 million and accrued interest of $2.7 million.

(3) Includes principal amount of $375.0 million, tender premium of $43.4 million and accrued interest of $13.7 million.

(4) Includes principal amount of $100.0 million, tender premium of $18.9 million and accrued interest of $2.8 million.

(5) Transaction costs include, among other things, expenses associated with the debt tender offers, the New Notes offering, the Merit acquisition and the New Credit Agreement.

The purchase price allocation for the Merit acquisition is tentative and subject to adjustment pending final valuations on property and equipment and identifiable intangible assets, determination of final valuation allowances on deferred tax assets, integration plan matters (see Note J) and certain other matters. The Company expects the Merit purchase price allocation to be finalized by September 30, 1998.

GREEN SPRING MINORITY SHAREHOLDER CONVERSION. The four minority shareholders of Green Spring converted their ownership interests into 2,831,516 shares of Magellan common stock in accordance with the terms in the Green Spring Exchange Agreement at various dates during January 1998. The Company accounted for the Green Spring Minority Shareholder Conversion as a purchase of the minority interests in Green Spring at the fair value of the consideration paid of approximately $63.5 million.

The following unaudited pro forma information for the six months ended March 31, 1997 and 1998 has been prepared assuming the Crescent Transactions (as defined), Allied acquisition, HAI acquisition, the Transactions and the Green Spring Minority Shareholder Conversion were consummated on October 1, 1996. The unaudited pro forma information does not purport to be indicative of the results that would have actually been obtained had such transactions been consummated, or which may be attained in future periods (in thousands, except per share data):

	PRO FORMA FOR THE SIX MONTHS ENDED	
	MARCH 31, 1997	MARCH 31, 1998
Net revenue	$ 752,648	$ 899,280
Income before extraordinary item(1)	7,154	4,622
Net income(1)(2)	4,204	4,947
Income per common share--basic:		
Income before extraordinary item	0.23	0.15
Net income	0.13	0.16
Income per common share--diluted:		
Income before extraordinary item	0.22	0.14
Net income	0.13	0.15

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(1) Excludes expected cost savings related to the Integration Plan and Managed Care integration costs. See Note J.

NOTE H--ACQUISITIONS (CONTINUED)

(2) Excludes the extraordinary losses on early extinguishments of debt for the six months ended March 31, 1998, that were directly attributable to the

consummation of the Transactions.

NOTE I--CONTINGENCIES

The Company is self-insured for a substantial portion of its general and professional liability risks. The reserves for self-insured general and professional liability losses, including loss adjustment expenses, are based on actuarial estimates that are discounted at an average rate of 6% to their present value based on the Company's historical claims experience adjusted for current industry trends. The reserve for unpaid claims is adjusted periodically as such claims mature, to reflect changes in actuarial estimates based on actual experience. During the quarter and the six months ended March 31, 1997 and the six months ended March 31, 1998, the Company recorded reductions in malpractice claim reserves of approximately $5.0 million and $4.1 million, respectively, as a result of updated actuarial estimates. This reduction resulted primarily from updates to actuarial assumptions regarding the Company's expected losses for more recent policy years. These revisions are based on changes in expected values of ultimate losses resulting from the Company's claim experience, and increased reliance on such claim experience. While management and its actuaries believe that the present reserve is reasonable, ultimate settlement of losses may vary from the amount provided.

Certain of the Company's subsidiaries are subject to claims, civil suits, and governmental investigations and inquiries relating to their operations and certain alleged business practices. In the opinion of management, based on consultation with counsel, resolution of these matters will not have a material adverse effect on the Company's financial position or results of operations.

On August 1, 1996, the United States Department of Justice, Civil Division, filed an Amended Complaint in a civil QUI TAM action initiated in November 1994 against the Company and its Orlando South hospital subsidiary ("Charter Orlando") by two former employees. The First Amended Complaint alleges that Charter Orlando violated the federal False Claims Act (the "Act") in billing for inpatient treatment provided to elderly patients. The Court granted the Company's motion to dismiss the government's First Amended Complaint yet granted the government leave to amend its First Amended Complaint. The government filed a Second Amended Complaint on December 12, 1996 which, similar to the First Amended Complaint, alleges that the Company and its subsidiary violated the Act in billing for the treatment of geriatric patients. Like the First Amended Complaint, the Second Amended Complaint is based on disputed clinical and factual issues which the Company believes do not constitute a violation of the Act.

On the Company's motion, the Court ordered the parties to participate in mediation of the matter. The parties have reached a tentative settlement of this matter. Pursuant to the tentative settlement, the Company would pay approximately $4.8 million, which has been accrued. Furthermore, Charter Orlando (now operated by CBHS) would agree not to seek reimbursement for services provided to patients covered under the Medicare program for a period of up to fifteen months. The Company has agreed to reimburse CBHS for the resulting loss of revenues during such period. The Company has an accrued obligation of $2.2 million for this reimbursement.

NOTE J--MANAGED CARE INTEGRATION PLAN AND COSTS

INTEGRATION PLAN

The Company owns three behavioral managed care organizations ("BMCOs"), Green Spring, HAI and Merit, as a result of acquisitions consummated in fiscal 1996 (Green Spring) and fiscal 1998 (HAI and Merit). The Company also owns two other specialty managed care organizations, Allied and Care Management Resources, Inc. ("CMR"). Management has approved and committed the Company to a plan to combine and integrate the operations of its BMCOs and other specialty managed care organizations (the "Integration Plan") that will result in the elimination of duplicative functions and will standardize business practices and information technology platforms. The Company expects to achieve approximately

$60 million of cost savings on an annual basis by August 1999 at its BMCOS and approximately $3 million of cost savings on an annual basis at CMR as a result of the Integration Plan.

