

SECURITIES AND EXCHANGE COMMISSION

FORM 10-K

Annual report pursuant to section 13 and 15(d)

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LOGO

FORM 10-K

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF
THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED JUNE 30, 1996

Commission file number 1-10875
NOVACARE, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

<TABLE>

<S>		<C>	
	DELAWARE		13-3247827
	(STATE OF INCORPORATION)		(I.R.S. EMPLOYER IDENTIFICATION NO.)
	1016 WEST NINTH AVENUE, KING OF PRUSSIA, PA		19406
	(ADDRESS OF PRINCIPAL EXECUTIVE OFFICE)		(ZIP CODE)

</TABLE>

Registrant's telephone number, including area code: (610) 992-7200

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

<TABLE>

<S>	<C>	<C>
Title of each class		Name of each exchange on which registered
COMMON STOCK, PAR VALUE \$.01 PER SHARE		NEW YORK STOCK EXCHANGE, INC.
5 1/2% CONVERTIBLE SUBORDINATED DEBENTURES DUE 2000		NEW YORK STOCK EXCHANGE, INC.

</TABLE>

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. []

AS OF SEPTEMBER 6, 1996, 62,461,021 SHARES OF COMMON STOCK WERE OUTSTANDING, AND THE AGGREGATE MARKET VALUE OF THE SHARES OF COMMON STOCK HELD BY NON-AFFILIATES WAS APPROXIMATELY \$557,543,691. (DETERMINATION OF STOCK OWNERSHIP BY NON-AFFILIATES WAS MADE SOLELY FOR THE PURPOSE OF RESPONDING TO THIS REQUIREMENT AND THE REGISTRANT IS NOT BOUND BY THIS DETERMINATION FOR ANY OTHER PURPOSE.)

DOCUMENTS INCORPORATED BY REFERENCE

PART III INCORPORATES INFORMATION BY REFERENCE FROM PORTIONS OF THE REGISTRANT'S PROXY STATEMENT FOR THE 1996 ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON OCTOBER 31, 1996.

NOVACARE, INC. AND SUBSIDIARIES

FORM 10-K -- FISCAL YEAR ENDED JUNE 30, 1996

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FURNISHED PURSUANT TO GENERAL INSTRUCTION G(4) OF FORM 10-K

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PART I

ITEM 1. BUSINESS

THE COMPANY

NovaCare, Inc. ("NovaCare" or the "Company") was organized and formed in 1985 and is the leading national provider of medical rehabilitation services outside the medical rehabilitation hospital setting.

Rehabilitation is the process that restores individuals disabled by trauma or disease to their optimal level of functionality and self-sufficiency. Over 80% of individuals receiving rehabilitation services return to the community in productive endeavors or to active retirement. NovaCare's comprehensive medical rehabilitation services include: (i) providing rehabilitation therapy, subacute and rehabilitation program consulting and management services on a contract basis to health care institutions, primarily long-term care facilities, and (ii) providing outpatient, orthotic and prosthetic ("O&P") and occupational health rehabilitation services through a national network of patient care centers and integrated delivery systems comprising health care providers and payors. The Company operated medical rehabilitation hospitals until April 1, 1995, the effective date of the sale of such hospitals, discussed in Part II to this Form 10-K. For the fiscal year ended June 30, 1995, the medical rehabilitation hospitals represented 12% of the Company's consolidated net revenues.

REHABILITATION INDUSTRY BACKGROUND

Depending on an individual's diagnostic and therapeutic needs, rehabilitation services are delivered in a variety of settings, including rehabilitation hospitals, rehabilitation units in acute care hospitals, long-term care facilities, outpatient rehabilitation facilities, rehabilitation agencies and clinics, schools and patients' homes. These services are provided by a variety of healthcare professionals including physiatrists and other qualified rehabilitation physicians, occupational, physical and respiratory therapists, rehabilitation nurses, speech-language pathologists, audiologists, psychologists, social workers, orthotists, prosthetists, recreational

therapists, rehabilitation counselors and others.

Recent industry analysis suggests that medical rehabilitation is a \$12-15 billion industry, projected to grow at a rate of 10-12% per year through the end of the decade. The industry's growth has been fueled primarily by the following factors:

Demand for services. Advances in technology and the aging population continue to drive demand. The need for rehabilitation services is significant. Technological advances in medical care have improved survival rates for patients who have suffered severe injury or disease. The U.S. Bureau of the Census reported in a 1991 survey that 33 million Americans had a disability and could not perform basic physical activity or needed assistance to do so. The Bureau of the Census statistics also show that the fastest growing segment of the population is the group over 65 years of age. This group has the highest requirement for rehabilitation services. Approximately 75% of strokes and 70% of amputations occur in persons over the age of 65. Almost 50% of Americans over 75 years of age currently require some form of rehabilitation. Demand has also increased as a result of higher quality of life expectations among disabled individuals.

Cost-effectiveness of service. A major factor in the growth of the rehabilitation industry is the recognition by payors (insurance companies, managed care plans, employers, government programs and individual patients) of the benefits of rehabilitation in reducing lifetime costs of care. Recent studies suggest that from \$11.00 to \$30.00 in medical costs are saved for every dollar spent on rehabilitation. Efforts to reduce workers' compensation expenses have also stimulated demand for rehabilitation of injured workers and workhardening and injury-prevention programs in the work place.

Reimbursement for services. The reimbursement for patients in acute care hospitals encourages their rapid discharge while they remain in need of rehabilitation services. Rehabilitation services are covered for payment by Medicare and Medicaid and are typically covered by commercial health insurance policies, including managed care plans. Under the Omnibus Budget Reconciliation Act of 1987, long-term care facilities that participate in the Medicare program are required to offer physical

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therapy, occupational therapy and speech-language pathology services to improve the functionality of patients.

COMPANY STRATEGY

Values Based Business

The Company's management has formally set forth the Company's values -- what NovaCare stands for, what motivates its employees, and what sets NovaCare apart -- and communicated and discussed them with each of its employees. These values include the Company's:

<TABLE>	
<S>	<C>
Credo	Helping Make Life a Little Better
Purpose	To effectively meet the rehabilitation needs of our patients through clinical leadership
Beliefs	Respect for the Individual Service to the Customer Pursuit of Excellence Commitment to Personal Integrity
</TABLE>	

It is management's belief that a strong commitment to these values will enable the Company's employees to build the business and their careers, and that these values are a foundation upon which NovaCare's business plans are developed.

Emphasis on Rehabilitation Services

NovaCare's rehabilitation services strategy is to integrate its expert rehabilitation and specialty health care services with managed care, hospital and long-term care delivery systems. The Company's strategy is formulated to maintain NovaCare's position as the largest provider of low-cost, clinically excellent, medical rehabilitation services outside the medical rehabilitation hospital setting. The strategy is based on the belief that:

- Medical rehabilitation services will continue to experience steady or

growing demand because health care payor cost-containment efforts will continue to drive patients toward lower-cost services.

- Managed care is expected to grow at the rate of 15% per year over the next decade, demanding high quality health care services at a reasonable cost.
- In geographic markets, large integrated delivery systems comprising healthcare providers and payors will be networked as referral sources to facilitate integrated patient care and to ease administration for payors and providers.
- The aging of the population will increase the demand for medical rehabilitation services as the elderly consume a disproportionate amount of rehabilitation care.
- Purchasers of medical rehabilitation services will increase their emphasis on cost-effective clinical outcomes in the selection of rehabilitation providers.
- Costs can be lowered through clinical and systems innovations coupled with "flat" organizations having broad spans of control.
- Medical rehabilitation services, outside the medical rehabilitation hospital setting are not capital intensive, allowing for responsiveness to changes in reimbursement or market conditions and for internal growth, without the use of substantial capital resources.

Plan for Growth

The Company experienced significant growth in the years prior to fiscal 1996, largely from acquisitions. During the past year, management curtailed its acquisition activity in order to restructure the organization in light of anticipated regulatory changes relating to long-term care services, recent government efforts to reform

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health care (see "Reimbursement/Government Relations," discussed later), and the increasing penetration of managed care in the outpatient rehabilitation customer base.

The new organization is substantially complete, resulting in significantly reduced overhead costs, highly centralized administrative support services to all NovaCare's businesses, and the flexibility to respond to business growth and industry changes.

The Company's plan for growth has four principal components: (i) expansion of its national network of outpatient rehabilitation and O&P centers, (ii) development of a national network of occupational health services capabilities, (iii) affiliation with integrated delivery systems in targeted geographic markets, and (iv) entry into the professional employer organization industry.

Expansion of Outpatient Rehabilitation and O&P Services. NovaCare plans to expand the Company's extensive network of outpatient rehabilitation and O&P sites in targeted geographic markets through acquisitions and start-up centers. Management believes that the size and density of NovaCare's outpatient services network in many markets positions the Company favorably to affiliate with integrated delivery systems and to compete for referrals from managed care organizations and industrial customers.

Development of Occupational Health Services. Occupational health services are integrated systems of care for injured or ill workers covered by workers' compensation insurance. The system includes a network of physician practices specializing in occupational healthcare who oversee the workers' initial evaluation, care planning, and clinical progress through their return to work. Treatment of patients is generally performed in healthcare centers comparably equipped to NovaCare's outpatient rehabilitation centers.

The Company plans to acquire established occupational health services practices in targeted geographic markets. The Company believes such acquisitions will compliment the Company's expansion of outpatient services, capitalize on patient flow synergies and further position NovaCare for affiliation with integrated delivery systems, managed care referrals and industrial customers.

Affiliation with Integrated Delivery Systems ("IDS's"). NovaCare intends to affiliate its rehabilitation services, principally outpatient and occupational health services, with leading healthcare IDS's in targeted geographic markets. Management believes that as the largest combined outpatient

rehabilitation and O&P services network in the United States and an emerging occupational health services network, NovaCare is in the best position to meet the needs of an IDS. NovaCare offers the attributes that an IDS looks for in a partner: (i) dispersed outpatient services capabilities, (ii) excellent clinical reputation and outcomes, (iii) sophisticated systems capabilities to track and measure patient progress through their plans of care, and (iv) a strong financial position to support expansion of network growth.

Entry into the Professional Employer Organization ("PEO") Industry. PEO's provide small and medium-sized businesses with an outsourcing solution to the complexities and costs related to employment management. The employment management services provided by a PEO include human resource and payroll administration, employment regulatory compliance management, workers' compensation coverage, healthcare and other employee benefits. A PEO establishes a co-employer relationship with its clients and contractually assumes substantial employer responsibilities with respect to work-site employees.

NovaCare's plan is to acquire PEO's in the same targeted markets in which the Company intends to be affiliated with integrated delivery systems. NovaCare's ability to manage both a meaningful portion of the healthcare services and the employee workforce in a local market affords the following benefits: (i) reduced workers' compensation costs, (ii) increased access to patient flow for NovaCare's medical rehabilitation centers and its integrated delivery system partners, and (iii) increased leverage in negotiating the purchase of healthcare and other benefits.

As a large employer, managing 14,500 geographically dispersed employees in 2,300 sites in 43 states, NovaCare provides a comprehensive range of employment-related services. Management believes that additional economies of scale can be attained by entering into agreements with numerous small to medium-sized employers to perform employment-related functions of the quality and cost typically not available to businesses of that size. Management also believes that a PEO affords an attractive solution for long-term care

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facilities which, as an industry, have the highest workers' compensation claims in the United States. The Company's existing customer base of small- and medium-sized long-term care facilities in which the Company provides therapy services on a contract basis, discussed later, offers a potential source for NovaCare to contract PEO services.

Cost Containment

A central aspect of the Company's strategy is to position itself as a low-cost provider of rehabilitation services. Clinical improvements and innovation are expected to lower the cost of rehabilitation service delivery. The Company's management is devoting a substantial portion of its efforts to such clinical objectives in addition to managing other costs. Management believes its efforts to flatten and increase the flexibility of the organization to respond to change and its investment in common, efficiency enhancing clinical and administrative systems will allow the Company to operate successfully in an increasingly challenging reimbursement environment.

Clinical Leadership and Outcomes

Management believes that payors will ultimately demand that low cost be accompanied by proof of quality outcomes. The Company has committed resources to develop systems that capture outcomes in a useable format. Management believes that, as payors become more sophisticated and require providers to prove the delivery of quality service, the Company's commitment to outcomes measurement, coupled with its emphasis on clinical performance, will enhance its competitive position.

OUTPATIENT SERVICES

During fiscal year 1996, NovaCare merged its outpatient services businesses, comprising outpatient rehabilitation and O&P services, under a common management team to take advantage of administrative and operational economies of scale and in light of the evolution of rehabilitation services toward IDS's. For the fiscal years ended June 30, 1996 and 1995, outpatient services represented 37% and 31% respectively, of the Company's consolidated net revenues.

Outpatient Rehabilitation Services

Management believes that NovaCare is a leading provider of freestanding outpatient rehabilitation services in the United States, with a national network of 326 centers, comprising stand-alone clinics, hospital-based clinics and

employer on-site clinics. Through these settings, licensed physical and occupational therapists develop individual treatment plans to rehabilitate patients recovering from musculoskeletal injury and/or surgery.

Outpatient rehabilitation services include general rehabilitation, which is designed to return injured and post-operative patients to their optimal functional capacity; sports rehabilitation, which is designed to minimize the "down-time" of injured sports participants and safely return them to sports activities; industrial rehabilitation and work hardening, which are designed to reduce work-related injuries and rehabilitate and strengthen injured patients to allow a rapid, safe return to normal job activities; and hospital-based services, which involve the provision of inpatient and outpatient rehabilitation services on a contract basis to acute care hospitals.

Patients are generally referred by physicians (most commonly orthopedists, physiatrists, primary care physicians, internists and neurologists), managed care insurers, workers' compensation insurers, case managers, industrial companies and rehabilitation nurses. In a number of states, patients can obtain outpatient therapy services by "direct access," that is, without a physician's referral.

Analysts estimate that the outpatient rehabilitation industry approximates \$11 billion and is growing at a rate of 8-10% per year. NovaCare's share of the industry total, based on fiscal 1996 revenues, is approximately 2%.

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Orthotic and Prosthetic Services

NovaCare is the largest custom O&P patient care services organization in the U.S. with approximately 10% market share. Services are provided by 363 orthotists and prosthetists, referred to as practitioners, through 130 patient care centers.

Orthotic rehabilitation involves the fitting, design, fabrication and use of custom-made braces and support devices for treatment of musculoskeletal conditions resulting from illness, injury or congenital anomalies. Prosthetic rehabilitation involves the fitting, fabrication and use of custom-made artificial limbs typically required by people who have suffered the loss of a limb from vascular diseases, diabetes, cancer or trauma. During fiscal 1995, the Company acquired Sabolich Prosthetic and Research Center ("Sabolich"), a nationally renowned leader in prosthetic research, design and patient care, providing services at four patient care centers throughout the U.S. The breakthrough technology and research provided by Sabolich is believed by management to clinically differentiate NovaCare in O&P services worldwide.

The principal referral source for O&P rehabilitation services is the orthopedic surgeon. However, other specialized physicians, such as physiatrists and vascular surgeons, and managed care payors have emerged as important referral sources. Secondary referral sources include physical therapists, orthopedic nurses, orthopedic technicians and other rehabilitation professionals.

The O&P rehabilitation industry is estimated to be a \$1.0 billion industry. According to industry sources, O&P patient care services in the United States are currently provided through more than 1,100 patient care centers.

OCCUPATIONAL HEALTH SERVICES

Occupational health services comprise the treatment for work-related injuries and illnesses, physical and rehabilitation therapy, pre-placement physical examinations and evaluations, case management, diagnostic testing and other employer-requested or government-mandated services. The most common work related injuries are soft tissue injuries, lacerations, moderate trauma injuries to the spine or extremities, and exposure to hazardous materials. Treatments are provided by licensed physicians, registered nurses and physical therapists. The physicians are generally trained and experienced in occupational and industrial medicine or have other medical backgrounds compatible with occupational related injuries.

The occupational health services market is highly fragmented. Industry analysts estimate that there are more than 2,000 occupational healthcare locations in the United States, representing a \$30 billion industry. The Company believes that, due to increasing business and regulatory complexity, capital requirements and the development of IDS networks, an increasing number of physicians specializing in occupational health services are seeking to affiliate with large healthcare service organizations.

The dollar amount of workers' compensation claims has increased

significantly in recent years, resulting in escalating employer costs. The increase is attributable to: (i) an increase in work-related injuries and illnesses, (ii) the rise in the cost of healthcare, and (iii) the requirement that employers pay the majority of lost wages, replacement wages, legal and other benefit expenses. In the aggregate, workers' compensation costs amounted to \$63 billion annually in the United States in 1993. Occupational health services is an employers' solution to controlling workers' compensation costs attributable to medical costs and lost time from work.

NovaCare currently manages work injury rehabilitation and prevention programs for employers through on-site programs and outpatient care through the Company's outpatient services. NovaCare performs work-site analysis to assess workplace risk, provide work-site safety programs and help employers comply with work-related state and federal requirements. By acquiring practices in targeted markets, NovaCare plans to expand its linkage with workers needing occupational rehabilitation, enhance the patient volume of outpatient rehabilitation through occupational health referrals, and increase the attractiveness of the Company to potential IDS partners.

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INTEGRATED DELIVERY SYSTEMS

IDS's are a vertical integration of healthcare providers, physicians and payors who mutually benefit by networking to (i) increase patient referral opportunities and access to services, (ii) lower administrative and capital costs, and (iii) control the quality of patient care. Membership in an IDS is generally on the basis of a contractual or shared ownership agreement. Under a contractual agreement, the IDS member is essentially a vendor with an exclusive or non-exclusive short-term commitment to participate in the IDS. Shared ownership arrangements are typically in the form of a joint venture wherein the IDS member enters into a long-term (5 years or more) exclusive commitment and shares in IDS profits and losses. Such an arrangement is essentially a partnership with shared control and specific dissolution terms. NovaCare intends to pursue IDS memberships principally on a shared ownership basis.

NovaCare plans to enter IDS arrangements in targeted geographic markets in which the Company currently has an existing network of outpatient services sites, or through acquisitions or start-ups, and will have a significant enough presence in a targeted market to engage in an IDS affiliation. Targeted markets are selected on the basis of demographics, ability to retain market share, pricing levels, labor costs, synergies with potential partners operationally and culturally, and the ability to affect IDS affiliation due to the provider, physician and payor structure in the market.

In fiscal 1996, the Company entered into its inaugural IDS joint venture in Atlanta with Columbia/HCA, the largest healthcare provider in the United States. NovaCare and Columbia/HCA contributed their outpatient rehabilitation sites to a newly formed company under joint ownership. NovaCare provides management services to the joint venture, which is made up of 18 outpatient sites formerly owned entirely by NovaCare or Columbia/HCA. In addition, the joint venture manages rehabilitation at eight Columbia/HCA hospital-based sites.

LONG-TERM CARE SERVICES

NovaCare's long-term care services portfolio consists of contract therapy, management, consulting and temporary staffing services delivered principally to long-term care providers. For the fiscal years ended June 30, 1996 and 1995, long-term care services represented 63% and 57%, respectively, of the Company's consolidated net revenues.

Contract Therapy Services

NovaCare provides multi-disciplinary rehabilitation therapy services on a contract basis, principally to long-term care facilities. The multi-disciplinary team comprises physical therapists, occupational therapists, and speech-language pathologists working together to improve the ability of patients to perform the activities of daily living. Physical therapy effects improved muscular and neural responses in an effort to improve patients' physical strength and range of motion. Occupational therapy is the evaluation and treatment of physical, cognitive and psychosocial performance deficits in activities of daily living. Speech-language pathology is the diagnosis and treatment of speech, language, voice and swallowing disorders.

NovaCare is the largest contract therapy provider to the long-term care industry with a market share of approximately 11%, as measured by fiscal 1996 net revenues. As of June 30, 1996, NovaCare provided these services in more than 1,800 facilities located in 42 states.

Analysts estimate that the market for therapy services delivered under contract to long-term care facilities is approximately \$4.5 billion. A 1995 management-sponsored survey indicated that 73% of long-term care facility rehabilitation services are performed on a contract basis.

The long-term care industry has typically contracted for therapy services for the following reasons:

Insufficient caseload. The average nursing facility of approximately 100 beds has insufficient and/or fluctuating caseload, which makes it uneconomical to operate its own therapy program with the full-time employment of therapists and the associated costs of administration.

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Supply of therapists. There is an inadequate supply of therapists and the work force is characterized by high turnover. Consistent staffing levels are difficult to maintain, which jeopardizes service levels and quality.

Expertise. Therapy revenues represent a relatively small percentage of a nursing facility's total revenues and operating activities. Reimbursement and regulatory complexities concerning appropriate utilization, documentation, denials management and quality oversight, if inadequately administered, can seriously erode the profitability of therapy programs staffed by and managed by employees of the long-term care facility. As a result, nursing facilities frequently choose to contract for specialized expertise.

In the current unsettled reimbursement environment (See "Reimbursement/Government Relations", discussed later), NovaCare believes that it is well-positioned to compete effectively with other contract therapy companies due to: (i) its highly centralized administrative functions and flexible organization structure which can respond to business growth and industry change, (ii) a nationwide recruiting organization and substantial staffing capabilities, (iii) a multi-disciplinary team approach to therapy that is designed to deliver a high level of quality and efficient care, (iv) sophisticated management information systems to assist clinicians and management in analyzing clinical outcomes, therapy utilization, claim denials, staffing and educational activities, (v) a clinical support network to provide timely expert clinical advice to care providers, (vi) a nationwide sales organization to secure customer contracts in support of business growth and (vii) reimbursement and regulatory expertise to assist nursing facility operators in their dealings with third-party payors, principally Medicare.

The supply of therapists is growing at a rate of less than 5% per year, yet the demand for therapists is growing at 8% to 10% per year. The Bureau of Labor Statistics estimates that the shortage of therapists will continue into the first decade of the next century. The principal limitations on the supply of therapists are the lack of funding to increase the number and size of educational programs and increasingly stringent accreditation requirements.

Despite this imbalance, NovaCare has been successful in hiring a disproportionate number of therapists due in part to its "employer of choice" programs and clinical and systems support networks. The number of full-time-equivalent therapists hired in the Company's contract therapy business during fiscal 1996 was 2,298.

Employer of Choice Programs. NovaCare's employer of choice initiatives comprise defined career ladders for clinicians, clinical training and competitive compensation programs and benefits as well as management and technological support designed to attract and retain therapists. At June 30, 1996, NovaCare employed 34 recruiters, which management believes is the largest clinical recruiting organization in the U.S. Over the past two years, one-fifth of the therapists who joined NovaCare's contract therapy business choose NovaCare as a result of employee referrals.

Clinical Support. A network of local and national clinical experts is available to all clinicians as support resources in all aspects of the clinical practice. Responses to inquiries are generally within 24 hours.

Systems Support. NovaCare's proprietary information system, NovaNet PLUS, reduces therapist record-keeping burdens, streamlines administrative activities and captures information of value to clinicians, management and customers. Integrated outcomes measurement, currently collected outside NovaNet PLUS, will be incorporated into the system in fiscal 1997. Management believes that this innovative system continues to increase NovaCare's attractiveness as an employer of therapists.

Clinical Leadership. NovaCare and Harvard School of Public Health have jointly undertaken a leadership role in devising a standard system for measuring the effectiveness of rehabilitation outcomes for geriatric patients. Once identified, the outcomes measurement system will serve as the standard to determine the treatment and payment for rehabilitation services to the geriatric population. Management believes that NovaCare's leadership in outcomes measurement will enhance the Company's visibility in the clinical community and its attractiveness as an employer.

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Employee turnover in the rehabilitation industry is high relative to other industries because of the supply/demand imbalance. Also affecting turnover is the aggressive recruiting that occurs within the industry, and a highly mobile therapist population. Furthermore, therapist turnover rates in long-term care facilities are traditionally higher than in other therapy settings

During fiscal 1996, and to a lesser extent in fiscal 1995, NovaCare reduced its dependence on large chains of long-term care facilities. The percentage of NovaCare's net revenues attributable to large long-term care chains declined to 23% at June 30, 1996 from 27% in fiscal 1994. Of the remaining contracts with large national chains, those considered by management to represent an in-house transition threat has declined to 9% of NovaCare's net revenues at June 30, 1996. Of the revenue attributable to the transition from outsourcing with NovaCare to providing therapy services in-house, most notably that of Beverly Health and Rehabilitation in fiscal 1996, the majority of this business was replaced with new, mostly regional and independent customers, diversifying the Company's customer base. The change in the Company's customer base necessitated work-site redeployment of therapists. The destabilizing effect on the work environment was the principal reason why therapist turnover was 44% in fiscal 1996 compared with 38% in 1995. Management believes that the employee turnover effects of contract turnover will decrease due to the decreased dependency on the large long-term care chains representing an in-house threat.

Nursing facility operators have from time to time provided therapy services on an in-house basis, with varying degrees of success. A recent multi-year study of the costs of in-house programs compared with the costs of contract therapy indicated higher average therapy costs per patient care hour in long-term care facilities with in-house programs. The study surveyed over 15,000 long-term care facilities and examined several years of Medicare cost reports for long-term care facilities with in-house therapy programs. Nevertheless, a number of national multi-facility long-term care companies have directly hired therapists to staff and manage their therapy program in-house. These in-house decisions appear to be based, at least in part, on a desire to gain greater clinical control over therapy programs, overriding economic concerns. This trend has been exacerbated by the recent consolidation activity in the nursing home industry. Management does not expect the in-house trend to have a significant impact on future results due to the Company's reduced dependency on national multi-facility long-term care companies which represent an in-house threat and the economic opportunity outsourcing provides.

NovaCare contracts predominantly with regional and local long-term care companies and independently-owned nursing facilities for the provision of rehabilitation therapy to their patients. Contracts are generally written for a period of two years and include automatic renewals for one year. Contracts are typically terminable upon 30 to 90 days notice by either party.

NovaCare is compensated for its contract services on a fee-for-service basis, and generally collects payment for services from the long-term care facility, which in turn may receive reimbursement from Medicare, Medicaid, private insurance or the patient. Payments from Medicare and Medicaid are subject to complex regulations. Medicare regulations are subject to anticipated changes that may have a material effect on the long-term care services business. See "Reimbursement/Government Relations," discussed later. NovaCare generally indemnifies its customers against medical denials of reimbursement by third party payors, including Medicare. NovaCare has established internal utilization and documentation standards and systems to minimize denials. During the past three fiscal years, on average, less than 2% of NovaCare's services were ultimately denied payment.

Management and Consulting Services

The Company focuses on the delivery of expert management and specialty consulting services to health care and long-term care institutions. Such services currently include long-term care facility rehabilitation program management and consulting and subacute program development and management.

Rehabilitation Program Management and Consulting. The Company provides

rehabilitation program consulting and management services to long-term care facility operators. Due to regulatory and reimbursement complexities in the long-term care industry, these services assist long-term care providers with utilization, documentation, receivables and denials management, cost reporting and quality oversight. The

Company had arrangements to provide such services to 624 long-term care facilities at June 30, 1996 as compared with 539 at June 30, 1995.

Subacute Program Development and Management. NovaCare manages subacute programs for long-term care facilities on a contract basis. Subacute care is defined as a level of care for patients with medically stable but frequently complex conditions requiring extensive nursing services, rehabilitation services and physician oversight in an inpatient setting. These patients do not require the intensity or scope of services found in an acute care hospital. Subacute care providers bridge the gap between more costly acute care settings and lower cost nursing facilities, which typically lack the intensive integrated services required for these higher acuity patients. At June 30, 1996, NovaCare managed distinct subacute units in 39 long-term care facilities, with 22 additional units in various stages of development or under consideration.

Demand for subacute services is driven by the desire of payors to contain the costs of health care and by Medicare's prospective payment system, which encourages the early discharge of patients from acute care hospitals. Subacute care is a \$4 billion industry, which has not grown at the rate anticipated due to changes in reimbursement for such services.

Temporary Staffing

Given the demand for outsourced temporary staffing in long-term care facilities, especially within large nursing home chains which have taken therapy services in-house, NovaCare entered the temporary staffing business in fiscal 1996. The Company's NovaPro division utilizes NovaCare's existing resources to recruit and train therapists for temporary assignment positions in selected markets. NovaPro is reimbursed and the therapist paid based on hours worked.

PROFESSIONAL EMPLOYER ORGANIZATIONS

The PEO industry has experienced significant growth in recent years. Analysts estimate that gross revenues in the PEO industry will grow at a compound annual rate of approximately 30% for the next five years. The Company believes that the growth in the number of small businesses in the United States, the low market penetration of the PEO industry, and the increasing willingness of businesses to outsource non-core activities and functions has contributed to the growing demand for PEO services.

The PEO industry is highly fragmented. Industry data indicates that there were approximately 1,100 PEO's in operation in 1995. The Company believes that increasing regulatory complexity and the increasing capital requirements associated with developing larger service delivery infrastructures and management information systems should lead to significant consolidation opportunities in the PEO industry.

Demand for Services. The PEO industry evolved in response to the increasing employment and benefit costs and the complexity of the legal and regulatory environment for small and medium-sized employers. According to the U.S. Small Business Administration, there were approximately 5.1 million businesses in the United States with fewer than 500 employees in 1992. Collectively, these businesses employed an estimated 49 million employees, and represented approximately \$1.1 trillion in aggregate annual payroll, implying a potential market size for PEO services of \$1.3 trillion (assuming an average mark-up of approximately 20%).

Cost-effectiveness of Service. The Company believes its services will assist business owners in: (i) managing escalating costs associated with workers' compensation, health insurance coverage, workplace safety programs, and employee-related litigation, (ii) providing employees with competitive health care and related benefits that are more characteristic of large employers, and (iii) reducing the time and effort required by business owners and executives to deal with the complexities of employment management.

COMPETITION

The health care industry in general, and rehabilitation in particular, are highly competitive and subject to continual changes in methods of service delivery and provider selection. Rehabilitation is largely a local market business and competition varies considerably among markets. NovaCare competes in

the geographic markets where it provides long-term care services and where its outpatient services patient care centers are

located. The primary competitive factors in such local markets are: (i) quality of patient care services, (ii) charges for services, (iii) responsiveness to meeting the needs of patients, customer health care facilities, referral sources and payors, and (iv) increasingly, networked integration with other healthcare providers and payors.

Key competitive factors in the long-term care services business include the ability to provide therapy staff to meet the therapy needs at customer facilities and the ability to provide management and clinical support to such staff. NovaCare competes in local markets with other national, regional and local contract therapy providers. NovaCare believes that its ability to recruit therapists, manage geographically dispersed service professionals and provide expert clinical support, allows it to compete successfully with other contract therapy providers in the markets where NovaCare provides services. The demographics of potential customers has and will continue to change as some large long-term care facility chains choose to take their therapy services in-house. This may increase the competition for remaining customers. The Company has diversified its customer base in the long-term care industry to replace business lost because of such in-house programs (See "Contract Therapy Services," previously discussed).

In the outpatient services business, key competitive factors include the ability to develop and maintain relationships with referral sources (physicians, rehabilitation professionals, hospitals and payors) and to provide sufficient geographic coverage to allow the Company, alone or with other providers, to compete successfully for patients from managed care payors, workers' compensation payors and employers in manufacturing and service industries. The Company competes in local markets with other national, regional and local outpatient rehabilitation service providers, as well as hospital-based outpatient clinics and physician-directed therapy practices. Some of these competitors may have greater patient referral, personnel and geographic resources in certain local markets. Competition in the O&P industry is highly fragmented; however, there are several regional providers with multiple facilities in certain local markets. Management believes that the Company competes successfully within its local markets based on a reputation for quality and service, an ability to provide geographic coverage and competitive prices, affiliation with an IDS network, and technologically superior O&P product offerings.

In the occupational health services industry, the market is highly fragmented and competitive. Competitors include independent physicians, hospitals, insurance companies, HMO's, managed care providers and networks of primary care physician specialists. The ability to compete successfully is dependent upon the same key factors critical to success in the outpatient services business.

National and local sponsorship and support of organizations for injured and disabled individuals enhance NovaCare's visibility and competitive position. In addition, NovaCare has developed affiliations with academic institutions and has provided funding for the development of a number of university physical therapy and occupational therapy programs.

REIMBURSEMENT/GOVERNMENT RELATIONS

Reimbursement for medical rehabilitation services is available through Medicare, Medicaid, commercial insurance, managed care programs, workers' compensation and other government programs. Medicare is a federally funded health program which provides health insurance coverage for certain disabled persons and persons age 65 or older. Medicaid is a health insurance program, jointly funded by the federal and state governments, which provides health insurance coverage for certain financially or medically needy persons regardless of age. Medicaid benefits supplement Medicare benefits for financially needy persons age 65 or older. Congress has provided, through the Medicare program, for coverage of contract therapy services, outpatient rehabilitation services and O&P devices and patient care services. Medicare reimbursement rules are different for a number of these services. Moreover, in many states Medicaid reimburses for rehabilitation services for eligible recipients. A substantial portion of NovaCare's business, in effect, is reimbursed by Medicare, and a small portion by Medicaid. As a result, regulations regarding Medicare and Medicaid eligibility, certification and reimbursement are important to NovaCare's activities and changes in these programs or regulations could adversely affect NovaCare's business.

Congress has had under consideration, and is likely to consider again,

slow the annual rate of growth of Medicare and Medicaid expenditures are expected. Such changes may impact reimbursement for rehabilitation.

Contract Therapy Services

Contract therapy services are covered and reimbursed in one of two ways. In most cases, NovaCare bills a facility, which, in turn, invoices a third-party payor, such as Medicare. NovaCare also provides services through its own certified rehabilitation agencies, which directly bills a third-party payor, such as Medicare.

Medicare reimburses the long-term care facility for contract therapy services on a cost basis, and reimbursement levels are determined based on a reasonable-cost standard. Specific guidelines exist for evaluating the reasonable cost of physical therapy and there are general guidelines for evaluating the reasonable cost of occupational therapy and speech-language pathology services. With respect to physical therapy, the specific guideline system is called salary-equivalency. The physical therapy salary-equivalency rates have been adjusted annually based on a 1983 standard but do not adequately reflect salary inflation since 1983. As a result, physical therapy contract services are essentially a break-even business for many contractors, including NovaCare.

The Health Care Financing Administration ("HCFA"), the federal agency responsible for the rules governing Medicare and Medicaid, has indicated it intends to issue specific reimbursement guidelines for occupational therapy and speech-language pathology services and to recalculate and update the existing guidelines for physical therapy services. Proposed rules governing such guidelines are expected for public comment in the last quarter of calendar year 1996. Final rules are expected to be promulgated in the second quarter of calendar year 1997.

Management believes that, when occupational therapy and speech-language pathology services guidelines are established, HCFA will recalculate and update the physical therapy salary-equivalency guidelines in consideration of the substantial increases in salary and services standards since these guidelines were last revised. Because the nature and magnitude of these changes are not certain at this time, there are no assurances with respect to the impact such changes may have on NovaCare. NovaCare is actively involved with industry trade groups working to ensure final rules are based on timely, accurate and relevant data. Management is taking steps which it believes will help to mitigate any adverse economic impact of these changes. There can be no assurance that future (i) legislation, either health care or budgetary, (ii) regulatory changes or (iii) interpretations of regulations, will not have a material adverse effect on the future operations of the Company.

Until such time as salary-equivalency guidelines are formally promulgated, contract occupational therapy and speech-language pathology services are evaluated based upon the reasonableness of costs incurred by the provider under a "prudent buyer" standard. During the past three years, HCFA has issued several directives to its fiscal intermediaries instructing them on how to ensure therapy costs are reasonable. Intermediaries have been instructed to consider relevant facts and circumstances concerning a facility's contracting costs. The attention being given by HCFA to these instructions has increased scrutiny of contracting practices. NovaCare is working with its customers to resolve issues raised by fiscal intermediaries in cost report audits.

Over the past 15 years, numerous proposals for some form of prospective payment system have been suggested for nursing facilities. NovaCare is part of an ongoing industry effort that works closely with federal regulators in assessing alternatives to present reimbursement systems. Legislation has been introduced in Congress to implement a comprehensive prospective payment system for nursing homes including a separate payment for ancillary services, including therapy services. This measure and related ideas may be considered as part of Medicare reforms and/or cost containment legislation. NovaCare is actively involved in the trade groups assisting the Congress in evaluating these payment strategies.

NovaCare also receives reimbursement by Medicare for 5% of its contract therapy services provided through certified rehabilitation agencies. See "Government Regulation," discussed later. NovaCare's certified rehabilitation agencies file annual cost reports under the Medicare program which are used to determine cost settlements for the prior year and interim payment rates for the upcoming year. Funds received under various

state programs and Medicare are subject to audit with respect to proper application of the various payment formulas. These audits can result in retroactive adjustments of payments received from the program by NovaCare. If, as a result of such audits, it is determined that overpayments for services were made to NovaCare, the excess amount must be repaid by NovaCare to the government. If, on the other hand, it is determined that an underpayment was made, the government agency will make an additional payment to NovaCare.

Outpatient and Occupational Health Services

The principal sources of reimbursement for outpatient and occupational health services are managed care plans, commercial and workers' compensation insurance, motor vehicle insurance and individual patients.

Workers' compensation is a statutorily defined employee benefit which varies on a state-by-state basis. Workers' compensation laws generally require employers to pay for employees' costs of medical treatment, lost wages, legal fees and other costs associated with work-related injuries and disabilities and, in certain jurisdictions, mandatory vocational rehabilitation. Companies provide such coverage to their employees through either the purchase of insurance from private insurance companies, participation in state-administered funds or through self-insurance. Workers' compensation represented approximately 27% of fiscal 1996 outpatient and occupational health revenues.

Managed care plans represented approximately 13% of fiscal 1996 outpatient and occupational health revenues. NovaCare receives revenues under managed care plans either on a discounted fee-for-service basis or, in a growing number of cases, on the basis of capitated fees per covered member per month.

NovaCare receives reimbursement by Medicare for outpatient and occupational healthcare services primarily through NovaCare's certified rehabilitation agencies and on a fee schedule basis for O&P services. See "Government Regulation," discussed later. Medicare and other government health insurance programs represent approximately 8% of revenues.

GOVERNMENT REGULATION

The health care industry, including rehabilitation services, is subject to extensive federal, state and local regulation. The various layers of regulation affect NovaCare's business by requiring licensure or certification of its employees and facilities and controlling reimbursements for services provided. Government and other third-party payors' health care policies and programs have been subject to changes in payment and methodologies for a number of years. Efforts to reform the nation's health care system could induce additional changes. See "Reimbursement/Government Relations," previously discussed.

NovaCare operates certified rehabilitation agencies to facilitate billing for outpatient services and a portion of its long-term care services. In order to receive Medicare reimbursement directly, outpatient centers must be certified by Medicare as rehabilitation agencies or comprehensive outpatient rehabilitation facilities. The certification criteria relate to the type of facility and its equipment, record keeping, staffing and service as well as compliance with all state and local laws. In addition, certain states require facilities to obtain state licensure as a health facility as a requirement for reimbursement. As of June 30, 1996, NovaCare operated 20 and 55 certified rehabilitation agencies for contract therapy services and outpatient rehabilitation services, respectively. Management believes its operations are structured to comply with all applicable rules and regulations.

In order to participate in the Medicare program, NovaCare's O&P patient care centers are required to secure and maintain a supplier number. This process requires certain disclosures and procedural requirements, which change periodically. All of NovaCare's O&P patient care centers presently maintain such a supplier number.

In most states, the employment of therapists by business corporations is a permissible practice. However, several states, including states in which NovaCare operates, have enacted legislation or regulations or have interpreted existing licensing laws to restrict business corporations, such as NovaCare, from practicing therapy

through the direct employment of therapists. Management believes its operations

are structured to comply with applicable laws and regulations.

Various state and federal laws and regulations govern the relationships between providers of health care services and physicians, including employment or service contracts and investment relationships. These laws and regulations include the fraud and abuse provisions of the Medicare and Medicaid statutes, which prohibit the payment, receipt or offering of any direct or indirect remuneration for the referral of or to induce a referral of Medicare or Medicaid patients or for the ordering or providing of Medicare or Medicaid covered services, items or equipment and the self-referral provisions of federal and state law which generally prohibit referrals by a physician to persons with whom the physician has certain types of financial relationships. Violations of these provisions may result in civil or criminal penalties for individuals or entities and/or exclusion from participation in the Medicare and Medicaid programs. Management believes it is in compliance with these laws and regulations and has established a broad-based compliance program to ensure conformity to these rules as well as to other laws and regulations.

INSURANCE

The Company maintains professional liability insurance in amounts deemed appropriate by management based upon historical claims and the nature and risks of the business. The Company also maintains property and general liability insurance for the customary risks inherent in the operation of businesses in general. While NovaCare believes its insurance policies to be adequate in amount and coverage for its current operations, there can be no assurance that any future claims will not exceed the limits of those policies or that such insurance will continue to be available.

EMPLOYEES

As of June 30, 1996, NovaCare had approximately 14,500 employees. NovaCare's employees are not represented by any labor union. Management believes that its relationships with its employees are favorable.

EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers of NovaCare who served during the fiscal year are as follows:

<TABLE>

<CAPTION>

NAME	POSITION	AGE
<S>	<C>	<C>
John H. Foster.....	Chairman of the Board, Chief Executive Officer and Director	54
Timothy E. Foster.....	President, Chief Operating Officer and Director	44
C. Arnold Renschler, M.D.	Senior Vice President and Chief Clinical Officer and Director	54
Daryl A. Dixon.....	President and General Manager, Contract Services Division	36
Ronald G. Hiscock.....	President and General Manager, Outpatient Division	45
Peter D. Bewley.....	Senior Vice President, General Counsel and Secretary	50
Robert E. Healy, Jr.	Senior Vice President, Finance and Administration and Chief Financial Officer	43
Laurence F. Lane.....	Senior Vice President, Regulatory Affairs	51
Arthur T. Locilento, Jr. ...	Senior Vice President, Human Resources	53
Susan J. Campbell.....	Vice President, Communications and Investor Relations	45
Barry M. Carlstedt.....	President and General Manager, Hospital Development Group	37
Richard A. McDonald.....	Vice President, Treasurer	49
Barry E. Smith.....	Vice President, Controller, and Chief Accounting Officer	43
James T. Walmsley.....	Vice President, Reimbursement	46
Steven M. Wise.....	Vice President, Information Systems and Chief Information Officer	40

</TABLE>

No family relationships exist among any of the directors or executive officers of NovaCare. Executive officers serve at the discretion of the NovaCare Board of Directors.

JOHN H. FOSTER has been Chairman of the Board and Chief Executive Officer of NovaCare since December 1984. Mr. Foster is also Chairman of the Board and Chief Executive Officer of Apogee, Inc., a national mental health services company; and a director of Corning Incorporated, an international corporation with business interests in specialty materials, communications, laboratory services and consumer products. Mr. Foster is founder and Chairman of the Board of Foster Management Company, an investment advisor, and general partner of various venture capital investment funds.

TIMOTHY E. FOSTER has been President and Chief Operating Officer since October 1994. He served as Senior Vice President, Finance and Administration and Chief Financial and Accounting Officer of NovaCare from November 1988 to October 1994, Treasurer of NovaCare from March 1992 to October 1994, and has been a director of NovaCare since December 1984. Mr. Foster currently serves as a Director of Apogee, Inc., a national mental health services company, a position he has had since February 1995.

C. ARNOLD RENSCHLER, M.D. was Senior Vice President and Chief Clinical Officer of NovaCare since May 1994 and was a director of NovaCare from 1990 until his resignation effective July 19, 1996. He was President and General Manager of Polaris. Dr. Renschler served as President and General Manager, Medical Rehabilitation Hospital Division of NovaCare from January 1994 to May 1995. Between July 1992 and January 1994, he was President and General Manager of NovaCare's Contract Services Division. Dr. Renschler was President and Chief Operating Officer of NovaCare from January 1990 until September 1992.

DARYL A. DIXON has been President and General Manager of NovaCare's Contract Services Division since January 1994. He joined NovaCare in February 1992 as Regional Vice President in the Contract Services Division and was Vice President, Operations of the Contract Services Division from November 1992 until January 1994. From 1982 to 1992, he held various positions at Manor HealthCare, Inc., a nursing home management company.

RONALD G. HISCOCK has been President and General Manager of NovaCare's Outpatient Rehabilitation Division since February 1996 and has been President and General Manager of NovaCare's Orthotics and Prosthetics Division since April 1995. He joined NovaCare in June 1992 as the East Region President for the Orthotics and Prosthetics Division and was the Division's Vice President of Operations from July 1994

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through March 1995. Prior to joining NovaCare, he spent 23 years in senior management positions with Sears Roebuck and Company and Montgomery Ward.

PETER D. BEWLEY has been Senior Vice President, General Counsel and Secretary of NovaCare since May 1994. Most recently, Mr. Bewley was at Johnson & Johnson, where he was Associate General Counsel, since 1977.

ROBERT E. HEALY, JR. has been Senior Vice President, Finance and Administration and Chief Financial Officer since December 1995. From January 1994 to December 1995 he was Vice President Chief Financial Officer of NovaCare's Contract Services Division. He served as Vice President Finance and Chief Accounting Officer of the Company from March 1992 to January 1994, and Vice President and Controller of the Company from February 1988 to March 1992.

LAURENCE F. LANE has been Senior Vice President, Regulatory Affairs of NovaCare since October 1994. From November 1986 to October 1994 he was Vice President Regulatory Affairs.

ARTHUR T. LOCILENTO, JR. has been Senior Vice President, Human Resources of NovaCare since October 1994. From March 1988 to October 1994, he was Vice President Human Resources.

SUSAN J. CAMPBELL has been Vice President, Communications and Investor Relations of NovaCare since April 1995. She joined NovaCare in March 1992 as Director of Investor Relations and was Vice President, Investor Relations from April 1994 to April 1995. Ms. Campbell was Vice President, Investor Relations, First Fidelity Bancorporation from 1982 to 1992.

BARRY M. CARLSTEDT has been President and General Manager, Hospital Development Group since March 1996. From June 1995 to March 1996, he was Region President of outpatient rehabilitation services. Prior to joining NovaCare in June 1995, he was President and Chief Executive Officer of Associated Rehabilitation Services, Inc.

RICHARD A. MCDONALD has been Vice President, Treasurer since August 1996 and was Director, Treasury Services from May 1995 until August 1996. Prior to joining the Company, he was a financial consultant to Continental Medical Systems, Inc. He served as an assistant treasurer with American Healthcare Management from 1990 until 1994.

BARRY E. SMITH has been Controller and Chief Accounting Officer of the Company since December 1995 and has been Vice President of Finance of the Contract Services Division since March 1995. He was Vice President of Finance of the Medical Rehabilitation Hospital Division from February 1994 through the sale date of the division, April 1995. From May 1992 through February 1994 he served

in various positions in NovaCare's Corporate Finance Department. Prior to joining NovaCare, Mr. Smith was Manager of Internal Audit for SPS Technologies, Inc., since September 1990.

JAMES T. WALMSLEY has been Vice President, Reimbursement of NovaCare since January 1994 and Director of Reimbursement since April 1992. Prior to joining NovaCare, he was Vice President, Reimbursement and Regulatory Affairs for National Medical Enterprise's Specialty Hospital Division. From 1982 to 1990, he worked in the Management Consulting Services Group of Price Waterhouse.

STEVEN M. WISE has been Vice President Information Systems and Chief Information Officer since December 1995. He joined NovaCare in 1993 as Director, Systems and Programming, for the contract therapy services business. Prior to joining NovaCare, he was employed at Ortho-McNeil Pharmaceutical Company where he held various management positions in business systems development.

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ITEM 2. PROPERTIES

NovaCare's principal executive offices are located at 1016 West Ninth Avenue, King of Prussia, Pennsylvania, where NovaCare leases approximately 93,246 square feet of office space. The lease for this office space expires in June 2005. NovaCare leases other office and center space at approximately 550 locations in various cities within the United States. Such space aggregates approximately 1,200,000 square feet under lease arrangements which typically are three years or less in duration.

NovaCare leases expire at various times through 2020. NovaCare anticipates that it will be able to renew its leases upon their expiration or lease other facilities on comparable terms if leases are not renewed. NovaCare believes that it has adequate capacity for its present needs and planned expansion in the near future.

NovaCare also has sublease agreements for approximately 24,748 square feet of office space, expiring February 2003 with companies in which NovaCare's Chairman of the Board and Chief Executive Officer is a Director and/or an Executive Officer.

ITEM 3. LEGAL PROCEEDINGS

NovaCare is a party to various claims, legal actions and complaints arising in the ordinary course of business. In the opinion of management and legal counsel, all such matters are adequately covered by insurance, or, if not covered, are without merit or are of such kind, or involve such amounts, that unfavorable disposition would not have a material adverse effect on the financial position or results of operations of NovaCare.

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

None.

PART II

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

NovaCare's common stock is traded on the New York Stock Exchange (NYSE) under the symbol NOV. On September 6, 1996, there were 2,261 holders of record of common stock.

The following table sets forth the high and low sales prices per share of common stock as reported on the NYSE Composite Tape for the relevant periods.

<TABLE>
<CAPTION>

	COMMON STOCK PRICES	
	HIGH	LOW
<S>	<C>	<C>
YEAR ENDED JUNE 30, 1996		
First Quarter.....	\$ 9.50	\$ 6.25
Second Quarter.....	8.50	5.13
Third Quarter.....	8.25	5.25
Fourth Quarter.....	7.63	6.25
YEAR ENDED JUNE 30, 1995		
First Quarter.....	\$16.88	\$10.63
Second Quarter.....	11.25	7.13

Third Quarter.....	9.88	7.38
Fourth Quarter.....	9.50	7.38

</TABLE>

With the exception of 2-for-1 stock splits of common stock effected in the form of stock dividends in June 1987 and July 1991, no other dividends have been paid or declared on common stock since NovaCare's initial

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public offering on November 5, 1986. NovaCare does not expect to declare any cash dividends on common stock in the foreseeable future.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data should be read in conjunction with NovaCare's consolidated financial statements and the accompanying notes presented elsewhere herein.

NOVACARE, INC. AND SUBSIDIARIES

FIVE YEAR FINANCIAL SUMMARY
(IN THOUSANDS, EXCEPT PER SHARE DATA)

<TABLE>
<CAPTION>

	YEARS ENDED JUNE 30,				
	1996	1995	1994	1993	1992
	<C>	<C>	<C>	<C>	<C>
STATEMENT OF OPERATIONS DATA:					
Net revenues.....	\$793,038	\$905,359	\$789,745	\$582,342	\$392,278
Gross profit.....	217,558	265,127	260,738	187,831	125,089
Income from operations.....	37,499	143,881	108,208	78,819	54,527
Net interest (expense) income.....	(7,537)	(17,893)	(11,773)	(2,841)	1,355
Income before income taxes.....	29,866	125,584	95,892	75,542	55,461
Income taxes.....	14,585	63,660	37,678	27,906	18,868
Net income.....	15,281	61,924	58,214	47,636	36,593
Net income applicable to common stock(1).....	15,281	61,924	58,214	47,585	36,483
Net income per common share.....	.24	.95	.90	.79	.64

</TABLE>

<TABLE>
<CAPTION>

	AS OF JUNE 30,				
	1996	1995	1994	1993	1992
	<C>	<C>	<C>	<C>	<C>
BALANCE SHEET DATA:					
Working capital.....	\$223,712	\$255,126	\$194,324	\$265,908	\$ 97,608
Total assets.....	789,731	852,557	850,541	611,567	312,566
Total indebtedness.....	192,215	225,015	344,602	206,415	37,528
Total liabilities.....	305,337	364,922	434,837	282,587	88,587
Shareholders' equity.....	484,394	487,635	415,704	328,980	223,979

</TABLE>

(1) Gives effect to dividends, whether or not declared, on 10% mandatorily redeemable preferred stock issued by a consolidated subsidiary in fiscal 1991 which was redeemed in fiscal 1993.

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

NOVACARE, INC. AND SUBSIDIARIES

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

OVERVIEW

During fiscal 1996, the Company's net income declined to \$15.3 million

compared to \$61.9 million in fiscal 1995. Excluding nonrecurring items, the Company's net income declined to \$30.9 million from \$40.1 million in fiscal 1995. Nonrecurring items in fiscal 1996 included the after-tax impact of a \$13.4 pretax restructuring charge and a \$10.5 million pretax charge for a change in estimate. Nonrecurring items in fiscal 1995 consisted of an \$88.2 million pretax gain on the sale of the medical rehabilitation hospitals, a \$29.9 million pretax restructuring charge and a \$1.0 million pretax charge relating to the settlement of certain shareholder litigation.

Change in Estimate

In the third quarter of fiscal 1996, the Company recorded a \$10.5 million charge to revenues to fully reflect payor allowances that had not been sufficiently recognized by certain billing systems during the first three quarters of fiscal 1996 and prior years. The Company has implemented a new methodology for estimating allowances pending implementation of a fully integrated billing and allowance system in the upcoming fiscal year.

Restructuring Charge

As discussed in Note 2 to the accompanying Consolidated Financial Statements, in fiscal 1996 the Company recorded a \$13.4 million provision for restructure pertaining to the consolidation and reorganization of outpatient and orthotic and prosthetic ("O&P") services and certain administrative functions. During fiscal 1996, the Company continued to implement the productivity and cost reduction program initiated in fiscal 1995, the provision for which amounted to \$29.9 million. The 1995 program, consisting of closing certain contract services offices, O&P branches and outpatient centers in selected markets, and the consolidation of certain finance and other administrative functions, is substantially complete. The plan initiated in fiscal 1996 will be substantially complete by the third quarter of fiscal 1997. The Company estimates that these plans, when fully implemented, will reduce or eliminate in the aggregate approximately \$30 million to \$35 million of annual expenses.

Of the total restructuring charges, \$19.6 million relates to amounts to be paid in cash. The noncash portion of the charge relates to the write-off of certain assets, principally goodwill, related to facilities closed or to be closed.

Sale of Medical Rehabilitation Hospitals

Effective April 1, 1995, the Company sold its medical rehabilitation hospitals in a transaction valued at \$242.9 million. The transaction resulted in a pretax gain on the sale of \$88.2 million. The medical rehabilitation hospitals contributed \$110.6 million and \$137.1 million in net revenues, \$31.3 million and \$39.8 million in gross profit and \$15.1 million and \$18.7 million in income from operations in fiscal 1995 and 1994, respectively.

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NOVACARE, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS -- (CONTINUED)

Proforma Results of Operations

The following table displays the proforma results of operations had the sale of the medical rehabilitation hospitals occurred July 1, 1993 and excluding restructuring charges:

<TABLE>
<CAPTION>

	1996(1)	1995	1994
	-----	-----	-----
<S>	<C>	<C>	<C>
Net revenues.....	\$793,039	\$794,716	\$652,656
Gross profit.....	\$217,558	\$233,844	\$220,924
Income from operations.....	\$ 50,869	\$ 71,379	\$ 95,278

</TABLE>

(1) Includes the \$10.5 million charge for a change in estimate

RESULTS OF OPERATIONS

General Trends

During the periods discussed below, the Company's results of operations

have been affected by certain industry trends, nonrecurring items as discussed earlier under "Overview" and changes in the Company's capital structure discussed later under "Liquidity and Capital Resources".

Industry Trends

During the past year, the Company and other rehabilitation providers faced, and will continue to face, a number of uncertainties. These uncertainties include: (i) the potential impact of any Congressional proposals addressing health care reform and a "balanced budget," (ii) pending regulatory pressure to revise certain reimbursement rates, discussed later, (iii) increasing competition among providers of rehabilitation services for existing business, and (iv) increased penetration in the outpatient setting by managed care payors, with lower rates of reimbursement.

In light of these uncertainties, management curtailed its acquisition activities in fiscal 1996 in order to restructure the organization. The new organization is substantially complete, resulting in significantly reduced overhead costs, highly centralized administrative support services to all the Company's businesses, and the flexibility to respond to business growth and industry change.

During fiscal 1996, and to a lesser extent in fiscal 1995, large nursing home chains transitioned from outsourcing rehabilitation therapy services to providing such services in-house. Although a recent study indicated higher average therapy costs per patient care hour in long-term care facilities with in-house programs compared with facilities with contract therapy services, the in-house trend appears to be based, at least in part, on a desire to gain greater clinical control over therapy programs.

Responding to this trend, the Company reduced its dependence on large chains of long-term care facilities. The percentage of NovaCare's net revenues attributable to large long-term care chains declined to 23% at June 30, 1996 from 27% in fiscal 1994. Of the remaining contracts with large national chains, those considered by management to represent an in-house transition threat has declined to 9% of NovaCare's net revenues at June 30, 1996. Of the revenue attributable to the transition from outsourcing with NovaCare to providing therapy services in-house, most notably that of Beverly Health and Rehabilitation in fiscal 1996, the majority of this business was replaced with new, mostly regional and independent customers, diversifying the Company's customer base.

Year Ended June 30, 1996 Compared with the Year Ended June 30, 1995.

Net revenues for the year ended June 30, 1996 decreased from the prior year by \$112.3 million or 12% to \$793.0 million and income from operations decreased by \$106.4 million or 74% to \$37.5 million. As previously

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NOVACARE, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS -- (CONTINUED)

described, the results of operations were effected by a change in estimate, restructuring charges and the sale of the medical rehabilitation hospitals. Excluding all of these items, net revenues increased \$8.8 million or 1%, gross profit decreased \$5.8 million or 3% and income from operations decreased \$10.0 million or 14% in fiscal 1996 compared with fiscal 1995, respectively.

The \$8.8 million increase in net revenues in fiscal 1996 resulted from: (i) an increase in contract therapy services revenues resulting principally from a 1.3% increase in net revenue per billable hour combined with a 0.3% increase in contract therapy services billable hours, (ii) a 6.0% increase in O&P net revenue per patient combined with a 2.6% increase in O&P patients billed, (iii) an increase in long-term care management and consulting services, and (iv) a 3.0% increase in outpatient rehabilitation visits due primarily to the acquisition of 25 businesses in fiscal 1995, offset by a \$4.1% decrease in outpatient rehabilitation net revenue per visit.

The \$5.8 million decrease in gross profit in fiscal 1996 resulted principally from increased costs of competitive compensation and benefits, and decreased productivity and pricing pressure in outpatient rehabilitation services. Further, income from operations decreased an additional \$4.2 million resulting principally from an increase in depreciation offset somewhat by cost reduction programs undertaken during the year. The increase in depreciation was due to the full year effect of assets acquired in fiscal 1995 and placing in service certain internally developed software during fiscal 1996.

Interest expense, net of interest income, decreased \$10.4 million compared with the prior period principally due to full payments of amounts borrowed under the Company's credit facility and increased cash invested as a result of the sale of the medical rehabilitation hospitals.

Income tax expense as a percentage of pretax income decreased to 48.8% for the year ended June 30, 1996 from 50.7% for the previous year. The principal reasons for the effective rate being higher than the statutory federal rate were state income taxes, non-deductible nonrecurring items and nondeductible amortization of excess cost of net assets acquired ("amortization"). See Note 9 to the Consolidated Financial Statements for the reconciliation of expected tax expense to actual tax expense.

Year Ended June 30, 1995 Compared with the Year Ended June 30, 1994.

Net revenues for the year ended June 30, 1995 increased \$115.6 million or 15%, gross profit increased \$4.4 million or 2% and income from operations increased \$35.7 million or 33% from fiscal 1994. Excluding the medical rehabilitation hospital's operations and nonrecurring items, net revenues increased \$142.1 million or 22%, gross profit increased \$12.9 million or 6% and income from operations decreased \$23.9 million or 25% in fiscal 1995 compared with 1994, respectively.

The principal reasons for the net revenues increase during this period were: (i) an increase in contract therapy services billable hours of or 8.4%, combined with an aggregate increase in net revenue per billable hour of approximately 3.0%, (ii) an increase in outpatient rehabilitation visits of 63.0% resulting primarily from 25 acquisitions in fiscal 1995 and the full effect of 42 acquisitions during fiscal 1994 and (iii) an increase in O&P patients billed of 10.6% combined with an aggregate increase in net revenue per patient billable hour of 12.4%.

The decrease in gross profit for the year ended June 30, 1995, as contrasted with the increase in net revenues, resulted principally from an increase in the costs of contract therapy services as a percentage of net revenues. The increase resulted primarily from: (i) salary rate increases for therapists well in excess of aggregate net revenues per billable hour rate increases, (ii) an overall decrease in therapist productivity primarily due to increased employee turnover and contract turnover and (iii) a decrease in the percentage of billable hours in the higher-margin occupational therapy and speech-language pathology services. Further, operating income decreased \$23.9 million resulting principally from (i) administrative expenses and amortization of businesses acquired in fiscal 1995 and the full year effect of businesses acquired in fiscal 1994,

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NOVACARE, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS -- (CONTINUED)

(ii) increased administrative expenses in support of acquisitions, and (iii) increased depreciation primarily due to the placing in service of certain internally-developed software during the year.

Interest expense, net of interest income, increased \$6.1 million compared with the year-earlier period principally as a result of increased borrowings under the Company's credit facility to fund acquisitions partially offset by an increase in short-term investments in the fourth quarter of fiscal 1995 in connection with the sale of the Company's medical rehabilitation hospitals, previously discussed.

Income tax expense as a percentage of pretax income increased to 50.7% for the year ended June 30, 1995 from 39.3% for the previous year. The principal reasons for the effective rate being higher than the statutory federal rate were state income taxes, non-deductible nonrecurring items and nondeductible amortization of excess cost of net assets acquired ("amortization"). See Note 9 to the Consolidated Financial Statements for the reconciliation of expected tax expense to actual tax expense.

LIQUIDITY AND CAPITAL RESOURCES

As of June 30, 1996, cash and cash equivalents totaled \$95.7 million, a decrease of \$62.9 million from \$158.6 million at June 30, 1995. Cash generated from operating activities rose to \$57.7 million in 1996 from \$43.6 million and \$33.7 million in fiscal 1995 and 1994, respectively. This \$14.1 million increase in cash flows from operating activities from fiscal 1995 to 1996 resulted

principally from the \$9.0 million use of cash in fiscal 1995 by the medical rehabilitation hospitals prior to their sale and the following items (each before the effect on cash flows of the sale of the medical rehabilitation hospitals and nonrecurring items): (i) an \$11.6 million increase in depreciation and amortization, non-cash charges, discussed previously, (ii) a \$16.1 million increase in income taxes due to the timing of payments for income taxes in fiscal 1996 compared with fiscal 1995, (iii) an \$11.4 million decrease in accounts payable and accrued expenses due primarily to the timing of compensation related expenses, and (iv) a \$6.3 million decrease in net income.

The \$9.9 million increase in cash flows from operating activities from fiscal 1994 to 1995 resulted principally from a \$20.8 million decrease in cash flows from the medical rehabilitation hospitals from fiscal 1994 to 1995 prior to their sale and the following items (each net of the effects of cash flows from the medical rehabilitation hospitals prior to their sale and nonrecurring items): (i) an \$8.8 million increase in depreciation and amortization, described previously, (ii) a \$22.9 million decrease in accounts receivable due primarily to improved collection experience in fiscal 1995, (iii) a \$9.3 million increase in accounts payable and accrued expenses due primarily to the timing of compensated related expenses and (iv) an \$18.1 million decrease in net income.

Investing activities, net of the effects of the sale of the medical rehabilitation hospital operations and the proceeds from the sale of marketable securities of \$88.2 million and \$25.4 million in fiscal 1995 and 1994, respectively, consumed \$51.7 million in cash during fiscal 1996 compared to \$106.9 million and \$184.5 million in fiscal 1995 and 1994, respectively. Cash paid for acquisitions decreased significantly to \$20.8 million in fiscal 1996 from \$71.7 and \$149.8 million in fiscal 1995 and 1994, respectively, as the Company curtailed its acquisition activity in fiscal 1996 to focus on its organization restructure. Capital expenditures remained relatively constant during the three year period ended June 30, 1996 at \$26.6 million, \$29.5 million and \$28.0 million as the Company continued to invest in internally and externally developed software and equipment needed for technological efficiency in clinical and administrative activities in support of clinical programs and outcomes, cost reduction initiatives and future growth plans.

The Company used \$55.7 million and \$111.2 million for financing activities in 1996 and 1995 respectively, while \$65.3 million was provided in fiscal 1994. Major financing activities in fiscal 1996 included stock repurchases of approximately 3.4 million shares for \$24.9 million and the repayment of approximately \$33.4 million of debt. In 1995, the Company borrowed \$74.1 million principally to fund acquisition activity.

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NOVACARE, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS -- (CONTINUED)

Upon receipt of the proceeds from the sale of the medical rehabilitation hospitals, the Company repaid the entire amount then outstanding under the Company's line of credit. In fiscal 1994, the Company's \$61.8 million net borrowings were used principally to fund acquisitions and capital expenditures.

In fiscal 1996, the Company's Board of Directors approved a three-year growth strategy for the Company. The strategy contemplates expansion of existing outpatient rehabilitation and O&P operations as well as the development of occupational health operations and a professional employer organization ("PEO") and affiliation with integrated delivery systems in targeted markets through acquisition start-ups, and joint ventures. Given the Company's cash position of \$95.7 million at June 30, 1996 and debt capacity as suggested by its favorable debt to total capital ratio of 28.4%, it is anticipated that the Company will take advantage of its underleveraged position and ability to borrow under its existing line of credit. Cash payments for acquired businesses under this strategy are expected to be approximately \$100 million in fiscal 1997. Capital expenditures are expected to be approximately \$23 million in fiscal 1997 as the Company acquires property and equipment for the establishment of start-up outpatient and orthotic and prosthetic facilities in selected markets and continues to invest in systems to enhance clinical productivity, outcomes measurement and administrative efficiencies.

The Company believes that the cash flows generated by the Company's operations together with its existing cash and availability of credit will be sufficient to meet the Company's short and long-term cash needs.

Inflation

A significant portion of the Company's operating expenses are subject to

inflationary increases, particularly therapist salary increases, which historically have exceeded other medical industry salary rate increases due to the existing supply shortage of therapists. The Company has historically been unable to substantially offset inflationary increases through charge increases, but has somewhat mitigated the effect by expanding services and increasing operating efficiencies. In the existing regulatory environment and to the extent that inflation occurs in the future, it is unlikely that the Company will be able to pass on the increased costs associated with providing health care services to customers insured by government or managed care payors. However, management believes that the Company will be able to somewhat offset this impact through business expansion, increasing operating efficiencies and affiliation with integrated delivery systems (see "Forward Outlook").

RECENTLY ISSUED ACCOUNTING STANDARDS

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ("SFAS 123"). SFAS 123 defines a fair value based method of accounting for employee stock options and similar instruments and must be either adopted or the proforma income statement effects must be disclosed in notes to the financial statements no later than the first quarter fiscal 1997. The Company intends to elect disclosure of the proforma income statement effects of SFAS 123, therefore the new Statement will not affect the Company's financial position or results of operations.

In March 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 121, Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed of ("SFAS 121") which the Company is required to adopt no later than the first quarter of fiscal year 1997. SFAS 121 established accounting standards for the impairment of long-lived assets, certain identifiable intangibles, and goodwill related to those assets to be held and used and for long-lived assets and certain intangible assets to be disposed of. Management does not believe the adoption of SFAS 121 will have a material effect on the Company's financial position or results of operations.

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NOVACARE, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS -- (CONTINUED)

FORWARD OUTLOOK

The medical rehabilitation industry is projected to grow at a rate of 10-12% per year through the end of the decade based on recent industry analysis. The industry's growth is fueled by the: (i) demand for services due to technological advances and the aging population, (ii) cost effectiveness of rehabilitation services, and (iii) an acute care hospital reimbursement system which encourages rapid discharge while the patient remains in need of rehabilitation services. Concurrent with rehabilitation industry growth, managed care is expected to grow 15% per year over the next decade, demanding high quality health care services at a reasonable cost. In geographic markets, large hospital-based integrated delivery systems comprising healthcare providers and payors will be networked as referral sources to facilitate integrated patient care and ease of administration for payors and providers. Medical rehabilitation services companies, such as NovaCare, with networks of rehabilitation services centers, are in the best position to meet the needs of integrated delivery systems.

The PEO industry provides small- and medium-sized businesses with an outsourcing solution to the complexities and costs related to employment management. The Company believes that: (i) the growth in the number of small businesses in the United States, the low market penetration of the PEO industry, and the willingness of business to outsource non-core activities and functions has contributed to the growing demand for PEO services, and (ii) increasing regulatory complexity and capital requirements associated with developing larger service delivery infrastructures and management information systems should lead to significant consolidation opportunities in the PEO industry.

As a large employer managing geographically dispersed employees in approximately 2,300 work-sites in 43 states, NovaCare already provides a comprehensive range of employment-related services. NovaCare plans to acquire PEO's in the same targeted markets in which the Company intends to be affiliated with integrated delivery systems. The Company believes that its ability to manage a meaningful portion of both the healthcare services and employer workforce in a local market, afford the following benefits: (i) reduced workers' compensation costs, (ii) increased access to patient flow for NovaCare's medical rehabilitation centers and integrated delivery system partners, and (iii)

increased economies of scale in negotiating the purchase of healthcare insurance and other benefits and leveraging the administrative costs associated with employment management.

The Health Care Financing Administration, the federal agency responsible for the rules governing Medicare and Medicaid, has indicated it intends to issue specific reimbursement guidelines for occupational therapy and speech-language pathology services and to recalculate and update the existing guidelines for physical therapy services. Proposed rules governing such guidelines are expected for public comment in the last quarter of calendar year 1996. Final rules are expected to be promulgated in the second quarter of calendar year 1997. NovaCare is actively involved with industry trade groups working to ensure that such final rules are based on timely, accurate and relevant data.

In the current unsettled reimbursement environment, NovaCare believes that it is well-positioned to compete effectively with other contract therapy companies due to: (i) its highly centralized administrative functions and flexible organization structure which can respond to business growth and industry change (ii) a nationwide recruiting organization and substantial staffing capabilities, (iii) a multi-disciplinary team approach to therapy that is designed to deliver a high level of quality and efficient care, (iv) sophisticated management information systems to assist clinicians and management in analyzing clinical outcomes, therapy utilization, claim denials, staffing and educational activities, (v) a clinical support network to provide timely expert clinical advice to care providers, (vi) a nationwide sales organization to secure customer contracts in support of business growth, and (vii) reimbursement and regulatory expertise to assist nursing facility operators in their dealings with third-party payors, principally Medicare.

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NOVACARE, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS -- (CONTINUED)

Although the in-house transition of large long-term care chains to in-house programs will likely continue in the near-term, the impact on the Company is not expected to be significant due to the Company's reduced dependency on national multi-facility long-term care companies which represent an in-house threat and the economic opportunity outsourcing provides.

Over the past year, NovaCare's stock price has been subject to significant volatility. If net revenues or earnings fail to meet expectations of the investment community, there could be an immediate and significant adverse impact on the trading price for the Company's stock. Because of stock market forces beyond NovaCare's control and the nature of NovaCare's business, such changes can be sudden.

CAUTIONARY STATEMENT

Except for historical information, matters discussed in this Form 10-K are forward-looking statements that are based on management's estimates, assumptions and projections. Important factors that could cause results to differ materially from those expected by management include the timing and nature of reimbursement changes (including imposition of and changes in salary equivalency rates for Medicare, changes in workers' compensation and other governmental rate and reimbursement systems changes), the number and productivity of clinicians, decisions by chain customers as to whether to take therapy and other services in-house, pricing of managed care and other third party contracts, the direction and success of competitors, management retention and development, management's success in developing and introducing new products and lines of business and unanticipated market changes.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

NOVACARE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)

<TABLE>
<CAPTION>

AS OF JUNE 30,

	1996	1995
	-----	-----
<S>	<C>	<C>
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 95,724	\$158,636
Accounts receivable, net of allowance in 1996 and 1995 of \$18,995 and \$19,718, respectively.....	192,636	192,652
Inventories.....	13,948	11,213
Deferred income taxes.....	14,875	16,748
Other current assets.....	14,976	34,571
	-----	-----
Total current assets.....	332,159	413,820
Property and equipment, net.....	63,319	63,659
Excess cost of net assets acquired, net.....	354,117	352,115
Investment in joint ventures.....	11,984	--
Deferred income taxes.....	2,332	1,470
Other assets, net.....	25,820	21,493
	-----	-----
	\$789,731	\$852,557
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of financing arrangements.....	\$ 8,173	\$ 32,684
Accounts payable and accrued expenses.....	93,854	93,088
Income taxes payable.....	6,420	32,922
	-----	-----
Total current liabilities.....	108,447	158,694
Financing arrangements, net of current portion.....	184,042	192,331
Deferred income taxes.....	9,625	8,147
Other.....	3,223	5,750
	-----	-----
Total liabilities.....	305,337	364,922
	-----	-----
Commitments and contingencies.....	--	--
Shareholders' equity:		
Common stock, \$.01 par value; authorized 200,000 shares, issued 66,091 shares in 1996 and issued 65,476 shares in 1995.....	661	656
Additional paid-in capital.....	253,918	250,857
Retained earnings.....	253,430	238,149
	-----	-----
	508,009	489,662
Less: Common stock in treasury (at cost), 3,190 shares in 1996 and 187 shares in 1995.....	(23,465)	(1,614)
Deferred compensation.....	(150)	(413)
	-----	-----
Total shareholders' equity.....	484,394	487,635
	-----	-----
	\$789,731	\$852,557
	=====	=====

</TABLE>

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

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NOVACARE, INC. AND SUBSIDIARIES

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

<TABLE>
<CAPTION>

	FOR THE YEARS ENDED JUNE 30,		
	-----	-----	-----
	1996	1995	1994
<S>	<C>	<C>	<C>
Net revenues.....	\$793,038	\$905,359	\$789,745
Cost of services.....	575,480	640,232	529,007
	-----	-----	-----
Gross profit.....	217,558	265,127	260,738
Selling, general and administrative expenses.....	140,456	151,759	125,098
Provision for uncollectible accounts.....	16,359	15,918	14,453
Amortization of excess cost of net assets acquired.....	9,874	10,937	7,225
Provision for restructure and other nonrecurring items.....	13,370	(57,368)	5,754
	-----	-----	-----
Income from operations.....	37,499	143,881	108,208

Investment income.....	4,999	5,405	5,304
Interest expense.....	(12,536)	(23,298)	(17,077)
Minority interest.....	(96)	(404)	(543)
	-----	-----	-----
Income before income taxes.....	29,866	125,584	95,892
Income taxes.....	14,585	63,660	37,678
	-----	-----	-----
Net income.....	\$ 15,281	\$ 61,924	\$ 58,214
	=====	=====	=====
Net income per common share.....	\$.24	\$.95	\$.90
	=====	=====	=====
Weighted average number of common shares outstanding.....	64,325	65,163	64,663
	=====	=====	=====

</TABLE>

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

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NOVACARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(IN THOUSANDS)

<TABLE>
<CAPTION>

	SHARES ISSUED		COMMON STOCK (\$.01 PAR VALUE)	TREASURY STOCK	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	DEFERRED COMPEN- SATION	VALUATION ALLOWANCE
	COMMON	TREASURY						
	-----	-----	-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Balance at June 30, 1993.....	62,156	(60)	\$621	\$ (71)	\$213,310	\$116,273	\$ (1,153)	\$ --
Adjustment for pooling of interests...	554	--	6	(1)	7,247	1,738	155	--
Issued in connection with employee benefit plans.....	367	60	4	72	4,552	--	--	--
Issued in connection with acquisitions.....	1,151	--	12	--	15,510	--	--	--
Valuation allowance resulting from the application of SFAS No. 115.....	--	--	--	--	--	--	--	(816)
Repurchase of common stock.....	--	(17)	--	(305)	--	--	--	--
Amortization of deferred compensation.....	--	--	--	--	--	--	336	--
Net income.....	--	--	--	--	--	58,214	--	--
	-----	-----	-----	-----	-----	-----	-----	-----
Balance at June 30, 1994.....	64,228	(17)	643	(305)	240,619	176,225	(662)	(816)
Issued in connection with employee benefit plans.....	302	52	4	453	3,497	--	--	--
Issued in connection with acquisitions.....	946	29	9	250	6,741	--	--	--
Valuation allowance resulting from the application of SFAS No. 115.....	--	--	--	--	--	--	--	816
Repurchase of common stock.....	--	(251)	--	(2,012)	--	--	--	--
Amortization of deferred compensation.....	--	--	--	--	--	--	249	--
Net income.....	--	--	--	--	--	61,924	--	--
	-----	-----	-----	-----	-----	-----	-----	-----
Balance at June 30, 1995.....	65,476	(187)	656	(1,614)	250,857	238,149	(413)	--
Issued in connection with employee benefit plans.....	199	198	1	1,624	1,336	--	--	--
Issued in connection with acquisitions.....	416	203	4	1,478	1,725	--	--	--
Repurchase of common stock.....	--	(3,404)	--	(24,953)	--	--	--	--
Amortization of deferred compensation.....	--	--	--	--	--	--	263	--
Net income.....	--	--	--	--	--	15,281	--	--
	-----	-----	-----	-----	-----	-----	-----	-----
Balance at June 30, 1996.....	66,091	(3,190)	\$661	\$ (23,465)	\$253,918	\$253,430	\$ (150)	\$ --
	=====	=====	=====	=====	=====	=====	=====	=====

</TABLE>

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

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NOVACARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)<TABLE>
<CAPTION>

	FOR THE YEARS ENDED JUNE 30,		
	1996	1995	1994
<S>	<C>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income.....	\$ 15,281	\$ 61,924	\$ 58,214
Adjustments to reconcile net income to net cash flows from operating activities:			
Gain on sale of medical rehabilitation hospitals.....	--	(88,243)	--
Depreciation and amortization.....	33,159	30,190	22,514
Minority interest.....	96	404	543
Provision for uncollectible accounts.....	16,359	15,918	14,453
Deferred income taxes.....	3,631	(1,525)	(2,704)
Noncash portion of nonrecurring items.....	8,256	15,415	667
Changes in assets and liabilities, net of effects from acquisitions:			
Accounts and notes receivable.....	(12,676)	(31,164)	(44,875)
Other current assets.....	(2,029)	(1,487)	(6,074)
Accounts payable and accrued expenses.....	(6,152)	10,279	(9,662)
Income taxes payable.....	1,553	28,982	2,498
Other, net.....	220	2,925	(1,888)
Net cash flows provided by operating activities.....	57,698	43,618	33,686
CASH FLOWS FROM INVESTING ACTIVITIES:			
Marketable securities:			
Purchase of investments.....	--	--	(146,496)
Proceeds from sales of investments.....	--	88,151	171,872
Net cash proceeds from marketable securities.....	--	88,151	25,376
Payments for businesses acquired, net of cash acquired.....	(20,764)	(71,759)	(149,772)
Additions to property, equipment and capitalized software.....	(26,621)	(29,529)	(27,961)
Net (payment for) proceeds from sale of medical rehabilitation hospitals.....	(13,208)	206,838	--
Other, net.....	(4,326)	(5,513)	(6,771)
Net cash (used in) provided by investing activities.....	(64,919)	188,188	(159,128)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from long-term debt and credit agreements.....	133	74,077	184,208
Payment of long-term debt and credit agreements.....	(33,769)	(187,206)	(122,409)
Proceeds from common stock issued.....	2,898	3,947	3,529
Payment for purchase of treasury stock.....	(24,953)	(2,012)	--
Net cash flows (used in) provided by financing activities.....	(55,691)	(111,194)	65,328
Net increase (decrease) in cash and cash equivalents.....	(62,912)	120,612	(60,114)
Cash and cash equivalents, beginning of year.....	158,636	38,024	102,324
Adjustments for pooling of interests.....	--	--	(4,186)
Cash and cash equivalents, end of year.....	\$ 95,724	\$ 158,636	\$ 38,024

</TABLE>

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

NOVACARE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 1996
(IN THOUSANDS, EXCEPT PER SHARE DATA)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations: NovaCare, Inc. is a national provider of

comprehensive medical rehabilitation services through a system comprising: (1) rehabilitation therapy, subacute and rehabilitation programs and management services on a contract basis to health care institutions, primarily long-term care facilities; and (2) a national network of outpatient rehabilitation and orthotic and prosthetic clinics and integrated delivery systems comprising health care providers and payors.

Principles of Consolidation: The Consolidated Financial Statements include the accounts of NovaCare, Inc., its majority-owned subsidiaries and companies effectively controlled through management agreements (collectively, "NovaCare" or the "Company"). Investments in 20% or more of the voting stock of an affiliate are accounted for under the equity method. All significant intercompany accounts and transactions have been eliminated. Certain amounts in the fiscal 1995 and 1994 consolidated financial statements have been reclassified to conform with the 1996 presentation.

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. During the third quarter of fiscal 1996, the Company recorded a \$10.5 million charge to net revenues to reflect payor allowances that had not been sufficiently recognized by certain billing systems.

Cash and Cash Equivalents: The Company considers its holdings of highly liquid debt and money-market instruments to be cash equivalents if the securities mature within 90 days from the date of acquisition or contain an investor put option which can be exercised at par within 90 days of acquisition. These investments are carried at cost, which approximates fair value.

Net Revenues: Net revenues are reported at the net realizable amounts from customers, third party payors, and others for services rendered. Net revenues generated from Medicare and Medicaid reimbursement programs represented 12%, 18% and 20% of the Company's net revenues for fiscal 1996, 1995, and 1994, respectively. Settlement amounts due to or receivable from Medicare and Medicaid programs are determined by fiscal intermediaries. Management believes that adequate provision has been made in the consolidated financial statements for potential adjustments resulting from such determinations.

Inventories: Inventories consist of orthotic and prosthetic merchandise held for resale, work in process and raw materials, and are carried at the lower of cost, determined on the first-in, first-out basis, or market.

Property and Equipment: Property and equipment are stated at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets, which principally range from three to seven years for property and equipment and 30 to 40 years for buildings. Assets under capital leases and leasehold improvements are amortized over the lesser of the lease term or the asset's estimated useful life. Property and equipment also includes external and incremental internal costs incurred to develop major business systems. Capitalized software costs are amortized on a straight-line basis over three to five years.

