UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended September 30, 2000

/ / 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 (State or other jurisdiction of incorporation or organization)	58-1076937 (I.R.S. Employer Identification No.)
6950 COLUMBIA GATEWAY DRIVE SUITE 400 COLUMBIA, MARYLAND (Address of principal executive offices)	21046 (Zip Code)

Registrant's telephone number, including area code: (410) 953-1000

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

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
Common Stock ($0.25 par value)	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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

The aggregate market value of the common stock held by non-affiliates of the registrant at November 30, 2000 was approximately $93,939,264.

The number of shares of the registrant's common stock outstanding as of November 30, 2000 was 34,921,746.

DOCUMENTS INCORPORATED BY REFERENCE: The registrant's definitive proxy materials on Schedule 14A relating to its annual meeting of stockholders to be held on February 21, 2001 are incorporated by reference into Part III as set forth herein.

MAGELLAN HEALTH SERVICES, INC.
ANNUAL REPORT ON FORM 10-K
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2000

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PART I

ITEM 1. BUSINESS

Magellan Health Services, Inc. (the "Company"), which was incorporated in 1969 under the laws of the State of Delaware, is a national healthcare company. The Company primarily operates through two principal segments and engages in the behavioral managed healthcare business and the human services business The Company's executive offices are located at Suite 400, 6950 Columbia Gateway Drive, Columbia, Maryland 21046, and its telephone number at that location is (410) 953-1000.

RECENT DEVELOPMENTS

DIVESTITURE OF SPECIALTY MANAGED HEALTHCARE BUSINESS. On October 4, 2000 the Board of Directors of the Company, adopted a formal plan of disposal of the specialty managed healthcare business segment. This action represents a disposal of a business segment under Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations--Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" ("APB 30"). APB 30 requires that the results of continuing operations be reported separately from those of discontinued operations for all periods presented and that any gain or loss from disposal of a segment of a business be reported in conjunction with the related results of discontinued operations. Accordingly, the Company has restated its results of operations for all prior periods. The Company recorded an after-tax loss on disposal of its specialty managed healthcare segment of approximately $17.7 million (primarily non-cash), in the fourth quarter of fiscal 2000. See Note 3--"Discontinued Operations" to the Company's audited consolidated financial statements set forth elsewhere herein.

The specialty managed healthcare segment includes the businesses acquired in conjunction with the purchase of Vivra, Inc. ("Vivra") on February 29, 2000 and Allied Health Group, Inc. ("Allied") on December 5, 1997. The initial purchase price of Vivra was $10.25 million and additional consideration of $10.0 million may be payable based upon future results. Approximately 30% of the voting interest in Vivra was owned by the investment firm Texas Pacific Group ("TPG") at the time of the Company's acquisition. Three of the Company's twelve board members are affiliated with TPG; however, these three Board members did not participate in the Board's approval of the Vivra acquisition. TPG is the holder of 59,063 shares of the Company's redeemable preferred stock, representing approximately 16% of the outstanding voting securities of the Company at September 30, 2000. See Note 7--"Redeemable Preferred Stock" to the Company's audited consolidated financial statements set forth elsewhere herein. The

Company paid approximately $54.5 million for Allied.

BANK AMENDMENT. On August 11, 2000, the Company was successful in amending certain financial covenants and terms of the Credit Agreement (as defined). The Company believes the amended Credit Agreement will enable the Company to comply with all future financial covenants based on the Company's projected operating performance. The Company incurred approximately $3.1 million in fees to obtain this amendment and the Company's borrowing rate on its term debt was increased by 1.25%, resulting in increased interest cost in future periods.

TPG INVESTMENT. On December 15, 1999, the Company entered into an amended and restated definitive agreement with TPG Magellan, LLC, an affiliate of the investment firm Texas Pacific Group ("TPG"), pursuant to which TPG purchased approximately $59.1 million of the Company's Series A Cumulative Convertible Preferred Stock (the "Series A Preferred Stock") and an Option (the "Option") to purchase an additional approximately $21.0 million of Series A Preferred Stock. Net proceeds from issuance of the Series A Preferred Stock were $54.0 million. Approximately 50% of the net proceeds received from the issuance of the Series A Preferred Stock was used to reduce debt outstanding under the Term Loan Facility (as defined) with the remaining 50% of the proceeds being used for general corporate purposes. The Series A Preferred Stock carries a dividend of 6.5% per annum, payable in quarterly installments in cash or common stock, subject to certain conditions. Dividends not paid in cash or common

stock will accumulate. The Series A Preferred Stock is convertible at any time into the Company's common stock at a conversion price of $9.375 per share (which would result in approximately 6.3 million shares of common stock if all of the currently issued Series A Preferred Stock were to convert) and carries "as converted" voting rights. The Company may, under certain circumstances, require the holders of the Series A Preferred Stock to convert such stock into common stock. The Series A Preferred Stock, plus accrued and unpaid dividends thereon, must be redeemed by the Company on December 15, 2009. The Option may be exercised in whole or in part at any time on or prior to June 15, 2002. The terms of the shares of Series A Preferred Stock issuable pursuant to the Option are identical to the terms of the shares of Series A Preferred Stock issued to TPG at the closing of the TPG Investment. See Note 7--"Redeemable Preferred Stock" to the Company's audited consolidated financial statements set forth elsehwere herein.

TPG has three representatives on the Company's twelve-member Board of Directors.

HISTORY

Prior to June 1997, the Company's primary business was the operation of psychiatric hospitals. During the first quarter of fiscal 1996, the Company acquired a 61% ownership interest in Green Spring Health Services, Inc. ("Green Spring"), a managed care company specializing in mental health and substance abuse/dependence services. At that time, the Company intended to become a fully integrated behavioral healthcare provider by combining the behavioral managed healthcare products offered by Green Spring with the direct treatment services offered by the Company's psychiatric hospitals. Subsequent to the Company's acquisition of Green Spring, the growth of the behavioral managed healthcare industry accelerated. The Company concluded that the behavioral managed healthcare industry 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 of its managed healthcare business.

In June 1997, the Company sold substantially all of its domestic acute-care psychiatric hospitals and residential treatment facilities (collectively, the "Psychiatric Hospital Facilities") to Crescent Real Estate ("Crescent") for approximately $400.0 million (the "Crescent Transactions"). Simultaneously with the sale of the Psychiatric Hospital Facilities, the Company and Crescent Operating, Inc. ("COI"), an affiliate of Crescent, formed Charter Behavioral Health Systems, LLC ("CBHS") to conduct the operations of 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 ownership interest of CBHS was owned by COI.

During fiscal 1999, the Company completed its exit from the healthcare provider and franchising businesses. In April 1999, the Company sold its European psychiatric provider operations to Investment AB Bure of Sweden for approximately $57.0 million. On September 10, 1999, the Company consummated the transfer of certain assets and other interests pursuant to a Letter Agreement dated August 10, 1999 with Crescent, COI and CBHS. Under the Letter Agreement, the Company redeemed 80% of its common interest and all of its preferred interest in CBHS, agreed to transfer to CBHS its interests in five of its six hospital-based joint ventures ("Provider JVs") and related real estate as soon as practicable, transferred certain assets to CBHS, agreed to pay $2.0 million to CBHS in 12 equal monthly installments beginning on the first anniversary of the closing date, transferred its healthcare franchising interest to CBHS and forgave unpaid franchise fees of approximately $115 million (the "CBHS Transaction").

The CBHS Transaction, together with the formal plan of disposal authorized by the Company's Board of Directors on September 2, 1999, represents the disposal of the Company's healthcare provider and healthcare franchising business segments under APB 30. Pursuant to APB 30, the Company has restated its results of operations for all prior periods. The Company recorded an after-tax loss on disposal of its healthcare provider and healthcare franchising business segments of approximately $47.4 million (primarily non-cash), in the fourth quarter of fiscal 1999.

The Crescent Transactions provided the Company with approximately $200 million of net cash proceeds, after debt repayment, for use in implementing its business strategy of expanding its managed care operations. The Company used the proceeds to finance the acquisition of Allied as well as two important acquisitions in managed behavioral healthcare (collectively, the "Managed Care Acquisitions"). A summary of the Managed Care Acquisitions and related transactions are as follows:

HUMAN AFFAIRS INTERNATIONAL, INCORPORATED ACQUISITION. On December 4, 1997, the Company consummated the purchase of Human Affairs International, Incorporated ("HAI"), formerly a unit of Aetna/U.S. Healthcare ("Aetna"), for approximately $122.1 million, which the Company funded from cash on hand. HAI managed behavioral healthcare programs primarily through employee assistance programs ("EAPs") and other behavioral managed healthcare plans. The Company may be required to make additional contingent payments of up to $60.0 million annually to Aetna through 2003. The Company has made additional purchase price payments totaling $120 million through September 30, 2000. The amount and timing of the payments will be contingent upon the number of HAI's covered lives in specified products. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Outlook--Liquidity and Capital Resources."

MERIT ACQUISITION. On February 12, 1998, the Company consummated the acquisition of Merit Behavioral Care Corporation ("Merit") for cash consideration of approximately $450 million plus the repayment of Merit's debt. Merit managed behavioral healthcare programs across all segments of the healthcare industry, including health maintenance organizations ("HMO's"), Blue Cross/Blue Shield organizations and other insurance companies, corporations and labor unions, federal, state and local governmental agencies and various state Medicaid programs. In connection with the consummation of the Merit acquisition, the Company entered into a new senior secured bank credit agreement (the "Credit Agreement"), providing for a revolving credit facility (the "Revolving Facility") and a term loan facility (the "Term Loan Facility") which provides for borrowings of up to $700 million and the Company issued the 9% Series A Senior Subordinated Notes due 2008 (the "Notes") pursuant to an indenture which governs the Notes ("Indenture").

INDUSTRY

According to industry sources, 22.1 percent of American adults suffer from a diagnosable mental disorder in any given year. Applied to recent population census, this would translate to approximately 44 million individuals. In the United States during 1996, approximately $69 billion was spent or more than seven percent of total health spending, was on mental health services. Further, direct costs associated with substance abuse were nearly $13 billion. These direct costs have grown, in part, as society has begun to recognize and address behavioral health concerns and employers have realized that rehabilitation of employees suffering from substance abuse and relatively mild mental health problems can reduce losses due to absenteeism and decreased productivity. In addition, estimation of indirect costs associated with these issues approach $79 billion annually, reflecting the fact that four of the ten leading causes of disability in the United States are mental disorders.

In response to these escalating costs, behavioral managed healthcare companies such as Green Spring, HAI and Merit were formed. Behavorial managed healthcare companies focus on matching an appropriate level of specialist and treatment setting with the patient to provide care in a cost-efficient manner while improving early access to care and utilizing the most modern and effective treatments. As the growth of behavioral managed healthcare has increased, there has been a significant decrease in occupancy rates and average lengths of stay for inpatient psychiatric facilities and an increase in outpatient treatment and alternative care services.

According to an industry trade publication entitled "Open Minds Year Book of Managed Behavioral Health Market Share in the United States 2000-2001" published by Open Minds, Gettysburg, Pennsylvania (hereinafter referred to as "OPEN MINDS"), as of July 2000, approximately 209.2 million beneficiaries were

covered by some form of behavioral managed healthcare plan. The number of covered beneficiaries has grown from approximately 86.3 million beneficiaries in 1993 to approximately 209.2 million as of July 2000, representing a 13% compound annual growth rate since 1993 and 15% growth just in the last year. In addition, according to OPEN MINDS, beneficiaries covered under risk-based programs, see below, are growing even more rapidly, from approximately 13.6 million as of January 1993 to approximately 62.9 million as of July, 2000, representing a compound annual growth rate of 24% and growth of over 27% since last year.

OPEN MINDS divides the managed behavioral healthcare industry as of July 2000 into the following categories of care, based on services provided, extent of care management and level of risk assumption:

CATEGORY OF CARE	BENEFICIARIES (IN MILLIONS)	PERCENT OF TOTAL
Risk-Based Network Products	62.9	30.1%
EAPs	51.0	24.3
Integrated Products	15.5	7.4
Utilization Review/Care Management Products	37.4	17.9
Non-Risk-Based Network Products	42.4	20.3
Total	209.2	100.0%

Management believes the current trends in the behavioral healthcare industry include increased risk-based network managed care products and significant expansion of EAP services offered to employees. Management believes that these trends have developed in response to the attempt by payors to reduce rapidly escalating behavioral healthcare costs and to limit their risk associated with such costs while continuing to provide access to high quality care. Expansion of EAP services is a reflection of the tight labor market and represents a relatively inexpensive way to help retain workers and reduce turnover. According to OPEN MINDS, risk-based network products and EAPs are the most rapidly growing segments of the behavioral managed healthcare industry.

The following is a summary of each of these categories of care.

RISK-BASED NETWORK PRODUCTS. Under risk-based network products, the behavioral managed healthcare company assumes all or a portion of the responsibility for the cost of providing a full or specified range of behavioral healthcare treatment services. Most of these programs have payment arrangements in which the managed care company agrees to arrange for services in exchange for a fixed fee per member per month that varies depending on the profile of the beneficiary population or otherwise shares the responsibility for arranging for all or some portion of the treatment services at a specific cost per member. Under these products, the behavioral managed healthcare company not only reviews and monitors a course of treatment, but also arranges and pays for the provision of patient care. Therefore, the behavioral managed healthcare company must contract with, credential and manage a network of specialized providers and facilities that covers the complete continuum of care. The behavioral managed healthcare company must also see that the appropriate level of care is delivered in the appropriate setting. Given the ability of payors of behavioral healthcare benefits to reduce their risk with respect to the cost of treatment services through risk-based network products while continuing to provide access to high quality care, this market segment has grown rapidly in recent years. In addition to the expected growth in total beneficiaries covered under behavioral managed healthcare products, this shift of beneficiaries into risk-based network products should further contribute to revenue growth for the behavioral managed healthcare industry because such contracts generate significantly higher revenue than non-risk based contracts. The higher revenue is intended to compensate the behavioral managed healthcare company for bearing the financial responsibility for the cost of delivering care. The Company's risk-based products are risk-based network products as defined by OPEN MINDS.

According to OPEN MINDS, industry enrollment in risk-based products has grown from approximately 13.6 million covered lives in 1993 to approximately 62.9 million covered lives in 2000, a compound annual growth rate of over 24%. Despite this growth, only approximately 30% of total managed behavioral healthcare covered lives were enrolled in risk-based products as of July, 2000. The Company believes that the market for risk-based products has grown and will continue to grow as payors attempt to reduce their responsibility for the cost of providing behavioral healthcare while ensuring an appropriate level of access to care. Risk-based products can generate significantly greater revenue per covered life than other non-risk product types. See "Cautionary Statements--Risk--Based Products."

EMPLOYEE ASSISTANCE PROGRAMS. An EAP is a worksite-based program designed to assist in the early identification and resolution of productivity problems associated with behavioral conditions or other personal concerns of employees and their dependants. Under an EAP, staff or network providers or other affiliated clinicians provide assessment and referral services to employee beneficiaries and their dependants. These services consist of evaluating a patient's needs and, if indicated, providing limited counseling and/or identifying an appropriate provider, treatment facility or other resource for more intensive treatment services. The EAP industry developed largely out of employers' efforts to combat alcoholism and substance abuse problems afflicting workers. A recent industry survey estimated the total cost of this dependency at approximately $98.6 billion per year. Many businesses have implemented alcoholism and drug abuse treatment programs in the workplace, and in some cases have expanded those services to cover a wider spectrum of personal problems experienced by workers and their families. As a result, EAP products now typically include consultation services, evaluation and referral services, employee education and outreach services. The Company believes that federal and state "drug-free workplace" measures and Federal Occupational Safety and Health Act requirements, taken together with the growing public perception of increased violence in the workplace, have prompted many companies to implement EAPs. Although EAPs originated as a support tool to assist managers in dealing with troubled employees, payors increasingly regard EAPs as an important component in the continuum of behavioral healthcare services.

INTEGRATED EAP/MANAGED BEHAVIORAL HEALTHCARE PRODUCTS. EAPs are utilized in a preventive role and in facilitating early intervention and brief treatment of behavioral healthcare problems before more extensive treatment is required. Consequently, EAPs often are marketed and sold in tandem with managed behavioral healthcare programs through "integrated" product offerings. Integrated products offer employers comprehensive management and treatment of all aspects of behavioral healthcare. In an effort to reduce costs, increase accessibility and ease of treatment, employers are increasingly attempting to consolidate EAP and managed behavioral healthcare services into a single product. Although integrated EAP/managed behavioral healthcare products are currently only a small component of the overall industry, the Company expects this market segment to grow.

UTILIZATION REVIEW/CARE MANAGEMENT PRODUCTS. Under utilization review/care management products, a managed behavioral healthcare company manages and often arranges for treatment, but does not maintain a network of providers or assume any of the responsibility for the cost of providing treatment services. The Company categorizes its products within this segment of the managed behavioral healthcare industry (as it is defined by OPEN MINDS) as administrative services only ("ASO") products. The Company does not expect this segment of the industry to experience significant growth.

NON-RISK-BASED NETWORK PRODUCTS. Under non-risk-based network products, the behavioral managed healthcare company provides a full array of managed care services, including selecting, credentialing and managing a network of providers (such as psychiatrists, psychologists, social workers and hospitals), and performs utilization review, claims administration and care management functions. The third-party payor remains responsible for the cost of providing the treatment services rendered. The Company categorizes its products within this segment of the behavioral managed healthcare industry (as it is defined by OPEN MINDS) as ASO products.

Management believes that the growth of the behavioral managed healthcare industry will continue, as payors of behavioral healthcare benefits attempt to reduce the costs of behavioral healthcare while maintaining high quality care. Management also believes that a number of opportunities exist in the behavioral managed healthcare industry for continued growth, primarily for risk-based products, including state and federal parity legislation.

State and federal legislation that eliminates the difference in coverage limits for medical health coverage as compared to mental health coverage is referred to as parity legislation or anti-discrimination legislation. Historically, copayments and deductibles have been higher for mental health treatment than for traditional medical coverage. This has served as an artificial barrier to utilization in some cases. Currently, 29 states have passed legislation that requires insurance companies to provide the same levels of coverage between medical and mental health coverage. The Company believes that this trend will continue, and perhaps accelerate. All federal employees will be covered by mental health parity effective January 1, 2001 due to an executive order signed by President Clinton. Additional federal legislation is under consideration that could apply to all companies regardless of the exemptions provided under the Employee Retirement Income Security Act of 1974 ("ERISA"). The Company believes parity and other legislation may result in additional demands for its products due to: (1) increased need for managed behavioral healthcare services to mitigate increased cost and (2) current customers of ASO products switching to risk arrangements due to the higher coverage requirements associated with parity.

HUMAN SERVICES. The Company's human services business (see below) is conducted in three markets, the mental retardation/developmental disability community-based ("MR/DD") market, the at-risk youth market and the acquired brain injury market. It is estimated that in 1998, approximately $25 billion was spent for MR/DD services for approximately 400,000 persons, which is believed to represent only 10% of the estimated potential market of persons with some level of developmental disability. Over the past twenty years, the preferred care for these persons has been shifting from institutional to community-based care and the demand continues to outpace capacity. State Medicaid programs are the primary source of funding for MR/DD services. The at-risk youth market, which includes children with severe emotional, developmental and behavioral disorders and youth under the auspices of the juvenile justice system, is expected to grow from $22 billion in 1998 to approximately $29.3 billion in 2003. Program models utilized to treat at-risk youth include residential treatment facilities, alternative schools and community-based programs. The acquired brain injury market ("ABI") serves the more than 2 million individuals who suffer traumatic brain injuries each year. Improvements in medicine result in more persons surviving ABI but often with a resulting substantial disability, often for extended periods of time. The Company believes the improvements in medicine, pressures of managed care, and other factors will result in increasing need for community-based, post-acute long-term care options.

COMPANY OVERVIEW

The Company conducts operations in two business segments: behavioral managed healthcare and human services.

BEHAVIORAL MANAGED HEALTHCARE. According to enrollment data reported in OPEN MINDS, the Company is the nation's largest provider of behavioral managed healthcare services. As of September 30, 2000, the Company had approximately 71.0 million covered lives under behavioral managed healthcare contracts and managed behavioral healthcare programs for approximately 3,300 customers. Through its current network of over 40,000 providers and 5,000 treatment facilities, the Company manages behavioral healthcare programs for HMOs, Blue Cross/Blue Shield organizations and other insurance companies, corporations, federal, state and local governmental agencies, labor unions and various state Medicaid programs. The Company believes it has the largest and most comprehensive behavioral healthcare provider network in the United States.

The Company's professional care managers coordinate and manage the delivery of behavioral healthcare treatment services through the Company's network of providers, which includes psychiatrists, psychologists, licensed clinical social workers, marriage and family therapists and licensed clinical professional counselors. The treatment services provided by the Company's behavioral provider network include outpatient programs (such as counseling and therapy), intermediate care programs (such as sub-acute emergency care, intensive outpatient programs and partial hospitalization services), inpatient treatment services and alternative care services (such as residential treatment, home and community-based programs and rehabilitative and support services). The Company provides these services through: (i) risk-based products; (ii) EAPs; (iii) ASO products and (iv) products that combine features of some or all of these products. Under risk-based products, the Company arranges for the provision of a full range of behavioral healthcare services for beneficiaries of its customers' healthcare benefit plans through fee arrangements under which the Company assumes all or a portion of the responsibility for the cost of providing such services in exchange for a fixed per member per month fee. Under EAPs, the Company provides assessment services to employees and dependents of its customers, and if required, referral services to the appropriate behavioral healthcare service provider. Under ASO products, the Company provides services such as utilization review, claims administration and provider network management. The Company does not assume the responsibility for the cost of providing behavioral healthcare services pursuant to its ASO products.

HUMAN SERVICES. The Company's human services business provided specialty home-based behavioral healthcare services through its wholly-owned subsidiary National Mentor, Inc. ("Mentor"), to approximately 7,800 individuals in 21 states as of September 30, 2000. Mentor was founded in 1983 and was acquired by the Company in January 1995. Mentor's services include specialty home-based behavioral healthcare services, which feature individualized home and community-based health and human services delivered in highly structured and professionally monitored family environments or "mentor" homes. The mentor homes serve clients with chronic behavioral disorders and disabilities requiring long-term care, including children and adolescents with behavioral problems, individuals with mental retardation or developmental disabilities, and individuals with neurological impairment or other medical and behavioral frailties. Mentor also provides various residential and day services for individuals with acquired brain injuries and for individuals with mental retardation and developmental disabilities.

For financial information regarding the business segments see Note 14--"Business Segment Information" to the Company's audited consolidated financial statements set forth elsewhere herein.

BUSINESS STRATEGY

The Company's business strategy is comprised of two primary objectives: (i) evaluate the potential to sell or exit non-core and/or under performing assets and (ii) take advantage of our market leadership position and economies of scale to improve cost structure and overall efficiency in providing service in the behavioral managed healthcare arena.

The Company has taken aggressive action recently to dispose of those assets that are not generating cash for debt reduction or are not part of its ongoing strategy. These activities include: (i) the exit from its specialty managed healthcare segment; (ii) the exit from its psychiatric practice management business; and (iii) the sale of its Canadian operations. The Company is currently evaluating the potential to divest on acceptable terms certain other assets and businesses, including Mentor, and is currently involved in discussions with various parties. There can be no assurance that the Company will be able to divest any asset or businesses or that such divestiture would result in significant reductions of long-term debt or improvements in liquidity.

The second part of the Company's strategy centers on improving the efficiencies of its business. In the past two years, Magellan consolidated its behavioral managed healthcare businesses, elminating duplicate staffing and facilities. The Company is now focusing on the next level of integration that includes reduction in computer system platforms, best practices analysis, standardization of provider contracting and utilization of the internet to reduce administrative burden to both providers, customers and beneficiaries. The Company believes that it will reduce administrative costs and improve customer service through these measures; however, there can be no assurance that the Company will be able to implement these initiatives or realize the anticipated savings.

The Company believes this strategy will position the Company to take advantage of favorable macro-economic trends that support continued growth in the behavioral managed healthcare industry.

BEHAVIORAL MANAGED HEALTHCARE PRODUCTS AND SERVICES

GENERAL. The following table sets forth the approximate number of covered lives as of September 30, 1999 and 2000 and revenue for fiscal 1999 and 2000 for the types of behavioral managed healthcare programs offered by the Company:

PROGRAMS	COVERED LIVES	PERCENT	REVENUE	PERCENT
	(IN MILLIONS, EXCEPT PERCENTAGES)			
1999				
Risk-Based Products(1)	35.8	53.9%	$1,282.8	86.5%
ASO products	30.6	46.1	200.4	13.5
Total	66.4	100.0%	$1,483.2	100.0%
2000				
Risk-Based Products(1)	39.1	55.1%	$1,453.4	87.8%
ASO products	31.9	44.9	201.7	12.2
Total	71.0	100.0%	$1,655.1	100.0%

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(1) Includes Risk-Based Products, Employee Assistance Programs and Integrated Products.

The number of covered lives fluctuates based on several factors, including the number of contracts entered into by the Company and changes in the number of employees, subscribers or enrollees of the Company's customers covered by such contracts.

RISK-BASED PRODUCTS. Under the Company's risk-based products, the Company typically arranges for the provision of a full range of outpatient, intermediate and inpatient treatment services to beneficiaries of its customers' healthcare benefit plans, primarily through arrangements in which the Company assumes all of the responsibility for the cost of providing such services in exchange for a per member per month fee. The Company's experience with risk-based contracts covering a large number of lives has given it a broad base of data from which to analyze utilization rates. The Company believes that this broad database permits it to estimate utilization trends and costs more accurately than many of its competitors, which allows it to bid effectively. The Company believes that its experience has also allowed it to develop effective measures for managing the cost of providing a unit of care to its covered lives. The Company has developed or acquired clinical protocols, which permit it to assist its network providers to administer effective treatment in a cost efficient manner, and claims management technology, which permits the Company to reduce the cost of processing claims. The Company's care managers are an essential element in its provision of cost-effective care. Care managers, in consultation with treating professionals, and using the Company's clinical protocols, authorize an appropriate level and intensity of services that can be delivered in a cost-efficient manner.

EMPLOYEE ASSISTANCE PROGRAMS. The Company's EAP products typically provide assessment and referral services to employees and dependents of the Company's customers in an effort to assist in the early identification and resolution of productivity problems associated with the employees who are impaired by behavioral conditions or other personal concerns. For many EAP customers, the Company also provides limited outpatient therapy (typically limited to eight or fewer sessions) to patients requiring such services. For these services, the Company typically is paid a fixed fee per member per month; however, the Company is usually not responsible for the cost of providing care beyond these services. If further services are necessary beyond limited outpatient therapy, the Company will refer the beneficiary to an appropriate provider or treatment facility.

INTEGRATED PRODUCTS. Under its integrated products, the Company typically establishes an EAP to function as the "front end" of a managed care program that provides a full range of services, including more intensive treatment services not covered by the EAP. The Company typically manages the EAP and accepts all or some of the responsibility for the cost of any additional treatment required upon referral out of the EAP, thus integrating the two products and using both the Company's care management and clinical care techniques to manage the provision of care.

ASO PRODUCTS. Under its ASO products, the Company provides services ranging from utilization review and claims administration to the arrangement for and management of a full range of patient treatment services, but does not assume any of the responsibility for the cost of providing treatment services. Services include member assistance, management reporting and claims processing in addition to utilization review and care management. The Company is paid a fee for such services.

BEHAVIORAL MANAGED HEALTHCARE CUSTOMERS

GENERAL. The following table sets forth the approximate number of covered lives as of September 30, 1999 and 2000 and revenue for fiscal 1999 and 2000 in each of the Company's behavioral customer groups described below:

MARKET	COVERED LIVES	PERCENT	REVENUE	PERCENT
	(IN MILLIONS, EXCEPT PERCENTAGES)			
1999				
Workplace (Corporations and Labor Unions)............	27.0	40.7%	$ 230.6	15.5%
Health Plans..	36.5	54.9	846.9	57.1
Public Sector (Primarily Medicaid)..................	2.9	4.4	405.9	27.4
Total...	66.4	100.0%	$1,483.2	100.0%
2000				
Workplace (Corporations and Labor Unions)............	27.9	39.3%	$ 234.4	14.1%
Health Plans..	40.1	56.5	951.1	57.5
Public Sector (Primarily Medicaid)..................	3.0	4.2	469.6	28.4
Total...	71.0	100.0%	$1,655.1	100.0%

CORPORATIONS AND LABOR UNIONS. Corporations and, to a lesser extent, labor unions, account for a large number of the Company's contracts to provide behavioral managed healthcare services and, in particular, EAP and integrated EAP/managed care services. The Company has structured a variety of fee arrangements with corporate customers to cover all or a portion of the responsibility of the cost of providing treatment services. In addition, the Company operates a number of programs for corporate customers on an ASO basis. Management believes the corporate market is an area of potential growth for the Company, as corporations are anticipated to increase their utilization of behavioral managed healthcare services. In an effort to increase penetration of the corporate market, the Company intends to build upon its experience in managing programs for large corporate customers (such as IBM, Federal Express

and AT&T) and to market integrated programs to existing EAP customers and other prospective corporate clients.

HEALTH PLANS. The Company is a leader in providing behavioral managed healthcare services to HMO beneficiaries. HMO contracts are Risk-Based or ASO contracts. Although certain large HMOs provide their own behavioral managed healthcare services, many HMOs "carve out" behavioral healthcare from their general healthcare services and subcontract such services to behavioral managed healthcare companies such as the Company. The Company anticipates that its business with HMOs will continue to grow. The Company believes that it is one of the nation's leading providers of behavioral managed healthcare services to Blue Cross/Blue Shield organizations, serving 33 such organizations as of September 30, 2000.

PUBLIC SECTOR. The Company provides behavioral managed healthcare services to Medicaid recipients through both direct contracts with state and local governmental agencies and through subcontracts with HMOs focused on Medicaid beneficiary populations. In addition to the Medicaid population, other public entitlement programs, such as Medicare and state insurance programs for the uninsured, offer the Company areas of potential future growth. The Company expects that governmental agencies will continue to implement a significant number of managed care Medicaid programs through contracts with HMOs and that many HMOs will subcontract with behavioral managed healthcare organizations, such as the Company, for behavioral healthcare services. The Company also expects that other states will continue the trend of "carving-out" behavioral healthcare services from their general healthcare benefit plans and contracting directly with behavioral managed healthcare companies such as the Company. See "Cautionary Statements--Dependence on Government Spending for Managed Healthcare; Possible Impact of Healthcare Reform" and "Cautionary Statements--Regulation".

BEHAVIORAL MANAGED HEALTHCARE CONTRACTS

The Company's contracts with customers typically have terms of one to three years, and in certain cases contain renewal provisions (at the customer's option) for successive terms of between one and two years (unless terminated earlier). Substantially all of these contracts may be immediately terminated with cause and many are terminable without cause by the customer or the Company either upon the giving of requisite notice and the passage of a specified period of time (typically between 60 and 180 days) or upon the occurrence of other specified events. In addition, the Company's contracts with federal, state and local governmental agencies, under both direct contract and subcontract arrangements with HMOs, generally are conditioned on legislative appropriations. These contracts, notwithstanding terms to the contrary, generally can be terminated or modified by the customer if such appropriations are not made. See "Cautionary Statements--Risk-Based Products" and "Cautionary Statements--Reliance on Customer Contracts."

The specific terms of the Company's contracts are determined by whether the contracts are for risk-based, EAP, integrated or ASO products. Risk-based, EAP and ASO contracts generally provide for payment of a per member per month fee to the Company. The Company's billing arrangements for integrated products vary on a case by case basis.

BEHAVIORAL MANAGED HEALTHCARE NETWORK

The Company's behavioral managed healthcare and EAP treatment services are provided by a network of third-party providers. The number and type of providers in a particular area depend upon customer preference, site, geographic concentration and demographic make-up of the beneficiary population in that area. Network providers include a variety of specialized behavioral healthcare personnel, such as psychiatrists, psychologists, licensed clinical social workers, substance abuse counselors and other professionals.

As of September 30, 2000, the Company had contractual arrangements covering over 40,000 individual third-party network providers. The Company's network providers are independent contractors located throughout the local areas in which the Company's customers' beneficiary populations reside. Network providers work out of their own offices, although the Company's personnel are available to assist them with consultation and other needs. Network providers include both individual practitioners, as well as individuals who are members of group practices or other licensed centers or programs. Network providers typically execute standard contracts with the Company for which they are typically paid by the Company on a fee-for-service basis. In some cases, network providers are paid on a "case rate" basis, whereby, the provider is paid a set rate for an entire course of treatment, or through other risk sharing arrangements.

As of September 30, 2000, the Company's behaviorial managed healthcare network also included contractual arrangements with approximately 5,000 third-party treatment facilities, including inpatient psychiatric and substance abuse hospitals, intensive outpatient facilities, partial hospitalization facilities, community health centers and other community-based facilities, rehabilitative and support facilities, and other intermediate care and alternative care facilities or programs. This variety of facilities enables the Company to offer patients a full continuum of care and to refer patients to the most appropriate facility or program within that continuum. Typically, the Company contracts with facilities on a per diem or fee-for-service basis and, in some cases, on a "case rate" or capitated basis. The contracts between the

Company and inpatient and other facilities typically are for one year terms and, in some cases, are automatically renewable at the Company's option. Facility contracts are usually terminable by the Company or the facility owner upon 30 to 120 days' notice.

COMPETITION

Each segment of the Company's business is highly competitive. With respect to its behavioral managed healthcare business, the Company competes with large insurance companies, HMOs, PPOs, third-party administrators ("TPAs"), independent practitioner associations ("IPAs"), multi-disciplinary medical groups and other managed care companies. Many of the Company's competitors are significantly larger and have greater financial, marketing and other resources than the Company, and some of the Company's competitors provide a broader range of services. The Company may also encounter substantial competition in the future from new market entrants. Many of the Company's customers that are managed care companies may, in the future, seek to provide behavioral managed healthcare services directly to their employees or subscribers directly, rather than by contracting with the Company for such services. Because of competition, the Company does not expect to be able to rely on price increases to achieve revenue growth and expects to continue experiencing pressure on direct operating margins. See "Cautionary Statements--Highly Competitive Industry."

The Company's human services operations compete with various for profit and not-for-profit entities, including, but not limited to: (i) behavioral managed healthcare companies that have started managing human services for governmental agencies; (ii) home health care organizations; (iii) proprietary nursing home companies; and (iv) proprietary human services companies. The Company believes that the most significant factors in a customer's selection of services include price, quality of services and outcomes. The pricing aspect of such services is especially important to attract public sector agencies looking to outsource public services to the private sector as demand for quality services escalates while budgeted dollars for healthcare services are reduced. The Company's management believes that it competes effectively with respect to these factors.

The Company believes it benefits from the competitive strengths described below:

INDUSTRY LEADERSHIP. The Company is the largest provider of behavioral managed healthcare services in the United States, according to enrollment data reported in OPEN MINDS. The Company believes, based on data reported in OPEN MINDS, that it also now has the number one market position in each of the major behavioral managed healthcare product markets in which it competes. The Company believes its position

will enhance its ability to: (i) provide a consistent level of high quality service on a nationwide basis; (ii) enter into agreements with behavioral healthcare providers that allow it to control healthcare costs for its customers; and (iii) market its behavioral managed care products to large corporate, HMO and health insurance customers, which, the Company believes, increasingly prefer to be serviced by a single-source provider on a national basis. See "Cautionary Statements--Highly Competitive Industry" and "--Reliance on Customer Contracts" for a discussion of the risks associated with the highly competitive nature of the behavioral managed healthcare industry and the Company's reliance on contracts with payors of behavioral healthcare benefits, respectively.

BROAD PRODUCT OFFERING AND NATIONWIDE PROVIDER NETWORK. The Company offers behavioral managed care products that can be designed to meet specific customer needs, including risk-based and partial risk-based products, integrated EAPs, stand-alone EAPs and ASO products. The Company's provider network encompasses approximately 40,000 providers and 5,000 treatment facilities in all 50 states. The Company believes that the combination of its product offerings and its provider network allows the Company to meet its customers needs for behavioral managed healthcare on a nationwide basis, and positions the Company to capture incremental revenue opportunities resulting from the continued growth of the behavioral managed healthcare industry and the continued migration of its customers from ASO and EAP products to higher revenue risk-based products. See "Cautionary Statements--Risk-Based Products" for a discussion of the risks associated with risk-based products, which are the Company's primary source of revenue.

BROAD BASE OF CUSTOMER RELATIONSHIPS. The Company believes that the breadth of its customer relationships are attributable to the Company's broad product offerings, nationwide provider network, commitment to quality care and ability to manage behavioral healthcare costs effectively. The Company's customers include: (i) Blue Cross/Blue Shield organizations; (ii) national HMOs and other large insurers, such as Aetna and Humana; (iii) large corporations, such as IBM, Federal Express and AT&T; (iv) state and local governmental agencies through commercial, Medicaid and other programs; and (v) the federal government through contracts with CHAMPUS, as defined, and the U.S. Postal Service. This broad base of customer relationships provides the Company with stable and diverse sources of revenue, earnings and cash flows and an established base from which to continue to increase covered lives and revenue. See "Cautionary Statements--Reliance on Customer Contracts" for a discussion of the risks associated with the Company's reliance on certain contracts with payors of behavioral healthcare benefits.

PROVEN RISK MANAGEMENT EXPERIENCE. The Company had approximately 39.1 million covered lives under risk-based contracts at September 30, 2000, making it the nation's industry leader in at-risk behavioral managed healthcare products, based on data reported in OPEN MINDS. The Company's experience with risk-based products covering a large number of lives has given it a broad base of data from which to analyze utilization rates. The Company believes that this broad database permits it to estimate utilization trends and costs more accurately than many of its competitors, which allows it to bid effectively. The Company believes that its experience has also allowed it to develop effective measures for controlling the cost of providing a unit of care to its covered lives. Among other cost control measures, the Company has developed or acquired clinical protocols, which permit the Company to assist its network providers to administer effective treatment in a cost efficient manner, and claims management technology, which permits the Company to reduce the cost of processing claims.

INSURANCE

The Company maintains a general, professional and managed care liability insurance policy with an unaffiliated insurer. The policy is written on a "claims-made" basis, subject to a $250,000 per claim and $1.0 million annual aggregate self-insured retention for general and professional liability, and also subject to a $500,000 per claim and $2.5 million annual aggregate self-insured retention for managed care liability, for a two-year policy period ending June 17, 2002.

REGULATION

GENERAL. The behavioral managed healthcare industry and the provision of behavioral healthcare services are subject to extensive and evolving state and federal regulation. The Company is subject to certain state laws and regulations, including those governing: (i) the licensing of insurance companies, HMOs, PPOs, TPAs and companies engaged in utilization review and (ii) the licensing of healthcare professionals, including restrictions on business corporations from practicing, controlling or exercising excessive influence over behavioral healthcare services through the direct employment of psychiatrists or, in a few states, psychologists and other behavioral healthcare professionals. These laws and regulations vary considerably among states and the Company may be subject to different types of laws and regulations depending on the specific regulatory approach adopted by each state to regulate the managed care business and the provision of behavioral healthcare treatment services. In addition, the Company is subject to certain federal laws as a result of the role the Company assumes in connection with managing its customers' employee benefit plans. The regulatory scheme generally applicable to the Company's behavioral managed healthcare operations is described in this section.

The Company believes its operations are structured to comply with applicable laws and regulations in all material respects and that it has received all licenses and approvals that are material to the operation of its business. However, regulation of the managed healthcare industry is evolving, with new legislative enactments and regulatory initiatives at the state and federal levels being implemented on a regular basis. Consequently, it is possible that a court or regulatory agency may take a position under existing or future laws or regulations, or as a result of a change in the interpretation thereof, that such laws or regulations apply to the Company in a different manner than the Company believes such laws or regulations apply. Moreover, any such position may require significant alterations to the Company's business operations in order to comply with such laws or regulations, or interpretations thereof. Expansion of the Company's business to cover additional geographic areas, to serve different types of customers, to provide new services or to commence new operations could also subject the Company to additional licensure requirements and/or regulation.

LICENSURE. Certain regulatory agencies having jurisdiction over the Company possess discretionary powers when issuing or renewing licenses or granting approval of proposed actions such as mergers, a change in ownership, transfer or assignment of licenses and certain intracorporate transactions. One or multiple agencies may require as a condition of such licensure or approval that the Company cease or modify certain of its operations in order to comply with applicable regulatory requirements or policies. In addition, the time necessary to obtain licensure or approval varies from state to state, and difficulties in obtaining a necessary license or approval may result in delays in the Company's plans to expand operations in a particular state and, in some cases, lost business opportunities. Compliance activities, mandated changes in the Company's operations, delays in the expansion of the Company's business or lost business opportunities as a result of regulatory requirements or policies could have a material adverse effect on the Company.

INSURANCE, HMO AND PPO ACTIVITIES. To the extent that the Company operates or is deemed to operate in one or more states as an insurance company, HMO, PPO or similar entity, it may be required to comply with certain laws and regulations that, among other things, may require the Company to maintain certain types of assets and minimum levels of deposits, capital, surplus, reserves or net worth. In many states, entities that assume risk under contracts with licensed insurance companies or HMOs have not been considered by state regulators to be conducting an insurance or HMO business. As a result, the Company has not sought licensure as either an insurer or HMO in certain states. The National Association of Insurance Commissioners (the "NAIC") has undertaken a comprehensive review of the regulatory status of entities arranging for the provision of healthcare services through a network of providers that, like the Company, may assume risk for the cost and quality of healthcare services, but that are not currently licensed as an HMO or similar entity. As a result of this review, the NAIC developed a "health organizations risk-based capital" formula, designed specifically for managed care organizations, that

establishes a minimum amount of capital necessary for a managed care organization to support its overall operations, allowing consideration for the organization's size and risk profile. The NAIC initiative also may result in the adoption of a model NAIC regulation in the area of health plan standards, which could be adopted by individual states in whole or in part, and could result in the Company being required to meet additional or new standards in connection with its existing operations. Individual states have also recently adopted their own regulatory initiatives that subject entities such as the Company to regulation under state insurance laws. This includes, but is not limited to, requiring licensure as an insurance company or HMO and requiring adherence to specific financial solvency standards. State insurance laws and regulations may limit the ability of the Company to pay dividends, make certain investments and repay certain indebtedness. Licensure as an insurance company, HMO or similar entity could also subject the Company to regulations governing reporting and disclosure, mandated benefits, rate setting, and other traditional insurance regulatory requirements. PPO regulations to which the Company may be subject may require the Company to register with a state authority and provide information concerning its operations, particularly relating to provider and payor contracting. The imposition of such requirements could increase the Company's cost of doing business and could delay the Company's conduct or expansion of its business in some areas. The licensure process under state insurance laws can be lengthy and, unless the applicable state regulatory agency allows the Company to continue to operate while the licensure process is ongoing, the Company could experience a material adverse effect on its operating results and financial condition while its licensure application is pending. In addition, failure by the Company to obtain and maintain required licenses typically also constitutes an event of default under the Company's contracts with its customers. The loss of business from one or more of the Company's major customers as a result of such an event of default or otherwise could have a material adverse effect on the Company.

UTILIZATION REVIEW AND THIRD-PARTY ADMINISTRATOR ACTIVITIES. Numerous states in which the Company does business have adopted, or are expected to adopt, regulations governing entities engaging in utilization review and TPA activities. Utilization review regulations typically impose requirements with respect to the qualifications of personnel reviewing proposed treatment, timeliness and notice of the review of proposed treatment, and other matters. TPA regulations typically impose requirements regarding claims processing and payments and the handling of customer funds. Utilization review and TPA regulations may increase the Company's cost of doing business in the event that compliance requires the Company to retain additional personnel to meet the regulatory requirements and to take other required actions and make necessary filings. Although compliance with utilization review regulations has not had a material adverse effect on the Company, there can be no assurance that specific regulations adopted in the future would not have such a result, particularly since the nature, scope and specific requirements of such provisions vary considerably among states that have adopted regulations of this type.

There is a trend among states to require licensure or certification of entities performing utilization review or TPA activities; however, certain federal courts have held that such licensure requirements are preempted by the Employee Retirement Income Security Act of 1974, as amended, ("ERISA"). ERISA preempts state laws that mandate employee benefit structures or their administration, as well as those that provide alternative enforcement mechanisms. The Company believes that its TPA activities performed for its self-insured employee benefit plan customers are exempt from otherwise applicable state licensing or registration requirements based upon federal preemption under ERISA and has relied on this general principle in determining not to seek licensure for certain of its activities in many states. Existing case law is not uniform on the applicability of ERISA preemption with respect to state regulation of utilization review or TPA activities. There can be no assurance that additional licensure will not be required with respect to utilization review or TPA activities in certain states.