The Integration Plan will result in the elimination of approximately 1,000 positions during fiscal 1998 and fiscal 1999. Approximately 110 employees had been involuntarily terminated pursuant to the Integration Plan as of March 31, 1998 and approximately 100 additional employees had been specifically identified for involuntary termination. Approximately 200 positions have been eliminated by normal attrition through April 30, 1998. The remaining positions to be eliminated have been identified, and will be eliminated through a combination of normal attrition and involuntary termination.

The employee groups of the BMCOs that are primarily affected include executive management, finance, human resources, information systems and legal personnel at the various BMCOs corporate headquarters and regional offices and credentialing, claims processing, contracting and marketing personnel at various operating locations. The Company expects to complete the specific identification of all personnel who will be involuntarily terminated by September 30, 1998 and will complete its involuntary terminations by April 1999.

The Integration Plan will also result in the closure of approximately 40 to 45 leased facilities at the BMCOs during fiscal 1998 and fiscal 1999. As of March 31, 1998, 17 offices had been specifically identified for closure and 23 to 28 additional offices are under consideration for closure. The Company expects to complete the specific identification of remaining office closures by September 30, 1998.

The Company has recorded approximately $18.3 million of liabilities related to the Integration Plan, of which $11.7 million was recorded as part of the Merit purchase price allocation and $6.6 million was recorded in the statement of operations under "Managed Care integration costs". These amounts represent those portions of the Integration Plan obligations that were measurable as of March 31, 1998. The Company expects to record additional liabilities as a result of the Integration Plan in fiscal 1998 and fiscal 1999 as final decisions regarding office closures and other contractual obligation terminations are made.

NOTE J--MANAGED CARE INTEGRATION PLAN AND COSTS (CONTINUED)

The following table provides a rollforward of liabilities resulting from the Integration Plan (in thousands):

TYPE OF COST	BALANCE SEPTEMBER 30, 1997	ADDITIONS	PAYMENTS (1)	BALANCE MARCH 31, 1998
Employee termination benefits	$ --	$ 12,763	$ (613)	$ 12,150
Facility closing costs	--	5,279	--	5,279
Other	--	244	--	244
	$ --	$ 18,286	$ (613)	$ 17,673

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(1) Includes $0.5 million in payments related to Merit

OTHER INTEGRATION COSTS

The Integration Plan will result in additional incremental costs that must be expensed as incurred in accordance with Emerging Issues Task Force Consensus 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)" that are not described above and certain other charges. Other integration costs

include, but are not limited to, outside consultants, costs to relocate closed office contents and long-lived asset impairments. Other integration costs are reflected in the statement of operations under "Managed Care integration costs".

During the quarter and the six months ended March 31, 1998, the Company incurred approximately $4.5 million in other integration costs, including long-lived asset impairments of approximately $2.2 million and outside consulting costs of approximately $2.0 million. The asset impairments relate primarily to identifiable intangible assets that no longer have value and have been written off as a result of the Integration Plan.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Quarterly Report on Form 10-Q includes "forward-looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Although the Company believes that its plans, intentions and expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such plans, intentions or expectations will be achieved. Important factors that could cause actual results to differ materially from the Company's forward-looking statements are set forth in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1997. All forward-looking statements attributable to the Company or persons acting on behalf of the Company are expressly qualified in their entirety by the cautionary statements set forth in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1997.

OVERVIEW

The Company has historically derived the majority of its revenue from providing healthcare services in an inpatient setting. Payments from third-party payors are the principal source of revenue for most healthcare providers. In the early 1990's, many third-party payors sought to control the cost of providing care to their patients by instituting managed care programs or seeking the assistance of managed care companies. Providers participating in managed care programs agree to provide services to patients for a discount from established rates, which generally results in pricing concessions by the providers and lower margins. Additionally, managed care programs generally encourage alternatives to inpatient treatment settings and reduce utilization of inpatient services. As a result, third-party payors established managed care programs or engaged managed care companies in many areas of healthcare, including behavioral healthcare. The Company, which until June 1997 was the largest operator of psychiatric hospitals in the United States, was adversely affected by the adoption of managed care programs by third-party payors.

Prior to the first quarter of fiscal 1996, the Company was not a provider of behavioral managed care services. During the first quarter of fiscal 1996, the Company acquired a 61% ownership interest in Green Spring. At that time, the Company intended to become a fully integrated behavioral healthcare provider by combining the managed behavioral healthcare products offered by Green Spring with the direct treatment services offered by the Company's psychiatric hospitals. The Company believed that an entity that participated in both the managed care and provider segments of the behavioral healthcare industry could more efficiently provide and manage behavioral healthcare for insured populations than an entity that was solely a managed care company. The Company also believed that earnings from its managed care business would offset, in part, the negative impact on the financial performance of its psychiatric hospitals caused by managed care. Green Spring was the Company's first significant involvement in managed behavioral healthcare. During the first quarter of fiscal 1998, the minority shareholders of Green Spring converted their interests in Green Spring into an aggregate of 2,831,516 shares of Company Common Stock (the "Green Spring Minority Shareholder Conversion").

Subsequent to the Company's acquisition of Green Spring, the growth of the managed behavioral healthcare industry accelerated. Under the Company's majority ownership, Green Spring increased its base of covered lives from 12.0 million as of the end of calendar year 1995 to 21.1 million as of the end of calendar year 1997, a compound annual growth rate of over 32%. While growth in the industry was accelerating, the managed behavioral healthcare industry also began to consolidate. The Company concluded that consolidation presented an opportunity

for the Company to enhance its stockholder value by increasing its participation in the managed behavioral healthcare industry, which the Company believed offered growth and earnings prospects superior to those of the psychiatric hospital industry. Therefore, the

Company decided to sell its domestic psychiatric facilities to obtain capital for expansion in the managed behavioral healthcare business.