Excess Cost of Net Assets Acquired: Assets and liabilities acquired in connection with business combinations accounted for under the purchase method are recorded at their respective fair values. Deferred taxes have been recorded to the extent of the difference between the fair value and the tax basis of the assets acquired and liabilities assumed. The excess of the purchase price over the fair value of net assets acquired, including the recognition of applicable deferred taxes, is amortized on a straight-line basis over a 40 year

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NOVACARE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

JUNE 30, 1996

(IN THOUSANDS, EXCEPT PER SHARE DATA)

period. The Company performs an annual assessment of the recoverability of goodwill based on estimated future cash flows.

Other Assets: Other assets consist principally of deferred financing fees, investments in affordable income housing partnerships and notes receivable. Deferred financing fees are amortized over the term of the related debt obligations and are included as a component of interest expense. Investments in affordable income housing partnerships are recorded at cost and are subject to

an annual assessment as to carrying value.

Income Taxes: The Company records deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns.

Net Income Per Common Share: Net income per common share has been computed by dividing net income applicable to common stock by the weighted average number of common shares outstanding during the year, giving effect to dilutive stock options and warrants.

Recently Issued Accounting Standards: In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ("SFAS 123"). SFAS 123 defines a fair value based method of accounting for employee stock options and similar instruments and must be adopted or the proforma income statement effects must be disclosed in notes to the financial statements no later than the first quarter of fiscal year 1997. The Company intends to elect disclosure of the proforma income statement effects of SFAS 123, therefore the new Statement will not affect the Company's financial position or results of operations.

In March 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed of" ("SFAS 121"), which the Company is required to adopt no later than the first quarter of fiscal year 1997. SFAS 121 establishes accounting standards for the impairment of long-lived assets, certain identifiable intangibles, and goodwill related to those assets to be held and used and for long-lived assets and certain intangibles to be disposed of. Management does not believe the adoption of SFAS 121 will have a material effect on the Company's financial position or results of operations.

2. PROVISION FOR RESTRUCTURE AND OTHER NONRECURRING ITEMS

The following table sets forth the Company's provision for restructure and other nonrecurring items for each of the three years in the period ended June 30, 1996:

<TABLE>
<CAPTION>

	1996	1995	1994
	-----	-----	-----
<S>	<C>	<C>	<C>
Productivity and cost reduction programs:			
Employee severance costs.....	\$ 2,931	\$ 7,042	\$ --
Lease terminations.....	4,032	6,847	--
Asset write-offs, net of estimated sale proceeds....	5,965	15,415	--
Other.....	442	571	--
Gain on sale of medical rehabilitation hospitals.....	--	(88,243)	--
Settlement of shareholder litigation.....	--	1,000	--
Merger expenses:			
Professional fees.....	--	--	2,305
Name change.....	--	--	1,600
Printing and filing fees.....	--	--	775
Other.....	--	--	1,074
	-----	-----	-----
	\$13,370	\$ (57,368)	\$5,754
	=====	=====	=====

</TABLE>

NOVACARE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)
JUNE 30, 1996
(IN THOUSANDS, EXCEPT PER SHARE DATA)

During the third quarter of fiscal 1996, the Company recorded a provision for restructure pertaining to the consolidation and reorganization of its outpatient and orthotic & prosthetic operations and certain administrative functions. The provision reflects the cost of exiting and combining facilities, along with severance for work force reductions. Employee severance costs incurred in the provision represent the accumulation of termination benefits set forth in the Company's severance policy for approximately 340 employees. The outpatient and orthotic and prosthetics consolidation and reorganization will be substantially completed by March 31, 1997.

During fiscal 1996, the Company continued to implement the productivity and

cost reduction program initiated in fiscal 1995. The program, consisting of closing certain contract services offices, orthotic and prosthetic branches, and outpatient centers in selected markets, and the consolidation of certain finance and other administrative functions is substantially complete. The Company completed the employee reduction portion of the program by terminating 660 employees and also wrote off assets consisting of goodwill in the amount of \$10,713 associated with facilities, branches or centers the Company is closing and certain fixed assets related to those facilities in the amount of \$4,702. Lease termination costs will continue to be incurred through fiscal 1997 as sub-lease and closure arrangements are finalized in facilities and offices closed.

At June 30, 1996, approximately \$8,241 remained accrued for facility, branch and clinic closure and administrative consolidation costs. Of the \$8,241 accrued, approximately \$5,959 relates to the fiscal 1996 provision for restructure. The remainder relates to the provision for restructure taken in the fourth quarter of fiscal 1995. The remaining amount in the 1995 fiscal plan relates to remaining lease obligations on facilities which have been closed and the costs associated with the closure of certain facilities which were sold in conjunction with the restructure.

Effective April 1, 1995, the Company sold its medical rehabilitation hospitals for \$242,888 which consisted of cash of \$232,394 and debt and cash assumed by the purchaser of \$19,156 and \$8,662, respectively. Of the cash portion of the purchase price, \$16,894 was unpaid at June 30, 1995 and was included as a component of other current assets. Substantially all of this amount was received in July 1995. Had the sale of the medical rehabilitation hospitals taken place on July 1, 1993 pro forma unaudited net revenues for the fiscal years ended June 30, 1995 and 1994 would have been \$794,716 and \$652,656, respectively and pro forma unaudited income from operations would have been \$40,504 and \$89,524, respectively.

During fiscal 1994 the Company acquired all of the outstanding common stock of RehabClinics, Inc. ("RCI") in a transaction accounted for as a pooling of interests. Certain nonrecurring expenses were incurred as a result of the merger. Substantially all charges were cash in nature.

3. MERGER, ACQUISITION AND JOINT VENTURE TRANSACTIONS

During fiscal year 1996, the Company acquired seven businesses which provide outpatient rehabilitation services and six businesses which provide orthotic and prosthetic rehabilitation services. During the fiscal year, the Company also acquired 50% of the shares of GP Therapy, LLC, a joint venture with Columbia/HCA, and 40% of Gil/Balsano Consulting, LLC. The carrying value of these investments is \$11,984. The difference between the cost of the investment and the underlying equity in net assets of the joint venture has been assigned to goodwill.

During fiscal year 1995, the Company acquired 25 businesses which provide outpatient rehabilitation services, one business which provides orthotic and prosthetic rehabilitation services and two businesses which provide contract therapy services.

Proforma results including these acquisitions and joint ventures would not be significantly different from those actually recorded.

NOVACARE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)
 JUNE 30, 1996
 (IN THOUSANDS, EXCEPT PER SHARE DATA)

Information with respect to businesses acquired in purchase transactions was as follows (the allocation for fiscal 1996 acquisitions is preliminary):

<TABLE>
 <CAPTION>

	AS OF JUNE 30,	
	1996	1995
	-----	-----
<S>	<C>	<C>
Excess cost of net assets acquired.....	\$391,324	\$379,605
Less: accumulated amortization.....	(37,207)	(27,490)
	-----	-----
	\$354,117	\$352,115
	=====	=====

</TABLE>

<TABLE>
<CAPTION>

	YEARS ENDED JUNE 30,	
	1996	1995
<S>	<C>	<C>
Cash paid (net of cash acquired).....	\$5,850	\$60,929
Notes issued.....	990	12,620
Other consideration.....	19	1,377
	-----	-----
Liabilities assumed.....	6,859	74,926
	617	7,027
	-----	-----
Fair value of assets acquired, principally accounts receivable and property and equipment.....	7,476	81,953
	-----	-----
Cost in excess of fair value of net assets acquired.....	1,430	7,891
	-----	-----
	\$6,046	\$74,062
	=====	=====

</TABLE>

Certain purchase agreements require additional payments if specific financial targets and non-financial conditions are met. Aggregate contingent payments in connection with these acquisitions at June 30, 1996 of approximately \$25,850 in cash and 495 shares of common stock have not been included in the initial determination of cost of the businesses acquired since the amount of such contingent consideration, if any, is not presently determinable. During the fiscal years ended June 30, 1996, 1995 and 1994, the Company paid \$14,914, \$10,830 and \$14,799, respectively, in cash and issued 619, 975 and 348 shares of common stock, respectively, in connection with businesses acquired in prior years.

4. CASH EQUIVALENTS AND MARKETABLE SECURITIES

As of June 30, 1994, the Company adopted Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities ("SFAS 115"). Accordingly, amounts for fiscal 1994 shown on the Statement of Cash Flows do not reflect the security classifications required by SFAS 115. During fiscal 1995, the Company changed its investment portfolio from securities classified under SFAS 115 as available for sale and held-to-maturity securities to instruments considered cash equivalents. Proceeds from available for sale and held-to-maturity securities were \$38,145 and \$50,006, respectively, for fiscal 1995.

For the years ended June 30, 1996, 1995 and 1994, investment income consisted of the following:

<TABLE>
<CAPTION>

	YEARS ENDED JUNE 30,		
	1996	1995	1994
<S>	<C>	<C>	<C>
Interest income.....	\$4,999	\$5,700	\$ 4,965
Gross realized gain on sales of marketable securities...	--	67	392
Gross realized loss of sales of marketable securities...	--	(362)	(1,553)
Reserve for loss on marketable securities.....	--	--	1,500
	-----	-----	-----
	\$4,999	\$5,405	\$ 5,304
	=====	=====	=====

</TABLE>

NOVACARE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)
JUNE 30, 1996
(IN THOUSANDS, EXCEPT PER SHARE DATA)

5. INVENTORIES

Inventories consisted of the following:

<TABLE>
<CAPTION>

	AS OF JUNE 30,	
	1996	1995
<S>	<C>	<C>
Finished goods.....	\$ 863	\$ 857
Work in process.....	3,355	1,447
Materials and supplies.....	9,730	8,909
	-----	-----
	\$13,948	\$11,213
	=====	=====

</TABLE>

6. PROPERTY AND EQUIPMENT

The components of property and equipment were as follows:

<TABLE>
<CAPTION>

	AS OF JUNE 30,	
	1996	1995
<S>	<C>	<C>
Land and buildings.....	\$ 3,573	\$ 4,576
Property, equipment and furniture.....	65,401	64,086
Capitalized software.....	31,515	21,641
Leasehold improvements.....	15,124	7,866
	-----	-----
	115,613	98,169
Less: accumulated depreciation and amortization.....	(52,294)	(34,510)
	-----	-----
	\$ 63,319	\$ 63,659
	=====	=====

</TABLE>

7. FINANCING ARRANGEMENTS

Financing arrangements consisted of the following:

<TABLE>
<CAPTION>

	AS OF JUNE 30,	
	1996	1995
<S>	<C>	<C>
Convertible subordinated debentures (5.5%), due January 2000...	\$175,000	\$175,000
Reverse repurchase agreements (5.65%), payable through September 30, 1995.....	--	18,000
Subordinated promissory notes (5% to 9%), payable through 2002.....	15,516	26,867
Notes (6% to 12%), payable through November 2000.....	172	720
Capitalized lease obligations, payable through 2000.....	1,527	4,428
	-----	-----
	192,215	225,015
Less: current portion.....	8,173	32,684
	-----	-----
	\$184,042	\$192,331
	=====	=====

</TABLE>

The Company has in place a revolving credit facility with a syndicate of lenders providing for a total commitment of up to \$150,000 upon which no amounts are currently drawn. The Company is charged a fee of .25% per annum on the unused portion of the commitment. At June 30, 1996, total credit availability had been reduced by \$520 for issued letters of credit.

During fiscal 1995, the Company entered into reverse repurchase agreements with primary government dealers. In the reverse repurchase agreements, the Company sold U.S. government securities subject to an

agreement to repurchase those securities at a mutually agreed upon date and price, which approximates market. These transactions were accounted for as loans to the Company collateralized by the underlying securities which are held by the primary government dealers.

On January 20, 1993, the Company issued \$175,000 of convertible subordinated debentures due January 15, 2000, priced at par to yield 5.5%. The debentures are convertible, at the option of the holder, into shares of the Company's common stock at a conversion price of \$26.65 per share. Subsequent to January 14, 1996, the debentures are redeemable, in whole or in part, at the option of the Company. There is no sinking fund applicable to the debentures.

The fair value of the Company's convertible subordinated debentures based on quoted market prices at June 30, 1996 and 1995 was \$154,875 and \$151,375, respectively. The estimated fair value of all other debt and financing arrangements approximates carrying value.

At June 30, 1996, aggregate annual maturities of financing arrangements were as follows for the next five fiscal years and thereafter:

<TABLE>
<CAPTION>

FISCAL YEAR	
<S>	<C>
1997.....	\$ 8,173
1998.....	4,404
1999.....	3,134
2000.....	176,234
2001.....	117
Thereafter.....	153
	\$192,215
	=====

</TABLE>

Interest paid on debt during fiscal 1996, 1995 and 1994 amounted to \$11,730, \$20,377 and \$17,258, respectively.

8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses are summarized as follows:

<TABLE>
<CAPTION>

	AS OF JUNE 30,	
	1996	1995
<S>	<C>	<C>
Accounts payable.....	\$ 8,026	\$15,721
Accrued compensation and benefits.....	51,472	37,984
Accrued costs of productivity and cost improvement programs.....	8,241	11,730
Accrued interest.....	4,868	5,158
Other.....	21,247	22,495
	\$93,854	\$93,088
	=====	=====

</TABLE>

The balance for the productivity and cost improvement program relates to the 1996 and 1995 programs discussed in Note 2.

NOVACARE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)
JUNE 30, 1996
(IN THOUSANDS, EXCEPT PER SHARE DATA)

9. INCOME TAXES

The components of income tax expense were as follows:

<TABLE>
<CAPTION>

YEARS ENDED JUNE 30,

	1996	1995	1994
<S>	<C>	<C>	<C>
Current:			
Federal.....	\$ 8,048	\$53,258	\$36,988
State.....	2,906	11,927	3,394
	10,954	65,185	40,382
Deferred:			
Federal.....	3,301	(1,182)	(2,410)
State.....	330	(343)	(294)
	3,631	(1,525)	(2,704)
	\$14,585	\$63,660	\$37,678

</TABLE>

The components of net deferred tax assets as of June 30, 1996 and 1995 were as follows:

<TABLE>
<CAPTION>

	1996	1995
<S>	<C>	<C>
Accruals and reserves not currently deductible for tax purposes.....	\$10,484	\$ 8,334
Restructuring reserve.....	6,043	8,413
Cash basis accounting for tax purposes.....	--	661
Other.....	680	810
Gross deferred tax assets.....	17,207	18,218
Expenses capitalized for financial statement purposes.....	(6,274)	(3,608)
Depreciation and capital leases.....	(2,589)	(3,207)
Other, net.....	(762)	(1,332)
Gross deferred tax liabilities.....	(9,625)	(8,147)
Net deferred tax asset.....	\$ 7,582	\$10,071

</TABLE>

The reconciliation of the expected tax expense (computed by applying the federal statutory tax rate to income before income taxes) to actual tax expense was as follows:

<TABLE>
<CAPTION>

YEARS ENDED JUNE 30,

	1996	1995	1994
<S>	<C>	<C>	<C>
Expected federal income tax expense.....	\$10,453	\$43,954	\$33,562
State income taxes, less federal benefit.....	2,108	7,530	1,767
Non-deductible nonrecurring items.....	1,027	9,178	1,217
Non-deductible amortization of excess cost of net assets acquired.....	2,011	2,370	1,954
Dividend exclusion and non-taxable interest income....	(395)	(401)	(676)
Other, net.....	(619)	1,029	(146)
	\$14,585	\$63,660	\$37,678

</TABLE>

Income taxes paid during fiscal 1996, 1995 and 1994 amounted to \$38,699, \$37,604 and \$37,817, respectively.

10. LEASES

The Company is obligated under capital leases for office space and office, transportation and therapy equipment. All other capital leases expire over the next five years.

Included in property and equipment in the accompanying Consolidated Balance Sheets are the following assets held under capital leases:

<TABLE>
 <CAPTION>

	AS OF JUNE 30,	
	1996	1995
<S>	<C>	<C>
Property, equipment and furniture.....	\$ 3,196	\$ 7,265
Less: accumulated amortization.....	(1,605)	(2,498)
	\$ 1,591	\$ 4,767
	=====	=====

</TABLE>

The Company also rents office space and office, transportation and therapy equipment under non-cancelable operating leases. In an effort to leverage its purchasing power with lessors, the Company has leased and concurrently subleased certain office space to companies that are related through control by the Company's Chairman and Chief Executive Officer. The Company is fully reimbursed for its lease costs for the aforementioned office space under noncancelable sublease agreements.

Future minimum lease commitments for all non-cancelable leases as of June 30, 1996 are as follows:

<TABLE>
 <CAPTION>

FISCAL YEAR	CAPITAL LEASES	OPERATING LEASES	SUB-LEASE RECEIVABLES
<S>	<C>	<C>	<C>
1997.....	\$ 979	\$21,304	\$ 374
1998.....	438	17,803	328
1999.....	91	15,551	356
2000.....	16	10,204	361
2001.....	9	5,967	187
Thereafter.....	132	7,412	286
	-----	-----	-----
Total minimum lease payments.....	1,665	\$78,241	\$ 1,892
		=====	=====
Less: amount representing interest.....	138		

Present value of minimum payments under capital lease obligations.....	\$ 1,527		
	=====		

</TABLE>

11. BENEFIT PLANS

Stock Option Plan:

The Company's 1986 Stock Option Plan, as amended, provides for issuance of options to purchase up to 5,800 shares of common stock to employees, officers and directors. Under the plan, substantially all options are granted for a term of up to 10 years at prices equal to the fair market value at the date of grant.

In May 1996, the Board approved an option exchange whereby option holders were allowed to acquire new options to purchase shares of common stock in exchange for the surrender by such option holders of certain existing options held by them under the plan. The exchange formula took into account the vesting schedule and exercise price of the surrendered options. Under the exchange program, 1,157 options were surrendered and 888 new options were granted. The options granted as a result of the exchange vest over five years, although vesting can be accelerated if the Company's stock price achieves certain levels.

NOVACARE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)
 JUNE 30, 1996
 (IN THOUSANDS, EXCEPT PER SHARE DATA)

The following summarizes the activity of this stock option plan:

<TABLE>
 <CAPTION>

	YEARS ENDED JUNE 30,		
	1996	1995	1994
<S>	<C>	<C>	<C>
Options:			
Outstanding at beginning of year.....	2,649	2,771	2,239
Granted.....	2,592	1,162	1,068
Exercised.....	(71)	(77)	(277)
Canceled.....	(1,982)	(1,207)	(259)
Outstanding at end of year.....	3,188	2,649	2,771
Option price per share ranges:			
Outstanding at beginning of year.....	\$.09-\$21.00	\$.09-\$23.50	\$.09-\$23.50
Granted.....	5.75- 7.50	7.25- 13.00	10.16- 16.75
Exercised.....	.09- 9.13	.09- 14.38	.09- 16.50
Outstanding at end of year.....	\$.12-\$20.58	\$.09-\$21.00	\$.09-\$23.50
Options exercisable at end of year.....	363	1,109	897
Exercisable option price ranges.....	\$.09-\$20.58	\$.09-\$21.00	\$.09-\$23.50
Options available for grant at end of year under the 1986 Stock Option Plan.....	982	1,601	1,807

</TABLE>

Deferred Compensation:

Deferred compensation represents common stock issued to certain key employees wherein the recipient becomes fully vested at the end of a five-year period. Compensation expense is charged to income over the vesting period.

Other Stock Awards:

During May 1996, the Board also decided, subject to shareholder approval, to offer the Chairman and President of the Company a comparable exchange to the exchange offered to the option holders of the 1986 Stock Option Plan. Under the exchange, the Chairman received fewer options than would have been warranted under the 1986 Stock Option Plan formula of exchange while the President was offered an exchange and additional options, resulting in a net reduction of outstanding options of 909. The new options were at the same price and with the same vesting term as the options issued pursuant to the exchange described above, except that 3,317 options of the 3,500 total options issued have a seven year term.

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NOVACARE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)
 JUNE 30, 1996
 (IN THOUSANDS, EXCEPT PER SHARE DATA)

The following summarizes the other stock award activity:

<TABLE>
 <CAPTION>

	YEARS ENDED JUNE 30,		
	1996	1995	1994
<S>	<C>	<C>	<C>
Options:			
Outstanding at beginning of year.....	4,704	4,708	1,958
Granted.....	3,500	--	2,750
Exercised.....	--	(4)	--
Canceled.....	(4,650)	--	--

Outstanding at end of year.....	3,554	4,704	4,708
	=====	=====	=====
Option price per share:			
Outstanding at beginning of year.....	\$ 2.25-\$19.50	\$2.25-\$19.50	\$2.25-\$17.00
Granted.....	6.88	--	19.50
Exercised.....	--	2.25	--
Canceled.....	10.44- 19.50		
Outstanding at end of year.....	2.25- 6.88	2.25- 19.50	2.25- 19.50
Options exercisable at end of year.....	54	1,914	1,118
Exercisable option price ranges.....	\$ 2.25-\$ 4.88	\$2.25-\$19.50	\$2.25-\$17.00

</TABLE>

Retirement Plans:

The Company has defined contribution 401(k) plans covering substantially all of its employees. Company contributions for fiscal 1996, 1995 and 1994 were \$3,634, \$3,878, and \$3,715, respectively. In fiscal 1992, the Company established a non-qualified supplemental benefit plan covering certain key employees. The Company's matching contribution was \$582, \$302 and \$192 for fiscal 1996, 1995 and 1994, respectively.

12. COMMITMENTS AND CONTINGENCIES

The Company is subject to legal proceedings and claims which arise in the ordinary course of its business. In the opinion of management, the amount of ultimate liability, if any, with respect to these actions will not have a materially adverse effect on the financial position or results of operations of the Company.

13. SHAREHOLDER RIGHTS PLAN

Under the terms of a Shareholder Rights Plan adopted in 1995, the Company's Board of Directors declared a dividend distribution of one right for each outstanding common share. The rights may not be exercised or traded apart from the common shares to which they are attached until 10 days after a person or group has acquired, obtained the right to acquire, or commenced a tender offer for, at least 20% of the Company's outstanding common shares. In such event, each right will become exercisable for one common share for a price of \$27. If a person or group acquires, or obtains the right to acquire, 20% or more of the Company's outstanding common shares, each right will become exercisable for common shares worth \$54 and the rights held by the acquiror will become null and void. If the Company is involved in a merger and its common shares are changed or exchanged, or if more than 50% of its assets or earnings power is sold or transferred, each right will become exercisable for common stock of the acquiror worth \$54. The rights will expire on March 20, 2000 unless earlier redeemed by the Company for \$.001 per right. Subject to its right to extend the redemption period, the Company may redeem the rights at any time until any person or group has acquired, or obtained the right to acquire, at least 20% of the Company's outstanding common shares.

NOVACARE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)
JUNE 30, 1996
(IN THOUSANDS, EXCEPT PER SHARE DATA)

14. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

<TABLE>

<CAPTION>

	FOURTH QUARTER -----	THIRD QUARTER -----	SECOND QUARTER -----	FIRST QUARTER -----
<S>	<C>	<C>	<C>	<C>
YEAR ENDED JUNE 30, 1996:				
Net revenues.....	\$202,551	\$191,393	\$200,957	\$198,137
Gross profit.....	57,382	45,490	57,506	57,180
Income from operations.....	16,428	(9,549)	15,123	15,497
Net income (loss).....	8,411	(8,580)	7,447	8,003
Net income (loss) per common share.....	\$.13	\$ (.13)	\$.12	\$.12
YEAR ENDED JUNE 30, 1995:				
Net revenues.....	\$201,450	\$240,898	\$232,201	\$230,810
Gross profit.....	62,494	69,959	65,444	67,230
Income from operations.....	78,049	21,456	21,310	23,066
Net income.....	33,036	8,953	8,887	11,048
Net income per common share.....	\$.51	\$.14	\$.14	\$.17

</TABLE>

Results from the third quarter of fiscal 1996 included a \$13,370 provision for restructure and a \$10,462 charge to fully reflect payor allowances that had not been sufficiently recognized by certain billing systems. Results for the fourth quarter of fiscal 1995 included a pretax gain of \$88,243 on the sale of hospital operations and \$29,875 charge related to a productivity and cost improvement program. Results for the third quarter of fiscal 1995 included a \$1,000 charge for settlement of certain shareholder litigation.

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders and Board of Directors of
NovaCare, Inc.

In our opinion, the consolidated financial statements listed in the index appearing under Item 14(a)(1) and (2) on page 41 present fairly, in all material respects, the financial position of NovaCare, Inc. and its subsidiaries at June 30, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 1996, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PRICE WATERHOUSE LLP

Philadelphia, PA
July 31, 1996

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

The Registrant has had no changes in or disagreements with accountants on accounting and financial disclosure of the type referred to in Item 304 of Regulation S-K.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

For information concerning this item, see "Item 1 -- Business -- Executive Officers of the Registrant" and the table and text under the caption "Name of Nominee and Biographical Information" and "Section 16(a) Reporting Requirements" of the Proxy Statement to be filed with respect to the 1996 annual meeting of shareholders to be held on October 31, 1996 (the "Proxy Statement"), which information is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

For information concerning this item, see the table and text under the captions "Executive Compensation", "Compensation of Directors of the Company", "Compensation Committee Interlocks and Insider Participation" and "Employment Agreements" of the Proxy Statement, which information is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

For information concerning this item, see the table and text under the captions "Shares of Common Stock Owned Beneficially as of September 6, 1996" and "Information Concerning Certain Shareholders" of the Proxy Statement, which information is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

For information concerning this item, see the text under the caption "Certain Transactions" of the Proxy Statement, which information is incorporated

herein by reference.

PART IV

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

(a) The following documents are filed as part of this report:

<TABLE>		PAGE
<CAPTION>		NUMBER

<S>	<C>	<C>
(1)	FINANCIAL STATEMENTS	
	Consolidated Balance Sheets at June 30, 1996 and 1995.....	25
	Consolidated Statements of Operations for the three years in the period ended June 30, 1996.....	26
	Consolidated Statements of Changes in Shareholders' Equity for the three years in the period ended June 30, 1996.....	27
	Consolidated Statements of Cash Flows for the three years in the period ended June 30, 1996.....	28
	Notes to Consolidated Financial Statements.....	29
	Report of Independent Accountants.....	40
(2)	FINANCIAL STATEMENT SCHEDULES:	
	VIII -- Valuation and Qualifying Accounts for the three years in the period ended June 30, 1996.....	43
(3)	EXHIBITS (NUMBERED IN ACCORDANCE WITH ITEM 601 OF REGULATION S-K):	
	The exhibits required to be filed are listed in the index to exhibits.....	44

</TABLE>

(b) Current Reports on Form 8-K: (None)

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POWER OF ATTORNEY

The Registrant and each person whose signature appears below hereby appoint John H. Foster and Timothy E. Foster as attorneys-in-fact with full power of substitution, severally, to execute in the name and on behalf of the Registrant and each such person, individually and in each capacity stated below, one or more amendments to the annual report which amendments may make such changes in the report as the attorney-in-fact acting in the premises deems appropriate and to file any such amendment to the report with the Securities and Exchange Commission.

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.

NOVACARE, INC.

By: /s/ ROBERT E. HEALY, JR.

(ROBERT E. HEALY, JR.,
SENIOR VICE PRESIDENT, FINANCE AND
ADMINISTRATION
AND CHIEF FINANCIAL 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.

<TABLE>		
<CAPTION>		
SIGNATURE	TITLE	DATE
-----	-----	-----
<C>	<S>	<C>
/s/ JOHN H. FOSTER	Chairman of the Board, Chief Executive Officer and Director	September 23, 1996
(JOHN H. FOSTER)		
/s/ TIMOTHY E. FOSTER	President, Chief Operating Officer and Director	September 23, 1996
(TIMOTHY E. FOSTER)		

/s/ ROBERT E. HEALY, JR. ----- (ROBERT E. HEALY, JR.) /s/ BARRY E. SMITH ----- (BARRY E. SMITH) /s/ E. MARTIN GIBSON ----- (E. MARTIN GIBSON) /s/ SIRI S. MARSHALL ----- (SIRI S. MARSHALL) /s/ STEPHEN E. O'NEIL ----- (STEPHEN E. O'NEIL) /s/ GEORGE W. SIGULER ----- (GEORGE W. SIGULER) /s/ ROBERT G. STONE, JR. ----- (ROBERT G. STONE, JR.) /s/ DANIEL C. TOSTESON, M.D. ----- (DANIEL C. TOSTESON, M.D.)	Senior Vice President, Finance and Administration and Chief Financial Officer Vice President, Controller, and Chief Accounting Officer Director Director Director Director Director Director Director	September 23, 1996 September 23, 1996 September 23, 1996 September 23, 1996 September 23, 1996 September 23, 1996 September 23, 1996 September 23, 1996
--	--	--

</TABLE>

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SCHEDULE VIII

NOVACARE, INC.

VALUATION AND QUALIFYING ACCOUNTS
YEARS ENDED JUNE 30, 1996, 1995 AND 1994
(IN THOUSANDS)

<TABLE>

<CAPTION>

DESCRIPTION	BALANCE AT BEGINNING OF PERIOD	CHARGED TO COSTS AND EXPENSES	OTHER	DEDUCTIONS	BALANCE AT END OF PERIOD
-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>
Year ended June 30, 1996:					
Allowance for uncollectible accounts.....	\$ 16,023	16,359	1,187(2)	(20,818)	\$ 12,751
Allowance for Medicare denials and other allowances.....	\$ 3,695	--	9,018(3)	(6,469)	\$ 6,244
Year ended June 30, 1995:					
Allowance for uncollectible accounts.....	\$ 17,692	15,918	643(2)	(18,230)	\$ 16,023
Allowance for Medicare denials and other allowances.....	\$ 15,039	--	5,887(3)	(17,231)	\$ 3,695
Year ended June 30, 1994:					
Allowance for uncollectible accounts.....	\$ 11,303(1)	14,453	647(2)	(8,711)	\$ 17,692
Allowance for Medicare denials and other allowances.....	\$ 13,324	--	67,151(3)	(65,436)	\$ 15,039

</TABLE>

(1) Differs from balance at end of prior period due to changes in fiscal year of merged subsidiary from December 31 to June 30.

(2) Allowances for doubtful accounts related to acquired receivables.

(3) Charged against net revenues.

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INDEX TO EXHIBITS

<TABLE>

<CAPTION>

EXHIBIT NUMBER	EXHIBIT DESCRIPTION	PAGE NUMBER
-----	-----	-----

<S>	<C>	<C>
2	Stock Purchase Agreement dated as of February 3, 1995 by and among NovaCare, Inc., NC Resources, Inc., and HEALTHSOUTH Corporation (incorporated by reference to Exhibit 2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1995).	--
3(a)*	Certificate of Incorporation of the Company, as amended to date (incorporated by reference to Exhibit 3(a) to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1992).	--
3(b)	By-laws of the Company, as amended to date (incorporated by reference to Exhibit 3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1995).	--
4(a)	Stock Option Plan, as amended to date.	
4(b)*	Form of Indenture dated as of January 15, 1993 between the Company and Pittsburgh National Bank relating to 5 1/2% Convertible Subordinated Debentures Due 2000 (incorporated by reference to Exhibit 4 to Registration Statement on Form S-3 No. 33-55710).	--
4(c)	Rights Agreement dated as of March 9, 1995 by and between NovaCare, Inc. and American Stock Transfer & Trust Company, as Rights Agent (incorporated by reference to Exhibit 99(a) to the Company's current report on Form 8-k dated March 14, 1995).	--
10(a)	Employment Agreement dated as of July 1, 1994 between the Company and John H. Foster (incorporated by reference to Exhibit 10(b) to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1995).	--
10(b)	Amendment dated February 2, 1995 to the employment agreement dated as of July 1, 1994 between the Company and John H. Foster (incorporated by reference to Exhibit 10(b) to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1995).	--
10(c)*	Employment Agreement dated as of January 3, 1994 between the Company and C. Arnold Renschler, M.D. (incorporated by reference to Exhibit 10(f) to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1995).	--
10(d)*	Amendment dated May 25, 1995 to the Employment Agreement between the Company and C. Arnold Renschler, M.D. dated as of January 3, 1994 (incorporated by reference to Exhibit 10(f) to the Company Annual Report on Form 10-K for the year ended June 30, 1995).	--
10(e)	Employment Agreement between the Company and Timothy E. Foster dated as of December 2, 1994 (incorporated by reference to Exhibit 10(c) to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 1994).	--
10(f)	Amendment dated as of July 1, 1996 to the employment agreement dated December 2, 1994 between the Company and Timothy E. Foster.	
10(g)*	Employment Agreement dated as of January 6, 1995 between the Company and Daryl A. Dixon and Promissory Note of Daryl A. Dixon in favor of the Company dated January 6, 1995 (incorporated by reference to Exhibit 10(i) to the Company's Annual Report on Form 10-K for the year ended June 30, 1995).	--
10(h)	Employment agreement dated as of January 24, 1996 between the Company and Ronald G. Hiscock (incorporated by reference to Exhibit 10 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1996).	--
10(i)	Employment agreement dated as of March 17, 1995 between the Company and Robert E. Healy, Jr.	

</TABLE>

<TABLE>
<CAPTION>
EXHIBIT
NUMBER

PAGE
NUMBER

<S>	<C>	<C>
10(j)	(i) Revolving Credit Facility Agreement dated as of May 27, 1994 by and among NovaCare and certain of its subsidiaries and PNC Bank, First Union National Bank of North Carolina, Mellon Bank, N.A., Nations Bank of North Carolina, N.A., CoreStates Bank, N.A. and National Westminster Bank, N.A. (incorporated by reference to Exhibit 10(g) to the Company's Annual Report on Form 10-K for the year ended June 30, 1994).	--
	(ii) Revolving Credit Facility Credit Agreement First Amendment dated as of September 20, 1994 by and among NovaCare and certain of its subsidiaries and PNC Bank, N.A., First Union National Bank of North Carolina, Mellon Bank, N.A., Nations Bank of North Carolina, N.A., CoreStates Bank, N.A., and National Westminster Bank, N.A. (incorporated by reference to Exhibit 10(a) to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 1994).	--
	(iii) Revolving Credit Facility Agreement Second Amendment dated as	--

of November 28, 1994 by and among NovaCare and certain of its subsidiaries and PNC Bank, N.A., First Union National Bank of North Carolina, Mellon Bank, N.A., Nations Bank of North Carolina, N.A., CoreStates Bank, N.A., National Westminster Bank, N.A., and Fleet Bank of Massachusetts, N.A. (incorporated by reference to Exhibit 10(b) to the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 1994).

(iv) Revolving Credit Facility Agreement Third Amendment dated as of May 15, 1995 by and among NovaCare and certain of its subsidiaries and PNC Bank, N.A., First Union National Bank of North Carolina, Mellon Bank, N.A., Nationsbank, N.A. (Carolina), CoreStates Bank, N.A., NatWest Bank, N.A., and Fleet Bank of Massachusetts, N.A. (incorporated by reference to Exhibit 10(b) to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1995).

(v) Revolving Credit Facility Agreement Fourth Amendment dated as of May 19, 1995 by and among NovaCare and certain of its subsidiaries and PNC Bank, N.A., First Union National Bank of North Carolina, Mellon Bank, N.A., Nationsbank, N.A. (Carolina), CoreStates Bank, N.A., NatWest Bank, N.A., and Fleet Bank of Massachusetts (incorporated by reference to Exhibit 10(a) to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1995).

(vi) Revolving Credit Facility Agreement Fifth Amendment dated as of June 30, 1996 by and among NovaCare and certain of its subsidiaries and PNC Bank, N.A., First Union National Bank of North Carolina, Mellon Bank, N.A., Nationsbank, N.A. (Carolina), CoreStates Bank, N.A. and Fleet Bank of Massachusetts.

(vii) Revolving Credit Facility Agreement Sixth Amendment dated as of June 30, 1996 by and among NovaCare and certain of its subsidiaries and PNC Bank, N.A., CoreStates Bank, N.A., First Union National Bank of North Carolina, Fleet Bank of Massachusetts, N.A., Mellon Bank, N.A. and Nationsbank, N.A.

10(k)* Supplemental Benefits Plan (incorporated by reference to Exhibit 10(h) to the Company's Annual Report on Form 10-K for the year ended June 30, 1994).

13 Annual Report to Shareholders for the fiscal year ended June 30, 1996.

21 Subsidiaries of the Company.

23 Consent of Independent Accountants.

24 Power of Attorney (see "Power of Attorney" in Form 10-K).

27 Financial Data Schedules.

</TABLE>

Copies of the exhibits filed with this Annual Report on Form 10-K or incorporated by reference herein do not accompany copies hereof for distribution to shareholders of the Company. The Company will furnish a copy of any of such exhibits to any stockholder requesting the same.

Exhibits denoted by an asterisk were filed prior to the Company's adoption of filing via EDGAR.

NOVACARE, INC.

1986 Stock Option Plan
(as amended May 17, 1996)

1. Purposes of Plan. The purposes of this Plan, which shall be known as the 1986 Stock Option Plan and is hereinafter referred to as the "Plan", are (i) to provide incentives for key employees of NovaCare, Inc. (the "Company") and its subsidiary or parent corporations (within the respective meanings of Section 425(f) and 425(e) of the Internal Revenue Code of 1986, as amended (the "Code"), and referred to herein as "Subsidiary" and "Parent", respectively) by encouraging their ownership of the common stock, \$.01 par value, of the Company (the "Stock") and (ii) to aid the Company in retaining such key employees, upon whose efforts the Company's success and future growth depends, and attracting other such employees.

2. Administration. The Plan shall be administered by the Stock Option Committee (the "Committee") of the Board of Directors, as hereinafter provided. For purposes of administration, the Committee, subject to the

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terms of the Plan, shall have plenary authority to establish such rules and regulations, make such determinations and interpretations, and take such other administrative actions as it deems necessary or advisable. All determinations and interpretations made by the Committee shall be final, conclusive and binding on all persons, including Optionees (as hereinafter defined) and their legal representatives and beneficiaries.

The Committee shall be appointed from time to time by the Board of Directors and shall consist of not fewer than three of its members. Unless otherwise determined by the Board of Directors, no member of the Board of Directors who serves on the Committee shall be eligible to participate in the Plan. The Board of Directors shall designate one of the members of the Committee as its Chairman. The Committee shall hold its meetings at such times and places as it may determine. A majority of its members shall constitute a quorum. All determinations of the Committee shall be made by a majority of its members. Any decision or determination reduced to writing and signed by all members shall be as effective as if it had been made by a majority vote at a

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meeting duly called and held. The Committee may appoint a secretary (who need not be a member of the Committee). No member of the Committee shall be liable for any act or omission with respect to his service on the Committee, if he acts in good faith and in a manner he reasonably believes to be in or not opposed to the best interests of the Company. Service on the Committee shall constitute service as a director of the Company for all purposes.

3. Stock Available for Options. There shall be

available for options under the Plan a total of 5,800,000 shares of Stock, subject to any adjustments which may be made pursuant to Section 5(f). Shares of Stock used for purposes of the Plan may be either authorized and unissued shares, or previously issued shares held in the treasury of the Company, or both. Shares of Stock covered by options which have terminated or expired prior to exercise shall be available for further options hereunder.

4. Eligibility. Options under the Plan may be granted to key employees of the Company or any Subsidiary or Parent, including officers or directors of the Company or any Subsidiary or Parent. Options may be granted to

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eligible employees whether or not they hold or have held options previously granted under the Plan or otherwise granted or assumed by the Company. In selecting employees for options, the Committee may take into consideration any factors it may deem relevant, including its estimate of the employee's present and potential contributions to the success of the Company and its Subsidiaries. Service as a director or officer of the Company or any Parent or Subsidiary shall be considered employment for purposes of the Plan. In the event the Company becomes obligated to grant options, through the assumption of, or in substitution for, outstanding awards previously granted by an acquired company or a company with which the Company combines, options may be granted to a non-continuing director of such acquired or combining company who does not become an employee or director of the Company or any Subsidiary or Parent.

5. Terms and Conditions of Options. The Committee shall, in its discretion, prescribe the terms and conditions of the options to be granted hereunder, which

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terms and conditions need not be the same in each case, subject to the following:

(a) Option Price. Except in the case of an option granted in assumption of or substitution for an outstanding award of a company acquired by the Company or with which the Company combines, the price at which each share of Stock covered by an option granted under the Plan may be purchased shall be determined by the Committee and shall not be less than the market value per share of Stock on the date of grant of an option as determined pursuant to Section 5(c). The date of the grant of an option shall be the date specified by the Committee in its grant of the option.

(b) Option Period. The period for exercise of an option shall in no event be more than ten years from the date of grant. Options may, in the discretion of the Committee, be made exercisable in

installments during the option period. Any shares not purchased on any applicable installment date may be purchased thereafter at any time before the expiration of the option period.