"ANY WILLING PROVIDER" LAWS. Several states in which the Company does business have adopted, or are expected to adopt, "any willing provider" laws. Such laws typically impose upon insurance companies, PPOs, HMOs or other types of third-party payors an obligation to contract with, or pay for the services of, any healthcare provider willing to meet the terms of the payor's contracts with similar providers.

Compliance with any willing provider laws could increase the Company's costs of assembling and administering provider networks and could, therefore, have a material adverse effect on its operations.

LICENSING OF HEALTHCARE PROFESSIONALS. The provision of behavioral healthcare treatment services by psychiatrists, psychologists and other providers is subject to state regulation with respect to the licensing of healthcare professionals. In addition, the oversight supervision and case management of the human services business is subject to similar regulation requiring licensure or accreditation of personnel performing such functions. The Company believes that the healthcare professionals who provide behavioral healthcare treatment on behalf of or under contracts with the Company and the case managers and other personnel of the health services business are in compliance with the applicable state licensing requirements and current interpretations thereof; however, there can be no assurance that changes in such state licensing requirements or interpretations thereof will not adversely affect the Company's existing operations or limit expansion. With respect to the Company's crisis intervention program, additional licensure of clinicians who provide telephonic assessment or stabilization services to individuals who are calling from out-of-state may be required if such assessment or stabilization services are deemed by regulatory agencies to be treatment provided in the state of such individual's residence. The Company believes that any such additional licensure could be obtained; however, there can be no assurance that such licensing requirements will not adversely affect the Company's existing operations or limit expansion.

PROHIBITION ON FEE SPLITTING AND CORPORATE PRACTICE OF PROFESSIONS. The laws of some states limit the ability of a business corporation to directly provide, control or exercise excessive influence over behavioral healthcare services through the direct employment of psychiatrists, psychologists, or other behavioral healthcare professionals, who are providing direct clinical services. In addition, the laws of some states prohibit psychiatrists, psychologists, or other healthcare professionals from splitting fees with other persons or entities. These laws and their interpretations vary from state to state and enforcement by the courts and regulatory authorities may vary from state to state and may change over time. The Company believes that its operations as currently conducted are in material compliance with the applicable laws, however, there can be no assurance that the Company's existing operations and its contractual arrangements with psychiatrists, psychologists and other healthcare professionals will not be successfully challenged under state laws prohibiting fee splitting or the practice of a profession by an unlicensed entity, or that the enforceability of such contractual arrangements will not be limited. The Company believes that it could, if necessary, restructure its operations to comply with changes in the interpretation or enforcement of such laws and regulations, and that such restructuring would not have a material adverse effect on its operations.

DIRECT CONTRACTING WITH LICENSED INSURERS. Regulators in several states in which the Company does business have adopted policies that require HMOs or, in some instances, insurance companies, to contract directly with licensed healthcare providers, entities or provider groups, such as IPAs, for the provision of treatment services, rather than with unlicensed intermediary companies. In such states, the Company's customary model of contracting directly with its customers may need to be modified so that, for example, the IPAs (rather than the Company) contract directly with the HMO or insurance company, as appropriate, for the provision of treatment services. The Company intends to work with a number of these HMO customers to restructure existing contractual arrangements, upon contract renewal or in renegotiations, so that the entity which contracts with the HMO directly is an IPA. The Company does not expect this method of contracting to have a material adverse effect on its operations.

CONFIDENTIALITY AND PATIENT PRIVACY. Confidentiality and patient privacy requirements are particularly strict in the field of behavioral healthcare services, and additional legislative initiatives relating to confidentiality and privacy are expected. The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") requires the Secretary of the Department of Health and Human Services ("HHS") to adopt standards relating to the transmission of health information by healthcare providers and healthcare plans. HIPAA calls for HHS to create regulations in several different areas to address security, privacy and

administrative simplification. The regulations specifically relate to electronic transactions and code sets, security and electronic signatures, privacy, provider and employer IDs as well as health plan and individual IDs. While only the regulations relating to electronic transactions and code sets section are final, other areas of the regulations are expected to be finalized in the next few months. The regulations go into effect 26 months after they are released, with a deadline to implement the regulations governing electronic transaction and code sets by October 16, 2002. On November 3, 1999, the Secretary promulgated proposed regulations to protect the privacy of such health information that is electronically transmitted or maintained. In addition, on August 17, 2000, HHS published a final rule establishing standard data content and formats for the submission of electronic claims and other administrative and health transactions. The wide reaching implications of these regulations are beginning to be addressed now to ensure the Company's compliance with the regulations by the implementation dates. These regulations, while creating a need for some software changes, present more business and policy issues rather than technology issues. The regulations will require changes to the Company's provider contracts, as well as the creation of new policies for transmitting patient information to ensure that the new privacy and electronic security measures are satisfied. In some cases, these changes will mean executing chain of trust agreements with business partners and ensuring that encryption technology is used when transmitting electronic files. In addition, the Company's systems must be equipped to handle both the electronic transactions governed by the regulations, as well as paper transactions, which are not affected by the regulations and to manage different sets of data depending on whether the transaction is electronic or paper in nature. While the Company believes it has existing systems and policies in place in many instances that will assist in the Company's compliance, the Company expects that significant resources will be required over the next two years to ensure compliance.

REGULATION OF CUSTOMERS. Regulations imposed upon the Company's customers include, among other things, benefits mandated by statute, exclusions from coverages prohibited by statute, procedures governing the payment and processing of claims, record keeping and reporting requirements, requirements for and payment rates applicable to coverage of Medicaid and Medicare beneficiaries, provider contracting and enrollee rights, and confidentiality requirements. Although the Company believes that such regulations do not at present materially impair the Company's operations, there can be no assurance that such indirect regulation will not have a material adverse effect on the Company in the future.

ERISA. Certain of the Company's services are subject to the provisions of ERISA. ERISA governs certain aspects of the relationship between employer-sponsored healthcare benefit plans and certain providers of services to such plans through a series of complex laws and regulations that are subject to periodic interpretation by the Internal Revenue Service and the Department of Labor. In some circumstances, and under certain customer contracts, the Company may be expressly named as a "fiduciary" under ERISA, or be deemed to have assumed duties that make it an ERISA fiduciary, and thus be required to carry out its operations in a manner that complies with ERISA requirements in all material respects. Although the Company believes that it is in material compliance with the applicable ERISA requirements and that such compliance does not currently have a material adverse effect on the Company's operations, there can be no assurance that continuing ERISA compliance efforts or any future changes to the applicable ERISA requirements will not have a material adverse effect on the Company.

OTHER PROPOSED LEGISLATION. In the last five years, legislation has periodically been introduced at the state and federal level providing for new healthcare regulatory programs and materially revising existing healthcare regulatory programs. Any such legislation, if enacted, could materially adversely affect the Company's business, financial condition or results of operations. Such legislation could include both federal and state bills affecting the Medicaid programs which may be pending in or recently passed by state legislatures and which are not yet available for review and analysis. Such legislation could also include proposals for national health insurance and other forms of federal regulation of health insurance and healthcare delivery. It is not possible at this time to predict whether any such legislation will be adopted at the federal or state level, or the nature, scope or applicability to the Company's business of any such

legislation, or when any particular legislation might be implemented. No assurance can be given that any such federal or state legislation will not have a material adverse effect on the Company.

REGULATION OF HUMAN SERVICES. The human services business is subject to certain state laws, regulations, and/or requirements with respect to its services, including those governing: (i) the licensing of child placement agencies; (ii) the registration or certification of Medicaid participating providers; and (iii) a state's authorization or recognition of a provider's capacity to deliver services to adults with developmental disabilities and/or mental retardation. These laws and regulations vary considerably among states and the Company may be subject to different types of laws and regulations depending on the specific regulatory approach adopted by each state to regulate the provision of these services.

OTHER REGULATION OF HEALTHCARE PROVIDERS. The Company's business is affected indirectly by regulations imposed upon healthcare providers. Regulations imposed upon healthcare providers include provisions relating to the conduct of, and ethical considerations involved in, the practice of psychiatry, psychology, social work and related behavioral healthcare professions and, in certain cases, the common law duty to warn others of danger or to prevent patient self-injury.

CAUTIONARY STATEMENTS

This Form 10-K includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (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 below and elsewhere in this Form 10-K. 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 below.

LEVERAGE AND DEBT SERVICE OBLIGATIONS. The Company is currently highly leveraged, with indebtedness that is substantial in relation to its stockholders' equity. As of September 30, 2000, the Company's aggregate outstanding indebtedness was approximately $1.1 billion and the Company's stockholders' equity was approximately $128.5 million. The Credit Agreement and the Indenture permit the Company to incur or guarantee certain additional indebtedness, subject to certain limitations.

The Company's high degree of leverage could have important consequences to the Company, including, but not limited to, the following: (i) the Company's ability to obtain additional financing for working capital, capital expenditures, acquisitions, general corporate purposes or other purposes may be impaired in the future; (ii) a substantial portion of the Company's cash flows from operations must be dedicated to the payment of principal and interest on its indebtedness; (iii) the Company is substantially more leveraged than certain of its competitors, which might place the Company at a competitive disadvantage; (iv) the Company may be hindered in its ability to adjust rapidly to changing market conditions and (v) the Company's high degree of leverage could make it more vulnerable in the event of a downturn in general economic conditions or its business or in the event of adverse changes in the regulatory environment or other adverse circumstances applicable to the Company.

The Company's ability to repay or to refinance its indebtedness and to pay interest on its indebtedness will depend on its financial and operating performance, which, in turn, is subject to prevailing economic and competitive conditions and to certain financial, business and other factors, many of which are beyond the Company's control. These factors could include operating difficulties, increased operating costs, the actions of competitors, regulatory developments and delays in implementing strategic projects. The Company's ability to meet its debt service and other obligations may depend in significant part on the extent to which the Company can successfully implement its business strategy. There can be no assurance

that the Company will be able to implement its strategy fully or that the anticipated results of its strategy will be realized. See "Business--Business Strategy."

If the Company's cash flows and capital resources are insufficient to fund its debt service obligations, the Company may be forced to reduce or delay capital expenditures, sell assets or seek to obtain additional equity capital or to restructure its debt. There can be no assurance that the Company's cash flows and capital resources will be sufficient for payment of principal of and interest on its indebtedness in the future, or that any such alternative measures would be successful or would permit the Company to meet its scheduled debt service obligations.

In addition, because the Company's obligations under the Credit Agreement bear interest at floating rates, an increase in interest rates could adversely affect, among other things, the Company's ability to meet its debt service obligations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Outlook--Results of Operations."

RESTRICTIVE FINANCING COVENANTS. The Credit Agreement and the Indenture contain a number of covenants that restrict the operations of the Company and its subsidiaries. In addition, the Credit Agreement, as amended, requires the Company to comply with specified financial ratios and tests, including a minimum interest coverage ratio, a maximum leverage ratio, a minimum net worth test, a maximum senior debt ratio and a minimum "EBITDA" test (as defined in the Credit Agreement, as amended). There can be no assurance that the Company will be able to comply with such covenants, ratios and tests in the future. The Company's ability to comply with such covenants, ratios and tests may be affected by events beyond its control, including prevailing economic, financial and industry conditions. The breach of any such covenants, ratios or tests could result in a default under the Credit Agreement that would permit the lenders to declare all amounts outstanding thereunder to be immediately due and payable, together with accrued and unpaid interest, and to prevent the Company from paying principal, premium, interest or other amounts due on any or all of the Notes until the default is cured or all senior indebtedness is paid or satisfied in full. Furthermore, the commitments of the lenders under the Credit Agreement to make further extensions of credit thereunder could be terminated. If the Company were unable to repay all amounts accelerated, the lenders could proceed against the subsidiary guarantors and the collateral securing the Company's and the subsidiary guarantors' obligations pursuant to the Credit Agreement. If the indebtedness outstanding pursuant to the Credit Agreement were to be accelerated, there can be no assurance that the assets of the Company would be sufficient to repay such indebtedness and the other indebtedness of the Company. The value of the Company's common stock would be adversely affected if the Company were unable to repay such indebtedness.

RISK-BASED PRODUCTS. Revenues under risk-based contracts are the primary source of the Company's revenue from its behavioral managed healthcare business. Such revenues accounted for approximately 77.6% of the Company's total revenue and approximately 87.8% of its behavioral managed healthcare revenue in fiscal 2000. Under a risk-based contract, the Company assumes all or a portion of the responsibility for the cost of providing a full or specified range of behavioral healthcare treatment services to a specified beneficiary population in exchange, generally, for a fixed fee per member per month. 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 aggregate cost of behavioral healthcare treatment services provided to a given beneficiary population in a given period exceeds the aggregate of the per member per month fees received by the Company with respect to the beneficiary population in such period, the Company will incur a loss with respect to such beneficiary population during such period. Furthermore, the Company may be required to pay during any period amounts with respect to behavioral healthcare treatment services provided to a given beneficiary population that exceed per member per month fees received with respect to such beneficiary population during the same period. There can be no assurance that the Company's assumptions as to service utilization rates and costs will accurately and adequately reflect actual utilization rates and costs, nor can there be any assurance that increases in behavioral healthcare costs or

higher-than-anticipated utilization rates, significant aspects of which are outside the Company's control, will not cause expenses associated with such contracts to exceed the Company's revenue for such contracts. In addition, there can be no assurance that adjustments will not be required to the estimates, particularly those regarding cost of care, made in reporting historical financial results. See Note 1 to the audited consolidated financial statements of the Company included elsewhere herein. The Company expects to attempt to increase membership in its risk-based products. If the Company is successful in this regard, the Company's exposure to potential losses from its risk-based products will also be increased. Furthermore, certain of such contracts and certain state regulations limit the profits that may be earned by the Company on risk-based business and may require refunds if the loss experience is more favorable than that originally anticipated. Such contracts and regulations may also require the Company or certain of its subsidiaries to reserve a specified amount of cash as financial assurance that it can meet its obligations under such contracts. As of September 30, 2000, the Company had restricted cash and investments of $117.7 million pursuant to such contracts and regulations. Such amounts will not be available to the Company for general corporate purposes. Furthermore, certain state regulations restrict the ability of subsidiaries that offer risk-based products to pay dividends to the Company. Certain state regulations relating to the licensing of insurance companies may also adversely affect the Company's risk-based business. See "Business Regulation." Although experience varies on a contract-by-contract basis, historically, the Company's risk-based contracts have been profitable. However, the degree of profitability varies significantly from contract to contract. For example, the Company's Medicaid contracts with governmental entities generally tend to have direct profit margins that are lower than the Company's other contracts. The most significant factor affecting the profitability of risk-based contracts is the ability to control direct service costs in relation to contract pricing.

RELIANCE ON CUSTOMER CONTRACTS. Approximately 88.3% of the Company's revenue in fiscal 2000 was derived from contracts with payors of behavioral healthcare benefits. The Company's behavioral managed healthcare contracts typically have terms of one to three years, and in certain cases contain renewal provisions providing for successive terms of between one and two years (unless terminated earlier). Substantially all of these contracts are immediately terminable with cause and many, including some of the Company's most significant contracts, are terminable without cause by the customer upon the provision of requisite notice and the passage of a specified period of time (typically between 60 and 180 days), or upon the occurrence of certain other specified events. The Company's ten largest behavioral managed healthcare customers accounted for approximately 56.6% of the Company's behavioral managed healthcare revenue for fiscal 2000. Both the Company and Premier Behavioral Systems of Tennessee, LLC ("Premier"), in which the Company has a fifty percent interest, separately contract with the State of Tennessee to manage the behavioral healthcare benefits for the State's TennCare program. The Company's direct Contract (exclusive of Premier) represented approximately 13.7% of the Company's behavioral managed healthcare revenue and approximately 12.1% of the Company's consolidated revenue in fiscal 2000. The Company's managed behavioral contracts with Aetna, including Nylcare and Prudential, which were acquired by Aetna in July 1998 and August 1999, respectively, represented approximately 17.2% of the Company's behavioral managed healthcare revenue and approximately 15.2% of the Company's consolidated revenue in fiscal 2000. The current TennCare and Aetna contracts extend through December 31, 2000 and December 31, 2003, respectively. The Company is in the process of renegotiating its TennCare contract. There can be no assurance that such contracts will be extended or successfully renegotiated or that the terms of any new contracts will be comparable to those of existing contracts. Loss of all of these contracts or customers would, and loss of any one of these customers could, have a material adverse effect on the Company. In addition, price competition in bidding for contracts can significantly affect the financial terms of any new or renegotiated contract.

DEPENDENCE ON GOVERNMENT SPENDING FOR HEALTHCARE; POSSIBLE IMPACT OF HEALTHCARE REFORM. A significant portion of the Company's revenue is derived, directly or indirectly, from federal, state and local governmental agencies, including state Medicaid programs. Reimbursement rates vary from state to state, are subject to periodic negotiation and may limit the Company's ability to maintain or increase rates. The

Company is unable to predict the impact on the Company's operations of future regulations or legislation affecting Medicaid or Medicare programs, or the healthcare industry in general, and there can be no assurance that future regulations or legislation will not have a material adverse effect on the Company. Moreover, any reduction in government spending for such programs could also have a material adverse effect on the Company. In addition, the Company's contracts with federal, state and local governmental agencies, under both direct contract and subcontract arrangements, generally are conditioned upon financial appropriations by one or more governmental agencies, especially with respect to state Medicaid programs. These contracts generally can be terminated or modified by the customer if such appropriations are not made. Finally, some of the Company's contracts with federal, state and local governmental agencies, under both direct contract and subcontract arrangements, require the Company to perform additional services if federal, state or local laws or regulations imposed after the contract is signed so require, in exchange for additional compensation to be negotiated by the parties in good faith. Government and other third-party payors are generally seeking to impose lower reimbursement rates and to renegotiate reduced contract rates with service providers in a trend toward cost control. See "Business--Industry--Areas of Growth" and "Business--Business Strategy."

The House of Representatives of the U.S. Congress recently passed the Norwood-Dingell bill which would (if it or similar legislation became law), among other things, place limits on healthcare plans, methods of operations, limit employers' and health care plans' ability to define medical necessity and permit employers and health care plans to be sued in state courts for coverage determinations. It is uncertain whether the Company could recoup, through higher premiums or other measures, the increased costs of federally mandated benefits or other increased costs caused by such legislation or similar legislation. The Company cannot predict the effect of this legislation, nor other legislation that may be adopted by Congress, and no assurance can be given that such legislation will not have an adverse effect on the Company.

REGULATION. The healthcare industry and the provision of behavioral healthcare and human services are subject to extensive and evolving state and federal regulation. The Company is subject to certain state laws and regulations, including those governing: (i) the licensing of insurance companies, HMOs, PPOs, TPAs and companies engaged in utilization review and (ii) the licensing of healthcare professionals, including restrictions on business corporations from practicing, controlling or exercising excessive influence over behavioral healthcare services through the direct employment of psychiatrists or, in a few states, psychologists and other behavioral healthcare professionals. In addition, the Company is subject to certain federal laws as a result of the role the Company assumes in connection with managing its customers' employee benefit plans. The Company's managed care operations are also indirectly affected by regulations applicable to the establishment and operation of behavioral healthcare clinics and facilities.

In many states, entities that assume risk under contracts with licensed insurance companies or HMOs have not been considered by state regulators to be conducting an insurance or HMO business. As a result, the Company has not sought licensure as either an insurer or HMO in certain states. Regulators in some states, however, have determined that risk assuming activity by entities that are not themselves providers of care is an activity that requires some form of licensure. There can be no assurance that other states in which the Company operates will not adopt a similar view, thus requiring the Company to obtain additional licenses. Such additional licensure might require the Company to maintain minimum levels of deposits, net worth, capital, surplus or reserves, or limit the Company's ability to pay dividends, make investments or repay indebtedness. The imposition of these additional licensure requirements could increase the Company's cost of doing business or delay the Company's conduct or expansion of its business.

Regulators may impose operational restrictions on entities granted licenses to operate as insurance companies or HMOs. For example, the California Department of Corporations ("DOC") imposed certain restrictions on the Company in connection with its issuance of an approval of the Company's acquisitions of HAI and Merit, including restrictions on the ability of the California subsidiaries of HAI and Merit to

fund the Company's operations in other states and on the ability of the Company to make certain operational changes with respect to HAI and Merit California subsidiaries.

In addition, utilization review and TPA activities conducted by the Company are regulated by many states, which states impose requirements upon the Company that increase its business costs. The Company believes that its TPA activities performed for its self-insured employee benefit plan customers are exempt from otherwise applicable state licensing or registration requirements based upon federal preemption under ERISA, and has relied on this general principle in determining not to seek licensure for certain of its activities in many states. Existing case law is not uniform on the applicability of ERISA preemption with respect to state regulation of utilization review or TPA activities. There can be no assurance that additional licensure will not be required with respect to utilization review or TPA activities in certain states. See "Business--Regulation--Insurance, HMO, and PPO Activities" and "--Utilization Review and Third-Party Administrator Activities."

State regulatory agencies responsible for the administration and enforcement of the laws and regulations to which the Company's operations are subject have broad discretionary powers. A regulatory agency or a court in a state in which the Company operates could take a position under existing or future laws or regulations, or change its interpretation or enforcement practices with respect thereto, that such laws or regulations apply to the Company differently than the Company believes such laws and regulations apply or should be enforced. The resultant compliance with, or revocation of, or failure to obtain, required licenses and governmental approvals could result in significant alteration to the Company's business operations, delays in the expansion of the Company's business and lost business opportunities, any of which, under certain circumstances, could have a material adverse effect on the Company.

The laws of some states limit the ability of a business corporation to directly provide, control or exercise excessive influence over behavioral healthcare services through the direct employment of psychiatrists, psychologists, or other behavioral healthcare professionals. In addition, the laws of some states prohibit psychiatrists, psychologists, or other healthcare professionals from splitting fees with other persons or entities. These laws and their interpretations vary from state to state and enforcement by the courts and regulatory authorities may vary from state to state and may change over time. The Company believes that its operations as currently conducted are in material compliance with the applicable laws, however there can be no assurance that the Company's existing operations and its contractual arrangements with psychiatrists, psychologists and other healthcare professionals will not be successfully challenged under state laws prohibiting fee splitting or the practice of a profession by an unlicensed entity, or that the enforceability of such contractual arrangements will not be limited. The Company believes that it could, if necessary, restructure its operations to comply with changes in the interpretation or enforcement of such laws and regulations, and that such restructuring would not have a material adverse effect on its operations.

Confidentiality and patient privacy requirements are particularly strict in the field of behavioral healthcare services, and additional legislative initiatives relating to confidentiality and privacy are expected. HIPAA requires the HHS to adopt standards relating to the transmission of health information by healthcare providers and healthcare plans. HIPAA calls for HHS to create regulations in several different areas to address security, privacy and administrative simplification. The regulations specifically relate to electronic transactions and code sets, security and electronic signatures, privacy, provider and employer IDs as well as health plan and individual IDs. While only the regulations relating to electronic transactions and code sets section are final, other areas of the regulations are expected to be finalized in the next few months. The regulations go into effect 26 months after they are released, with a deadline to implement the regulations governing electronic transaction and code sets by October 16, 2002. On November 3, 1999, the Secretary promulgated proposed regulations to protect the privacy of such health information that is electronically transmitted or maintained. In addition, on August 17, 2000, HHS published a final rule establishing standard data content and formats for the submission of electronic claims and other administrative and health transactions. The wide reaching implications of these regulations are beginning to be

addressed now to ensure the Company's compliance with the regulations by the implementation dates. These regulations, while creating a need for some software changes, present more business and policy issues rather than technology issues. The regulations will require changes to the Company's provider contracts, as well as the creation of new policies for transmitting patient information to ensure that the new privacy and electronic security measures are satisfied. In some cases, these changes will mean executing chain of trust agreements with business partners and ensuring that encryption technology is used when transmitting electronic files. In addition, the Company's systems must be equipped to handle both the electronic transactions governed by the regulations, as well as paper transactions, which are not affected by the regulations and to manage different sets of data depending on whether the transaction is electronic or paper in nature. While the Company believes it has existing systems and policies in place in many instances that will assist in the Company's compliance, the Company expects that significant resources will be required over the next two years to ensure compliance.

Several states in which the Company does business have adopted, or are expected to adopt, "any willing provider" laws. Such laws typically impose upon insurance companies, PPOs, HMOs or other types of third-party payors an obligation to contract with, or pay for the services of, any healthcare provider willing to meet the terms of the payor's contracts with similar providers. Compliance with any willing provider laws could increase the Company's costs of assembling and administering provider networks and could, therefore, have a material adverse effect on its operations.

HIGHLY COMPETITIVE INDUSTRY. The industry in which the Company conducts its managed care businesses is highly competitive. The Company competes with large insurance companies, HMOs, PPOs, TPAs, provider groups and other managed care companies. Many of the Company's competitors are significantly larger and have greater financial, marketing and other resources than the Company, and some of the Company's competitors provide a broader range of services. The Company may also encounter substantial competition in the future from new market entrants. Many of the Company's customers that are managed care companies may, in the future, seek to provide behavioral managed healthcare services to their employees or subscribers directly, rather than contracting with the Company for such services. See "Business--Competition."

RISKS RELATED TO AMORTIZATION OF INTANGIBLE ASSETS. The Company's total assets at September 30, 2000 reflect goodwill of approximately $1.1 billion, which is amortized over 25 to 40 years, and other identifiable intangible assets (primarily customer lists, provider networks and treatment protocols) of approximately $152.0 million that are amortized over 4 to 30 years. At September 30, 2000, net intangible assets were 68.0% of total assets of $1.8 billion. The amortization periods used by the Company may differ from those used by other entities. In addition, the Company may be required to shorten the amortization period for intangible assets in future periods based on the prospects of acquired companies. There can be no assurance that the value of such assets will ever be realized by the Company. The Company evaluates, on a regular basis, whether events and circumstances have occurred that indicate that all or a portion of the carrying value of intangible assets may no longer be recoverable, in which case a charge to earnings for impairment losses could become necessary. During fiscal 2000 the Company recorded a $91.0 million impairment charge. This charge related to the write-down of certain long-lived assets of the Company's specialty managed healthcare segment and the Company's Group Practice Affiliates subsidiary (GPA). See Note 3--"Discontinued Operations" and Note 10--"Managed Care Integration Plan and Costs and Special Charges", to the Company's audited consolidated financial statements included elsewhere herein. Any determination requiring additional write-offs of a significant portion of unamortized intangible assets would adversely affect the Company's results of operations. A write-off of intangible assets could become necessary if the anticipated undiscounted cash flows of an acquired company do not support the carrying value of long-lived assets, including intangible assets.

PROFESSIONAL LIABILITY; INSURANCE. The management and administration of the delivery of behavioral and specialty managed healthcare services and human services, like other healthcare services, entail

significant risks of liability. The Company is regularly subject to lawsuits alleging malpractice and related legal theories, some of which involve situations in which participants in the Company's behavioral programs have committed suicide. The Company is also subject to claims of professional liability for alleged negligence in performing utilization review activities, as well as for acts and omissions of independent contractors participating in the Company's third-party provider networks. The Company is subject to claims for the costs of services for which payment was denied. There can be no assurance that the Company's procedures for limiting liability have been or will be effective, or that one or more lawsuits will not have a material adverse effect on the Company in the future.

Recently, certain managed healthcare companies, including the Company, have been targeted as defendants in several national class action lawsuits regarding their business practices. These class action complaints include (i) inadequate disclosure of provider compensation arrangements to members, (ii) misrepresentation and omissions in advertising and health plan materials and (iii) concealment of information from health plan members used to determine what claims will be paid, procedures to determine medical necessity and procedures to determine the extent and type of coverage. The Company believes that these national class action lawsuits are part of a trend targeting the healthcare industry, particularly managed care companies. There can be no assurance that such lawsuits, which are generally uninsured, won't have a material adverse effect on the Company.

The Company carries professional liability insurance, subject to certain deductibles. There can be no assurance that such insurance will be sufficient to cover any judgments, settlements or costs relating to present or future claims, suits or complaints or that, upon expiration thereof, sufficient insurance will be available on favorable terms, if at all. If the Company is unable to secure adequate insurance in the future, or if the insurance carried by the Company is not sufficient to cover any judgments, settlements or costs relating to any present or future actions or claims, there can be no assurance that the Company will not be subject to a liability that could have a material adverse effect on the Company. See "Business--Insurance" and "Legal Proceedings."

The Company has certain potential liabilities relating to the self-insurance program it maintained with respect to its provider business prior to the Crescent Transactions. In addition, the Company continues to be subject to governmental investigations and inquiries, civil suits and other claims and assessments with respect to the provider business. See "Legal Proceedings" and Note 12--"Commitments and Contingencies", to the Company's audited consolidated financial statements included elsewhere herein.

EXECUTIVE OFFICERS OF THE REGISTRANT

NAME	AGE	POSITION
Henry T. Harbin, M.D.	53	President, Chief Executive Officer and Director
Daniel S. Messina	45	Executive Vice President, Chief Operating Officer and Director
Mark S. Demilio	45	Executive Vice President, Finance and Legal
Clarissa C. Marques, Ph.D.	48	Executive Vice President and Chief Administrative Officer
Dennis P. Moody	43	Executive Vice President, Business Operations

HENRY T. HARBIN, M.D. became President, Chief Executive Officer and a Director of the Company on March 18, 1998. Dr. Harbin served as President and Chief Executive Officer of Green Spring from 1994 to 1998. Dr. Harbin served as Executive Vice President of the Company from 1995 until becoming President and

Chief Executive Officer of the Company.

DANIEL S. MESSINA became Executive Vice President and Chief Operating Officer in September 2000. Prior to joining the Company, Mr. Messina was chief financial officer and head of business strategy for Aetna U.S. Healthcare in Hartford, Connecticut from February 1990 to September 2000. Mr. Messina has also served on the Board of Directors of the Company since 1998.

MARK S. DEMILIO became Executive Vice President, Finance and Legal of the Company in November 2000. Mr. Demilio served as Executive Vice President and General Counsel from July 1999. Prior thereto, Mr. Demilio was with Youth Services International, Inc., a publicly traded company that managed facilities for adjudicated youth, serving as Executive Vice President Business Development and General Counsel from March 1997 and Acting Chief Financial Officer from June 1998. Mr. Demilio was a partner with Miles & Stockbridge, a Baltimore, Maryland-based law firm, from 1994 to March 1997 and served as an associate with that firm from 1989.

CLARISSA C. MARQUES, PH.D. became Executive Vice President and Chief Adminsitrative Officer in June 2000. Prior thereto, Dr. Marques served as the Executive Vice President and Clinical and Quality Management since March 1998. Dr. Marques serviced as the Executive Vice President and Chief Clinical Officer of Green Spring during 1997 and 1998 and Senior Vice President of Green Spring from 1992 to 1997.

DENNIS P. MOODY became Executive Vice President of Business Operations in October 2000. Prior thereto, Mr. Moody served as President and Chief Operating Officer of the Health Plan Solutions Group since February 1998. Mr. Moody previously held the following positions with Merit from 1991 through 1997: Executive Vice President, National Business (1997), Executive Vice President, National Services (1995 - 1996), Executive Vice President, Regional Operations (1994 - 1995), and Regional Vice President (1991 - 1994).

EMPLOYEES OF THE REGISTRANT

At September 30, 2000, the Company had approximately 12,800 full-time and part-time employees. The Company believes it has satisfactory relations with its employees.

ITEM 2. PROPERTIES

The Company's principal executive offices are located in Columbia, Maryland; the lease for the Company's headquarters expires in 2003. Additionally, the Company leases 158 offices with terms expiring between 2000 and 2008.

ITEM 3. LEGAL PROCEEDINGS

The management and administration of the delivery of behavioral managed healthcare services, and the direct provision of behavioral healthcare treatment services, entail significant risks of liability. From time to time, the Company is subject to various actions and claims arising from the acts or omissions of its employees, network providers or other parties. In the normal course of business, the Company receives reports relating to suicides and other serious incidents involving patients enrolled in its programs. Such incidents occasionally give rise to malpractice, professional negligence and other related actions and claims against the Company or its network providers. As the number of lives covered by the Company grows and the number of providers under contract increases, actions and claims against the Company (and, in turn, possible legal liability) predicated on malpractice, professional negligence or other related legal theories can be expected to increase. See "Business Cautionary Statements--Professional Liability; Insurance." Many of these actions and claims received by the Company seek substantial damages and therefore require the defendant to incur significant fees and costs related to their defense. To date, claims and actions against the Company alleging professional negligence have not resulted in material liabilities and the Company does not believe that any pending action against it will have a material adverse effect on the Company. However, there can be no assurance that pending or future actions or claims for professional liability (including any judgments, settlements or costs associated therewith) will not have a material adverse effect on the Company. See "--Insurance" and "Cautionary Statements--Professional Liability; Insurance."

From time to time, the Company receives notifications from and engages in discussions with various governmental agencies concerning its respective managed care businesses and operations. As a result of these contacts with regulators, the Company in many instances implements changes to its operations, revises its filings with such agencies and/or seeks additional licenses to conduct its business. In recent years, in response to governmental agency inquiries or discussions with regulators, the Company has determined to seek licensure as a single service HMO, TPA or utilization review agent in one or more jurisdictions.

The healthcare industry is subject to numerous laws and regulations. The subjects of such laws and regulations include, but are not limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and/or allegations concerning possible violations of fraud and abuse and false claims statutes and/or regulations by healthcare providers. Entities that are found to have violated these laws and regulations may be excluded from participating in government healthcare programs, subjected to fines or penalties or required to repay amounts received from the government for previously billed patient services. The Office of the Inspector General of the Department of Health and Human Services and the United States Department of Justice ("Department of Justice") and certain other governmental agencies are currently conducting inquiries and/or investigations regarding the compliance by the Company and certain of its subsidiaries with such laws and regulations. Certain of the inquiries relate to the operations and business practices of the Psychiatric Hospital Facilities prior to the consummation of the Crescent Transactions in June 1997. The Department of Justice has indicated that its inquiries are based on its belief that the federal government has certain civil and administrative causes of action under the Civil False Claims Act, the Civil Monetary Penalties Law, other federal statutes and the common law arising from the participation in federal health benefit programs of The Psychiatric Hospital Facilities nationwide. The Department of Justice inquiries relate to the following matters: (i) Medicare cost reports; (ii) Medicaid cost statements; (iii) supplemental applications to CHAMPUS (as defined) based on Medicare cost reports; (iv) medical necessity of services to patients and admissions; (v) failure to provide medically necessary treatment or admissions; and (vi) submission of claims to government payors for inpatient and outpatient psychiatric services. No amounts related to such proposed causes of action have yet been specified. The Company cannot reasonably estimate the settlement amount, if any, associated with the Department of Justice inquiries. Accordingly, no reserve has been recorded related to this matter.

Five affiliated outpatient clinic providers that are participating providers in the TennCare program asserted claims against Green Spring Health Services, Inc., a wholly-owned subsidiary of the Company ("Green Spring") and Premier, the joint venture that contracts with the State of Tennessee to manage services under the TennCare program and in which the Company holds a 50% interest, alleging that Premier and Green Spring failed to pay the providers in accordance with their contracts. The claims allege losses of in excess of $16.0 million in the aggregate and are proceeding in five separate arbitrations. On December 8, 2000 the Chancery Court of Davidson County, Tennessee entered a judgment confirming an arbitration award against Premier and Green Spring in the amount of $3.7 million in favor of one of the providers. The Court denied a motion by Premier and Green Spring to vacate the arbitration award on grounds that the provider procured the award by fraud and that the arbitrators exceeded their authority. Premier and Green Spring believe that the Court's order was erroneous and intend to pursue vigorously an appeal of this judgment. The other arbitrations are at various stages of proceedings. The Company believes that adequate reserves have been recorded with respect to any potential loss in these matters.

On or about August 4, 2000, the Company was served with a lawsuit filed by Wachovia Bank, N.A. ("Wachovia") in the Court of Common Pleas of Richland County, South Carolina seeking recovery under the indemnification provisions of the Engagement Letter between South Carolina National Bank (now Wachovia) and the Company and the ESOP Trust Agreement between South Carolina National Bank (now Wachovia) and the Company for losses sustained in a settlement entered into by Wachovia with the United States Department of Labor in connection with the ESOP's purchase of stock of the Company while Wachovia served as ESOP Trustee. Wachovia also alleges fraud, negligent misrepresentation and other claims and asserts its losses exceed $30 million. While the claim is in the initial stage, and an outcome cannot be determined, the Company believes the claims of Wachovia are without merit and is defending them vigorously.

On October 26, 2000, two class action complaints (the "Class Actions") were filed against Magellan Health Services, Inc. and Magellan Behavioral Health, Inc. (the "Defendants") in the United States District Court for the Eastern District of Missouri under the Racketeer Influenced and Corrupt Organizations Act ("RICO") and the Employment Retirement Income Security Act of 1974 ("ERISA"). The class representatives purport to bring the actions on behalf of a nationwide class of individuals whose behavioral health benefits have been provided, underwritten and/or arranged by the Defendants since 1996. The complaints allege violations of RICO and ERISA arising out of the Defendants' alleged misrepresentations with respect to and failure to disclose, its claims practices, the extent of the benefits coverage and other matters that cause the value of benefits to be less than the amount of premium paid. The complaints seek unspecified compensatory damages, treble damages under RICO, and an injunction barring the alleged improper claims practices, plus interest, costs and attorneys' fees. These actions are similar to suits filed against a number of other health care organizations, elements of which have already been dismissed by various courts around the country. While the Class Actions are in the initial stages, and an outcome cannot be determined, the Company believes that the claims are without merit and intend to defend them vigorously.

The Company also is subject to or party to other litigation, claims, and civil suits relating to its operations and business practices. Certain of the Company's managed care litigation matters involve class action lawsuits, which allege (i) the Company inappropriately denied and/or failed to authorize benefits for mental health treatment under insurance policies with a customer of the Company and (ii) a provider at a Company facility violated privacy rights of certain patients. In addition, the Company is subject to certain contingencies in connection with the CBHS bankruptcy as discussed in Note 3--"Discontinued Operations" to the Company's audited consolidated financial statements set forth elsewhere herein. In the opinion of management, the Company has recorded reserves that are adequate to cover litigation and claims that have been or may be asserted against the Company, and for which the outcome is probable and reasonably estimable, arising out of such other litigation and claims. Furthermore, management believes that the resolution of such litigation and claims will not have a material adverse effect on the Company's financial position or results of operations; however, there can be no assurance in this regard.

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

None.

PART II

ITEM 5. MARKET PRICE FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company has one class of common stock, $0.25 par value per share, which is listed for trading on the New York Stock Exchange (ticker symbol "MGL"). As of December 22, 2000, there were 9,289 holders of record of the Company's common stock. The following table sets forth the high and low sales prices of the Company's common stock from October 1, 1998 through the fiscal year ended September 30, 2000 as reported by the New York Stock Exchange:

	COMMON STOCK SALES PRICES	
CALENDAR YEAR	HIGH	LOW
1998		
Fourth Quarter	10 3/4	6 3/8
1999		
First Quarter	11 1/8	4 3/16
Second Quarter	10	3 9/16
Third Quarter	10 1/2	6 7/8
Fourth Quarter	7 1/4	5 5/16
2000		
First Quarter	7 9/16	4 5/8
Second Quarter	4 13/16	1 15/16
Third Quarter	4	1 1/4

The Company did not declare any cash dividends during fiscal 1999 or 2000. As of December 22, 2000, the Company was prohibited from paying dividends on its common stock under the terms of the Credit Agreement, except in very limited circumstances.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected historical consolidated financial information of the Company for each of the five years in the period ended September 30, 2000. On September 2, 1999, the Company's Board of Directors approved a formal plan to dispose of the businesses included in the Company's healthcare provider and healthcare franchising segments and on September 10, 1999, the Company consummated such disposal. On October 4, 2000, the Company adopted a formal plan to dispose of the business included in the Company's specialty managed healthcare segment. Accordingly, the statement of operations data has been restated to reflect the healthcare provider, healthcare franchising and specialty managed healthcare segments as discontinued operations. Selected consolidated financial information for the three years ended September 30, 2000 and as of September 30, 1999 and 2000 presented below, have been derived from, and should be read in conjunction with, the Company's audited consolidated financial statements and the notes thereto included elsewhere herein. Selected consolidated financial information for the two years ended September 30, 1997 and as of September 30, 1996 and 1997 has been derived from the Company's unaudited consolidated financial statements. The selected financial data set forth below also should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere herein.

	FISCAL YEAR ENDED SEPTEMBER 30,				
	1996	1997	1998	1999	2000
	(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)				
STATEMENT OF OPERATIONS DATA:					
Net revenue	$ 302,573	$463,872	$1,167,274	$1,674,479	$1,873,554
Salaries, cost of care and other operating expenses	299,855	436,169	1,043,251	1,468,879	1,652,582
Equity in (earnings) loss of unconsolidated subsidiaries	2,005	5,567	(12,795)	(20,442)	(9,792)
Depreciation and amortization	14,290	19,683	46,898	68,921	75,413
Interest, net	48,584	46,438	76,505	93,752	97,286
Stock option expense (credit)	914	4,292	(5,623)	18	--
Managed care integration costs	--	--	16,962	6,238	--
Special charges, net	1,221	--	--	4,441	25,398
Income (loss) from continuing operations before income taxes, minority interest and extraordinary items	(64,296)	(48,277)	2,076	52,672	32,667
Provision for (benefit from) income taxes	(25,719)	(19,311)	5,238	28,256	15,478
Income (loss) from continuing operations before minority interest and extraordinary items	(38,577)	(28,966)	(3,162)	24,416	17,189
Minority interest	4,531	6,856	4,094	630	114
Income (loss) from continuing operations before extraordinary items	(43,108)	(35,822)	(7,256)	23,786	17,075
Discontinued operations:					
Income (loss) from discontinued operations	75,491	40,577	20,988	28,325	(65,221)
Loss on disposal of discontinued operations	--	--	--	(47,423)	(17,662)
Income (loss) before extraordinary items	32,383	4,755	13,732	4,688	(65,808)
Extraordinary items -- losses on early extinguishments of debt	--	(5,253)	(33,015)	--	--
Net income (loss)	32,383	(498)	(19,283)	4,688	(65,808)
Preferred dividend requirement and amortization of redeemable preferred stock issuance costs	--	--	--	--	3,802
Income (loss) available to common stockholders	$ 32,383	$ (498)	$ (19,283)	$ 4,688	$ (69,610)

INCOME (LOSS) PER COMMON SHARE AVAILABLE TO COMMON STOCKHOLDERS -- BASIC:					
Income (loss) from continuing operations before extraordinary items...............	(1.39)	(1.24)	(0.24)	0.75	0.41
Income (loss) from discontinued operations...............................	2.43	1.41	0.68	(0.60)	(2.58)
Loss from extraordinary items.............	--	(0.18)	(1.07)	--	--
Net income (loss)..........................	$ 1.04	$ (0.02)	$ (0.63)	$ (0.15)	$ (2.17)
INCOME (LOSS) PER COMMON SHARE AVAILABLE TO COMMON STOCKHOLDERS -- DILUTED:					
Income (loss) from continuing operations before extraordinary items...............	$ (1.39)	$ (1.24)	$ (0.24)	$ 0.75	$ 0.41
Income (loss) from discontinued operations...............................	2.43	1.41	0.68	(0.60)	(2.56)
Loss from extraordinary items.............	--	(0.18)	(1.07)	--	--
Net income (loss)..........................	$ 1.04	$ (0.02)	$ (0.63)	$ (0.15)	$ (2.15)
BALANCE SHEET DATA (END OF PERIOD):					
Current assets............................	$ 338,150	$507,038	$ 399,724	$ 374,927	$ 319,653
Current liabilities.......................	274,316	219,376	454,766	474,268	469,879
Property and equipment, net...............	495,390	109,214	177,169	120,667	112,612
Total assets..............................	1,140,137	896,868	1,917,088	1,881,615	1,803,787
Total debt and capital lease obligations...	572,058	395,294	1,225,646	1,144,308	1,098,047
Stockholders' equity......................	121,817	159,498	188,433	196,696	128,464

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Prior to June 1997, the Company derived the majority of its revenue from providing behavioral healthcare services in an inpatient setting. During the first quarter of fiscal 1996, the Company acquired a 61% ownership interest in Green Spring Health Services, Inc. At that time, the Company intended to become a fully integrated behavioral healthcare provider by combining the behavorial managed healthcare products offered by Green Spring with the direct treatment services offered by the Company's psychiatric hospitals. During the second quarter of fiscal 1998, the minority stockholders of Green Spring converted their 39% ownership interest in Green Spring into an aggregate of 2,831,516 shares of Magellan common stock.