During the third quarter of fiscal 1997, the Company sold substantially all of its domestic acute-care psychiatric hospitals and residential treatment facilities (the "Psychiatric Hospital Facilities") to Crescent Real Estate Equities Limited Partnership ("Crescent") for $417.2 million in cash (before costs of approximately $16.0 million) and certain other consideration (the "Crescent Transactions"). Simultaneously with the sale of the Psychiatric Hospital Facilities, the Company and COI, an affiliate of Crescent, formed CBHS, a joint venture, to operate the Psychiatric Hospital Facilities and certain other facilities transferred to CBHS by the Company. The Company retained a 50% ownership of CBHS; the other 50% of the equity of CBHS is owned by COI.

In related transactions, (i) Crescent leased the Psychiatric Hospital Facilities to CBHS and (ii) the Company entered into a master franchise agreement (the "Master Franchise Agreement") with CBHS and a franchise agreement with each of the Psychiatric Hospital Facilities and the other facilities operated by CBHS (collectively, the "Franchise Agreements"). The Company's sale of the Psychiatric Hospital Facilities and the related transactions described above are referred to as the "Crescent Transactions." Pursuant to the Franchise Agreements, the Company franchises the "CHARTER" System of behavioral healthcare to each of the Psychiatric Hospital Facilities and other facilities operated by CBHS. In exchange, CBHS agreed to pay the Company, pursuant to the Master Franchise Agreement, annual franchise fees (the "Franchise Fees") of approximately $78.3 million. However, CBHS's obligation to pay the Franchise Fees is subordinate to its obligation to pay rent for the Psychiatric Hospital Facilities to Crescent. The sale of the Psychiatric Hospital Facilities provided the Company with approximately $200 million of net cash proceeds, after debt repayment, for use in implementing its business strategy. The Company used the net cash proceeds to finance the acquisitions of HAI and Allied in December 1997. The Company further implemented its business strategy through the Merit acquisition. See Note H--"Acquisitions -- Merit Acquisition". On March 3, 1998, the Company entered into definitive agreements with COI and CBHS to, among other things, sell the Company's franchise operations, certain domestic provider operations and certain other assets and operations for $280.0 million, subject to certain adjustments, in cash and $30.0 million in COI common stock.

If the CBHS Transactions are consummated, the Company will have completed the divestiture of substantially all of its domestic provider business and will have transformed the Company into almost entirely a specialty managed healthcare company. The Company undertook the transformation because it believed that the specialty managed healthcare industry offers growth and earnings prospects superior to those available to the psychiatric hospital industry because, among other things, third party payors for healthcare services are continuing to seek to control the cost of providing care to their patients by instituting managed care programs or seeking the assistance of managed care companies. Furthermore, government payors are continuing to reduce reimbursement rates or coverage in an effort to control costs.

As a result of the Merit acquisition, the Company generates a significant portion of its revenue and earnings from its managed care business. The percentage of the Company's revenue derived from its managed care business, in general, and its risk-based products, in particular, will increase further if the CBHS Transactions are consummated.

A significant portion of the Company's managed care revenue and earnings are generated from risk-based products. The Company believes enrollment in risk-based products will continue to grow through new covered lives and the transition of covered lives in ASO and EAP products to higher revenue risk-based products. Risk-based products typically generate significantly higher amounts of revenue than other managed behavioral healthcare products. Because the Company is responsible for the cost of care, risk-based products typically have lower margins than non-risk-based products. Furthermore, under risk-based contracts, the Company assumes all or a portion of the responsibility for the cost of providing a full or specified range of specialty healthcare treatment services to a specified beneficiary population. In order for

such contracts to be profitable, the Company must accurately estimate the rate of service utilization by beneficiaries enrolled in programs managed by the Company and control the unit cost of such services. If the Company is unable to either estimate the rate of service utilization or control the cost of such services, its risk-based contracts may be unprofitable.

RESULTS OF OPERATIONS

REVENUE. Managed care revenue increased 214.9% to $289.8 million for the quarter ended March 31, 1998 from $92.0 million in the same period in fiscal 1997 and increased 142.3% to $426.8 million for the six months ended March 31, 1998 from $176.2 million in the same period in fiscal 1997. The increases resulted primarily from the acquisitions of HAI, Allied and Merit in fiscal 1998 and the continued revenue growth at Green Spring. HAI, Allied and Merit's aggregate revenues were approximately $174.2 million and $201.9 million for the quarter and the six months ended March 31, 1998, respectively. Green Spring revenues were positively impacted by the award of several new contracts and acquisitions in fiscal 1997 and fiscal 1998, resulting in a 45.7% increase in covered lives to 22.6 million as of March 31, 1998 as compared to March 31, 1997.

Public sector revenue increased 55.6% to $32.8 million for the quarter ended March 31, 1998 from $21.1 million in the same period in fiscal 1997 and increased 43.1% to $59.1 million for the six months ended March 31, 1998 from $41.3 million in the same period in fiscal 1997. The increases were primarily attributable to a 21.3% increase in placements in Mentor homes since March 31, 1997 to 3,100 individuals and fiscal 1998 acquisitions.

Healthcare franchising revenue was $16.5 million and $36.1 million for the quarter and the six months ended March 31, 1998, respectively. The healthcare franchising revenue consisted of the Franchise Fees.