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(c) Exercise of Options. In order to exercise an option, the holder thereof (the "Optionee") shall deliver to the Company written notice specifying the number of shares of Stock to be purchased, together with cash or a certified or bank cashier's check payable to the order of the Company in the full amount of the purchase price therefor; provided that, for the purpose of assisting an Optionee to exercise an option, the Company may make loans to the Optionee or guarantee loans made by third parties to the Optionee, on such terms and conditions as the Board of Directors may authorize; and provided further that such purchase price may be paid in shares of Stock owned by the Optionee having a market value on the date of exercise equal to the aggregate purchase price, or in a combination of cash and Stock. For purposes of the Plan, the market value per share of Stock shall be the last sale price regular way on the date of reference, or, in case no sale takes place on such date, the average of the closing high bid and low asked prices regular way, in either case on the principal national securities exchange on which the Stock is listed or admitted to trading, or if the Stock is not listed

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or admitted to trading on any national securities exchange, the last sale price reported on the National Market System of the National Association of Securities Dealers Automated Quotation System ("NASDAQ") on such date, or the average of the closing high bid and low asked prices of the Stock in the over-the-counter market reported on NASDAQ on such date, whichever is applicable, or if there are no such prices reported on NASDAQ on such date, as furnished to the Committee by any New York Stock Exchange member selected from time to time by the Committee for such purpose. If there is no bid or asked price reported on any such date, the market value shall be determined by the Committee in accordance with the regulations promulgated under Section 2031 of the Code, or by any other appropriate method selected by the Committee. If the Optionee so requests, shares of Stock purchased upon exercise of an option may be issued in the name of the Optionee or another person. An Optionee shall have none of the rights of a stockholder until the shares of Stock are issued to him. An option may not be exercised for less than ten shares of Stock, or the

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number of shares of Stock remaining subject to such option, whichever is smaller.

(d) Effect of Termination of Employment. An option may not be exercised after the Optionee has ceased to be in the full-time employ of the Company or any Subsidiary or Parent, except in the following circumstances:

(i) If the Optionee's employment is terminated by action of his employer, or by reason of disability or retirement under any retirement plan maintained by the Company or any Subsidiary or Parent, the option may be exercised by the Optionee within three months after such termination, but only as to any shares exercisable on the date the Optionee's employment so terminates;

(ii) In the event of the death of the Optionee during the three month period after termination of employment covered by (i) above, the person or persons to whom his rights are transferred by will or the laws of descent and distribution shall have a period of one year from

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the date of his death to exercise any options which were exercisable by the Optionee at the time of his death;

(iii) In the event of the death of the Optionee while employed, the option shall thereupon become exercisable in full, and the person or persons to whom the Optionee's rights are transferred by will or the laws of descent and distribution shall have a period of one year from the date of the Optionee's death to exercise such option. The provisions of the foregoing sentence shall apply to any outstanding options which are incentive stock options to the extent permitted by Section 422A(b) (7) of the Code and such outstanding options in excess thereof shall, immediately upon the occurrence of the event described in the foregoing sentence, be treated for all purposes of the plan as nonstatutory stock options and shall be immediately exercisable as such as provided in the foregoing sentence.

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(iv) If the Optionee is not an employee or director of the Company or any Subsidiary or Parent and is a non-continuing director of a company acquired by the Company or with which the Company has combined and the Company has become obligated to grant options to such Optionee

as a result of such acquisition or combination.

In no event shall any option be exercisable more than ten years from the date of grant thereof. Nothing in the Plan or in any option granted pursuant to the Plan (in the absence of an express provision to the contrary) shall confer on any individual any right to continue in the employ of the Company or any Subsidiary or Parent or interfere in any way with the right of the Company to terminate his employment at any time.

(e) Nontransferability of Options. During the lifetime of an Optionee, options held by such Optionee shall be exercisable only by him. No option shall be transferable other than by will or the laws of descent and distribution.

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(f) Adjustments for Change in Stock Subject to Plan and Other Events. In the event of a reorganization, recapitalization, stock split, stock dividend, combination of shares, merger, consolidation, rights offering, or any other change in the corporate structure or shares of the Company, (i) except as provided in (ii) below, the Committee shall make such adjustments, if any, as it deems appropriate in the number and kind of shares subject to the Plan, in the number and kind of shares covered by outstanding options, or in the option price per share, or both and (ii) the Board of Directors of the Company shall make such adjustments, if any, as it deems appropriate in the maximum number of shares which may be subject to options granted to all directors of the Company and in the maximum number of shares which may be subject to options granted to each director, in each case pursuant to Section 5(i), in the number and kind of shares covered by outstanding options, or in the option price per share, or both, with respect to options held by directors of the Company.

In connection with any merger or consolidation in which the Company is not the surviving corporation or any

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sale or transfer by the Company of all or substantially all of its assets or any tender offer or exchange offer for or the acquisition, directly or indirectly, by any person or group of all or a majority of the then outstanding voting securities of the Company, all outstanding options granted to any Optionee on or before December 31, 1989 or to a Director during the period of his directorship at any time before or after December 31, 1989 shall become exercisable in full, notwithstanding any other provision of the Plan or of any such outstanding options granted thereunder, on and after (i) the fifteenth day prior to the effective date of such merger, consolidation, sale, transfer, acquisition or change in control or (ii) the date of commencement of such

tender offer or exchange offer, as the case may be. The Committee may, in its sole discretion determine that certain other options granted after December 31, 1989 shall become exercisable in full under such circumstances determined by the Committee. The provisions of this paragraph shall apply to any outstanding options which are incentive stock options to the extent permitted by Section 422A(b) (7) of the Code and such outstanding options in excess thereof shall,

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immediately upon the occurrence of the event described in clause (i) or (ii) of the foregoing sentence, be treated for all purposes of the Plan as nonstatutory stock options and shall be immediately exercisable as such as provided in the foregoing sentence. Notwithstanding the foregoing, in no event shall any option be exercisable after the date of termination of the exercise period of such option specified in Sections 5(b), 5(d) and 5(i) (2).

(g) Registration, Listing and Qualification of Shares of Stock. Each option shall be subject to the requirement that if at any time the Board of Directors shall determine that the registration, listing or qualification of the shares of Stock covered thereby upon any securities exchange or under any federal or state law, or the consent or approval of any governmental regulatory body is necessary or desirable as a condition of, or in connection with, the granting of such option or the purchase of shares of Stock thereunder, no such option may be exercised unless and until such registration, listing, qualification, consent or approval shall have been effected or obtained free of any conditions not acceptable to the Board of Directors. The

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Company may require that any person exercising an option shall make such representations and agreements and furnish such information as it deems appropriate to assure compliance with the foregoing or any other applicable legal requirement.

(h) Other Terms and Conditions. The Committee may impose such other terms and conditions, not inconsistent with the terms hereof, on the grant or exercise of options, as it deems advisable.

(i) Terms and Conditions of Options Granted to Directors. Notwithstanding any provision contained in this Plan to the contrary, in the event that the Board of Directors shall determine to authorize grants of options to members of the Committee pursuant to Section 2, then, the terms and conditions of options granted under the Plan to any director of the Company shall be as follows:

(1) The price at which each share of Stock subject to an option may be purchased shall, subject to any adjustments which may be made pursuant to Section 5(f), in no event be less than the market value per share

the option is intended to be an incentive stock option pursuant to Section 6 and the Optionee owns on the date of grant securities possessing more than 10% of the total combined voting power of all classes of securities of the Company or of any Parent or Subsidiary, the price per share shall not be less than 110% of the market value per share of Stock on the date of grant.

(2) The option may be exercised to purchase shares of Stock covered by the option:

A. in accordance with the following schedule:

<TABLE>
<CAPTION>

Exercise Period -----	Cumulative Percentage of Aggregate Number of Shares of Stock Covered by Option Which May be Purchased -----
<S> Within 1st year from date of grant.....	<C> 0%
Beginning one year from date of grant.....	33-1/3%
Beginning two years from date of grant.....	66-2/3%
Beginning three years from date of grant.....	100%

</TABLE>

less, in the case of each exercise period, the number of shares of Stock, if any, previously purchased under the option; or

B. in accordance with a price-triggered vesting schedule that permits exercise of specific increments of options upon achievement of identified target prices above the exercise price in accordance with the terms of similar options approved within ninety days prior to the Directors' option grant date by the Stock Option Committee for members of the Company's

management.

Any option granted under this subparagraph (i) (2) shall terminate and no shares of Stock may be purchased thereunder more than ten years after the date of grant, provided that if the option is intended to be an incentive stock option pursuant to Section 6 and the Optionee owns on the date of grant stock possessing more than 10% of the total combined voting power of all classes of securities of the Company or of any Parent or Subsidiary, the Option shall not be exercisable after the fifth anniversary of the date of grant.

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(3) The maximum number of shares of Stock which may be subject to options granted to all directors pursuant the Plan shall be 1,750,000 shares in the aggregate and the maximum number of shares of Stock which may be subject to options granted to any director pursuant to the Plan (including any options granted under the Plan to a director in his position as an officer or employee of the Company) shall be 500,000 shares.

6. Provisions Applicable to Incentive Stock Options. The Committee may, in its discretion, grant options under the Plan to eligible employees which constitute "incentive stock options" (within the meaning of Section 422A(b) of the Code), provided, however, that (a) no such incentive stock options granted before January 1, 1987 shall (i) be exercisable while there is "outstanding" (within the meaning of Section 422A(c) (7) of the Internal Revenue Code of 1954) any incentive stock option previously granted to the holder thereof to purchase Stock of the Company, or of any Parent or Subsidiary, or of any predecessor of any such corporations, or (ii) cover a number of shares in excess of the maximum number of shares

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permitted to be covered pursuant to the provisions of Section 422A(b) (8) of the Internal Revenue Code of 1954, (b) the aggregate fair market value of the Stock with respect to which incentive stock options granted after 1986 are exercisable for the first time by the Optionee during any calendar year shall not exceed the limitation set forth in Section 422A(b) (7) of the Code, and provided further that Section 5(d) (ii) hereof shall not apply to any incentive stock option.

7. Amendment and Termination. Unless the Plan shall theretofore have been terminated as hereinafter provided, the Plan shall terminate on, and no option shall be granted hereunder after, December 31, 1996; provided, however, that the Board of Directors may at any time prior to that date terminate the Plan. The Board of Directors may at any time amend the Plan; provided, however, that, except as contemplated in Section 5(f), the Board of Directors shall not, without approval by a majority of the votes cast

by the stockholders of the Company at a meeting of stockholders at which a proposal to amend the Plan is voted upon, (i) increase the maximum number of shares of Stock for

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which options may be granted under the Plan, (ii) change the minimum option prices, (iii) extend the period during which options may be granted or exercised, or (iv) except as otherwise provided in the Plan, amend the requirements as to the class of employees eligible to receive options. No termination or amendment of the Plan may, without the consent of an Optionee, adversely affect the rights of such Optionee under any option held by such Optionee.

8. Effectiveness of Plan. The Plan will not be made effective unless approved by a majority of the votes cast by the stockholders of the Company at a meeting of stockholders duly called and held for such purpose, and no option granted hereunder shall be exercisable prior to such approval.

9. Other Actions. Nothing contained in the Plan shall be construed to limit the authority of the Company to exercise its corporate rights and powers, including but not by way of limitation, the right of the Company to grant or assume options for proper corporate purposes other than under the Plan with respect to any employee or other person, firm, corporation or association.

EMPLOYMENT AGREEMENT

AMENDED AND RESTATED EMPLOYMENT AGREEMENT dated as of the first day of July, 1996 by and between NOVACARE, INC., a Delaware corporation (the "Company"), and TIMOTHY E. FOSTER (the "Executive").

W I T N E S S E T H:

WHEREAS, the Executive has served as President and Chief Operating Officer of the Company since October 1994;

WHEREAS, the Company and the Executive entered into an Employment Agreement dated as of December 2, 1994; and

WHEREAS, the Company and the Executive wish to amend and restate said agreement to set forth the terms and conditions on which the Executive will continue to serve in his current positions.

NOW, THEREFORE, in consideration of the premises and the mutual agreements hereinafter set forth, the parties hereto hereby agree as follows:

1. EMPLOYMENT, TERM, AUTOMATIC EXTENSION.

1.1 Employment. The Company agrees to employ the Executive, and the Executive agrees to serve in the employ of the Company, for the term set forth in Section 1.2, in the positions and with the responsibilities, duties and authority set forth in Section 2 and on the other terms and conditions set forth in this Agreement.

1.2 Term. The term of the Executive's employment under this Agreement shall commence on the date hereof and shall terminate on the third anniversary of the date hereof, unless extended or sooner terminated in accordance with this Agreement.

1.3 Automatic Extension. As of June 30, 1998, and as of each subsequent June 30 (each, an "Automatic Renewal Date"), unless either party shall have given a notice of non-extension prior to such Automatic Renewal Date, the term of this Agreement shall be extended automatically for a period of one year to the anniversary of the expiration date of the then-current term of this Agreement. Once a notice of non-extension shall have been given by either party, there shall be no further automatic extension of this Agreement.

2. POSITION, DUTIES.

The Executive shall serve in the positions of President and Chief Operating Officer of the Company. The Executive shall perform, faithfully and diligently, such duties, and shall have such responsibilities, appropriate to said positions, as shall be assigned to him from time to time by the Chief Executive Officer and the Board of Directors of the Company. The Executive shall report to the Chief Executive Officer of the Company. The Executive shall devote such time and attention to the performance of his duties and responsibilities hereunder as shall be necessary for the proper discharge thereof, as determined by the Chief Executive Officer of the Company.

3. SALARY, INCENTIVE BONUS, STOCK OPTIONS.

3.1 Salary. During the term of this Agreement, in consideration of the performance by the Executive of the services set forth in Section 2 and his observance of the other covenants set forth herein, the Company shall pay to the Executive, and the Executive shall accept, a base salary at the rate of \$500,000 per annum, payable in accordance with the standard payroll practices of the Company. The Executive shall be entitled to such increases in base salary during the term hereof as shall be determined by the Chief Executive Officer of the Company and approved by the Compensation Committee of the Board of Directors of the Company in their sole discretion, taking account of the performance of the Company and the Executive, the size of the Company from time to time, and other factors generally considered relevant to the salaries of officers holding similar positions with enterprises comparable to the Company. In no event shall the base salary of the Executive be decreased during the term of this Agreement.

3.2 Incentive Bonuses. (a) In addition to the base salary provided for in Section 3.1, the Company shall pay to the Executive an incentive bonus with respect to each fiscal year of the Company ending during the term of this Agreement in accordance with this Section 3.2. The incentive bonus for each fiscal year under this Section 3.2 shall be the greater of the amounts determined under clause (X) or clause (Y):

(X) an amount equal to the product of the Net Income (as hereinafter defined) of the Company multiplied by the Applicable Percentage (as hereinafter defined); provided that no incentive bonus shall be payable under this Section 3.2 with respect to a fiscal year in which Net Income is less than ninety percent (90%) of Budgeted Net Income (as hereinafter defined).

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For purposes of this clause (X):

(i) the term "Net Income" shall mean, for any fiscal year of the Company, the consolidated after-tax profit of the Company and its wholly-owned subsidiaries for such year, without regard to extraordinary non-operating profits and losses such as gain from sale of operating units, as shown in the audited financial statements of the Company for such fiscal year. In the event of any change in the fiscal year of the Company, appropriate adjustments shall be made to the provisions of this Section 3.2 in order to carry out the essential intent and principles of this Section 3.2;

(ii) the term "Applicable Percentage" shall mean one half of one percent (0.5%) of Net Income for each fiscal year of the Company, beginning with the fiscal year ending June 30, 1996; provided that in any Fiscal Year in which Net Income is between 90% and 99% of Budgeted Net Income, the Applicable Percentage shall be the Applicable Percentage for such Fiscal Year determined without regard to this proviso multiplied by the "Adjustment Percentage" in the table below opposite the percentage (rounded down to the nearest complete percentage point) of Budgeted Net Income attained as Net Income in such Fiscal Year:

<TABLE>

<CAPTION>

	Percentage of Budgeted Net Income Attained	Adjustment Percentage
<S>	<C>	<C>
	90%	45%
	91%	51%
	92%	56%
	93%	62%
	94%	67%
	95%	73%
	96%	78%
	97%	84%
	98%	89%
	99%	95%

</TABLE>

(iii) the term "Budgeted Net Income" shall mean, for any fiscal year of the Company, net income as set forth in the annual business plan of the Company for such fiscal year as prepared by the Company's management and approved by the Board of Directors of the Company; and

(iv) the term "extraordinary non-operating profits and losses such as gain from sale of operating units" shall include capital transaction outside the normal course of

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business but shall not include restructuring charges, charges to increase accounts receivable reserves or similar charges which relate to the operations of the Company or its business units.

(Y) an amount of up to \$100,000 for the fiscal year of the Company ending June 30, 1996, and an amount of up to \$160,000 for the fiscal year of the Company ending June 30, 1997, based on achievement of the applicable performance measures set forth in Exhibit A to this Agreement.

(b) In the event of the termination of employment of the Executive pursuant to Section 6.1 (Death), 6.2 (Disability), Section 6.4 (Without Cause), 6.5 (Voluntary Termination), 6.6 (Constructive Termination) or

6.7 (Change of Control) of this Agreement, the Executive (or his estate or other legal representative) shall be entitled to a bonus for the fiscal year in which such termination takes place in an amount equal to the product of (i) the bonus for such fiscal year determined pursuant to Section 3.2, multiplied by (ii) a fraction, the numerator of which is the number of days from the beginning of such fiscal year to the date of termination, and the denominator of which is 365. In the event of the termination of employment of the Executive pursuant to Section 6.3 (Due Cause) of this Agreement, the Executive shall not be entitled to a bonus for the fiscal year of the Company in which such termination takes place. The Executive shall not be entitled to a bonus for any fiscal year of the Company subsequent to the fiscal year in which the termination of his employment pursuant to Section 6.1 (Death), 6.2 (Disability), 6.3 (Due Cause) or 6.5 (Voluntary Termination) takes place.

(c) The bonus payable to the Executive (or his estate or other legal representative) for any fiscal year of the Company pursuant to this Section 3.2 shall be paid by the Company within ten (10) days of receipt by the Company of the audited financial statements of the Company for such fiscal year.

3.3 Stock Options. (a) On May 3, 1996, the Company granted to the Executive options (the "Options") to purchase 1,000,000 shares of the Company's common stock, par value \$.01 per share ("Common Stock"), at an exercise price per share equal to the market value of the Common Stock on the date of grant. The options were not granted under the 1986 Stock Option Plan (the "1986 Plan"), and are subject to stockholder approval. The Options:

(i) have a term of seven (7) years from the date of grant;

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(ii) become exercisable as follows (but only after November 3, 1996):

(A) 20% on the first to occur of the first anniversary of the date of grant or the average price (as defined in the Stock Option Certificate) of the common stock of NovaCare achieving \$8 per share;

(B) 40% on the first to occur of the second anniversary of the date of grant or the average price of the common stock of NovaCare achieving \$10 per share;

(C) 60% on the first to occur of the third anniversary of the date of grant or the average price of the common stock of NovaCare achieving \$12 per share;

(D) 80% on the first to occur of the fourth anniversary of the date of grant or the average price of the common stock of NovaCare achieving \$14 per share;

(E) 100% on the first to occur of the fifth

anniversary of the date of grant or the average price of the common stock of NovaCare achieving \$16 per share;

(iii) except as provided in clause (iv) of this Section 3.3, remain exercisable for a period of twelve (12) months commencing on the date of termination of employment of the Executive, but only as to those shares as to which the Options were exercisable at the date of termination; and

(iv) become exercisable in full upon a Change in Control of the Company (as defined in Section 6.7), whether or not the employment of the Executive shall be terminated, and upon the termination of the employment of the Executive pursuant to Section 6.1 (Death), Section 6.2 (Disability) or Section 6.4 (Without Due Cause) and, in any such case, shall remain exercisable for the balance of the ten year term.

The Options are or shall be evidenced by a Stock Option Certificate or other appropriate documentation embodying the foregoing terms and other standard terms and conditions not inconsistent with the foregoing terms.

(b) The Executive has heretofore been granted options to purchase 500,000 shares of Common Stock pursuant to the Company's Option Exchange Program, which grant was approved by the Compensation Committee of the Board of Directors of the Company on May 2, 1996. The Executive has heretofore also been

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granted options to purchase an aggregate of 7,200 shares of Common Stock pursuant to the 1986 Plan.

4. EXPENSE REIMBURSEMENT.

During the term of this Agreement, the Company shall reimburse the Executive for all reasonable and necessary out-of-pocket expenses incurred by him in connection with the performance of his duties hereunder, upon the presentation of proper accounts therefor in accordance with the Company's policies.

5. BENEFITS, PERQUISITES.

5.1 Generally. During the term of this Agreement, the Executive will be eligible to participate in all employee benefit plans and programs offered by the Company from time to time to its employees of comparable seniority, subject to the provisions of such plans and programs as in effect from time to time.

5.2 Perquisites. (a) During the term of this Agreement, the Company shall provide the Executive with the use of the Company's private corporate jet for personal travel in connection with two vacations annually; provided that the Company shall have no obligation to provide the Executive with the use of a private corporate jet under this Section 5.2 during any period that the Company does not own or lease a private corporate jet.

(b) During the term of this Agreement, the Company shall also provide the Executive with the following: (i) a telephone in his automobile (for which the Company shall pay for all installation, service and other charges), (ii) first class airfare for travel in connection with the performance of his duties hereunder, (iii) a corporate credit card of the Executive's choosing and (iv) a four-week paid vacation each year.

6. TERMINATION OF EMPLOYMENT.

6.1 Death. In the event of the death of the Executive, the Company shall (i) pay to the estate or other legal representative of the Executive (a) the base salary provided for in Section 3.1 (at the annual rate then in effect) accrued to the date of the Executive's death and not theretofore paid to the Executive and (b) any incentive bonus which shall be or become payable pursuant to Section 3.2. Rights and benefits of the estate or other legal representative or transferee of the Executive (a) with respect to the Options shall be determined in accordance with Section 3.3 and (b) under the benefit plans and

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programs of the Company shall be determined in accordance with the provisions of such plans and programs. Neither the estate or other legal representative of the Executive nor the Company shall have any further rights or obligations under this Agreement, except as provided in Section 15.

6.2 Disability. If the Executive shall become incapacitated by reason of sickness, accident or other physical or mental disability and shall be unable to perform his normal duties hereunder for a period of six (6) consecutive months, then, at any time following the conclusion of such six (6) month period, the employment of the Executive hereunder may be terminated by the Company or the Executive, upon thirty (30) days' notice to the other. In the event of such termination, the Company shall (a) pay to the Executive the base salary provided for in Section 3.1 (at the annual rate then in effect) accrued to the date of such termination and not theretofore paid and (b) pay to the Executive any incentive bonus which shall be or become payable under Section 3.2. Rights and benefits of the Executive or his transferee (a) with respect to the Options shall be determined in accordance with Section 3.3 and (b) under the other benefit plans and programs of the Company shall be determined in accordance with the terms and provisions of such plans and programs. Neither the Executive nor the Company shall have any further rights or obligations under this Agreement, except as provided in Sections 7, 8, 9 and 15.

6.3 Due Cause. The employment of the Executive hereunder may be terminated by the Company at any time for Due Cause (as hereinafter defined). In the event of such termination, the Company shall pay to the Executive the base salary provided for in Section 3.1 (at the annual rate then in effect) accrued to the date of such termination and not theretofore paid to the Executive. The Company shall also pay to the Executive any incentive bonus which shall be or become payable to the Executive under Section 3.2 with respect to any fiscal year of the Company ended prior to the date of such termination.

Rights and benefits of the Executive or his transferee (a) with respect to the Options shall be determined in accordance with Section 3.3 and (b) under the benefit plans and programs of the Company shall be determined in accordance with the provisions of such plans and programs. For purposes hereof, "Due Cause" shall mean (i) willful, gross neglect or willful, gross misconduct in the Executive's discharge of his duties and responsibilities under this Agreement, or (ii) the Executive's conviction of a felony; provided, however, that the Executive shall be given written notice by the Chief Executive Officer of the Company that it intends to terminate the Executive's employment for Due Cause, which written notice shall specify the

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act or acts upon which the Chief Executive Officer of the Company intends so to terminate the Executive's employment, and the Executive shall then be given the opportunity, within fifteen (15) days of his receipt of such notice, to have a meeting with the Chief Executive Officer of the Company to discuss such act or acts. If the basis of such written notice is other than an act or acts described in clause (ii), the Executive shall be given seven (7) days after such meeting within which to cease or correct the performance (or nonperformance) giving rise to such written notice and, upon failure of the Executive within such seven (7) days to cease or correct such performance (or nonperformance), the Executive's employment by the Company shall automatically be terminated hereunder for Due Cause. Neither the Executive nor the Company shall have any further rights or obligations under this Agreement, except as provided in Sections 7, 8, 9 and 15.

6.4 Termination by the Company Without Cause. (a) The Company may terminate the Executive's employment at any time for whatever reason it deems appropriate or without reason; provided, however, that in the event that such termination is not pursuant to Section 6.1 (Death), 6.2 (Disability), 6.3 (Due Cause) or 6.5 (Voluntary Termination), the Company shall pay to the Executive:

(A) on the date of termination, the base salary provided for in Section 3.1 (at the annual rate then in effect) accrued to the date of termination and not theretofore paid to the Executive;

(B) severance pay, in the form of salary continuation for a period ("Severance Pay Period") of two (2) years commencing on the date of termination, at a rate equal to the base salary provided for in Section 3.1 (at the annual rate then in effect);

(C) any incentive bonus which shall be or become payable to the Executive pursuant to Section 3.2;

(D) on a date (the "Payment Date") within ten (10) days of receipt by the Company of the audited financial statements of the Company for the fiscal year in which such termination shall have occurred, an amount equal to the Final Bonus (as hereinafter defined) and, on the first anniversary of the Payment Date, an amount equal to one-half of the Final Bonus. As used herein, (X) if the date of termination of the Executive's employment shall occur during the first six months of any fiscal year of the Company, the

term "Final Bonus" shall mean an amount equal to the bonus earned by the Executive for the last completed

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fiscal year of the Company preceding the date of termination of his employment and (Y) if the date of termination of the Executive's employment shall occur during the last six months of any fiscal year of the Company, the term "Final Bonus" shall mean an amount equal to the greater of (i) the bonus earned by the Executive for the last completed fiscal year of the Company preceding the date of termination of his employment or (ii) the bonus for the fiscal year in which the termination of employment occurs, as determined pursuant to Section 3.2(a) and before prorating pursuant to Section 3.2(b).

(b) During the Severance Pay Period, the Executive shall diligently seek other full-time employment which is suitable and appropriate in light of his background, experience, seniority and stature. Amounts payable to the Executive pursuant to Section 6.4(a)(B) and 6.4(a)(D) shall be offset by amounts earned from other employment (whether as an employee, a consultant or otherwise) during the Severance Pay Period (provided that the Executive shall in no event be required to refund any amounts which he has previously received from the Company and provided, further, that there shall be no offset for the amounts earned by the Executive during the Severance Period from positions held by the Executive prior to commencement of the Severance Period).

(c) Rights and benefits of the Executive or his transferee (a) with respect to the Options shall be determined in accordance with Section 3.3 and (b) under the other benefit plans and programs of the Company shall be determined in accordance with the provisions of such plans and programs. Neither the Executive nor the Company shall have any further rights or obligations under this Agreement, except as provided in Sections 7, 8, 9 and 15.

6.5 Voluntary Termination. The Executive may terminate his employment with the Company at any time upon thirty (30) days' prior written notice to the Company. In the event of such termination (unless such termination is within one year following a Change in Control of the Company, in which case the provisions of Section 6.7 hereof shall be applicable), the Company shall pay to the Executive the base salary provided for in Section 3.1 (at the annual rate then in effect) accrued to the date of such termination and not theretofore paid to the Executive. The Company shall also pay to the Executive any incentive bonus which shall be or become payable pursuant to Section 3.2. Rights and benefits of the Executive or his transferee (a) with respect to the Options shall be determined in accordance with Section 3.3 and (b) under the benefit plans and programs of the Company shall be determined in accordance with

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the provisions of such plans and programs. Neither the Executive nor the Company shall have any further rights or obligations under this Agreement, except as provided in Sections 7, 8, 9 and 15.

6.6 Constructive Termination. Anything herein to the contrary notwithstanding, if the Company:

(A) demotes the Executive to a lesser position than provided in Section 2;

(B) causes a material change in the nature or scope of the authorities, powers, functions, duties, or responsibilities attached to the Executive's position as described in Section 2;

(C) decreases the Executive's base salary, changes the bonus formula provided for in Section 3 or eliminates any of the benefits or perquisites provided for in Section 5; or

(D) fails to cause the election of the Executive to the Board of Directors of the Company;

then, within thirty (30) days after learning of the action (or inaction), the Executive may advise the Company in writing that the action (or inaction) constitutes a termination of his employment by the Company pursuant to Section 4.4 (Without Cause), in which event the Company shall have thirty (30) days (the "Correction Period") in which to correct such action (or inaction). If the Company does not correct such action (or inaction) during the Correction Period, such action (or inaction) shall (unless consented to in writing by the Executive) constitute a termination of the Executive's employment by the Company pursuant to Section 6.4 (Without Cause) effective on the first business day following the end of the Correction Period.

6.7 Termination of Employment Following a Change in Control. Anything herein to the contrary notwithstanding, the Executive may terminate his employment with the Company during the one (1) year period following a Change in Control, and such termination shall constitute a termination of the Executive's employment by the Company pursuant to Section 6.4 (Without Cause); provided, however, that the amounts referred to in paragraphs (A) and (B) of Section 6.4 shall be paid to the Executive in a lump sum on the date of termination and the amounts referred to in paragraph (D) of Section 6.4 shall be paid to the Executive in a lump sum on the Payment Date; and further provided that the Executive shall be under no obligation to seek other employment and shall be under no obligation to offset any

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amounts earned from such other employment (whether as an employee, a consultant or otherwise) against such payments. For purposes of this Agreement, a Change in Control of the Company shall be deemed to have occurred if:

(A) a "person" (meaning an individual, a partnership, or other group or association as defined in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, other than the Executive or a group including the Executive), either (i) acquires twenty percent (20%) or more of the combined voting power of the outstanding securities of the Company having a right to vote in elections of directors and such acquisition shall not have been approved within sixty (60) days following such acquisition by a majority of the Continuing Directors (as hereinafter defined) then in office or (ii) acquires fifty percent (50%) or more of the combined voting power of the

outstanding securities of the Company having a right to vote in elections of directors; or

(B) Continuing Directors shall for any reason cease to constitute a majority of the Board of Directors of the Company; or

(C) all or substantially all of the business and/or assets of the Company is disposed of by the Company to a party or parties other than a subsidiary or other affiliate of the Company, pursuant to a partial or complete liquidation of the Company, sale of assets (including stock of a subsidiary of the Company) or otherwise.

For purposes of this Agreement, the term "Continuing Director" shall mean a member of the Board of Directors of the Company who either was a member of the Board of Directors on the date hereof or who subsequently became a Director and whose election, or nomination for election, was approved by a vote of at least two-thirds of the Continuing Directors then in office.

6.8 Acceleration of Payments. In the event that the Company shall fail to pay to the Executive any amount payable pursuant to this Section 6 at the time such payment is due, all amounts to be paid to the Executive (or his estate or legal representative) pursuant to this Section 6, Section 3 and any other provision of this Agreement shall become immediately due and payable without any further action by the Executive (or his estate or legal representative).

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7. CONFIDENTIAL INFORMATION.

7.1 Nondisclosure. The Executive shall, during the term of this Agreement and at all times thereafter, treat as confidential and, except as required in the performance of his duties and responsibilities under this Agreement, not disclose, publish or otherwise make available to the public or to any individual, firm or corporation any confidential information (as hereinafter defined).

7.2 Confidential Information Defined. For the purposes hereof, the term "confidential information" shall mean all information acquired by the Executive in the course of the Executive's employment with the Company in any way concerning the products, projects, activities, business or affairs of the Company or the Company's customers, including, without limitation, all information concerning trade secrets and the products or projects of the Company and/or any improvements therein, all sales and financial information concerning the Company, all customer and supplier lists, all information concerning projects in research and development or marketing plans for any such products or projects, and all information in any way concerning the products, projects, activities, business or affairs of customers of the Company which is furnished to the Executive by the Company or any of its agents or customers, as such; provided, however, that the term "confidential information" shall not include information which (a) becomes generally available to the public other than as a

result of a disclosure by the Executive, (b) was available to the Executive on a non-confidential basis prior to his employment with the Company or (c) becomes available to the Executive on a non-confidential basis from a source other than the Company or any of its agents or customers provided that such source is not bound by a confidentiality agreement with the Company or any of such agents or customers.

8. INTERFERENCE WITH THE COMPANY.

8.1 Restrictions. The Executive acknowledges that the services to be rendered by him to the Company are of a special and unique character. In order to induce the Company to enter into this Agreement, and in consideration of his employment hereunder, the Executive agrees, for the benefit of the Company, that he will not, during the period of his employment with the Company and thereafter, for the Applicable Period (as hereinafter defined) commencing on the date of termination of his employment with the Company:

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(a) engage, directly or indirectly, whether as principal, consultant, employee, partner, stockholder, limited partner or other investor (other than a passive investment of (i) not more than five percent (5%) of the stock or equity of any corporation the capital stock of which is publicly traded or (ii) not more than five percent (5%) of the ownership interest of any partnership or other entity) or otherwise, within the United States of America, with any firm or person in any activity or business venture which is in competition with any line or lines of business being conducted by the Company or any subsidiary of the Company at the date of termination of the Executive's employment with the Company, accounting for ten percent (10%) or more of the Company's consolidated gross sales, revenues or earnings before taxes for the fiscal year ended immediately prior to the conduct in question (the "Competition Restriction"); or

(b) solicit or entice or endeavor to solicit or entice away from the Company any person who was an employee of the Company at job grade numbering 32 or higher, either for his own account or for any individual, firm or corporation, whether or not such person would commit any breach of his contract of employment by reason of leaving the service of the Company (the "Solicitation Restriction"); or

(c) employ, directly or indirectly, any person who was an employee of the Company at job grade numbering 32 or higher at any time during the one year period ending on the date of termination of the Executive's employment with the Company, except that this restriction shall not apply in the case of any person whose employment shall have been terminated by the Company (the "Hiring Restriction").

8.2 Time Periods. As used in this Section 8, the term "Applicable Period" shall mean:

(a) twenty-four (24) months in the case of a termination of employment pursuant to Section 6.3 (Due Cause), Section 6.4

(Without Due Cause), Section 6.6 (Constructive Termination), or Section 6.7 (Change in Control); and

(b) twenty-four (24) months in the case of a termination pursuant to Section 6.2 (Disability) or Section 6.5 (Voluntary Termination), but only if the Company gives notice to the Executive within thirty (30) days of the date of termination of employment of its intention to enforce such restrictions against the Executive, and subject to the Company's continued payment to the Executive during such twenty-four (24) month period of the base salary provided for in Section 3.1 (at the annual rate in effect at the date of termination).

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9. EQUITABLE RELIEF.

In the event of a breach or threatened breach by the Executive of any of the provisions of Sections 7 or 8 of this Agreement, the Executive hereby consents and agrees that the Company shall be entitled to an injunction or similar equitable relief from any court of competent jurisdiction restraining the Executive from committing or continuing any such breach or threatened breach or granting specific performance of any act required to be performed by the Executive under any of such provisions, without the necessity of showing any actual damage or that money damages would not afford an adequate remedy and without the necessity of posting any bond or other security. Nothing herein shall be construed as prohibiting the Company from pursuing any other remedies at law or in equity which it may have.

10. SUCCESSORS AND ASSIGNS.

10.1 Assignment by the Company. The Company shall require any successors (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company to assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform if no such succession had taken place. As used in this Section, the "Company" shall mean the Company as hereinbefore defined and any successor to its business and/or assets as aforesaid which otherwise becomes bound by all the terms and provisions of this Agreement by operation of law and this Agreement shall be binding upon, and inure to the benefit of, the Company, as so defined.

10.2 Assignment by the Executive. The Executive may not assign this Agreement or any part thereof without the prior written consent of a majority of the Board of Directors of the Company; provided, however, that nothing herein shall preclude one or more beneficiaries of the Executive from receiving any amount that may be payable following the occurrence of his legal incompetency or his death and shall not preclude the legal representative of his estate from receiving such amount or from assigning any right hereunder to the person or persons entitled thereto under his will or, in the case of intestacy, to the person or persons entitled thereto under the laws of intestacy applicable to his estate. The term "beneficiaries", as used in this Agreement, shall mean a beneficiary or beneficiaries so designated to receive any such amount or, if no

beneficiary has been so designated, the legal representative of the Executive (in the event of his incompetency) or the Executive's estate.

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11. GOVERNING LAW.

This Agreement shall be deemed a contract made under, and for all purposes shall be construed in accordance with, the laws of the Commonwealth of Pennsylvania applicable to contracts to be performed entirely within such state. In the event that a court of any jurisdiction shall hold any of the provisions of this Agreement to be wholly or partially unenforceable for any reason, such determination shall not bar or in any way affect the Company's right to relief as provided for herein in the courts of any other jurisdiction. Such provisions, as they relate to each jurisdiction, are, for this purpose, severable into diverse and independent covenants. Service of process on the parties hereto at the addresses set forth herein shall be deemed adequate service of such process.

12. ENTIRE AGREEMENT.

This Agreement contains all the understandings and representations between the parties hereto pertaining to the subject matter hereof and supersedes all undertakings and agreements, whether oral or in writing, if any there be, previously entered into by them with respect thereto.

13. AMENDMENT, MODIFICATION, WAIVER.

No provision of this Agreement may be amended or modified unless such amendment or modification is agreed to in writing and signed by the Executive and by a duly authorized representative of the Company other than the Executive. Except as otherwise specifically provided in this Agreement, no waiver by either party hereto of any breach by the other party hereto of any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of a similar or dissimilar provision or condition at the same or any prior or subsequent time, nor shall the failure of or delay by either party hereto in exercising any right, power or privilege hereunder operate as a waiver thereof to preclude any other or further exercise thereof or the exercise of any other such right, power or privilege.

14. ARBITRATION.

Any controversy or claim arising out of or relating to this Agreement, or any breach thereof, shall, except as provided in Section 9, be settled by arbitration in accordance with the rules of the American Arbitration Association then in effect and judgment upon such award rendered by the arbitrator may be entered in any court having jurisdiction thereof. The

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arbitration shall be held in the area where the Company then has its principal place of business. The arbitration award shall include attorneys' fees and costs to the prevailing party.

15. ADVANCE OF DEFENSE EXPENSES.

In the event of any action, proceeding or claim against the Executive arising out of his serving or having served in his capacity as an officer and/or director of the Company, which in the Executive's sole judgment requires him to retain counsel (such choice of counsel to be made in his sole and absolute discretion) or otherwise expend his personal funds for his defense in connection therewith, the Company shall be obligated to advance to the Executive (or pay directly to his counsel) counsel fees and other costs associated with the Executive's defense of such action, proceeding or claim; provided, however, that in such event the Executive shall first agree in writing, without posting bond or collateral, to repay all sums paid or advanced to him pursuant to this Section 15 in the event that the final disposition of such action, proceeding or claim is one for which the Executive would not be entitled to indemnification pursuant to the provisions of the laws of the State of Delaware or the Certificate of Incorporation or By-laws of the Company.

16. NOTICES.

Any notice to be given hereunder shall be in writing and delivered personally or sent by certified mail, postage prepaid, return receipt requested, addressed to the party concerned at the address indicated below or at such other address as such party may subsequently designate by like notice:

If to the Company:

NovaCare, Inc.
1016 West Ninth Avenue
King of Prussia, Pennsylvania 19406
Attention: Chief Executive Officer

If to the Executive:

Timothy E. Foster
1235 Page Terrace
Villanova, Pennsylvania 19085

17. SEVERABILITY.

Should any provision of this Agreement be held by a court or arbitration panel of competent jurisdiction to be

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enforceable only if modified, such holding shall not affect the validity of the remainder of this Agreement, the balance of which shall continue to be binding upon the parties hereto with any such modification to become a part hereof and treated as though originally set forth in this Agreement. The parties further agree that any such court or arbitration panel is expressly authorized to modify any such unenforceable provision of this Agreement in lieu of severing such unenforceable provision from this Agreement in its entirety, whether by rewriting the offending provision, deleting any or all of the offending

provision, adding additional language to this Agreement, or by making such other modifications as it deems warranted to carry out the intent and agreement of the parties as embodied herein to the maximum extent permitted by law. The parties expressly agree that this Agreement as so modified by the court or arbitration panel shall be binding upon and enforceable against each of them. In any event, should one or more of the provisions of this Agreement be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provisions hereof, and if such provision or provisions are not modified as provided above, this Agreement shall be construed as if such invalid, illegal or unenforceable provisions had never been set forth herein.

18. WITHHOLDING.

Anything to the contrary notwithstanding, all payments required to be made by the Company hereunder to the Executive or his beneficiaries, including his estate, shall be subject to withholding of such amounts relating to taxes as the Company may reasonably determine it should withhold pursuant to any applicable law or regulation. In lieu of withholding such amounts, in whole or in part, the Company, may, in its sole discretion, accept other provision for payment of taxes as permitted by law, provided it is satisfied in its sole discretion that all requirements of law affecting its responsibilities to withhold such taxes have been satisfied.