Subsequent to the Company's acquisition of Green Spring, the growth of the behavioral managed healthcare industry accelerated. The Company concluded that the behavioral managed healthcare industry 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 of its behavioral managed healthcare business.

On June 17, 1997, the Company consummated the Crescent Transactions which provided the Company with approximately $200 million of net cash proceeds, after debt repayment, for use in implementing its business strategy to increase its participation in the managed healthcare industry. The Company used the net cash proceeds of approximately $200 million, after debt repayment, to finance the acquisitions of HAI and Allied in December 1997. The Company further implemented its business strategy through the acquisition of Merit in February 1998.

On September 10, 1999, the Company consummated the CBHS Transactions. The CBHS Transactions, together with the formal plan of disposal authorized by the Company's Board of Directors on September 2, 1999, represented the disposal of the Company's healthcare provider and healthcare franchising business segments.

On October 4, 2000, the Company adopted a formal plan to dispose of the business included in the Company's specialty managed healthcare segment. The specialty managed healthcare segment includes the businesses acquired in conjunction with the purchase of Vivra which was consummated February 29, 2000 and Allied on December 5, 1997. The initial purchase price of Vivra was $10.25 million and additional consideration of $10.0 million may be payable based upon future results. The Company paid approximately $54.5 million for Allied.

APB 30 requires that the results of continuing operations be reported separately from those of discontinued operations for all periods presented and that any gain or loss from disposal of a segment of a business be reported in conjunction with the related results of discontinued operations. Accordingly, the Company has restated its results of operations for all prior periods related to the healthcare provider, healthcare franchising and specialty managed healthcare business segments. The Company recorded an after-tax loss on disposal of its healthcare provider and healthcare franchising business segments of approximately $47.4 million (primarily non-cash), in fiscal 1999 and an after tax loss of $17.7 million on the disposal of its specialty managed healthcare segment in fiscal 2000.

The Company currently operates through two principal business segments which are engaged in:

- THE BEHAVIORAL MANAGED HEALTHCARE BUSINESS. The Company's behavioral managed healthcare segment coordinates and manages the delivery of behavioral healthcare treatment services through its network of providers, which includes psychiatrists, psychologists and other medical professionals.

  The treatment services provided through these provider networks include outpatient programs (such as counseling or therapy), intermediate care programs (such as intensive outpatient programs and partial hospitalization services), inpatient treatment and alternative care services (such as residential treatment and home or community-based programs). The Company provides these services primarily through: (i) risk-based products, where the Company assumes all or a portion of the responsibility for the cost of providing treatment services in exchange for a fixed per member per month fee, (ii) ASO products, where the Company provides services such as utilization review, claims administration or provider network management, (iii) EAPs and (iv) products which combine features of some or all of the Company's risk-based, ASO, or EAP products.

- THE HUMAN SERVICES BUSINESS. The Company provides various human services through Mentor. These human services include specialty home-based healthcare services provided through "mentor" homes as well as residential and day treatment services for individuals with acquired brain injuries and for individuals with mental retardation and developmental disabilities.

At September 30, 2000, the Company's behavioral managed healthcare segment, managed the behavioral healthcare benefits of approximately 71.0 million individuals and Mentor, the human services segment, provided over 7,800 individuals with community-based services.

RESULTS OF OPERATIONS

The following tables summarize, for the periods indicated, operating results by continuing business segments (in thousands).

FISCAL 1998	BEHAVIORAL MANAGED HEALTHCARE	HUMAN SERVICES	CORPORATE OVERHEAD AND OTHER	CONSOLIDATED
Net revenue	$1,026,243	$141,031	$ --	$1,167,274
Salaries, cost of care and other operating expenses	901,846	125,539	15,866	1,043,251
Equity in earnings of unconsolidated subsidiaries	(12,795)	--	--	(12,795)
	889,051	125,539	15,866	1,030,456
Segment Profit(1)	$ 137,192	$ 15,492	$(15,866)	$ 136,818

FISCAL 1999	BEHAVIORAL MANAGED HEALTHCARE	HUMAN SERVICES	CORPORATE OVERHEAD AND OTHER	CONSOLIDATED
Net revenue	$1,483,202	$191,277	$ --	$1,674,479
Salaries, cost of care and other operating expenses	1,285,391	169,549	13,939	1,468,879
Equity in earnings of unconsolidated subsidiaries	(20,442)	--	--	(20,442)
	1,264,949	169,549	13,939	1,448,437
Segment Profit(1)	$ 218,253	$ 21,728	$(13,939)	$ 226,042

FISCAL 2000	BEHAVIORAL MANAGED HEALTHCARE	HUMAN SERVICES	CORPORATE OVERHEAD AND OTHER	CONSOLIDATED
Net revenue	$1,655,101	$218,453	--	$1,873,554
Salaries, cost of care and other operating expenses	1,442,964	196,332	13,286	1,652,582
Equity in earnings of unconsolidated subsidiaries	(9,792)	--	--	(9,792)
	1,433,172	196,332	13,286	1,642,790
Segment Profit(1)	$ 221,929	$ 22,121	$(13,286)	$ 230,764

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(1) The Company evaluates performance of its segments based upon profit or loss from continuing operations before depreciation, amortization, interest, net, stock option expense (credit), managed care integration costs, special charges, net, income taxes and minority interest ("Segment Profit"). See Note 14, "Business Segment Information", to the Company's audited consolidated financial statements appearing elsewhere herein.

FISCAL 1999 COMPARED TO FISCAL 2000

BEHAVIORAL MANAGED HEALTHCARE. Revenue increased 11.6% or $171.9 million, to $1.66 billion for fiscal 2000, from $1.48 billion in fiscal 1999. Salaries, cost of care and other operating expenses increased 12.3%, or $157.6 million, to $1.44 billion for fiscal 2000, from $1.29 billion for fiscal 1999. The increases resulted primarily from increased membership growth and new contracts. Operating expenses increased at a greater rate than revenue primarily as a result of losses and reduced profitability in certain public sector contracts. Total covered lives increased 6.9% or 4.6 million to 71.0 million at September 30, 2000 from 66.4 million at September 30, 1999. Equity in earnings of unconsolidated subsidiaries decreased 52.1% or $10.7 million to $9.8 million in fiscal 2000 from $20.4 million in fiscal 1999. This decrease was a result of the decreased earnings of Premier Behavioral Systems of Tennessee, LLC ("Premier"), in which the Company maintains a 50% interest. The decrease in Premier's profitability was primarily a result of the 1999 period benefiting from positive contractual rate adjustments and an increase in accruals for potential losses from certain legal actions in the 2000 period. The Company frequently records retroactive customer settlements, which may be favorable or unfavorable, under its commercial behavioral managed healthcare contracts. Revenue and Segment Profit for fiscal 2000 reflect approximately $1.4 million of such favorable settlements compared to favorable settlements of $9.8 million during fiscal 1999. The Company recorded $3.7 million and $(0.8) million of favorable (unfavorable) retroactive customer settlements in the fourth quarter of fiscal 1999 and 2000, respectively.

HUMAN SERVICES. Revenue from the human services segment increased 14.2%, or $27.2 million, to $218.5 million for fiscal 2000, from $191.3 million in fiscal 1999. Salaries, cost of care and other operating expenses increased 15.8%, or

$26.8 million, to $196.3 million for fiscal 2000 from $169.5 million in fiscal 1999. The increase in revenue is a result of increased placements and acquisitions completed in fiscal 1999 and 2000. Increased operating expenses resulted from: (i) increase in placements; (ii) decreased profitability and exit costs incurred related to certain contracts and operations; and (iii) increased spending on conversion of computer systems. Total placements increased 21.9% to approximately 7,800 at September 30, 2000, compared to approximately 6,400 at September 30, 1999.

CORPORATE OVERHEAD AND OTHER. Salaries and other operating expenses decreased 4.9%, or $0.7 million, primarily as a result of ongoing integration of corporate administrative functions with business unit administrative functions.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization increased 9.4%, or $6.5 million, to $75.4 million for fiscal 2000, from $68.9 million in fiscal 1999. The increase was primarily attributed to depreciation related to recent capital expenditures and amortization related to the additional purchase price payment of $60 million with respect to the HAI acquisition made in fiscal 2000. See Note 3--"Acquisitions and Joint Ventures" to the Company's audited consolidated financial statements set forth elsewhere herein.

INTEREST, NET. Interest expense, net, increased 3.7%, or $3.5 million, to $97.3 million for fiscal 2000, from $93.8 million in fiscal 1999. The increase was primarily the result of higher borrowing rates during fiscal 2000.

OTHER ITEMS. The Company recorded special charges of $25.4 million during fiscal 2000 comprised of: (i) $4.5 million of severance and lease termination costs and $15.8 million of impairment of certain long lived assets related to the closure of offices in connection with the psychiatric practice management

business; (ii) $7.0 million of severance and lease termination costs related to the restructuring of the corporate function and certain behavioral managed healthcare sites and (iii) a $1.9 million non-recurring gain on the sale of the corporate aircraft.

The Company's effective tax rate was 47.4% for fiscal 2000. The effective tax rate exceeds statutory rates due primarily to non-deductible goodwill amortization resulting primarily from acquisitions, offset by reductions in reserve estimates of approximately $9.1 million related to settlements with the Internal Revenue Service during the fourth quarter of fiscal 2000.

DISCONTINUED OPERATIONS. The following tables summarize, for the periods indicated, income (loss) from discontinued operations, net of tax:

	1999	2000
Healthcare provider segment	$32,883	$ --
Healthcare franchising segment	(3,238)	--
Specialty managed healthcare segment	(1,320)	(65,221)
	$28,325	$(65,221)

Income from the healthcare provider segment decreased 100%, or $32.8 million to $0 million for fiscal 2000 compared to $32.8 million for fiscal 1999. The decrease is primarily attributable to (i) the net effect of the Company's sale of its European hospital operations in April 1999, which included a gain on sale of $14.4 million, net of tax, (ii) income of $8.8 million, net of tax, from cost report settlements related primarily to the resolution of Medicare cost report matters in the fourth quarter of fiscal 1999 associated with the Company's sale of the Psychiatric Hospital Facilities, and (iii) discontinuance of all significant activities related to this segment in fiscal 2000. The Company ceased all activities related to its healthcare franchising segments during fiscal 1999.

The loss from the specialty managed healthcare segment increased $63.9 million, to a loss of $65.2 million, net of tax, for fiscal 2000 compared to a loss of $1.3 million, net of tax, for fiscal 1999. During fiscal 2000 the Company recorded: (i) a pre-tax charge of $58.2 million in the second quarter related to the impairment of long-lived assets; (ii) pre-tax operating losses of approximately $41.1 million prior to the discontinued operations measurement date; and (iii) a federal tax benefit of $34.1 million. The operating losses were attributable to: (i) performance of certain risk-based contracts; (ii) cost to exit risk-based contracts including provision for uncollectible receivables and additional contractual liabilities; and (iii) severance and shut down cost incurred in conjunction with the wind down of operations.

The Company recorded a loss on disposal of discontinued operations of approximately $17.7 million, net of tax benefit of $9.2 million, at the end of fiscal 2000. This loss represents the additional cost incurred as a result of the plan adopted on October 4, 2000 to fully exit the specialty managed healthcare segment. See Note 3-"Discontinued Operations" to the Company's audited consolidated financial statements set forth elsewhere herein. The pre-tax loss is comprised of a $17.1 million impairment of the remaining long-lived assets and $9.8 million in lease terminations and other exit costs as defined by APB 30.

FISCAL 1998 COMPARED TO FISCAL 1999

BEHAVIORAL MANAGED HEALTHCARE. Revenue increased 44.5% or $457.0 million, to $1.48 billion for fiscal 1999, from $1.03 billion in fiscal 1998. Salaries, cost of care and other operating expenses increased 42.5%, or $383.5 million, to $1.29 billion for fiscal 1999, from $901.8 million in fiscal 1998. Equity in earnings of unconsolidated subsidiaries increased $7.6 million, to $20.4 million for fiscal 1999, from $12.8 million for fiscal 1998. The increases resulted primarily from (i) the HAI and Merit acquisitions in fiscal 1998, (ii) increased enrollment related to existing customers, (iii) expanded services and lives under management with certain public sector customers, (iv) new business development and (v) increases in retroactive customer settlements, offset by reductions in general and administrative costs as a result of the

integration of Green Spring, HAI and Merit and the termination of one public sector contract (Montana Medicaid) in fiscal 1999. Total covered lives increased 7.8% or 4.8 million to 66.4 million at September 30, 1999 from 61.6 million at September 30, 1998. The Company frequently records retroactive customer settlements, which may be favorable or unfavorable, under its commercial behavioral managed healthcare contracts. Revenue and Segment Profit for fiscal 1999 reflect approximately $9.8 million of such favorable settlements compared to favorable settlements of $1.8 million during fiscal 1998. The Company recorded $3.7 million of favorable retroactive customer settlements in the fourth quarter of fiscal 1999.

HUMAN SERVICES. Revenue from the human services segment increased 35.7%, or $50.3 million, to $191.3 million for fiscal 1999, from $141.0 million in fiscal 1998. Salaries, cost of care and other operating expenses increased 35.1%, or $44.0 million, to $169.5 million for fiscal 1999 from $125.5 million in fiscal 1998. The increases were attributable to acquisitions consummated in fiscal 1998 and fiscal 1999 and internal growth, offset by reductions in revenue and Segment Profit at one acquired business in fiscal 1999 as a result of rate and placement reductions from a state agency. Total placements increased 9.5% to approximately 6,400 at September 30, 1999, compared to approximately 5,900 at September 30, 1998.

CORPORATE OVERHEAD AND OTHER. Salaries and other operating expenses decreased 12.1%, or $1.9 million, primarily as a result of ongoing integration of corporate administrative functions with business unit administrative functions.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization increased 46.9%, or $22.0 million, to $68.9 million for fiscal 1999, from $46.9 million in fiscal 1998. The increase was primarily attributed to (i) the acquisition of HAI and Merit in fiscal 1998, (ii) depreciation related to fiscal year 2000 capital expenditures and (iii) amortization related to the additional purchase price payment of $60 million to Aetna with respect to the HAI acquisition made in fiscal 1999.

INTEREST, NET. Interest expense, net, increased 22.6%, or $17.3 million, to $93.8 million for fiscal 1999, from $76.5 million in fiscal 1998. The increase was primarily the result of interest expense incurred on borrowings used to fund the Merit acquisition and related transactions in fiscal 1998.

OTHER ITEMS. Stock option expense for fiscal 1999 was not material compared to a credit of $5.6 million in fiscal 1998 primarily due to fluctuations in the market price of the Company's stock in fiscal 1998.

The Company recorded managed care integration costs of $6.2 million for fiscal 1999, compared to $17.0 million in fiscal 1998. For a more complete discussion of managed care integration costs, see Note 10, "Managed Care Integration Plan and Costs and Special Charges" to the Company's audited consolidated financial statements set forth elsewhere herein.

The Company recorded special charges of $4.4 million during fiscal 1999 related primarily to the loss on disposal of an office building, executive severance and costs associated with moving the Company's corporate headquarters from Atlanta, Georgia to Columbia, Maryland.

The Company's effective income tax rate was 53.6% for fiscal 1999. The effective income tax rate exceeds statutory rates due primarily to non-deductible goodwill amortization resulting from acquisitions.

Minority interest decreased $3.5 million, to $0.6 million during fiscal 1999 primarily as a result of the Green Spring minority stockholder conversion in fiscal 1998.

DISCONTINUED OPERATIONS. The following tables summarize, for the periods indicated, income (loss) from discontinued operations, net of tax:

SEGMENT	1998	1999
Health Care Provider Segment............................	$12,132	$32,883
Health Care Franchising Segment.........................	8,399	(3,238)
Specialty Managed Healthcare Segment....................	457	(1,320)
	$20,988	$28,325

Income from the healthcare provider segment increased 171.1%, or $20.8 million to $32.9 million for fiscal 1999 compared to $12.1 million for fiscal 1998. The increase is primarily attributable to (i) the net effect of the Company's sale of its three European Hospitals in April 1999, which included a gain on sale of $14.4 million, net of tax, (ii) increases in income of $8.8 million, net of tax, from cost report settlements related primarily to the resolution of Medicare cost report matters in the fourth quarter of fiscal 1999 associated with the Company's sale of the Psychiatric Hospital Facilities, and (iii) increases in income of $4.8 million, net of tax, related to adjustments to accounts receivable collection fee reserves recorded in connection with the Crescent Transactions, offset by reductions in adjustments to income of $2.5 million, net of tax, related to updated actuarial estimates of malpractice claims.

Income from the healthcare franchising segment decreased $11.6 million, net of tax, to a loss of $3.2 million, net of tax, for fiscal 1999 compared to income of $8.4 million, net of tax, for the same period in 1998. The decrease was primarily attributable to the declining operating performance of CBHS, which resulted in the Company recording and collecting no franchise fees from CBHS in fiscal 1999.

Income from the specialty managed healthcare segment decreased $1.8 million, to a loss of $1.3 million, net of tax, for fiscal 1999 compared to an income of $0.5 million, net of tax, for the same period in 1998. The decrease is primarily a result of a loss of a significant customer at the end of 1998 and increased administrative spending during 1999.

The Company recorded a loss on disposal of discontinued operations of approximately $47.4 million during fiscal 1999 as a result of the CBHS Transactions. See Note 3, "Discontinued Operations" to the Company's audited consolidated financial statements set forth elsewhere herein.

EXTRAORDINARY ITEM. The Company recorded an extraordinary loss on early extinguishment of debt of approximately $33.0 million, net of tax, during fiscal 1998, related primarily to refinancing the Company's long-term debt in connection with the Merit acquisition.

OUTLOOK--RESULTS OF OPERATIONS

BEHAVIORAL MANAGED HEALTHCARE RESULTS OF OPERATIONS. The Company's behavioral managed healthcare Segment Profit is subject to significant fluctuations on a quarterly basis. These fluctuations may result from: (i) changes in utilization levels by enrolled members of the Company's risk-based contracts, including seasonal utilization patterns; (ii) performance-based contractual adjustments to revenue, reflecting utilization results or other performance measures; (iii) retroactive contractual adjustments under commercial contracts and CHAMPUS contracts; (iv) retrospective membership adjustments; (v) timing of implementation of new contracts and enrollment changes; (vi) pricing adjustments upon long-term contract renewals; and (vii) changes in estimates regarding medical costs and incurred but not yet reported medical claims.

Both the Company and Premier, in which the Company has a fifty percent interest, separately contract with the State of Tennessee to manage the behavioral healthcare benefits for the State's TennCare program ("TennCare Contracts"). The Company's direct contract (exclusive of Premier) represented approximately 13.7% of the Company's behavioral managed healthcare revenue and approximately 12.1% of the

Company's consolidated revenue in fiscal 2000. The TennCare Contracts contained provisions that limited the Company's profits, subject to the recoupment of losses incurred in prior periods. An amendment to the contracts in July 2000 eliminated the ability to recoup prior period losses. The Company's profit under the TennCare Contracts benefited during fiscal 1999 and, to a lesser extent, during fiscal 2000 from the ability to recoup prior period losses. The Company's Segment Profit under the TennCare Contracts was lower in fiscal 2000 than fiscal 1999 as result of these contract provisions and accruals for potential losses related to litigation involving Premier in which the Company has a 50% interest. See Item 3--"Legal Proceedings". The Company anticipates segment profit in fiscal 2001 to be comparable to fiscal 2000.

INTEREST RATE RISK. The Company had $466.6 million of total debt outstanding under the Credit Agreement at September 30, 2000. Debt under the Credit Agreement bears interest at variable rates. Historically, the Company has elected the interest rate option under the Credit Agreement that is an adjusted London inter-bank offer rate ("LIBOR") plus a borrowing margin. See Note 5, "Long-Term Debt, Capital Lease Obligations and Operating Leases", to the Company's audited consolidated financial statements appearing elsewhere herein. Based on September 30, 2000 borrowing levels, a 25 basis point increase in interest rates would cost the Company approximately $1.2 million per year in additional interest expense. LIBOR-based Eurodollar borrowing rates have increased during fiscal 2000. One month and six month LIBOR-based Eurodollar rates increased by approximately 120 basis points and 80 basis points, respectively, between September 1999 and September 2000 and may continue to increase during fiscal 2001. The Company's earnings could be adversely affected by further increases in interest rates.

HISTORICAL LIQUIDITY AND CAPITAL RESOURCES--FISCAL 1998-2000

OPERATING ACTIVITIES. The Company's net cash provided by (used in) operating activities was $(4.2) million, $41.9 million and $86.7 million for fiscal 1998, 1999 and 2000, respectively. The increase in cash provided by operating activities in fiscal 2000 compared to fiscal 1999 was primarily effected by: (i) $22.6 million reduction of liability related to the unpaid claims portfolio transfer consummated during fiscal 1999; (ii) improved collection of accounts receivable in fiscal 2000 including amounts in connection with Medicare cost reports related to the psychiatric hospital business; (iii) increases in medical claims payables and (iv) offset by non-recurring cash payments totaling $38.1 million related to CHAMPUS adjustments incurred in fiscal 2000. The increase in cash provided by operating activities in fiscal 1999 compared to fiscal 1998 was primarily the result of reduction in income taxes paid, net of refunds received, of $10.8 million, and increases in cash flows from operations as a result of the HAI and Merit acquisitions, offset by reductions in franchise fees collected from CBHS of $40.6 million, changes in reserve for unpaid claims of $11.0 million and increases in interest paid of $6.9 million.

INVESTING ACTIVITIES. The Company utilized $44.2 million, $48.1 million and

$36.9 million in funds during fiscal 1998, 1999 and 2000, respectively, for capital expenditures. The increase in fiscal 1999 was the result of the Company's transition to the managed care business from the provider business.

The Company used $1.05 billion, $69.5 million and $68.6 million in funds during fiscal 1998, 1999 and 2000, respectively, net of cash acquired, for acquisitions and investments in businesses. This included primarily managed care acquisitions and human services acquisitions in fiscal 1998 and additional purchase price consideration of $60.0 million paid to Aetna in connection with the HAI acquisition in fiscal 1999 and 2000.

The Company received distributions from unconsolidated subsidiaries of $11.4 million, $22.0 million and $14.3 million in fiscal 1998, 1999 and 2000, respectively. Distributions received from Choice (as defined) were $11.4 million, $13.0 million and $14.1 million in fiscal 1998, 1999 and 2000 respectively, with the remaining distributions being received from the Provider JVs in fiscal 1999 and 2000.

The Company received proceeds from the sale of assets of $11.9 million, $54.2 million and $3.3 million in fiscal 1998, 1999 and 2000, respectively. The sales proceeds were generated primarily from (i) the sale of hospital real estate related to closed hospitals retained by the Company in fiscal 1998, (ii) the sale

of the European psychiatric provider operations in fiscal 1999, and (iii) sale of the corporate aircraft in fiscal 2000.

FINANCING ACTIVITIES. The Company borrowed approximately $1.2 billion, $76.8 million and $59.6 million during fiscal 1998, 1999 and 2000, respectively. The fiscal 1998 borrowings primarily funded the Merit acquisition and related long-term debt refinancing with the remaining amounts representing borrowings under the Revolving Facility for short-term capital needs. The fiscal 1999 and 2000 borrowings were primarily draws under the Revolving Facility for short-term capital needs.

The Company repaid approximately $438.6 million, $156.0 million and $110.3 million of debt and capital lease obligations during fiscal 1998, 1999 and 2000, respectively. The fiscal 1998 repayments related primarily to the extinguishment of the Magellan Outstanding Notes as part of the Merit acquisition. The fiscal 1999 and 2000 payments were for Term Loan Facility principal amortization and required Term Loan Facility principal payments primarily related to the sale of the European Hospitals and the TPG investment.

The Company completed the sale of 59,063 shares of Series A Redeemable Preferred Stock to TPG during the quarter ended December 31, 1999, for a total price of approximately $54.0 million, net of issuance costs. Approximately 50% of the net proceeds were used to reduce debt outstanding under the Term Loan Facility with the remaining 50% being used for general corporate purposes. See Note 7--"Redeemable Preferred Stock" to the Company's audited historical consolidated financial statements set forth elsewhere herein.

On November 1, 1996, the Company announced that its board of directors had approved the repurchase of an additional 3.0 million shares of common stock from time to time subject to the terms of the Company's then current credit agreements. During fiscal 1998, the Company repurchased approximately 0.7 million shares of its common stock for approximately $14.4 million.

As of September 30, 2000, the Company had approximately $90.4 million of availability under the Revolving Facility, excluding approximately $29.6 million of availability reserved for certain letters of credit. The Company believes it was in compliance with all debt covenants as of September 30, 2000.

OUTLOOK--LIQUIDITY AND CAPITAL RESOURCES

DEBT SERVICE OBLIGATIONS. The interest payments on the Company's $625.0 million 9% Series A Senior Subordinated Notes due 2008 and interest and principal payments on indebtedness outstanding pursuant to the Company's $700.0 million Credit Agreement represent significant liquidity requirements for the Company. Borrowings under the Credit Agreement bear interest at floating rates and require interest payments on varying dates depending on the interest rate option selected by the Company. As of September 30, 2000, borrowings pursuant to the Credit Agreement included $436.6 million under the Term Loan

Facility and up to $150.0 million under the Revolving Facility. The Company had $30.0 million of borrowings and $29.6 million of letters of credit outstanding under the Revolving Facility at September 30, 2000. As of September 30, 2000, the Company is required to repay the principal amount of borrowings

outstanding under the Term Loan Facility and the principal amount of the Notes in the years and amounts set forth in the following table (in millions):

FISCAL YEAR	REMAINING PRINCIPAL AMOUNT
2001	$ 34.1
2002	43.3
2003	80.7
2004	167.3
2005	115.6
2006	25.6
2007	--
2008	$625.0

In addition, any amounts outstanding under the Revolving Facility mature in February 2004.

POTENTIAL PURCHASE PRICE ADJUSTMENTS. In December 1997, the Company purchased HAI from Aetna for approximately $122.1 million, excluding transaction costs. In addition, the Company incurred the obligation to make contingent payments to Aetna which may total up to $60.0 million annually over the five-year period subsequent to closing. The Company may be obligated to make contingent payments under two separate calculations, which are primarily based upon membership levels during the contract year (as defined) and are calculated at the end of the contractual year. "Contract Year" means each of the twelve-month periods ending on the last day of December in 1998, 1999, 2000, 2001, and 2002.

The Company paid $60.0 million to Aetna for both the Contract Years ended December 31, 1998 and 1999. Also, based upon the most recent membership enrollment data related to the Contract Year to end December 31, 2000 ("Contract Year 3"), the Company believes beyond a reasonable doubt that it will be required to make the full $60.0 million payment related to Contract Year 3 and, therefore, the amount is included in goodwill and other intangible assets at September 30, 2000. The Company recorded $120.0 million of goodwill and other intangible assets related to the purchase of HAI during fiscal 1999 related to Contract Years 1 and 2. The Contract Year 3 liability of $60.0 million is included in "Deferred credits and other long-term liabilities" in the Company's consolidated balance sheet as of September 30, 2000. The Company intends to borrow under the Revolving Facility, if necessary, to meet this obligation, which is expected to be paid during the second quarter of fiscal 2001.

By virtue of acquiring Merit, the Company may be required to make certain payments to the former shareholders of CMG Health, Inc. ("CMG"), a managed behavioral healthcare company that was acquired by Merit, in September, 1997. Such contingent payments are subject to an aggregate maximum of $23.5 million. The Company has initiated legal proceedings against certain former owners of CMG with respect to representations made by such former owners in conjunction with Merit's acquisition of CMG. Whether any contingent payments will be made to the former shareholders of CMG and the amount and timing of contingent payments, if any, may be subject to the outcome of these proceedings.

REVOLVING FACILITY AND LIQUIDITY. The Revolving Facility provides the Company with revolving loans and letters of credit in an aggregate principal amount at any time not to exceed $150.0 million. At September 30, 2000, the Company had approximately $90.4 million of availability under the Revolving Facility. The Company estimates that it will spend approximately $34.0 million for capital expenditures in fiscal 2001. The majority of the Company's anticipated capital expenditures relate to management information systems and related equipment. The Company believes that the cash flows generated from its operations, together with amounts available for borrowing under the Revolving Facility, will be sufficient to fund its debt service requirements, anticipated capital expenditures, contingent payments, if any, with respect to HAI and CMG, and other investing and financing activities over the next year. The Company expects to have significant liquidity needs during the second fiscal quarter of fiscal 2001 including, but not

limited to, (i) semi-annual interest payments on the Notes of $28.1 million and (ii) contingent consideration payable to Aetna of $60.0 million. The Company expects its borrowing capacity under the Revolving Facility to decline to approximately $25.0 million to $35.0 million by March 31, 2001 subject to, among other things: (i) the timing and amount of contingent consideration paid related to HAI and CMG (if any), (ii) operating and cash flow performance of the Company in fiscal 2001 and (iii) capital resources needed to pursue certain new risk-based managed care business. If the Company's estimate of its borrowing capacity under the Revolving Facility is projected to fall below the levels described above, management intends to delay or forego certain investing activities, including capital expenditures and acquisitions, and possibly forego certain new business opportunities. The Company's future operating performance and ability to service or refinance the Notes or to extend or refinance the indebtedness outstanding pursuant to the Credit Agreement will be subject to future economic conditions and to financial, business, legal, regulatory and other factors, many of which are beyond the Company's control.

RESTRICTIVE FINANCING COVENANTS. The Credit Agreement imposes restrictions on the Company's ability to make capital expenditures, and both the Credit Agreement and the Indenture limit the Company's ability to incur additional indebtedness. Such restrictions, together with the highly leveraged financial condition of the Company, may limit the Company's ability to respond to market opportunities. The covenants contained in the Credit Agreement also, among other things, restrict the ability of the Company to: dispose of assets; repay other indebtedness; amend other debt instruments (including the Indenture); pay dividends; create liens on assets; enter into sale and leaseback transactions; make investments, loans or advances; redeem or repurchase common stock; and make acquisitions.

STRATEGIC ALTERNATIVES TO REDUCE LONG-TERM DEBT AND IMPROVE LIQUIDITY. The Company's sale of the European Hospitals in April 1999 was one of the steps in the Company's exit from the healthcare provider and healthcare franchising businesses in order to reduce long-term debt and improve liquidity. The Company is currently involved in discussions with various parties to divest certain other non-core businesses. This may include the sale of Mentor, if the Company can negotiate terms that it deems to be acceptable. There can be no assurance that the Company will be able to divest any businesses or that the divestiture of such businesses would result in significant reductions of long-term debt or improvements in liquidity.

On December 15, 1999, the Company received approximately $54.0 million of net proceeds (after transaction costs) upon issuance of Series A Preferred Stock to TPG. Approximately 50% of the net proceeds received from the issuance of the Series A Preferred Stock was used to reduce debt outstanding under the Term Loan Facility with the remaining 50% of the proceeds being used for general corporate purposes. The Company is also reviewing additional strategic alternatives to improve its capital structure and liquidity. There can be no assurance that the Company will be able to consummate any transaction that will improve its capital structure and/or liquidity.

NET OPERATING LOSS CARRYFORWARDS. During fiscal 2000, the Company reached an agreement (the "Agreement") with the Internal Revenue Service ("IRS") related to its federal income tax returns for the fiscal years ended September 30, 1992 and 1993. The IRS had originally proposed to disallow approximately $162 million of deductions related primarily to interest expense in fiscal 1992. Under the Agreement, the Company will pay approximately $1 million in taxes and interest to the IRS to resolve the assessment relating to taxes due for these open years, although no concession was made by either party as to the Company's ability to utilize these deductions through net operating loss carryforwards. As a result of the Agreement the Company recorded a reduction in deferred tax reserves of approximately $9.1 million as a change in estimate in the current year. While any IRS assessment related to these deductions is not expected to result in a material cash payment for income taxes related to prior years the Company's federal income tax net operating loss carryforwards could be reduced if the IRS later successfully challenges these deductions.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, FAS No. 133 "Accounting for Derivative Instruments and Hedging Activities," (FAS No. 133) was issued. FAS No. 133 establishes accounting and reporting standards for derivative instruments and derivative instruments embedded in other contracts, (collectively referred to as derivatives) and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (b) a hedge of the exposure to variability in cash flows attributable to a particular risk, or (c) a hedge of the foreign currency exposure of a net investment on a foreign operation, an unrecognized firm commitment, an available for sale security and a forecasted transaction. FAS No. 137, "Accounting for Derivative Instruments and Hedging Activities--Deferral of the Effective Date of FASB Statement No. 133" was issued in June 1999 and deferred the effective date of FAS No. 133 to fiscal years beginning after June 15, 2000. FAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities", was issued on June 2000 and also amends FAS No. 133. FAS No. 138 addresses a limited number of issues causing implementation difficulties. Consequently, the Company will be required to implement FAS No. 133 for all fiscal quarters for the fiscal year beginning October 1, 2000. The Company expects the adoption of this pronouncement will not have a material effect on the Company's financial statements.

Emerging Issues Task Force Issue 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but a Minority Shareholder or Shareholders Have Certain Approval or Veto Rights" ("EITF 96-16") supplements the guidance contained in AICPA Accounting Research Bulletin 51, "Consolidated Financial Statements", and in Statement of Financial Accounting Standards No. 94, "Consolidation of All Majority-Owned Subsidiaries" ("ARB 51/FAS 94"), about the conditions under which the Company's consolidated financial statements should include the financial position, results of operations and cash flows of subsidiaries which are less than wholly-owned along with those of the Company and its subsidiaries.

In general, ARB 51/FAS 94 requires consolidation of all majority-owned subsidiaries except those for which control is temporary or does not rest with the majority owner. Under the ARB 51/FAS 94 approach, instances of control not resting with the majority owner were generally regarded to arise from such events as the legal reorganization or bankruptcy of the majority-owned subsidiary. EITF 96-16 expands the definition of instances in which control does not rest with the majority owner to include those where significant approval or veto rights, other than those which are merely protective of the minority shareholder's interest, are held by the minority shareholder or shareholders ("Substantive Participating Rights"). Substantive Participating Rights include, but are not limited to: (i) selecting, terminating and setting the compensation of management responsible for implementing the majority-owned subsidiary's policies and procedures; and (ii) establishing operating and capital decisions of the majority-owned subsidiary, including budgets, in the ordinary course of business.

The provisions of EITF 96-16 apply to new investment agreements made after July 24, 1997, and to existing agreements which are modified after such date. The Company has made no new investments, and has modified no existing investments, to which the provisions of EITF 96-16 would have applied.

In addition, the transition provisions of EITF 96-16 must be applied to majority-owned subsidiaries previously consolidated under ARB 51/FAS 94 for which the underlying agreements have not been modified in financial statements issued for years ending after December 15, 1998 (fiscal 1999 for the

Company). The adoption of the transition provisions of EITF 96-16 on October 1, 1998 had the following effect on the Company's consolidated financial position:

	OCTOBER 1, 1998
Increase (decrease) in:	

Cash and cash equivalents	$(21,092)
Other current assets	(9,538)
Long-term assets	(30,049)
Investment in unconsolidated subsidiaries	26,498
Total Assets	$(34,181)
Current liabilities	$(10,381)
Minority interest	(23,800)
Total Liablities	$(34,181)

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has significant interest rate risk related to its variable rate debt outstanding under the Credit Agreement. See "Cautionary Statements--Leverage and Debt Service Obligations," "Management's Discussion and Analysis of Financial Condition and Results of Operations--Outlook--Results of Operations" and "Outlook--Liquidity and Capital Resources" and Note 5-"Long-Term Debt, Capital Lease Obligations and Operating Leases" to the Company's audited consolidated financial statements set forth elsewhere herein.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Information with respect to this item is contained in the Company's audited consolidated financial statements and financial statement schedule indicated in the Index on Page F-1 of this Annual Report on Form 10-K and is incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information with respect to the Company's executive officers is contained under "Item 1. Business--Executive Officers of the Registrant." Pursuant to General Instruction G(3) to Form 10-K, the information required by this item with respect to directors and compliance with Section 16(a) of the Exchange Act has been omitted inasmuch as the Company files with the Securities and Exchange Commission a definitive proxy statement not later than 120 days subsequent to the end of its fiscal year. Such information is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

Pursuant to General Instruction G(3) to Form 10-K, the information required with respect to this item has been omitted inasmuch as the Company files with the Securities and Exchange Commission a definitive proxy statement not later than 120 days subsequent to the end of its fiscal year. Such information is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Pursuant to General Instruction G(3) to Form 10-K, the information required with respect to this item has been omitted inasmuch as the Company files with the Securities and Exchange Commission a definitive proxy statement not later than 120 days subsequent to the end of its fiscal year. Such information is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Pursuant to General Instruction G(3) to Form 10-K, the information required with respect to this item has been omitted inasmuch as the Company files with the Securities and Exchange Commission a definitive proxy statement not later than 120 days subsequent to the end of its fiscal year. Such information is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(A) DOCUMENTS FILED AS PART OF THE REPORT:

1. FINANCIAL STATEMENTS

Information with respect to this item is contained on Pages F-1 to F-44 of this Annual Report on Form 10-K.

2. FINANCIAL STATEMENT SCHEDULE

Information with respect to this item is contained on page S-1 of this Annual Report on Form 10-K.

3. EXHIBITS

EXHIBIT NO.	DESCRIPTION OF EXHIBIT
2(a)	Master Service Agreement, dated August 5, 1997, between the Company, Aetna U.S. Healthcare, Inc. and Human Affairs International, Incorporated, which was filed as Exhibit 2(b) to the Company's current report on Form 8-K, which was filed on December 17, 1997, and is incorporated herein by reference.
2(b)	First Amendment to Master Services Agreement, dated December 4, 1997, between the Company, Aetna U.S. Healthcare, Inc. and Human Affairs International, Incorporated, which was filed as Exhibit 2(d) to the Company's current report on Form 8-K, which was filed on December 17, 1997, and is incorporated herein by reference.
2(c)	Asset Purchase Agreement, dated October 16, 1997, among the Company; Allied Health Group, Inc.; Gut Management, Inc.; Sky Management Co,; Florida Specialty Network, LTD; Surgical Associates of South Florida, Inc.; Surginet, Inc.; Jacob Nudel, M.D.; David Russin, M.D. and Lawrence Schimmel, M.D., which was filed as Exhibit 2(e) 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(d)	First Amendment to Asset Purchase Agreement, dated December 5, 1997, among the Company; Allied Health Group, Inc.; Gut Management, Inc.; Sky Management Co.; Florida Specialty Network, LTD; Surgical Associates of South Florida, Inc.; Surginet, Inc.; Jacob Nudel, M.D.; David Russin M.D.; and Lawrence Schimmel, M.D., which was filed as Exhibit 2(f) 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(e)	Second Amendment to Asset Purchase Agreement, dated November 18, 1998, among the Company; Allied Health Group, Inc.; Gut Management, Inc.; Sky Management Co.; Florida Specialty Network, LTD; Surgical Associates of South Florida, Inc.; Surginet, Inc.; Jacob Nudel, M.D.; David Russin M.D.; and Lawrence Schimmel, M.D., which was filed as Exhibit 2(m) to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1998 and is incorporated herein by reference.
2(f)	Third Amendment to Asset Purchase agreement, dated December 31, 1998, among the Company; Allied Health Group, Inc.; Gut Management, Inc.; Sky Management Co.; Florida Specialty Network, LTD; Surgical Associates of South Florida, Inc.; Surginet, Inc.; Jacob Nudel, M.D.; David Russin, M.D.; and

	Lawrence Schimmel, M.D., which was filed as Exhibit 2(b) to the Company's Quarterly on Form 10-Q for the quarterly period ended December 31, 1998 and is incorporated herein by reference.
2(g)	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(h)	Share Purchase Agreement, dated April 2, 1999, by and among the Company, Charter Medical International, S.A., Inc. (a wholly owned subsidiary of the Company), Investment AB Bure, and CMEL Holding Limited (a wholly owned subsidiary of Investment AB Bure), filed as Exhibit 2(a) to the Company's current report on Form 8-K, which was filed on April 12, 1999, and is incorporated herein by reference.

EXHIBIT NO.	DESCRIPTION OF EXHIBIT
2(i)	Stock Purchase Agreement, dated April 2, 1999, by and among the Company, Charter Medical International S.A., Inc. (a wholly owned subsidiary of the Company), Investment AB Bure and Grodrunden 515 AB (a wholly owned subsidiary of Investment AB Bure), filed as Exhibit 2(b) to the Company's current report on Form 8-K, which was filed on April 12, 1999, and is incorporated herein by reference.
2(j)	First Amendment to Share Purchase Agreement, dated April 8, 1999, by and among the Company, Charter Medical International S.A., Inc. (a wholly owned subsidiary of the Company), Investment AB Bure, and CMEL Holding Limited (a wholly owned subsidiary of Investment AB Bure), filed as Exhibit 2(c) to the Company's current report on Form 8-K, which was filed on April 12, 1999, and is incorporated herein by reference.
2(k)	First Amendment to Stock Purchase Agreement, dated April 8, 1999, among the Company, Charter Medical International S.A., Inc. (a wholly owned subsidiary of the Company), Investment AB Bure, and CMEL Holding Limited (a wholly owned subsidiary of Investment AB Bure), filed as Exhibit 2(d) to the Company's current report on Form 8-K, which was filed on April 12, 1999, and is incorporated herein by reference.
2(l)	Letter Agreement dated August 10, 1999 by and among the Company, Charter Behavioral Health Systems, LLC, Crescent Real Estate Equities Limited Partnership and Crescent Operating, Inc., which was filed as Exhibit 2(a) to the Company's current report on Form 8-K, which was filed on September 24, 1999 and is incorporated herein by reference.
3(a)	Restated Certificate of Incorporation of the Company, as filed in Delaware on October 16, 1992, which was filed as Exhibit 3(a) to the Company's Annual Report on Form 10-K for the year ended September 30, 1992, and is incorporated herein by reference.
3(b)	Bylaws of the Company, which were filed as Exhibit 3(b) to the Corporation's Annual Report on Form 10-K for the year ended September 30, 1999 and are incorporated herein by reference.
3(c)	Certificate of Ownership and Merger merging Magellan Health Services, Inc. (a Delaware corporation) into Charter Medical

Corporation (a Delaware corporation), as filed in Delaware on December 21, 1995, which was filed as Exhibit 3(c) to the Company's Annual Report on Form 10-K for the year ended September 30, 1995, and is incorporated herein by reference.

4(a)	Stock and Warrant Purchase Agreement, dated December 22, 1995, between the Company and Richard E. Rainwater, which was filed as Exhibit 4(f) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1995, and is incorporated herein by reference.
4(b)	Amendment No. 1 to Stock and Warrant Purchase Agreement, dated January 25, 1996, between the Company and Rainwater-Magellan Holdings, L.P., which was filed as Exhibit 4.7 to the Company's Registration Statement on Form S-3 dated February 26, 1996, and is incorporated herein by reference.
4(c)	Warrant Purchase Agreement, dated January 29, 1997, between the Company and Crescent Real Estate Equities Limited Partnership which was filed as Exhibit 4(a) to the Company's current report on Form 8-K, which was filed on April 23, 1997, and is incorporated herein by reference.

EXHIBIT NO.	DESCRIPTION OF EXHIBIT
4(d)	Amendment No. 1, dated June 17, 1997, to the Warrant Purchase Agreement, dated January 29, 1997, between the Company and Crescent Real Estate Equities Limited Partnership, which was filed as Exhibit 4(b) to the Company's current report on Form 8-K, which was filed on June 30, 1997, and is incorporated herein by reference.
4(e)	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, which was filed April 3, 1998, and is incorporated herein by reference.
4(f)	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, which was filed April 3, 1998, and is incorporated herein by reference.
4(g)	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, which was filed on April 3, 1998, and is incorporated herein by reference.
4(h)	Credit Agreement, dated 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, which was filed April 3, 1998, and is incorporated herein by reference.
4(i)	Amendment No. 1, dated as of September 30, 1998, to the 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(e) to the Company's Registration Statement Form S-4 (no. 333-49335), which was filed on October 5, 1998, and is incorporated herein by reference.