Provider business revenue decreased 86.0% to $33.2 million for the quarter ended March 31, 1998 from $236.9 million in the same period in fiscal 1997 and decreased 86.2% to $66.3 million for the six months ended March 31, 1998 from $479.3 million in the same period in fiscal 1997. The decreases resulted primarily from the effect of the consummation of the Crescent Transactions on June 17, 1997, following which revenue from the Psychiatric Hospital Facilities and other facilities transferred to CBHS was no longer recorded as part of the Company's revenue. During the quarters ended March 31, 1997 and 1998, the Company recorded revenue of $2.8 million and $1.4 million, respectively, for settlements and adjustments related to reimbursement issues with respect to psychiatric hospitals owned or formerly owned by the Company. During the six months ended March 31, 1997 and 1998, the Company recorded revenue of $13.8 million and $2.2 million, respectively, related to reimbursement issues. During fiscal 1997, the Company recorded $27.4 million for such settlements. Management anticipates that revenue related to such settlements will decline significantly for fiscal 1998.

SALARIES, COST OF CARE AND OTHER OPERATING EXPENSES. Salaries, cost of care and other operating expenses attributable to the managed care business increased 215.5% to $260.0 million for the quarter ended March 31, 1998 from $82.4 million in the same period in fiscal 1997 and increased 142.2% to $383.1 million for the six months ended March 31, 1998 from $158.2 million in the same period in fiscal 1997. The increases resulted primarily from the acquisitions of HAI, Allied and Merit, which had aggregate expenses of $154.1 million and $178.5 million for the quarter and the six months ended March 31, 1998, respectively, and from continued growth at Green Spring.

Public sector salaries, cost of care and other operating expenses increased 62.6% to $29.7 million for the quarter ended March 31, 1998 from $18.3 million in the same period in fiscal 1997 and increased 48.2% to $53.6 million for the six months ended March 31, 1998 from $36.1 million in the same period in fiscal 1997. The increases were due primarily to internal growth, increases in costs related to expansion and new product development and fiscal 1998 acquisitions.

Healthcare franchising operating expenses were $2.7 million and $5.0 million for the quarter and the six months ended March 31, 1998. The Company recorded no expenses with respect to the healthcare franchising business during the quarter and the six months ended March 31, 1997 because the Crescent Transactions were not consummated until the third quarter of fiscal 1997.

Salaries, cost of care and other operating expenses attributable to the provider business decreased 84.2% to $27.5 million for the quarter ended March 31, 1998 from $173.7 million in the same period in fiscal 1997 and decreased 86.1% to $49.7 million for the six months ended March 31, 1998 from $358.4 million in the same period in fiscal 1997. The decreases resulted primarily from the effect of the consummation of the Crescent Transactions, following which operating expenses of the Psychiatric Hospital Facilities and other facilities transferred to CBHS were no longer accounted for as part of the Company's operating expenses. During the quarter and the six months ended March 31, 1997, the Company recorded reductions of expenses of approximately $5.0 million compared to reductions of $4.1 million for the six months ended March 31, 1998, as a result of updated actuarial estimates related to malpractice claim reserves. These reductions resulted primarily from updates to actuarial assumptions regarding the Company's expected losses for more recent policy years. These revisions are based on changes in expected values of ultimate losses resulting from the Company's claim experience, and increased reliance on such claim experience. While management and its actuaries believe that the present reserve is reasonable, ultimate settlement of losses may vary from the amount recorded and result in additional fluctuations in income in future periods.

BAD DEBT EXPENSE. Bad debt expense, which is primarily attributable to the provider business, decreased 95.5%, or $14.5 million, for the quarter ended March 31, 1998 compared to the same period in fiscal 1997 and decreased 95.0% or $33.6 million for the six months ended March 31, 1998 compared to the same period in fiscal 1997. The decreases were primarily attributable to the effect of the consummation of the Crescent Transactions, following which the bad debt expense incurred by the Psychiatric Hospital Facilities and other facilities transferred to CBHS was no longer accounted for as part of the Company's bad debt expense.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization decreased 1.0%, or $0.1 million, for the quarter ended March 31, 1998 compared to the same period in fiscal 1997 and decreased 23.9% or $6.3 million for the six months ended March 31, 1998 compared to the same period in fiscal 1997. The decreases were primarily attributable to the effect of the consummation of the Crescent Transactions, whereby the Psychiatric Hospital Facilities were sold to Crescent, offset by increases in depreciation and amortization resulting from the HAI, Allied and Merit acquisitions of $6.4 million and $6.9 million, in aggregate, for the quarter and the six months ended March 31, 1998, respectively.

INTEREST, NET. Interest expense, net, increased 33.2%, or $4.4 million, for the quarter ended March 31, 1998 compared to the same period in fiscal 1997 and decreased 6.7% or $1.8 million for the six months ended March 31, 1998 compared to the same period in fiscal 1997. The changes were primarily the result of lower interest expense due to lower average borrowings and higher interest income due to temporary investments of the cash received in the Crescent Transactions through February 12, 1998, offset by interest expense incurred on borrowings used to fund the Merit acquisition and related transactions.

OTHER ITEMS. Stock option expense for the quarter and the six months ended March 31, 1998 decreased $0.4 million and $5.0 million, respectively, from the prior year periods primarily due to fluctuations in the market price of the Company's common stock.

The Company recorded Managed Care integration costs of $11.1 million for the quarter and the six months ended March 31, 1998. See Note J--"Managed Care Integration Plan and Costs".

The Company recorded equity in the loss of CBHS of $5.6 million and $17.1 million for the quarter and the six months ended March 31, 1998, respectively, representing the Company's proportionate (50%) loss in CBHS. See Note G--"Investment in CBHS".

The Company recorded unusual items, net, of $1.4 million, during the quarter and the six months ended March 31, 1997, which consisted of a $2.8 million pre-tax gain on the sale of two psychiatric hospitals offset by a $4.2 million charge for the closure of three psychiatric hospitals and one general hospital. The Company recorded unusual items, net, of $0.1 million, during the quarter and the six months ended March 31, 1998 for the net loss on the sale of four hospitals that were previously closed.