19. SURVIVORSHIP.

The respective rights and obligations of the parties hereunder shall survive any termination of this Agreement to the extent necessary to the intended preservation of such rights and obligations.

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20. TITLES.

Titles of the sections and paragraphs of this Agreement are intended solely for convenience and no provision of this Agreement is to be construed by reference to the title of any section or paragraph.

21. COUNTERPARTS.

This Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which taken together shall constitute one and the same instrument.

* * *

19

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date first above written.

NOVACARE, INC.

By

John H. Foster
Chairman of the Board

Timothy E. Foster

The foregoing Agreement has been
Approved by the Compensation Committee
of the Board of Directors:

Robert G. Stone
Chairman of Compensation Committee

20

EXHIBIT A

FISCAL YEAR
ENDING

APPLICABLE PERFORMANCE MEASURES

June 30, 1996

Aggregate Contract Services,
Polaris and Corporate EBITDA
(before restructure charges,
extraordinary items and
intercompany eliminations) for the
six months ended June 30, 1996 of
not less than \$26 million

June 30, 1997

Total Company consolidated EBITDA
for the twelve months ended June
30, 1997 before restructure charges
and extraordinary items of not less
than \$82 million

March 17, 1995

Mr. Robert E. Healy, Jr.
1929 Black Rock Rd.
Paoli, PA 19301

Dear Rob:

This letter will confirm our agreement relative to your role and compensation as Vice President and Chief Financial Officer of the Contract Services Division. The agreements we reached are as follows:

- RESPONSIBILITIES - You will assume responsibility for certain division staff departments for such time as determined by me. These functions and their managers are:
 - Human Resources - Kathy Kehoe
 - Sales and Marketing - Rick Smith
 - Clinical Services - Denise Mayhan
 - Customer Relations - Hal Price
 - Information Services - Steve Wise
- BASE SALARY - You will be paid \$7,307.69 bi-weekly. That annualizes to a salary of \$190,000.00 effective February 17, 1995. You will be eligible for a salary review in January, 1996.
- INCENTIVE - You will continue to be eligible for a bonus of 35% of your base salary as determined by the performance of the Contract Services Division and personal goals which you and I have negotiated.
- EQUITY - You will continue to be eligible to participate in the 1986 Stock Option Plan as determined by division performance and your performance against personal goals subject to approval by the Board of Directors.

Mr. Robert E. Healy, Jr.
March 17, 1995
Page 2

- SEVERANCE - Should your employment be terminated for reasons other than cause, NovaCare will continue to pay your base salary for a period of twelve (12) months or until you find comparable employment which ever comes first. All other provisions of the Contract Services Division

Severance Policies will also be in effect in the event of your termination including the execution of an Agreement and General Release. For purposes of this agreement, due cause shall include (a) the Employee's willful and continuing failure to discharge his duties, or (b) the Employee's commission of a felony or any crime or offense involving moral turpitude.

It is understood that the Employee's employment is at will. The Employee or the Company may terminate the Employee's employment at any time. The Employee and the Company acknowledge that there is no implied or actual employment contract for a period of time.

I believe that these are the issues that we discussed. Let me again confirm your importance to the Contract Services Division executive team. Your support, loyalty and counsel are appreciated. You have been Helping Make Life a Little Better for this business. Please acknowledge your acceptance by signing a copy of this letter and returning it to me.

Sincerely,

/s/ _____
Daryl A. Dixon
President and General Manager
Contract Services Division

DAD/mp

/s/ _____
Robert E. Healy, Jr.

Date

cc: Tim Foster

NOVACARE, INC.
1016 WEST NINTH AVENUE
KING OF PRUSSIA, PA 19406

June 30, 1996

PNC Bank, National Association,
as Agent
One PNC Plaza
Fifth Avenue and Wood Street
Pittsburgh, PA 15265
Attn: Marcie Knittel, Vice President

RE: Fifth Amendment to Credit Agreement (the "Fifth
Amendment")

Dear Marcie:

We refer to that certain Credit Agreement, dated as of May 27, 1994, as amended (the "Credit Agreement"), by and among NovaCare, Inc. ("NovaCare") and certain of its Subsidiaries, the Banks party thereto and PNC Bank, National Association, as agent for the Banks ("Agent"). Defined terms used herein, not otherwise defined herein, shall have the meanings given to them under the Credit Agreement as amended hereby.

The Borrowers and Guarantors, the Banks and the Agent hereby desire to amend the Credit Agreement, as hereinafter provided.

The parties hereto in consideration of their mutual covenants and agreements hereinafter set forth, and intending to be legally bound hereby, covenant and agree as follows:

AGREEMENT

1. Amendment of Credit Agreement

The parties hereto do hereby modify and amend the Credit Agreement as follows:

(a) Cover page is hereby amended by deleting in line 1 the number "\$175,000,000" and inserting in lieu thereof the number "150,000,000".

(b) Recital paragraph 1, page 1, is hereby amended by deleting in line 3 the number "\$175,000,000" and inserting in lieu thereof the number "\$150,000,000".

2

(c) Upon the effectiveness of this Fifth Amendment and for periods subsequent to such effective date, NatWest Bank N.A. (which has merged with and into Fleet Bank, N.A., with Fleet Bank, N.A. as the surviving entity) shall no longer be a Bank.

2. Amendment to Schedules.

(a) Schedules. Schedule 1.01(B) [List of Banks, Commitments and Closing Fees] to the Agreement is hereby amended and restated in its entirety in the form of such Schedule attached hereto.

3. Conditions of Effectiveness.

The effectiveness of this Fifth Amendment is expressly conditioned upon the occurrence and completion of all of the following: (i) the Agent's receipt of counterparts of this Fifth Amendment duly executed by the Borrowers, the Guarantors and the Banks; (ii) the Agent's receipt of a certificate signed by the Secretary or Assistant Secretary of the Borrowers and Guarantors, certifying as to all action taken by the Borrowers and Guarantors to authorize the execution, delivery and performance of this Fifth Amendment; (iii) an opinion of Peter D. Bewley, General Counsel of the Loan Parties reasonably satisfactory to the Agent regarding this Fifth Amendment; and (iv) receipt by Fleet Bank, N.A. of all principal due and payable to Fleet Bank, N.A. together with accrued interest thereon and any outstanding fees payable through and including the effective date of this Fifth Amendment.

This Fifth Amendment shall be dated as of and shall be effective as of the date and year first above written which shall be the date

of satisfaction of all conditions precedent to effectiveness as set forth in this Section 3.

4. Consent of All Banks.

Pursuant to Section 11.01(b) of the Credit Agreement, this Fifth Amendment shall require the written consent of all of the Banks.

5. Full Force and Effect.

Except as expressly modified and amended by this Fifth Amendment, the Credit Agreement and the other Loan Documents are hereby ratified and confirmed and shall remain in full force and effect.

6. Costs, Expenses, Disbursements.

The Borrowers hereby agree to reimburse the Agent and the Banks on demand for all costs, expenses and disbursements relating to this Fifth Amendment which are payable by the Borrowers as provided in Section 10.05 of the Credit Agreement.

- 2 -

3

7. Counterparts.

This Fifth Amendment may be executed by different parties hereto in any number of separate counterparts, each of which, when so executed and delivered, shall be an original, and all of such counterparts shall together constitute one and the same instrument.

8. Governing Law.

This Fifth Amendment shall be deemed to be a contract under the laws of the Commonwealth of Pennsylvania and for all purposes shall be governed by and construed and enforced in accordance with the internal laws of the Commonwealth of Pennsylvania without regard to its conflict of laws principles.

- 3 -

4

[Signature Page 1 of 7 to Fifth Amendment]

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

<TABLE>
<S>

<C>
BORROWERS AND GUARANTORS:

ATTEST: NOVACARE, INC., a Delaware corporation, and each of the other BORROWERS listed on Schedule 6.01(c) of the Credit Agreement (which Schedule is attached hereto as Exhibit I) and each of the GUARANTORS listed on Schedule 6.01(c) of the Credit Agreement (which Schedule is attached hereto as Exhibit I), other than those listed below

By: _____

By: _____
[Name],

[Seal] the _____ [Title] of each Borrower and Guarantor listed on Schedule 6.01(c) of the Credit Agreement (which Schedule is attached hereto as Exhibit I), other than those listed below, which is a corporation and of each general partner of each Borrower and Guarantor which is a partnership

ATTEST: NACC, INC., a Delaware Corporation

By: _____

By: _____

[Name],

the _____ [Title] of NACC, Inc.

[Seal]

</TABLE>

5

[Signature Page 2 of 7 to Fifth Amendment]

<TABLE>

<S>

ATTEST:

<C>

CR SERVICES CORP., a Delaware corporation

By: _____

By: _____

[Name],

[Seal]

the _____ [Title] of
CR Services Corp.

Address for Notices for each of the
foregoing Borrowers and Guarantors:

1016 West Ninth Avenue
King of Prussia, PA 19406

Telecopier No. (610) 992-3328
Attention: Chief Financial Officer
Telephone No. (610) 992-7200

</TABLE>

6

[Signature Page 3 of 7 to Fifth Amendment]

[INTENTIONALLY BLANK]

7

[Signature Page 4 of 7 to Fifth Amendment]

AGENT:

PNC BANK, NATIONAL ASSOCIATION, as Agent

By: _____

Title: _____

Address for Notices:

One PNC Plaza
Fifth Avenue and Wood Street
Pittsburgh, PA 15265

Telecopier No. (412) 762-2784
Attention: Regional Healthcare Group
Telephone No. (412) 762-8343

BANKS:

PNC BANK, NATIONAL ASSOCIATION

By: _____

Title: _____

Address for Notices:

One PNC Plaza
Fifth Avenue and Wood Street
Pittsburgh, PA 15265

Telecopier No. (412) 762-2784
Attention: Regional Healthcare Group
Telephone No. (412) 762-8343

8

[Signature Page 5 of 7 to Fifth Amendment]

CORESTATES BANK, N.A.

By: _____

Name: _____

Title: _____

Address for Notices:

1339 Chestnut Street
P.O. Box 7618
FC 1-8-3-22
Philadelphia, PA 19101

Telecopier No. (215) 786-7721
Attention: Jennifer W. Leibowitz
Assistant Vice President
Telephone No. (215) 786-3972

FIRST UNION NATIONAL BANK
OF NORTH CAROLINA

By: _____

Name: James F. Young
Title: Assistant Vice President

Address for Notices:

One First Union Center
301 S. Giles Street
Charlotte, NC 28288-0735

Telecopier No. (704) 374-4092
Attention: James F. Young,
Assistant Vice President
Telephone No. (704) 383-0507

9

FLEET BANK OF MASSACHUSETTS, N.A.

By: _____
Name: _____
Title: _____

Address for Notices:

Health Care and Non Profit Group
Fleet Center MA BOF 04A
75 State Street
Boston, MA 02109-1810

Telecopier No. (617) 346-1646
Attention: Amy Fredericks
Vice President
Telephone No. (617) 346-1629

MELLON BANK, N.A.

By: _____
Name: _____
Title: _____

Address for Notices:

Healthcare Banking
Plymouth Meeting/Exec. Campus
610 W. Germantown Pike
Suite 200/AIM #19E-0246
Plymouth Meeting, PA 19462

Telecopier No. (610) 941-4136
Attention: Carol Paige
Vice President
Telephone No. (610) 941-8409

NATIONSBANK, N.A.

By: _____
Name: _____
Title: _____

Address for Notices:

6610 Rockledge Drive
1st Floor
Bethesda, MD 20817-1876

Telecopier No. (301) 571-0719
Attention: Michael B. Andry
Vice President
Telephone No. (301) 571-0710

FLEET BANK, N.A.

By: _____
Name: _____

Title: _____

Address for Notices:

1133 Avenue of the Americas
40th Floor
New York, NY 10036

Telecopier No. (212) 703-1744
Attention: W. Wakefield Smith
Vice President
Telephone No. (212) 703-1714

11

Exhibit 10(j) (vii)

NOVACARE, INC.
1016 WEST NINTH AVENUE
KING OF PRUSSIA, PA 19406

June 30, 1996

PNC Bank, National Association,
as Agent
One PNC Plaza
Fifth Avenue and Wood Street
Pittsburgh, PA 15265
Attn: Marcie Knittel, Vice President

RE: Sixth Amendment to Credit Agreement (the "Sixth Amendment")

Dear Marcie:

We refer to that certain Credit Agreement, dated as of May 27, 1994, as amended (the "Credit Agreement"), by and among NovaCare, Inc. ("NovaCare") and certain of its Subsidiaries, the Banks party thereto and PNC Bank, National Association, as agent for the Banks ("Agent"). Defined terms used herein, not otherwise defined herein, shall have the meanings given to them under the Credit Agreement as amended hereby.

The Borrowers and Guarantors, the Banks and the Agent hereby desire to amend the Credit Agreement, as hereinafter provided.

The Borrowers have requested that the Banks waive the limitation set forth in Section 8.02(j)(ii) of the Credit Agreement for the limited purpose of permitting Nova Care to repurchase up to \$55 million of its common stock during the fiscal year beginning July 1, 1995 and ending June 30, 1996.

The parties hereto in consideration of their mutual covenants and agreements hereinafter set forth, and intending to be legally bound hereby, covenant and agree as follows:

AGREEMENT

1. Amendment and Restatement. Articles I through XI of the Credit Agreement are hereby amended and restated in their entirety as of the date hereof to read as set forth on Exhibit I hereto (The cover page, opening paragraph and recitals to the Agreement are also included in Exhibit I for convenience).

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2. Amendment to Exhibits and Schedules.

(a) Exhibits. The following Exhibits to the Credit Agreement are hereby amended and restated in their entirety in the forms of such Exhibits attached hereto:

Exhibit 1.01(P)(1)(E)	Permitted Poolings Notice Certificate
Exhibit 1.01(P)(1)(F)	Permitted Poolings Approval Certificate - Agent
Exhibit 1.01(P)(1)(G)	Permitted Poolings Approval Certificate - Required Banks
Exhibit 1.01(P)(2)	Permitted Purchases Approval

(b) Schedules. The following Schedules to the Credit Agreement are hereby amended and restated in their entirety in the forms of such Schedules attached hereto:

Schedule 1.01(E) Excluded Entities
Schedule 6.01(c) Subsidiaries

3. Closing Fees.

The Borrowers, jointly and severally, agree to pay to the Agent for the account of each Bank, as consideration for this Sixth Amendment, a nonrefundable fee equal to the amount set forth across from such Bank's name on Exhibit II hereto, payable on or before the Sixth Amendment Effective Date.

4. Dissolution of NovaCare Management.

NovaCare represents and warrants that it has caused the dissolution of NovaCare Management in accordance with the provisions of Section 8.02(d) of the Credit Agreement and delivered evidence of such dissolution to the Agent, in form and substance satisfactory to the Agent.

5. Waivers.

(a) Waiver - Section 8.02(j) (ii)

The Banks hereby waive the percentage limitation set forth in Section 8.02(j) (ii) of the Credit Agreement which prohibits payments by NovaCare for stock repurchases or redemptions exceeding twenty-five percent (25%) of consolidated net income earned in respect of any fiscal year for the sole, limited purpose of permitting Nova Care to repurchase, during the fiscal year beginning July 1, 1995 and ending June 30, 1996, up to an aggregate maximum amount

- 2 -

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of \$55 million of its capital stock (such \$55 million maximum amount to be based upon the close price of the stock on each date of repurchase as quoted on the New York Stock Exchange), so long as no Event of Default or Potential Event of Default shall have occurred or be continuing or shall exist after giving effect to any and all such repurchases.

(b) Waiver - Compliance Certificate for Quarter Ended March 31, 1996

It is acknowledged that the compliance certificate delivered to the Banks by the Borrowers for the quarter ended March 31, 1996, as required by Section 8.01(m) (iii) of the Credit Agreement, was prepared and calculations set forth therein were made in accordance with the Credit Agreement as amended and restated by this Sixth Amendment. The Banks hereby waive the requirement of the Borrowers to provide a compliance certificate pursuant to Section 8.01(m) (iii) of the Credit Agreement for the quarter ended March 31, 1996 prepared and calculated in accordance with the Credit Agreement in effect at the time of delivery of such compliance certificate for such fiscal quarter.

6. Conditions of Effectiveness.

The effectiveness of this Sixth Amendment and Waiver is expressly conditioned upon the occurrence and completion of all of the following: (i) receipt by the Agent of the nonrefundable fee set forth in that certain letter agreement among the Agent and the Borrowers with respect to this Sixth Amendment; (ii) receipt by the Agent on behalf of the Banks of the nonrefundable fees equal to the aggregate of the amounts set forth on Exhibit II hereto; (iii) the Agent's receipt of counterparts of this Sixth Amendment duly executed by the Borrowers, the Guarantors and the Banks; (iv) the Agent's receipt of a certificate signed by the Secretary or Assistant Secretary of the Borrowers and Guarantors, certifying as to all action taken by the Borrowers and Guarantors to authorize the execution, delivery and performance of this Sixth Amendment; (v) an opinion of Peter D. Bewley, General Counsel of the Loan Parties, reasonably satisfactory to the Agent regarding this Sixth Amendment, and (vi) with respect to each new Guarantor or new Borrower (a "Joining Subsidiary") documentation as required under Section 11.18 of the Credit Agreement, including without limitation the completion of the following: (1) executing and delivering to the Agent (A) in the case of a Joining Subsidiary which becomes a Borrower, a Revolving Credit Note in the form of Exhibit

1.01(R) to the Credit Agreement, payable to each Bank, (B) a joinder to the Credit Agreement in form satisfactory to the Agent, (C) a counterpart signature page to the Guaranty Agreement executed by certain Loan Parties which is in the form of Exhibit 1.01(G)(1) to the Credit Agreement,, in the case of a Joining Subsidiary which becomes a Borrower, and Exhibit 1.01(G)(2) to the Credit Agreement, in the case of a Joining Subsidiary which becomes a Guarantor, (D) if it owns stock or other ownership interests in any Qualifying Subsidiary, a joinder to the Pledge Agreement executed by certain Loan Parties which is in the form of Exhibit 1.01(P)(4) to the Credit Agreement, 1.01(P)(5) to the Credit Agreement, or 1.01(P)(6) to the Credit Agreement, as applicable, and delivering, as applicable, the original certificates evidencing such stock or other ownership interest if it is certificated with appropriate stock powers or other assignments signed in blank and UCC-1 financing statements necessary to perfect the security interests of the Agent for the benefit of the Banks therein, (E) a joinder to the Subordination

- 3 -

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Agreement (Intercompany) executed by certain Loan Parties which is in the form of Exhibit 1.01(S) to the Credit Agreement, (F) a joinder to the Agency Agreement executed by certain Loan Parties appointing NovaCare as agent; (2) delivering to the Agent an opinion of Peter D. Bewley, General Counsel of the Loan Parties, reasonably satisfactory to the Agent regarding such Joining Subsidiary and such joinder; (3) delivering to the Agent certified copies of its organizational documents and other documents as requested by the Agent; and (4) the Loan Party which owns the stock or other ownership interest of the Joining Subsidiary shall execute and deliver to the Agent for the benefit of the Banks a Pledge Agreement in the form of Exhibit 1.01(P)(4), 1.01(P)(5) or 1.01(P)(6) to the Credit Agreement, as applicable, and the original certificates evidencing such stock or other ownership interest if it is certificated with appropriate stock powers or other assignments signed in blank and UCC-1 financing statements necessary to perfect the security interests of the Agent for the benefit of the Banks therein, and (G) updated Schedules to the Credit Agreement and the other Loan Documents, if any, to update such schedules with respect to each Joining Subsidiary, such updated Schedules to be in form and substance satisfactory to the Required Banks.

This Sixth Amendment shall be dated as of and shall be effective as of the date and year first above written subject to satisfaction of all conditions precedent to effectiveness as set forth in this Section 5, which date shall be the Sixth Amendment Effective Date.

7. Consent of All Banks.

Pursuant to Section 11.01(b) of the Credit Agreement, this Sixth Amendment shall require the written consent of all of the Banks.

8. Full Force and Effect.

Each of the following documents shall remain in full force and effect on and after the date of this Amendment:

(a) each of the Schedules attached to the Credit Agreement except for Schedules which are being amended and restated hereby;

(ii) each of the Exhibits attached to the Credit Agreement except for Exhibits which are being amended and restated hereby; and

(iii) the Notes, the Guaranty Agreements, the Pledge Agreements, the Agent's Fee Letter, the Subordination Agreement (Intercompany), the Borrower Agency Agreement and all other Loan Documents (except for Articles I through XI of the Agreement and the Exhibits and Schedules thereto listed in Paragraph 2 hereof, each of which are being amended and restated hereby) remain in full force and effect on and after the date hereof. On and after the date hereof, each reference in the Credit Agreement to "this Agreement", "hereunder" or words of like import shall mean and be a reference to the Credit Agreement, as amended by this Amendment, and each reference in each other Loan Document to the "Credit Agreement" shall

- 4 -

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mean and be a reference to the Credit Agreement, as previously amended and as amended by this Amendment. No novation is intended by this Sixth Amendment.

The parties hereto do not amend or waive any provisions of the Agreement or the other Loan Documents except as expressly set forth herein.

9. Costs, Expenses, Disbursements.

The Borrowers hereby agree to reimburse the Agent and the Banks on demand for all costs, expenses and disbursements relating to this Sixth Amendment which are payable by the Borrowers as provided in Section 10.05 of the Credit Agreement.

10. Counterparts.

This Sixth Amendment may be executed by different parties hereto in any number of separate counterparts, each of which, when so executed and delivered, shall be an original, and all of such counterparts shall together constitute one and the same instrument.

11. Governing Law.

This Sixth Amendment shall be deemed to be a contract under the laws of the Commonwealth of Pennsylvania and for all purposes shall be governed by and construed and enforced in accordance with the internal laws of the Commonwealth of Pennsylvania without regard to its conflict of laws principles.

[INTENTIONALLY BLANK]

[Signature Page 1 of 7 to Sixth Amendment]

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

<TABLE>
<S>

<C>
BORROWERS AND GUARANTORS:

ATTEST: NOVACARE, INC., a Delaware corporation, and each of the other BORROWERS listed on Schedule 6.01(c) of the Credit Agreement (which Schedule is attached hereto as Exhibit [III]) and each of the GUARANTORS listed on Schedule 6.01(c) of the Credit Agreement (which Schedule is attached hereto as Exhibit [III]), other than those listed below

By: _____

By: _____

[Name],

[Seal]

the _____ [Title] of each Borrower and Guarantor listed on Schedule 6.01(c) of the Credit Agreement (which Schedule is attached hereto as Exhibit [III]), other than those listed below, which is a corporation and of each general partner of each Borrower and Guarantor which is a partnership

ATTEST:

NACC, INC., a Delaware Corporation

By: _____

By: _____

[Name],

[Seal]

the _____ [Title] of NACC, Inc.

</TABLE>

[Signature Page 2 of 7 to Sixth Amendment]

<TABLE>
<S>
ATTEST

<C>
CR SERVICES CORP., a Delaware corporation

By: _____

By: _____
[Name],

[Seal]

the _____ [Title] of
CR Services Corp.

Address for Notices for each of the
foregoing Borrowers and Guarantors:

1016 West Ninth Avenue
King of Prussia, PA 19406

Telecopier No. (610) 992-3328
Attention: Chief Financial Officer
Telephone No. (610) 992-7200

</TABLE>

[Signature Page 3 of 7 to Sixth Amendment]

[INTENTIONALLY BLANK]

[Signature Page 4 of 7 to Sixth Amendment]

AGENT:

PNC BANK, NATIONAL ASSOCIATION, as Agent

By: _____

Title: _____

Address for Notices:

One PNC Plaza
Fifth Avenue and Wood Street
Pittsburgh, PA 15265

Telecopier No. (412) 762-2784
Attention: Regional Healthcare Group
Telephone No. (412) 762-8343

BANKS:

PNC BANK, NATIONAL ASSOCIATION

By:

Title: _____

Address for Notices:

One PNC Plaza
Fifth Avenue and Wood Street
Pittsburgh, PA 15265

Telecopier No. (412) 762-2784
Attention: Regional Healthcare Group
Telephone No. (412) 762-8343

20

[Signature Page 5 of 7 to Sixth Amendment]

CORESTATES BANK, N.A.

By: _____

Name: _____

Title: _____

Address for Notices:

1339 Chestnut Street
P.O. Box 7618
FC 1-8-3-22
Philadelphia, PA 19101

Telecopier No. (215) 786-7721
Attention: Jennifer W. Leibowitz
Assistant Vice President
Telephone No. (215) 786-3972

FIRST UNION NATIONAL BANK
OF NORTH CAROLINA

By: _____

Name: James F. Young
Title: Assistant Vice President

Address for Notices:

One First Union Center
301 S. Giles Street
Charlotte, NC 28288-0735

Telecopier No. (704) 374-4092
Attention: James F. Young,
Assistant Vice President
Telephone No. (704) 383-0507

21

[Signature Page 6 of 7 to Sixth Amendment]

FLEET BANK OF MASSACHUSETTS, N.A.

By: _____

Name: _____

Title: _____

Address for Notices:

Health Care and Non Profit Group
Fleet Center MA BOF 04A
75 State Street
Boston, MA 02109-1810

Telecopier No. (617) 346-1634
Attention: Amy Fredericks
Vice President
Telephone No. (617) 346-1646

MELLON BANK, N.A.

By: _____
Name: _____
Title: _____

Address for Notices:

Healthcare Banking
Plymouth Meeting/Exec. Campus
610 W. Germantown Pike
Suite 200/AIM #19E-0246
Plymouth Meeting, PA 19462

Telecopier No. (610) 941-4136
Attention: Carol Paige
Vice President
Telephone No. (610) 941-8409

22

[Signature Page 7 of 7 to Sixth Amendment]

NATIONSBANK, N.A.

By: _____
Name: _____
Title: _____

Address for Notices:

6610 Rockledge Drive
1st Floor
Bethesda, MD 20817-1876

Telecopier No. (301) 571-0719
Attention: Michael B. Andry
Vice President
Telephone No. (301) 571-0710

23

EXHIBIT I

AMENDED AND RESTATED ARTICLES

SCHEDULE 6.01(c)
REVISED JUNE 30, 1996

SUBSIDIARIES

I. SUBSIDIARY CORPORATIONS

<TABLE>
<CAPTION>

Subsidiary -----	Jurisdiction -----	Borrower/ Guarantor -----	Authorized Capital -----	No. Shares Issued -----	Shareholder(s) -----
<S> Advance Orthotics, Inc.	<C> Texas	<C> G	<C> 50,000 common shares, no par value	<C> 50,000	<C> NovaCare Orthotics & Prosthetics West, Inc.
Affiliated Physical Therapists, Ltd.	Arizona	G	120,091 common shares, \$1 par value 83,067 preferred shares, \$1 par value	35,600	RehabClinics, Inc.
Atlantic Rehabilitation Services, Inc.	New Jersey	G	1,000 shares, no par value	20	RehabClinics, Inc.
Boca Rehab Agency, Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Bowman-Shelton Orthopedic Service, Incorporated	Oklahoma	G	3,000 common shares, \$1.00 par value	3,000	NovaCare Orthotics & Prosthetics East, Inc.
Buendel Physical Therapy, Inc.	Florida	G	750 common shares, \$10.00 par value	100	RehabClinics, Inc.
Cannon & Associates, Inc.	Delaware	G	10,000 common shares, no par value 1,286 cumulative redeemable preferred shares, \$.01 par value	3,000	NovaCare, Inc. (PA)
Cenla Physical Therapy & Rehabilitation Agency, Inc.	Louisiana	G	10,000 shares, no par value	2,000	RehabClinics, Inc.

</TABLE>

<TABLE>
<CAPTION>

Subsidiary -----	Jurisdiction -----	Borrower/ Guarantor -----	Authorized Capital -----	No. Shares Issued -----	Shareholder(s) -----
<S> Center for Physical Therapy and Sports Rehabilitation, Inc.	<C> New Mexico	<C> G	<C> 500,000 common shares, no par value	<C> 1,000	<C> RehabClinics, Inc.
CenterTherapy, Inc.	Minnesota	G	50,000 Class A voting shares, \$.01 par value, 50,000 Class B non-voting shares, \$.01 par value	475 Class A voting	RehabClinics, Inc.
Coplin Physical Therapy Associates, Inc.	Minnesota	G	2,500 common shares, no par value	100	RehabClinics, Inc.
CR Services Corp.	Delaware	G	1,000 common shares, \$.01 par value	100	NovaCare, Inc. (DE)
Crowley Physical Therapy Clinic, Inc.	Louisiana	G	10,000 common shares, no par value	500	RehabClinics, Inc.
Douglas Avery and Associates, Ltd.	Virginia	G	500 Series A Voting Common Shares, \$10.00 par value 300 Series B Non-Voting Common Shares, \$.01 par value	100	RehabClinics, Inc.
Douglas C. Claussen, R.P.T., Physical Therapy, Inc.	California	G	50,000 shares, no par value	10,187	RehabClinics, Inc.
Francis Naselli, Jr. & Stewart Rich	Pennsylvania	G	1,000 common shares, no par value	1,000	RehabClinics, Inc.

Physical Therapists, Inc.			value		
Galaxy Service Corporation	Illinois	--	1,200 Class A common shares, no par value		RCI (S.P.O.R.T.), Inc. (60%)
Gallery Physical Therapy Center, Inc.	Minnesota	G	1,048.85 common shares, no par value	1,048.85	RehabClinics, Inc.

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<TABLE>
<CAPTION>

Subsidiary	Jurisdiction	Borrower/ Guarantor	Authorized Capital	No. Shares Issued	Shareholder(s)
-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>
Georgia Physical Therapy of West Georgia, Inc.	Georgia	G	5,000,000 common shares, \$0.01 par value	1,000,200	RehabClinics, Inc.
Georgia Physical Therapy, Inc.	Georgia	G	100,000 shares, \$0.50 par value	1,000	RehabClinics, Inc.
Greater Sacramento Physical Therapy Associates, Inc.	California	G	100,000 common shares No par value	38,250 11,250	RehabClinics, Inc. Peters, Starkey & Todrank Physical Therapy Corporation
Gulf Breeze Physical Therapy, Inc.	Florida	G	7,500 common shares, \$1.00 par value	200	RehabClinics, Inc.
Gulf Coast Hand Specialists, Inc.	Florida	G	7,500 common shares, \$1.00 par value	100	RehabClinics, Inc.
Hand Therapy and Rehabilitation Associates, Inc.	California	G	10,000 common shares, no par value	6,000	RehabClinics, Inc.
Hand Therapy Associates, Inc.	Arizona	G	1,000,000 common shares, \$10 par value	250	RehabClinics, Inc.
Hawley Physical Therapy, Inc.	California	G	100,000 common shares, no par value	20,000	RehabClinics, Inc.
Heartland Rehabilitation, Inc.	Indiana	G	1,000 common shares, no par value	100	NovaCare, Inc. (PA)
Indianapolis Physical Therapy and Sports Medicine, Inc.	Indiana	G	400,000 common shares, no par value	267,808	RehabClinics, Inc.
Jim All, Inc.	Texas	--	1,000,000 shares, \$1.00 par value	1,000	NovaCare Orthotics & Prosthetics West, Inc.

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<TABLE>
<CAPTION>

Subsidiary	Jurisdiction	Borrower/ Guarantor	Authorized Capital	No. Shares Issued	Shareholder(s)
-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>
Kesinger Physical Therapy, Inc.	California	G	10,000 common shares, no par value	1,000	RehabClinics, Inc.
Life Dimensions of California, Inc.	California	G	1,000 shares, no par value	50	NovaCare, Inc. (PA)
Lynn M. Carlson, Inc.	Arizona	G	1,000,000 common shares, \$1 par value	6,400	RehabClinics, Inc.
McFarlen & Associates, Inc.	Texas	--	100,000 common shares, \$0.10 par value	1,000	NovaCare Orthotics & Prosthetics West, Inc.

Michigan Therapy Centre, Inc.	Michigan	G	50,000 common shares, \$.01 par value	11,765	RehabClinics, Inc.
Mill River Management, Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Mitchell Tannenbaum I, Inc.	Illinois	G	1,000 common shares, no par value	100	RCI (S.P.O.R.T.), Inc.
Mitchell Tannenbaum II, Inc.	Illinois	G	1,000 common shares, no par value	100	RCI (S.P.O.R.T.), Inc.
Mitchell Tannenbaum III, Inc.	Illinois	G	1,000 common shares, no par value	100	RCI (S.P.O.R.T.), Inc.
Monmouth Rehabilitation, Inc.	New Jersey	G	100 shares, no par value	80	RehabClinics, Inc.
NACC, Inc.	Delaware	B	1,000 common shares, \$.01 par value	25 25 125	RehabClinics, Inc. NovaCare Orthotics & Prosthetics, Inc. NovaCare, Inc. (PA)

</TABLE>

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<TABLE>
<CAPTION>

Subsidiary	Jurisdiction	Borrower/ Guarantor	Authorized Capital	No. Shares Issued	Shareholder(s)
-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>
National Rehab Services	California	G	1,000,000 common shares, no par value	5,000	NovaCare, Inc. (PA)
NC Cash Management, Inc.	Delaware	G	1,000 common shares, \$.01 par value	100	NC Resources, Inc.
NC Resources, Inc.	Delaware	G	1,000 common shares, \$.01 par value	100	NovaCare, Inc. (DE)
New Mexico Physical Therapists, Inc.	New Mexico	G	50,000 common shares, \$1.00 par value	559	RehabClinics, Inc.
Northside Physical Therapy, Inc.	Ohio	G	500 common shares, without par value	100	RehabClinics, Inc.
NovaCare (Arizona), Inc.	Arizona	G	1,000 shares, no par value	1,000	NovaCare, Inc. (PA)
NovaCare (Colorado), Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	NovaCare, Inc. (PA)
NovaCare (Illinois), Inc.	Illinois	G	1,000 shares, no par value	1,000	NovaCare, Inc. (PA)
NovaCare (Texas), Inc.	Texas	G	100 common shares, \$.01 par value	100	NovaCare, Inc. (PA)
NovaCare, Inc.	Pennsylvania	G	5,000 common shares, no par value	1,000	NC Resources, Inc.
NovaCare Management Company, Inc.	Delaware	G	1,000 common shares, \$.01 par value	100	NovaCare Orthotics & Prosthetics, Inc.
NovaCare Management Services, Inc.	Delaware	G	1,000 common shares, \$.01 par value	100	NovaCare, Inc. (DE)
NovaCare Northside Therapy, Inc.	Minnesota	G	2,500 shares, \$10.00 par value	100	NovaCare, Inc. (PA)

</TABLE>

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<TABLE> <CAPTION>		Borrower/ Guarantor		Authorized Capital	No. Shares Issued	Shareholder(s)
Subsidiary	Jurisdiction	<C>	<C>			
<S> NovaCare Orthotics & Prosthetics East, Inc.	Delaware	G	1,000	common shares, \$.01 par value	1,000	NovaCare Orthotics & Prosthetics Holdings, Inc.
NovaCare Orthotics & Prosthetics Holdings, Inc.	Delaware	G	1,000	shares, \$.01 par value	1,000	NovaCare Orthotics & Prosthetics, Inc.
NovaCare Orthotics & Prosthetics West, Inc.	California	G	5,000,000	shares, \$.10 par value	689,681	NovaCare Orthotics & Prosthetics Holdings, Inc.
NovaCare Orthotics & Prosthetics, Inc.	Delaware	G	1,000	common shares, \$.01 par value	1,000	NC Resources, Inc.
NovaCare Outpatient Rehabilitation I, Inc.	Kansas	G	100,000	common shares, no par value	1,250	RehabClinics, Inc.
NovaCare Outpatient Rehabilitation, Inc.	Kansas	G	500,000	common shares, \$1 par value	10,851	RehabClinics, Inc.
NovaCare Rehab Agency of Alabama, Inc.	Alabama	G	1,000	common shares, \$.01 par value	1,000	NovaCare, Inc. (PA)
NovaCare Rehab Agency of Florida, Inc.	Florida	G	1,000	common shares, \$.01 par value	1,000	NovaCare, Inc. (PA)
NovaCare Rehab Agency of Georgia, Inc.	Georgia	G	1,000	common shares, \$.01 par value	1,000	NovaCare, Inc. (PA)
NovaCare Rehab Agency of Illinois, Inc.	Illinois	G	1,000	common shares, \$.01 par value	1,000	NovaCare, Inc. (PA)
NovaCare Rehab Agency of North Carolina, Inc.	North Carolina	G	1,000	common shares, \$.01 par value	1,000	NovaCare, Inc. (PA)
NovaCare Rehab Agency of Northern California, Inc.	California	G	9,000	common shares, \$1.00 par value	100	NovaCare, Inc. (PA)

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<TABLE> <CAPTION>		Borrower/ Guarantor		Authorized Capital	No. Shares Issued	Shareholder(s)
Subsidiary	Jurisdiction	<C>	<C>			
<S> NovaCare Rehab Agency of Ohio, Inc.	Ohio	G	1,000	common shares, \$.01 par value	1,000	NovaCare, Inc. (PA)
NovaCare Rehab Agency of Oklahoma, Inc.	Oklahoma	G	1,000	common shares, \$.01 par value	1,000	NovaCare, Inc. (PA)
NovaCare Rehab Agency of Pennsylvania, Inc.	Pennsylvania	G	1,000	common shares, \$.01 par value	1,000	NovaCare, Inc. (PA)
NovaCare Rehab Agency of Southern California, Inc.	California	G	9,000	common shares, \$1.00 par value	100	NovaCare, Inc. (PA)
NovaCare Rehab Agency of South Carolina, Inc.	South Carolina	G	1,000	shares, \$.01 par value	1,000	NovaCare, Inc. (PA)
NovaCare Rehab Agency of Tennessee, Inc.	Tennessee	G	1,000	common shares, \$.01 par value	1,000	NovaCare, Inc. (PA)
NovaCare Rehab Agency of Virginia, Inc.	Virginia	G	1,000	common shaer, \$.01 par value	1,000	NovaCare, Inc. (PA)
NovaCare Rehabilitation Agency of Wisconsin, Inc.	Wisconsin	G	9,000	shares, \$1.00 par value	10	NovaCare, Inc. (PA)

NovaCare Rehabilitation, Inc.	Minnesota	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
NovaCare Service Corp.	Delaware	G	1,000 common shares, \$.01 par value	1,000	NovaCare, Inc. (DE)
Ortho Rehab Associates, Inc.	Florida	G	1,000 common shares, \$1.00 par value	100	RehabClinics, Inc.
Orthopedic and Sports Physical Therapy of Cupertino, Inc.	California	G	100,000 common shares, no par value	3,000	RehabClinics, Inc.

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Subsidiary	Jurisdiction	Borrower/ Guarantor	Authorized Capital	No. Shares Issued	Shareholder(s)
<S> OSI Midwest, Inc.	<C> Nebraska	<C> --	<C> 10,000 common shares, \$1.00 par value	<C> 7,651	<C> NovaCare Orthotics & Prosthetics Holdings, Inc.
Peters, Starkey & Todrank Physical Therapy Corporation	California	G	50,000 common shares, no par value	91	RehabClinics, Inc.
Physical Focus Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Physical Rehabilitation Partners, Inc.	Louisiana	G	5,000 common shares, no par value	106.12	RehabClinics, Inc.
Physical Therapy Institute, Inc.	Louisiana	G	500 common shares, no par value	500	RehabClinics, Inc.
Quad City Management, Inc.	Iowa	G	100,000 common shares, no par value	1,000	RehabClinics, Inc.
RCI (Colorado), Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
RCI (Exertec), Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
RCI (Illinois), Inc.	Delaware	G	100 common shares, no par value	100	RehabClinics, Inc.
RCI (Michigan), Inc.	Delaware	G	1,000 Shares, \$.01 par value	1,000	RehabClinics, Inc.
RCI (S.P.O.R.T.), Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
RCI (WRS), Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.

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Subsidiary	Jurisdiction	Borrower/ Guarantor	Authorized Capital	No. Shares Issued	Shareholder(s)
<S> RCI Nevada, Inc.	<C> Delaware	<C> G	<C> 1,000 common shares, \$.01 par value	<C> 1,000	<C> RehabClinics, Inc.
Rebound Oklahoma, Inc.	Oklahoma	G	500 shares, \$1.00 par value	500	RehabClinics, Inc.
Redwood Pacific Therapies, Inc.	California	G	100,000 common shares, no par value	15,120	RehabClinics, Inc.

			value		
Rehab Managed Care of Arizona, Inc.	Delaware	B	1,000 common shares, \$.01 par value	100	RehabClinics, Inc.
Rehab Provider Network of Florida, Inc.	Florida	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab Provider Network - California, Inc.	California	G	100 common shares, \$.10 par value	100	RehabClinics, Inc.
Rehab Provider Network - Delaware, Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab Provider Network - Georgia, Inc.	Georgia	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab Provider Network - Illinois, Inc.	Illinois	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab Provider Network - Indiana, Inc.	Indiana	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab Provider Network - Maryland, Inc.	Maryland	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab Provider Network - Michigan, Inc.	Michigan	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.