4(j)	Amendment No. 2, dated as of April 30, 1999, to the 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(a) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1999 and is incorporated herein by reference.
4(k)	Amendment No. 3, dated as of July 29, 1999, to the Credit Agreement dated as of February 12, 1998, among the Company's subsidiaries listed therein and the Chase Manhattan Bank, as administrative agent, which was filed as Exhibit 4(n) to the Company's Annual Report on Form 10-K for the year ended September 30, 1999 and is incorporated herein by reference.
4(l)	Amendment No. 4, dated as of September 8, 1999, to the Credit Agreement dated as of February 12, 1998, among the Company's subsidiaries listed therein and the Chase Manhattan Bank, as administrative agent, which was filed as Exhibit 4(o) to the Company's Annual Report on Form 10-K for the year ended September 30, 1999 and is incorporated herein by reference..
4(m)	Amendment No. 5, dated as of January 12, 2000, to the 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 adminitrative agent, which was filed as Exhibit 4(a) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1999 and is incorporated herein by reference.

EXHIBIT NO.	DESCRIPTION OF EXHIBIT
4(n)	Registration Rights Agreement, dated as of July 19, 1999, between the Company and TPG Magellan LLC, filed as Exhibit 4.2 to the Company's current report on Form 8-K, which was filed on July 21, 1999, and is incorporated herein by reference.
4(o)	Amended and Restated Investment Agreement, dated December 14, 1999, between the Company and TPG Magellan LLC together with the following exhibits: (i) form of Certificate of Designations of Series A Cumulative Convertible Preferred Stock; (ii) form of Certificate of Designation of Series B Cumulative Convertible Preferred Stock; (iii) form of Certificate of Designations of Series C Junior Participating Preferred Stock, which was filed as Exhibit 4(r) to the Company's Annual Report on Form 10-K for the year ended September 30, 1999 and is incorporated herein by reference.
4(p)	Amendment Number One to Registration Rights Agreement, dated as of October 15, 1999, between the Company and TPG Magellan LLC, which was filed as Exhibit 4(d) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1999 and is incorporated herein by reference.
4(q)	Amendment No. 6, dated as of August 10, 2000, to the 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(a) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2000 and is incorporated herein by reference.
+4(r)	Amendment No. 7, dated as of September 19, 2000, to the 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.
+4(s)	Amendment No. 8, dated as of November 21, 2000, to the 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.
*10(a)	1992 Stock Option Plan of the Company, as amended, which was filed as Exhibit 10(c) to the Company's Annual Report on Form 10-K for the year ended September 30, 1994, and is incorporated herein by reference.
*10(b)	1992 Directors' Stock Option Plan of the Company, as amended, which was filed as Exhibit 10(d) to the Company's Annual Report on Form 10-K for the year ended September 30, 1994, and is incorporated herein by reference.
*10(c)	1994 Stock Option Plan of the Company, as amended, which was filed as Exhibit 10(e) to the Company's Annual Report on Form 10-K for the year ended September 30, 1994, and is incorporated herein by reference.
*10(d)	Directors' Unit Award Plan of the Company, which was filed as Exhibit 10(i) to the Company's Registration Statement on Form S-4 (No. 33-53701) filed May 18, 1994, and is incorporated herein by reference.
*10(e)	1996 Stock Option Plan of the Company, which was filed as Exhibit 10(a) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1996 and is incorporated herein by reference.
*10(f)	1996 Directors' Stock Option Plan of the Company, which was filed as Exhibit 10(b) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1996 and is incorporated herein by reference.

EXHIBIT NO.	DESCRIPTION OF EXHIBIT
*10(g)	1997 Stock Option Plan of the Company, which was filed as Exhibit 10(i) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1997, and is incorporated herein by reference.
*10(h)	Amendment to the Company's 1992 Directors' Stock Option Plan, which was filed as Exhibit 10(d) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.
*10(i)	Amendment to the Company's Directors' 1996 Directors Stock Option Plan, which was filed as Exhibit 10(e) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.
*10(j)	Amendment to the Company's 1994 Stock Option Plan, which was filed as Exhibit 10(f) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.
*10(k)	Amendment to the Company's 1996 Stock Option Plan, which was filed as Exhibit 10(g) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.

*10(l)	Amendment to the Company's 1997 Stock Option Plan, which was filed as Exhibit 10(h) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.
*10(m)	Amended 1998 Stock Option Plan of the Company, which was filed as Exhibit 10(i) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.
*10(n)	Third Amendment to the Company's 1998 Stock Option Plan, which was filed as Exhibit 10(j) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.
*10(o)	Written description of the Green Spring Health Services, Inc. Annual Incentive Plan for the period ended September 30, 1998, which was filed as Exhibit 10(s) to the Company's Annual Report on Form 10-K for the year ended September 30, 1998 and is incorporated herein by reference.
*10(p)	Magellan Corporate Short-Term Incentive Plan for the fiscal year ended September 30, 1999, which was filed as Exhibit 10(a) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.
*10(q)	Magellan Behavioral Health Short-Term Incentive Plan for the fiscal year ended September 30, 1999, which was filed as Exhibit 10(b) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.
*10(r)	Letter Agreement, dated March 2, 1999, between the Company and Clifford W. Donnelly, Executive Vice President of the Company, which was filed as Exhibit 4(a) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1999 and is incorporated herein by reference.
*10(s)	Letter Agreement, dated June 4, 1999, between the Company and Mark S. Demilio, Executive Vice President of the Company, which was filed as Exhibit 4(a) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended December 31, 1999 and is incorporated herein by reference.

EXHIBIT NO.	DESCRIPTION OF EXHIBIT
10(t)	Warrant Purchase Agreement, dated June 16, 1997, between the Company and Crescent Operating, Inc., which was filed as Exhibit 99(g) to the Company's current report on Form 8-K, which was filed on June 30, 1997, and is incorporated herein by reference.
*10(u)	1998 Stock Option Plan of the Company which was filed as Exhibit (ay) to the Company's Registration Statement on Form S-4, which was filed on April 3, 1998, and is incorporated herein by reference.
*10(v)	Employment Agreement, dated December 9, 1998, between Magellan Behavioral Health, Inc. and John Wider, President and Chief Operating Officer of Magellan Behavioral Health, Inc., which was filed as Exhibit 10 to the Company's Form 10-Q for the quarterly period ended December 31, 1998 and is incorporated herein by reference.
*10(w)	Employment Agreement, dated February 11, 1999, between the

	Company and Clarissa C. Marques, Ph.D., Executive Vice President of the Company, which was filed as Exhibit 10(c) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999 and is incorporated herein by reference.
*10(x)	Employment Agreement, dated June 25, 1998, between the Company and Henry T. Harbin, M.D., President, Chief Executive Officer of the Company, which was filed as exhibit 10(a) to the Company's quarterly report on Form 10-Q for the quarterly period ended June 30, 1998 and is incorporated herein by reference.
10(y)	Offer to Purchase and Consent Solicitation Statement, dated January 12, 1998, by the Company for all of its 11 1/4% Series A Senior Subordinated Notes due 2008, which was filed as Exhibit 10(ad) to the Company's Registration Statement on Form S-4, which was filed on April 3, 1998, and is incorporated herein by reference.
10(z)	Offer to Purchase and Consent Solicitation Statement, dated January 12, 1998, by Merit Behavioral Care Corporation for all of its 11 1/2% Senior Subordinated Notes due 2005, which was filed as Exhibit 10(ad) to the Company's Registration Statement on Form S-4, which was filed on April 3, 1998, and is incorporated herein by reference.
10(aa)	Agreement and Plan of Merger by and among Merit Behavioral Care Corporation, Merit Merger Corp., and CMG Health, Inc. dated as of July 14, 1997, which was filed as Exhibit 10(ah) to the Company's Annual Report on Form 10-K for the year ended September 30, 1998 and is incorporated herein by reference.
10(ab)	Stock purchase Agreement, dated as of Januiary 28, 2000, by and among Magellan Health Services, Inc.; Allied Specialty Care Services, Inc. and Vivra Holdings, Inc., which was filed as Exhibit 2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2000 and is incorporated herein by reference.
10(ac)	Magellan Corporate Short-Term Incentive Plan for the fiscal year ended September 30, 2000, which was filed as Exhibit 10(a) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2000 and is incorporated herein by reference.
10(ad)	Magellan Behavioral Health Short-Term Incentive Plan for the fiscal year ended September 30, 2000, which was filed as Exhibit 10(b) to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2000 and is incorporated herein by reference.
+10(ae)	Magellan Health Services, Inc.--2000 Employee Stock Purchase Plan.
+10(af)	Magellan Health Services, Inc.--2000 Long-Term Incentive Compensation Plan.
+21	List of subsidiaries of the Company.

EXHIBIT NO.	DESCRIPTION OF EXHIBIT
+23	Consent of Arthur Andersen LLP.
+27	Financial Data Schedule

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* Constitutes a management contract or compensatory plan arrangement.

\+ Filed herewith.

(B) REPORTS ON FORM 8-K:

None

(C) EXHIBITS REQUIRED BY ITEM 601 OF REGULATION S-K:

Exhibits required to be filed by the Company pursuant to Item 601 of Regulation S-K are contained in a separate volume.

(D) FINANCIAL STATEMENTS AND SCHEDULES REQUIRED BY REGULATION S-X ITEM 14(D):

(1) The audited consolidated financial statements of Choice Behavioral Health Partnership ("Choice"), which has a fiscal year end of December 31, 2000, will be filed in an amendment to this Form 10-K no later than March 31, 2001.

(2) Not applicable.

(3) Information with respect to this item is contained on page S-1 of this Annual Report on Form 10-K.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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: December 26, 2000

Mark S. Demilio
Executive Vice President, Finance and Legal

Date: December 26, 2000

Thomas C. Hofmeister
Senior Vice President and Chief Accounting Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
--- Henry T. Harbin	President, Chief Executive Officer And Director	December 26, 2000
--- David Bonderman	Director	December 26, 2000
--- Jonathan J. Coslet	Director	December 26, 2000
--- G. Fred DiBona, Jr.	Director	December 26, 2000
--- Andre C. Dimitriadis	Director	December 26, 2000

--- A.D. Frazier, Jr.	Director	December 26, 2000
--- Gerald L. McManis	Director	December 26, 2000

SIGNATURE	TITLE	DATE
--- Daniel S. Messina	Chief Operating Officer and Director	December 26, 2000
--- Robert W. Miller	Chairman of the Board of Directors	December 26, 2000
--- Darla D. Moore	Director	December 26, 2000
--- Jeffrey A. Sonnenfeld	Director	December 26, 2000
--- James B. Williams	Director	December 26, 2000

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES
INDEX TO FINANCIAL STATEMENTS

The following consolidated financial statements of the registrant and its subsidiaries are submitted herewith in response to Item 8 and Item 14(a)1:

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MAGELLAN HEALTH SERVICES, INC.	
Audited Consolidated Financial Statements	
Report of independent public accountants................	F-2
Consolidated balance sheets as of September 30, 1999 and 2000..	F-3
Consolidated statements of operations for the fiscal years ended September 30, 1998, 1999 and 2000..........	F-4
Consolidated statements of changes in stockholders' equity for the fiscal years ended September 30, 1998, 1999 and 2000..	F-5
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Notes to consolidated financial statements.............	F-7

The following financial statement schedule of the registrant and its subsidiaries is submitted herewith in response to Item 14(a)2:

	PAGE
Schedule II -- Valuation and qualifying accounts........	S-1

Financial statements in response to Item 14(d)(1):

CHOICE BEHAVIORAL HEALTH PARTNERSHIP

The audited consolidated financial statements of Choice Behavioral Health Partnership ("Choice"), which has a fiscal year end of December 31, 2000, will be filed in an amendment to this Form 10-K no later than March 31, 2001.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of Magellan Health Services, Inc:

We have audited the accompanying consolidated balance sheets of Magellan Health Services, Inc. (a Delaware corporation) and subsidiaries as of September 30, 1999 and 2000, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the three years in the period ended September 30, 2000. These consolidated financial statements and the schedule referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Magellan Health Services, Inc. and subsidiaries as of September 30, 1999 and 2000 and the results of their operations and their cash flows for each of the three years in the period ended September 30, 2000 in conformity with accounting principles generally accepted in the United States.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule listed in the index to financial statements is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, fairly states, in all material respects, the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

Arthur Andersen LLP

Baltimore, Maryland
December 11, 2000

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	SEPTEMBER 30, 1999	SEPTEMBER 30, 2000
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 37,440	$ 41,628
Accounts receivable, less allowance for doubtful accounts of $28,437 at September 30, 1999 and $11,592 at September 30, 2000	198,646	137,224
Restricted cash and investments	116,824	117,723
Refundable income taxes	3,452	4,416
Other current assets	18,565	18,662

Total Current Assets	374,927	319,653
Property and equipment, net	120,667	112,612
Deferred income taxes	91,657	121,782
Investments in unconsolidated subsidiaries	18,396	12,746
Other long-term assets	9,599	10,235
Goodwill, net of accumulated amortization of $60,869 at September 30, 1999 and $81,286 at September 30, 2000	1,108,086	1,074,753
Other intangible assets, net of accumulated amortization of $26,457 at September 30, 1999 and $40,789 at September 30, 2000	158,283	152,006
	$1,881,615	$1,803,787

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:		
Accounts payable	$ 44,425	$ 40,687
Accrued liabilities	209,796	175,698
Medical claims payable	189,928	219,375
Current maturities of long-term debt and capital lease obligations	30,119	34,119
Total Current Liabilities	474,268	469,879
Long-term debt and capital lease obligations	1,114,189	1,063,928
Deferred credits and other long-term liabilities	92,948	83,226
Minority interest	3,514	456
Commitments and Contingencies		
Redeemable Preferred Stock	--	57,834
Stockholders' Equity:		
Preferred stock, without par value		
Authorized -- 10,000 shares at September 30, 1999 and 9,793 shares at September 30, 2000		
Issued and outstanding -- none	--	--
Common stock, par value $.25 per share		
Authorized -- 80,000 shares		
Issued and outstanding -- 34,268 shares at September 30, 1999 and 34,936 shares at September 30, 2000	8,566	8,733
Other Stockholders' Equity:		
Additional paid-in capital	352,030	349,541
Accumulated deficit	(144,550)	(210,358)
Warrants outstanding	25,050	25,050
Common stock in treasury, 2,289 shares at September 30, 1999 and September 30, 2000	(44,309)	(44,309)
Cumulative foreign currency adjustments included in other comprehensive income	(91)	(193)
Total Stockholders' Equity	196,696	128,464
	$1,881,615	$1,803,787

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

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	FISCAL YEAR ENDED SEPTEMBER 30,		
	1998	1999	2000
Net revenue	$1,167,274	$1,674,479	$1,873,554

Costs and expenses:			
Salaries, cost of care and other operating expenses	1,043,251	1,468,879	1,652,582
Equity in earnings of unconsolidated subsidiaries	(12,795)	(20,442)	(9,792)
Depreciation and amortization	46,898	68,921	75,413
Interest, net	76,505	93,752	97,286
Stock option expense (credit)	(5,623)	18	--
Managed care integration costs	16,962	6,238	--
Special charges	--	4,441	25,398
	1,165,198	1,621,807	1,840,887
Income from continuing operations before income taxes, minority interest and extraordinary items	2,076	52,672	32,667
Provision for income taxes	5,238	28,256	15,478
Income (loss) from continuing operations before minority interest and extraordinary items	(3,162)	24,416	17,189
Minority interest	4,094	630	114
Income (loss) from continuing operations before extraordinary items	(7,256)	23,786	17,075
Discontinued operations:			
Income (loss) from discontinued operations (1)	20,988	28,325	(65,221)
Loss on disposal of discontinued operations, net of income tax benefit of $31,616 in 1999 and $9,224 in 2000	--	(47,423)	(17,662)
	20,988	(19,098)	(82,883)
Income (loss) before extraordinary items	13,732	4,688	(65,808)
Extraordinary items -- net losses on early extinguishments of debt (net of income tax benefit of $22,010 in 1998)	(33,015)	--	--
Net income (loss)	(19,283)	4,688	(65,808)
Preferred dividend requirement and amortization of redeemable preferred stock issuance costs	--	--	3,802
Income (loss) available to common stockholders	(19,283)	4,688	(69,610)
Other comprehensive income (loss)	675	1,106	(102)
Comprehensive income (loss)	$ (18,608)	$ 5,794	$ (69,712)
Weighted average number of common shares outstanding -- basic	30,784	31,758	32,144
Weighted average number of common shares outstanding -- diluted	30,784	31,916	32,386
Income (loss) per common share available to common stockholders -- basic:			
Income (loss) from continuing operations before extraordinary items	$ (0.24)	$ 0.75	$ 0.41
Income (loss) from discontinued operations	$ 0.68	$ (0.60)	$ (2.58)
Extraordinary losses on early extinguishments of debt	$ (1.07)	$ --	$ --
Net income (loss)	$ (0.63)	$ 0.15	$ (2.17)
Income (loss) per common share available to common stockholders -- diluted:			
Income (loss) from continuing operations before extraordinary items	$ (0.24)	$ 0.75	$ 0.41
Income (loss) from discontinued operations	$ 0.68	$ (0.60)	$ (2.56)
Extraordinary losses on early extinguishments of debt	$ (1.07)	$ --	$ --
Net income (loss)	$ (0.63)	$ 0.15	$ (2.15)

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(1) Net of income tax provision (benefit) of $13,687, $19,763 and (34,059) for fiscal 1998, 1999 and 2000, respectively.

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

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(IN THOUSANDS)

	FISCAL YEAR ENDED SEPTEMBER 30,		
	1998	1999	2000
Common Stock:			
Balance, beginning of period	$ 8,361	$ 8,476	$ 8,566
Exercise of options	115	90	167
Balance, end of period	8,476	8,566	8,733
Additional paid-in capital:			
Balance, beginning of period	340,645	349,651	352,030
Stock option expense (credit)	(5,623)	18	--
Exercise of options and warrants	3,867	2,542	1,313
Preferred dividend requirement and amortization of redeemable preferred stock issuance cost	--	--	(3,802)
Green Spring Minority Stockholder Conversion	10,722	--	--
Other	40	(181)	--
Balance, end of period	349,651	352,030	349,541
Accumulated deficit:			
Balance, beginning of period	(129,955)	(149,238)	(144,550)
Net income (loss)	(19,283)	4,688	(65,808)
Balance, end of period	(149,238)	(144,550)	(210,358)
Warrants outstanding:			
Balance, beginning and end of period	25,050	25,050	25,050
Common stock in treasury:			
Balance, beginning of period	(82,731)	(44,309)	(44,309)
Purchases of treasury stock	(14,352)	--	--
Green Spring Minority Stockholder Conversion	52,774	--	--
Balance, end of period	(44,309)	(44,309)	(44,309)
Cumulative foreign currency adjustments included in other comprehensive income:			
Balance, beginning of period	(1,872)	(1,197)	(91)
Components of other comprehensive income (loss):			
Unrealized foreign currency translation gain (loss) (net of reclassification adjustment related to sale of European Hospitals of $1,678 in 1999)	1,125	(230)	(171)
Sale of European Hospitals	--	2,074	--
	1,125	1,844	(171)
Provision for (benefit from) income taxes	450	738	(69)
Other comprehensive income (loss)	675	1,106	(102)
Balance, end of period	(1,197)	(91)	(193)
Total Stockholders' Equity	$ 188,433	$ 196,696	$ 128,464

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

MAGELLAN HEALTH SERVICES, INC. SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(IN THOUSANDS)

	FISCAL YEAR ENDED SEPTEMBER 30,		
	1998	1999	2000
Cash Flows From Operating Activities			
Net income (loss)	$ (19,283)	$ 4,688	$(65,808)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Gain on sale of assets	(3,001)	(23,623)	(2,442)
Loss on CBHS Transactions	--	79,039	--
Depreciation and amortization	49,264	73,531	79,244
Impairment of long-lived assets	2,507	--	91,015
Other non-cash portion of special charges and discontinued operations	37,499	(422)	
Equity in earnings of unconsolidated subsidiaries	(12,795)	(20,442)	(9,792)
Stock option expense (credit)	(5,623)	18	--
Non-cash interest expense	2,935	3,843	4,376
Extraordinary losses on early extinguishments of debt	55,025	--	--
Cash flows from changes in assets and liabilities, net of effects from sales and acquisitions of businesses:			
Accounts receivable, net	(1,585)	(21,321)	63,057
Restricted cash and investments	(21,782)	(22,130)	(899)
Other assets	1,945	8,759	(8,246)
Accounts payable and accrued liabilities	(50,082)	(20,842)	(42,960)
Medical claims payable	6,358	(22,202)	19,767
Income taxes payable and deferred income taxes	(14,489)	14,143	(31,089)
Reserve for unpaid claims	(19,177)	(30,196)	(78)
Other liabilities	(9,290)	17,224	(8,361)
Minority interest, net of dividends paid	(929)	3,142	(1,010)
Other	(1,701)	(1,333)	(102)
Total adjustments	15,079	37,188	152,480
Net cash provided by (used in) operating activities	(4,204)	41,876	86,672
Cash Flows From Investing Activities:			
Capital expenditures	(44,213)	(48,119)	(36,924)
Acquisitions and investments in businesses, net of cash acquired	(1,046,436)	(69,457)	(68,597)
Conversion of joint ventures from consolidation to equity method	--	(21,092)	--
Distributions received from unconsolidated subsidiaries	11,441	21,970	14,324
Decrease in assets restricted for settlement of unpaid claims and other long-term liabilities	51,006	42,570	(214)
Proceeds from sale of assets	11,875	54,196	3,300
Net cash used in investing activities	(1,016,327)	(19,932)	(88,111)
Cash Flows From Financing Activities:			
Payments on debt and capital lease obligations	(438,633)	(156,004)	(110,260)
Proceeds from issuance of debt, net of issuance costs	1,188,706	76,818	59,642
Proceeds from issuance of redeemable preferred stock, net of issuance costs	--	--	54,765
Proceeds from exercise of stock options and warrants	3,982	2,632	1,480
Purchases of treasury stock	(14,352)	--	--
Net cash provided by (used in) financing activities	739,703	(76,554)	5,627
Net increase (decrease) in cash and cash equivalents	(280,828)	(54,610)	4,188
Cash and cash equivalents at beginning of period	372,878	92,050	37,440
Cash and cash equivalents at end of period	$ 92,050	$ 37,440	$ 41,628

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

MAGELLAN HEALTH SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The consolidated financial statements of Magellan Health Services, Inc., a Delaware corporation, ("Magellan" or the "Company") include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company conducts business in two business segments, the behavioral managed healthcare business segment and the human services business segment. These segments are described in further detail in Note 14, "Business Segment Information."

On September 2, 1999, the Company's Board of Directors approved a formal plan to dispose of the businesses and interests that comprise the Company's healthcare provider and healthcare franchising business segments (the "Disposal Plan"). On October 4, 2000, the Company adopted a formal plan to dispose of the business and interest that comprised the Company's specialty managed healthcare business segment. The results of operations of the healthcare provider, healthcare franchising and specialty managed healthcare business segments have been reported in the accompanying financial statements as discontinued operations for all periods presented. In reporting the specialty managed healthcare segment as discontinued operations, the Company has followed the provisions of Emerging Issues Task Force No. 95-18 ("EITF 95-18"), "Accounting and Reporting for a Discontinued Business Segment When the Measurement Date Occurs after the Balance Sheet Date but before the Issuance of Financial Statements."

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

MANAGED CARE REVENUE

Managed care revenue is recognized over the applicable coverage period on a per member basis for covered members and as earned and estimable for performance-based revenues. Deferred revenue is recorded when premium payments are received in advance of the applicable coverage period.

ADVERTISING COSTS

The production costs of advertising are expensed as incurred. The Company does not consider any of its advertising costs to be direct-response and, accordingly, does not capitalize such costs. Advertising costs consist primarily of radio and television air time, which are expensed as incurred, and printed media services. Advertising expense for continuing operations was approximately \$2.4 million, \$2.1 million and \$2.9 million for the fiscal years ended September 30, 1998, 1999 and 2000, respectively. Advertising expense for discontinued operations was approximately \$2.5 million, \$0.5 million and \$0.1 million for the years ended September 30, 1998, 1999, and 2000, respectively.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INTEREST, NET

The Company records interest expense net of interest income. Interest income for the fiscal years ended September 30, 1998, 1999, and 2000 was approximately \$10.8 million, \$10.4 million and \$9.4 million, respectively.

CASH AND CASH EQUIVALENTS

Cash equivalents are short-term, highly liquid interest-bearing investments with a maturity of three months or less when purchased, consisting primarily of money market instruments.

RESTRICTED CASH AND INVESTMENTS

Restricted cash and investments at September 30, 1999 and 2000 include approximately $116.8 million and $117.7 million, respectively 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.

CONCENTRATION OF CREDIT RISK

Accounts receivable subject the Company to a concentration of credit risk with third party payors that include health insurance companies, managed healthcare organizations, healthcare providers and governmental entities. The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific payors, historical trends and other information. Management believes the allowance for doubtful accounts is adequate to provide for normal credit losses.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost, except for assets that have been impaired, for which the carrying amount is reduced to estimated fair value. Expenditures for renewals and improvements are charged to the property accounts. Replacements and maintenance and repairs that do not improve or extend the life of the respective assets are expensed as incurred. Internal-use software is capitalized in accordance with AICPA Statement of Position 98-1, "Accounting for Cost of Computer Software Developed or Obtained for Internal Use." Amortization of capital lease assets is included in depreciation expense. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets, which is generally two to ten years for buildings and improvements, three to ten years for equipment and three to five years for capitalized internal-use software. Depreciation expense for continuing operations was $18.6 million, $28.0 million and $34.2 million for the fiscal years ended September 30, 1998, 1999 and 2000, respectively. Depreciation expense for discontinued operations was $5.4 million, $4.3 million and $2.5 million for the fiscal years ended September 30, 1998, 1999 and 2000, respectively.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Property and equipment, net, consisted of the following at September 30, 1999 and 2000 (in thousands):

	SEPTEMBER 30,	
	1999	2000
Land	$ 114	$ 114
Buildings and improvements	12,079	13,146
Equipment	119,518	130,953
Capitalized internal-use software	55,648	63,500
	187,359	207,713
Accumulated depreciation	(66,692)	(95,101)
Property and equipment, net	$120,667	$112,612

INTANGIBLE ASSETS

Intangible assets are composed principally of (i) goodwill, (ii) customer lists and relationships and (iii) deferred financing costs. Goodwill represents the excess of the cost of businesses acquired over the fair value of the net identifiable assets at the date of acquisition and is amortized using the straight-line method over 25 to 40 years. Customer lists and relationships and other intangible assets are amortized using the straight-line method over their estimated useful lives of 4 to 30 years. Deferred financing costs are amortized over the terms of the underlying agreements.

The Company continually monitors events and changes in circumstances which could indicate that carrying amounts of intangible assets may not be recoverable. When events or changes in circumstances are present that indicate the carrying amount of intangible assets may not be recoverable, the Company assesses the recoverability of intangible assets by determining whether the carrying value of such intangible assets will be recovered through the future cash flows expected from the use of the asset and its eventual disposition. In fiscal 2000, the Company recorded impairment losses on intangible assets and other long-lived assets of $15.8 million for continuing operations and $75.3 million for discontinued operations. See Note 3--"Discontinued Operations" and Note 10--"Managed Care Integration Costs and Special Charges".

MEDICAL CLAIMS PAYABLE

Medical claims payable represent the liability for healthcare claims reported but not yet paid and claims incurred but not yet reported ("IBNR") related to the Company's managed healthcare businesses. The IBNR portion of medical claims payable is estimated based upon authorized healthcare services, past claim payment experience for member groups, adjudication decisions, enrollment data, utilization statistics and other factors. Although considerable variability is inherent in such estimates, management believes the liability for medical claims payable is adequate. Medical claims payable balances are continually monitored and reviewed. Changes in assumptions for care costs caused by changes in actual experience could cause these estimates to change in the near term.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FOREIGN CURRENCY

Changes in the cumulative translation of foreign currency assets and liabilities are presented as a separate component of stockholders' equity. Gains and losses resulting from foreign currency transactions, which were not material, are included in operations as incurred.

NET INCOME (LOSS) PER COMMON SHARE

Net income (loss) per common share is computed based on the weighted average number of shares of common stock and common stock equivalents outstanding during the period. See Note 6.

STOCK-BASED COMPENSATION

In October 1995, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," ("FAS 123") which became effective for fiscal years beginning after December 15, 1995 (fiscal 1997 for the Company). FAS 123 established new financial accounting and reporting standards for stock-based compensation plans. Entities are allowed to measure compensation cost for stock-based compensation under FAS 123 or APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Entities electing to remain with the accounting in APB 25 are required to make pro forma disclosures of net income and income per common share as if the provisions of FAS 123 had been applied. The Company has adopted FAS 123 on a pro forma disclosure basis. The Company continues to account for stock-based compensation under APB 25. See Note 6, "Stockholders' Equity".

RECENT ACCOUNTING PRONOUNCEMENTS

In June 1998, FAS No. 133 "Accounting for Derivative Instruments and Hedging Activities," (FAS No. 133) was issued. FAS No. 133 establishes accounting and reporting standards for derivative instruments and derivative instruments embedded in other contracts, (collectively referred to as derivatives) and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (b) a hedge of the exposure to variability in cash flows attributable to a particular risk, or (c) a hedge of the foreign currency exposure of a net investment on a foreign operation, an unrecognized firm commitment, an available for sale security and a forecasted transaction. FAS No. 137, "Accounting for Derivative Instruments and Hedging Activities--Deferral of the Effective Date of FASB Statement No. 133" was issued in June 1999 and deferred the effective date of FAS No. 133 to fiscal years beginning after June 15, 2000. FAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities", was issued on June 2000 and also amends FAS No. 133. FAS No. 138 addresses a limited number of issues causing implementation difficulties. Consequently, the Company will be required to implement FAS No. 133 for all fiscal quarters for the fiscal year beginning October 1, 2000. The Company expects the adoption of this pronouncement will not have a material effect on the Company's financial statements.

Emerging Issues Task Force Issue 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Approval or Veto Rights" ("EITF 96-16") supplements the guidance contained in AICPA Accounting Research Bulletin 51, "Consolidated Financial Statements", and in Statement of Financial Accounting Standards No. 94, "Consolidation of All Majority-Owned Subsidiaries" ("ARB 51/FAS 94"), about the conditions under which the Company's consolidated financial statements should include the financial position, results of operations and cash flows of subsidiaries which are less than wholly-owned along with those of the Company's wholly-owned subsidiaries.

In general, ARB 51/FAS 94 requires consolidation of all majority-owned subsidiaries except those for which control is temporary or does not rest with the majority owner. Under the ARB 51/FAS 94 approach, instances of control not resting with the majority owner were generally regarded to arise from such events as the legal reorganization or bankruptcy of the majority-owned subsidiary. EITF 96-16 expands the definition of instances in which control does not rest with the majority owner to include those where significant approval or veto rights, other than those which are merely protective of the minority shareholder's interest, are held by the minority shareholder or shareholders ("Substantive Participating Rights"). Substantive Participating Rights include, but are not limited to: i) selecting, terminating and setting the compensation of management responsible for implementing the majority-owned subsidiary's policies and procedures, and ii) establishing operating and capital decisions of the majority-owned subsidiary, including budgets, in the ordinary course of business.

The provisions of EITF 96-16 apply to new investment agreements made after July 24, 1997, and to existing investment agreements which are modified after this date. The Company has made no new investments, and has modified no existing investments, to which the provisions of EITF 96-16 would have applied.

In addition, the provisions of EITF 96-16 must be applied to majority-owned subsidiaries previously consolidated under ARB 51/FAS 94 for which the underlying agreements have not been modified in financial statements issued for years ending after December 15, 1998 (fiscal 1999 for the Company). The adoption of the provisions of EITF 96-16 on October 1, 1998, had the following effects on the Company's consolidated financial position (in thousands):

OCTOBER 1,

	1998
Increase (decrease) in:	
Cash and cash equivalents	$(21,092)
Other current assets	(9,538)
Long-term assets	(30,049)
Investment in unconsolidated subsidiaries	26,498
Total Assets	$(34,181)
Current liabilities	$(10,381)
Minority interest	(23,800)
Total Liabilities	$(34,181)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

RECLASSIFICATIONS

Certain reclassifications have been made to fiscal 1998 and 1999 amounts to conform to fiscal 2000 presentation.

2. ACQUISITIONS AND JOINT VENTURES

ACQUISITIONS

MERIT ACQUISITION. On February 12, 1998, the Company consummated the acquisition of Merit Behavioral Care Corporation ("Merit") for cash consideration of approximately $448.9 million plus the repayment of Merit's debt. Merit managed behavioral healthcare programs 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 governmental agencies and various state Medicaid programs. The Company accounted for the Merit acquisition using the purchase method of accounting. By virtue of acquiring Merit, the Company may be required to make certain payments to the former shareholders of CMG Health, Inc. ("CMG") a managed behavioral healthcare company that was acquired by Merit in September 1997. Such contingent payments are subject to an aggregate maximum of $23.5 million. The Company has initiated legal proceedings against certain former owners of CMG with respect to representations made by such former owners in conjunction with Merit's acquisition of CMG. Whether any contingent payments will be made to the former shareholders of CMG and the amount and timing of contingent payments, if any, may be subject to the outcome of these proceedings.

In connection with the acquisition of Merit, the Company (i) terminated its existing 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 "Credit Agreement") providing for a revolving credit facility (the "Revolving Facility") and a term loan facility (the "Term Loan Facility") of up to $700 million; and (vi) issued $625 million in 9.0% Senior Subordinated Notes due 2008 (the "Notes").

2. ACQUISITIONS AND JOINT VENTURES (CONTINUED)

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
Credit Agreement:	
Revolving Facility (1)................................	20,000
Term Loan Facility....................................	550,000
The 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.

(2) Includes principal amount of $193.7 million and accrued interest of $2.8 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 $18.8 million and accrued interest of $2.9 million.

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

HAI ACQUISITION. On December 4, 1997, the Company consummated the purchase of Human Affairs International, Incorporated ("HAI"), formerly a unit of Aetna, Inc. ("Aetna"), for approximately $122.1 million, which the Company funded from cash on hand. HAI managed behavioral healthcare programs, primarily through Employee Assistance Programs ("EAPs") and other behavioral managed healthcare plans. The Company may be obligated to make contingent payments totaling $60 million annually, under two separate calculations, which are primarily based upon membership levels during the contract year (as defined) and are calculated at the end of the contract year. "Contract Year" means each of the twelve-month periods ending on the last day of December in 1998, 1999, 2000, 2001 and 2002. The Company accounted for the HAI acquisition using the purchase method of accounting.

The Company paid $60.0 million to Aetna for both the Contract Years ended December 31, 1998 and 1999. Also, based upon the most recent membership enrollment data related to the Contract Year to end December 31, 2000 ("Contract Year 3"), the Company believes beyond a reasonable doubt that it will be required to make the full $60 million payment related to Contract Year 3 and has included this amount in

2. ACQUISITIONS AND JOINT VENTURES (CONTINUED)

goodwill. The Company recorded $120.0 million of goodwill and other intangible assets related to the purchase of HAI during fiscal 1999, related to Contract Years 1 and 2. The Contract Year 3 liability of $60.0 million is included in "Deferred credits and other long-term liabilities" in the Company's consolidated balance sheet as of September 30, 2000. The Company intends to borrow under the

Revolving Facility to meet this obligation, which is expected to be paid during the second quarter of fiscal 2001.

The Company would record additional contingent consideration payable, if any, as goodwill and identifiable intangible assets.

GREEN SPRING ACQUISITION. On December 13, 1995, the Company acquired a 51% ownership interest in Green Spring Health Services, Inc. ("Green Spring") for approximately $68.9 million in cash, the issuance of 215,458 shares of common stock valued at approximately $4.3 million and the contribution of Group Practice Affiliates, Inc. ("GPA"), a wholly-owned subsidiary of the Company, which became a wholly-owned subsidiary of Green Spring. In addition, the minority stockholders of Green Spring were issued an option agreement whereby they could exchange their interests in Green Spring for an equivalent of the Company's common stock or subordinated notes (the "Exchange Option"). On December 20, 1995, the Company acquired an additional 10% ownership interest in Green Spring for approximately $16.7 million in cash as a result of an exercise by a minority stockholder of its Exchange Option. In January 1998, the minority stockholders of Green Spring converted their collective 39% interest in Green Spring into an aggregate of 2,831,516 shares of the Company's common stock through exercise of the Exchange Option (the "Green Spring Minority Stockholder Conversion"). As a result of the Green Spring Minority Stockholder Conversion, the Company owns 100% of Green Spring. The Company issued shares from treasury to effect the Green Spring Minority Stockholder Conversion and accounted for it as a purchase of minority interest at a fair value of consideration paid of approximately $63.5 million.

The Company accounted for the Green Spring acquisition using the purchase method of accounting. Green Spring's results of operations have been included in the Company's consolidated financial statements since the acquisition date, less minority interest through January, 1998, at which time the Company became the sole owner of Green Spring.

The following unaudited pro forma information for the fiscal year ended September 30, 1998 has been prepared assuming the HAI acquisition, Merit acquisition and the Green Spring Minority Stockholder Conversion (as defined) were consummated on October 1, 1997. 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 on October 1, 1997 or which may be attained in future periods (in thousands, except per share data):

	SEPTEMBER 30, 1998
Net revenue	$1,437,572
Loss from continuing operations before extraordinary item(1)(2)	(1,700)
Loss per common share -- basic:	
Loss from continuing operations before extraordinary item	(0.06)
Loss per common share -- diluted:	
Loss from continuing operations before extraordinary item	(0.06)

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(1) Excludes expected unrealized cost savings related to the Integration Plan (as defined) and managed care integration costs (See Note 10).

(2) Excludes the extraordinary losses on early extinguishment of debt for the

year ended September 30, 1998.

JOINT VENTURES

Through its acquisition of Merit, the Company became a 50% partner with Value Options, Inc. in Choice Behavioral Health Partnership ("Choice"), a managed behavioral healthcare company. Choice derives all of its revenues from a contract with the Civilian Health and Medical Program of the Uniformed Services ("CHAMPUS"), and with TriCare, the successor to CHAMPUS. The Company accounts for its investment in Choice using the equity method.

2. ACQUISITIONS AND JOINT VENTURES (CONTINUED)

A summary of unaudited financial information for the Company's investment in Choice is as follows (in thousands):

	SEPTEMBER 30, 1999	SEPTEMBER 30, 2000
Current assets	$19,572	$19,144
Property and equipment, net	228	132
Total assets	$19,800	$19,276
Current liabilities	$12,673	$16,212
Partners' capital	7,127	3,064
Total liabilities and partners' capital	$19,800	$19,276
Magellan investment in Choice	$ 3,563	$ 1,532

	FOR THE 231 DAYS ENDED SEPTEMBER 30, 1998	FISCAL YEAR ENDED SEPTEMBER 30, 1999	FISCAL YEAR ENDED SEPTEMBER 30, 2000
Net revenue	$38,676	$54,880	$56,349
Operating expenses	22,914	28,124	32,141
Net income	$15,762	$26,756	$24,208
Magellan equity income	$ 7,881	$13,378	$12,104
Cash distributions from Choice	$13,039	$13,047	$14,137

The Company owns a 50% interest in Premier Behavioral Systems of Tennessee, LLC ("Premier"). Premier was formed to manage behavioral healthcare benefits for the State of Tennessee's TennCare program. The Company accounts for its investment in Premier using the equity method. The Company's investment in Premier at September 30, 1998, 1999 and 2000 was $5.8 million, $12.1 million and $8.1 million, respectively. The Company's equity in income (loss) of Premier for fiscal 1998, 1999 and 2000 was $(4.7) million, $6.3 million and $(4.0) million, respectively. The Company has not received a partnership distribution from Premier during fiscal year 1998, 1999 and 2000.

3. DISCONTINUED OPERATIONS

HEALTHCARE PROVIDER AND FRANCHISING SEGMENTS

During fiscal 1997, the Company sold substantially all of its domestic acute-care psychiatric hospitals and residential treatment facilities (collectively, the "Psychiatric Hospital Facilities") to Crescent Real Estate Equities ("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 Crescent Operating, Inc. ("COI"), an affiliate of Crescent, formed Charter Behavioral Health Systems, LLC ("CBHS") to conduct the operations of 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 ownership interest of CBHS was owned by COI.

3. DISCONTINUED OPERATIONS (CONTINUED)

The Company initially used approximately $200 million of the proceeds from the Crescent Transactions to reduce its long-term debt, including borrowings under its then existing credit agreement. In December 1997, the Company used the remaining proceeds from the Crescent Transactions to acquire additional managed healthcare businesses. See Note 2, "Acquisitions and Joint Ventures."

On September 10, 1999, the Company consummated the transfer of assets and other interests pursuant to a Letter Agreement dated August 10, 1999 with Crescent, COI and CBHS that effects the Company's exit from its healthcare provider and healthcare franchising businesses (the "CBHS Transactions"). The terms of the CBHS Transactions are summarized as follows:

HEALTHCARE PROVIDER INTERESTS

- The Company redeemed 80% of its CBHS common interest and all of its CBHS preferred interest, leaving it with a 10% non-voting common interest in CBHS.

- The Company agreed to transfer to CBHS its interests in five of its six hospital-based joint ventures ("Provider JVs") and related real estate as soon as practicable.

- The Company transferred to CBHS the right to receive approximately $7.1 million from Crescent for the sale of two psychiatric hospitals that were acquired by the Company (and leased to CBHS) in connection with CBHS' acquisition of certain businesses from Ramsay Healthcare, Inc. in fiscal 1998.

- The Company forgave receivables due from CBHS of approximately $3.3 million for payments received by CBHS for patient services prior to the formation of CBHS on June 17, 1997. The receivables related primarily to patient stays that "straddled" the formation date of CBHS.

- The Company became obligated to pay $2.0 million to CBHS in 12 equal monthly installments beginning on the first anniversary of the closing date.

- CBHS became obligated to indemnify the Company for 20% of up to the first $50 million (i.e., $10 million) for expenses, liabilities and settlements, if any, related to government investigations for events that occurred prior to June 17, 1997 (the "CBHS Indemnification"). CBHS would be required to pay the Company a maximum of $500,000 per year under the CBHS Indemnification.

- Crescent, COI, CBHS and Magellan have provided each other with mutual releases of claims among all of the parties with respect to the original transactions that effected the formation of CBHS and the operation of CBHS since June 17, 1997 with certain specified exceptions.

- The Company transfered certain other real estate and interests related to the healthcare provider business to CBHS.

HEALTHCARE FRANCHISING INTERESTS

- The Company transferred its healthcare franchising interests to CBHS, which included Charter Advantage, LLC, the Charter call center operation, the Charter name and related intellectual property. The Company was released from performing any further franchise services or incurring future franchising expenses.

3. DISCONTINUED OPERATIONS (CONTINUED)

- The Company forgave prepaid call center management fees of approximately $2.7 million.

- The Company forgave unpaid franchise fees of approximately $115 million.

The CBHS Transactions, together with the formal plan of disposal authorized by the Company's Board of Directors on September 2, 1999, represented the disposal of the Company's healthcare provider and healthcare franchising business segments.

The Company's original plan of disposal contemplated that the disposition of all provider joint venture interests would take place within twelve months of the measurement date. The Company, with the cooperation of its joint venture partners and CBHS, has closed two of the five hospital-based joint ventures and is currently negotiating to sell its interest in the remaining three joint ventures. The proceeds from these sales will be transferred to CBHS subject to all rights of offset the Company has for certain amounts due from CBHS and certain other matters related to CBHS's bankruptcy proceedings (see discussion below). The Company is attempting to resolve with CBHS the amounts due to and from CBHS, which resolution, if any, will be subject to approvals required by CBHS's bankruptcy proceedings. Accordingly, these sales and transfers are not entirely within the control of the Company. The Company anticipates resolving these matters in fiscal 2001.

On February 16, 2000, CBHS filed a voluntary petition for relief of indebtedness under Chapter 11 of the United States Bankruptcy Code. The Company has no material receivables from CBHS apart from any amount which may be owed in the future for indemnification claims under the previously described provisions of the CBHS Transactions. In connection with the bankruptcy proceedings, CBHS has indicated it believes it has claims against the Company regarding certain previous transactions. The Company believes such claims are without merit; and in the event any such claims are made, the Company will vigorously defend such claims. The Company does not believe that CBHS' bankruptcy will have a material impact on its financial position.