The Company's effective income tax rate increased to 45.1% for the six months ended March 31, 1998, respectively, compared to 40% in the fiscal 1997 periods. The increase was primarily attributable to non-deductible goodwill amortization of approximately $2.1 million resulting from the Merit acquisition in fiscal 1998.

Minority interest decreased $1.5 million and $0.6 million during the quarter and the six months ended March 31, 1998, respectively, compared to the same periods in fiscal 1997. The decreases were primarily attributable to the Green Spring Minority Shareholder Conversion in January 1998 offset by Green Spring's net income growth in fiscal 1998 through January 1998.

The Company recorded extraordinary losses on early extinguishment of debt, net of tax, of $3.0 million and $33.0 million during the quarters ended December 31, 1996 and March 31, 1998, respectively, related primarily to the termination of its then existing credit agreement in fiscal 1997 and the termination of the Credit Agreement and extinguishment of the Old Notes in fiscal 1998. See Note D - -"Long-Term Debt and Leases".

IMPACT OF CRESCENT TRANSACTIONS ON RESULTS OF OPERATIONS

The Company owns a 50% equity interest in CBHS, from which it receives the Franchise Fees. The Franchise Fees represent a significant portion of the Company's earnings and cash flows. The following is a discussion of certain matters related to the Company's ownership of CBHS that may have a bearing on the Company's future results of operations.

CBHS may consolidate services in selected markets by closing facilities depending on market conditions and evolving business strategies. For example, during fiscal 1995 and 1996, the Company consolidated, closed or sold 15 and 9 psychiatric hospitals, respectively. During fiscal 1997, the Company consolidated or closed three psychiatric hospitals, prior to the Crescent Transactions. If CBHS closes additional psychiatric hospitals, it could result in charges to income for the costs attributable to the closures, which would result in additional losses in the equity in earnings of CBHS for the Company.

The Company's Joint Venture Hospitals and CBHS' hospitals continue to experience a shift in payor mix to managed care payors from other payors, which contributed to a reduction in revenue per equivalent patient day in fiscal 1996 and a decline in average length of stay in fiscal 1995, 1996 and 1997. Management anticipates a continued shift in hospital payor mix towards managed care payors as a result of changes in the healthcare marketplace. Future shifts in hospital payor mix to managed care payors could result in lower revenue per equivalent patient day and lower average length of stay in future periods for the Company's Joint Venture Hospitals and CBHS' hospitals, which could result in lower equity in earnings from CBHS for the Company and cash flows to pay the Franchise Fees. The hospitals currently managed or operated by CBHS, including hospitals closed or sold in 1997, reported a 10% reduction in equivalent patient days, a 7% reduction in average length of stay and a 4% decrease in admissions in fiscal 1997 compared to fiscal 1996.

The Balanced Budget Act of 1997 (the "Budget Act"), which was enacted by Congress in August 1997, includes provisions that eliminated the TEFRA bonus payment and reduced reimbursement of certain costs previously paid by Medicare and eliminated the Medicaid "disproportionate share" program. These provisions, along with other provisions in the Budget Act, will reduce the amount of revenue and earnings that CBHS hospitals will receive for the treatment of Medicare patients. CBHS management estimates

that such reductions will approximate $10 million in fiscal 1998, and due to the phase-in effects of the Budget Act, approximately $15 million annually in subsequent fiscal years.

Based on projections of fiscal 1998 operations prepared by management of CBHS and results of operations through March 31, 1998, the Company believes that CBHS will be unable to pay the full amount of the Franchise Fees it is contractually obligated to pay the Company during fiscal 1998. The Company currently estimates that CBHS will be able to pay approximately $58.0 million to $68.0 million of the Franchise Fees in fiscal 1998, a $10.0 million to $20.0 million shortfall relative to amounts payable under the Master Franchise Agreement. The Company may be required to record bad debt expense related to Franchise Fees receivable from CBHS, in fiscal 1998 or future periods if CBHS's operating performance does not allow for payment of Franchise Fees. Based on the

amount of unpaid Franchise Fees, the Company has certain rights under the Master Franchise Agreement. The Company will pursue all remedies available to it under the Master Franchise Agreement, as appropriate.

IMPACT OF THE MERIT ACQUISITION ON RESULTS OF OPERATIONS

As a result of the Merit acquisition, the Company has over 60 million covered lives under managed behavioral healthcare contracts and manages behavioral healthcare programs for over 4,000 customers. The Company believes it also now has the number one market position in each of the major product markets in which it competes. The Company believes that the Merit acquisition creates opportunities for the Company to achieve significant cost savings in its managed behavioral healthcare business. Management believes that cost saving opportunities will result from leveraging fixed overhead over a larger revenue base and an increased number of covered lives and from reducing duplicative corporate and regional selling, general and administrative expenses. As a result, the Company expects to achieve approximately $60.0 million of cost savings in its managed behavioral healthcare business on an annual basis within eighteen months following the consummation of the Merit acquisition. The Company expects to spend approximately $30.0 million during the eighteen months following the consummation of the Merit acquisition in connection with achieving such costs.

The Company expects to record additional managed care integration costs during future quarters to the extent the Integration Plan results in additional facility closures at HAI and Green Spring and for integration plan costs incurred that benefit future periods.

The full implementation of the Integration Plan is expected to take eighteen months. The Merit acquisition and related transactions are expected to be dilutive to earnings during the remaining quarters of fiscal 1998.