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<TABLE>
<CAPTION>

Subsidiary	Jurisdiction	Borrower/ Guarantor	Authorized Capital	No. Shares Issued	Shareholder(s)
-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>
Rehab Provider Network - New Jersey, Inc.	New Jersey	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab Provider Network - Ohio, Inc.	Ohio	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab Provider Network - Oklahoma, Inc.	Oklahoma	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab Provider Network - Pennsylvania, Inc.	Pennsylvania	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab Provider Network - Virginia, Inc.	Virginia	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab Provider Network - Washington, D.C., Inc.	District of Columbia	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab Provider Network of Colorado, Inc.	Colorado	G	100 common shares, \$.01 par value	100	RehabClinics, Inc.
Rehab Provider Network of Nevada, Inc.	Nevada	G	100 shares, \$1.00 par value	100	RehabClinics, Inc.
Rehab Provider Network of New Mexico, Inc.	New Mexico	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab Provider Network of Texas, Inc.	Texas	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab Provider Network of Wisconsin, Inc.	Wisconsin	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.
Rehab/Work Hardening Management Associates, Ltd.	Pennsylvania	G	500 shares, no par value	500	RehabClinics, Inc.

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<TABLE> <CAPTION>							
Subsidiary	Jurisdiction	Borrower/ Guarantor	Authorized Capital	No. Shares Issued	Shareholder(s)		
-----	-----	-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Rehab World, Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.		
RehabClinics (COAST), Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.		
RehabClinics (New Jersey), Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.		
RehabClinics (PTA), Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.		
RehabClinics (SPT), Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.		
RehabClinics Abilene, Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.		
RehabClinics Dallas, Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.		
RehabClinics Pennsylvania, Inc.	Pennsylvania	G	1,000 shares, no par value	1,000	RehabClinics (SPT), Inc.		
RehabClinics, Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	NC Resources, Inc.		
Robert M. Bacci, R.P.T. Physical Therapy, Inc.	California	G	100,000 shares no par value	5,000	RehabClinics, Inc.		
Robin Aids Prosthetics, Inc.	California	G	50,000 common shares, no par value	50,000	NovaCare Orthotics & Prosthetics West, Inc.		
S.T.A.R.T., Inc.	Massachusetts	G	12,500 common shares, no par value	200	RehabClinics, Inc.		

<TABLE> <CAPTION>							
Subsidiary	Jurisdiction	Borrower/ Guarantor	Authorized Capital	No. Shares Issued	Shareholder(s)		
-----	-----	-----	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
SG Rehabilitation Agency, Inc.	Pennsylvania	G	100,000 common shares, \$10.00 par value	100	NovaCare, Inc. (PA)		
SG Speech Associates, Inc.	Pennsylvania	G	100,000 common shares, \$10.00 par value	100	NovaCare, Inc. (PA)		
Southwest Medical Supply Company	New Mexico	G	10,000 common shares, \$1.00 par value	10,000	RehabClinics, Inc.		
Southwest Physical Therapy, Inc.	New Mexico	G	500,000 shares, no par value	12,500	RehabClinics, Inc.		
Southwest Therapists, Inc.	New Mexico	G	5 common shares, no par value	5	RehabClinics, Inc.		
Sporthopedics Sports and Physical Therapy Centers, Inc.	California	G	10,000 common shares, no par value	8,000	RehabClinics, Inc.		
Sports Therapy and Arthritis Rehabilitation, Inc.	Delaware	G	1,000 common shares, \$.01 par value	1,000	RehabClinics, Inc.		
Star Physical Therapy Inc.	Florida	G	1,000 shares, \$1.00 par value	60	RehabClinics, Inc.		

Stephenson-Holtz, Inc.	California	G	100,000 common shares no par value	10,000	RehabClinics, Inc.
The Center for Physical Therapy and Rehabilitation, Inc.	New Mexico	G	500,000 shares, no par value	1,000	RehabClinics, Inc.
Theodore Dashnaw Physical Therapy, Inc.	California	G	100 common shares, no par value	30	RehabClinics, Inc.

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Subsidiary	Jurisdiction	Borrower/ Guarantor	Authorized Capital	No. Shares Issued	Shareholder(s)
<S> Union Square Center for Rehabilitation & Sports Medicine, Inc.	<C> California	<C> G	<C> 1,000 shares, no par value	<C> 500	<C> RehabClinics, Inc.
Vanguard Rehabilitation, Inc.	Arizona	G	1,000,000 common shares, \$1.00 par value	64,500	RehabClinics, Inc.
Wayzata Physical Therapy Center, Inc.	Minnesota	G	2,500 common shares, no par value	1,000	RehabClinics, Inc.
West Suburban Health Partners, Inc.	Minnesota	G	25,000 common shares, \$1.00 par value	990	RehabClinics, Inc.
Western Rehab Services, Inc.	Arizona	G	100,000 common shares, no par value	1,000	NovaCare, Inc. (PA)
Workers Rehabilitation Services, Inc.	Illinois	--	10,000 common shares, no par value		RCI (WRS), Inc. (60%)

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II. PARTNERSHIP INTERESTS

Name	Jurisdiction	Partnership Interest
<S> Advanced Orthopedic Services, Ltd.	<C> Texas	<C> 99% limited partnership interest owned by RehabClinics Dallas, Inc. who is also the general partner 1% limited partnership interest owned by RehabClinics, Inc.
Galaxy North Limited Partnership	Illinois	60% owned by RCI (S.P.O.R.T.), Inc.
Galaxy West Limited Partnership	Illinois	60% owned by RCI (S.P.O.R.T.), Inc.
Land Park Physical Therapy	California	50% owned by RehabClinics, Inc. 50% owned by Union Square Center for Rehabilitation & Sports Medicine, Inc.
McFarlen & Associates I	Texas	99.9% owned by OSI Midwest, Inc.
McFarlen & Associates II	Texas	99.9% owned by OSI Midwest, Inc.
McFarlen & Associates III	Texas	99.9% owned by OSI Midwest, Inc.
McFarlen & Associates IV	Texas	99.9% owned by OSI Midwest, Inc.
Northwest Suburban Worker Rehabilitation Services Limited Partnership	Illinois	66 2/3% owned by RCI (WRS), Inc.

Orthomedics - Voner (Rancho)	California	50% owned by NovaCare Orthotics & Prosthetics Holdings, Inc.
Orthomedics - Voner (Whittier)	California	50% owned by NovaCare Orthotics & Prosthetics Holdings, Inc.
T.J. Partnership	Delaware	75% owned by RehabClinics (PTA), Inc.
West Suburban Worker Rehabilitation Services Limited Partnership	Illinois	66 2/3% owned by RCI (WRS), Inc.

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III. LIMITED LIABILITY CORP.

Name	Jurisdiction	Partnership Interest
TJ Corporation I, L.L.C.	Delaware	RCI (Illinois), Inc. - 75% interest
WorkCare, L.L.C.	Delaware	NovaCare, Inc. - 88% interest

IV. OPTIONS TO PURCHASE

- RCI (WRS), Inc., a Delaware corporation owns 66 2/3% of Worker Rehabilitation Services, Inc., an Illinois Corporation ("WRS"). WRS is a general and limited partner of Northwest Suburban Worker Rehabilitation Services Limited Partnership, an Illinois limited partnership currently owning a 66 2/3% interest. RCI (WRS), Inc. will acquire the remaining corporate and partnership interests on December 30, 1994 and December 30, 1995 in the amount of 16 2/3% and 16 2/3% each year.
- RCI (WRS), Inc., a Delaware corporation owns 66 2/3% of Worker Rehabilitation Services, Inc., an Illinois Corporation ("WRS"). WRS is a general and limited partner of West Suburban Worker Rehabilitation Services Limited Partnership, an Illinois limited partnership currently owning a 66 2/3% interest. RCI (WRS), Inc. will acquire the remaining corporate and partnership interests on December 30, 1994 and December 30, 1995 in the amount of 16 2/3% and 16 2/3% each year.
- RCI (S.P.O.R.T.), Inc., a Delaware corporation owns 60% of Galaxy Service Corporation, an Illinois corporation ("GSC"). GSC owns a 75% participating general partnership interest in Galaxy North Limited Partnership, an Illinois limited partnership (the "Partnership"). GSC will acquire the remaining 40% interest in GSC on December 31, 1994 and December 31, 1995 in the amount of 20% each year and the remaining 10% limited partnership interests in the Partnership December 31, 1994 and December 31, 1995 in amount of 5% per year.
- RCI (S.P.O.R.T.), Inc., a Delaware corporation owns 60% of Galaxy Service Corporation, an Illinois corporation ("GSC"). GSC owns a 75% participating general partnership interest in Galaxy Worth Limited Partnership, an Illinois limited partnership (the "Partnership"). GSC will acquire the remaining 40% interest in GSC on December 31, 1994 and December 31, 1995 in the amount of 20% each year and the remaining 10% limited partnership interests in the Partnership December 31, 1994 and December 31, 1995 in amount of 5% per year.
- Orthomedics - Voner (Rancho), a California general partnership. A 50% interest is held NovaCare Orthotics & Prosthetics Holdings, a Delaware wholly owned subsidiary of NovaCare Orthotics & Prosthetics, Inc., a Delaware wholly owned subsidiary of NovaCare, Inc. (Delaware). The remaining 50% is owned by Mr. Voner.

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6. Orthomedics - Voner (Whittier), a California general partnership. A 50% interest is held NovaCare Orthotics & Prosthetics Holdings, a Delaware wholly owned subsidiary of NovaCare Orthotics & Prosthetics, Inc., a Delaware wholly owned subsidiary of NovaCare, Inc. (Delaware). The remaining 50% is owned by Mr. Voner.

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EXHIBIT 10(j)

[TO BE USED IF POOLING
CONSIDERATION IS LESS THAN \$250
MILLION]

EXHIBIT 1.01(P)(1)(E)

PERMITTED POOLINGS NOTICE CERTIFICATE

, 19

PNC BANK, NATIONAL ASSOCIATION
as Agent for the Banks party
to the Credit Agreement Referred to Below
Fifth Avenue and Wood Street
Pittsburgh, PA 15265

Ladies and Gentlemen:

I refer to the Credit Agreement dated as of May 27, 1994 (as amended, supplemented or modified from time to time, the "Credit Agreement") among NOVACARE, INC., a Delaware corporation ("NovaCare"), each of the other Borrowers and the Guarantors that are parties thereto (the "Loan Parties"), the Banks party thereto and PNC BANK, NATIONAL ASSOCIATION, as Agent for such Banks. This Certificate is delivered pursuant to clause (E) of the definition of Permitted Poolings contained in Section 1.01 of the Credit Agreement in connection with the proposed pooling of interests described below. Unless otherwise defined herein, terms defined in the Credit Agreement are used herein with the same meanings.

I, _____, [President/Chief Executive Officer/Chief Financial Officer] of NovaCare, do hereby certify as of the date hereof, as follows:

(1) Description of Proposed Pooling. NovaCare desires to engage in a pooling of interests (the "Proposed Pooling") under the terms set forth below. The Proposed Pooling shall be a Permitted Pooling.

(a) The Pooling Partner is _____
[name], a _____
[type of entity and jurisdiction of organization].

(b) The Proposed Pooling is scheduled to close on _____, 19__ (the "Pooling Date").

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PNC BANK, NATIONAL ASSOCIATION
_____, 19__
Page 2

(c) The assets and businesses of the Pooling Partner are located in _____
[list locations and describe assets or business in those locations].

(d) The Proposed Pooling is an [Asset Acquisition/Stock Acquisition] structured as follows (describe structure of the pooling):

_____.

(2) (A) Pooling Consideration (Clauses (A) and (E) of definition of Permitted Pooling). The Proposed Pooling shall be accounted for under GAAP as a "pooling of interests." The consideration to be paid by the Loan Parties in connection with the

Proposed Pooling consists solely of shares of stock of NovaCare, cash payments in lieu of fractional shares and cash payments to dissenting shareholders. The Pooling Consideration is \$_____ which is less than \$250,000,000, the maximum Pooling Consideration permitted under clause (E) of the definition of Permitted Pooling. The Pooling Consideration is computed as follows:

(i) NovaCare is issuing shares of its capital stock as follows:

Class	# Shares	Issue	Market Value Per Share as of _____, 19____ (must be within 120 days of the Pooling Date)	Total Value
<S>	<C>	<C>	<C>	<C>
-----	-----	-----	-----	-----
-----	-----	-----	-----	-----
	Total			\$ =====

<S>	<C>
(ii) Cash in lieu of fractional shares or with respect to dissenters' rights to the extent that the amount thereof can be determined on or before the date which is fifteen (15) Business Days prior to the Pooling Date	\$ -----
(iii) Sum of (i) and (ii) (must be less than or equal to \$250,000,000)	\$ -----

</TABLE>

(B) Permitted Pooling Compliance. (Clause (L) of the definition of Permitted Pooling) On the Pooling Date and after giving effect to the proposed acquisition, the Pooling Consideration, when aggregated with the Pooling Consideration of all other Permitted Poolings which occurred during the period beginning on the Effective Date through and including the date of determination, is \$_____, which is less than or equal to the amount of \$500,000,000.

(3) Lines of Business (Clause (B) of definition of Permitted Pooling). The Pooling Partner is engaged in the business of _____. All of the net revenues of the Pooling Partner during its last completed fiscal year were derived from Permitted Lines of Business.

(4) Events of Default or Potential Default (Paragraph (C) of definition of Permitted Pooling). On the Pooling Date and after giving effect to the Proposed Pooling and any new Revolving Credit Loans to be requested or debt to be assumed in connection therewith, no event shall have occurred and be continuing which constitutes an Event of Default or Potential Default.

(5) Joinder of Pooling Partner and its Subsidiaries and Pledge of their Stock (Paragraph (D) of definition of Permitted Pooling). The following is a complete list of the corporations, partnerships or other entities: (i) whose stock or other ownership interests will be acquired by one or more Loan Parties in the Proposed Pooling, (ii) which have been or will be formed by the Loan Parties pursuant to the Proposed Pooling, (iii) which are Subsidiaries or Minority Subsidiaries of the entities listed in (i) and (ii) above:

<TABLE>

<CAPTION>

Name of Entity	Type of Entity and Jurisdiction of Organization	Person who holds Stock or other ownership Interests	Percentage of total ownership held	Is the Entity Joining the Credit Agreement (yes/no)
<S>	<C>	<C>	<C>	<C>
-----	-----	-----	-----	-----
-----	-----	-----	-----	-----
-----	-----	-----	-----	-----

</TABLE>

We are simultaneously delivering to the Agent Guaranty Agreements, Pledge Agreements, an opinion of counsel and certified copies of organizational documents, pursuant to which each entity listed above which is a Qualified Subsidiary shall join the Credit Agreement as a Guarantor and the stock of such Qualified Subsidiary shall be pledged to the Agent for the benefit of the Banks, in each instance on the Pooling Date. (The procedures for such joinders are described in Section 11.18 of the Credit Agreement. A Qualifying Subsidiary is an entity of which NovaCare or

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PNC BANK, NATIONAL ASSOCIATION

_____, 19____

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NovaCare's Subsidiaries hold 80% or more of the ownership interests as more fully set forth in the Credit Agreement.)

(6) Financial Covenant Compliance (Paragraph (E) of definition of Permitted Pooling). On the Pooling Date and after giving effect to the Proposed Pooling and any new Revolving Credit Loans to be requested in connection therewith, but otherwise on the basis of the most recent financial statements of NovaCare and its Subsidiaries delivered pursuant to Section 8.01(m) of the Credit Agreement and of the Pooling Partner and its Subsidiaries as attached hereto pursuant to Paragraph (9), the Loan Parties shall be in compliance with the following financial covenants on a pro forma basis for the effects of the Proposed Pooling:

- (A) Funded Debt to Capitalization. (Section 8.02(m)). On the Pooling Date, the ratio of (i) Consolidated Funded Debt to (ii) Capitalization shall be _____ to 1.0. Such ratio must not be more than the following ratios for the following periods:

<TABLE>
<CAPTION>

Period	Ratio
<S>	<C>
Closing Date through June 30, 1996	.50 to 1.0
July 1, 1996 and thereafter	.45 to 1.0

</TABLE>

- (a) Consolidated Funded Debt, the numerator of the foregoing ratio, is determined as follows:

Indebtedness of NovaCare and its Subsidiaries to persons other than NovaCare and its Subsidiaries on the Pooling Date in respect of, without duplication:

<TABLE>

<S>	<C>
(i) Borrowed money	\$ _____
(ii) Amounts raised under or liabilities in respect of any note purchase or acceptance credit facility	\$ _____
(iii) Reimbursement obligations under any letter of credit, currency swap agreement, interest rate swap, cap,	

collar or floor agreement or
 other interest rate
 management device \$ -----

(iv) Other transactions (including
 without limitation forward
 sale or purchase

</TABLE>

<TABLE>

<S> agreements, capitalized leases and <C>
 conditional sales agreements)
 having the commercial effect
 of a borrowing of money
 entered into to finance
 operations or capital
 requirements (but not
 including trade payables and
 accrued expenses incurred in
 the ordinary course of
 business which are not
 represented by a promissory
 note) \$ -----

(v) Any guaranty of indebtedness for borrowed money \$ -----

(vi) Sum of (i) through (v) equals
 Consolidated Funded Debt \$ -----

(b) Capitalization, the denominator of the foregoing ratio,
 is determined as follows as of the Pooling Date:

(i) Consolidated Funded Debt
 (amount from clause (vi) of
 Paragraph (a) above) \$ -----

(ii) Consolidated Net Worth, which
 is total stockholders' equity
 of NovaCare and its
 Subsidiaries as of the
 Pooling Date \$ -----

(iii) Sum of (i) and (ii) equals
 Capitalization \$ -----

</TABLE>

(B) Funded Debt to Cash Flow From Operations.
 (Section 8.02(n)). The ratio of (i)
 Consolidated Funded Debt on the Pooling Date
 to (ii) Consolidated Cash Flow from
 Operations for the four fiscal quarters
 ending immediately prior to the Pooling Date
 is _____ to 1.0. Such ratio must not be
 more than the following ratios for the
 following periods:

<TABLE>
 <CAPTION>

Period	Ratio
-----	-----
<S>	<C>
July 1, 1994 through	
June 30, 1995	3.00 to 1.00

July 1, 1995 through
December 31, 1995 2.75 to 1.00

January 1, 1996 and
thereafter 2.50 to 1.00

</TABLE>

<TABLE>

<S>	<C>
(a)	Consolidated Funded Debt, the numerator of the foregoing ratio (amount from clause (vi) of Paragraph 6(A) (a) above)
	\$ -----
(b)	Consolidated Cash Flow from Operations, the denominator of the foregoing ratio, for the four fiscal quarters ending immediately prior to the Pooling Date is determined as follows:
(i)	Net Income
	\$ -----
(ii)	Depreciation
	\$ -----
(iii)	Amortization
	\$ -----
(iv)	Other non-cash charges to net income
	\$ -----
(v)	Interest Expense
	\$ -----
(vi)	Income Tax Expense
	\$ -----
(vii)	Sum of (i), (ii), (iii), (iv), (v) and (vi)
	\$ -----
(viii)	Non-cash credits to net income
	\$ -----
(ix)	Item (vii) reduced by item (viii) equals Consolidated Cash Flow from Operations
	\$ -----

</TABLE>

(7) Indebtedness Assumed (Sections 8.02(a) (vi)).

(a) Proposed Pooling. The following is a list of Indebtedness of the Pooling Partner and its Subsidiaries (if any) which will be assumed or otherwise will remain outstanding following the Proposed Pooling:

<TABLE>

<CAPTION>

Creditor	Entity which will be liable therefor after Pooling	Collateral security securing the Indebtedness (if any)	Amount of Indebtedness
-----	-----	-----	-----
<S>	<C>	<C>	<C>
-----	-----	-----	\$ -----
-----	-----	-----	\$ -----
-----	-----	-----	\$ -----
-----	Total	-----	\$ ----- =====

</TABLE>

We are simultaneously sending you copies of the agreements governing the Indebtedness listed above.

(b) Aggregate Limit (Section 8.02(a)(vi)). The sum of the Indebtedness to be assumed in connection with the Proposed Pooling described in paragraph (a) above together with Indebtedness assumed by the Loan Parties in connection with Permitted Poolings during the current fiscal year is \$_____ which is less than \$100,000,000, the maximum amount permitted to be assumed during the current fiscal year. The amount of such Indebtedness is computed as follows:

<TABLE>

	<S>		<C>
(i)	Total from paragraph (a) above		\$ _____
(ii)	Indebtedness either (1) previously assumed by acquiring Loan Parties in Permitted Poolings during the current fiscal year, or (2) of Pooling Partners and their Subsidiaries whose stock or other ownership interests were previously acquired in Permitted Poolings during the current fiscal year, including, in the case of both (1) and (2), any Indebtedness which has been repaid since the date of the pooling as well as debt which remains outstanding on the date of this certificate:		

</TABLE>

<TABLE>
<CAPTION>

	Loan Party which assumed Indebtedness or Pooling Partner whose stock was acquired	Date of Permitted Pooling	Collateral securing Indebtedness (if any)	Amount of Indebtedness
	-----	-----	-----	-----
	<S>	<C>	<C>	<C>
	-----	-----	-----	-----
	-----	-----	-----	-----
	-----	-----	-----	-----
	Total			\$ _____

	(iii) Sum of (i) plus (ii) (may not exceed \$100,000,000)			\$ _____
				=====

</TABLE>

(c) Lease Obligations. Listed below are the future minimum lease payments under each non-cancellable lease of the Pooling Partner and its Subsidiaries (if any) (i) which will be assumed or otherwise will remain outstanding after the Proposed Pooling, and (ii) under which the annual lease payments exceed \$250,000:

<TABLE>
<CAPTION>

	Lessor	Expiration Date	Future Minimum Lease Payments
	-----	-----	-----
	<S>	<C>	<C>
	-----	-----	-----
	-----	-----	-----
	-----	-----	-----
		Total	\$ _____
			=====

</TABLE>

(8) Attached Financial Statements. Attached hereto are true and correct copies of (i) the consolidated balance sheets and income statements of Pooling Partner and its Subsidiaries for the prior three fiscal years and the interim statements ending on _____, (ii) any financial projections with respect to the Pooling Partner and its Subsidiaries received from Pooling Partner or prepared by the Loan Parties, and (iii) any revised budgets, and accompanying forecasts and projections prepared by NovaCare projecting its and its Subsidiaries' operations on a consolidated basis and separately for each line of business which have not previously been delivered to the Banks.

(9) Representations and Warranties. After giving effect to the Proposed Pooling, any new Revolving Credit Loans to be requested or debt to be assumed in connection

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PNC BANK, NATIONAL ASSOCIATION
_____, 19__
Page 9

therewith, the representations and warranties contained in Article VI of the Credit Agreement will be true on and as of the Pooling Date with the same effect as though such representations and warranties had been made on and as of the Pooling Date (except representations and warranties which expressly relate solely to an earlier date or time, which representations and warranties shall have been true and correct on and as of the specific dates or times referred to therein) and the Loan Parties shall have performed and complied with all covenants and conditions of the Credit Agreement.

IN WITNESS WHEREOF, the undersigned has executed this Certificate this ____ day of _____, 19__.

NOVACARE, INC.
By: _____
Name: _____
Title: _____

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LIST OF ENCLOSURES

NovaCare is enclosing the following with this Certificate:

<TABLE> <CAPTION>		Check if Enclosed ----- <C>
<S>	<C>	
1.	Joinder documentation described in Paragraph 5	-----
2.	Agreements governing assumed Indebtedness described in Paragraph 7(a)	-----
3.	Financial Statements of the Pooling Partner and its Subsidiaries described in Paragraph 8(i)	-----
4.	Financial projections of the Pooling Partner and its Subsidiaries described in Paragraph 8(ii)	-----
5.	Budget, forecasts and projections described in Paragraph 8(iii)	-----
</TABLE>		

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ASSUMED INDEBTEDNESS AGREEMENTS

NovaCare to attach agreements governing assumed Indebtedness described in Paragraph 7(a).

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[TO BE USED IF (i) POOLING CONSIDERATION EXCEEDS \$250 MILLION AND (ii) NOVACARE HAS NOT MADE ANY OTHER POOLINGS FOR CONSIDERATION EXCEEDING \$250 MILLION DURING CURRENT FISCAL YEAR]

EXHIBIT 1.01(P) (1) (F)

PERMITTED POOLINGS APPROVAL CERTIFICATE - AGENT

_____, 19____

PNC BANK, NATIONAL ASSOCIATION
as Agent for the Banks party
to the Credit Agreement Referred to Below
Fifth Avenue and Wood Street
Pittsburgh, PA 15265

Ladies and Gentlemen:

I refer to the Credit Agreement dated as of May 27, 1994 (as amended, supplemented or modified from time to time, the "Credit Agreement") among NOVACARE, INC., a Delaware corporation ("NovaCare"), each of the other Borrowers and the Guarantors that are parties thereto (the "Loan Parties"), the Banks party thereto and PNC BANK, NATIONAL ASSOCIATION, as Agent for such Banks. This Certificate is delivered pursuant to clause (F) of the definition of Permitted Poolings contained in Section 1.01 of the Credit Agreement in connection with the proposed pooling of interests described below. Unless otherwise defined herein, terms defined in the Credit Agreement are used herein with the same meanings.

I, _____, [President/Chief Executive Officer/Chief Financial Officer] of NovaCare, do hereby certify as of the date hereof, as follows:

(1) Description of Proposed Pooling. NovaCare desires to engage in a pooling of interests (the "Proposed Pooling") under the terms set forth below. The Proposed Pooling shall be a Permitted Pooling.

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- (a) The Pooling Partner is _____ [name], a _____ [type of entity and jurisdiction of organization].
(b) The Proposed Pooling is scheduled to close on _____, 19____ (the "Pooling Date").
(c) The assets and businesses of the Pooling Partner are located in _____ [list locations and describe assets or business in those locations].
(d) The Proposed Pooling is an [Asset Acquisition/Stock Acquisition] structured as follows (describe structure of the pooling): _____.

(2) Pooling Considerations And Permitted Pooling

Compliance

(A) Pooling Consideration (Clauses (A) and (F) of definition of Permitted Pooling). The Proposed Pooling shall be accounted for under GAAP as a "pooling of interests." The consideration to be paid by the Loan Parties in connection with the Proposed Pooling consists solely of shares of stock of NovaCare, cash payments in lieu of fractional shares and cash payments to dissenting shareholders. The Pooling Consideration is \$_____ which is more than \$250,000,000. The Pooling Consideration is computed as follows:

(i) NovaCare is issuing shares of its capital stock as follows:

<TABLE>
<CAPTION>

Class -----	# Shares -----	Issue -----	Market Value Per Share as of _____, 19____ (must be within 120 days of the Pooling Date)	Total Value -----
<S>	<C>	<C>	<C>	<C>
-----	-----	-----	-----	\$ -----
-----	-----	-----	-----	\$ -----
	Total			\$ =====

</TABLE>

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(ii) Cash in lieu of fractional shares or with respect to dissenters' rights to the extent that the amount thereof can be determined on or before the date which is fifteen (15) Business Days prior to the Pooling Date \$_____

(iii) Sum of (i) and (ii) (must be less than or equal to \$250,000,000) \$_____

(B) Permitted Pooling Compliance. (Clause (L) of the definition of Permitted Pooling) On the Pooling Date and after giving effect to the proposed acquisition, the Pooling Consideration, when aggregated with the Pooling Consideration of all other Permitted Poolings which occurred during the period beginning on the Effective Date through and including the date of determination, is \$_____, which is less than or equal to the amount of \$500,000,000.

(3) Lines of Business (Clause (B) of definition of Permitted Pooling). The Pooling Partner is engaged in the business of _____ . All of the net revenues of the Pooling Partner during its last completed fiscal year were derived from Permitted Lines of Business.

(4) Events of Default or Potential Default (Paragraph (C) of definition of Permitted Pooling). On the Pooling Date and after giving effect to the Proposed Pooling and any new Revolving Credit Loans to be requested or debt to be assumed in connection therewith, no event shall have occurred and be continuing which constitutes an Event of Default or Potential Default.

(5) Joinder of Pooling Partner and its Subsidiaries and Pledge of their Stock (Paragraph (D) of definition of Permitted Pooling). The following is a complete list of the corporations, partnerships or other entities: (i) whose stock or other ownership interests will be acquired by one or more Loan Parties in the Proposed Pooling, (ii) which have been or will be formed by the Loan Parties pursuant to the Proposed Pooling, (iii) which are Subsidiaries or Minority Subsidiaries of the entities listed in (i) and (ii) above:

- 3 -

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<TABLE>
<CAPTION>

Name of Entity	Type of Entity and Jurisdiction of Organization	Person who holds its Stock or other ownership Interests	Percentage of total ownership held	Is the Entity Joining the Credit Agreement (yes/no)
<S>	<C>	<C>	<C>	<C>
-----	-----	-----	-----	-----
-----	-----	-----	-----	-----
-----	-----	-----	-----	-----

</TABLE>

We are simultaneously delivering to the Agent Guaranty Agreements, Pledge Agreements, an opinion of counsel and certified copies of organizational documents, pursuant to which each entity listed above which is a Qualified Subsidiary shall join the Credit Agreement as a Guarantor and the stock of such Qualified Subsidiary shall be pledged to the Agent for the benefit of the Banks, in each instance on the Pooling Date. (The procedures for such joinders are described in Section 11.18 of the Credit Agreement. A Qualifying Subsidiary is an entity of which NovaCare or NovaCare's Subsidiaries hold 80% or more of the ownership interests as more fully set forth in the Credit Agreement.)

(6) Financial Covenant Compliance (Paragraph (F) of definition of Permitted Pooling). On the Pooling Date and after giving effect to the Proposed Pooling and any new Revolving Credit Loans to be requested in connection therewith, but otherwise on the basis of the most recent financial statements of NovaCare and its Subsidiaries delivered pursuant to Section 8.01(m) of the Credit Agreement and of the Pooling Partner and its Subsidiaries as attached hereto pursuant to Paragraph (9), the Loan Parties shall be in compliance with the following financial covenants on a pro forma basis for the effects of the Proposed Pooling:

- (A) Funded Debt to Capitalization. (Section 8.02(m)). On the Pooling Date, the ratio of (i) Consolidated Funded Debt to (ii) Capitalization shall be _____ to 1.0. Such ratio must not be more than the following ratios for the following periods:

<TABLE>
<CAPTION>

Period	Ratio
<S>	<C>
Closing Date through June 30, 1996	.50 to 1.0
July 1, 1996 and thereafter	.45 to 1.0

</TABLE>

- (a) Consolidated Funded Debt, the numerator of the foregoing ratio, is determined as follows:

Indebtedness of NovaCare and its Subsidiaries to persons other than NovaCare and its Subsidiaries on the Pooling Date in respect of, without duplication:

<TABLE>

<p><S></p>	<p><C></p>
(i) Borrowed money	\$ -----
(ii) Amounts raised under or liabilities in respect of any note purchase or acceptance credit facility	\$ -----
(iii) Reimbursement obligations under any letter of credit, currency swap agreement, interest rate swap, cap, collar or floor agreement or other interest rate management device	\$ -----
(iv) Other transactions (including without limitation forward sale or purchase agreements, capitalized leases and conditional sales agreements) having the commercial effect of a borrowing of money entered into to finance operations or capital requirements (but not including trade payables and accrued expenses incurred in the ordinary course of business which are not represented by a promissory note)	
(v) Any guaranty of indebtedness for borrowed money	\$ -----
(vi) Sum of (i) through (v) equals Consolidated Funded Debt	\$ -----
(b) Capitalization, the denominator of the foregoing ratio, is determined as follows as of the Pooling Date:	
(i) Consolidated Funded Debt (amount from clause (vi) of Paragraph (a) above)	\$ -----
(ii) Consolidated Net Worth, which is total stockholders' equity of NovaCare	

</TABLE>

<TABLE>

<p><S></p>	<p><C></p>
and its Subsidiaries as of the Pooling Date	\$ -----
(iii) Sum of (i) and (ii) equals Capitalization	\$ -----
(B) Funded Debt to Cash Flow From Operations. (Section 8.02(n)). The ratio of (i) Consolidated Funded Debt on the Pooling Date to (ii) Consolidated Cash Flow from Operations for the four fiscal quarters ending immediately prior to	

</TABLE>

the Pooling Date is _____ to 1.0.
Such ratio must not be more than the
following ratios for the following
periods:

<TABLE>
<CAPTION>

Period -----	Ratio -----
<S>	<C>
July 1, 1994 through June 30, 1995	3.00 to 1.00
July 1, 1995 through December 31, 1995	2.75 to 1.00
January 1, 1996 and thereafter	2.50 to 1.00

</TABLE>

<TABLE>

<S>		<C>
(a)	Consolidated Funded Debt, the numerator of the foregoing ratio (amount from clause (vi) of Paragraph 6(A) (a) above)	\$ -----
(b)	Consolidated Cash Flow from Operations, the denominator of the foregoing ratio, for the four fiscal quarters ending immediately prior to the Pooling Date is determined as follows:	
	(i) Net Income	\$ -----
	(ii) Depreciation	\$ -----
	(iii) Amortization	\$ -----
	(iv) Other non-cash charges to net income	\$ -----
	(v) Interest Expense	\$ -----

</TABLE>

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<TABLE>

<S>		<C>
(vi)	Income Tax Expense	\$ -----
(vii)	Sum of (i), (ii), (iii), (iv), (v) and (vi)	\$ -----
(viii)	Non-cash credits to net income	\$ -----
(ix)	Item (vii) reduced by item (viii) equals Consolidated Cash Flow from Operations	\$ -----

</TABLE>

(7) Indebtedness Assumed (Sections 8.02(a) (vi)).

(a) Proposed Pooling. The following is a list of Indebtedness of the Pooling Partner and its Subsidiaries (if any) which will be assumed or otherwise will remain outstanding following the Proposed Pooling:

<TABLE>
<CAPTION>

Entity which will be liable therefor after	Collateral security securing the Indebtedness	Amount of
--	--	--------------

Creditor -----	Pooling -----	(if any) -----	Indebtedness -----
<S>	<C>	<C>	<C>
-----	-----	-----	\$ -----
-----	-----	-----	\$ -----
-----	-----	-----	\$ -----
	Total		\$ =====

</TABLE>

We are simultaneously sending you copies of the agreements governing the Indebtedness listed above.

- (b) Aggregate Limit (Section 8.02(a)(vi)). The sum of the Indebtedness to be assumed in connection with the Proposed Pooling described in paragraph (a) above together with Indebtedness assumed by the Loan Parties in connection with Permitted Poolings during the current fiscal year is \$_____ which is less than \$100,000,000, the maximum amount permitted to be assumed during the current fiscal year. The amount of such Indebtedness is computed as follows:

<S>	<C>
(i)	Total from paragraph (a) above \$ -----

</TABLE>

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- (ii) Indebtedness either
(1) previously assumed by acquiring Loan Parties in Permitted Poolings during the current fiscal year, or (2) of Pooling Partners and their Subsidiaries whose stock or other ownership interests were previously acquired in Permitted Poolings during the current fiscal year, including, in the case of both (1) and (2), any Indebtedness which has been repaid since the date of the pooling as well as debt which remains outstanding on the date of this certificate:

Loan Party which assumed Indebtedness or Pooling Partner whose stock was acquired -----	Date of Permitted Pooling -----	Collateral securing the Indebtedness (if any) -----	Amount of Indebtedness -----
<S>	<C>	<C>	<C>
-----	-----	-----	\$ -----
-----	-----	-----	\$ -----
-----	-----	-----	\$ -----
Total			\$ -----

<TABLE>
<CAPTION>

</TABLE>

(c) Lease Obligations. Listed below are the future minimum lease payments under each non-cancellable lease of the Pooling Partner and its Subsidiaries (if any) which (i) will be assumed or otherwise will remain outstanding after the Proposed Pooling, and (ii) under which the annual lease payments exceed \$250,000:

<TABLE>
<CAPTION>

Lessor	Expiration Date	Future Minimum Lease Payments
<S>	<C>	<C>
-----	-----	-----
-----	-----	-----
-----	-----	-----
	Total	\$ _____

</TABLE>

59

(8) Attached Financial Statements. Attached hereto are true and correct copies of (i) the consolidated balance sheets and income statements of Pooling Partner and its Subsidiaries for the prior three fiscal years and the interim statements ending on _____, (ii) any financial projections with respect to the Pooling Partner and its Subsidiaries received from Pooling Partner or prepared by the Loan Parties, and (iii) any revised budgets, and accompanying forecasts and projections prepared by NovaCare projecting its and its Subsidiaries' operations on a consolidated basis and separately for each line of business which have not previously been delivered to the Banks.

(9) Representations and Warranties. After giving effect to the Proposed Pooling, any new Revolving Credit Loans to be requested or debt to be assumed in connection therewith, the representations and warranties contained in Article VI of the Credit Agreement will be true on and as of the Pooling Date with the same effect as though such representations and warranties had been made on and as of the Pooling Date (except representations and warranties which expressly relate solely to an earlier date or time, which representations and warranties shall have been true and correct on and as of the specific dates or times referred to therein) and the Loan Parties shall have performed and complied with all covenants and conditions of the Credit Agreement.

IN WITNESS WHEREOF, the undersigned has executed this Certificate this ____ day of _____, 19__.

NOVACARE, INC.

By: _____
Name: _____
Title: _____

ACKNOWLEDGED AND AGREED TO
AND PROPOSED POOLING APPROVED
THIS ____ DAY OF _____, 19__

PNC BANK, NATIONAL ASSOCIATION,
as Agent

By: _____

Name: _____
Title: _____

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LIST OF ENCLOSURES

NovaCare is enclosing the following with this Certificate:

<TABLE>		Check if
<CAPTION>		Enclosed

<S>	<C>	<C>
(1)	Joinder documentation described in Paragraph 5	-----
(2)	Agreements governing assumed Indebtedness described in Paragraph 7(a)	-----
(3)	Financial Statements of the Pooling Partner and its Subsidiaries described in Paragraph 8(i)	-----
(4)	Financial projections of the Pooling Partner and its Subsidiaries described in Paragraph 8(ii)	-----
(5)	Budget, forecasts and projections described in Paragraph 8(iii)	-----

</TABLE>

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[TO BE USED IF (i) POOLING CONSIDERATION EXCEEDS \$250 MILLION AND (ii) NOVACARE HAS MADE ONE OR MORE POOLINGS FOR CONSIDERATION EXCEEDING \$250 MILLION DURING CURRENT FISCAL YEAR]

EXHIBIT 1.01(P)(1)(G)

PERMITTED POOLINGS APPROVAL CERTIFICATE - REQUIRED BANKS

_____, 19

PNC BANK, NATIONAL ASSOCIATION
as Agent for the Banks party
to the Credit Agreement Referred to Below
Fifth Avenue and Wood Street
Pittsburgh, PA 15265

Ladies and Gentlemen:

I refer to the Credit Agreement dated as of May 27, 1994 (as amended, supplemented or modified from time to time, the "Credit Agreement") among NOVACARE, INC., a Delaware corporation ("NovaCare"), each of the other Borrowers and the Guarantors that are parties thereto (the "Loan Parties"), the Banks party thereto and PNC BANK, NATIONAL ASSOCIATION, as Agent for such Banks. This Certificate is delivered pursuant to clause (G) of the definition of Permitted Poolings contained in Section 1.01 of the Credit Agreement in connection with the proposed pooling of interests described below. Unless otherwise defined herein, terms defined in the Credit Agreement are used herein with the same meanings.

I, _____, [President/Chief Executive Officer/Chief Financial Officer] of NovaCare, do hereby certify as of the date hereof, as follows:

(1) Description of Proposed Pooling. NovaCare desires to engage in a pooling of interests (the "Proposed Pooling") under the terms set forth below. The Proposed Pooling shall be a Permitted Pooling.

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PNC BANK, NATIONAL ASSOCIATION
_____, 19__
Page 2

- (a) The Pooling Partner is _____ [name], a _____ [type of entity and jurisdiction of organization].
- (b) The Proposed Pooling is scheduled to close on _____, 19__ (the "Pooling Date").
- (c) The assets and businesses of the Pooling Partner are located in _____ [list locations and describe assets or business in those locations].
- (d) The Proposed Pooling is an [Asset Acquisition/Stock Acquisition] structured as follows (describe structure of the pooling):
_____.