SPECIALTY MANAGED HEALTHCARE SEGMENT

On December 5, 1997, the Company purchased the assets of Allied Health Group, Inc. and certain affiliates ("Allied"). Allied provided specialty managed care services, including risk-based products and administrative services to a variety of insurance companies and other customers. Allied's products included, among other things, claims authorization, analysis, adjudication and payment, comprising multiple clinical specialities. The Company paid approximately $50.0 million for Allied, with cash on hand. During the quarter ended December 31, 1998, the Company and the former owners of Allied amended the Allied purchase agreement (the "Allied Amendments"). The Allied Amendments resulted in the Company paying the former owners of Allied $4.5 million additional consideration, which was recorded as goodwill. On February 29, 2000, the Company consummated the purchase of the outstanding stock of Vivra, Inc. ("Vivra"), which also provided specialty managed care services. The initial purchase price of Vivra was $10.25 million, excluding transaction costs. Allied and Vivra, as well as certain other related assets comprised the Company's specialty managed healthcare segment. The Company accounted for the Allied and Vivra acquisitions using the purchase method of accounting.

On October 4, 2000, the Company adopted a formal plan to dispose of the business and interest that comprise the company's specialty managed healthcare segment. The Company intends to exit the Specialty business via sale and/or abandonment of businesses and related assets, certain of which activities had

3. DISCONTINUED OPERATIONS (CONTINUED)
already occurred in the normal course prior to October 4, 2000. The Company does not expect to receive significant proceeds from the sale of assets. Further, the Company is actively exiting all significant contracts entered into by Allied and Vivra. This effort is expected to be completed by September 30, 2001.

ACCOUNTING FOR DISCONTINUED OPERATIONS

The Company has accounted for the disposal of the segments under Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations--Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions" ("APB 30"). APB 30 requires that the results of continuing operations be reported separately from those of discontinued operations for all periods presented and that any gain or loss from disposal of a segment of a business be reported in conjunction with the related results of discontinued operations. Further, although the company adopted its formal plan on October 4, 2000, EITF 95-18 provides that the estimated loss from disposal and segment operating results should be presented as discontinued operations in the yet to be issued financial statements, if those statement are filed subsequent to the measurement date. Accordingly, the Company has restated its results of operations for all prior periods. The Company recorded an after-tax loss on disposal of its healthcare provider and healthcare franchising business segments of approximately $47.4 million, (primarily non-cash) in the fourth quarter of fiscal 1999 and an after-tax loss of $17.7 million related to the disposal of the specialty managed healthcare segment in the fourth quarter of fiscal 2000.

The summarized results of the discontinued operations segments are as follows (in thousands):

	FISCAL YEARS ENDED SEPTEMBER 30		
	1998	1999	2000
HEALTHCARE PROVIDER			
Net revenue (1)	$133,256	$ 74,860	$ --
Salaries, cost of care and other operating expenses	106,760	53,952	--
Equity in earnings of unconsolidated subsidiaries	--	(2,901)	--
Depreciation and amortization	5,266	2,141	--
Interest income (2)	(1,130)	(76)	--
Special charges (income), net	135	(33,046)	--
Other expenses (3)	10,093	21,907	--
Income (loss) from discontinued operations	$ 12,132	$ 32,883	$ --
HEALTHCARE FRANCHISING			
Net revenue	$ 55,625	$ 563	$ --
Salaries, cost of care and other operating expenses	9,072	5,623	--
Equity in earnings of unconsolidated subsidiaries	31,878	--	--
Depreciation and amortization	355	337	--
Special charges	323	--	--
Other expenses (3)	5,598	(2,159)	--
Income (loss) from discontinued operations	$ 8,399	$ (3,238)	$ --

3. DISCONTINUED OPERATIONS (CONTINUED)

	FISCAL YEARS ENDED SEPTEMBER 30		
	1998	1999	2000
SPECIALTY MANAGED HEALTHCARE			
Net revenue	$143,504	$197,157	$128,229
Salaries, cost of care and other operating expenses	140,375	194,747	165,505
Depreciation and amortization	2,366	4,610	3,831
Special charges	--	--	58,173
Other expenses (3)	306	(880)	(34,059)
Income (loss) from discontinued operations	$ 457	$ (1,320)	$(65,221)
DISCONTINUED OPERATIONS -- COMBINED			
Net revenue (1)	$332,385	$272,580	$128,229
Salaries, cost of care and other operating expenses	256,207	254,322	165,505
Equity in (earnings) losses of unconsolidated subsidiaries	31,878	(2,901)	--
Depreciation and amortization	7,987	7,088	3,831
Interest income (2)	(1,130)	(76)	--
Special charges (income), net	458	(33,046)	58,173
Other expenses (3)	15,997	18,868	(34,059)
Income (loss) from discontinued operations	$ 20,988	$ 28,325	$(65,221)

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(1) Includes $7.0 million and $21.6 million in fiscal 1998 and 1999, respectively, related to the settlement and adjustment of reimbursement issues related to prior periods ("Cost Report Settlements").

(2) Interest expense has not been allocated to discontinued operations.

(3) Includes income taxes and minority interest.

LOSS ON DISPOSAL OF HEALTHCARE PROVIDER AND FRANCHISING SEGMENTS

The summary of the loss on disposal recorded in fiscal 1999 related to the healthcare provider and healthcare franchising segments is as follows (in thousands):

Basis in Provider JV's	$44,598
Basis in Real Estate transferred to CBHS	13,969
Basis in Franchise and other operations	7,285
Working capital forgiveness	5,565
Transaction costs and legal fees	7,622
Loss before income taxes	79,039
Income tax benefit	(31,616)
	$47,423

Remaining assets and liabilities of the provider business at September 30, 2000 include, among other things, (i) hospital-based real estate of $6.0 million, (ii) long-term debt of $6.4 million related to the hospital-based real estate; (iii) reserve for discontinued operations of $5.8 million and (iv) accrued

3. DISCONTINUED OPERATIONS (CONTINUED)
liabilities of $12 million. The Company is also subject to inquiries and investigations from governmental agencies related to its operating and business practices prior to June 17, 1997. See Note 12 -- "Commitments and Contingencies".

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

TYPE OF COST	BALANCE SEPTEMBER 30, 1998	ADDITIONS	RECEIPTS (PAYMENTS)	OTHER	BALANCE SEPTEMBER 30, 1999
Transaction costs and legal fees.........	$ --	$ 7,622	$ (69)	$ --	$ 7,553
Provider JV working capital.............	--	2,931	--	185	3,116
Other..................................	--	755	--	--	755
	$ --	$11,308	$ (69)	$185	$11,424

TYPE OF COST	BALANCE SEPTEMBER 30, 1999	ADDITIONS	RECEIPTS (PAYMENTS)	OTHER	BALANCE SEPTEMBER 30, 1999
Transaction costs and legal fees.........	$ 7,553	$ --	$(5,804)	$ --	$ 1,749
Provider JV working capital.............	3,116	--	--	--	3,116
Other..................................	755	--	150	--	905
	$11,424	$ --	$(5,654)	$ --	$ 5,770

LOSS ON DISPOSAL OF SPECIALTY MANAGED HEALTHCARE SEGMENTS

The summary of the loss on disposal recorded during fiscal 2000 related to the disposal of the Company's specialty managed healthcare segment is as follows (in thousands):

Estimated leasehold obligations...........................	$ 5,051
Impairment of long-lived assets...........................	17,058
Other Cost of Disposal....................................	4,777
Loss Before Income Taxes..............................	26,886
Income Tax Benefit..	(9,224)
	$17,662

The remaining assets and liabilities of the specialty managed healthcare segment at September 30, 2000 include, among other things, (i) cash and accounts receivable of $9.5 million, (ii) property and equipment of $2.0 million, (iii) medical claims payable of $9.3 million, (iv) reserve for discontinued operations of $8.6 million and (v) accounts payable and accrued liabilities of $27.1 million. The reserve for discontinued operations is comprised of $5.1 million of estimated leasehold termination costs and $3.5 million of estimated operating losses from the measurement date to the date of disposal.

3. DISCONTINUED OPERATIONS (CONTINUED)
SPECIAL CHARGES (INCOME) RECORDED IN DISCONTINUED OPERATIONS

GENERAL

The following table summarizes special charges (income) recorded during the three years in the period ended September 30, 2000 in the Company's healthcare provider, healthcare franchising and specialty managed healthcare segments (in thousands):

	FISCAL YEAR ENDED SEPTEMBER 30,		
	1998	1999	2000
Gains on the sale of psychiatric hospitals, net	$(3,000)	$(24,974)	$ --
Collection fee reserves	--	(8,072)	--
Termination of CBHS sale transaction	3,458	--	--
Impairment of long-lived assets--Allied	--	--	58,173
	$ 458	$(33,046)	$58,173

GAINS ON SALE OF PSYCHIATRIC FACILITIES, NET

During fiscal 1998 and 1999, the Company recorded gains of approximately $3.0 million and $1.1 million, respectively, related to the sales of psychiatric hospitals and other real estate.

On April 9, 1999, the Company sold its European psychiatric provider operations to Investment AB Bure of Sweden for approximately $57.0 million (before transaction costs of approximately $2.5 million) (the "Europe Sale"). The Europe Sale resulted in a non-recurring gain of approximately $23.9 million before provision for income taxes which is included in gain of sale of psychiatric hospitals.

The Company used approximately $38.2 million of the net proceeds from the Europe Sale to make mandatory unscheduled principal payments on indebtedness outstanding under the Term Loan Facility (as defined). The remaining proceeds were used to reduce borrowings outstanding under the Revolving Facility (as defined).

COLLECTION FEE RESERVES

The Company reduced certain accounts receivable collection fee reserves by $8.1 million during the fourth quarter of fiscal 1999 as substantially all hospital-based receivables subject to the collection fees had been collected at September 30, 1999.

TERMINATION OF CBHS SALE TRANSACTION

On March 3, 1998, the Company and certain of its wholly owned subsidiaries entered into definitive agreements with COI and CBHS pursuant to which the Company would have, among other things, sold the Company's franchise operations, certain domestic provider operations and certain other assets and operations. On August 19, 1998, the Company announced that it had terminated discussions with COI for the sale of its interest in CBHS.

3. DISCONTINUED OPERATIONS (CONTINUED)

In connection with the termination of the CBHS sale transaction, the Company recorded a charge of approximately $3.5 million as follows (in thousands):

Severance(1)	$ 488
Lease termination(1)	1,067
Impairment of long-lived assets	153
Transaction costs and other	1,750
	$3,458

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(1) Relates to staffing reductions and lease terminations incurred in the Company's franchising and outcomes monitoring subsidiaries.

IMPAIRMENT OF LONG-LIVED ASSETS--ALLIED

The Company recorded a charge of approximately $58.2 million in the quarter ended March 31, 2000, related to the impairment of certain of Allied's long-lived assets in accordance with Statement of Financial Accounting Standards No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" ("FAS 121"). This amount included certain goodwill, certain property and equipment and identifiable intangible assets of Allied which, prior to the Vivra acquisition, was the principal component of the Company's specialty managed healthcare business segment. During the six months ended March 31, 2000, Allied recorded significant losses associated primarily with the termination or restructuring of various customer contracts. These events and the resulting expectation of lower future earnings and cash flows from Allied represented a change in circumstances with respect to the business of Allied. At that time the Company estimated that the future undiscounted cash flows expected to be generated by Allied were insufficient to fully recover the recorded cost of the long-lived assets. The Company recorded the impairment charge to write these assets down to their estimated fair value.

4. BENEFIT PLANS

The Company currently has a defined contribution retirement plan (the "401(k) Plan"), which is in the form of an amendment and restatement of the Green Spring 401(k) Plan. Certain other 401(k) plans and assets, including the Magellan 401(k) Plan, were merged into the Green Spring Plan effective January 1, 1999. Employee participants can elect to voluntarily contribute up to 15% of their compensation to the 401(k) Plan. The Company makes contributions to the 401(k) Plan based on employee compensation and contributions. Additionally, the Company can make a discretionary contribution of up to 2% of each eligible employee's compensation. The Company matches 50% of each employee's contribution up to 3% of their compensation. The Company recognized $3.0 million and $7.4 million of expense for the years ended September 30, 1999 and 2000, respectively, for the matching contribution to the 401(k) Plan.

Prior to January 1, 1999, the Company maintained a separate defined contribution plan (the "Magellan 401-K Plan"). Participants could contribute up to 15% of their compensation to the Magellan 401-K Plan. The Company made discretionary contributions of 2% of each employee's compensation and matched 50% of each employee's contribution up to 3% of their compensation. During the fiscal years

4. BENEFIT PLANS (CONTINUED)

ended September 30, 1998 and 1999 the Company expensed approximately $3.2 million and $1.2 million, respectively, to the Magellan 401-K Plan.

Prior to January 1, 1999, Green Spring maintained a separate defined contribution plan (the "Green Spring 401-K Plan"). Employee participants could elect to voluntarily contribute up to 6% or 12% of their compensation, depending upon each employee's compensation level, to the Green Spring 401-K Plan. Green Spring matched up to 3% of each employee's compensation. Employees vested in employer contributions over five years. During the fiscal years ended September 30, 1998 and 1999 the Company expensed approximately $1.2 million and $2.9 million, respectively, to the Green Spring 401-K Plan.

5. LONG-TERM DEBT, CAPITAL LEASE OBLIGATIONS AND OPERATING LEASES

Information with regard to the Company's long-term debt and capital lease obligations at September 30, 1999 and 2000 is as follows (in thousands):

	SEPTEMBER 30, 1999	SEPTEMBER 30, 2000
Credit Agreement:		
Revolving Facility (10.125% at September 30, 2000) due through 2004	$ 20,000	$ 30,000
Term Loan Facility (10.31% to 10.81% at September 30, 2000) due through 2006	492,873	436,612
9.0% Senior Subordinated Notes due 2008	625,000	625,000
11.5% other notes payable through 2005	35	35
5.65% capital lease obligations due through 2014	6,400	6,400
	1,144,308	1,098,047
Less amounts due within one year	30,119	34,119
	$1,114,189	$1,063,928

The aggregate scheduled maturities of long-term debt and capital lease obligations during the five fiscal years and beyond subsequent to September 30, 2000 are as follows (in thousands): 2001--$34,119; 2002--$43,328; 2003--$80,692, 2004--$167,336, 2005--$115,585 and 2006 and beyond--$656,987.

The Notes, which are carried at cost, had a fair value of approximately $534 million and $421 million at September 30, 1999 and 2000, respectively, based on market quotes. The Company's remaining debt is also carried at cost, which approximates fair market value.

The Company recognized a net extraordinary loss from the early extinguishment of debt of approximately $33.0 million, net of income tax benefit, during fiscal 1998, to write off unamortized deferred financing costs related to terminating the previous 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 Company's 7.5% Swiss bonds. The Credit Agreement provides for a Term Loan Facility in an original 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 $183.4 million Tranche C Term Loan (the "Tranche C Term Loan"), and a Revolving Facility providing for revolving loans to the Company

5. LONG-TERM DEBT, CAPITAL LEASE OBLIGATIONS AND OPERATING LEASES (CONTINUED)

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 $150.0 million. Letters of credit outstanding were $29.6 million at September 30, 2000.

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 $30.3 million in 2001,

$39.5 million in 2002, $42.1 million in 2003 and $9.9 million in 2004. The Tranche B Term Loan amortizes in installments in amounts equal to $1.9 million in each of 2001 and 2002, $36.7 million in 2003, $90.7 million in 2004 and $26.2 million in 2005. The Tranche C Term Loan amortizes in installments in each fiscal year in amounts equal to $1.9 million in each of 2001 through 2003, $36.7 million in 2004, $89.4 million in 2005 and $25.6 million in 2006. In addition, the Revolving Facility and Term Loan Facility are subject to mandatory prepayment and reductions (to be applied first to the Term Loan Facility) in an amount equal to (a) 75% of the net proceeds of certain offerings of equity securities by the Company or any of its subsidiaries, (b) 50% for the sale of National Mentor, Inc. ("Mentor") and certain identified non-core assets and 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 beginning September 30, 2001, upon the sale of Mentor, otherwise September 30, 2002, as defined, and (d) 100% of the net proceeds of certain other asset sales or other dispositions of property of the Company and its subsidiaries, in each case subject to certain limited exceptions.

The 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 Notes (the "Indenture")), 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 Credit Agreement requires the Company to comply with specified financial ratios and tests, including minimum coverage ratios, maximum leverage ratios, maximum senior debt ratios and minimum "EBITDA" (as defined in the Credit Agreement) and minimum net worth tests. As of September 30, 2000, the Company was in compliance with its debt covenants.

At the Company's election, the interest rates per annum applicable to the loans under the Credit Agreement are a fluctuating rate of interest measured by reference to either (a) an adjusted London inter-bank offer 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 2.50% for ABR loans and 3.50% for LIBOR loans, and are subject to reduction after December 2001 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 currently 2.75% and 3.0%, respectively, for ABR loans and 3.75% and 4.0%, 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.

5. LONG-TERM DEBT, CAPITAL LEASE OBLIGATIONS AND OPERATING LEASES (CONTINUED)

The obligations of the Company and the Subsidiary Borrowers under the Credit Agreement are unconditionally and irrevocably guaranteed by, subject to certain exceptions, each wholly owned subsidiary of the Company. In addition, the Revolving Facility, the Term Loan Facility 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.

The Notes are general unsecured senior subordinated obligations of the Company. The Notes are limited in aggregate principal amount to $625.0 million and will mature on February 15, 2008. Interest on the Notes accrues at the rate of 9.0% per annum and is payable semi-annually on each February 15 and August 15. The Notes were originally issued as unregistered securities and later exchanged for securities which were registered with the Securities and Exchange Commission. Due to a delay in the registration of the Notes to be exchanged, the Company was required to increase the interest rate on the Notes by 100 basis points per annum for the period from July 13, 1998 through November 9, 1998, the date of issuance of the Notes to be exchanged.

The Notes are redeemable at the option of the Company. The Notes may be redeemed at the option of the Company, 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 the 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 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 limits, among other things: (i) the incurrence of additional indebtedness by the Company and its restricted subsidiaries; (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 also prohibits certain restrictions on distributions from restricted subsidiaries. However, all such limitations and prohibitions are subject to certain qualifications and exceptions.

The Company leases certain of its operating facilities. The leases, which expire at various dates through 2008, generally require the Company to pay all maintenance, property and tax insurance costs.

5. LONG-TERM DEBT, CAPITAL LEASE OBLIGATIONS AND OPERATING LEASES (CONTINUED)

At September 30, 2000, aggregate amounts of future minimum payments under operating leases for continuing operations were as follows: 2001--$36.5 million; 2002--$31.5 million; 2003--$20.0 million; 2004--$11.3 million; 2005--$7.3 million; 2006 and beyond--$7.9 million.

Rent expense for continuing operations was $26.8 million, $39.5 million and $42.2 million, respectively, for the fiscal years ended September 30, 1998, 1999 and 2000. Rent expense for discontinued operations was $3.8 million, $2.1 million and $1.0 million, respectively, for the fiscal years ended September 30, 1998, 1999 and 2000.

6. STOCKHOLDERS' EQUITY

COMMON STOCK

The Company is prohibited from paying dividends on its common stock under the terms of the Indenture and the Credit Agreement except under very limited circumstances.

STOCK OPTION PLANS

The Company has stock option plans under which employees and non-employee directors may be granted options to purchase shares of Company common stock at the fair market value at the time of grant. Options generally vest over a period of three to four years and expire 10 years from the date of grant. The Company's stock option plan for employees also provides for the granting of performance based stock awards.

Summarized information relative to the Company's stock option plans is as follows:

	FISCAL YEAR ENDED SEPTEMBER 30,					
	1998		1999		2000	
	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE
Balance, beginning of period	4,122,109	$20.13	3,835,912	$22.23	4,406,882	$10.15
Granted	1,386,500	24.22	1,669,303	5.73	2,309,742	3.77
Canceled	(1,082,331)	23.66	(1,050,067)	19.97	(1,336,719)	16.32
Exercised	(590,366)	9.90	(48,266)	7.99	(800)	4.19
Balance, end of period	3,835,912	$22.23	4,406,882	$10.15	5,379,105	$ 5.57
Exercisable, end of period	2,375,919	$20.89	2,190,538	$13.74	2,020,049	$ 7.37

At September 30, 2000, 1,159,150 shares were available for future grants under the terms of these plans.

STOCK OPTION REPRICING

On November 17, 1998, the Company's Board of Directors approved the repricing of stock options outstanding under the Company's existing stock option plans (the "Stock Option Repricing"). Each holder

of 10,000 or more stock options that was eligible to participate in the Stock Option Repricing was required to forfeit a percentage of outstanding stock options as follows:

- Directors, including the Chief Executive Officer	40%
- Named Executive Officers	30%
- Other holders of 50,000 or more stock options	25%
- Other holders of 10,000-49,999 stock options	15%

The Stock Option Repricing was consummated on December 8, 1998 based on the fair value of the Company's common stock on such date. Approximately 2.0 million outstanding stock options were repriced to $8.406 and approximately 0.7 million outstanding stock options were cancelled as a result of the Stock Option Repricing. Each participant in the Stock Option Repricing was precluded from exercising vested repriced stock options until June 8, 1999.

STOCK OPTIONS OUTSTANDING

Summarized information relative to the Company's stock options outstanding on September 30, 2000 is as follows:

OPTIONS OUTSTANDING	OPTIONS EXERCISABLE
WEIGHTED	

RANGE OF EXERCISE PRICE	OPTIONS	AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE
$1.310 - $8.188	3,816,376	7.17	$4.40	741,524	$5.57
$8.406	1,517,729	6.29	8.41	1,263,524	8.41
$9.210 - $9.719	45,000	6.47	9.66	15,001	9.66
	5,379,105	6.92	$5.57	2,020,049	$7.37

EMPLOYEE STOCK PURCHASE PLANS

The 1997 Employee Stock Purchase Plan (the "1997 ESPP") covered shares of common stock that could be purchased by eligible employees of the Company. The 1997 ESPP offering periods had a term not less than three months and not more than 12 months. The first offering period under the 1997 ESPP began January 1, 1997 and the last offering period ended on or before December 31, 1999. The option price of each offering period was the lesser of (i) 85% of the fair value of a share of common stock on the first day of the offering period or (ii) 85% of the fair value of a share of common stock on the last day of the offering period.

6. STOCKHOLDERS' EQUITY (CONTINUED)

A summary of the 1997 ESPP is as follows:

OFFERING PERIOD	BEGAN	ENDED	SHARES PURCHASED	PURCHASE PRICE
1	January 2, 1997	June 30, 1997	73,410	$ 19.125
2	August 1, 1997	December 31, 1997	26,774	$ 19.125
3	January 1, 1998	June 30, 1998	43,800	$18.4875
4	July 1, 1998	December 31, 1998	163,234	$ 7.0125
5	January 1, 1999	June 30, 1999	152,570	$ 7.0125
6	July 1, 1999	December 31, 1999	185,079	$ 5.1531

The 2000 Employee Stock Purchase Plan (the "2000 ESPP") covers 1.2 million shares of common stock that can be purchased by eligible employees of the Company. The 2000 ESPP offering periods will have a term not less than three months and not more than 12 months. The first offering period under the 2000 ESPP began January 1, 2000 and the last offering period will end on or before December 31, 2003. The option price of each offering period will be the lesser of (i) 85% of the fair value of a share of common stock on the first day of the offering period or (ii) 85% of the fair value of a share of common stock on the last day of the offering period.

A summary of the 2000 ESPP is as follows:

OFFERING PERIOD	BEGAN	ENDED	SHARES PURCHASED	PURCHASE PRICE
1	January 1, 2000	June 30, 2000	481,922	$1.0625
2	July 1, 2000	December 31, 2000	--	--

The number of options granted and the option price for the most recent offering period will be determined on December 31, 2000 when the option price is known.

RIGHTS PLAN

The Company adopted a share purchase rights plan in fiscal 1992 (the "Rights Plan"). Pursuant to the Rights Plan, each share of common stock also represents one share purchase right (collectively, the "Rights"). The Rights trade automatically with the underlying shares of common stock. Upon becoming exercisable, but prior to the occurrence of certain events, each Right initially entitles its holder to buy one share of common stock from the Company at an exercise price of $60.00. The Rights will be distributed and become exercisable only if a person or group acquires, or announces its intention to acquire, common stock exceeding certain levels, as specified in the Rights Plan. Upon the occurrence of such events, the exercise price of each Right reduces to one-half of the then current market price. The Rights also give the holder certain rights in an acquiring company's common stock. The Company is entitled to redeem the Rights at a price of $.01 per Right at any time prior to the distribution of the Rights. The Rights have no voting power until exercised.

COMMON STOCK WARRANTS

The Company issued 114,690 warrants in fiscal 1992 which expire on June 30, 2002 (the "2002 Warrants") to purchase one share each of the Company's common stock. The 2002 Warrants have an exercise price of $5.24 per share. During fiscal 1998, 1,553 shares were issued upon the exercise of 2002 Warrants. At September 30, 2000, 18,920 of the 2002 Warrants were outstanding.

The Company also has 146,791 warrants outstanding with an exercise price of $38.70 per share which expire on September 1, 2006.

6. STOCKHOLDERS' EQUITY (CONTINUED)

Crescent and COI each have the right to purchase 1,283,311 shares of common stock 2,566,622 shares in aggregate; collectively the "Crescent Warrants") at a warrant exercise price of $30.00 per share (subject to adjustment pursuant to antidilution provisions). The Crescent Warrants are exercisable at the following times and in the following amounts:

DATE FIRST EXERCISABLE JUNE 17,	NUMBER OF SHARES OF COMMON STOCK ISSUABLE UPON EXERCISE OF WARRANTS	END OF EXERCISE PERIOD JUNE 17,
1998	30,000	2001
1999	62,325	2002
2000	97,114	2003
2001	134,513	2004
2002	174,678	2005
2003	217,770	2006
2004	263,961	2007
2005	313,433	2008
2006	366,376	2009
2007	422,961	2009
2008	483,491	2009

Crescent's and COI's rights with respect to the Crescent Warrants are not contingent on or subject to the satisfaction or completion of any obligation that Crescent or COI may have to CBHS, or that CBHS may have to the Company, or by any subordination of fees otherwise payable to the Company by CBHS.

The Crescent Warrants contain provisions relating to adjustments in the number of shares covered by the Crescent Warrants and the warrant exercise price in the event of stock splits, stock dividends, mergers, reorganizations and similar transactions.

The Crescent Warrants were recorded at $25.0 million upon issuance, which was their approximate fair value upon execution of the Warrant Purchase Agreement in January 1997.

TREASURY STOCK TRANSACTIONS

During fiscal 1998, the Company repurchased an aggregate of 696,600 shares of its common stock in the open market for approximately $14.4 million. Those transactions were funded with cash on hand.

In January 1998, the Company issued an aggregate of 2,831,516 shares of treasury stock to the then existing minority stockholders of Green Spring to effect the Green Spring Minority Stockholder Conversion. See Note 2, "Acquisitions and Joint Ventures."

6. STOCKHOLDERS' EQUITY (CONTINUED)

INCOME (LOSS) PER COMMON SHARE

The following table presents the components of weighted average common shares outstanding and income (loss) per share from continuing operations (in thousands, except per share data):

	YEAR ENDED SEPTEMBER 30,		
	1998	1999	2000
Numerator:			
Income (loss) from continuing operations before extraordinary items	$(7,256)	$23,786	$17,075
Less: preferred dividend requirement and amortization of redeemable preferred stock issuance costs	--	--	3,802
Income (loss) from continuing operations available to common stockholders--basic	(7,256)	23,786	13,273
Add: presumed conversion of redeemable preferred stock	--	--	--
Income (loss) from continuing operations available to common stockholders--diluted	$(7,256)	$23,786	$13,273
Denominator:			
Weighted average common shares outstanding -- basic	30,784	31,758	32,144
Common stock equivalents -- stock options	--	151	242
Common stock equivalents -- warrants	--	7	--
Common stock equivalents -- redeemable Preferred Stock	--	--	--
Weighted average common shares outstanding -- diluted	30,784	31,916	32,386
Income (loss) from continuing operations available to common stockholders per common share:			
Basic (basic numerator/basic denominator)	$ (0.24)	$ 0.75	$ 0.41
Diluted (diluted numerator/diluted denominator)	$ (0.24)	$ 0.75	$ 0.41

Conversion of redeemable preferred stock, and the redemption of the TPG series "A" option (see Note 7--"Redeemable Preferred Stock") were not presumed outstanding for fiscal 2000 due to their anti-dilutive effect.

Certain options and warrants to purchase shares of common stock which were outstanding during fiscal 2000 were not included in the computation of diluted EPS because of their anti-dilutive effect.

STOCK-BASED COMPENSATION

The Company discloses stock-based compensation under the requirements of FAS 123. FAS 123 requires disclosure of pro forma net income and pro forma net income per share as if the fair value-based method of accounting for stock options had been applied in measuring compensation cost for stock-based awards.

6. STOCKHOLDERS' EQUITY (CONTINUED)

Reported and pro forma net income and net income per share amounts are set forth below (in thousands, except per share data):

	FISCAL YEAR ENDED SEPTEMBER 30,		
	1998	1999	2000
Reported:			
Income (loss) from continuing operations before extraordinary items	$ (7,256)	$23,786	$17,075
Net income (loss)	(19,283)	4,688	(65,808)
Income (loss) per common share -- basic:			
Income (loss) from continuing operations before extraordinary items	(0.24)	0.75	0.41
Net income (loss)	(0.63)	0.15	(2.17)
Income (loss) per common share -- diluted:			
Income (loss) from continuing operations before extraordinary items	(0.24)	0.75	0.41
Net income (loss)	(0.63)	0.15	(2.15)
Pro Forma:			
Income (loss) from continuing operations before extraordinary items	$(11,201)	$16,763	$13,664
Net loss	(23,228)	(2,335)	(69,219)
Income (loss) per common share -- basic:			
Income (loss) from continuing operations before extraordinary items	(0.36)	0.53	0.31
Net loss	(0.75)	(0.07)	(2.15)
Income (loss) per common share -- diluted:			
Income (loss) from continuing operations before extraordinary items	(0.36)	0.53	0.31
Net loss	(0.75)	(0.07)	(2.14)

The fair values of the stock options and ESPP options granted were estimated on the date of their grant using the Black-Scholes option pricing model based on the following weighted average assumptions:

	1998	1999	2000
Risk-free interest rate	4.5%	5.8%	6.3%
Expected life	4 years	3.8 years	3 years
Expected volatility	50%	50%	85%
Expected dividend yield	0%	0%	0%

The weighted average fair value of options granted during fiscal 1998, 1999 and 2000 was $9.53, $2.21 and $1.83, respectively.

7. REDEEMABLE PREFERRED STOCK

TPG INVESTMENT. On December 5, 1999, the Company entered into a definitive agreement to issue approximately $59.1 million of cumulative convertible preferred stock to TPG Magellan, LLC, an affiliate of the investment firm Texas Pacific Group ("TPG") (the "TPG Investment").

Pursuant to the agreement, TPG purchased approximately $59.1 million of the Company's Series A Cumulative Convertible Preferred Stock (the "Series A Preferred Stock") and an Option (the "Option") to purchase an additional approximately $21.0 million of Series A Preferred Stock. Net proceeds from

7. REDEEMABLE PREFERRED STOCK (CONTINUED)

issuance of the Series A Preferred Stock were $54.0 million. Approximately 50% of the net proceeds received from the issuance of the Series A Preferred Stock was used to reduce debt outstanding under the Term Loan Facility (as defined) with the remaining 50% of the proceeds being used for general corporate purposes. The Series A Preferred Stock carries a dividend of 6.5% per annum, payable in quarterly installments in cash or common stock, subject to certain conditions. Dividends not paid in cash or common stock will accumulate. The Series A Preferred Stock is convertible at any time into the Company's common stock at a conversion price of $9.375 per share (which would result in approximately 6.3 million shares of common stock if all of the currently issued Series A Preferred Stock were to convert) and carries "as converted" voting rights. The Company may, under certain circumstances, require the holders of the Series A Preferred Stock to convert such stock into common stock. The Series A Preferred Stock, plus accrued and unpaid dividends thereon, must be redeemed by the Company on December 15, 2009. The Option may be exercised in whole or in part at any time on or prior to June 15, 2002. The Company may, under certain circumstances, require TPG to exercise the Option. The terms of the shares of Series A Preferred Stock issuable pursuant to the Options are identical to the terms of the shares of Series A Preferred Stock issued to TPG at the closing of the TPG Investment.

TPG has three representatives on the Company's twelve-member Board of Directors.

The TPG Investment is reflected under the caption "Redeemable preferred stock" in the Company's condensed consolidated balance sheet as follows (in thousands):

	SEPTEMBER 30, 2000
Redeemable convertible preferred stock:	
Series A -- stated value $1, 87 shares authorized, 59 shares issued and outstanding	$59,063
Series B -- stated value $1, 60 shares authorized, none issued and outstanding	--
Series C -- stated value $1, 60 shares authorized, none issued and outstanding	--
	59,063
Less: Fair value of Series A Option	(3,366)
Total redeemable convertible preferred stock	55,697
Accretion and accumulated unpaid dividends on Series A Preferred Stock	3,401
Fair value of Series A Option	3,366
Issuance costs, net of amortization of $401	(4,630)
	$57,834

8. INCOME TAXES

The provision for income taxes related to continuing operations consisted of the following (in thousands):

	FISCAL YEAR ENDED SEPTEMBER 30,		
	1998	1999	2000
Income taxes currently payable:			
Federal	$3,462	$ 555	$ 1,000
State	589	2,800	1,300
Foreign	--	500	500
Deferred income taxes:			
Federal	1,611	23,294	9,068
State	(424)	1,107	3,610
Foreign	--	--	--
	$5,238	$28,256	$15,478

A reconciliation of the Company's income tax provision (benefit) to that computed by applying the statutory federal income tax rate is as follows (in thousands):

	FISCAL YEAR ENDED SEPTEMBER 30,		
	1998	1999	2000
Income tax provision at federal statutory income tax rate	$ 727	$18,435	$11,433
State income taxes, net of federal income tax benefit	107	2,540	1,828
Non-deductable goodwill amortization	5,680	9,383	8,883
IRS settlement-change in estimate	--	--	(9,091)
Other--net	(1,276)	(2,102)	2,425
Income tax provision	$ 5,238	$28,256	$15,478

As of September 30, 2000, the Company has estimated tax net operating loss ("NOL") carryforwards of approximately $537 million available to reduce future federal taxable income. These NOL carryforwards expire in 2006 through 2020 and are subject to examination by the Internal Revenue Service. In addition, the Company also has estimated tax NOL carryforwards of approximately $125 million available to reduce the federal taxable income of Merit and its subsidiaries. These NOL carryforwards expire in 2009 through 2018 and are subject to examination by the Internal Revenue Service. Further, these NOL carryforwards are subject to limitations on the taxable income of Merit and its subsidiaries. The Company has recorded a valuation allowance against the portion of the total NOL deferred tax asset and certain other deferred tax assets, that in management's opinion, are not likely to be recovered.

8. INCOME TAXES (CONTINUED)

Components of the net deferred income tax (assets) liabilities at September 30, 1999 and 2000 are as follows (in thousands):

	SEPTEMBER 30,	
	1999	2000
Deferred tax liabilities:		
Property and depreciation	$ (2,060)	$ (18,081)
Long-term debt and interest	(19,735)	(8,476)
ESOP	(12,968)	(15,005)
Intangible assets	(11,332)	--
Other	(15,209)	(17,069)
Total deferred tax liabilities	(61,304)	(58,631)
Deferred tax assets:		
Intangible assets	--	19,764
Operating loss carryforwards	254,696	264,627
Self-insurance reserves	2,220	--
Discontinued operations liabilities	9,552	21,985
Other	51,953	18,995
Total deferred tax assets	318,421	325,371
Valuation allowance	(165,460)	(144,958)
Deferred tax assets after valuation allowance	152,961	180,413
Net deferred tax assets	$ 91,657	$ 121,782

During fiscal 2000, the Company reached an agreement (the "Agreement") with the Internal Revenue Service ("IRS") related to its federal income tax returns for the fiscal years ended September 30, 1992 and 1993. The IRS had originally proposed to disallow approximately $162 million of deductions related primarily to interest expense in fiscal 1992. Under the Agreement, the Company will pay approximately $1 million in taxes and interest to the IRS to resolve the assessment relating to taxes due for these open years, although no concession was made by either party as to the Company's ability to utilize these deductions through NOL carryforwards. As a result of the Agreement, the Company recorded a reduction in related reserves of approximately reversed $9.1 million, as a change in estimate in the current year.

The Internal Revenue Service is currently examining Merit's income tax returns for pre-acquisition periods. In management's opinion, adequate provisions have been made for any adjustments which may result from these examinations, including a potential reduction in the amount of NOL carryforwards. The Company believes the examinations could result in a reduction in NOL carryforwards available to offset future taxable income.

9. ACCRUED LIABILITIES

Accrued liabilities consist of the following (in thousands):

	SEPTEMBER 30,	
	1999	2000
Salaries, wages and other benefits	$ 22,318	$ 21,411
CHAMPUS Adjustments	51,784	22,603
Due to Providers	35,918	7,711
Other	99,776	123,973

	$209,796	$175,698

10. MANAGED CARE INTEGRATION COSTS AND SPECIAL CHARGES

INTEGRATION PLAN

During fiscal 1998, management committed the Company to a plan to combine and integrate the operations of its behavioral managed care organizations (BMCOs) and specialty managed care organizations (the "Integration Plan") that resulted in the elimination of duplicative functions and standardized business practices and information technology platforms. The Integration Plan resulted in the elimination of approximately 1,000 positions during fiscal 1998 and fiscal 1999. Approximately 510 employees were involuntarily terminated pursuant to the Integration Plan.

The employee groups of the BMCOs that were 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 Integration Plan resulted in the closure of approximately 20 leased facilities during fiscal 1998 and 1999.

The Company initially recorded approximately $21.3 million of liabilities related to the Integration Plan, of which $12.4 million was recorded as part of the Merit purchase price allocation and $8.9 million was recorded in the statement of operations under "Managed care integration costs" in fiscal 1998.

During fiscal 1999, the Company recorded adjustments of approximately $(0.3) million, net, to such liabilities, of which $(0.8) million was recorded as part of the Merit purchase price allocation and $0.5 million was recorded in the statement of operations under "Managed care integration costs." The Company may record additional adjustments to such liabilities during the future periods depending on changes in its ability to sublease closed offices.

10. MANAGED CARE INTEGRATION COSTS AND SPECIAL CHARGES (CONTINUED)

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

TYPE OF COST	BALANCE SEPTEMBER 30, 1998	ADJUSTMENTS	PAYMENTS	BALANCE SEPTEMBER 30, 1999
Employee termination benefits	$ 6,190	$1,959	$(7,380)	$ 769
Facility closing costs	7,475	(2,071)	(2,310)	3,094
Other	169	(169)	--	--
	$13,834	$ (281)	$(9,690)	$3,863

TYPE OF COST	BALANCE SEPTEMBER 30, 1999	ADJUSTMENTS	PAYMENTS	BALANCE SEPTEMBER 30, 2000
Employee termination benefits	$ 769	$151	$ (735)	$ 185
Facility closing costs	3,094	(151)	(1,312)	1,631

$3,863	$ --	$(2,047)	$1,816

OTHER INTEGRATION COSTS

The Integration Plan resulted in additional incremental costs that were 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 fiscal 1998, the Company incurred approximately $8.1 million, in other integration costs, including long-lived asset impairments of approximately $2.4 million, and outside consulting costs of approximately $4.1 million. The asset impairments relate primarily to identifiable intangible assets and leasehold improvements that no longer have value and have been written off as a result of the Integration Plan.

During fiscal 1999, the Company incurred approximately $5.7 million in other integration costs, primarily for outside consulting costs and employee and office relocation costs.

SPECIAL CHARGES.

During fiscal 1999, the Company recorded special charges of approximately $4.4 million related primarily to the loss on disposal of an office building, executive severance and relocation of its corporate headquarters from Atlanta, Georgia to Columbia, Maryland. In addition, during fiscal 2000 the Company incurred special charges of $9.6 million related to: (i) the closure of certain GPA offices, (ii) restructuring of the corporate function and certain behavioral managed healthcare office sites, and (iii) net of the $1.9 million non-recurring gain on the sale of the corporate aircraft. These charges resulted in $5.9 million

of accrued severance; $4.7 million of accrued lease termination costs and $0.9 million of other exit costs at September 30, 2000.

The Company recorded a charge of approximately $15.8 million during fiscal 2000 related to the impairment of certain long-lived assets in accordance with FAS 121. This amount is included in "Special charges" in the Company's consolidated statements of operations for such periods and is related to the goodwill, property and equipment and identifiable intangible assets of Group Practice Affiliate ("GPA"), which is a component of the Company's behavioral health business segment.

During the quarter ended September 30, 2000, GPA recorded operating losses of $2.0 associated primarily with the termination or restructuring of various customer contracts. These events and the resulting expectation of lower future earnings and cash flows from GPA represent a change in circumstances with respect to the business of GPA. The Company estimates that the future undiscounted cash flows expected to be generated by GPA are insufficient to fully recover the recorded cost of the GPA assets.

Accordingly, the Company adjusted the GPA assets to their estimated fair value as of September 30, 2000. Based upon the circumstances described above, the Company estimated that the fair value of the GPA assets was approximately $2.1 million at September 30, 2000. This value reflects the Company's estimate of the recoverable fair value of GPA's property and equipment through sale or continued use.

11. SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow information is as follows (in thousands):

	YEAR ENDED SEPTEMBER 30,		
	1998	1999	2000
Income taxes paid, net of refunds received	$11,116	$ 347	$ 3,208
Interest paid, net of amounts capitalized	95,153	102,094	102,236
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	--	--

12. COMMITMENTS AND CONTINGENCIES

The Company is self-insured for a portion of its general and professional liability risks. The reserves for self-insured general and professional liability losses, including loss adjustment expenses, were included in reserve for unpaid claims in the Company's balance sheet and were based on actuarial estimates that were discounted at an average rate of 6% to their present value based on the Company's historical claims experience adjusted for current industry trends. These reserves related primarily to the professional liability risks of the Company's healthcare provider segment prior to the Crescent Transactions. The undiscounted amount of the reserve for unpaid claims at September 30, 1998 was approximately $34.6 million. The carrying amount of accrued medical malpractice claims was $26.2 million at September 30, 1998. The reserve for unpaid claims was adjusted periodically as such claims matured, to reflect changes in actuarial estimates based on actual experience. During fiscal 1998, the Company recorded reductions in malpractice claim reserves of approximately $4.1 million, respectively, as a result of updated actuarial

12. COMMITMENTS AND CONTINGENCIES (CONTINUED)

estimates which is included in discontinued operations. This reduction resulted primarily from updates to actuarial assumptions regarding the Company's expected losses for more recent policy years. This revision was based on changes in expected values of ultimate losses resulting from the Company's claim experience, and increased reliance on such claim experience. On July 2, 1999, the Company transferred its remaining medical malpractice claims portfolio (the "Loss Portfolio Transfer") to a third-party insurer for approximately $22.3 million. The Loss Portfolio Transfer was funded from assets restricted for settlement of unpaid claims. The insurance limit obtained through the Loss Portfolio Transfer for future medical malpractice claims is $26.3 million.

The healthcare industry is subject to numerous laws and regulations. The subjects of such laws and regulations include, but are not limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and/or allegations concerning possible violations of fraud and abuse and false claims statutes and/or regulations by healthcare providers. Entities that are found to have violated these laws and regulations may be excluded from participating in government healthcare programs, subjected to fines or penalties or required to repay amounts received from the government for previously billed patient services. The Office of the Inspector General of the Department of Health and Human Services and the United States Department of Justice ("Department of Justice") and certain other governmental agencies are currently conducting inquiries and/or investigations regarding the compliance by the Company and certain of its subsidiaries with such laws and regulations. Certain of the inquiries relate to the operations and business practices of the Psychiatric Hospital Facilities prior to the consummation of the Crescent Transactions in June 1997. The Department of Justice has indicated that its inquiries are based on its belief that the federal government has certain civil and administrative causes of action under the Civil False Claims Act, the Civil

Monetary Penalties Law, other federal statutes and the common law arising from the participation in federal health benefit programs of CBHS psychiatric facilities nationwide. The Department of Justice inquiries relate to the following matters: (i) Medicare cost reports; (ii) Medicaid cost statements; (iii) supplemental applications to CHAMPUS/TRICARE based on Medicare cost reports; (iv) medical necessity of services to patients and admissions; (v) failure to provide medically necessary treatment or admissions; and (vi) submission of claims to government payors for inpatient and outpatient psychiatric services. No amounts related to such proposed causes of action have yet been specified. The Company cannot reasonably estimate the settlement amount, if any, associated with the Department of Justice inquiries. Accordingly, no reserve has been recorded related to this matter.