IMPACT OF THE CBHS TRANSACTIONS ON RESULTS OF OPERATIONS

If the CBHS Transactions are consummated, the Company will no longer conduct its franchising operations. Accordingly, the Company will no longer receive Franchise Fees or incur expenses related to the Franchise Fees. In addition, if the CBHS Transactions are consummated, the Company will sell substantially all of its domestic provider operations, including its ownership interests in CBHS. The net proceeds from the CBHS Transactions would be used to repay approximately $272.0 million of the Term Loans, which would reduce annual interest expense by approximately $22.5 million. The CBHS Transactions, if consummated, would reduce the Company's future earnings because the earnings of the Company attributable to the franchise operations and the domestic provider operations, including CBHS, which would be sold in the CBHS Transactions, would exceed the decrease in interest expense as a result of debt repayment. See Note G--"Investment in CBHS."

HISTORICAL LIQUIDITY AND CAPITAL RESOURCES

OPERATING ACTIVITIES. The Company's net cash used in operating activities was approximately $11.5 million and $17.0 million for the six months ended March 31, 1997 and 1998, respectively. Operating cash

flows for the six months ended March 31, 1998 were adversely affected by unpaid Franchise Fees of $10.0 million, the change in due to/from CBHS of $6.9 million, the prepayment of CHARTER call center management fees to CBHS of $5.9 million, insurance settlement payments of $8.8 million and the prepayment of accrued interest of $13.7 million on the Old Notes as a result of the Transactions.

INVESTING ACTIVITIES. The Company utilized $936.7 million in funds, net of cash acquired, for acquisitions and investments in businesses, including the Allied, HAI and Merit acquisitions, during the six months ended March 31, 1998. In addition, the Company paid approximately $5.9 million of Crescent Transaction costs during the six months ended March 31, 1998. The Company expects to fund an additional $15 million for transaction costs and construction costs related to the Crescent Transactions and transaction costs related to Allied, HAI and Merit during the remainder of fiscal 1998.

FINANCING ACTIVITIES. The Company borrowed approximately $126.8 million, net of issuance costs, in the first quarter of fiscal 1997, primarily to refinance its then existing credit agreement. The Company borrowed approximately $1.2 billion during the six months ended March 31, 1998 primarily to fund the

Transactions. Also, the Company extinguished the Old Notes for approximately $418.4 million during the six months ended March 31, 1998. The Company repurchased approximately 545,000 shares of its common stock for approximately $12.5 million during the six months ended March 31, 1998.

As of March 31, 1998, the Company had approximately $102.5 million of availability under the Revolving Facility of the New Credit Agreement. The Company was in compliance with all debt covenants as of March 31, 1998.

OUTLOOK--LIQUIDITY AND CAPITAL RESOURCES

The interest payments on the New Notes and interest and principal payments on indebtedness outstanding pursuant to the New Credit Agreement represent significant liquidity requirements for the Company. The Company believes that the operating cash flows generated from its businesses will provide the Company with the liquidity required to make such interest and principal payments. Borrowings under the New Credit Agreement will bear interest at floating rates and will require interest payments on varying dates depending on the interest rate option selected by the Company. Borrowings pursuant to the New Credit Agreement include $550 million in Term Loans and up to $150 million under the Revolving Facility. Commencing in the second quarter of fiscal 1999, the Company will be required to make principal payments with respect to the Term Loans. The Company will be required to repay the principal amount of borrowings outstanding under the Term Loan Facilities provided for in the New Credit Agreement and the principal amount of the New Notes in the years and amounts set forth in the following table:

FISCAL YEAR	PRINCIPAL AMOUNT
1999......	$ 19.9
2000......	32.4
2001......	38.9
2002......	49.4
2003......	92.0
2004......	156.5
2005......	131.7
2006......	29.2
2007......	--
2008......	625.0

In addition, any amounts outstanding under the Revolving Credit Facility created by the New Credit Agreement mature in 2004.

The Company has finalized its plans for the integration of the businesses of Green Spring, HAI and Merit. The Company expects to achieve approximately $60.0 million of cost savings on an annual basis

within eighteen months following the consummation of the Merit acquisition. Such cost savings are measured relative to the combined budgeted amounts of the Company, Merit and HAI for the current fiscal year prior to the cost savings initiatives. The Company expects to spend approximately $30.0 million during the eighteen months following the consummation of the Merit acquisition in connection with achieving such cost savings, including expenses related to reducing duplicative personnel in its managed care organizations, contractual terminations for eliminating excess real estate (primarily locations under operating leases) and other related costs in connection with the integration plan. Certain of such costs will be capital expenditures.

During December 1997, the Company purchased HAI and Allied for approximately $122.1 million and $70.0 million, respectively, excluding transaction costs. In addition, the Company incurred the obligation to make contingent payments to the former owners of HAI and Allied. With respect to HAI, the Company may be required to make additional contingent payments of up to $60.0 million annually to Aetna over the five-year period subsequent to closing. The Company is obligated to make contingent payments under two separate calculations. Under the first calculation, the amount and timing of the contingent payments will be based on growth in the number of lives covered by certain HAI products during the next five years. The Company may be required to make contingent payments of up to $25.0 million per year for each of the five years following the HAI

acquisition depending on the net annual growth in the number of lives covered by such HAI products. The amount to be paid per incremental covered life decreases during the five-year term of the Company's contingent payment obligation. Under the second calculation, the Company may be required to make contingent payments of up to $35.0 million per year for each of five years based on the net cumulative growth in the number of lives covered by certain other HAI products. Aetna will receive a specified amount per net incremental life covered by such products. The amount to be paid per incremental covered life increases with the number of incremental covered lives.

The Company may be required to pay up to $40.0 million in one-third increments during each of the three years following the closing of the Allied acquisition based on Allied's performance relative to certain earnings targets. In connection with Merit's acquisition of CMG Health, Inc. ("CMG"), the Company, by acquiring Merit, may be required to make certain future contingent cash payments over the next two years to the former shareholders of CMG based upon the performance of certain CMG customer contracts. Such contingent payments are subject to an aggregate maximum of $23.5 million.