Compliance (2) Pooling Consideration and Permitted Pooling

- (A) Pooling Consideration (Clauses (A) and (G) of definition of Permitted Pooling). The Proposed Pooling shall be accounted for under GAAP as a "pooling of interests." The consideration to be paid by the Loan Parties in connection with the Proposed Pooling consists solely of shares of stock of NovaCare, cash payments in lieu of fractional shares and cash payments to dissenting shareholders. The Pooling Consideration is \$ _____ which exceeds \$250,000,000. The Pooling Consideration is computed as follows:
 - (i) NovaCare is issuing shares of its capital stock as follows:

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PNC BANK, NATIONAL ASSOCIATION
_____, 19__
Page 3

<TABLE>
<CAPTION>

Class	# Shares	Issue	Market Value Per Share as of _____, 19__ (must be within 120 days of the Pooling Date)	Total Value
<S>	<C>	<C>	<C>	<C>
-----	-----	-----	-----	-----
-----	-----	-----	-----	-----
	Total			\$ =====

</TABLE>
<TABLE>

- (ii) Cash in lieu of fractional shares or with

respect to dissenters' rights to the extent that the amount thereof can be determined on or before the date which is fifteen (15) Business Days prior to the Pooling Date

\$

(iii) Sum of (i) and (ii) (must be less than or equal to \$250,000,000)

\$

</TABLE>

(B) Permitted Pooling Compliance (Clause (L) of the definition of Permitted Pooling) On the Pooling Date and after giving effect to the proposed acquisition, the Pooling Consideration, when aggregated with the Pooling Consideration of all other Permitted Poolings which occurred during the period beginning on the Effective Date through and including the date of determination, is \$_____, which is less than or equal to the amount of \$500,000,000.

(3) Lines of Business (Clause (B) of definition of Permitted Pooling). The Pooling Partner is engaged in the business of _____ . All of the net revenues of the Pooling Partner during its last completed fiscal year were derived from Permitted Lines of Business.

(4) Events of Default or Potential Default (Paragraph (C) of definition of Permitted Pooling). On the Pooling Date and after giving effect to the Proposed Pooling and any new Revolving Credit Loans to be requested or debt to be assumed in connection therewith, no

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PNC BANK, NATIONAL ASSOCIATION

, 19__

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event shall have occurred and be continuing which constitutes an Event of Default or Potential Default.

(5) Joinder of Pooling Partner and its Subsidiaries and Pledge of their Stock (Paragraph (D) of definition of Permitted Pooling). The following is a complete list of the corporations, partnerships or other entities: (i) whose stock or other ownership interests will be acquired by one or more Loan Parties in the Proposed Pooling, (ii) which have been or will be formed by the Loan Parties pursuant to the Proposed Pooling, (iii) which are Subsidiaries or Minority Subsidiaries of the entities listed in (i) and (ii) above:

<TABLE>
<CAPTION>

Name of Entity	Type of Entity and Jurisdiction of Organization	Person who holds its Stock or other ownership Interests	Percentage of total ownership held	Is the Entity Joining the Credit Agreement (yes/no)
<S>	<C>	<C>	<C>	<C>
-----	-----	-----	-----	-----
-----	-----	-----	-----	-----
-----	-----	-----	-----	-----

</TABLE>

We are simultaneously delivering to the Agent Guaranty Agreements, Pledge Agreements, an opinion of counsel and certified copies of organizational documents, pursuant to which each entity listed above which is a Qualified Subsidiary shall join the Credit Agreement as a Guarantor and the stock of such Qualified Subsidiary shall be pledged to the Agent for the benefit of the Banks, in each instance on the Pooling Date. (The procedures for such joinders are described in Section 11.18 of the Credit Agreement. A Qualifying

Subsidiary is an entity of which NovaCare or NovaCare's Subsidiaries hold 80% or more of the ownership interests as more fully set forth in the Credit Agreement.)

(6) Financial Covenant Compliance (Paragraph (G) of definition of Permitted Pooling). On the Pooling Date and after giving effect to the Proposed Pooling and any new Revolving Credit Loans to be requested in connection therewith, but otherwise on the basis of the most recent financial statements of NovaCare and its Subsidiaries delivered pursuant to Section 8.01(m) of the Credit Agreement and of the Pooling Partner and its Subsidiaries as attached hereto pursuant to Paragraph (9), the Loan Parties shall be in compliance with the following financial covenants on a pro forma basis for the effects of the Proposed Pooling:

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PNC BANK, NATIONAL ASSOCIATION
_____, 19____
Page 5

(A) Funded Debt to Capitalization. (Section 8.02(m)). On the Pooling Date, the ratio of (i) Consolidated Funded Debt to (ii) Capitalization shall be _____ to 1.0. Such ratio must not be more than the following ratios for the following periods:

<TABLE>
<CAPTION>

Period	Ratio
-----	-----
<S>	<C>
Closing Date through June 30, 1996	.50 to 1.0
July 1, 1996 and thereafter	.45 to 1.0

</TABLE>

(a) Consolidated Funded Debt, the numerator of the foregoing ratio, is determined as follows:

Indebtedness of NovaCare and its Subsidiaries to persons other than NovaCare and its Subsidiaries on the Pooling Date in respect of, without duplication:

<TABLE>

<S>	<C>
(i) Borrowed money	\$ -----
(ii) Amounts raised under or liabilities in respect of any note purchase or acceptance credit facility	\$ -----
(iii) Reimbursement obligations under any letter of credit, currency swap agreement, interest rate swap, cap, collar or floor agreement or other interest rate management device	\$ -----
(iv) Other transactions (including without limitation forward sale or purchase agreements, capitalized leases and conditional sales agreements) having the commercial effect of a borrowing of money entered into to finance operations or capital requirements (but not including trade payables and	

</TABLE>

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PNC BANK, NATIONAL ASSOCIATION
_____, 19____
Page 6

<TABLE>

<S>

<C>

accrued expenses incurred in the ordinary course of business which are not represented by a promissory note)

\$

(v) Any guaranty of indebtedness for borrowed money

\$

(vi) Sum of (i) through (v) equals Consolidated Funded Debt

\$

(a) Capitalization, the denominator of the foregoing ratio, is determined as follows as of the Pooling Date:

(i) Consolidated Funded Debt (amount from clause (vi) of Paragraph (a) above)

\$

(ii) Consolidated Net Worth, which is total stockholders' equity of NovaCare and its Subsidiaries as of the Pooling Date

\$

(iii) Sum of (i) and (ii) equals Capitalization

\$

</TABLE>

(B) Funded Debt to Cash Flow From Operations. (Section 8.02(n)). The ratio of (i) Consolidated Funded Debt on the Pooling Date to (ii) Consolidated Cash Flow from Operations for the four fiscal quarters ending immediately prior to the Pooling Date is _____ to 1.0. Such ratio must not be more than the following ratios for the following periods:

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PNC BANK, NATIONAL ASSOCIATION

_____, 19____

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<TABLE>

<CAPTION>

Period -----	Ratio -----
<S>	<C>
July 1, 1994 through June 30, 1995	3.00 to 1.00
July 1, 1995 through December 31, 1995	2.75 to 1.00
January 1, 1996 and thereafter	2.50 to 1.00

(a) Consolidated Funded Debt, the numerator of the foregoing ratio (amount from clause (vi) of Paragraph 6(A) (a) above)

\$

</TABLE>

(b) Consolidated Cash Flow from Operations, the denominator of the foregoing ratio, for the four fiscal quarters ending immediately prior to the Pooling Date is determined as follows:

<TABLE>

<S>

(i) Net Income

<C>

\$

(ii)	Depreciation	\$	-----
(iii)	Amortization	\$	-----
(iv)	Other non-cash charges to net income	\$	-----
(v)	Interest Expense	\$	-----
(vi)	Income Tax Expense	\$	-----
(vii)	Sum of (i), (ii), (iii), (iv), (v) and (vi)	\$	-----
(viii)	Non-cash credits to net income	\$	-----
(ix)	Item (vii) reduced by item (viii) equals Consolidated Cash Flow from Operations	\$	-----

</TABLE>

(7) Indebtedness Assumed (Sections 8.02(a)(vi)).

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PNC BANK, NATIONAL ASSOCIATION

_____, 19__

Page 8

(a) Proposed Pooling. The following is a list of Indebtedness of the Pooling Partner and its Subsidiaries (if any) which will be assumed or otherwise will remain outstanding following the Proposed Pooling:

<TABLE>

<CAPTION>

Creditor -----	Entity which will be liable therefor after Pooling -----	Collateral security securing the Indebtedness (if any) -----	Amount of Indebtedness -----
<S>	<C>	<C>	<C>
-----	-----	-----	\$ -----
-----	-----	-----	\$ -----
-----	-----	-----	\$ -----
	Total		\$ =====

</TABLE>

We are simultaneously sending you copies of the agreements governing the Indebtedness listed above.

(b) Aggregate Limit (Section 8.02(a)(vi)). The sum of the Indebtedness to be assumed in connection with the Proposed Pooling described in paragraph (a) above together with Indebtedness assumed by the Loan Parties in connection with Permitted Poolings during the current fiscal year is \$_____ which is less than \$100,000,000, the maximum amount permitted to be assumed during the current fiscal year. The amount of such Indebtedness is computed as follows:

<TABLE>

<S>		<C>
(i)	Total from paragraph (a) above	\$ -----

(ii) Indebtedness either (1) previously assumed by acquiring Loan Parties in Permitted Poolings during the current fiscal year, or (2) of Pooling Partners and their Subsidiaries whose stock or other ownership interests were previously acquired in Permitted Poolings during the current fiscal year, including, in the case of both (1) and (2), any Indebtedness which has been repaid since the date of the pooling as well

</TABLE>

as debt which remains outstanding on the date of this certificate:

<TABLE>
<CAPTION>

Loan Party which assumed Indebtedness or Pooling Partner whose stock was acquired ----- <S>	Date of Permitted Pooling -----	Collateral securing the Indebtedness (if any) -----	Amount of Indebtedness ----- <C>
-----	-----	-----	\$ -----
-----	-----	-----	\$ -----
-----	-----	-----	\$ -----
Total			\$ -----
	(ii) Sum of (i) plus (ii) (may not exceed \$100,000,000)		\$ -----

</TABLE>

(c) Lease Obligations. Listed below are the future minimum lease payments under each non-cancellable lease of the Pooling Partner and its Subsidiaries (if any) (i) which will be assumed or otherwise will remain outstanding after the Proposed Pooling, and (ii) under which the annual lease payments exceed \$250,000:

<TABLE>
<CAPTION>

Lessor ----- <S>	Expiration Date ----- <C>	Future Minimum Lease Payments ----- <C>
-----	-----	-----
-----	-----	-----
-----	-----	-----
	Total	\$ =====

</TABLE>

(8) Attached Financial Statements. Attached hereto are

true and correct copies of (i) the consolidated balance sheets and income statements of Pooling Partner and its Subsidiaries for the prior three fiscal years and the interim statements ending on _____, (ii) any financial projections with respect to the Pooling Partner and its Subsidiaries received from Pooling Partner or prepared by the Loan Parties, and (iii) any revised

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PNC BANK, NATIONAL ASSOCIATION

_____, 19__

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budgets, and accompanying forecasts and projections prepared by NovaCare projecting its and its Subsidiaries' operations on a consolidated basis and separately for each line of business which have not previously been delivered to the Banks.

(9) Representations and Warranties. After giving effect to the Proposed Pooling, any new Revolving Credit Loans to be requested or debt to be assumed in connection therewith, the representations and warranties contained in Article VI of the Credit Agreement will be true on and as of the Pooling Date with the same effect as though such representations and warranties had been made on and as of the Pooling Date (except representations and warranties which expressly relate solely to an earlier date or time, which representations and warranties shall have been true and correct on and as of the specific dates or times referred to therein) and the Loan Parties shall have performed and complied with all covenants and conditions of the Credit Agreement.

IN WITNESS WHEREOF, the undersigned has executed this Certificate this ____ day of _____, 19__.

NOVACARE, INC.

By: _____
Name: _____
Title: _____

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PNC BANK, NATIONAL ASSOCIATION

_____, 19__

Page 11

<TABLE>

<p><S></p> <p>NovaCare is enclosing the following with this Certificate:</p> <p>(1) Joinder documentation described in Paragraph 5</p> <p>(2) Agreements governing assumed Indebtedness described in Paragraph 7(a)</p> <p>(3) Financial Statements of the Pooling Partner and its Subsidiaries described in Paragraph 8(i)</p> <p>(4) Financial projections of the Pooling Partner and its Subsidiaries described in Paragraph 8(ii)</p> <p>(5) Budget, forecasts and projections described in Paragraph 8(iii)</p>	<p><C></p> <p>-----</p> <p>-----</p> <p>-----</p> <p>-----</p> <p>-----</p>
--	---

</TABLE>

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PNC BANK, NATIONAL ASSOCIATION

_____, 19__

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ACKNOWLEDGED AND AGREED TO AND PROPOSED
POOLING APPROVED BY EACH BANK WHICH HAS
EXECUTED THIS CERTIFICATE BELOW AS OF
THE _____ DAY OF

_____, 19__ .

PNC BANK, NATIONAL ASSOCIATION

By: _____
Name: _____
Title: _____

CORESTATES BANK, N.A.

By: _____
Name: _____
Title: _____

FIRST UNION NATIONAL BANK OF NORTH CAROLINA

By: _____
Name: _____
Title: _____

MELLON BANK, N.A.

By: _____
Name: _____
Title: _____

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_____, 19____
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NATIONSBANK N.A.

By: _____
Name: _____
Title: _____

FLEET BANK OF MASSACHUSETTS, N.A.

By: _____
Name: _____
Title: _____

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[TO BE USED FOR CERTAIN PERMITTED PURCHASES]

EXHIBIT 1.01(P) (2)
PERMITTED PURCHASES APPROVAL CERTIFICATE -
REQUIRED BANKS

_____, 19____

PNC BANK, NATIONAL ASSOCIATION
as Agent for the Banks party
to the Credit Agreement Referred to Below

Ladies and Gentlemen:

I refer to the Credit Agreement dated as of May _____, 1994 (as amended, supplemented or modified from time to time, the "Credit Agreement") among NOVACARE, INC., a Delaware corporation ("NovaCare"), each of the other Borrowers and the Guarantors that are parties thereto (the "Loan Parties"), the Banks party thereto and PNC BANK, NATIONAL ASSOCIATION, as Agent for such Banks. This Certificate is delivered pursuant to clause (D) of the definition of Permitted Purchase contained in Section 1.01 of the Credit Agreement in connection with the proposed purchase transaction described below. Unless otherwise defined herein, terms defined in the Credit Agreement are used herein with the same meanings.

I, _____, [President/Chief Executive Officer/Chief Financial Officer] of NovaCare, do hereby certify as of the date hereof, as follows:

(1) Description of Proposed Permitted Purchase. NovaCare desires that _____ [List Loan Party(s) that will be making the Acquisition] (the "Acquiring Loan Party") [acquire the assets/acquire the stock or other ownership interest/merge with/or merge into] _____ [Insert name of entity whose assets are being acquired or whose stock or other ownership interest is being acquired] (the "Seller") (the "Acquisition").

- (i) The Seller is _____ [type of entity and jurisdiction of organization].
- (ii) The Acquisition is scheduled to close on _____, 19__ (the "Purchase Date").

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PNC BANK, NATIONAL ASSOCIATION
_____, 199__
Page 2

- (iii) The assets and businesses of the Seller are located in _____ [list locations and describe assets or business in those locations].
- (iv) The Acquisition shall be an [Asset Acquisition/Stock Acquisition] (see Section 1.01 of the Credit Agreement for definition of these terms).

(2) Purchase Price; Assumed Indebtedness. (Clause (D) of definition of Permitted Purchase).

- (A) Purchase Price. The Purchase Price in connection with the proposed Acquisition is \$_____ computed in accordance with GAAP as set forth below.

<TABLE>	<S>	<C>
	(i) Cash to be paid at Closing	\$ -----
	(ii) Amount of deferred payments	\$ -----
	(iii) Stock, securities or other consideration to be given by Loan Parties (describe): _____	\$ -----
	(iv) Other amounts to be added or subtracted (describe): _____	\$ -----
	Total	\$ -----

</TABLE>
(B) Assumed Indebtedness - This Acquisition. The following is a list of (1) the Indebtedness to be assumed by the Loan Parties in connection with the Acquisition, and (2) the Indebtedness of the Seller which shall remain

outstanding following the Acquisition (this number (2) applies only if the Acquisition is a Stock Acquisition):

<TABLE>
<CAPTION>

Creditor ----- <S>	Obligor on the Indebtedness ----- <C>	Collateral security securing the Indebtedness (if any) ----- <C>	Amount of Indebtedness ----- <C>
-----	-----	-----	\$ -----
-----	-----	-----	\$ -----
-----	-----	-----	\$ -----
	Total:		\$ =====

</TABLE>

We are simultaneously sending you copies of the agreements governing the Indebtedness listed above.

- (C) Assumed Indebtedness - Aggregate Limitations (Section 8.02(a)(vi)). The amount of Indebtedness of the Loan Parties described in Section 8.02(a)(vi) of the Credit Agreement shall be \$_____ on the Purchase Date which is less than \$20,000,000, the maximum permitted amount. The amount of such Indebtedness is computed as follows:

<TABLE>

<S>	<C>
(i) Purchase Money Security Interests entered into in the ordinary course of business	\$ -----
(ii) Indebtedness Assumed in Permitted Purchases - Indebtedness (including extensions and renewals thereof) either (1) assumed by Loan Parties pursuant to acquisitions of the assets of other persons (by purchase, merger or otherwise) in Permitted Purchases (including the proposed Acquisition) between the Closing Date and the Purchase Date or (2) of corporations, partnerships or other entities whose stock, partnership interests or other ownership interests were acquired by Loan Parties (by purchase, merger or otherwise) in Permitted Purchases between the Closing Date and the Purchase Date, which in the case of either (1) or (2) above remains outstanding on the Purchase Date:	

</TABLE>

<TABLE>

<S>	<C>
(a) Indebtedness assumed in the	

proposed Acquisition (from paragraph (B) above)

\$ _____

(b) Indebtedness assumed in prior Permitted Purchases:

</TABLE>
<TABLE>
<CAPTION>

	Loan Party which is now liable on the Indebtedness	Date of Permitted Purchase	Collateral securing the Indebtedness (if any)	Indebtedness Outstanding
<S>	-----	-----	-----	<C> \$ -----
	-----	-----	-----	\$ -----
	-----	-----	-----	\$ -----
		Total		\$ =====
(c)	Sum of (a) plus (b)			\$ -----
(iii)	Sum of Lines (i) and (ii) (c) (may not exceed \$20,000,000)			\$ -----

</TABLE>

(D) Lease Obligations. Listed below are the future minimum lease payments under each non-cancellable lease of the Seller and its Subsidiaries (if any) (i) which will be assumed or otherwise will remain outstanding after the Acquisition, and (ii) under which the annual lease payments exceed \$250,000:

<TABLE>
<CAPTION>

Lessor	Expiration Date	Future Minimum Lease Payments
<S>	<C>	<C>
-----	-----	-----
-----	-----	-----
-----	-----	-----
	Total	\$ =====

</TABLE>

(3) Lines of Business (Clause (A) of definition of Permitted Purchase). The Seller is engaged in the business of _____, which complies with Section 8.02(g) of the Credit Agreement.

(4) Events of Default or Potential Default (Paragraph (B) of definition of Permitted Purchase). On the Purchase Date and after giving effect to the Acquisition and any new Revolving Credit Loans to be requested or debt to be assumed in connection therewith, no event shall have occurred and be continuing which constitutes an Event of Default or Potential Default.

(5) Joinder of the Seller and its Subsidiaries and Pledge of their Stock (Paragraph (C) of definition of Permitted Purchase). The following is a complete list of the corporations, partnerships or other entities: (i) whose stock or other ownership interests will be acquired by one or more Loan Parties in the Acquisition, (ii) which have been or will be formed by the Loan Parties pursuant to the Acquisition, (iii) which are Subsidiaries or Minority Subsidiaries of the entities listed in (i) and (ii) above:

<TABLE>
<CAPTION>

Name of Entity	Type of Entity and Jurisdiction of Organization	Person who holds its Stock or other ownership Interests	Percentage of total ownership held	Is the Entity Joining the Credit Agreement (yes/no)
<S>	<C>	<C>	<C>	<C>
-----	-----	-----	-----	-----
-----	-----	-----	-----	-----
-----	-----	-----	-----	-----

</TABLE>

We are simultaneously delivering to the Agent Guaranty Agreements, Pledge Agreements, an opinion of counsel and certified copies of organizational documents, pursuant to which each entity listed above which is a Qualified Subsidiary shall join the Credit Agreement as a Guarantor and the stock of such Qualified Subsidiary shall be pledged to the Agent for the benefit of the Banks, in each instance on the Purchase Date. (The procedures for such joinders are described in Section 11.18 of the Credit Agreement. A Qualifying Subsidiary is an entity of which NovaCare or

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_____, 199__
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NovaCare's Subsidiaries hold 80% or more of the ownership interests as more fully set forth in the Credit Agreement.)

(6) Financial Covenant Compliance (Paragraph (E) of definition of Permitted Purchase). On the Purchase Date and after giving effect to the Acquisition and any new Revolving Credit Loans to be requested or debt to be assumed in connection therewith, but otherwise on the basis of the most recent financial statements of NovaCare and its Subsidiaries delivered pursuant to Section 8.01(m) of the Credit Agreement and of the Seller and its Subsidiaries as attached hereto pursuant to Paragraph (8), the Loan Parties shall be in compliance with the following financial covenants:

- (A) Funded Debt to Capitalization. (Section 8.02(m)). On the Purchase Date, the ratio of (i) Consolidated Funded Debt to (ii) Capitalization shall be _____ to 1.0. Such ratio must not be more than the following ratios for the following periods:

<TABLE>
<CAPTION>

Period	Ratio
<S>	<C>
Closing Date through June 30, 1996	.50 to 1.0
July 1, 1996 and thereafter	.45 to 1.0

</TABLE>

- (a) Consolidated Funded Debt, the numerator of the foregoing ratio, is determined as follows:

Indebtedness of NovaCare and its Subsidiaries to persons other than NovaCare and its Subsidiaries on the Purchase Date in respect of, without duplication:

<TABLE>

<S>	<C>
(i) Borrowed money	\$ _____
(ii) Amounts raised under or liabilities in respect of any note purchase or acceptance credit facility	\$ _____

(iii) Reimbursement obligations under any letter of credit, currency swap agreement, interest rate swap, cap,

</TABLE>

<TABLE>

<S>	collar or floor agreement or other interest rate management device	<C> \$ -----
(iv)	Other transactions (including without limitation forward sale or purchase agreements, capitalized leases and conditional sales agreements) having the commercial effect of a borrowing of money entered into to finance operations or capital requirements (but not including trade payables and accrued expenses incurred in the ordinary course of business which are not represented by a promissory note)	\$ -----
(v)	any guaranty of indebtedness for borrowed money	\$ -----
(vi)	Sum of (i) through (v) equals Consolidated Funded Debt	\$ -----
(b)	Capitalization, the denominator of the foregoing ratio, is determined as follows as of the Purchase Date:	
(i)	Consolidated Funded Debt (amount from clause (vi) of Paragraph (a) above)	\$ -----
(ii)	Consolidated Net Worth, which is total stockholders' equity of NovaCare and its Subsidiaries as of the Purchase Date	\$ -----
(iii)	Sum of (i) and (ii) equals Capitalization	\$ -----

</TABLE>

(B) Funded Debt to Cash Flow From Operations. (Section 8.02(n)). The ratio of (i) Consolidated Funded Debt on the Purchase Date to (ii) Consolidated Cash Flow from Operations for the four fiscal quarters ending immediately prior to the Purchase Date is

_____ to 1.0. Such ratio must not be more than the following ratios for the following periods:

<TABLE>
<CAPTION>

Period -----	Ratio -----
<S> July 1, 1994 through June 30, 1995	<C> 3.00 to 1.00

July 1, 1995 through December 31, 1995		2.75 to 1.00
January 1, 1996 and thereafter		2.50 to 1.00
(a)	Consolidated Funded Debt, the numerator of the foregoing ratio (amount from clause (vi) of Paragraph 6(A) (a) above)	\$ -----
(b)	Consolidated Cash Flow from Operations, the denominator of the foregoing ratio, for the four fiscal quarters ending immediately prior to the Purchase Date is determined as follows:	
	(i) Net Income	\$ -----
	(ii) Depreciation	\$ -----
	(iii) Amortization	\$ -----
	(iv) Other non-cash charges to net income	\$ -----
	(v) Interest Expense	\$ -----
	(vi) Income Tax Expense	\$ -----
	(vii) Sum of (i), (ii), (iii), (iv), (v) and (vi)	\$ -----
	(viii) Non-cash credits to net income	\$ -----

</TABLE>

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PNC BANK, NATIONAL ASSOCIATION
_____, 199__
Page 9

<TABLE>

<S>	(ix) Item (vii) reduced by item (viii) equals Consolidated Cash Flow from Operations	<C> \$ -----
-----	--	-----------------

</TABLE>

(7) Permitted Purchase Compliance. (Clause (E) of definition of Permitted Purchase). On the Purchase Date and after giving effect to the Acquisition, the Purchase Price for such Acquisition, when aggregated with the Purchase Price of all other Permitted Purchases which occurred during the period beginning on the Effective Date through and including the date of determination is \$ _____, which is less than or equal to the amount of \$160,000,000.

(8) Attached Financial Statements. Attached hereto are true and correct copies of (i) the consolidated balance sheets and income statements of Seller and its Subsidiaries for their immediately preceding fiscal year and all other financial statements delivered by the Seller in connection with the Acquisition which consist of the following _____ [list]; (ii) any financial projections with respect to the Seller and its Subsidiaries received from the Seller or prepared by the Loan Parties; and (iii) any revised budgets, and accompanying forecasts and projections prepared by NovaCare projecting its and its Subsidiaries' operations on a consolidated basis and separately for each line of business which have not previously been delivered to the Banks.

(9) Representations and Warranties. After giving effect to the Acquisition, any new Revolving Credit Loans to be requested or debt to be assumed in connection therewith, the representations and warranties contained in Article VI of the Credit Agreement shall be true on and as of the Purchase Date with the same effect as though such representations and warranties had been made on and as of the Purchase Date (except representations and warranties which expressly relate solely to an earlier date or time, which representations and warranties shall have been true and correct on and as of the specific dates or times referred to therein) and the Loan Parties shall have performed and complied with all covenants and conditions of the Credit Agreement.

IN WITNESS WHEREOF, the undersigned has executed this Certificate this ____ day of _____, 19__.

By: _____
Name: _____
Title: _____

NovaCare is enclosing the following with this Certificate:
<TABLE>
<CAPTION>

<S>	<C>	NovaCare to
(10)	Agreements governing assumed Indebtedness described in Paragraph 2(B)	Check if
		Enclosed

		<C>

(11)	Joinder documentation described in Paragraph 5	-----
(12)	Financial Statements of the Seller and its Subsidiaries described in Paragraph 8(i)	-----
(13)	Financial projections of the Seller and its Subsidiaries described in Paragraph 8(ii)	-----
(14)	Budget, forecasts and projections described in Paragraph 8(iii)	-----

ACKNOWLEDGMENT BY BANKS:

NovaCare to initial either (a) or (b) below as applicable:

<S>	<C>	Initial
(15)	Each Bank shall be deemed to approve of this proposed Acquisition unless it notifies NovaCare in writing within ten (10) Business Days after it receives a copy of this certification that it disapproves of this certification because both of the following are true:	Applicable
		Line

		<C>

	(A) the Purchase Price listed in Paragraph 2(A) of this certificate is less than or equal to \$30,000,000	
	and	
	(B) the amount of the Assumed Indebtedness set forth in Paragraph 2(B) of this certificate is less than or equal to \$15,000,000	-----
(16)	Each Bank shall be deemed to approve of this proposed Acquisition only by notifying NovaCare in writing of its approval because either of the following is true:	
	(A) the Purchase Price set forth in Paragraph 2(A) of this certificate is greater than \$30,000,000	

or

(B) the amount of Assumed Indebtedness set forth in Paragraph 2(B) of this certificate is greater than \$15,000,000

</TABLE>

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PNC BANK, NATIONAL ASSOCIATION
_____, 199__
Page 12

Banks to Sign and Initial Approval or Disapproval of proposed Acquisition:

<TABLE>
<CAPTION>

	Approve -----	Disapprove -----
<S> PNC BANK, NATIONAL ASSOCIATION	<C>	<C>
By: -----	-----	-----
Name: -----		
Title: -----		
 CORESTATES BANK, N.A.		
By: -----	-----	-----
Name: -----		
Title: -----		
 FIRST UNION NATIONAL BANK OF NORTH CAROLINA		
By: -----	-----	-----
Name: -----		
Title: -----		
 MELLON BANK, N.A.		
By: -----	-----	-----
Name: -----		
Title: -----		
 NATIONSBANK N.A.		
By: -----	-----	-----
Name: -----		
Title: -----		
 FLEET BANK OF MASSACHUSETTS, N.A.		
By: -----	-----	-----
Name: -----		
Title: -----		

</TABLE>

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EXHIBIT 8.01 (m) (iii)
COMPLIANCE CERTIFICATE

, 19

PNC BANK, NATIONAL ASSOCIATION
 as Agent for the Banks party
 to the Credit Agreement Referred to Below
 Fifth Avenue and Wood Street
 Pittsburgh, PA 15265

Ladies and Gentlemen:

I refer to the Credit Agreement dated as of May 27, 1994 (as amended, supplemented or modified from time to time, the "Credit Agreement") among NOVACARE, INC., a Delaware corporation ("NovaCare"), and the other Borrowers and the Guarantors under such Credit Agreement (collectively, the "Loan Parties"), the Banks party thereto and PNC BANK, NATIONAL ASSOCIATION, as Agent for such Banks. Unless otherwise defined herein, terms defined in the Credit Agreement are used herein with the same meanings.

I, _____, [President/Chief Executive Officer/Chief Financial Officer] of NovaCare, do hereby certify pursuant to Section 8.01(m)(iii) of the Credit Agreement on behalf of NovaCare as of the [fiscal quarter/year ended _____, 19__] the "Report Date", as follows:

- (1) Minimum Current Ratio. (Section 8.02(k)). The ratio of (i) consolidated current assets of NovaCare and its Subsidiaries to (ii) consolidated current liabilities of NovaCare and its Subsidiaries calculated as of the Report Date is _____ to 1.0 which is not less than the following ratios for the following periods:

Period	Ratio
<S> Closing Date through 6/30/1997	<C> 2.0 to 1.0
7/1/1997 and thereafter	1.75 to 1.0

- (2) Minimum Net Worth. (Section 8.02(l)). As of the Report Date, the Consolidated Net Worth is \$_____ which is not less than the Minimum Net Worth Requirement which is \$_____. Such amounts are computed as follows:

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 PNC BANK, NATIONAL ASSOCIATION
 _____, 19__
 Page 2
 <TABLE>

<S>	<C>	<C>
(A) Consolidated Net Worth as of the Report Date:		
Total stockholders' equity of NovaCare and its Subsidiaries		\$ _____
(B-1) Minimum Net Worth Requirement as of the Report Date for any Report Date occurring between the Closing Date through, but not including, the Sixth Amendment Effective Date:		
(i)		\$375,250,000
(ii) Seventy-five percent (75%) of Consolidated Net Income of NovaCare and its Subsidiaries for each fiscal quarter in which net income was earned (as opposed to a net loss) from March 31, 1994 through (and including) the Report Date computed as follows:		
(a) consolidated net income		\$ _____
(b) Less: increases in net income resulting from changes in GAAP after Closing Date		(\$ _____)
(c) Plus: decreases in net		_____

	income resulting from changes in GAAP after Closing Date	\$	-----
(d)	Subtotal sum of (a), (b) and (c)	\$	-----
(e)	Line (d) times 75%	\$	-----
(iii)	One hundred percent (100%) of all proceeds received by NovaCare in connection with the sale of shares of its capital stock after deducting any expenses associated with such sale (including proceeds from conversion of the Subordinated Debentures) during the		

</TABLE>

<TABLE>	<S>	period from March 31, 1994 through (and including) the Report Date	<C>	<C>
	(iv)	Sum of (i), (ii) and (iii) equals Minimum Net Worth Requirement	\$	-----
	(B-2)	Minimum Net Worth Requirement as of the Report Date. For any Report Date occurring on and after the Sixth Amendment Effective Date through and including June 30, 1996:	\$	-----
	(i)			\$487,635,000
	(ii)	Ninety-five percent (95%) of Consolidated Net Income of NovaCare and its Subsidiaries for each fiscal quarter after the fiscal quarter ended June 30, 1995 in which net income was earned (as opposed to a net loss) from July 1, 1995 through (and including) the Report Date computed as follows:		
	(a)	consolidated net income	\$	-----
	(b)	Less: increases in net income resulting from changes in GAAP after Closing Date	(\$	-----)
	(c)	Plus: decreases in net income resulting from changes in GAAP after Closing Date	\$	-----
	(d)	Subtotal sum of (a), (b) and (c)	\$	-----
	(e)	Line (d) times 95%	\$	-----
	(iii)	One hundred percent (100%) of all proceeds received by NovaCare in connection with the sale of shares of its capital stock after deducting any expenses associated with such sale (including proceeds from conversion of the Subordinated Debentures) during the		

</TABLE>

<TABLE>

<S>

<C>

	period from July 1, 1995 through (and including) the Report Date	\$	-----
(iv)	One hundred percent (100%) of the cash purchase price of common stock of NovaCare repurchased by NovaCare, up to an aggregate maximum amount of \$55,000,000 during the period from July 1, 1995 through (and including) the Report Date	\$	-----
(v)	Aggregate deductions from Consolidated Net Income for non-cash extraordinary items, up to an aggregate maximum amount of \$83,000,000 during the period from July 1, 1995 through (and including) the Report Date	\$	-----
(vi)	Sum of amounts under clauses (i), (ii) and (iii) reduced by amounts under clauses (iv) and (v) equals Minimum Net Worth Requirement	\$	-----
(B-3)	Minimum Net Worth Requirement as of the Report Date for any Report Date occurring on or after July 1, 1996:		
(i)	Amount determined under item (vi) of clause (B-2) above as of June 30, 1996	\$	-----
(ii)	Seventy-five percent (75%) of Consolidated Net Income of NovaCare and its Subsidiaries for each fiscal quarter in which net income was earned (as opposed to a net loss) from July 1, 1996 through (and including) the Report Date computed as follows:		
(a)	consolidated net income	\$	-----

</TABLE>

<TABLE>

<S>

<C>

(b)	Less: increases in net income resulting from changes in GAAP after Closing Date	(\$	_____)
(c)	Plus: decreases in net income resulting from changes in GAAP after Closing Date	\$	-----
(d)	Subtotal sum of (a), (b) and (c)	\$	-----
(e)	Line (d) times 75%	\$	-----
(iii)	One hundred percent (100%) of all proceeds received by NovaCare in connection with the sale of shares of its capital stock after deducting any expenses associated with such sale (including proceeds from conversion of the Subordinated Debentures) during the period from July 1, 1996 through (and including) the Report Date	\$	-----
(iv)	Sum of (i), (ii), and (iii) equals Minimum Net Worth Requirement	\$	-----

</TABLE>

(3) Funded Debt to Capitalization. (Section 8.02(m)).
As of the Report Date, the ratio of (i) Consolidated

Funded Debt to (ii) Capitalization is _____ to 1.0. Such ratio must not be more than the following ratios for the following periods:

<TABLE>
<CAPTION>

Period	Ratio
-----	-----
<S> Closing Date through June 30, 1996	<C> .50 to 1.0
July 1, 1996 and thereafter	.45 to 1.0

</TABLE>

(A) Consolidated Funded Debt, the numerator of the foregoing ratio, is determined as follows:

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_____, 19____
Page 6

<TABLE>

<S>	<C>	<C>
Indebtedness of NovaCare and its Subsidiaries on the Report Date to persons other than NovaCare and its Subsidiaries in respect of, without duplication:		
(i)	Borrowed money	\$ -----
(ii)	Amounts raised under or liabilities in respect of any note purchase or acceptance credit facility	\$ -----
(iii)	Reimbursement obligations under any letter of credit, currency swap agreement, interest rate swap, cap, collar or floor agreement or other interest rate management device	\$ -----
(iv)	Other transactions (including without limitation forward sale or purchase agreements, capitalized leases and conditional sales agreements) having the commercial effect of a borrowing of money entered into to finance operations or capital requirements (but not including trade payables and accrued expenses incurred in the ordinary course of business which are not represented by a promissory note)	\$ -----
(v)	any guaranty of indebtedness for borrowed money	\$ -----
(vi)	Sum of (i) through (v) equals Consolidated Funded Debt	\$ -----
(B) Capitalization, the denominator of the foregoing ratio, is determined as follows:		
(i)	Consolidated Funded Debt (amount from clause (vi) of Paragraph (A) above)	\$ -----

</TABLE>

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PNC BANK, NATIONAL ASSOCIATION
_____, 19____
Page 7

<TABLE>

<S> <C>

(ii)	Consolidated Net Worth, which is total stockholders' equity of NovaCare and its Subsidiaries as of the Report Date	\$	-----
(iii)	Sum of (i) and (ii) equals Capitalization	\$	-----

</TABLE>

(4) Funded Debt to Cash Flow From Operations. (Section 8.02(n)). The ratio of (i) Consolidated Funded Debt on the Report Date to (ii) Consolidated Cash Flow from Operations for the four fiscal quarters ending on the Report Date is _____ to 1.0. Such ratio must not be more than the following ratios for the following periods:

<TABLE>
<CAPTION>

Period	Ratio
-----	-----
<S>	<C>
July 1, 1994 through June 30, 1995	3.00 to 1.00
July 1, 1995 through December 31, 1995	2.75 to 1.00
January 1, 1996 and thereafter	2.50 to 1.00
(A) Consolidated Funded Debt, the numerator of the foregoing ratio (amount from Paragraph 3(A) above)	\$

(B) Consolidated Cash Flow from Operations(1), the denominator of the foregoing ratio, for the four fiscal quarters ending on the Report Date is determined as follows:	
(i) Net Income	\$

(ii) Depreciation	\$

(iii) Amortization	\$

(iv) Other non-cash charges to net income	\$

</TABLE>

(1) To be adjusted in accordance with the definition of Consolidated Cash Flow from Operations set forth in the Credit Agreement to give effect to Permitted Acquisitions and Permitted Asset Transfers during the four fiscal quarters ending on the Report Date.

<TABLE>

<S>	<C>
(v) Interest Expense	\$

(vi) Income Tax Expense	\$

(vii) Sum of (i), (ii), (iii), (iv), (v) and (vi)	\$

(viii) Non-cash credits to net income	\$

(ix) Item (vii) reduced by item (viii) equals Consolidated Cash Flow from Operations	\$

</TABLE>

(5) Minimum Fixed Charge Coverage Ratio (2). (Section 8.02(o)). The ratio of (i) Consolidated Earnings Available for Fixed Charges to (ii) Consolidated Fixed Charges for the four fiscal quarters ending on the Report Date is _____ to 1.0. Such ratio must not be less than the following ratios for the following periods:

<TABLE>
<CAPTION>

Period	Ratio
----- <S> Closing Date through June 30, 1996	----- <C> 1.5 to 1.0
July 1, 1996 and thereafter	1.75 to 1.0
(A-1) For any Report Date occurring between the Closing Date through, but not including the Sixth Amendment Effective Date, Consolidated Earnings Available for Fixed Charges, the numerator of the foregoing ratio is determined as follows:	
(i) Net income	\$ -----
(ii) Interest expense	\$ -----
(iii) Income tax expense	\$ -----

</TABLE>

(2) To be adjusted in accordance with the definitions of Consolidated Earnings Available for Fixed Charges and Consolidated Fixed Charges set forth in the Credit Agreement to give effect to Permitted Acquisitions which occur during the four fiscal quarters ending on the Report Date.