Five affiliated outpatient clinic providers that are participating providers in the TennCare program asserted claims against Green Spring Health Services, Inc., a wholly-owned subsidiary of the Company ("Green Spring") and Premier Behavioral Systems of Tennessee, LLC, ("Premier") the joint venture that contracts with the State of Tennessee to manage services under the TennCare program and in which the Company holds a 50% interests alleging, that Premier and Green Spring failed to pay the providers in accordance with their contracts. The claims, allege losses in excess of $16 million in the aggregate and are proceeding in five separate arbitrations. On December 8, the Chancery Court of Davidson County, Tennessee entered a judgment confirming an arbitration award against Premier and Green Spring in the amount of $3.7 million in favor of one of the providers. The Court denied a motion by Premier and Green Spring to vacate the arbitration award on grounds that the provider procured the award by fraud and that the arbitrators exceeded their authority. Premier and Greenspring believe that the Court's order was

erroneous and intend to pursue vigorously an appeal of this judgment. The other arbitrations are at various stages of proceedings. Management intends to rigorously defend these claims. The Company believes that adequate reserves have been recorded with respect to any potential loss in these matters.

On or about August 4, 2000, the Company was served with a lawsuit filed by Wachovia Bank, N.A. ("Wachovia") in the Court of Common Pleas of Richland County, South Carolina seeking recovery under the indemnification provisions of an Engagement Letter between South Carolina National Bank (now Wachovia) and the Company and the ESOP Trust Agreement between South Carolina National Bank (now Wachovia) and the Company for losses sustained in a settlement entered into by Wachovia with the United States Department of Labor in connection with the ESOP's purchase of stock of the Company while Wachovia served as ESOP Trustee. Wachovia also alleges fraud, negligent misrepresentation and other claims and asserts its losses exceed $30 million. While the claim is in its initial stage and an outcome cannot be determined, the Company believes the claims of Wachovia are without merit and is defending them vigorously.

On October 26, 2000, two class action complaints (the "Class Actions") were filed against Magellan Health Services, Inc. and Magellan Behavioral Health, Inc. (the "Defendants") in the United States District Court for the Eastern District of Missouri under the Racketeer Influenced and Corrupt Organizations Act ("RICO") and the Employment Retirement Income Security Act of 1974 ("ERISA"). The class representatives purport to bring the actions on behalf of a nationwide class of individuals whose behavioral health benefits have been provided, underwritten and/or arranged by the Defendants since 1996. The complaints allege violations of RICO and ERISA arising out of the Defendants' alleged misrepresentations with respect to and failure to disclose, its claims practices, the extent of the benefits coverage and other matters that cause the value of benefits to be less than the amount of premium paid claims practices. The complaints seek unspecified compensatory damages, treble damages under RICO, and an injunction barring the alleged improper claims practices, plus interest, costs and attorneys' fees. While the claim is in the initial stages and an outcome cannot be determined, the Company believes that the claims are without merit and intends to defend them vigorously.

The Company is also subject to or party to other litigation, claims, and civil suits, relating to its operations and business practices. Certain of the Company's managed care litigation matters involve class action lawsuits, which allege (i) the Company inappropriately denied and/or failed to authorize benefits for mental health treatment under insurance policies with a customer of the Company and (ii) a provider at a Company facility violated privacy rights of certain patients. The Company is also subject to certain contingencies in connection with the CBHS bankruptcy as discussed in Note 3. In the opinion of management, the Company has recorded reserves that are adequate to cover litigation, claims or assessments that have been or may be asserted against the Company, and for which the outcome is probable and reasonably estimable, arising out of such other litigation, claims and civil suits. Furthermore, management believes that the resolution of such litigation, claims and civil suits will not have a material adverse effect on the Company's financial position or results of operations; however, there can be no assurance in this regard.

The Company provides mental health and substance abuse services, as a subcontractor, to beneficiaries of CHAMPUS. The fixed monthly amounts that the Company receives for medical costs under CHAMPUS contracts are subject to retroactive adjustment ("CHAMPUS Adjustments") based upon actual healthcare utilization during the period known as the "data collection period". The Company has

12. COMMITMENTS AND CONTINGENCIES (CONTINUED)

recorded reserves of approximately $51.8 million and $22.6 million as of September 30, 1999 and 2000, respectively, for CHAMPUS Adjustments. During the first quarter of fiscal 2000, the Company reached a settlement agreement with a contractor under one of its CHAMPUS contracts whereby the Company agreed to pay approximately $38.1 million to the contractor during the quarter ended December 31, 1999. The Company and the contractor under this CHAMPUS contract are in the process of appealing the department of defense's retroactive adjustment. While management believes that the present reserve for CHAMPUS Adjustments is reasonable, ultimate settlement resulting from the adjustment and available appeal process may vary from the amount provided.

13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Gerald L. McManis, a director of the Company, is the President of McManis Associates, Inc. ("MAI"), a healthcare development and management consulting firm. During fiscal 1998, MAI provided consulting services to the Company with respect to the development of strategic plans and a review of the Company's business processes. The Company incurred approximately $85,000 in fees for such services and related expenses during fiscal 1998.

G. Fred DiBona, Jr., a director of the Company, is a Director and the President and Chief Executive Officer of Independence Blue Cross ("IBC"), a health insurance company.

IBC owned 16.67% of Green Spring prior to December 13, 1995. On December 13, 1995, IBC sold 4.42% of its ownership interest in Green Spring to the Company for $5,376,000 in cash. IBC had a cost basis of $3,288,000 in the 4.42% ownership interest sold to the Company. The Exchange Option described previously gave IBC the right to exchange its ownership interest in Green Spring for a maximum of 889,456 shares of Common Stock or $20,460,000 in subordinated notes through December 13, 1998. IBC exercised its Exchange Option in January 29, 1998 for Magellan Common Stock valued at approximately $17.9 million.

IBC and its affiliated entities contract with the Company for provider network, care management and medical review services pursuant to contractual relationships. The Company recorded revenue of approximately $54.6 million, $59.1 million and $58.8 million from IBC during fiscal 1998, 1999 and 2000, respectively.

Darla D. Moore, a director of the Company since February 1996, is the spouse of Richard E. Rainwater, Chairman of the Board of Crescent and one of the largest stockholders of the Company. Because of her relationship to Mr. Rainwater, Ms. Moore did not participate in any Board action taken with respect to the Crescent Transactions.

Approximately 30% of the voting interest in Vivra was owned by TPG at the time of the Company's acquisition of Vivra.

14. BUSINESS SEGMENT INFORMATION

The Company operates through two reportable business segments engaging in the behavioral managed healthcare business and the human services business. The behavioral managed healthcare segment provides behavioral managed care services to health plans, insurance companies, corporations, labor unions and various governmental agencies. The human services segment provides therapeutic foster care

14. BUSINESS SEGMENT INFORMATION (CONTINUED)
services and residential and day services to individuals with acquired brain injuries and for individuals with mental retardation and developmental disabilities.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance of its segments based on profit or loss from continuing operations before depreciation, amortization, interest, net, stock option expense (credit), managed care integration costs, special charges, net, income taxes and minority interest ("Segment Profit"). Intersegment sales and transfers are not significant.

The following tables summarize, for the periods indicated, operating results and other financial information, by business segment (in thousands):

	BEHAVIORAL MANAGED HEALTHCARE	HUMAN SERVICES	CORPORATE OVERHEAD AND OTHER	CONSOLIDATED
1998				
Net revenue	$1,026,243	$141,031	$ --	$1,167,274
Segment profit (loss)	137,192	15,492	(15,866)	136,818
Equity in earnings of unconsolidated subsidiaries	12,795	--	--	12,795
Investment in unconsolidated subsidiaries	10,125	--	941	11,066
Capital expenditures	27,535	8,391	8,287	44,213
Total assets	$1,356,259	$119,356	$441,473	$1,917,088
1999				
Net revenue	$1,483,202	$191,277	$ --	$1,674,479
Segment Profit (loss)	218,253	21,728	(13,939)	226,042
Equity in earnings of unconsolidated subsidiaries	20,442	--	--	20,442
Investment in unconsolidated subsidiaries	18,396	--	--	18,396
Capital expenditures	37,487	5,779	4,853	48,119
Total assets	$1,472,539	$127,348	$281,728	$1,881,615
2000				
Net revenue	$1,655,101	$218,453	$ --	$1,873,554
Segment Profit (loss)	221,931	22,119	(13,286)	230,764
Equity in earnings of unconsolidated subsidiaries	9,792	--	--	9,792
Investment in unconsolidated subsidiaries	12,746	--	--	12,746
Capital expenditures	26,550	7,153	3,221	36,924
Total assets	$1,471,937	$135,685	$196,165	$1,803,787

The following tables reconcile segment profit to consolidated income from continuing operations before income taxes, minority interest and extraordinary items:

14. BUSINESS SEGMENT INFORMATION (CONTINUED)

1998	
Segment profit	$136,818
Depreciation and amortization	(46,898)
Interest, net	(76,505)
Stock option credit	5,623
Managed care integration costs	(16,962)
Income from continuing operations before income taxes, minority interest and extraordinary items	$ 2,076
1999	
Segment Profit	$226,042
Depreciation and amortization	(68,921)
Interest, net	(93,752)
Stock option expense	(18)
Managed care integration costs	(6,238)
Special charges	(4,441)
Income from continuing operations before income taxes, minority interest and extraordinary items	$ 52,672
2000	
Segment Profit	$230,764
Depreciation and amortization	(75,413)
Interest, net	(97,286)
Special charges	(25,398)
Income from continuing operations before income taxes, minority interest and extraordinary items	$ 32,667

Revenue generated and long-lived assets located in foreign countries are not material. Revenues from two customers of the Company's behavioral managed healthcare segment each represented approximately $284 million and $227 million of the Company's consolidated revenues for fiscal 2000 and $235 million and $214 million of the Company's consolidated revenues for fiscal 1999. In fiscal 1998, approximately $154 million in revenues were derived from one contract.

15. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following is a summary of the unaudited quarterly results of operations for the years ended September 30, 1999 and 2000.

	FOR THE QUARTER ENDED			
	DECEMBER 31, 1999	MARCH 31, 2000	JUNE 30, 2000	SEPTEMBER 30, 2000

	(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)			
FISCAL 2000				
Net Revenue	$436,969	$466,200	$479,174	$491,211
Cost and expenses:				
Salaries, cost of care and other operating expenses	383,724	413,611	422,409	432,838
Equity in earnings of unconsolidated subsidiaries	(3,474)	(2,908)	(2,465)	(945)
Depreciation and amortization	18,268	18,509	19,171	19,465
Interest, net	23,991	24,254	23,956	25,085
Special charges, net	--	--	--	25,398
	422,509	453,466	463,071	501,841
Income (loss) from continuing operations before income taxes and minority interest	14,460	12,734	16,103	(10,630)
Provision for income taxes	7,240	3,244	8,653	(3,659)
Income (loss) from continuing operations before minority interest	7,220	9,490	7,450	(6,971)
Minority interest	142	(111)	74	9
Income (loss) from continuing operations	7,078	9,601	7,376	(6,980)
Discontinued operations:				
Income (loss) from discontinued operations	(4,412)	(55,137)	(2,418)	(3,254)
Loss on disposal of discontinued operations	--	--	--	(17,662)
	(4,412)	(55,137)	(2,418)	(20,916)
Net income (loss)	2,666	(45,536)	4,958	(27,896)
Preferred dividend requirement and amortization of redeemable preferred stock issuance costs	216	1,088	1,195	1,303
Income (loss) available to common stockholders	$ 2,450	$(46,624)	$ 3,763	$(29,199)
Weighted average number of shares outstanding -- basic	31,980	32,058	32,166	32,368
Weighted average number of shares outstanding -- diluted	33,324	38,589	38,878	32,368
Income (loss) per share available to common stockholders -- basic				
Income from continuing operations	$ 0.22	$ 0.27	$ 0.19	$ (0.26)
Income (loss) from discontinued operations	$ (0.14)	$ (1.72)	$ (0.07)	$ (0.64)
Net income (loss)	$ 0.08	$ (1.45)	$ 0.12	$ (0.90)
Income (loss) per common share available to common stockholders -- diluted:				
Income from continuing operations	$ 0.21	$ 0.25	$ 0.19	$ (0.26)
Income (loss) from discontinued operations	$ (0.13)	$ (1.43)	$ (0.06)	$ (0.64)
Net income (loss)	$ 0.08	$ (1.18)	$ 0.13	$ (0.90)

15. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED) (CONTINUED)

	FOR THE QUARTER ENDED			
	DECEMBER 31, 1998	MARCH 31, 1999	JUNE 30, 1999	SEPTEMBER 30, 1999
	(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)			

FISCAL 1999				
Net Revenue	$402,290	$429,342	$418,680	$424,167
Cost and expenses:				
Salaries, cost of care and other operating expenses	351,688	380,208	368,371	368,612
Equity in earnings of unconsolidated subsidiaries	(3,783)	(6,262)	(8,196)	(2,201)
Depreciation and amortization	16,567	16,690	18,701	16,963
Interest, net	24,122	24,229	22,662	22,739
Stock option expense	12	6	--	--
Managed care integration costs	1,750	2,119	522	1,847
Special charges, net	1,084	2,252	--	1,105
	391,440	419,242	402,060	409,065
Income from continuing operations before income taxes and minority interest	10,850	10,100	16,620	15,102
Provision for income taxes	6,127	5,847	8,444	7,838
Income from continuing operations before minority interest	4,723	4,253	8,176	7,264
Minority interest	410	(34)	189	65
Income from continuing operations	4,313	4,287	7,987	7,199
Discontinued operations:				
Income (loss) from discontinued operations	(132)	(330)	13,512	15,275
Loss on Disposal of discontinued operations	--	--	--	(47,423)
	(132)	(330)	13,512	(32,148)
Net income (loss)	4,181	3,957	21,499	(24,949)
Preferred dividend requirement and amortization of redeemable preferred stock issuance costs	--	--	--	--
Income (loss) available to common stockholders	$ 4,181	$ 3,957	$ 21,499	$(24,949)
Weighted average number of shares outstanding-basic	31,613	31,741	31,778	31,850
Weighted average number of shares outstanding-diluted	31,660	31,751	32,041	32,200
Income (loss) per common share available to common stockholders -- basic:				
Income from continuing operations	$ 0.14	$ 0.13	$ 0.25	$ 0.23
Income (loss) from discontinued operations	$ (0.01)	$ (0.01)	$ 0.43	$ (1.01)
Net income (loss)	$ 0.13	$ 0.12	$ 0.68	$ (0.78)
Income (loss) per common share available to common stockholders -- diluted:				
Income from continuing operations	$ 0.14	$ 0.13	$ 0.25	$ 0.22
Income (loss) from discontinued operations	$ (0.01)	$ (0.01)	$ 0.42	$ (1.00)
Net income (loss)	$ 0.13	$ 0.12	$ 0.67	$ (0.78)

MAGELLAN HEALTH SERVICES, INC.
SCHEDULE II--VALUATION AND QUALIFYING ACCOUNTS
(IN THOUSANDS)

CLASSIFICATION	BALANCE AT BEGINNING OF PERIOD	CHARGED TO COSTS AND EXPENSES	CHARGED TO OTHER ACCOUNTS--DESCRIBE	DEDUCTIONS--DESCRIBE	BALANCE AT END OF PERIOD
Fiscal year ended					

September 30, 1998:					
Allowance for doubtful accounts..............	$40,311	$ 4,977(D)	$15,031(A) 4,376(C)	$24,440(B) 5,388(F)	$34,867
	$40,311	$ 4,977	$19,407	$29,828	$34,867
Fiscal year ended September 30, 1999:					
Allowance for doubtful accounts..............	$34,867	$ 3,277(D) (8,072)(E)	$ 2,362(A) 604(C)	$ 1,280(B) 672(F) 2,649(H)	$28,437
	$34,867	$(4,795)	$ 2,966	$ 4,601	$28,437
Fiscal year ended September 30, 2000:					
Allowance for doubtful accounts..............	$28,437	$ 8,651(D)	$ 494(A)	$ 3,355(B) 22,635(C)	$11,592
	$28,437	$ 8,651	$ 494	$25,990	$11,592

(A) Recoveries of accounts receivable previously written off.

(B) Accounts written off.

(C) Allowance for doubtful accounts (net) assumed or disposed of in acquisitions or dispositions.

(D) Bad debt expense.

(E) Accounts receivable collection fees included in loss on Crescent Transactions.

(F) Accounts receivable collection fees payable to CBHS and outside vendors.

(G) Amounts reclassified to contractual allowances.

(H) Conversion of Provider JVs from consolidation to equity method.

Exhibit 4(r)

AMENDMENT No. 7 entered into as of September 19, 2000 (this "Amendment"), to the Credit Agreement dated as of February 12, 1998 (as amended, supplemented or otherwise modified from time to time, the "CREDIT AGREEMENT"), among Magellan Health Services, Inc., a Delaware corporation (the "PARENT BORROWER"); Charter Behavioral Health System of New Mexico, Inc., a New Mexico corporation; Merit Behavioral Care Corporation, a Delaware corporation; each other wholly owned domestic subsidiary of the Parent Borrower that becomes a "Subsidiary Borrower" pursuant to Section 2.23 of the Credit Agreement (each, a "SUBSIDIARY BORROWER" and, collectively, the "SUBSIDIARY BORROWERS" (such term is used herein as modified in Article I of the Credit Agreement); the Parent Borrower and the Subsidiary Borrowers are collectively referred to herein as the "BORROWERS"); the Lenders (as defined in Article I of the Credit Agreement); The Chase Manhattan Bank, a New York banking corporation, as administrative agent (in such capacity, the "ADMINISTRATIVE AGENT") for the Lenders, as collateral agent (in such capacity, the "COLLATERAL AGENT") for the Lenders and as an issuing bank (in such capacity, an "ISSUING BANK"); First Union National Bank, a national banking corporation, as syndication agent (in such capacity, the "SYNDICATION AGENT") for the Lenders and as an issuing bank (in such capacity, an "ISSUING BANK"); and Credit Lyonnais New York Branch, a licensed branch of a bank organized and existing under the laws of the Republic of France, as documentation agent (in such capacity, the "DOCUMENTATION AGENT") for the Lenders and as an issuing bank (in such capacity, an "ISSUING BANK" and, together with The Chase Manhattan Bank and First Union National Bank, each in its capacity as an issuing bank, the "ISSUING BANKS").

A. The Lenders and the Issuing Banks have extended credit to the Borrowers, and have agreed to extend credit to the Borrowers, in each case pursuant to the terms and subject to the conditions set forth in the Credit Agreement.

B. Capitalized terms used but not defined herein have the meanings assigned to them in the Credit Agreement (as amended hereby).

C. The Borrowers and the Required Lenders have agreed to amend certain provisions of the Credit Agreement as set forth herein on the terms and subject to the conditions set forth in this Amendment.

Accordingly, in consideration of the mutual agreements herein contained and other good and valuable consideration, the sufficiency and receipt of which are hereby acknowledged, the parties hereto agree as follows:

SECTION 1. AMENDMENTS TO SECTION 1.01. (a) The definition of the term "Excess Cash Flow" is hereby amended by (i) adding after the words "the term `Net Cash Proceeds'" the following text: "arising as a result of any Condemnation Event or Casualty Event" and (ii)(A) replacing the term "and" with a "," prior to clause (ii) of the

proviso at the end of such defined term and (B) adding the following text at the end of such clause (ii): "and (iii) for avoidance of doubt, any proceeds resulting from the Mentor Sale."

(b) The definition of the term "Permitted Acquisition" is amended by replacing clause (e) with the following text:

> (e) the amounts paid for all Permitted Acquisitions (including, without limitation, any Indebtedness incurred or assumed in connection therewith, but excluding (i) any capital

stock or other equity interests issued or delivered as part of the consideration for such Permitted Acquisition, (ii) Permitted CBHS Lease Transaction Amounts, and (iii) the Permitted Premier Acquisition and the Permitted CBHS Joint Venture Acquisitions/Sales) (x) after the Closing Date shall not exceed, in the event the Leverage Ratio as of the last day of the most recently ended fiscal quarter for which financial statements have been delivered, or were required to have been delivered, by the Parent Borrower pursuant to Section 5.04(a) or 5.04(b), prior to such Permitted Acquisition, on a pro forma basis after giving effect to all such Permitted Acquisitions, is greater than or equal to 4.00:1.00, $100,000,000, and (y) after the completion of the Mentor Sale shall not exceed, in the event the Leverage Ratio as of the last day of the most recently ended fiscal quarter for which financial statements have been delivered, or were required to have been delivered, by the Parent Borrower pursuant to Section 5.04(a) or 5.04(b), prior to such Permitted Acquisition, on a pro forma basis after giving effect to all such Permitted Acquisitions, is greater than or equal to the applicable Leverage Ratio shown below, the respective sublimit amount shown for such Leverage Ratio:

LEVERAGE RATIO	PERMITTED ACQUISITIONS SUBLIMIT
Greater than 5.00:1.00	$2,500,000
Greater than 4.50:1.00, but less than or equal to 5:00:1.00	$10,000,000
Greater than 3.75:1.00, but less than or equal to 4.50:1.00	$25,000,000
Less than or equal to 3.75:1.00	No Sublimit

(c) The definition of the term "Permitted Stock Repurchases or Dividends" is hereby amended to replace the word "and" prior to clause (y) in the second clause (B) of the first sentence thereof with a "," and adding the following text after such clause (y):

and (z) in the case of Permitted Stock Repurchases or Dividends as described in clauses (a) or (b) above made after the completion of the Mentor Sale, and so long as the Leverage Ratio as of the last day of the most recently ended fiscal quarter for which financial statements have been delivered, or were required to have been delivered, by the Parent Borrower pursuant to Section 5.04(a) or 5.04(b), prior to such Permitted

Stock Repurchase or Dividend, is greater than or equal to 4.00:1.00, $2,000,000,

(d) Section 1.01 of the Credit Agreement is hereby amended by adding the defined terms "Permitted CBHS Joint Venture Acquisition/Sale" and "Permitted Premier Acquisition" to read in the entirety as follows:

"PERMITTED CBHS JOINT VENTURE ACQUISITION/SALE" shall mean the acquisition by the Parent Borrower or any of its Subsidiaries of the partnership or limited liability company interests of any other partners or limited liability company members of any CBHS Joint Venture, to the extent such acquisition is (i) made in contemplation of a CBHS Joint Venture Sale in respect of such CBHS Joint Venture or the assets owned or used by it, (ii) effected for an amount paid by the Parent Borrower or such Subsidiaries that is to be recouped by the Parent Borrower or such Subsidiaries in the contemplated CBHS Joint Venture Sale, and (iii) preceded or promptly followed by a closing of the contemplated CBHS Joint Venture Sale pursuant to which such amount is recouped; PROVIDED, HOWEVER, that to the extent any such amount is not so recouped, such excess amount shall be included in determining the Parent Borrower's compliance with the limitations on Permitted Acquisitions set forth in clause (e) of the definition thereof.

"PERMITTED PREMIER ACQUISITION" shall mean the acquisition by the Parent Borrower or any of its Subsidiaries of Premier Behavioral Systems of Tennessee, LLC ("Premier") through the redemption or purchase of the limited liability company interests held by other member(s) of Premier, to the extent such redemption or purchase is effected directly or indirectly from funds or other property of Premier paid or distributed for such purpose; PROVIDED, HOWEVER, to the extent any funds or other property of the Parent Borrower or any Subsidiary are used to effect such redemption or purchase, the amount of such funds or property shall be included in determining the Parent Borrower's compliance with the limitations on Permitted Acquisitions set forth in clause (e) of the definition thereof.

SECTION 2. AMENDMENT TO SECTION 2.13(B). Section 2.13(b) of the Credit Agreement is hereby amended by substituting the date "September 30, 2001" for the date "September 30, 2002" in clause (i) of such Section.

SECTION 3. REPRESENTATIONS AND WARRANTIES. Each Borrower represents and warrants to the Administrative Agent and to each of the Lenders that:

(a) This Amendment has been duly authorized, executed and delivered by it and constitutes a legal, valid and binding obligation of each Loan Party party hereto, enforceable against such Loan Party in accordance with its terms.

(b) Before and after giving effect to this Amendment, the representations and warranties set forth in Article III of the Credit Agreement are true and correct in all material respects on and as of the date hereof with the same effect as if made on and as of the date hereof, except to the extent such representations and warranties expressly relate to an earlier date.

(c) Before and after giving effect to this Amendment, no Event of Default or Default has occurred and is continuing.

SECTION 4. CONDITIONS TO EFFECTIVENESS. This Amendment shall be deemed agreed to by the parties to the Credit Agreement when the Administrative Agent shall have received counterparts of this Amendment that, when taken together, bear the signatures of the Borrowers and the Required Lenders, but this Amendment shall not become effective until the date that the Mentor Sale is completed.

SECTION 5. CREDIT AGREEMENT. Except as specifically amended hereby, the Credit Agreement shall continue in full force and effect in accordance with the provisions thereof as in existence on the date hereof. After the date hereof, any reference to the Credit Agreement shall mean the Credit Agreement as amended hereby. This Amendment shall be a Loan Document for all purposes.

SECTION 6. APPLICABLE LAW. THIS AMENDMENT SHALL BE GOVERNED BY, CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF NEW YORK.

SECTION 7. COUNTERPARTS. This Amendment may be executed in two or more counterparts, each of which shall constitute an original but all of which when taken together shall constitute but one agreement. Delivery of an executed signature page to this Amendment by facsimile transmission shall be effective as delivery of a manually signed counterpart of this Amendment.

SECTION 8. EXPENSES. The Parent Borrower agrees to reimburse the Administrative Agent for its out-of-pocket expenses in connection with this Amendment, including the reasonable fees, charges and disbursements of Cravath, Swaine & Moore, counsel for the Administrative Agent.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be duly executed by their respective authorized officers as of the day and year first written above.

MAGELLAN HEALTH SERVICES, INC.,

By /s/ James R. Bedenbaugh

Name: James R. Bedenbaugh
Title: SVP & Treasurer

CHARTER BEHAVIORAL HEALTH SYSTEM OF NEW MEXICO, INC.,

By /s/ Charlotte A. Sanford

Name: Charlotte A. Sanford
Title: Treasurer

MERIT BEHAVIORAL CARE CORPORATION,

By /s/ Charlotte A. Sanford

Name: Charlotte A. Sanford
Title: Treasurer

THE CHASE MANHATTAN BANK, individually and as Administrative Agent, Collateral Agent and an Issuing Bank,

By /s/ Dawn Lee Lum

Name: Dawn Lee Lum
Title: Vice President

FIRST UNION NATIONAL BANK, individually and as Syndication Agent and an Issuing Bank,

By /s/ Joyce L. Barry

Name: Joyce L. Barry
Title: SVP

ML CLO XV PILGRIM AMERICA (CAYMAN) LTD.
BY: PILGRIM INVESTMENTS, INC.
AS ITS INVESTMENT MANAGER

By /s/ Michel Prince, CFA

Name: Michel Prince, CFA
Title: Vice President

PILGRIM AMERICA HIGH INCOME INVESTMENTS LTD.
BY: PILGRIM INVESTMENTS, INC.
AS ITS INVESTMENT MANAGER

By /s/ Michel Prince, CFA

Name: Michel Prince, CFA
Title: Vice President

PILGRIM PRIME RATE TRUST
BY: PILGRIM INVESTMENTS, INC.
AS ITS INVESTMENT MANAGER

By /s/ Michel Prince, CFA

Name: Michel Prince, CFA
Title: Vice President

HIGHLAND CAPITAL MANAGEMENT, L.P.,

By /s/ James Dondero

Name: James Dondero
Title: President

MERRILL LYNCH SENIOR FLOATING RATE FUND, INC.

By /s/ Colleen M. Cunniffe

Name: Colleen M. Cunniffe
Title: Authorized Signatory

MERRILL LYNCH DEBT STRATEGIES PORTFOLIO
BY: MERRILL LYNCH INVESTMENT MANAGERS, L.P.,
AS INVESTMENT ADVISOR,

By /s/ Colleen M. Cunniffe

Name: Colleen M. Cunniffe
Title: Authorized Signatory

MERRILL LYNCH GLOBAL INVESTMENT
SERIES: INCOME STRATEGIES PORTFOLIO
BY: MERRILL LYNCH INVESTMENT MANAGERS, L.P.,
AS INVESTMENT ADVISOR,

By /s/ Colleen M. Cunniffe

Name: Colleen M. Cunniffe
Title: Authorized Signatory

INDOSUEZ CAPITAL FUNDING IV, L.P.
BY: INDOSUEZ CAPITAL
AS PORTFOLIO ADVISOR,

By /s/ Melissa Marano

Name: Melissa Marano
Title: Vice President

BLACK DIAMOND CLO 1998-1 LTD.,

By /s/ John H. Cullinane

Name: John H. Cullinane
Title: Director

BLACK DIAMOND INTERNATIONAL FUNDING, LTD.,

By /s/ John H. Cullinane

Name: John H. Cullinane
Title: Director

VAN KAMPEN PRIME RATE INCOME TRUST
BY: VAN KAMPEN INVESTMENT ADVISORY CORP.,

By /s/ Brian T. Buscher

Name: Brian T. Buscher
Title: Manager Operations & Compliance

SENIOR DEBT PORTFOLIO
BY: BOSTON MANAGEMENT AND RESEARCH
AS INVESTMENT ADVISOR,

By /s/ Scott H. Page

Name: Scott H. Page
Title: Vice President

EATON VANCE INSTITUTIONAL SENIOR LOAN FUND
BY: EATON VANCE MANAGEMENT
AS INVESTMENT ADVISOR,

By /s/ Scott H. Page

Name: Scott H. Page
Title: Vice President

ARCHIMEDES FUNDING II, LTD.,

By /s/ Helen Y. Rhee

Name: Helen Y. Rhee
Title: Vice President & Portfolio Manager

SUMMIT BANK,

By /s/ William Dinicola

Name: William Dinicola
Title: Vice President

BATTERSON PARK CBO I
BY: GENERAL RE-NEW ENGLAND ASSET MANAGEMENT, INC.,
AS COLLATERAL MANAGER,

By /s/ Susan Bosworth

Name: Susan Bosworth

Title: Vice President

BANK POLSKA KASA OPIEKI S.A., NEW YORK BRANCH,

By /s/ Barry W. Henry

Name: Barry W. Henry
Title: Vice President
Senior Lending Officer

C.M. LIFE INSURANCE COMPANY,

By /s/ Clifford M. Noreen

Name: Clifford M. Noreen
Title: Senior Managing Director

MASSMUTUAL HIGH YIELD PARTNERS II LLC,
BY: HYP MANAGEMENT, INC.
AS MANAGING MEMBER

By /s/ Clifford M. Noreen

Name: Clifford M. Noreen
Title: Senior Managing Director

MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY,

By /s/ Clifford M. Noreen

Name: Clifford M. Noreen
Title: Senior Managing Director

MASSMUTUAL/DARBY CBO LLC
BY: MASSMUTUAL/DARBY CBO IM, INC.
AS LLC MANAGER

By /s/ Clifford M. Noreen

Name: Clifford M. Noreen
Title: Senior Managing Director

MASSMUTUAL CORPORATE VALUE PARTNERS LTD.
BY: DAVID L. BABSON AND COMPANY INC. UNDER DELEGATED
AUTHORITY FROM MASS. MUTUAL LIFE INSURANCE COMPANY,
AS MANAGER,

By /s/ Clifford M. Noreen

Name: Clifford M. Noreen
Title: Senior Managing Director

KZH HIGHLAND-2 LLC,

By /s/ Kimberly Rowe

Name: Kimberly Rowe
Title: Authorized Agent

KZH PAMCO LLC,

By /s/ Kimberly Rowe

Name: Kimberly Rowe
Title: Authorized Agent

CREDIT LYONNAIS NEW YORK BRANCH,

By /s/ Charles Heidsieck

Name: Charles Heidsieck
Title: Senior Vice President

KZH ING-2 LLC,

By /s/ Kimberly Rowe

Name: Kimberly Rowe
Title: Authorized Agent

KZH ING-3 LLC,

By /s/ Kimberly Rowe

Name: Kimberly Rowe
Title: Authorized Agent

KZH PONDVIEW LLC,

By /s/ Kimberly Rowe

Name: Kimberly Rowe
Title: Authorized Agent

KZH SHOSHONE LLC,

By /s/ Kimberly Rowe

Name: Kimberly Rowe
Title: Authorized Agent

KZH SOLEIL LLC,

By /s/ Kimberly Rowe

Name: Kimberly Rowe
Title: Authorized Agent

BANK OF TOKYO-MITSUBISHI TRUST CO.,

By /s/ Spencer Hughes

Name: Spencer Hughes
Title: Vice President

THE BANK OF NOVA SCOTIA,

By /s/ W.J. Brown

Name: W.J. Brown
Title: Vice President

GENERAL ELECTRIC CAPITAL CORPORATION,

By /s/ Thomas E. Johnstone

Name: Thomas E. Johnstone
Title: Duly Authorized Signatory

KZH CRESCENT-2 LLC,

By /s/ Kimberly Rowe

Name: Kimberly Rowe
Title: Authorized Agent

TCW LEVERAGED INCOME TRUST, L.P.
BY: TCW ADVISERS (BERMUDA), LTD.,
AS GENERAL PARTNER,

By /s/ Mark Gold

Name: Mark Gold
Title: Managing Director

By: TCW INVESTMENT MANAGEMENT COMPANY,
AS INVESTMENT ADVISER,

By /s/ Jonathan Berg

Name: Jonathan Berg
Title: Assistant Vice President

TCW LEVERAGED INCOME TRUST II, L.P.
BY: TCW ADVISERS (BERMUDA), LTD.,
AS GENERAL PARTNER,

By /s/ Mark Gold

Name: Mark Gold
Title: Managing Director

By: TCW INVESTMENT MANAGEMENT COMPANY,
AS INVESTMENT ADVISER,

By /s/ Jonathan Berg

Name: Jonathan Berg
Title: Assistant Vice President

SEQUILS I, LTD.
BY: TCW ADVISORS, INC.
AS ITS COLLATERAL MANAGER,

By /s/ Mark Gold

Name: Mark Gold
Title: Managing Director

By /s/ Jonathan Berg

Name: Jonathan Berg
Title: Assistant Vice President

Exhibit 4(s)

AMENDMENT No. 8 entered into as of November 21, 2000 (this "AMENDMENT"), to the Credit Agreement dated as of February 12, 1998 (as amended, supplemented or otherwise modified from time to time, the "CREDIT AGREEMENT"), among Magellan Health Services, Inc., a Delaware corporation (the "PARENT BORROWER"); Charter Behavioral Health System of New Mexico, Inc., a New Mexico corporation; Merit Behavioral Care Corporation, a Delaware corporation; each other wholly owned domestic subsidiary of the Parent Borrower that becomes a "Subsidiary Borrower" pursuant to Section 2.23 of the Credit Agreement (each, a "SUBSIDIARY BORROWER" and, collectively, the "SUBSIDIARY BORROWERS" (such term is used herein as modified in Article I of the Credit Agreement); the Parent Borrower and the Subsidiary Borrowers are collectively referred to herein as the "BORROWERS"); the Lenders (as defined in Article I of the Credit Agreement); The Chase Manhattan Bank, a New York banking corporation, as administrative agent (in such capacity, the "ADMINISTRATIVE AGENT") for the Lenders, as collateral agent (in such capacity, the "COLLATERAL AGENT") for the Lenders and as an issuing bank (in such capacity, an "ISSUING BANK"); First Union National Bank, a national banking corporation, as syndication agent (in such capacity, the "SYNDICATION AGENT") for the Lenders and as an issuing bank (in such capacity, an "ISSUING BANK"); and Credit Lyonnais New York Branch, a licensed branch of a bank organized and existing under the laws of the Republic of France, as documentation agent (in such capacity, the "DOCUMENTATION AGENT") for the Lenders and as an issuing bank (in such capacity, an "ISSUING BANK" and, together with The Chase Manhattan Bank and First Union National Bank, each in its capacity as an issuing bank, the "ISSUING BANKS").

A. The Lenders and the Issuing Banks have extended credit to the Borrowers, and have agreed to extend credit to the Borrowers, in each case pursuant to the terms and subject to the conditions set forth in the Credit Agreement.

B. The Parent Borrower has requested that the Required Lenders amend certain provisions of the Credit Agreement as set forth herein, and the Required Lenders are willing so to amend such provisions of the Credit Agreement, on the terms and subject to the conditions set forth in this Amendment.

C. Capitalized terms used but not defined herein have the meanings assigned to them in the Credit Agreement (as amended hereby).

Accordingly, in consideration of the mutual agreements herein contained and other good and valuable consideration, the sufficiency and receipt of which are hereby acknowledged, the parties hereto agree as follows:

SECTION 1. AMENDMENT TO SECTION 6.05. Section 6.05 of the Credit Agreement is hereby amended by (a) deleting the word "and" immediately after the semicolon in paragraph (k) of such Section, (b) deleting the "." at the end of paragraph (l)

of such Section and substituting in lieu thereof the text"; and" and (c) adding a new paragraph (m) to such Section, to read in its entirety as follows:

> (m) the Parent Borrower and its Subsidiaries may conduct an Asset Sale in respect of Green Spring Health Services of Canada Co. (whether conducted as a sale of assets or a sale of capital stock, or as a sale of equity interests of any Person(s) whose only material asset is the capital stock of Green Spring Health Services of

Canada Co., in any case for an amount equal to the fair market value thereof (as determined in good faith by a Financial Officer of the Parent Borrower)), PROVIDED that no Default or Event of Default has occurred and is continuing at the time of sale and the Net Cash Proceeds from such sale shall be applied as required by Section 2.13(a)(2).

SECTION 2. REPRESENTATIONS AND WARRANTIES. Each Borrower represents and warrants to the Administrative Agent and to each of the Lenders that:

(a) This Amendment has been duly authorized, executed and delivered by it and constitutes a legal, valid and binding obligation of each Loan Party party hereto, enforceable against such Loan Party in accordance with its terms.

(b) Before and after giving effect to this Amendment, the representations and warranties set forth in Article III of the Credit Agreement are true and correct in all material respects on and as of the date hereof with the same effect as if made on and as of the date hereof, except to the extent such representations and warranties expressly relate to an earlier date.

(c) Before and after giving effect to this Amendment, no Event of Default or Default has occurred and is continuing.

SECTION 3. CONDITIONS TO EFFECTIVENESS. This Amendment shall become effective as of November 21, 2000, when (a) the Administrative Agent shall have received counterparts of this Amendment that, when taken together, bear the signatures of the Borrowers and the Required Lenders and (b) the representations and warranties set forth in Section 2 hereof are true and correct.

SECTION 4. CREDIT AGREEMENT. Except as specifically amended hereby, the Credit Agreement shall continue in full force and effect in accordance with the provisions thereof as in existence on the date hereof. After the date hereof, any reference to the Credit Agreement shall mean the Credit Agreement as amended hereby. This Amendment shall be a Loan Document for all purposes.

SECTION 5. APPLICABLE LAW. THIS AMENDMENT SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF NEW YORK.

SECTION 6. COUNTERPARTS. This Amendment may be executed in two or more counterparts, each of which shall constitute an original but all of which when taken together shall constitute but one agreement. Delivery of an executed signature page to this Amendment by facsimile transmission shall be effective as delivery of a manually signed counterpart of this Amendment.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be duly executed by their respective authorized officers as of the day and year first written above.

MAGELLAN HEALTH SERVICES, INC.,

By /s/ JAMES R. BEDENBAUGH

Name: James R. Bedenbaugh
Title: Senior Vice President & Treasurer

CHARTER BEHAVIORAL HEALTH SYSTEM OF NEW MEXICO, INC.,

By /s/ CHARLOTTE A. SANFORD

Name: Charlotte A. Sanford
Title: Treasurer

MERIT BEHAVIORAL CARE CORPORATION,

By /s/ CHARLOTTE A. SANFORD
Name: Charlotte A. Sanford
Title: Treasurer

THE CHASE MANHATTAN BANK,
individually and as Administrative Agent,
Collateral Agent and an Issuing Bank,

By /s/ DAWN LEE LUM
Name: Dawn Lee Lum
Title: Vice President

FIRST UNION NATIONAL BANK,
individually and as Syndication Agent and
an Issuing Bank,

By /s/ JOYCE L. BARRY
Name: Joyce L. Barry
Title: Senior Vice President

SIGNATURE PAGE TO AMENDMENT NO. 8 DATED AS OF NOVEMBER 21, 2000, TO THE CREDIT AGREEMENT DATED AS OF FEBRUARY 12, 1998 (AS PREVIOUSLY AMENDED, SUPPLEMENTED OR OTHERWISE MODIFIED FROM TIME TO TIME), AMONG MAGELLAN HEALTH SERVICES, INC., CHARTER BEHAVIORAL HEALTH SYSTEM OF NEW MEXICO, INC., MERIT BEHAVIORAL CARE CORPORATION, THE SUBSIDIARY BORROWERS, THE LENDERS, THE CHASE MANHATTAN BANK, AS ADMINISTRATIVE AGENT, AS COLLATERAL AGENT AND AS AN ISSUING BANK, FIRST UNION NATIONAL BANK, AS SYNDICATION AGENT AND AS AN ISSUING BANK, AND CREDIT LYONNAIS NEW YORK BRANCH, AS DOCUMENTATION AGENT.

NAME OF INSTITUTION: ARCHIMEDES FUNDING II, LTD.
BY: ING Capital Advisors LLC,
as Collateral Manager

By /s/ HELEN Y. RHEE
Name: Helen Y. Rhee
Title: Vice President & Portfolio Manager

NAME OF INSTITUTION: BANK OF TOKYO-MITSUBISHI TRUST COMPANY,

By /s/ SPENCER HUGHES
Name: Spencer Hughes
Title: Vice President

NAME OF INSTITUTION: BLACK DIAMOND CLO 98-1 LTD.,

By /s/ JOHN H. CULLINANE
Name: John H. Cullinane
Title: Director

SIGNATURE PAGE TO AMENDMENT NO. 8 DATED AS OF NOVEMBER 21, 2000, TO THE CREDIT AGREEMENT DATED AS OF FEBRUARY 12, 1998 (AS PREVIOUSLY AMENDED, SUPPLEMENTED OR OTHERWISE MODIFIED FROM TIME TO TIME), AMONG MAGELLAN HEALTH SERVICES, INC., CHARTER BEHAVIORAL HEALTH SYSTEM OF NEW MEXICO, INC., MERIT BEHAVIORAL CARE CORPORATION, THE SUBSIDIARY BORROWERS, THE LENDERS, THE CHASE MANHATTAN BANK, AS ADMINISTRATIVE AGENT, AS COLLATERAL AGENT AND AS AN ISSUING BANK, FIRST UNION NATIONAL BANK, AS SYNDICATION AGENT AND AS AN ISSUING BANK, AND CREDIT LYONNAIS NEW YORK BRANCH, AS DOCUMENTATION AGENT.

NAME OF INSTITUTION: BLACK DIAMOND INTERNATIONAL FUNDING, LTD.,

By /s/ DAVID DYER

Name: David Dyer
Title: Director

NAME OF INSTITUTION: CREDIT LYONNAIS NEW YORK BRANCH,

By /s/ CHARLES H. HEIDSIECH

Name: Charles H. Heidsiech
Title: Senior Vice President

NAME OF INSTITUTION: DELANO COMPANY
By: Pacific Investment Management Company LLC, as its Investment Advisor

By /s/ RAYMOND G. KENNEDY

Name: Raymond G. Kennedy
Title: Executive Vice President

SIGNATURE PAGE TO AMENDMENT NO. 8 DATED AS OF NOVEMBER 21, 2000, TO THE CREDIT AGREEMENT DATED AS OF FEBRUARY 12, 1998 (AS PREVIOUSLY AMENDED, SUPPLEMENTED OR OTHERWISE MODIFIED FROM TIME TO TIME), AMONG MAGELLAN HEALTH SERVICES, INC., CHARTER BEHAVIORAL HEALTH SYSTEM OF NEW MEXICO, INC., MERIT BEHAVIORAL CARE CORPORATION, THE SUBSIDIARY BORROWERS, THE LENDERS, THE CHASE MANHATTAN BANK, AS ADMINISTRATIVE AGENT, AS COLLATERAL AGENT AND AS AN ISSUING BANK, FIRST UNION NATIONAL BANK, AS SYNDICATION AGENT AND AS AN ISSUING BANK, AND CREDIT LYONNAIS NEW YORK BRANCH, AS DOCUMENTATION AGENT.