The Revolving Facility will provide the Company with revolving loans and letters of credit in an aggregate principal amount at any time not to exceed $150.0 million. At March 31, 1998, the Company had approximately $102.5 million of availability under the Revolving Facility. The Company believes that the cash flow generated from its operations together with amounts available for borrowing under the New Credit Agreement, should be sufficient to fund its debt service requirements, anticipated capital expenditures, contingent payments, if any, with respect to HAI, Allied and CMG and other investing and financing activities. The CBHS Transactions, if consummated, would result in an estimated annual reduction in cash flows from operations provided by franchise operations, offset, in part, by reduced interest payments as a result of repayment of indebtedness with the proceeds received by the Company from the CBHS Transactions. The Company currently estimates that it will spend approximately $50.0 million for capital expenditures in fiscal 1998. On a combined basis, the Company (excluding its provider business), Merit and HAI spent approximately $40.0 million for capital expenditures during fiscal 1997. The majority of the Company's budgeted capital expenditures relate to management information systems and related equipment. The Company's future operating performance and ability to service or refinance the New Notes or to extend or refinance the indebtedness outstanding pursuant to the New Credit Agreement will be subject to future economic conditions and to financial, business and other factors, many of which are beyond the Company's control.

RECENT ACCOUNTING PRONOUNCEMENTS

In March 1998, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants ("AICPA") issued Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" ("SOP 98-1"). SOP 98-1 establishes accounting guidance for internal-use software. SOP 98-1 requires the following:

- Computer software costs that are incurred in the preliminary project stage (as described in SOP 98-1) should be expensed as incurred. Once the capitalization criteria of SOP 98-1 have been met, external direct costs of materials and services consumed in developing or obtaining internal-use computer software; payroll and payroll-related costs for employees who are directly associated with and who devote time to the internal-use computer software project (to the extent of the time spent directly on the project); and interest costs incurred when developing computer software for internal use should be capitalized. Training costs and data conversion costs should generally be expensed as incurred.

- Internal costs incurred for upgrades and enhancements should be expensed or capitalized in accordance with SOP 98-1. Internal costs incurred for maintenance should be expensed as incurred. Entities that cannot separate internal costs on a reasonably cost-effective basis between maintenance and relatively minor upgrades and enhancements should expense such costs as incurred.

- External costs incurred under agreements related to specified upgrades and enhancements should be expensed or capitalized in accordance with SOP 98-1. However, external costs related to maintenance, unspecified upgrades and enhancements, and costs under agreements that combine the costs of maintenance and unspecified upgrades and enhancements should be recognized

in expense over the contract period on a straight-line basis unless another systematic and rational basis is more representative of the services received.

- Impairment should be recognized and measured in accordance with the provisions of FASB Statement No. 121, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF.

- The capitalized costs of computer software developed or obtained for internal use should be amortized on a straight-line basis unless another systematic and rational basis is more representative of the software's use.

SOP 98-1 becomes effective for financial statements for fiscal years beginning after December 15, 1998. The provisions of SOP 98-1 should be applied to internal-use software costs incurred in those fiscal years for all projects, including those projects in progress upon initial application of SOP 98-1. Costs incurred prior to the initial application of SOP 98-1, whether capitalized or not, should not be adjusted to the amounts that would have been capitalized had SOP 98-1 been in effect when those costs were incurred.

The Company must adopt SOP 98-1 no later than October 1, 1999. Each of the Company's operating units maintains its own information systems, which includes internal-use software as defined by SOP 98-1. The care management and claims processing systems used in the managed care segment are the Company's most significant internal-use software applications. The Company is in the process of evaluating the requirements of SOP 98-1 versus its internal-use software capitalization policies. The Company does not believe SOP 98-1 will have a material impact on its financial position or results of operations.

In April 1998, the AICPA issued Statement of Position 98-5, "Reporting on the Costs of Start-up Activities" ("SOP 98-5"). SOP 98-5 requires all nongovernmental entities to expense costs of start-up activities as those costs are incurred. Start-up costs, as defined by SOP 98-5, include pre-operating costs, pre-opening costs and organization costs.

SOP 98-5 becomes effective for financial statements for fiscal years beginning after December 31, 1998. At adoption, a company must record a cumulative effect of a change in accounting principle to write

off any unamortized start-up costs remaining on the balance sheet when SOP 98-5 is adopted. Prior year financial statements cannot be restated. The Company must adopt SOP 98-5 no later than October 1, 1999. The Company does not believe SOP 98-5 will have a material impact on its financial position or results of operations.

MODIFICATION OF COMPUTER SOFTWARE FOR THE YEAR 2000

The Company and its subsidiaries have internally developed computer software systems that process transactions based on storing two digits for the year of a transaction (i.e., "97" for 1997) rather than four digits, which will be required for year 2000 transaction processing. CBHS expects to spend $1.0 million in the aggregate during fiscal 1998 and fiscal 1999 to modify internal use software. The Company expects to spend approximately $1.6 million in the aggregate during fiscal 1998 and fiscal 1999 to modify internal use software. The Company does not anticipate incurring any other significant costs for year 2000 software modification. The cost of modifying internal use software for the year 2000 is charged to expense as incurred.

PART II -- OTHER INFORMATION

ITEM 1. -- LEGAL PROCEEDINGS

Certain of the Company's subsidiaries are subject to or parties to claims, civil suits and governmental investigations and inquiries relating to their operations and certain alleged business practices. In the opinion of management, based on consultation with counsel, resolution of these matters will not have a material adverse effect on the Company's financial position or results of operations.

ITEM 4. -- SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company held an annual meeting of stockholders on February 6, 1998.