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PNC BANK, NATIONAL ASSOCIATION
_____, 19____
Page 9

<TABLE>

<S>		<C>
(iv) Operating lease expense		\$ -----
(v) The sum of (i) through (iv)		\$ -----
(A-2) For any Report Date occurring between the Closing Date through, but not including the Sixth Amendment Effective Date, Consolidated Fixed Charges, the denominator of the foregoing ratio, for the four fiscal quarters ending on the Report Date, is determined as follows:		
(vi) Interest expense		\$ -----
(vii) Operating lease expense		\$ -----
(viii) The sum of (i) and (ii)		\$ -----
(B-1) For any Report Date occurring on or after the Sixth Amendment Effective Date, Consolidated Earnings Available for Fixed Charges, the numerator of the foregoing ratio is determined as follows:		
(i) Net Income		\$ -----
(ii) Interest Expense		\$ -----
(iii) Income Tax Expense		\$ -----
(iv) Depreciation		\$ -----
(v) Amortization		\$ -----
(vi) Other non-cash charges to net income		\$ -----
(vii) Expenses under operating leases		\$ -----
(viii) Sum of (i), (ii), (iii), (iv), (v) and (vi)		\$ -----

(ix)	Non-cash credits to net income	\$	-----
(x)	Item (viii) reduced by item (ix) equals Consolidated Earnings Available for Fixed Charges	\$	-----

</TABLE>

<TABLE>

<S>		<C>	
(B-2)	For any Report Date occurring on or after the Sixth Amendment Effective Date, Consolidated Fixed Charges, the denominator of the foregoing ratio is determined as follows:		
(i)	Interest Expense	\$	-----
(ii)	Expenses under operating leases	\$	-----
(iii)	Income Tax Expense	\$	-----
(iv)	Current maturities of long-term Indebtedness	\$	-----
(v)	Current principal payments under capitalized leases (for the twelve (12) month period following the Report Date)	\$	-----
(vi)	The sum of (i) through (v)	\$	-----

</TABLE>

- (6) [INTENTIONALLY OMITTED]
- (7) Indebtedness Assumed in Permitted Acquisitions; Purchase Money Security Interests (Sections 8.02(a)(v) and (vi)).
- (a) Permitted Purchases and Purchase Money Security Interests (Section 8.02(a)(v)). The amount of Indebtedness of the Loan Parties described in Section 8.02(a)(v) of the Credit Agreement is \$_____ on the Report Date which is less than \$20,000,000, the maximum permitted amount. The amount of such Indebtedness is computed as follows:

<TABLE>

<S>		<C>	
(i)	Purchase Money Security Interests entered into in the ordinary course of business	\$	-----

</TABLE>

- (ii) Permitted Purchases - Indebtedness (including extensions and renewals thereof) either (1) assumed by Loan Parties pursuant to acquisitions of the assets of other persons (by purchase, merger or otherwise) in Permitted Purchases between the Closing Date and the Report Date or (2) of corporations, partnerships or other entities whose stock, partnership interests or other ownership interests were acquired by Loan Parties (by purchase, merger or otherwise) in Permitted Purchases between the Closing Date

and the Report Date, which in the case

of either (1) or (2) above remains outstanding on the Report Date:

<TABLE>
<CAPTION>

Loan Party which is now liable on the Indebtedness	Date of Permitted Purchase	Collateral securing the Indebtedness (if any)	Indebtedness Outstanding
<S>			<C>
-----	-----	-----	\$
-----	-----	-----	\$
-----	-----	-----	\$
	Total		\$
	(iii) Sum of Lines (i) and (ii) (may not exceed \$20,000,000)		\$

</TABLE>

(b) Permitted Poolings (Section 8.02(a)(vi)). The amount of Indebtedness of the Loan Parties described in Section 8.02(a)(vi) of the Credit Agreement incurred during the current fiscal year was \$_____ which is less than \$100,000,000, the maximum amount permitted to be incurred during the current fiscal year. The amount of such Indebtedness is computed as follows:

Indebtedness either (1) assumed by acquiring Loan Parties in Permitted Poolings during the current fiscal year, or (2) of Pooling Partners and their Subsidiaries whose stock or other ownership interests were acquired in Permitted Poolings during the current fiscal year, including in the case of both (1) and (2) any Indebtedness which has been repaid since the date of the pooling as well as Indebtedness which remains outstanding on the date of this certificate.

<TABLE>
<CAPTION>

Loan Party which assumed Indebtedness or Pooling Partner whose stock was acquired	Date of Permitted Pooling	Collateral securing the Indebtedness (if any)	Amount of Indebtedness
<S>	<C>	<C>	<C>
-----	-----	-----	\$
-----	-----	-----	\$
-----	-----	-----	\$
	Total (may not exceed \$100,000,000)		\$

</TABLE>

(8) Permitted Additional Institutional Indebtedness (Section 8.02(a)(viii) and definition of "Permitted Additional Institutional Indebtedness"). The following is a list of Permitted Additional Institutional Indebtedness outstanding on the Report Date:

<TABLE>
<CAPTION>

Lender	Loan Party	Amount	has been delivered to Agent** (yes/no)
<S>	<C>	<C>	<C>
-----	-----	\$-----	-----
-----	-----	\$-----	-----
-----	-----	\$-----	-----

</TABLE>

** Documentation governing Indebtedness should be enclosed with the certificate if it has not previously been delivered to Agent

(9) Permitted Additional Subordinated Indebtedness in Excess of \$5,000,000 (Section 8.02(a)(ix) and definition of "Permitted Additional Subordinated Indebtedness"). The following is a list of all Permitted Additional Subordinated Indebtedness outstanding on the Report Date which individually exceeds \$5,000,000:

<TABLE>
<CAPTION>

Lender	Loan Party	Amount	Documentation governing debt has been delivered to Agent ** (yes/no)
<S>	<C>	<C>	<C>
-----	-----	\$-----	-----
-----	-----	\$-----	-----
-----	-----	\$-----	-----

</TABLE>

** Documentation governing Indebtedness should be enclosed with the certificate if it has not previously been delivered to Agent

(10) Permitted Acquisitions. (Section 8.02(d)) The Loan Parties made the following Permitted Acquisitions during the quarter ending on the Report Date:

<TABLE>
<CAPTION>

Seller/ Pooling Partner	Type of Transaction (Permitted Purchase/ Permitted Pooling)	Date of Closing	Purchase Price/ Pooling Consideration
<S>	<C>	<C>	<C>
-----	-----	-----	-----
-----	-----	-----	-----
-----	-----	-----	-----

</TABLE>

(11) Permitted Investment in Excluded Entities; (Sections 8.02(f) and (i)). The Loan Parties' Restricted

Investments: (a) of the type described in clause (i) of the definition of Permitted Investment in Excluded Entities collectively are \$_____ ; (b) of the type described in clause (ii) of the definition of Permitted Investment in Excluded Entities collectively are \$_____ ; and (c) of the type described in clause (iii) of the definition of Permitted Investment in Excluded Entities collectively are \$_____. In the aggregate, the Permitted Investment in Excluded Entities described in the preceding clauses (a), (b), and (c) is \$_____ which is less than \$30,000,000. The foregoing is computed below. The table below lists as of the Report Date each Subsidiary and Minority Subsidiary which is not a Borrower or Guarantor (whether or not the Loan Parties have made a Restricted Investment therein), each Unaffiliated Managed Company in

which the Loan Parties have made a Restricted Investment and each other entity in which the Loan Parties have made a Permitted Investment in Excluded Entities.

<TABLE>
<CAPTION>

Excluded Entity ----- <S>	(i) Investments (3) in or contributions to Excluded Entity -----	(ii) Loans to Excluded Entity -----	(iii) Guaranties on behalf of Excluded Entity ----- <C>	(iv) Other obligations to or for the benefit of Excluded Entity ----- <C>	Total Restricted Investments (Sum of columns (i) thru (iv)) ----- <C> \$ ----- \$ ----- \$ -----
-----	-----	-----	-----	-----	-----
-----	-----	-----	-----	-----	-----
Total (must be less than \$30,000,000)					\$ -----

</TABLE>

- (12) Events of Default or Potential Default. No event has occurred and is continuing which constitutes an Event of Default or Potential Default.
- (13) Representations and Warranties. The representations and warranties contained in Article VI of the Credit Agreement are true on and as of the date hereof with the same effect as though such representations and warranties had been made on and as of the date hereof (except representations and warranties which expressly relate solely to an earlier date or time, which representations and warranties shall have been true and correct on and as of the specific dates or times referred to therein) and the Loan Parties have performed and complied with all covenants and conditions hereof.

(3) Indicate if nature of Restricted Investment is tangible property. Restricted Investment in certain Excluded Entities is limited to the per entity amount specified in the definition of Permitted Investment in Excluded Entities.

IN WITNESS WHEREOF, the undersigned has executed this
Certificate this ____ day of _____, 19____.

By: _____
Name: _____
Title: _____

[PICTURE OF PERSON]

BOLD new strategies for
GROWTH:

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NOVACARE, INC.

NovaCare is a national provider of specialty health care services whose 14,500 employees provide and manage physical rehabilitation, orthotics and prosthetics, subacute and occupational health services at 2,300 sites of care in 43 states serving 30,000 patients per day. As a large and leading Professional Employer Organization, NovaCare will expertly administer human resources functions for small businesses, handling payroll distribution, purchasing and administering health care and other benefits, and managing workers' compensation, employment regulatory compliance and a broad array of other employee-related services.

NOVACARE'S VALUES

Our Values are the strong foundation upon which we build our company. They are also the basis upon which we establish our reputation.

Our Credo, Helping Make Life a Little Better, exemplifies all that we do. It is our guiding principle, our North Star. From clinician to staff support person, we are united in this commitment.

Our Purpose, to effectively meet the rehabilitation needs of our patients through clinical leadership, represents our philosophy and reason for being. Everything we do supports our Purpose. We are dedicated to patient care and clinical leadership.

Our Beliefs reflect the values we strive to uphold each day:

RESPECT FOR THE INDIVIDUAL
SERVICE TO THE CUSTOMER
PURSUIT OF EXCELLENCE
COMMITMENT TO PERSONAL INTEGRITY

These four characteristics define the NovaCare employee and our relationships with our patients, customers and co-workers.

ABOUT THE COVER

NovaCare prosthetists made it possible for Daina Bradley to walk again. Daina is the brave young woman who endured the amputation of her right leg while trapped in the rubble of the 1995 Oklahoma City bombing. More than a year later, Daina's as active as ever thanks to NovaCare's unique Sabolich socket prosthetic device. She is an exceptional example of how technological leadership in orthotics and prosthetics is making a difference in the lives of thousands of amputees every year. This annual report is about how NovaCare is extending its leadership into many other areas with the potential to make a difference.

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NOVACARE, INC. AND SUBSIDIARIES

FINANCIAL HIGHLIGHTS

<TABLE>
<CAPTION>

(In thousands, except per share data.)

For the Year Ended June 30,	1996	1995	1994
<S>	<C>	<C>	<C>
Net revenues	\$793,038	\$905,359	\$789,745
Net income	15,281	61,924	58,214
Net income per common share	\$.24	\$.95	\$.90

Weighted average number of common shares outstanding

	64,325	65,163	64,663
--	--------	--------	--------

<CAPTION>

As of June 30,	1996	1995	1994
<S>	<C>	<C>	<C>
Working capital	\$223,712	\$225,126	\$194,324
Total assets	789,731	852,557	850,541
Total liabilities	305,337	364,922	434,837
Shareholders' equity	\$484,394	\$487,635	\$415,704

</TABLE>

<TABLE>

<CAPTION>

NET REVENUES

(\$ in millions)

Adjusted for the sale of the medical rehabilitation hospitals division in 1995 and a \$10.5 million charge for a change in estimate.

<S>	<C>
94	653
95	795
96	804

</TABLE>

<TABLE>

<CAPTION>

CASH FLOW FROM OPERATIONS

(\$ in millions)

<S>	<C>
94	34
95	44
96	58

</TABLE>

NOVACARE 1996 ANNUAL REPORT 1

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EXTENDING our leadership

NOVACARE HAS EARNED NATIONAL RECOGNITION FOR ITS LEADERSHIP IN CLINICAL OUTCOMES, PROSTHETICS TECHNOLOGY AND WORKER REHABILITATION; WE'VE BEEN CITED AS WELL FOR OUR SUCCESSFUL APPROACH TO ORGANIZATIONAL STRUCTURE AND EMPLOYEE RELATIONS. FISCAL 1997 IS THE YEAR THAT WE EXTEND OUR LEADERSHIP IN NEW DIRECTIONS TO CREATE OPPORTUNITIES FOR GROWTH AND HIGHER SHAREHOLDER RETURNS.

[PICTURES OF MAGAZINES AND NEWSPAPERS]

Best-selling author Fred Wiersema's new book CUSTOMER INTIMACY showcases companies with exceptional customer relationships, foremost among them NovaCare, along with General Electric, IBM, Nike, and Microsoft.

Our breakthrough prosthetics technology has been hailed around the world, most recently in FORTUNE magazine, featuring our myoelectric arm, which enables the patient to open and close the hand by flexing muscles in the residual arm.

NovaCare's strong values-based culture and inverted organization are featured in the March-April 1996 HARVARD BUSINESS REVIEW article "Managing Professional Intellect: Making the Most of the Best."

USA TODAY joined more than 500 publications around the world reporting NovaCare's development of prosthetic technology that enables the patient to feel hot and cold.

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[photo]

NovaCare Prosthetist and 1996 Paralympic Bronze Medal Winner Kurt Collier, shown here with John H. Foster, was honored at the White House by President Clinton. Kurt took the Pentathlon Bronze at this international competition for physically disabled athletes.

[television]

A CBS REPORTS documentary in August 1996 spotlighted NovaCare as the nation's largest employer of rehabilitation professionals, drawing particular attention to our highly successful recruiting programs.

[newspaper]

A March NEW YORK TIMES article on return-to-work rehabilitation drew national attention to our on-site rehabilitation program at CIGNA's Philadelphia headquarters. CIGNA is one of many major U.S. employers that use NovaCare for physical therapy services.

[report cover]

NovaCare leads the rehabilitation industry in its commitment to assuring the highest quality cost-effective care. In May, NovaCare co-sponsored a symposium with Harvard School of Public Health assembling for the first time 60 national experts from all areas of health care to discuss improving clinical outcomes for senior Americans with disabilities.

NOVACARE 1996 ANNUAL REPORT 3

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[PICTURE]

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to our SHAREHOLDERS

Fiscal 1996 was a year of mapping a new strategic direction for NovaCare -- an initiative made possible by our market leadership in rehabilitation and our exceptionally strong balance sheet.

At the end of fiscal 1995, we looked to 1996 as a year to restructure our organization -- to make it "right" to meet emerging opportunities in health care. We enter the new year with our restructuring in place. It is time now for growth and value creation.

This letter is about 1996 and the steps we took to address challenges in our businesses. Most importantly, it is about our new strategic direction.

A YEAR OF ACTION AND RESOLUTION

In 1996 financial performance was not up to our standards. Earnings before a charge for a change in estimate and nonrecurring items decreased to \$.48 from \$.61 per share in 1995. Yet, 1996 marked a critical turning point for NovaCare. It was a year of action leading to resolution of many challenges we faced a year ago. We returned former levels of profitability to long-term care contract services where we operate rehabilitation programs in nursing homes; we merged

our two outpatient businesses; and, we implemented a plan for strengthening and growing our outpatient services.

LONG-TERM CARE SERVICES REPOSITIONED

We successfully repositioned our long-term care services business in fiscal 1996: We reduced our dependence on those large nursing home chains inclined to provide rehabilitation services with in-house staff by replacing them with new, mostly smaller, customers, thus diversifying our customer base and contributing to a more stable workforce. We centralized administrative functions, resulting in substantially reduced costs and a new organization with the flexibility to succeed in a changing payor world. Although regulatory uncertainty continues, our restructured organization makes us confident that we can weather proposed Medicare reimbursement changes.

Going forward, we will maintain our number-one market position in long-term care rehabilitation, investing only in projects that will improve clinical outcomes or lower costs. The substantial cash flow generated by this business will be used to fund growth in other areas.

OUTPATIENT SERVICES STRENGTHENED

We merged our orthotics and prosthetics (O&P) and physical therapy businesses in December 1995. This merger, along with streamlining staff and closing less profitable centers, is expected to generate \$10-\$15 million in annual savings, with most of it realized by the end of fiscal 1997.

Future improvements in the merged outpatient business will come from marketing and acquisitions, resulting in more centers with more patients per center. Outpatient services remains one of the fastest growing segments of health care and is our link with emerging payor and provider relationships in health care.

BOLD NEW STRATEGIES FOR GROWTH

Our growth plan is based on our view of emerging payor and provider trends, and what they imply for new opportunities in and outside health care. Our strategy for growth is built on a four-part foundation:

- expansion of outpatient physical therapy and O&P services
- affiliation with integrated delivery systems
- development of occupational health practices
- entry into the professional employer organization industry.

Although each area is attractive in its own right, the combination of these businesses with NovaCare's existing core competencies and leading market positions is powerful.

OUTPATIENT SERVICES

The first part of our strategy is to substantially expand our outpatient physical therapy and O&P services in target markets through acquisitions and start-up centers. We are building from a position of strength: Our O&P business is the leading practice in the world with respect to technology and patient care, and we are one of the two major networks of outpatient physical therapy centers.

INTEGRATED DELIVERY SYSTEMS

The second part of our growth strategy -- further building our outpatient volumes -- is to affiliate our outpatient services with leading integrated health care delivery systems.

[PICTURE OF JOHN H, FOSTER, CHAIRMAN AND CHIEF EXECUTIVE OFFICER AND TIMOTHY E FOSTER, PRESIDENT AND CHIEF OPERATING OFFICER]

of networks of hospitals, physician practices, and ancillary services in local markets. Such alliances are a response by providers to pressure for seamless, integrated care created by the shift to a managed care environment. NovaCare, with 500 outpatient centers across the U.S., and, more importantly, its clusters of centers in many markets, is best positioned to become the rehabilitation provider in these networks.

OCCUPATIONAL HEALTH

The third part of our growth strategy is occupational health, a \$30 billion highly fragmented industry and the last major unconsolidated frontier in health care. Occupational health is a relatively new concept of care combining the medical care and rehabilitation for injured and ill workers covered by workers' compensation insurance. The result is high quality care for the patient and substantially lower costs for the employer.

PROFESSIONAL EMPLOYER ORGANIZATION

The fourth part of our growth strategy takes us into a new and emerging industry, that of the Professional Employer Organization (PEO), in which health care is a critical component. A PEO manages the human resources function for other employers, principally small businesses. It distributes payroll; buys and administers health insurance plans; deals with employment regulations; in some cases, recruits and hires for the employer; and, it handles workers' compensation arrangements --a particularly solid fit with NovaCare expertise. The employer is able to reduce costs and offer employees a broader range of services because of PEO scale economies.

We will establish or acquire PEOs in markets in which we are building occupational health practices and affiliating with integrated delivery systems -- the same markets where we will focus acquisition and start-up activity in our outpatient business.

As we conclude fiscal 1996, we look back on two difficult years in terms of financial performance and return to shareholders. During this time, we've been building in the right direction: We've addressed the challenges in our existing businesses, put the infrastructure in place for a return to growth, and fashioned a winning strategy for the future.

Eleven years ago, NovaCare defined the long-term care contract services industry and set the industry standard for quality and professionalism. Five years ago, it did the same in the orthotics and prosthetics industry. Now we intend to do it yet again: in the emerging occupational health and PEO industries.

On behalf of your Board and management, I offer my appreciation to you, our shareholders, for your continuing confidence and support. I also extend thanks and admiration to all NovaCare employees. It is through their efforts that we are Helping Make Life a Little Better for nearly 30,000 patients each day, and pursuing bold new strategies for growth.

/s/ John H. Foster

John H. Foster
Chairman and Chief Executive Officer

NovaCare is the largest combined outpatient physical therapy and orthotics and prosthetics network in the U.S. and an emerging player in the occupational health arena putting us in the best position to meet the needs of integrated delivery systems. These emerging networks are looking for an expert partner to manage and provide these specialized services: a partner with an excellent clinical reputation and outcomes, sophisticated systems capable of tracking and measuring patient progress through the plan of care, and a strong financial position to support expansion of the network as it grows. NovaCare brings these strengths to such partnerships. In turn, NovaCare's patient volumes will increase due to its broadened exposure to the market's gatekeepers -- be they hospitals, payors, or physicians. Our experience with integrated systems is positive: We are currently in a highly

STRATEGY : EXPANSION OF OUTPATIENT SERVICES

PART 1 CHANGES IN U.S. HEALTH CARE HAVE DRAMATICALLY INCREASED UTILIZATION OF OUTPATIENT CARE, FROM SURGI-CENTERS TO REHABILITATION SERVICES. TODAY'S OUTPATIENT PHYSICAL THERAPY INDUSTRY IS ESTIMATED AT \$11 BILLION COMPARED TO JUST \$7 BILLION FOUR YEARS AGO, AND ANALYSTS PROJECT AN EIGHT TO TEN PERCENT GROWTH RATE OVER THE NEXT FIVE YEARS.

Growth in the outpatient services industry is being fueled by demand from: an aging population; increased survival rates from catastrophic injuries and illnesses; and increased awareness that rehabilitation helps reduce overall health care expenditures. In addition, shorter hospital stays move patients to outpatient settings earlier in their recovery, when higher level care is needed. Most people requiring braces and artificial limbs also need rehabilitation, so combining outpatient rehabilitation and orthotics and prosthetics services (a \$1 billion industry in itself) makes sense in contracting with managed care and integrated delivery systems. In addition to these factors, demand for O&P services is sensitive to technological advances (such as those being made by NovaCare), which result in growing numbers of patients seeking the latest, lightest and most responsive prosthetics. Additionally, 40 percent of lower-limb amputations in the U.S. are associated with diabetes: This becomes more significant as the population ages.

<TABLE>
 <CAPTION>
 ESTIMATED OUTPATIENT
 REHABILITATION INDUSTRY
 (\$ in billions)
 <S> <C>
 94 7.0
 95 7.6
 96 8.4
 97 9.4
 98 10.5
 </TABLE>

NovaCare plans to expand its O&P leadership into international markets in fiscal 1997.

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successful joint venture in Atlanta with Columbia/HCA, the nation's largest health care company, in which we manage rehabilitation care for the entire system.

NovaCare also plans to play a major role in developing occupational health practices in selected markets, bringing our expertise in case management,

outcomes measurements and rehabilitation to bear in this emerging speciality field that treats illnesses and injuries covered by workers' compensation programs. Only recently have managed care principles, long a fact-of-life for health care insurance, been applied to workers' compensation. The vehicle for this transition is occupational health, which brings together all health care services necessary to return a worker to full functionality and back-to-work in the quickest and most cost-effective man-

"Our experience with integrated systems is positive: We are currently in a highly successful joint venture in Atlanta with Columbia/HCA, the nation's largest health care company, in which we manage rehabilitation care for the entire system."

STRATEGY : INTEGRATED DELIVERY SYSTEM

PART 2 MANAGED CARE IS EXPECTED TO GROW AT A 15 PERCENT ANNUAL RATE OVER THE NEXT DECADE, DRIVING CONTINUED DEMAND FOR HIGH QUALITY HEALTH CARE SERVICES AT REASONABLE COST. INTEGRATED DELIVERY SYSTEMS ARE ONE OF THE NEW FORMS OF CONSOLIDATION ARISING TO MEET THOSE NEEDS.

Health care providers and payors -- hospitals, insurers, physicians, and ancillaries, such as outpatient services -- are rushing to form and market these coordinated networks of care to price-sensitive managed care referral sources.

The networks manage patient costs through participant incentive arrangements that encourage efficient use of services, an integrated plan of care, and a smooth, seamless transition from hospital to post-acute care. Analysts predict that within the next ten years, many markets will be dominated by two to four of these networks, which will act as "gatekeepers" -- that is, they will control access -- to most health care services. Physicians are joining forces and affiliating with integrated systems in order to be better able to negotiate contracts with large insured plans. Insurers prefer to deal with integrated delivery systems in order to avoid difficulties of myriad individual contract negotiations, case management and performance monitoring.

HOSPITALS IN NETWORKS

55% IN NETWORK

11% PLAN TO JOIN NETWORK

34% NO NETWORK PLANS

Source: Cowen & Company

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ner. Today, NovaCare manages work injury rehabilitation and prevention programs for employers through on-site programs and outpatient care. We perform worksite analysis to assess workplace risk and provide worksite safety programs that help employers comply with work-related state and federal requirements. By acquiring occupational medicine practices in strategic markets, NovaCare will expand its linkages with workers needing rehabilitation and increase its attractiveness as a partner in integrated delivery systems.

Potential NovaCare/PEO-industry synergies are powerful. The obvious advantage to an employer of linkage with NovaCare is our ability to control the cost of health care, including workers' compensation and rehabilitation. In fact, the success of the PEO

"Although each area [of future growth] is attractive in its own right, the combination of these businesses with NovaCare's existing core competencies and leading market positions is powerful."

STRATEGY : Occupational Health

PART 3 OCCUPATIONAL HEALTH IS A BURGEONING \$30 BILLION INDUSTRY, REPRESENTING AN INTEGRATED APPROACH TO TREATING WORK-RELATED ILLNESSES AND INJURIES COVERED UNDER WORKERS' COMPENSATION PROGRAMS. DEMAND FOR THESE SERVICES IS EXPLODING AS A RESULT OF OUT-OF-CONTROL WORKERS' COMPENSATION EXPENSES, WHICH CAN BE A SIGNIFICANT PORTION OF A BUSINESS' OPERATING COSTS.

Workers' compensation costs climbed to \$63 billion in 1993 -- up 200 percent over ten years. Under workers' compensation, employers must pay not only the medical cost of work-related claims but also replacement wages, legal and other benefit expenses, most of which increase in direct proportion to the workers' time away from the job. Understandably, employers are looking for solutions. In response, occupational health practices are developing to provide the full continuum of health care services, from initial evaluation through rehabilitation, in order to control costs. Injured or ill workers and their employers reap the benefits. Occupational health physicians and nurses arrange appointments with specialists, if necessary, manage the worker's care, and focus at the same time on the employer's concerns, providing progress reports and working toward the employee's safe and quick return to work, even light duty work. Occupational health centers also provide pre-employment physicals, drug and alcohol testing, workplace safety and injury prevention programs.

<TABLE>

<CAPTION>

ESTIMATED WORKERS' COMPENSATION COSTS

(\$ in billions)

<S>	<C>
85	29
86	34
87	38
88	43
89	48
90	56
91	62
92	70
00 E	140

</TABLE>

Source: Towers Perrin

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arrangement depends heavily on control of health care costs. The new PEO business is a natural outgrowth of NovaCare's strength and experience in managing a dispersed workforce. Today, we employ 14,500 individuals across 43 states. Through PEO acquisitions this fiscal year, we expect to manage at least as many other employees, making NovaCare's PEO one of the largest in the U.S. As one of the largest employers in many markets, we will gain leverage in negotiating better rates for health care and workers' compensation coverage for our PEO employees. Further, since we will establish or acquire PEOs in the same markets in which we are joining integrated delivery systems, those systems, including our own centers, will be in a position to provide health care services to employees of our PEO. Our PEO may also be an attractive solution for many of the small- to medium-sized nursing homes in which we provide long-term care contract services: Nursing homes have recently moved to the top of the list of U.S. businesses with the most workers' compensation claims.

STRATEGY : Professional Employer Organization

PART 4 ANALYSTS SAY THAT PEOS -- AN OUTSOURCING SOLUTION TO THE COMPLEXITIES AND COSTS OF EMPLOYMENT MANAGEMENT -- ARE POTENTIALLY A \$1.3 TRILLION INDUSTRY, WITH REVENUES GROWING AT A 30 PERCENT ANNUAL RATE AT LEAST THROUGH THE YEAR 2005. PEO SERVICES, PRIMARILY PROVIDED TO SMALL- TO MEDIUM-SIZED BUSINESSES, INCLUDE PAYROLL AND HUMAN RESOURCE

Other service providers, such as payroll processing firms, benefits and safety consultants and temporary services agencies also offer services to assist businesses with certain tasks. However, they do not provide such a comprehensive range of employment-related services. PEOs, on the other hand, offer a "one stop shop" where employers can find solutions to all of their human resources problems and save money in the process. By consolidating the employees of many employers, PEOs achieve economies of scale (reducing benefit costs by five to 15 percent) and are able to offer employees services and insurance coverage at levels typically available only to large corporations. An area of particular savings for member employers is workers' compensation. With workers' compensation costs predicted to grow at 10 percent annually, small- to medium-sized companies with high workers' compensation claims stand to benefit substantially by outsourcing to PEOs. Analysts project that virtually all employers with 500 or fewer employees -- of which there are over five million in the U.S. -- would benefit financially by outsourcing to PEOs. Currently, only 50,000 small businesses use PEOs.

[PIE CHART]

U.S. SMALL COMPANY EMPLOYMENT
 / / LESS THAN 500 EMPLOYEES
 REPRESENTS 49 MILLION EMPLOYEES

 / / MORE THAN 500 EMPLOYEES

Source: Bureau of Labor Statistics,
 Small Business Administration

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NOVACARE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

<TABLE>
 <CAPTION>
 (In thousands)

	As of June 30,	
	1996	1995
	-----	-----
<S>	<C>	<C>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 95,724	\$ 158,636
Accounts receivable, net of allowance in 1996 and 1995 of \$18,995 and \$19,718 respectively	192,636	192,652
Inventories	13,948	11,213
Deferred income taxes	14,875	16,748
Other current assets	14,976	34,571
	-----	-----
Total current assets	332,159	413,820
Property and equipment, net	63,319	63,659
Excess cost of net assets acquired, net	354,117	352,115
Investment in joint ventures	11,984	--
Deferred income taxes	2,332	1,470
Other assets, net	25,820	21,493
	-----	-----
	\$ 789,731	\$ 852,557
	=====	=====

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:

Current portion of financing arrangements	\$ 8,173	\$ 32,684
Accounts payable and accrued expenses	93,854	93,088
Income taxes payable	6,420	32,922
	-----	-----
Total current liabilities	108,447	158,694
Financing arrangements, net of current portion	184,042	192,331
Deferred income taxes	9,625	8,147
Other	3,223	5,750
	-----	-----
Total liabilities	305,337	364,922
	-----	-----
Comments and contingencies	--	--
Shareholders' equity:		
Common stock, \$.01 par value; authorized 200,000 shares, issued 66,091 shares in 1996 and issued 65,476 shares in 1995 ..	661	656
Additional paid-in capital	253,918	250,857
Retained earnings	253,430	238,149
	-----	-----
	508,009	489,662
Less: Common stock in treasury (at cost), 3,190 shares in 1996 and 187 shares in 1995	(23,465)	(1,614)
Deferred compensation	(150)	(413)
	-----	-----
Total shareholders' equity	484,394	487,635
	-----	-----
	\$ 789,731	\$ 852,557
	=====	=====

</TABLE>

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

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NOVACARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

<TABLE>

<CAPTION>

(In thousands except per share data)

	For the Years Ended June 30,		
	1996	1995	1994
	-----	-----	-----
<S>	<C>	<C>	<C>
Net revenues	\$ 793,038	\$ 905,359	\$ 789,745
Cost of services	575,480	640,232	529,007
	-----	-----	-----
Gross profit	217,558	265,127	260,738
Selling, general & administrative expenses	140,456	151,759	125,098
Provision for uncollectible accounts	16,359	15,918	14,453
Amortization of excess cost of net assets acquired	9,874	10,937	7,225
Provision for restructure and other nonrecurring items ...	13,370	(57,368)	5,754
	-----	-----	-----
Income from operations	37,499	143,881	108,208
Investment income	4,999	5,405	5,304
Interest expense	(12,536)	(23,298)	(17,077)
Minority interest	(96)	(404)	(543)
	-----	-----	-----
Income before income taxes	29,866	125,584	95,892
Income taxes	14,585	63,660	37,678

Net income	\$ 15,281	\$ 61,924	\$ 58,214
Net income per common share	\$.24	\$.95	\$.90
Weighted average number of common share outstanding	64,325	65,163	64,663

</TABLE>

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

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DIRECTORS

JOHN H. FOSTER
Chairman of the Board and
Chief Executive Officer

TIMOTHY E. FOSTER
President and Chief Operating Officer

E. MARTIN GIBSON
Retired Chairman and
Chief Executive Officer,
Corning Lab Services, Inc.

SIRI S. MARSHALL
Senior Vice President,
General Counsel and Secretary,
General Mills, Inc.

STEPHEN E. O'NEIL
Private Investor

GEORGE W. SIGULER
Founding Partner,
Siguler, Guff & Company, LLC

ROBERT G. STONE, JR.
Retired Chairman of the Board,
Kirby Corporation

DANIEL C. TOSTESON, M.D.
Dean of the Faculty of Medicine,
Harvard Medical School

SENIOR MANAGEMENT

PETER D. BEWLEY
Senior Vice President,
General Counsel and Secretary

SUSAN J. CAMPBELL
Vice President, Communications
and Investor Relations

DARYL A. DIXON
President and General Manager,
Contract Services Division

JOHN H. FOSTER
Chairman of the Board and
Chief Executive Officer

TIMOTHY E. FOSTER
President and Chief Operating Officer

ROBERT E. HEALY, JR.
Senior Vice President,
Finance and Administration and
Chief Financial Officer

RONALD G. HISCOCK
President and General Manager,
Outpatient Division

LAURENCE F. LANE
Senior Vice President,
Regulatory Affairs

ARTHUR T. LOCILENTO, JR.
Senior Vice President,
Human Resources

STEVEN M. WISE
Vice President, Information Systems and
Chief Information Officer

Note: No family relationships exist
among any of the directors or officers

SHAREHOLDER INFORMATION

Corporate Headquarters

NovaCare, Inc.
1016 West Ninth Avenue
King of Prussia, PA 19406
(610) 992-7200

STOCK TRADING

NovaCare, Inc. common stock and 5.5% convertible subordinated debentures, due in 2000, are traded on the New York Stock Exchange under the symbols "NOV" and "NOV/2000", respectively.

INFORMATION REQUESTS

Investors, analysts and others seeking information should contact: NovaCare's
Communications and Investor Relations Department
(610) 992-7495

SHAREHOLDER RECORDS

Shareholders desiring to change the name, address or ownership of stock or to report lost certificates should contact:
American Stock Transfer Company
40 Wall Street, 46th Floor
New York, NY 10005
(718) 921-8200

Subsidiaries of the Company

ASK Colorado Health Care Services, P.C.
Advance Orthotics, Inc.
Affiliated Physical Therapists, Ltd.
Artificial Limb and Brace Center
Atlantic Rehabilitation Services, Inc.
Boca Rehab Agency, Inc.
Bowman-Shelton Orthopedic Service, Incorporated
Buendel Physical Therapy, Inc.
C.O.A.S.T. Institute Physical Therapy, Inc.
CR Services Corp.
Cannon & Associates, Inc.
Cenla Physical Therapy & Rehabilitation Agency, Inc.
Center for Physical Therapy & Sports Rehabilitation, Inc.
CenterTherapy, Inc.
Certified Orthopedic Appliance Co., Inc.
Coplín Physical Therapy Associates, Inc.
Crowley Physical Therapy Clinic, Inc.
Douglas Avery & Associates, Ltd.
Douglas C. Claussen, R.P.T., Physical Therapy, Inc.
Francis Naselli, Jr. & Stewart Rich Physical Therapists, Inc.
GP Therapy, L.L.C.
Galaxy Service Corporation
Gallery Physical Therapy Center, Inc.
Georgia Physical Therapy of West Georgia, Inc.
Georgia Physical Therapy, Inc.
Greater Sacramento Physical Therapy Associates, Inc.
Gulf Breeze Physical Therapy, Inc.
Gulf Coast Hand Specialists, Inc.
Hand Therapy Associates, Inc.
Hand Therapy and Rehabilitation Associates, Inc.
Hawley Physical Therapy, Inc.
Heartland Rehabilitation, Inc.
Indianapolis Physical Therapy and Sports Medicine, Inc.
Jim All, Inc.
Kesinger Physical Therapy, Inc.
Lynn M. Carlson, Inc.
McFarlen & Associates, Inc.
MedStat, P.C.

Michigan Therapy Centre, Inc.
Mill River Management, Inc.
Mitchell Tannebaum I, Inc.
Mitchell Tannebaum II, Inc.
Mitchell Tannenbaum III, Inc.

Monmouth Rehabilitation, Inc.
NACC, Inc.
NC (Wisconsin), S.C.
NC Cash Management, Inc.
NC Occupational Therapy, P.C.
NC Physical Therapy, P.C.
NC Resources, Inc.
National Rehab Services
New Mexico Physical Therapists, Inc.
Northside Physical Therapy, Inc.
NovaCare (Arizona), Inc.
NovaCare (Colorado), Inc.
NovaCare (Illinois), Inc.
NovaCare (Texas), Inc.
NovaCare Easton & Moran Physical Therapy, Inc.
NovaCare Management Company, Inc.
NovaCare Management Services, Inc.
NovaCare Northside Therapy, Inc.
NovaCare Orthotics & Prosthetics East, Inc.
NovaCare Orthotics & Prosthetics Holdings, Inc.
NovaCare Orthotics & Prosthetics West, Inc.
NovaCare Orthotics & Prosthetics, Inc.
NovaCare Outpatient Rehabilitation I, Inc.
NovaCare Outpatient Rehabilitation, Inc.
NovaCare Rehab Agency of Alabama, Inc.
NovaCare Rehab Agency of Florida, Inc.
NovaCare Rehab Agency of Georgia, Inc.
NovaCare Rehab Agency of Illinois, Inc.
NovaCare Rehab Agency of North Carolina, Inc.
NovaCare Rehab Agency of Northern California, Inc.
NovaCare Rehab Agency of Ohio, Inc.
NovaCare Rehab Agency of Oklahoma, Inc.
NovaCare Rehab Agency of Oregon, Inc.
NovaCare Rehab Agency of Pennsylvania, Inc.
NovaCare Rehab Agency of South Carolina, Inc.
NovaCare Rehab Agency of Southern California, Inc.
NovaCare Rehab Agency of Tennessee, Inc.
NovaCare Rehab Agency of Virginia, Inc.
NovaCare Rehab Agency of Washington, Inc.
NovaCare Rehabilitation Agency of Wisconsin, Inc.

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NovaCare Rehabilitation, Inc.
NovaCare Service Corp.
NovaCare Speech Therapy & Audiology, Inc.
NovaCare, Inc.
NovaCare, Inc. (Delaware)
OSI Midwest, Inc.
Ortho Rehab Associates, Inc.
Orthomedics - Voner of Whittier
Orthomedics - Voner

Orthopedic and Sports Physical Therapy of Cupertino, Inc.
Peters, Starkey & Todrank Physical Therapy Corporation
Physical Focus, Inc.
Physical Rehabilitation Partners, Inc.
Physical Therapy Institute, Inc.
Quad City Management, Inc.
Quad City Regional Spine Institute, P.C.
RCI (Colorado), Inc.
RCI (Exertec), Inc.
RCI (Illinois), Inc.
RCI (Michigan), Inc.
RCI (S.P.O.R.T.), Inc.
RCI (WRS), Inc.
RCI Nevada, Inc.
Rebound Oklahoma, Inc.
Redwood Pacific Therapies, Inc.
Rehab Managed Care of Arizona, Inc.
Rehab Provider Network - California, Inc.
Rehab Provider Network - Delaware, Inc.
Rehab Provider Network - Georgia, Inc.
Rehab Provider Network - Illinois, Inc.
Rehab Provider Network - Indiana, Inc.
Rehab Provider Network - Maryland, Inc.
Rehab Provider Network - Michigan, Inc.
Rehab Provider Network - New Jersey, Inc.
Rehab Provider Network - Ohio, Inc.
Rehab Provider Network - Oklahoma, Inc.
Rehab Provider Network - Pennsylvania, Inc.
Rehab Provider Network - Virginia, Inc.
Rehab Provider Network - Washington, D.C., Inc.
Rehab Provider Network of Colorado, Inc.
Rehab Provider Network of Florida, Inc.
Rehab Provider Network of Nevada, Inc.
Rehab Provider Network of New Mexico, Inc.
Rehab Provider Network of Texas, Inc.
Rehab Provider Network of Wisconsin, Inc.
Rehab World, Inc.
Rehab/Work Hardening Management Associates, Ltd.

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RehabClinics (Coast), Inc.
RehabClinics (New Jersey), Inc.
RehabClinics (PTA), Inc.
RehabClinics (SPT), Inc.
RehabClinics Abilene, Inc.
RehabClinics Dallas, Inc.
RehabClinics Pennsylvania, Inc.
RehabClinics, Inc.
Robert M. Bacci, R.P.T., Physical Therapy, Inc.
Robin-Aids Prosthetics, Inc.
S.T.A.R.T., Inc.

SG Rehabilitation Agency, Inc.
SG Speech Associates, Inc.
Southwest Medical Supply Company, Inc.
Southwest Physical Therapy, Inc.
Southwest Therapists, Inc.
Sporthopedics Sports and Physical Therapy Centers, Inc.
Sports Therapy and Arthritis Rehabilitation, Inc.
Sprint Physical Therapy, P.C.
Star Physical Therapy, Inc.
Start to Finish Therapy, P.C.
Stephenson-Holtz, Inc.
T.J. Partnership I
TJ Corporation I, L.L.C.
The Center for Physical Therapy and Rehabilitation, Inc.
Theodore Dashnaw Physical Therapy, Inc.
Therex, P.C.
Union Square Center for Rehabilitation & Sports Medicine, Inc.
Vanguard Rehabilitation, Inc.
Wayzata Physical Therapy Center, Inc.
West Suburban Health Partners, Inc.
Western Rehab Services, Inc.
WorkCare, L.L.C.
Workers Rehabilitation Services, Inc.

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 33-88744; 33-88745; 33-88746) of NovaCare, Inc. of our report dated July 31, 1996 appearing on page 40 of this Form 10-K.

/s/ Price Waterhouse LLP

PRICE WATERHOUSE LLP

Philadelphia, PA
September 23, 1996

<TABLE> <S> <C>

<ARTICLE> 5

<LEGEND>

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CONDENSED CONSOLIDATED BALANCE SHEET AS OF JUNE 30, 1996 AND THE CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS FOR THE YEAR ENDED JUNE 30, 1996, AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH STATEMENTS IN FORM 10-K, FOR THE FISCAL PERIOD ENDED JUNE 30, 1996.

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<CIK> 0000802843

<NAME> NOVACARE, INC

<MULTIPLIER> 1,000

<CURRENCY> US DOLLAR

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<NET-INCOME>	15,281

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0.24

<EPS-DILUTED>

0.24

<FN>

<F1>"TOTAL COSTS" consist of salaries, wages, and benefits, rent expense, supply costs, depreciation and other.

<F2>"OTHER EXPENSES" consist of amortization, merger and other non recurring items, minority interest and investment income.

</FN>

</TABLE>