NAME OF INSTITUTION: CAPTIVA III FINANCE LTD., as advised by Pacific Investment Management Company LLC

By /s/ DAVID DYER

Name: David Dyer
Title: Director

NAME OF INSTITUTION: GENERAL ELECTRIC CAPITAL CORPORATION,

By /s/ WILLIAM E. MAGEE

Name: William E. Magee
Title: Duly Authorized Signatory

NAME OF INSTITUTION: HIGHLAND CAPITAL MANAGEMENT L.P.,

By /s/ MARK K. OKADA CFA

Name: Mark K. Okada CFA
Title: Executive Vice President
Highland Capital Management L.P.

SIGNATURE PAGE TO AMENDMENT NO. 8 DATED AS OF NOVEMBER 21, 2000, TO THE CREDIT AGREEMENT DATED AS OF FEBRUARY 12, 1998 (AS PREVIOUSLY AMENDED, SUPPLEMENTED OR OTHERWISE MODIFIED FROM TIME TO TIME), AMONG MAGELLAN HEALTH SERVICES, INC., CHARTER BEHAVIORAL HEALTH SYSTEM OF NEW MEXICO, INC., MERIT BEHAVIORAL CARE CORPORATION, THE SUBSIDIARY BORROWERS, THE LENDERS, THE CHASE MANHATTAN BANK, AS ADMINISTRATIVE AGENT, AS COLLATERAL AGENT AND AS AN ISSUING BANK, FIRST UNION NATIONAL BANK, AS SYNDICATION AGENT AND AS AN ISSUING BANK, AND CREDIT LYONNAIS NEW YORK BRANCH, AS DOCUMENTATION AGENT.

NAME OF INSTITUTION: INDOSUEZ CAPITAL FUNDING IIA, LIMITED
By: Indosuez Capital as Portfolio Advisor

By /s/ MELISSA MARANO

Name: Melissa Marano
Title: Vice President

NAME OF INSTITUTION: INDOSUEZ CAPITAL FUNDING IV, L.P.
By: Indosuez Capital as Portfolio Advisor

By /s/ MELISSA MARANO

Name: Melissa Marano
Title: Vice President

NAME OF INSTITUTION: KZH CRESCENT-2 LLC,

By /s/ SUSAN LEE

Name: Susan Lee
Title: Authorized Agent

NAME OF INSTITUTION: KZH ING-2 LLC,

By /s/ SUSAN LEE

Name: Susan Lee
Title: Authorized Agent

SIGNATURE PAGE TO AMENDMENT NO. 8 DATED AS OF NOVEMBER 21, 2000, TO THE CREDIT AGREEMENT DATED AS OF FEBRUARY 12, 1998 (AS PREVIOUSLY AMENDED, SUPPLEMENTED OR OTHERWISE MODIFIED FROM TIME TO TIME), AMONG MAGELLAN HEALTH SERVICES, INC., CHARTER BEHAVIORAL HEALTH SYSTEM OF NEW MEXICO, INC., MERIT BEHAVIORAL CARE CORPORATION, THE SUBSIDIARY BORROWERS, THE LENDERS, THE CHASE MANHATTAN BANK, AS ADMINISTRATIVE AGENT, AS COLLATERAL AGENT AND AS AN ISSUING BANK, FIRST UNION NATIONAL BANK, AS SYNDICATION AGENT AND AS AN ISSUING BANK, AND CREDIT LYONNAIS NEW YORK BRANCH, AS DOCUMENTATION AGENT.

NAME OF INSTITUTION: KZH ING-3 LLC,

By /s/ SUSAN LEE

Name: Susan Lee
Title: Authorized Agent

NAME OF INSTITUTION: KZH HIGHLAND-2 LLC,

By /s/ SUSAN LEE

Name: Susan Lee
Title: Authorized Agent

NAME OF INSTITUTION: KZH PAMCO LLC,

By /s/ SUSAN LEE

Name: Susan Lee
Title: Authorized Agent

NAME OF INSTITUTION: KZH PONDVIEW LLC,

By /s/ SUSAN LEE

Name: Susan Lee
Title: Authorized Agent

SIGNATURE PAGE TO AMENDMENT NO. 8 DATED AS OF NOVEMBER 21, 2000, TO THE CREDIT AGREEMENT DATED AS OF FEBRUARY 12, 1998 (AS PREVIOUSLY AMENDED, SUPPLEMENTED OR OTHERWISE MODIFIED FROM TIME TO

TIME), AMONG MAGELLAN HEALTH SERVICES, INC., CHARTER BEHAVIORAL HEALTH SYSTEM OF NEW MEXICO, INC., MERIT BEHAVIORAL CARE CORPORATION, THE SUBSIDIARY BORROWERS, THE LENDERS, THE CHASE MANHATTAN BANK, AS ADMINISTRATIVE AGENT, AS COLLATERAL AGENT AND AS AN ISSUING BANK, FIRST UNION NATIONAL BANK, AS SYNDICATION AGENT AND AS AN ISSUING BANK, AND CREDIT LYONNAIS NEW YORK BRANCH, AS DOCUMENTATION AGENT.

NAME OF INSTITUTION: KZH SHOSHONE LLC,

By /s/ SUSAN LEE

Name: Susan Lee
Title: Authorized Agent

NAME OF INSTITUTION: KZH SOLEIL LLC,

By /s/ SUSAN LEE

Name: Susan Lee
Title: Authorized Agent

NAME OF INSTITUTION: MORGAN STANLEY DEAN WITTER PRIME INCOME TRUST,

By /s/ SHEILA FINNERTY

Name: Sheila Finnerty
Title: Senior Vice President

SIGNATURE PAGE TO AMENDMENT NO. 8 DATED AS OF NOVEMBER 21, 2000, TO THE CREDIT AGREEMENT DATED AS OF FEBRUARY 12, 1998 (AS PREVIOUSLY AMENDED, SUPPLEMENTED OR OTHERWISE MODIFIED FROM TIME TO TIME), AMONG MAGELLAN HEALTH SERVICES, INC., CHARTER BEHAVIORAL HEALTH SYSTEM OF NEW MEXICO, INC., MERIT BEHAVIORAL CARE CORPORATION, THE SUBSIDIARY BORROWERS, THE LENDERS, THE CHASE MANHATTAN BANK, AS ADMINISTRATIVE AGENT, AS COLLATERAL AGENT AND AS AN ISSUING BANK, FIRST UNION NATIONAL BANK, AS SYNDICATION AGENT AND AS AN ISSUING BANK, AND CREDIT LYONNAIS NEW YORK BRANCH, AS DOCUMENTATION AGENT.

NAME OF INSTITUTION: PACIFICA PARTNERS I, L.P.,
BY: IMPERIAL CREDIT ASSET MANAGEMENT, INC.
AS ITS INVESTMENT MANAGER

By /s/ DEAN K. KAWAI

Name: Dean K. Kawai
Title: Vice President

NAME OF INSTITUTION: PARIBAS CAPITAL FUNDING LLC,

By /s/ M. STEVEN ALEXANDER

Name: M. Steven Alexander

Title: Director

NAME OF INSTITUTION: PILGRIM AMERICA HIGH INCOME INVESTMENTS LTD.
By: Pilgrim Investments Inc.
As its investment manager

By /s/ MICHEL PRINCE, CFA

Name: Susan Lee
Title: Authorized Agent

SIGNATURE PAGE TO AMENDMENT NO. 8 DATED AS OF NOVEMBER 21, 2000, TO THE CREDIT AGREEMENT DATED AS OF FEBRUARY 12, 1998 (AS PREVIOUSLY AMENDED, SUPPLEMENTED OR OTHERWISE MODIFIED FROM TIME TO TIME), AMONG MAGELLAN HEALTH SERVICES, INC., CHARTER BEHAVIORAL HEALTH SYSTEM OF NEW MEXICO, INC., MERIT BEHAVIORAL CARE CORPORATION, THE SUBSIDIARY BORROWERS, THE LENDERS, THE CHASE MANHATTAN BANK, AS ADMINISTRATIVE AGENT, AS COLLATERAL AGENT AND AS AN ISSUING BANK, FIRST UNION NATIONAL BANK, AS SYNDICATION AGENT AND AS AN ISSUING BANK, AND CREDIT LYONNAIS NEW YORK BRANCH, AS DOCUMENTATION AGENT.

ME OF INSTITUTION: ML CLO XV PILGRIM AMERICA (CAYMAN) LTD.
By: Pilgrim Investments Inc.
As its Investment manager

By /s/ MICHEL PRINCE, CFA

Name: Michel Prince, CFA
Title: Vice President

NAME OF INSTITUTION: PILGRIM PRIME RATE TRUST
By: Pilgrim Investments Inc,
As its investment manager

By /s/ MICHEL PRINCE, CFA

Name: Michel Prince, CFA
Title: Vice President

NAME OF INSTITUTION: SENIOR DEBT PORTFOLIO
By: Boston Management and Research
as Investment Advisor

By /s/ PAYSON F. SWAFFIELD

Name: Payson F. Swaffield
Title: Vice President

SIGNATURE PAGE TO AMENDMENT NO. 8 DATED AS OF

NOVEMBER 21, 2000, TO THE CREDIT AGREEMENT DATED AS OF FEBRUARY 12, 1998 (AS PREVIOUSLY AMENDED, SUPPLEMENTED OR OTHERWISE MODIFIED FROM TIME TO TIME), AMONG MAGELLAN HEALTH SERVICES, INC., CHARTER BEHAVIORAL HEALTH SYSTEM OF NEW MEXICO, INC., MERIT BEHAVIORAL CARE CORPORATION, THE SUBSIDIARY BORROWERS, THE LENDERS, THE CHASE MANHATTAN BANK, AS ADMINISTRATIVE AGENT, AS COLLATERAL AGENT AND AS AN ISSUING BANK, FIRST UNION NATIONAL BANK, AS SYNDICATION AGENT AND AS AN ISSUING BANK, AND CREDIT LYONNAIS NEW YORK BRANCH, AS DOCUMENTATION AGENT.

NAME OF INSTITUTION: EATON VANCE INSTITUTIONAL SENIOR LOAN FUND
By: EATON VANCE MANAGEMENT
AS INVESTMENT ADVISOR

By /s/ PAYSON SWAFFIELD

Name: Payson Swaffield
Title: Vice President

NAME OF INSTITUTION: SUMMIT BANK,

By /s/ WILLIAM DINICOLA

Name: William DiNicola
Title: Vice President

NAME OF INSTITUTION: THE BANK OF NOVA SCOTIA,

By /s/ W.J. BROWN

Name: W.J. Brown
Title: Vice President

SIGNATURE PAGE TO AMENDMENT NO. 8 DATED AS OF NOVEMBER 21, 2000, TO THE CREDIT AGREEMENT DATED AS OF FEBRUARY 12, 1998 (AS PREVIOUSLY AMENDED, SUPPLEMENTED OR OTHERWISE MODIFIED FROM TIME TO TIME), AMONG MAGELLAN HEALTH SERVICES, INC., CHARTER BEHAVIORAL HEALTH SYSTEM OF NEW MEXICO, INC., MERIT BEHAVIORAL CARE CORPORATION, THE SUBSIDIARY BORROWERS, THE LENDERS, THE CHASE MANHATTAN BANK, AS ADMINISTRATIVE AGENT, AS COLLATERAL AGENT AND AS AN ISSUING BANK, FIRST UNION NATIONAL BANK, AS SYNDICATION AGENT AND AS AN ISSUING BANK, AND CREDIT LYONNAIS NEW YORK BRANCH, AS DOCUMENTATION AGENT.

ME OF INSTITUTION: VAN KAMPEN PRIME RATE INCOME TRUST,
By: Van Kampen Investment Advisory Corp.

By /s/ DARVIN D. PIERCE

Name: Darvin D. Pierce
Title: Vice President

NAME OF INSTITUTION: AMSOUTH BANK,

By /s/ WILLIAM H. BERRELL

Name: William H. Berrell
Title: Vice President

NAME OF INSTITUTION: BANK POLSKA KASA OPIEKI, S.A.,

By /s/ BARRY W. HENRY

Name: Barry W. Henry
Title: Vice President

NAME OF INSTITUTION: BATTERSON PARK CBO I
By: General Re-New England Asset Management, Inc., as Collateral Manager

By /s/ SUSAN BOSWORTH

Name: Susan Bosworth
Title: Vice President

SIGNATURE PAGE TO AMENDMENT NO. 8 DATED AS OF NOVEMBER 21, 2000, TO THE CREDIT AGREEMENT DATED AS OF FEBRUARY 12, 1998 (AS PREVIOUSLY AMENDED, SUPPLEMENTED OR OTHERWISE MODIFIED FROM TIME TO TIME), AMONG MAGELLAN HEALTH SERVICES, INC., CHARTER BEHAVIORAL HEALTH SYSTEM OF NEW MEXICO, INC., MERIT BEHAVIORAL CARE CORPORATION, THE SUBSIDIARY BORROWERS, THE LENDERS, THE CHASE MANHATTAN BANK, AS ADMINISTRATIVE AGENT, AS COLLATERAL AGENT AND AS AN ISSUING BANK, FIRST UNION NATIONAL BANK, AS SYNDICATION AGENT AND AS AN ISSUING BANK, AND CREDIT LYONNAIS NEW YORK BRANCH, AS DOCUMENTATION AGENT.

NAME OF INSTITUTION: MERRILL LYNCH GLOBAL INVESTMENT SERIES INCOME STRATEGIES PORTFOLIO
By: Merrill Lynch Investment Managers, L.P. as its Investment Advisor

By /s/ COLLEEN M. CUNNIFFE

Name: Colleen M. Cunniffe
Title: Authorized Signatory

NAME OF INSTITUTION: MERRILL LYNCH DEBT STRATEGIES PORTFOLIO
By: Merrill Lynch Investment Managers, L.P. as its Investment Advisor

By /s/ COLLEEN M. CUNNIFFE

Name: Colleen M. Cunniffe
Title: Authorized Signatory

NAME OF INSTITUTION: MERRILL LYNCH SENIOR FLOATING RATE FUND, INC.

By /s/ COLLEEN M. CUNNIFFE

Name: Colleen M. Cunniffe
Title: Authorized Signatory

Exhibit 10(ae)

MAGELLAN HEALTH SERVICES, INC.
EMPLOYEE STOCK PURCHASE PLAN

2000 SUMMARY PLAN DESCRIPTION

MAGELLAN HEALTH SERVICES, INC.
2000 EMPLOYEE STOCK PURCHASE PLAN

1. PURPOSE. The purpose of the Magellan Health Services, Inc. 2000 Employee Stock Purchase Plan (the "Plan"), is to provide employees of Magellan Health Services, Inc. (the "Company") and its subsidiary companies with an opportunity to be compensated through the benefits of stock ownership and to acquire an interest in the Company through the purchase of Common Stock of the Company. It is the intention of the Company to have the Plan qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code of 1986 (the "Code"). The provisions of the Plan shall, accordingly, be construed so as to extend and limit participation in a manner consistent with the requirements of that section of the Code.

2. DEFINITIONS.

(a) "Base Pay" means the compensation payable to an employee by the Company or a designated subsidiary (as defined in Code Section 424(f)) (a "subsidiary") calculated at that employee's base salary or standard hourly rate of compensation, but excluding overtime, commissions, shift differential, incentive bonus compensation and compensation payable under any deferred compensation or other fringe benefit plan.

(b) "Employee" means for each Offering Period (as defined in Section 4) any person who is employed by the Company or by any subsidiary of the Company designated from time to time by the Committee (as defined in Section 13) to participate in such Offering Period.

3. ELIGIBILITY.

(a) Any Employee who shall be employed on the 60th day preceding the Offering Date of an Offering Period shall be eligible to participate in the Plan for such Offering Period. Notwithstanding the foregoing, the Committee, in its sole discretion, may credit the employment service of persons employed by a business acquired by the Company or by any subsidiary thereof for the purpose of satisfying the 60-day rule herein.

(b) Any provision of the Plan to the contrary notwithstanding, no Employee shall be granted an option:

(i) If, immediately after the grant such Employee would own shares, and/or hold outstanding options to purchase stock, possessing 5% or more of the total combined voting power or value of all classes of shares of the Company or of any subsidiary of the Company; or

(ii) Which permits his rights to purchase shares under all employee stock purchase plans of the Company and its subsidiaries to accrue at a rate which exceeds $25,000 of the fair market value of the shares (determined at the time such option is granted) for each calendar year in which such stock option is outstanding at any time.

4. OFFERING PERIODS. The Committee shall establish the Offering Periods under the Plan which shall be of not less than three months nor more than twelve months duration each, the first of which shall not begin before January 1, 2000, and the last of which shall end not later than December 31, 2002. The beginning date (the "Offering Date") and the ending date (the "Termination Date") of each Offering Period shall be set in advance of each Offering Period by the Committee.

5. PARTICIPATION. An eligible Employee may become a participant only by completing an election notice provided by the Company and filing it with the designated representative of the Company no later than the date specified by the Company in the election notice form.

Unless otherwise adjusted in accordance with rules established by the Committee in its sole discretion, payroll deductions for a participant with respect to an Offering Period shall commence with the first pay date beginning on or after the Offering Date, and shall end with the last pay date ending on or before the Termination Date, unless sooner terminated by the participant as provided in Section 10. All Employees granted options under the Plan shall have the same rights and privileges, except that the amount of stock which may be purchased under such option may vary in a uniform manner as described in Section 7.

6. METHOD OF PAYMENT. Payments for shares under the Plan may be made only by payroll deductions, as follows:

(a) If a participant wishes to participate in the Plan, then at the time he files his election notice, he shall elect to have deductions made from his Base Pay at a rate, expressed as a percentage, not to exceed 10% of his annualized Base Pay as of the Offering Date. Any or all amounts withheld during the one-month period immediately preceding the Termination Date in any Offering Period may be applied to the purchase of shares on the Termination Date or to the purchase of shares offered for the next subsequent Offering Period in a manner as may be determined by the Committee, in its sole discretion, but only if such application is administered consistently among all participants during such Offering Period.

(b) All payroll deductions made for a participant shall be credited to his account under the Plan. A participant may not make any separate cash payment into such account. A participant's account shall be no more than a bookkeeping account maintained by the Company, and neither the Company nor any subsidiary shall be obligated to segregate or hold in trust or escrow any funds in a participant's account.

(c) A participant's election to have deductions made from his Base Pay shall be effective for all pay dates occurring during the Offering Period which commences immediately following the filing, in accordance with Section 5, of the participant's election notice and for each subsequent Offering Period until such election is modified or revoked by the participant or until such participant no longer meets the eligibility requirements of Section 3(a). A participant may discontinue his participation in the Plan as provided in Section 10. A participant may elect to change the rate of payroll deductions at such times and in accordance with such rules as may be prescribed by the Committee; any such change in the rate of payroll deductions shall be applicable only with respect to Offering Periods commencing after a participant files with the Committee an election notice requesting such change.

7. GRANTING OF OPTION.

(a) Subject to any adjustment under Sections 12 or 17, on the Offering Date for each Offering Period, a participant shall be granted an option to purchase a number of whole shares determined by dividing the amount to be withheld for participation in the Plan and applied to such Offering Period by the option price per share of Common Stock determined in accordance with Section 7(b) but, in no event shall the maximum number of shares for which an option is granted to a participant with respect to any single Offering Period exceed 200 shares per month for each full or partial month during the Offering Period.

(b) The option price per share of shares purchased with payroll deductions for a participant will be equal to the lesser of: (i) 85% of the closing price of the Common Stock on the New York Stock Exchange on the Offering Date; or (ii) 85% of the closing price of the Common Stock on the New York Stock Exchange on the Termination Date. If no shares are traded on such exchange on either such date, such price shall be determined on the last trading date for such shares immediately preceding the Offering Date or the Termination Date, as applicable.

8. EXERCISE OF OPTION. Unless a participant gives written notice of withdrawal pursuant to Section 10(a) or such participant's payroll deductions are returned in accordance with Section 10(c), his option for the purchase of shares during an Offering Period with payroll deductions will be exercised automatically for him on the Termination Date of that Offering Period. The automatic exercise shall, subject to Sections 12 and 17, be for the purchase of the maximum number of full shares subject to his option which the sum of payroll deductions credited to the participant's account on the Termination Date can purchase at the option price.

9. DELIVERY. As promptly as practicable after the end of an Offering Period, the Company will deliver the shares purchased upon the exercise of the option to a designated broker selected by the Company to administer and hold shares in individual accounts established for the benefit of each participant. The Committee, in its sole discretion, may establish procedures to permit a participant to receive such shares directly. Amounts credited to the participant's account in excess of the amount necessary to pay the option price for the maximum number of full shares subject to his option shall either be refunded to the participant or credited to the participant's account for the next subsequent Offering Period as may be determined by the Committee, in its sole discretion.

10. WITHDRAWAL.

(a) A participant may withdraw payroll deductions credited to his account under the Plan by giving written notice to the representative of the Company designated on the election notice form. A participant may withdraw amounts credited to his account at any time prior to the first day of the calendar month ending on the Termination Date or such later date as may be established by the Committee in its sole discretion. All of the participant's payroll deductions credited to his account will be paid to him promptly after receipt of his notice of withdrawal, and no further deductions will be made from his pay during that Offering Period.

(b) A participant's withdrawal will not limit his eligibility to participate in any similar plan which may hereafter be adopted by the Company or in any subsequent Offering Period.

(c) Upon termination of the participant's employment during an Offering Period for any reason, including death or retirement, the payroll deductions credited to his account for such period will be returned to him or, in the case of his death, to the person or persons entitled thereto under Section 14. Notwithstanding the foregoing, the payroll deductions credited to the account of any participant whose employment is terminated during the calendar month ending on the Termination Date shall not be returned but shall instead be used to purchase shares in accordance with Section 8.

11. NO INTEREST. No interest shall be accrued or payable with respect to amounts in a participant's account.

12. STOCK.

(a) The shares of Common Stock to be sold to participants under the Plan may, at the election of the Company, be either treasury shares or shares originally issued for such purpose. The maximum number of shares which shall be made available for sale under the Plan shall be 1,000,000 shares and the maximum number of shares available for sale in each Offering Period shall be determined by the Committee in its sole discretion, subject in each case to adjustment upon changes in capitalization of the Company as provided in Section 17. If the total number of shares for which options are to be exercised for an Offering Period in accordance with Section 8 exceeds the number of shares then available under the Plan for such Offering Period, the Company shall make a pro rata allocation of the shares available based on a fraction, the numerator of which shall be the number of shares with respect to which a participant has an option to purchase for an Offering Period and the denominator of which shall be the number of shares available for purchase, with rounding down for each participant to the nearest whole number.

(b) A participant will have no interest in shares covered by an option until such option has been exercised.

13. ADMINISTRATION. The Plan shall be administered by a Committee (the "Committee") consisting of not less than three members who shall be appointed by the Chief Executive Officer of the Company. Each member of the Committee shall be either a director, an officer, or an employee of the Company or of a subsidiary thereof. The Committee shall be vested with full authority to make, administer, and interpret such rules and regulations as it deems necessary to administer the Plan, and any determination, decision, or action of the Committee in connection with the construction, interpretation, administration, or application of the Plan shall be final, conclusive, and binding upon all participants and all persons claiming under or through any participant.

14. DESIGNATION OF BENEFICIARY. A participant may file a written designation of a beneficiary who is to receive any shares or cash to the participant's credit under the Plan in the event of such participant's death before, on, or after the Termination Date but prior to the delivery of shares and, if applicable, cash. Such designation of beneficiary may be changed by the participant at any time by written notice. Upon the death of a participant and upon receipt by the Company of proof of the identity and existence at the participant's death of a beneficiary validly designated by him under the Plan, the Company shall deliver such shares or cash to the account of such beneficiary. In the event of the death of a participant and in the absence of a beneficiary validly designated under the Plan who is living at the time of such participant's death, the Company shall deliver such shares or cash to the account of the executor or administrator of the estate of the participant, or if no such executor or administrator has been appointed (to the knowledge of the Company) the Company, in its discretion, may deliver such shares or cash to the account of the spouse or to any one or more dependents or relatives of the participant, or if no spouse, dependent, or relative is known to the Company, then to the account of such other person as the Company may designate. No designated beneficiary shall, prior to the death of the participant by whom he has been designated, acquire any interest in the shares or cash credited to the participant under the Plan.

15. TRANSFERABILITY. Neither payroll deductions credited to a participant's account nor any rights with regard to the exercise of an option or to receive shares under the Plan may be assigned, transferred, pledged, or otherwise disposed of in any way by the participant. Any such attempted assignment, transfer, pledge, or other disposition shall be without effect, except that the Company may treat such act as an election to withdraw funds in accordance with Section 10.

16. USE OF FUNDS. All payroll deductions received or held by the Company under the Plan may be used by the Company for any corporate purpose.

17. ADJUSTMENTS UPON CHANGES IN CAPITALIZATION. In the event that the outstanding shares of Common Stock of the Company are hereafter increased or decreased or changed into or exchanged for a different number or kind of shares or other securities of the Company by reason of a recapitalization, reclassification, stock split, combination of shares, or dividend payable in shares of Common Stock, an appropriate adjustment shall be made by the Committee to the number and kind of shares as to which outstanding options shall be exercisable and to the option price. No fractional shares shall be issued or optioned in making the foregoing adjustments. All adjustments made by the Committee under this paragraph shall be conclusive and binding on all participants and all persons claiming under or through any participant.

Subject to any required action by the stockholders, if the Company shall be a party to any reorganization involving merger, consolidation, acquisition of the stock or acquisition of the assets of the Company, the Committee in its discretion may declare (a) that all options granted hereunder are to be terminated after giving at least ten days' notice to holders of outstanding options, or (b) that any option granted hereunder shall pertain to and apply with appropriate adjustment as determined by the Committee to the securities of the resulting corporation to which a holder of the number of shares of Common Stock subject to the option would have been entitled. The adoption of a plan of dissolution or liquidation by the Board of Directors and

stockholders of the Company shall cause every option outstanding hereunder to terminate on the fifteenth day thereafter, except that, in the event of the adoption of a plan of dissolution or liquidation in connection with a reorganization as provided in the preceding sentence, options outstanding hereunder shall be governed by and shall be subject to the provisions of the preceding sentence.

Any issue by the Company of stock of any class, or securities convertible into shares of stock of any class, shall not affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to any option, except as specifically provided otherwise in this Section 17. The grant of an option pursuant to the Plan shall not affect in any way the right or power of the Company to make adjustments, reclassifications, reorganizations or changes of its capital or business structure or to merge or to consolidate or to dissolve, liquidate or sell, or transfer all or any part of its business or assets.

18. AMENDMENT OR TERMINATION. The Board of Directors of the Company may at any time terminate or amend the Plan. No such termination can affect options previously granted and no amendment can make any change in any option theretofore granted which would adversely affect the rights of any participant. No amendment can be made without prior approval of the stockholders of the Company if such amendment would:

(a) Require the sale of more shares than are authorized under Section 12; or

(b) Permit payroll deductions or cash payments at a rate in excess of 10% of a participant's Base Pay.

19. NOTICES. All notices or other communications by a participant to the Company under or in connection with the Plan shall not be deemed to have been duly given until actually received by the representative of the Company designated on the election notice form provided by Section 5.

20. MISSING PAYEE. If (i) the Company utilizes a designated broker to administer and hold in individual accounts the shares purchased by the participants, (ii) the Company subsequently cannot ascertain the whereabouts of a participant whose account is held with the designated broker, (iii) after three years from the date of the last purchase by such participant, a notice of such account balance and pending action under this section is mailed to the last known address of such person, as shown on the records of the designated broker or the Company, and (iv) within three months after such mailing, such person has not made written claim therefor, then the Committee may direct that such account balance (including both shares and withholdings) otherwise due to such person be canceled and returned to the Company. Upon such cancellation, the Company or the designated broker shall have no further liability therefor, except that, in the event such person, within one year of the date of the notice referred to in (iii) above, notifies the Company or the broker of his whereabouts and requests the amounts due to him under the Plan, the number of shares (as may be adjusted to reflect any extraordinary corporate event or recapitalization) together with any dividends or other accretions thereon and the amount of withholdings contained in such account so canceled shall be delivered to him as provided herein by the Plan.

Exhibit 10(af)

MAGELLAN HEALTH SERVICES, INC.
2000 LONG-TERM INCENTIVE COMPENSATION PLAN

ARTICLE I

PURPOSE

The purpose of the 2000 Long-Term Incentive Compensation Plan is to promote the long-term viability and financial success of Magellan Health Services, Inc. (the Company) and its Affiliates by assisting in the recruiting and retention of key employees. The Plan is designed to enable key employees to acquire or increase a proprietary interest in the Company.

ARTICLE II

DEFINITIONS

2.01 "Affiliate" means any entity that is (i) a member of a controlled group of corporations as defined in Code Section 1563 (a), determined without regard to Code Sections 1563 (a) (4) and 1563 (e) (3) (c), of which the Company is a member according to Code Section 414(b); (ii) an unincorporated trade or business that is under common control with the Company, as determined according to Code Section 414(c); (iii) a member of an affiliated service group of which the Company is a member according to Code Section 414(m); or (iv) any other subsidiary corporation or business in which the Company has a substantial interest or business relation.

2.02 "Agreement" means a written agreement (including any amendment or supplement thereto) between the Company and a Participant specifying the terms and conditions of an Award.

2.03 "Award" means Options, Restricted Stock, Stock Appreciation Rights, Performance Shares, Dividend Units, and Incentive Awards.

2.04 "Board" means the Board of Directors of the Company.

2.05 "Code" means the Internal Revenue Code of 1986, as amended.

2.06 "Committee" means the Compensation Committee of the Board or any other Committee of the Board appointed to administer the Plan, provided that the composition of such Committee shall at all times meet the requirements of Rule 16b-3 under the Securities Exchange Act of 1934, and Code Section 162(m), each as amended.

2.07 "Common Stock" means the Common Stock of the Company, par value $0.25 per share.

2.08 "Company" means Magellan Health Services, Inc.

2.9 "Covered Employee" means a Participant who, as of the date of vesting and/or payout of an Award, as applicable, is one of the group of "covered employees," as defined in the regulations promulgated under Code Section 162(m), or any successor statue.

2.10 "Disability" means a physical or mental condition which prevents the Participant from engaging in any substantially gainful activity.

2.11 "Dividend Unit" means an Award granted under Article XI of the Plan.

2.12 "Fair Market Value" means, on any given date, the closing price of a share of Common Stock as reported on the New York Stock Exchange composite tape on such day or, if the Common Stock was not traded on such day, then on the next preceding day that the Common Stock was traded, all as reported by such source as the Committee may select.

2.13 "Final Award" means the actual Incentive Award earned during a Plan Year by a Participant, as determined by the Committee following the end of the Plan Year.

2.14 "Incentive Award" means an Award granted under Article XII of the Plan.

2.15 "Incentive Pool" means the fund established for purposes of determining potential aggregate Awards to all participants, according to the provisions of Section 12.02 herein.

2.16 "Incentive Pool Percentage" shall mean the percentage ascribed to such eligible Participant under Section 12.01 hereof.

2.17 "Option" means an Award granted under Article VII of the Plan.

2.18 "Participant" means a key employee of the Company or of an Affiliate, including a key employee who is a member of the Board, who satisfies the requirements of Article V of the Plan.

2.19 "Performance-Based Exception" means the performance-based exception from the tax deductibility limitations of Code Section 162(m).

2.20 "Performance Shares" means an Award granted under Article X of the Plan.

2.21 "Plan" means the Magellan Health Services, Inc. 2000 Long-Term Incentive Compensation Plan herein set forth, as the same may from time to time be amended.

2.22 "Plan Year" means the Company's fiscal year.

2.23 "Restricted Stock" means shares of Common Stock awarded to a Participant under

Article VIII of the Plan.

2.24 "Retirement" means normal retirement or early retirement as provided under the Company's Retirement Savings Plan.

2.25 "Stock Appreciation Rights" means an Award granted under Article IX of the Plan.

ARTICLE III

ADMINISTRATION

The Plan shall be administered by the Committee. The Committee shall have authority to grant Awards upon such terms (not inconsistent with the provisions of the Plan) as the Committee may consider appropriate. Such terms may include conditions (in addition to those contained in the Plan) on the exercisability of all or any part of an Option or of Stock Appreciation Rights or on the transferability or forfeitability of Restricted Stock. In addition, the Committee shall have complete authority to interpret all provisions of the Plan; to prescribe the form of Agreements; to adopt, amend, and rescind rules and regulations pertaining to the administration of the Plan; and to make all other determinations necessary or advisable for the administration of the Plan. The express grant in the Plan of any specific power to the Committee shall not be construed as limiting any power or authority of the Committee. Any decision made, or action taken, by the Committee shall not be construed as limiting any power or authority of the Committee. Any decision made, or action taken, by the Committee in connection with the administration of the Plan shall be final, conclusive, and binding with respect to all persons including all Participants. No member of the Committee shall be liable for any act done, or for any failure to act, if such act or failure to act was done or omitted in good faith with respect to the Plan or any Agreement or Award.

ARTICLE IV

SHARES SUBJECT TO THE PLAN AND MAXIMUM AWARDS

4.01 NUMBER OF SHARES AVAILABLE FOR GRANTS. Subject to adjustment as provided in Section 4.02 herein, the number of shares of Common Stock hereby reserved for issuance to Participants under the Plan shall be one million (1,000,000), no more than fifty thousand (50,000) of which may be granted in the form of Restricted Shares. The Committee shall determine the appropriate methodology for calculating the number of shares issued pursuant to the Plan. Shares of Common Stock delivered by the Company under the Plan may be authorized and unissued Common Stock, Common Stock held in the treasury of the Company, or Common Stock purchased on the open market (including private purchases) in accordance with applicable securities laws. Unless and until the Committee determines that an Award to a Covered Employee shall not be designed to comply with the Performance-Based Exception, the following rules shall apply to grants

of such Awards under the Plan:

(a) STOCK OPTIONS: The maximum aggregate number of shares of Common Stock that may be granted in the form of Stock Options, pursuant to any Award granted in any one fiscal year to any one single Participant shall be five hundred thousand (500,000).

(b) SARS: The maximum aggregate number of shares of Common Stock that may be granted in the form of Stock Appreciation Rights, pursuant to any Award granted in any one fiscal year to any one single Participant shall be one hundred thousand (100,000).

(c) RESTRICTED STOCK: The maximum aggregate grant with respect to Awards of Restricted Stock granted in any one fiscal year to any one Participant shall be twenty-five thousand (25,000) shares.

(d) PERFORMANCE SHARES, DIVIDEND UNITS, AND INCENTIVE AWARDS: The maximum aggregate payout (determined as of the end of the applicable performance period) with respect to Awards of Performance Shares and Incentive Awards granted in any one fiscal year to any one Participant shall be equal to the value of one hundred thousand (100,000) shares of Common Stock.

4.02 ADJUSTMENTS IN AUTHORIZED SHARES. In the event of any change in corporate capitalization, such as a stock split, or a corporate transaction, such as any merger, consolidation, separation, including a spin-off, or other distribution of stock or property of the Company, any reorganization (whether or not such reorganization comes within the definition of such term in Code Section 368) or any partial or complete liquidation of the Company, such adjustment shall be made in the number and class of shares of Common Stock which may be delivered under Section 4.01, in the number and class of and/or price of shares of Common Stock subject to outstanding Awards granted under the Plan, and in the Award limits set forth in subsections 4.01(a), (b), (c), and (d), as may be determined to be appropriate and equitable by the Committee, in its sole discretion, to prevent dilution or enlargement of rights; provided, however, that the number of shares of Common Stock subject to any Award shall always be a whole number.

ARTICLE V

ELIGIBILITY

Key employees of the Company or of any Affiliate are eligible to receive Awards under the Plan. An individual may receive more than one Award. The Committee shall, in its discretion, select the eligible key employees and shall base its selection on the employees' job responsibilities and present and potential contributions to the success of the Company and its Affiliates.

ARTICLE VI

GRANT OF AWARDS

The Committee may, from time to time, grant Awards to one or more eligible employees. In determining the size of Awards, the Committee shall take into account a Participant's responsibility level, performance, potential, and cash compensation level, the Fair Market Value at the time of the Award, as well as such other considerations as it deems appropriate.

ARTICLE VII

STOCK OPTIONS

7.01 GRANT OF OPTIONS. One or more Options may be granted to any eligible employee. Options shall be embodied in an Agreement in a form approved by the Committee. Options shall be subject to such terms and conditions as designated by the Committee in the Agreement, which shall not be inconsistent with the terms of the Plan.

7.02 INCENTIVE STOCK OPTIONS/NONQUALIFIED STOCK OPTIONS. The Agreement may provide for "incentive stock options" that are intended to satisfy the requirements of Section 422A of the Code, or such other options that are not intended to satisfy the requirements of Section 422A of the Code (hereinafter described as "nonqualified stock options"), that entitle the holder to purchase from the Company a stated number of shares of Common Stock at the price set forth in the Agreement. Each Option shall be an incentive stock option or a nonqualified stock option as specified in the Agreement. All Options that are not identified as incentive stock options in the Agreement are intended to be nonqualified stock options.

7.03 OPTION PRICE. The exercise price per share of an Option shall be an amount equal to the Fair Market Value per share of the Common Stock on the date of grant of such Option (or, in the case of a grant of an incentive stock option to a prospective employee, the date the grant becomes effective), provided, however, that the Committee may in its discretion elect to grant Options at an exercise price below the Fair Market Value per share of the Common Stock on the date of grant of such Option.

7.04 ADDITIONAL PROVISIONS APPLICABLE TO INCENTIVE STOCK OPTIONS. The aggregate Fair Market Value (determined at the time any incentive stock option is granted) of the Common Stock with respect to any Participant's incentive stock options, together with incentive stock options granted under any other plan of the Company or any subsidiary (as defined in Code Section 425 (f)), that are exercisable for the first time by such Participant during any calendar year shall not exceed

$100,000. In the event that a Participant holds incentive stock options that become first exercisable (as a result of acceleration of exercisability under the Plan or an Agreement, or otherwise) in any one calendar year for shares having a Fair Market Value at the date of grant in excess of $100,000, then the most recently granted of such incentive stock options, to the extent that they are exercisable for shares having an aggregate Fair Market Value in excess of $100,000, shall be deemed to be nonqualified stock options.

No incentive stock option may be granted under the Plan to any person who owns, directly or indirectly, within the meaning of Sections 422A(b) (6) and 425(d) of the Code, at the time the incentive stock option is granted, stock possessing more than 10% of the total combined voting power of all classes of stock of the Company or any subsidiary (as defined in Code Section 425(f)) unless the exercise price is at least 110% of the Fair Market Value of the shares subject to the incentive stock option, determined on the date of the grant, and the incentive stock option by its terms is not exercisable after the expiration of five years from the date such incentive stock option is granted.

7.05 OPTION EXERCISE PERIOD. Options are exercisable only to the extent that they are vested as provided in the applicable Stock Option Agreement. No Option shall be exercisable more than ten years from the date the Option was granted.

7.06 EMPLOYEE STATUS. In the event that the terms of any Option provide that it may be exercised only during employment or within a specified period of time after termination of employment, the Committee may decide in each case to what extent leaves of absence for governmental or military service, illness, temporary disability, or other reasons shall not be deemed terminations of employment.

7.07 NONTRANSFERABILITY.

(i) INCENTIVE STOCK OPTIONS. Except as otherwise provided in a Participant's Agreement, no incentive stock option granted under the Plan may be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated, other than by will or by the laws of descent and distribution. Further, all incentive stock options granted to a Participant under the Plan shall be exercisable during his or her lifetime only by such Participant.

(ii) NONQUALIFIED STOCK OPTIONS. Except as otherwise provided in a Participant's Agreement, no nonqualified stock option granted under this Article VII may be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated, other than by will or by the laws of descent and distribution. Further, except as otherwise provided in a Participant's Agreement, all nonqualified stock options granted to a Participant under this Article VII shall be exercisable during his or her lifetime only by such Participant.

7.08 EXERCISABILITY.

(i) GENERALLY. Subject to the other provisions of the Plan, an Option may be exercised in whole at any time or in part, from time to time, at such times and in compliance with such requirements as set forth in the Agreement. An Option granted under the Plan may be exercised with respect to any number of whole shares less than the full number for which the Option could be exercised. Such partial exercise of an Option shall not affect the right to exercise the Option from time to time in accordance with the Plan with respect to remaining shares subject to the Option. Upon the exercise of an Option granted in connection with Stock Appreciation Rights, the Participant shall surrender unexercised the Stock Appreciation Rights or, if the Option is not exercised in full, any portion of the Stock Appreciation Rights to which the exercised portion of the Option is related.

(ii) TERMINATION OF EMPLOYMENT.

(a) DEATH, DISABILITY, OR RETIREMENT. Except as otherwise provided in a Participant's Agreement, in the event of a Participant's death or Disability, Options shall become exercisable either according to the terms of the Agreement or on a pro-rata basis based upon the vesting period specified in the Agreement, whichever permits the Participant or beneficiary to exercise Options for a greater number of shares of Common Stock. In the event of Retirement, the Committee may accelerate the exercisability of Options.

(b) OTHER THAN DEATH, DISABILITY, OR RETIREMENT. Each Agreement shall set forth the extent to which the Participant shall have the right to exercise the Option following termination of the Participant's employment with the Company other than for death, Disability, or Retirement. Such provisions shall be determined in the sole discretion of the Board, shall be included in the Agreement entered into with each Participant, need not be uniform among all Options issued pursuant to this Article VII, and may reflect distinctions based on the reasons for termination.

7.09 EXERCISE; PAYMENT.

(i) EXERCISE. Unless provided otherwise in an Agreement, an Option shall be exercised, in whole or in part, by a written notice delivered to the Committee, which notice shall be on a form proscribed by the Committee and shall contain the provision or authorization with respect to tax withholding required by Section 17.06. The Option shall be deemed to have been exercised when such notice is received by the Committee.

(ii) PAYMENT. Payment of the Option exercise price shall be made in cash or a cash equivalent acceptable to the Committee. If the Agreement so provides, payment of all or part of the Option exercise price may be made in shares of Common Stock, or through such other arrangements as specified in the Agreement. If Common Stock is used to pay all or part of the Option exercise price, the shares surrendered must have a Fair Market Value (determined as of the day of exercise)

that is not less than such price or part thereof.

7.10 SHAREHOLDER RIGHTS. No Participant shall, as a result of having been granted any Option, have any rights as a shareholder until the date the Participant becomes a shareholder of record of shares of Common Stock upon exercise of such Option.

ARTICLE VIII

RESTRICTED STOCK

8.01 AWARDS. In accordance with the provisions of Article V of the Plan, the Committee may, in its discretion, designate individuals to whom any subsequent Awards of Restricted Stock are to be made and shall specify the terms and conditions subject to, and the number of shares of Common Stock covered by, the Awards.

8.02 GRANT. An Award of Restricted Stock shall be granted for no consideration other than services. Each grant of Restricted Stock shall be evidenced by an Agreement that shall specify the period(s) of restriction, the number of shares of Restricted Stock granted, and such other provisions as the Committee shall determine.

8.03 RESTRICTION PERIOD. The Committee shall establish restriction periods applicable to any Award and the time(s) at which such restrictions will lapse.

8.04 TERMINATION OF EMPLOYMENT.

(i) DEATH OR DISABILITY. In the event of a Participant's death or Disability, restrictions on Restricted Stock shall lapse on a pro-rata basis as designated by the Committee.

(ii) RETIREMENT. In the event of Retirement, the Committee may terminate any remaining restrictions on Restricted Stock.

(iii) OTHER THAN DEATH, DISABILITY OR RETIREMENT. Unless otherwise provided by the Committee in a Participant's Agreement, in the event that a Participant granted an Award of Restricted Stock shall cease to be an employee of the Company and all Affiliates for any reason, including, but not limited to an employing Affiliate's ceasing to be such, but other than death, Disability, or Retirement prior to the lapse of all restrictions applicable to such Restricted Stock, the shares of Restricted Stock awarded to the Participant shall be forfeited to the Company, effective with the effective date of the Participant's termination of employment. The Committee may decide in each case to what extent leaves of absence for governmental or military service, illness, temporary disability, or other reasons shall not be deemed a termination of employment.