The tabulation of votes with respect to each matter voted upon at the meeting is as follows:

	VOTES CAST		
	FOR	AUTHORITY WITHHELD	ABSTAIN
Election of:			
Andre C. Dimitriadis as a Director (term expiring in 2001)...	24,790,545	47,418	N/A
A.D. Frazier, Jr. as a Director (term expiring in 2001)...	24,666,312	171,651	N/A
G. Fred DiBona as a Director (term expiring in 2001)......	24,798,888	39,075	N/A

	FOR	AGAINST	ABSTAIN
Approval of :			
1998 Stock Option Plan..................................	23,669,563	1,039,876	8,797

ITEM 6. -- EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

2(a) Agreement and Plan of Merger, dated October 24, 1997, among the Company, Merit Behavioral Care Corporation and MBC Merger Corporation, which was filed as Exhibit 2(g) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1997, and is incorporated herein by reference.

2(b) Purchase Agreement, dated March 3, 1998, between the Company, Charter Behavioral Corporation, Charter Behavioral Health Systems, Inc., Green Spring Health Services, Inc., Advantage Behavioral Systems, Inc. and Charter Behavioral Health Systems, LLC, which was filed as Exhibit 2(f) to the Company's Registration Statement on Form S-4 filed on April 3, 1998, and is incorporated herein by reference.

2(c) Equity Purchase Agreement, dated March 3, 1998, between the Company, Charter Behavioral Health Systems, Inc. and Crescent Operating, Inc., which was filed as Exhibit 2(g) to the Company's Registration Statement on Form S-4 filed on April 3, 1998, and is incorporated herein by reference.

2(d) Support Agreement, dated March 3, 1998, between the Company and Crescent Operating, Inc., which was filed as Exhibit 2(h) to the Company's Registration Statement on Form S-4 filed on April 3, 1998, and is incorporated herein by reference.

4(a) Indenture, dated as of February 12, 1998, between the Company and Marine Midland Bank, as Trustee, relating to the 9% Senior Subordinated Notes due February 15, 2008 of the Company, which was filed as Exhibit 4(a) to the Company's Current Report on Form 8-K, as amended, dated April 3, 1998, and is incorporated herein by reference.

4(b) Purchase Agreement, dated February 5, 1998, between the Company and Chase Securities Inc., which was filed as Exhibit 4(b) to the Company's Current Report on Form 8-K, as amended, dated April 3, 1998, and is incorporated herein by reference.

4(c) Exchange and Registration Rights Agreement, dated February 12, 1998, between the Company and Chase Securities Inc., which was filed as Exhibit 4(c) to the Company's Current Report on Form 8-K, as amended, dated April 3, 1998, and is incorporated herein by reference.

4(d) Credit Agreement, dated as of February 12, 1998, among the Company, certain of the Company's subsidiaries listed therein and The Chase Manhattan Bank, as administrative agent, which was filed as Exhibit 4(d) to the Company's Current Report on Form 8-K, as amended, dated April 3, 1998, and is incorporated herein by reference.

10(a) 1998 Stock Option Plan of the Company, which was filed as Exhibit 10(ay) to the Company's Registration Statement on Form S-4 filed on April 3, 1998, and is incorporated herein by reference.

10(b) Letter Agreement, dated May 7, 1997, between Green Spring Health Services, Inc. and John J. Wider, Jr., Executive Vice President and Chief Operating Officer of Green Spring Health Services, Inc., which was filed as Exhibit 10(az) to the Company's Registration Statement on Form S-4 filed on April 3, 1998, and is incorporated herein by reference.

10(c) Employment Agreement, dated March 12, 1997, between Green Spring Health Services, Inc. and Clarissa C. Marques, Chief Clinical Officer of Green Spring Health Services, Inc., which was filed as Exhibit 10(ba) to the Company's Registration Statement on Form S-4 filed April 3, 1998, and is incorporated herein by reference.

10(d) Letter Agreement, dated February 2, 1995, between Green Spring Health Services, Inc. and Clarissa C. Marques, Senior Vice President of Green Spring Health Services, Inc., which was filed as Exhibit 10(bb) to the Company's Registration Statement on Form S-4 filed April 3, 1998, and is incorporated herein by reference.

27 Financial Data Schedule

(b) Report on Form 8-K

The following current reports on Form 8-K were filed by the Registrant with the Securities and Exchange Commission during the quarter ended March 31, 1998.

DATE OF REPORT	ITEM REPORTED AND DESCRIPTION	FINANCIAL STATEMENTS FILED
February 27, 1998	Acquisition--Merit Acquisition	No(1)

- ------------------------

(1) Amended on April 3, 1998 to include audited financial statements for the three years in the period ended September 30, 1997, unaudited financial statements for the three months ended December 31, 1997 and 1996 and as of December 31, 1997, unaudited pro forma statements of operations for the year ended September 30, 1997 and the three months ended December 31, 1997 and unaudited pro forma balance sheet as of December 31, 1997.

FORM 10-Q
MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
SIGNATURES

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

MAGELLAN HEALTH SERVICES, INC.
(Registrant)

Date: May 13, 1998 /s/ CRAIG L. MCKNIGHT

Craig L. McKnight
EXECUTIVE VICE PRESIDENT AND
CHIEF FINANCIAL OFFICER

Date: May 13, 1998 /s/ JEFFREY T. HUDKINS

Jeffrey T. Hudkins
VICE PRESIDENT AND CONTROLLER
(PRINCIPAL ACCOUNTING OFFICER)

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CONDENSED CONSOLIDATED BALANCE SHEETS AND CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS FOUND ON PAGES 2, 3, AND 4 OF THE COMPANY'S FORM 10-Q FOR THE YEAR-TO-DATE, AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.
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