8.05 SHAREHOLDER RIGHTS. While the shares are Restricted Stock, a Participant shall have all rights of a shareholder with respect to such shares, including the right to receive dividends and to vote the shares; provided, however, that (i) a Participant may not sell, transfer, pledge, exchange, hypothecate, or otherwise dispose of shares of Restricted Stock and (ii) the Company shall retain custody of the certificates evidencing shares of Restricted Stock.

8.06 WITHHOLDING NOTICE. Unless provided otherwise in an Agreement, at the time at which shares become freely transferable upon the lapse of restrictions, the Participant shall provide written notice to the Committee setting forth the provision or authorization with respect to tax withholding required by Section 17.06.

ARTICLE IX

STOCK APPRECIATION RIGHTS

9.01 GRANT OF STOCK APPRECIATION RIGHTS. Stock Appreciation Rights may be granted under the Plan in connection with an Option either at the time of grant or by amendment, or may be separately awarded. Stock Appreciation Rights shall be subject to such terms and conditions not inconsistent with the Plan as the Committee shall impose. Each grant of Stock Appreciation Rights shall be evidenced by an Agreement that shall specify the terms and conditions applicable to such Award.

9.02 EXERCISABILITY. Stock Appreciation Rights granted in connection with an Option shall be exercisable to the extent the Option is exercisable. Stock Appreciation Rights not granted in connection with an Option shall be exercisable pursuant to such terms and conditions established by the Committee and designated in the Agreement.

9.03 FAILURE TO EXERCISE. If a Participant who has been granted Stock Appreciation Rights has not exercised such rights as of the day the Stock Appreciation Rights expire due to passage of time, then such rights shall be deemed to have been exercised by the Participant on such day. The foregoing sentence applies only if the Fair Market Value of one share of Common Stock on such day exceeds the Fair Market Value of one share of Common Stock on the day the Stock Appreciation Rights were granted.

9.04 EXERCISE; FORM OF PAYMENT.

(i) EXERCISE. Unless otherwise provided otherwise in an Agreement, Stock Appreciation Rights shall be exercised, in whole or in part, by a written notice delivered to the Committee, which notice shall contain the provision or authorization with respect to tax withholding required by Section 17.06. The Stock Appreciation Rights shall be deemed to have been exercised when such notice is received by the Committee.

(ii) FORM OF PAYMENT. Upon the exercise of Stock Appreciation Rights granted in

connection with an Option, the Participant shall surrender unexercised the Option or, if the Stock Appreciation Rights are not exercised in full, any portion of the Option to which the Stock Appreciation Rights are related, and shall be entitled to receive payment (in cash or shares of Common Stock or a combination thereof as set forth in the Agreement at the time of grant) equal to the product of the excess of the Fair Market Value of one share of Common Stock at the date of exercise over the Option price, multiplied by the number of shares called for by the Stock Appreciation Rights (or portion thereof) which are so exercised. Upon exercise of Stock Appreciation Rights not granted in connection with an Option, the Participant shall be entitled to payment (in cash or shares of Common Stock or a combination thereof as set forth in the Agreement at the time of grant) equal to the product of the excess of the Fair Market Value of one share of Common Stock at the date of exercise over the Fair Market Value of one share of Common Stock at the date of grant of the Stock Appreciation Rights, multiplied by the number of shares called for by the Stock Appreciation Rights (or portion thereof) which are so exercised. The value of any Common Stock payable upon exercise of Stock Appreciation Rights shall be the Fair Market Value of the Common Stock on the day on which the Stock Appreciation Rights are exercised. Solely for purposes of Article VI of the Plan, to the extent that Stock Appreciation Rights granted in connection with an Option are exercised, such Option shall be deemed to have been exercised, and shall not be deemed to have lapsed.

9.05 NONTRANSFERABILITY. Stock Appreciation Rights granted under the Plan shall not be transferable by the Participant except by will or the laws of descent and distribution and shall be exercisable during the Participant's lifetime only by the Participant or, in the event of the Participant's mental or physical incapacity, by his legal representative.

9.06 LAPSE OF STOCK APPRECIATION RIGHTS. Stock Appreciation Rights granted in connection with an Option shall lapse in accordance with the same terms and conditions specified in the underlying Option. Stock Appreciation Rights not granted in connection with an Option shall lapse in accordance with the terms and conditions specified by the Committee in the Award.

9.07 TERMINATION OF EMPLOYMENT. Each Agreement shall set forth the extent to which the Participant shall have the right to exercise the Stock Appreciation Right following termination of the Participant's employment with the Company and/or its Affiliates. Such provisions shall be determined in the sole discretion of the Committee, shall be included in the Agreement entered into with Participants, need not be uniform among all Stock Appreciation Rights issued pursuant to the Plan, and may reflect distinctions based on the reasons for termination.

9.08 SHAREHOLDER RIGHTS. No Participant shall, as a result of having been granted Stock Appreciation Rights, have any rights as a shareholder until the date the Participant becomes a shareholder of record of shares of Common Stock upon exercise of the Stock Appreciation Rights if shares of Common Stock are issued to such Participant as a result of such exercise.

ARTICLE X

PERFORMANCE SHARES/PERFORMANCE UNITS

10.01 GRANT OF PERFORMANCE SHARES/PERFORMANCE UNITS. Awards made pursuant to this Article X shall be granted in the form of bookkeeping entries called Performance Shares or Performance Units, subject to such terms and conditions not inconsistent with the Plan as the Committee shall impose. Each Performance Unit shall have an initial value that is established by the Committee at the time of grant. Each Performance Share shall have an initial value equal to the Fair Market Value of a share of Common Stock on the date of grant. The Agreement shall specify the terms and conditions of the Award, including the performance-related objectives applicable to the Award and the extent to which satisfaction of such specified objectives will determine the number and/or value of Performance Units or Performance Shares that will be paid out to the Participant.

10.02 PERFORMANCE PERIOD. The measuring period to establish the performance objectives set forth in a Performance Share or Performance Unit Agreement shall be no less than three years.

10.03 FORM OF PAYMENT. Upon the completion of the applicable performance period, a determination shall be made as to the number of shares of Common Stock or cash equal to the Award value to be paid to the Participant for no consideration other than services. Unless provided otherwise in an Agreement, at the time of payment under the Performance Share or Performance Unit Award, the Participant shall provide written notice to the Committee setting forth the provision or authorization with respect to tax withholding required by Section 17.06.

10.04 TERMINATION OF EMPLOYMENT. Each Agreement shall set forth the extent to which the Participant shall have the right to receive a payout with respect to any outstanding Performance Shares or Performance Units following termination of the Participant's employment with the Company and/or its Affiliates. Such provisions shall be determined in the sole discretion of the Committee, shall be included in the Agreement entered into with Participants, need not be uniform among all Performance Shares or Performance Units issued pursuant to the Plan, and may reflect distinctions based on the reasons for termination.

10.05 SHAREHOLDER RIGHTS. No Participant shall, as a result of having been awarded Performance Shares or Performance Units, have any rights as a shareholder until the date the Participant becomes a shareholder of record of shares of Common Stock upon payment of the Performance Shares, if shares of Common Stock are issued to such Participant as a result of such payment.

ARTICLE XI

DIVIDEND UNITS

The Committee may grant Dividend Units equal to a specified number of shares of Common Stock on which Participants will receive cash payments equal to the dividends paid on the underlying number of shares when, as, and if paid. Each grant of Dividend Units shall be evidenced by an Agreement that shall specify the terms and conditions applicable to such Award, including the treatment of such Award upon the Participant's termination of employment. An Award of Dividend Units shall entitle the Participant to payment of an amount of cash equal to such cash dividends only and not to any right to the actual dividends on the underlying shares or to the underlying shares themselves. Such Awards of Dividend Units may be combined with other Awards.

ARTICLE XII

INCENTIVE AWARDS

12.01 GRANT OF INCENTIVE AWARDS. Subject to the terms of the Plan, the Committee may designate Participants to receive Incentive Awards under the Plan. Incentive Awards shall be made from an Incentive Pool established for each Plan Year by the Committee. The Committee shall allocate an Incentive Pool Percentage to each applicable Participant for each Plan Year. Such allocation shall be made within ninety (90) days of the commencement of the Plan Year. In no event may the Incentive Pool Percentage for any one individual Participant exceed fifty percent (50%) of the total Incentive Pool. In addition, the sum of all Participants' applicable Incentive Pool Percentages shall not equal more than one hundred percent (100%) of the Incentive Pool. Each Incentive Award shall be evidenced by an Agreement that shall specify the terms and conditions applicable to such Award.

12.02 DETERMINATION OF INCENTIVE POOL. The Incentive Pool shall be an amount designated by the Committee each Plan Year. The Incentive Pool amount for each Plan Year shall be determined by the Committee as soon as practicable following the close of such Plan Year.

12.03 DETERMINATION OF INCENTIVE AWARDS. As soon as possible after the final Incentive Pool amount can be determined, the Committee shall determine each Participant's allocated amount of the Incentive Pool by multiplying the final Incentive Pool amount for the Plan Year by each Participant's Incentive Pool Percentage. A Participant's Incentive Award shall then be determined based on the Participant's allocated portion of the Incentive Pool, as reduced in the sole discretion of the Committee. In no event, however, may a Participant's allocated portion of the Incentive Pool be increased as a result of a reduction of any other Participant's allocated portion. In reducing a Participant's Incentive Award, the Committee may consider any such factors it determines applicable.

12.04 FORM AND TIMING OF PAYMENT. Unless a qualifying deferral election is made by a Participant pursuant to Article XIV herein, each Participant's Final Award shall be paid in one (1) lump sum cash payment as soon as possible following the release of the Company's audited financial

statement for the Plan Year.

12.05 TERMINATION OF EMPLOYMENT.

(i) TERMINATION OF EMPLOYMENT DUE TO DEATH, DISABILITY, OR RETIREMENT. Unless determined otherwise by the Committee, in the event the employment of a Participant is terminated by reason of death, Disability, or Retirement during a

Plan Year, the Participant shall receive a payout of the Incentive Awards which is prorated, as specified by the Committee in its discretion.

Payment of earned Incentive Awards shall be made at a time specified by the Committee in its sole discretion and set forth in the Participant's Award Agreement. Notwithstanding the foregoing, with respect to Covered Employees who retire during a Plan Year, payments shall be made at the same time as payments are made to Participants who did not terminate employment during the applicable Plan Year.

(ii) TERMINATION OF EMPLOYMENT FOR OTHER REASONS. In the event that a Participant's employment terminates for any reason other than those reasons set forth in Section 12.06(i) herein, all Incentive Awards shall be forfeited by the Participant to the Company unless determined otherwise by the Committee.

12.06 NONTRANSFERABILITY. Except as otherwise provided by the Committee, Incentive Awards may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated, other than by will or by the laws of descent and distribution. Further, except as otherwise provided by the Committee, a Participant's rights under the Plan shall be exercisable during the Participant's lifetime only by the Participant's legal representative.

ARTICLE XIII

PERFORMANCE MEASURES

Unless and until the Committee proposes for shareholder vote and shareholders approve a change in the general performance measures set forth in this Article XIII, the attainment of which may determine the degree of payout and/or vesting with respect to Awards to Covered Employees which are designed to qualify for the Performance-Based Exception, the performance measure(s) to be used for purposes of such grants shall be chosen from among:

(a) Earnings per share;

(b) Net income (before or after taxes);

(c) Return measures (including, but not limited to, return on assets, equity, or sales);

(d) Cash flow return on investments which equals net cash flows divided by owners equity;

(e) Earnings before interest, taxes, depreciation, amortization (EBITDA);

(f) Gross revenues;

(g) Share price (including, but no limited to, growth measures and total shareholder return).

Company performance shall be based, at the Committee's discretion, on overall Company performance, performance of a specified segment of the Company's operations, such a business unit, division, product line, or other such segmentation, or any combination thereof. This measure may be expressed as a concrete goal, in terms of an increase or decrease, or in comparison to the Company's competitors, the industry, or some other comparator group.

The Committee shall have the discretion to adjust the determinations of the degree of attainment of the preestablished performance goals; provided, however, that Awards which are designed to qualify for the Performance-Based Exception, and which are held by Covered Employee, may not be adjusted upward (the Committee shall retain the discretion to adjust such Awards downward).

In the event that applicable tax and/or securities laws change to permit Committee or Board discretion to alter the governing performance measures without obtaining shareholder approval of such changes, the Committee shall have sole discretion to make such changes without obtaining shareholder approval. In addition, in the event that the Committee determines that it is advisable to grant Awards which shall not qualify for the Performance-Based Exception, the

Committee may make such grants without satisfying the requirements of Code Section 162(m).

ARTICLE XIV

DEFERRALS

The Committee may permit or require a Participant to defer receipt of the payment of cash or the delivery of shares of Common Stock that would otherwise be due to such Participant by virtue of the exercise of an Option or SAR, the lapse or waiver of restrictions with respect to Restricted Stock, the satisfaction of any requirements or goals with respect to Performance Shares or Incentive Awards or the receipt of dividend payments on Dividend Units. If any such deferral election is required or permitted, the Committee shall, in its sole discretion, establish rules and procedures for such payment deferrals.

ARTICLE XV

COMPLIANCE WITH LAW AND APPROVAL OF REGULATORY BODIES; LEGENDS

15.01 COMPLIANCE WITH LAW AND APPROVAL OF REGULATORY BODIES, LEGENDS. No Option or Stock Appreciation Rights shall be exercisable, no Common Stock shall be issued, no certificates for shares of Common Stock shall be delivered, and no payment shall be made under the Plan except in compliance with all applicable federal and state laws and regulations (including, without limitation, tax withholding requirements) and the rules of all stock exchanges on which the Common Stock may be listed. The Company shall have the right to rely on an opinion of its counsel as to such compliance. No Option or Stock Appreciation Rights shall be exercisable, no Common Stock shall be issued, no certificate for shares shall be delivered, and no payment shall be made under the Plan until the Company has obtained such consent or approval as the Company may deem advisable from regulatory bodies having jurisdiction over such matters. Any share certificate issued to evidence Common Stock or Restricted Stock may bear such legends and statements as the Company may deem advisable to assure compliance with the Plan and all federal and state laws and regulations.

15.02 COMPLIANCE WITH CODE SECTION 162(m). At all times when Code Section 162(m) is applicable, all Awards granted under this Plan shall comply with the requirements of Code Section 162(m); provided, however, that in the event the Committee determines that such compliance is not desired with respect to any Award or Awards available for grant under the Plan, then compliance with Code Section 162(m) will not be required. In addition, in the event that changes are made to Code Section 162(m) to permit greater flexibility with respect to any Award or Awards available under the Plan, the Board may, subject to this Article XV, make any adjustments it deems appropriate.

ARTICLE XVI

ACCELERATION OF AWARDS; CHANGE OF CONTROL

16.01 ACCELERATION OF AWARDS. Any other provision to the contrary in the Plan or any Award or Agreement notwithstanding, in the event that an Award pursuant to the terms of its grant is not immediately exercisable, is subject to restrictions, or is subject to the meeting of specified performance objectives, the Award may initially provide, or the Committee may at any time amend it to provide, for accelerated exercisability, termination of restrictions, or waiver or modification of performance objectives, subject to such terms and conditions and upon the occurrence of such events determined by the Committee in its sole discretion to justify such acceleration.

16.02 CHANGE OF CONTROL - ACCELERATION; AUTOMATIC VESTING OF AWARDS.

(i) ACCELERATION. Subject to the limitations in Section 16.03, any other provision to the contrary in the Plan or any Award or Agreement notwithstanding, all Options and Stock Appreciation Rights shall automatically become fully exercisable, all restrictions applicable to Restricted Stock shall automatically terminate and all performance objectives in Performance Share Awards and Incentive Awards shall be waived upon the occurrence of any one or more of the triggering events specified below:

(a) The acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") (a "Person") of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 20% or more of either (i) the then-outstanding shares of common stock of the Company (the "Outstanding Company Common Stock") or (ii) the combined voting power of the then-outstanding voting securities of the Company entitled to vote generally in the election of directors (the "Outstanding Company Voting Securities"); provided, however, that for purposes of this subsection (a), the following acquisitions shall not constitute a Change of Control: (i) any acquisition directly from the Company, (ii) any acquisition by the Company, (iii) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any corporation controlled by the Company, or (iv) any acquisition by any corporation pursuant to a transaction which complies with clauses (i), (ii), and (iii) of subsection (c) of this Section 16.02; or

(b) Individuals who, as of December 31, 1999, constitute the Board (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board; provided, however, that any individual becoming a Director subsequent to December 31, 1999 whose election, or nomination for election by the Company's shareholders, was approved by a vote of at least a majority of the Directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the board; or

(c) Consummation of a reorganization, merger or consolidation or sale or other disposition of all or substantially all of the assets of the Company (a "Business Combination"), in each case, unless, following such Business Combination, (i) all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Business Combination beneficially owned, directly or indirectly, more than 50% of, respectively, the then-outstanding shares of common stock and the combined voting power of the then-outstanding voting securities entitled to vote generally in the election of the directors, as the case may be, of the Corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction owns the Company or all or substantially all of the Companies assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination of the Outstanding Company Common

Stock and Outstanding Company Voting Securities, as the case may be, (ii) no Persons (excluding any Corporations resulting from such Business Combination or any employee benefit plan (or related trust) of the Company or such Corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 20% or more of, respectively, the then-outstanding shares of common stock of the Corporation resulting from such Business Combination, or the Combined Voting Power of the then-outstanding voting securities of such corporation except to the extent that such ownership existed prior to the Business Combination and (iii) at least a majority of the members of the Board of Directors of the Corporation resulting from such Business Combination were members of the Incumbent Board at the time of the execution of the initial agreement, or the action of the Board, providing for such Business Combination; or

(d) Approval by the shareholders of the Company of a complete liquidation or dissolution of the Company.

(ii) VESTING OF AWARDS. Except as provided below, upon the occurrence of any of the triggering events described in Section 16.02(i) above, all outstanding Awards shall automatically vest and be surrendered, and the Participants shall receive in full satisfaction therefore, distribution in the form of shares of Common Stock.

16.03 CERTAIN REDUCTION OF PAYMENTS. Anything in this Plan to the contrary notwithstanding, in the event the Company determines that any payment by it to a Participant (whether paid pursuant to the terms of this Plan or otherwise) would be nondeductible by the Company for federal income tax purposes because of Section 28OG of the Code, then any amounts payable to a Participant pursuant to this Plan shall be reduced automatically to an amount that maximizes the payments under the Plan without causing any payments to be nondeductible by the Company because of Section 280G of the Code.

ARTICLE XVII

GENERAL PROVISIONS

17.01 EFFECT ON EMPLOYMENT. Neither the adoption of the Plan, nor the receipt of any Award under the Plan, nor any documents under the Plan (or any part thereof), including but not limited to any Agreement, shall confer upon any employee any right to continue in the employ of the Company or any Affiliate, or in any way affect any right and power of the Company or any Affiliate to terminate the employment of any employee at any time with or without assigning a reason therefor.

17.02 UNFUNDED PLAN. The Plan shall be unfunded, and neither the Company nor any Affiliate shall be required to segregate any assets that may at any time be represented by Awards under the Plan. Any liability of the Company or any Affiliate to any person with respect to any Award under the Plan shall be based solely upon contractual obligations created pursuant to the Plan.

No such obligation of the Company or any Affiliate shall be deemed to be secured by any pledge of, or other encumbrance on, any property of the Company or any Affiliate.

17.03 RULES OF CONSTRUCTION. Headings are given to the articles and sections of the Plan solely as a convenience to facilitate reference. The reference to any statute, regulation, or other provision of law shall be construed to refer to any amendment to or successor of such provision of law.

17.04 FRACTIONAL SHARES. Any fractional shares concerning Awards shall be eliminated by rounding down for fractions less than one-half and rounding up for fractions equal to or more than one-half. No cash settlements shall be made with respect to fractional shares eliminated by rounding.

17.05 NONALIENATION. No benefit provided under the Plan shall be subject to alienation or assignment by a Participant (or by any person entitled to such benefit pursuant to the terms of the Plan), nor shall it be subject to attachment or other legal process of whatever nature. Any attempted alienation, assignment, or attachment shall be void and of no effect whatsoever. Payment shall be made only to the Participant entitled to receive the same or the Participant's authorized legal representative. Deposit of any sum in any financial institution to the credit of any Participant (or a person entitled to such sum pursuant to the terms of the Plan) shall constitute payment to that Participant (or such person).

17.06 TAX WITHHOLDING. Either the Company or an Affiliate, as appropriate, shall have the right to deduct from all Awards paid in cash any federal, state, or local taxes as it deems to be required by law to be withheld with respect to such cash payments. In the case of Awards paid in shares of Common Stock, the Participant receiving such Common Stock may be required to pay to the Company or an Affiliate, as appropriate, the amount of any such taxes which the Company or Affiliate is required to withhold with respect to such Common Stock. At the request of a Participant, or as required by law, such sums as may be required for the payment of any estimated or accrued income tax liability may be withheld or paid to the Company or an Affiliate, as appropriate, and paid over to the governmental entity entitled to receive the same.

17.07 GOVERNMENT AND OTHER REGULATIONS. The obligation of the Company to make payment of Awards in Common Stock or otherwise shall be subject to all applicable laws, rules, and regulations, and to such approvals by any government agencies as may be required. The Company shall be under no obligation to register under the Securities Act of 1933, as amended, or under any state securities or Blue Sky laws any of the shares of Common Stock issued, delivered, or paid in settlement under the Plan. If Common Stock awarded under the Plan may in certain circumstances be exempt from such registration, the Company may restrict its transfer in such manner as it deems advisable to ensure such exempt status.

17.08 RELIANCE ON REPORTS. Each member of the Committee shall be fully justified in relying or acting in good faith upon any report made by the independent public accountants of the

Company and upon any other information furnished in connection with the Plan. In no event shall any person who is or shall have been a member of the Committee be liable for any determination made, any other action taken, or any omission to act in reliance upon any such report or information.

17.09 COMPANY SUCCESSORS. In the event the Company becomes a party to a merger, consolidation, sale of substantially all of its assets, or any other corporate reorganization in which the Company will not be the surviving corporation or in which the holders of the Common Stock will receive securities of another corporation (in any such case, the "New Company"), then the New Company shall assume the rights and obligations of the Company under the Plan.

17.10 GOVERNING LAW. All matters relating to the Plan, any Awards, or any Agreements, shall be governed by the laws of the District of Columbia, without regard to the principles of conflict of laws.

17.11 RELATIONSHIP TO OTHER BENEFITS. No payment under the Plan shall be taken into account in determining any benefits under any other pension, retirement, profit-sharing, or other employee benefit plan of the Company or any Affiliate.

17.12 EXPENSES. The expenses of administering the Plan shall be borne by the Company.

17.13 PROCEEDS. Any cash proceeds received by the Company under the Plan shall be used for general corporate purposes, and any shares of Common Stock withheld by or paid to the Company under the Plan shall be held by the Company as treasury stock or shall be canceled, as the Company in its discretion shall determine.

ARTICLE XVIII

AMENDMENT

The Board may amend the Plan from time to time. No amendment may become effective until shareholder approval is obtained if such approval is required by any federal or state law or regulation or the rules of any stock exchange on which the Common Stock may be listed, or if the Board in its discretion determines that the obtaining of such shareholder approval is for any reason advisable. No amendment shall, without a Participant's consent, adversely affect any rights of such Participant under any Award outstanding at the time such amendment is made.

ARTICLE XIX

EFFECTIVE DATE; DURATION OF THE PLAN

The effective date of the Plan is October 1, 1999, subject to shareholder approval. Unless sooner terminated by the Board, the Plan shall terminate on September 30, 2009; provided, however, that any Award outstanding at the time of such termination shall continue in full force and effect and shall continue to be governed by the Plan and its applicable Agreement until the Award expires or is discharged by its terms.

Exhibit 21

C=corporation; GP=general partnership; LLC=limited liability company; LP=limited partnership; NP=non-profit corporation; ULLC=unlimited liability company

ENTITY NAME:	JURISDICTION OF DOMICILE:	ENTITY TYPE:
Allied Specialty Care Services, Inc.	Florida	C
Vivra, Inc.	Nevada	C
Vivra Heart Services, Inc.	Nevada	C
Vivra Network Services, Inc.	Florida	C
Eye Management, Inc.	Florida	C
PHP Holdings, Inc.	Colorado	C
Care Management Resources, Inc.	Florida	C
Charter Behavioral Corporation	Delaware	C
Green Spring Health Services, Inc.	Delaware	C
Advantage Behavioral Systems, Inc.	Pennsylvania	C
Resource Day Treatment Center	Pennsylvania	NP
AdvoCare of Tennessee, Inc.	Tennessee	C
Premier Holdings, Inc.	Tennessee	C
Magellan - PBS, LLC		LLC
Premier Behavioral Systems of Tennessee, LLC(1)	Tennessee	LLC
Ceres Behavioral Healthcare System, LLC(2)	Oregon	LLC
Green Spring Canadian Holding, Inc.	Delaware	C
Green Spring Health Services of Canada Co.	Nova Scotia	ULLC
CHC Quebec les specialistes en PAE, Inc		
Group Practice Affiliates, Inc.	Delaware	C
GPA Pennsylvania, Inc.	Pennsylvania	C
GMV, LLC		
Novapsy Clinic, LLC(3)	Virginia	LLC
Magellan Behavioral of Michigan, Inc.	Michigan	C
Green Spring of Pennsylvania,		
Inc.	Pennsylvania	C
Managed Care Services Mainstay of Central Pennsylvania, Inc.	Pennsylvania	C
Maryland Health Partners, LLC(4)	Maryland	LLC
Vista Behavioral Health Plans, Inc.	California	C
Human Affairs International, Incorporated	Utah	C
Human Affairs of Alaska, Inc.	Alaska	C
Human Affairs International of California	California	C
Human Affairs International of Pennsylvania, Inc.	Pennsylvania	C
Magellan Behavioral Health, Inc.	Delaware	C
Magellan Behavioral Health of Washington, Inc.	Washington	C
MCI/Magellan Partners, L.L.C.(5)	Delaware	LLC
Magellan Military Health Solutions, Inc.	Delaware	C
Tennessee Behavioral Health, Inc.	TN	C
Magellan Behavioral Health of Texas, Inc.	Texas	C
Magellan Capital, Inc.	Delaware	C
Magellan CBHS Holdings, Inc.	Delaware	C
Behavioral Health Systems of Indiana, Inc.	Indiana	C
The Charter Behavioral Health System of Northwest Indiana, LLC(6)	Delaware	LLC

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(1) 50% owned by Premier Holdings, Inc.
(2) 95% owned by Green Spring Health Services, Inc.
(3) 50% owned by Group Practice Affiliates, Inc.
(4) 50% owned by Green Spring Health Services, Inc.; 50% owned by CMG Health, Inc., a direct subsidiary of Merit Behavioral Care Corporation.
(5) 50% owned by Magellan Behavioral Health, Inc.
(6) 5% owned by Behavioral Health Systems of Indiana, Inc.; 95% owned by Charter Indiana BHS Holding, Inc.

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ENTITY NAME:	JURISDICTION OF DOMICILE:	ENTITY TYPE:
CCM, Inc.(7)	Nevada	C
Charter Alvarado Behavioral Health System, Inc.	California	C
Charter Asheville Behavioral Health System, Inc.	North Carolina	C
Charter Bay Harbor Behavioral Health System, Inc.	Florida	C
Charter Behavioral Health System of Athens, Inc.	Georgia	C
Charter Behavioral Health System of Central Georgia, Inc.	Georgia	C
Charter Behavioral Health System of Charleston, Inc.	South Carolina	C
Charter Behavioral Health System of Charlottesville, Inc.	Virginia	C
Charter Behavioral Health System of Chicago, Inc.	Illinois	C
Charter Behavioral Health System of Columbia, Inc.	Missouri	C
Charter Behavioral Health System of Corpus Christi, Inc.	Texas	C

Charter Behavioral Health System of Dallas, Inc.	Texas	C
Charter Behavioral Health System of Delmarva, Inc.	Maryland	C
Charter Behavioral Health System at Fair Oaks, Inc.	New Jersey	C
Charter Behavioral Health System of Fort Worth, Inc.	Texas	C
Charter Behavioral Health System at Hidden Brook, Inc.	Maryland	C
Charter Behavioral Health System of Jackson, Inc.	Mississippi	C
Charter Behavioral Health System of Kansas City, Inc.	Kansas	C
Charter Behavioral Health System of Lafayette, Inc.	Louisiana	C
The Charter Cypress Behavioral Health System, L.L.C.(8)	Tennessee	LLC
Charter Behavioral Health System of Lake Charles, Inc.	Louisiana	C
Charter Behavioral Health System of Massachusetts, Inc.	Massachusetts	C
Westwood/Pembroke Health System Limited Partnership(9)	Massachusetts	LP
Charter Behavioral Health System of Mississippi, Inc.	Mississippi	C
Charter Behavioral Health System of Nashua, Inc.	New Hampshire	C
Charter Behavioral Health System of Nevada, Inc.	Nevada	C
Charter Behavioral Health System of New Mexico, Inc.	New Mexico	C
The Charter Heights Behavioral Health System Limited Partnership(10)	Delaware	LP
Charter Behavioral Health System of Northwest Arkansas, Inc.	Arkansas	C
Charter Behavioral Health System of Paducah, Inc.	Kentucky	C
Charter Behavioral Health System at Potomac Ridge, Inc.	Maryland	C
Charter Behavioral Health of Puerto Rico, Inc.	Georgia	C
Charter Behavioral Health System of San Jose, Inc.	California	C
Charter Behavioral Health System of Toledo, Inc.	Ohio	C
Charter Canyon Behavioral Health System, Inc.	Utah	C
Charter Canyon Springs Behavioral Health System, Inc.	California	C
Charter Centennial Peaks Behavioral Health System, Inc.	Colorado	C
Charter Community Hospital, Inc.	California	C
Charter Fairmount Behavioral Health System, Inc.	Pennsylvania	C
Charter Fenwick Hall Behavioral Health System, Inc.	South Carolina	C
Charter Forest Behavioral Health System, Inc.	Louisiana	C

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(7) 50% owned by Magellan CBHS Holdings, Inc.; 50% owned by CMCI, Inc.
(8) 50% owned by Charter Behavioral Health System of Lafayette, Inc.
(9) Approximately 97.5% owned by Charter Behavioral Health System of Massachusetts, Inc.
(10) 67% owned by Charter Behavioral Health System of New Mexico, Inc.

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ENTITY NAME:	JURISDICTION OF DOMICILE:	ENTITY TYPE:
Charter Grapevine Behavioral Health System, Inc.	Texas	C
Charter Hospital of Mobile, Inc.	Alabama	C
Charter Hospital of Santa Teresa, Inc.	New Mexico	C
Charter Hospital of St. Louis, Inc.	Missouri	C
Charter Indiana BHS Holding, Inc.	Indiana	C
The Charter Behavioral Health System of Northwest Indiana, LLC(11)	Delaware	LLC
Charter Lakehurst Behavioral Health System, Inc.	New Jersey	C
Charter Linden Oaks Behavioral Health System, Inc.	Illinois	C
Naperville Psychiatric Ventures (12)	Illinois	GP
Charter Little Rock Behavioral Health System, Inc.	Arkansas	C
Charter Louisiana Behavioral Health System, Inc.	Louisiana	C
Charter Meadows Behavioral Health System, Inc.	Maryland	C
Charter Medical (Cayman Islands) Ltd.	Cayman Islands	C
Charter Medical - Clayton County, Inc.	Georgia	C
Charter Medical of East Valley, Inc.	Arizona	C
Charter Medical International, Inc.	Cayman Islands	C
Charter Medical International, S.A., Inc.	Nevada	C
Charter Medical International Services, Inc.	Cayman Islands	C
Charter Medical Leasing Limited	United Kingdom	C
Charter Medical - Long Beach, Inc.	California	C
Charter Medical of Puerto Rico, Inc.	Puerto Rico	C
Charter Milwaukee Behavioral Health System, Inc.	Wisconsin	C
Charter Mission Viejo Behavioral Health System, Inc.	California	C
Charter MOB of Charlottesville, Inc.	Virginia	C
Mental Healthsource, L.L.C.(13)	Virginia	LLC
Charter North Behavioral Health System, Inc.	Alaska	C
Charter North Counseling Center, Inc.	Alaska	C
Charter North Star Behavioral Health System, L.L.C.(14)	Tennessee	LLC
Charter Northridge Behavioral Health System, Inc.	North Carolina	C
Holly Hill/Charter Behavioral Health System, L.L.C.(15)	Tennessee	LLC
Charter Oak Behavioral Health System, Inc.	California	C
Charter Palms Behavioral Health System, Inc.	Texas	C
Charter Park Hospital Limited	United Kingdom	C
Charter Plains Behavioral Health System, Inc.	Texas	C
Charter Real Behavioral Health System, Inc.	Texas	C
Charter Rockford Behavioral Health System, Inc.	Delaware	C
Charter San Diego Behavioral Health System, Inc.	California	C
Charter Sioux Falls Behavioral Health System, Inc.	South Dakota	C
Charter Springs Behavioral Health System, Inc.	Florida	C
Charter Westbrook Behavioral Health System, Inc.	Virginia	C
CPS Associates, Inc.	Virginia	C
Charter White Oak Behavioral Health System, Inc.	Maryland	C

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(11) 95% owned by Charter Indiana BHS Holding, Inc.; 5% owned by Behavioral Health Systems of Indiana, Inc.
(12) 75% owned by Charter Linden Oaks Behavioral Health System, Inc.
(13) 50% owned by Charter MOB of Charlottesville, Inc.

(14) 57% owned by Magellan CBHS Holdings, Inc.
(15) 50% owned by Charter Northridge Behavioral Health System, Inc.

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ENTITY NAME:	JURISDICTION OF DOMICILE:	ENTITY TYPE:
Charter Woods Behavioral Health System, Inc.	Alabama	C
Desert Springs Hospital, Inc.	Nevada	C
CMCI, Inc.	Nevada	C
CCM, Inc.(16)	Nevada	C
CMFC, Inc.	Nevada	C
Florida Health Facilities, Inc.	Florida	C
Golden Isle Assurance Company Ltd.	Bermuda	C
NEPA - Massachusetts, Inc.	Massachusetts	C
New Allied, Inc.	Florida	C
Charter Behavioral Health System of the Inland Empire, Inc.	California	C
Plymouth Insurance Company, Ltd.	Bermuda	C
Strategic Advantage, Inc.	Minnesota	C
Western Behavioral Systems, Inc.	California	C
Magellan Executive Corporation	Delaware	C
Magellan Public Solutions, Inc.	Delaware	C
KidsCareNet of Milwaukee, LLC(17)	Wisconsin	LLC
Magellan Public Network, Inc.	Delaware	C
Correctional Behavioral Solutions, Inc.	Delaware	C
Correctional Behavioral Solutions of Indiana, Inc.	Indiana	C
Correctional Behavioral Solutions of New Jersey, Inc.	New Jersey	C
Correctional Behavioral Solutions of Ohio, Inc.	Ohio	C
National Mentor, Inc.	Delaware	C
Center for Comprehensive Services, Inc.	Illinois	C
First Step Independent Living Program, Inc.	California	C
Horrigan Cole Enterprises, Inc.	California	C
Illinois Mentor, Inc.	Illinois	C
Rehabilitation Achievement Center, Inc.	Illinois	C
Massachusetts Mentor, Inc.	Massachusetts	C
National Mentor Healthcare, Inc.	Massachusetts	C
Carolina Behavioral Services, LLC	Delaware	LLC
Loyd's Liberty Homes, Inc.	California	C
Unlimited Quest, Inc.	California	C
Ohio Mentor, Inc.	Ohio	C
South Carolina Mentor, Inc.	South Carolina	C
Solutions For Care, Inc.	Delaware	NP
Magellan Specialty Health, Inc.	Delaware	C
iHealth Technologies, Inc.(18)	Delaware	C
CAI Merger Corporation	Delaware	C
MBCH, Inc.	Delaware	C
Merit Behavioral Care Corporation	Delaware	C
American Biodyne, Inc.	Delaware	C
AGCA Acquisition Corporation-New York	Delaware	C
AGCA, Inc.	Pennsylvania	C

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(16) 50% owned by CMCI, Inc.; 50% owned by Magellan CBHS Holdings, Inc.
(17) 50% owned by Magellan Public Solutions, Inc.
(18) Formerly known as CAI Holdings, Inc.

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ENTITY NAME:	JURISDICTION OF DOMICILE:	ENTITY TYPE:
AGCA Headquarters Limited Partnership(19)	Pennsylvania	LP
AGCA New York, Inc.	New York	C
AGCA IPA of New York, Inc.	New York	C
MBC Health Care of New York, Inc., a New York Independent Practice Association	New York	C
MBC Health Services of New York, Inc., a New York Independent Practice Association	New York	C
MBC of New York, Inc., a New York Independent Practice Association	New York	C
MBC Providers of New York, Inc., a New York Independent Practice Association	New York	C
U.S. IPA Providers, Inc.	New York	C
Quality Healthcare Solutions, Inc.	Pennsylvania	C
Alliance Health Systems, Inc.(20)	Indiana	C
Arizona Biodyne, Inc.	Arizona	C
Colorado Biodyne, Inc.	Colorado	C
Hawaii Biodyne, Inc.	Hawaii	C
Louisiana Biodyne, Inc.	Louisiana	C
MBC Federal Programs, Inc.	Delaware	C

MBC of New Mexico, Inc.	New Mexico	C
Merit Behavioral Care of Florida, Inc.	Florida	C
Merit Behavioral Care of Illinois, Inc.	Illinois	C
Merit Behavioral Care of Massachusetts, Inc.	Massachusetts	C
Merit Behavioral Care of Montana, Inc.	Montana	C
Magellan Behavioral Health of Pennsylvania, Inc. (f/k/a Merit Behavioral Care of Pennsylvania, Inc.)	Pennsylvania	C
Merit Behavioral Care of Texas, Inc.	Texas	C
Ohio Biodyne, Inc.	Ohio	C
Vermont Biodyne, Inc.	Vermont	C
BCOV-GP, Inc.(21)	Delaware	C
Benesys Doctors, P.A.	Texas	
Benesys, Inc.	Delaware	C
CMG Health, Inc.	Maryland	C
ARD Properties, Inc.	Delaware	C
Choice Behavioral Health Partnership(22)	Virginia	GP
CMG Health of New York, Inc.	New York	C
Inpsych, Inc.	Maryland	C
Inpsych Kentucky, Inc.	Kentucky	C
Inpsych Midwest, Inc.	Missouri	C
Maryland Health Partners, LLC(23)	Maryland	LLC
Montana Community Partners, Inc.(24)	Montana	C

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(19) 15% owned by AGCA, Inc.
(20) 80% owned by American Biodyne, Inc.
(21) 50% owned by Merit Behavioral Care Corporation
(22) 50% owned by CMG Health, Inc.
(23) 50% owned by CMG Health, Inc.; 50% owned by Green Spring Health Services, Inc.
(24) 55% owned by CMG Health, Inc.

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ENTITY NAME:	JURISDICTION OF DOMICILE:	ENTITY TYPE:
Continuum Behavioral Care, LLC(25)	Rhode Island	LLC
Continuum Behavioral Healthcare Corporation	Delaware	C
Spectrum-Continuum Management Services of New York, LLC(26)	Delaware	LLC
Spectrum-Continuum IPA Providers of New York, LLC(27)	Delaware	LLC
EMHC-MBC of New York, LLC(28)	New York	LLC
EMHC/MBC IPA Providers of New York, LLC(29)	New York	LLC
EMHC-MBC Services of New York, LLC(30)	New York	LLC
Group Plan Clinic, Inc.	Texas	C
MBC Health Providers of Texas, Inc.	Texas	C
MBC of America, Inc.	Delaware	C
EMHC/MBC IPA Providers of New York, LLC(31)	New York	LLC
EMHC-MBC Services of New York, LLC(32)	New York	LLC
Empire Community Delivery Systems, LLC(33)	New York	LLC
MBC Management Services of New York, LLC(34)	New York	LLC
MBC of Nebraska, L.L.C.(35)	Nebraska	LLC
MBC of Tennessee, Inc.	Tennessee	C
MBC of Tennessee, LLC(36)	Tennessee	LLC
MBC/IPA Providers of New York, LLC(37)	New York	LLC
Royal Health Care, LLC(38)	New York	LLC
MBC of North Carolina, LLC	North Carolina	LLC
MBC of Tennessee, LLC(39)	Tennessee	LLC
MBC Washington Systems, Inc.	Washington	C
Community Sector Systems, Inc.(40)	Washington	C
Merit Behavioral Care Corporation of Iowa	Iowa	C
Merit Behavioral Care Systems Corporation	Ohio	C
INROADS Behavioral Health Services of Texas, L.P.(41)	Texas	LP
MBCS of Florida, Inc.	Florida	C
MBCS of North Carolina, Inc.	North Carolina	C
Merit INROADS Behavioral Health Services of Illinois, LLC(42)	Illinois	LLC
Merit Health Insurance Company	Illinois	C

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(25) 50% owned by Merit Behavioral Care Corporation
(26) 50% owned by Continuum Behavioral Healthcare Corporation
(27) 100% owned by Spectrum-Continuum Management Services of New York, LLC
(28) 79.8% owned by Merit Behavioral Care Corporation
(29) 99% owned by EMHC-MBC of New York, LLC; 1% owned by MBC of America, Inc.
(30) 99% owned by EMHC-MBC of New York, LLC; 1% owned by MBC of America, Inc.
(31) 1% owned by MBC of America, Inc.; 99% owned by EMHC-MBC of New York, LLC
(32) 1% owned by MBC of America, Inc.; 99% owned by EMHC-MBC of New York, LLC
(33) 16.667% owned by MBC of America, Inc.
(34) 80.2 % owned by MBC of America, Inc.

(35) 50% owned by MBC of America, Inc.
(36) MBC of America, Inc and Merit Behavioral Care Corporation serve as sole members
(37) 80.2% owned by MBC of America, Inc.
(38) 50% owned by MBC of America, Inc.
(39) Merit Behavioral Care Corporation and MBC of America, Inc. serve as sole members
(40) 19.9 % owned by MBC Washington Systems, Inc.
(41) 1% owned by Merit Behavioral Care Systems Corporation; 99% owned by Merit INROADS Behavioral Health Services, LLC
(42) 1% owned by Merit Behavioral Care Systems Corporation; 99% owned by Merit INROADS Behavioral Health Services, LLC

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ENTITY NAME:	JURISDICTION OF DOMICILE:	ENTITY TYPE:
Orion Life Insurance Company	Delaware	C
Merit Holdings Corp.	Delaware	C
MBC National Service Corporation	Delaware	C
Merit Behavioral Care of Arkansas, Inc.	Arkansas	C
Merit Behavioral Care of Maryland, Inc.	Maryland	C
Merit INROADS Behavioral Health Services, LLC(43)	Delaware	LLC
Merit INROADS Behavioral Health Services of Illinois, LLC(44)	Illinois	LLC
INROADS Behavioral Health Services of Texas, L.P.(45)	Texas	LP
MeritChoice, Inc.(46)	Delaware	C
MeritChoice, Ltd.(47)	Pennsylvania	LP
ProPsych, Inc.	Florida	C
PPC Group, Inc.	Delaware	C
Merit Behavioral Care of California, Inc.	Missouri	C
P.P.C., Inc.	Missouri	C
Personal Performance Consultants of New York, Inc.	New York	C
Washton Institute, Inc.	New York	C

NOTE: The ownership interest in each non-indented entity is directly-held by Magellan Health Services, Inc.; the ownership interest in each indented entity is directly-held by the preceding non-indented entity. The percentage of ownership in each entity is 100% unless otherwise noted in a footnote.

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(43) 99% owned by Merit Holdings Corp.; 1% owned by Merit Behavioral Care of Illinois, Inc.
(44) 99% owned by Merit INROADS Behavioral Health Services, LLC; 1% owned by Merit Behavioral Care Systems Corporation
(45) 99% owned by Merit INROADS Behavioral Health Services, LLC; 1% owned by Merit Behavioral Care Systems Corporation
(46) 50% owned by Merit Holdings Corp.
(47) 50% owned by Merit Holdings Corp.

Exhibit 23

Consent of independent public accountants

As independent public accountants, we hereby consent to the incorporation of our report dated December 11, 2000, and to all references to our firm included in this Form 10-K into the Company's previously filed Registration Statements on Form S-3 (File Nos. 333-20371, 333-50423, and 333-53353) and Form S-8 (File Nos. 333-12877, 333-46386, 333-46388, 333-49149, 333-57729, 333-72307, and 333-93911).

Baltimore, Maryland,
December 26, 2000

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