OPTION CARE INC/DE
Form 10-Q
August 09, 2004

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended

June 30, 2004

Commission file number 00-19878

OPTION CARE, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**36-3791193** (IRS Employer Identification No.)
485 Half Day Road, Suite 300 **Buffalo Grove, Illinois** (Address of principal executive office)	**60089** (zip code)

(847) 465-2100
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes ý No o

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	**Issued and Outstanding as of August 5, 2004**
Common Stock - $0.01 par value	21,387,359

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OPTION CARE, INC. AND SUBSIDIARIES

DESCRIPTION

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Option Care, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except per share amounts)

	June 30, 2004 (Unaudited)	December 31, 2003 (Note 1)
Assets		
Current assets:		
Cash and cash equivalents	$ 12,787	$ 3,961
Accounts receivable, net	60,761	62,190
Inventory	9,095	11,522
Deferred income tax benefit	3,711	4,442
Other current assets	5,616	5,279
Total current assets	91,970	87,394
Equipment and other fixed assets, net	12,680	12,145
Goodwill, net	65,651	64,970
Other assets	1,647	2,025
Total assets	$ 171,948	$ 166,534
Liabilities and stockholders equity		
Current liabilities:		
Trade accounts payable	$ 16,256	$ 19,940
Current portion of long-term debt	41	424
Other current liabilities	7,958	10,253
Total current liabilities	24,255	30,617
Long-term debt, less current portion	77	82
Long-term deferred income tax liability	6,331	5,677
Other liabilities	602	711
Minority interest	498	427
Total liabilities	31,763	37,514
Stockholders equity:		
Common stock, $.01 par value per share, 60,000 shares authorized, 21,321 and 20,942 shares issued and outstanding at June 30, 2004 and December 31, 2003, respectively	213	209
Common stock to be issued, 91 and 144 shares at June 30, 2004 and December 31, 2003, respectively	779	834
Additional paid-in capital	106,670	104,173
Retained earnings	32,523	23,965
Less treasury stock, at cost, common shares 15 at December 31, 2003		(161)

Total stockholders equity		140,185		129,020
Total liabilities and stockholders equity	$	171,948	$	166,534

See notes to condensed consolidated financial statements

Option Care, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(Unaudited)

(in thousands, except per share amounts)

	Three Months Ended June 30, 2004		Three Months Ended June 30, 2003		Six Months Ended June 30, 2004		Six Months Ended June 30, 2003	
Revenue:								
Specialty pharmacy services	$	58,407	$	48,172	$	123,339	$	105,206
Infusion and related healthcare services		37,450		34,126		72,396		67,199
Other		2,794		2,484		6,065		4,939
Total revenue		98,651		84,782		201,800		177,344
Cost of revenue:								
Cost of goods sold		58,997		47,001		122,805		101,825
Cost of services provided		10,616		10,126		21,260		20,584
Total cost of revenue		69,613		57,127		144,065		122,409
Gross profit		29,038		27,655		57,735		54,935
Selling, general and administrative expenses		19,200		18,177		38,449		36,208
Provision for doubtful accounts		1,462		2,330		3,021		4,208
Depreciation and amortization		569		684		1,250		1,352
Total operating expenses		21,231		21,191		42,720		41,768
Operating income		7,807		6,464		15,015		13,167
Interest income (expense), net		34		(6)		35		(106)
Other expense, net		(12)		(84)		(79)		(91)
Income before income taxes		7,829		6,374		14,971		12,970
Income tax provision		3,128		2,563		5,985		5,194
Net income	$	4,701	$	3,811	$	8,986	$	7,776
Net income per common share:								
Basic	$	0.22	$	0.18	$	0.42	$	0.37
Diluted	$	0.22	$	0.18	$	0.42	$	0.37
Shares used in computing net income per share:								
Basic		21,282		20,799		21,188		20,788
Diluted		21,742		21,222		21,644		21,175
Cash dividends per share	$	0.02	$		$	0.02	$	

See notes to condensed consolidated financial statements

Option Care, Inc. and Subsidiaries

Condensed Consolidated Statement of Stockholders Equity

(Unaudited)

(in thousands, except per share amounts)

	Common Stock Shares	Common Stock Amount	Common Stock to be Issued	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Stock-holders Equity
Balance at December 31, 2003	20,927	$ 209	$ 834	$ 104,173	$ 23,965	$ (161)	$ 129,020
Net income	—	—	—	—	8,986	—	8,986
Shares issued and issuable under stock plans (1)	480	5	(55)	2,451	—	2	2,403
Income tax benefit from stock option exercises	—	—	—	1,148	—	—	1,148
Purchase of treasury stock	(86)		—	—	—	(944)	(944)
Retirement of treasury stock		(1)	—	(1,102)	—	1,103	—
Cash dividends paid ($0.02 per share)	—	—	—	—	(428)	—	(428)
Balance at June 30, 2004	21,321	$ 213	$ 779	$ 106,670	$ 32,523	$	$ 140,185

(1) Amended and Restated Stock Incentive Plan and Employee Stock Purchase Plan.

See notes to condensed consolidated financial statements

Option Care, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)

	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
Cash flows from operating activities:		
Net income	$ 8,986	$ 7,776
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,494	2,263
Provision for doubtful accounts	3,021	4,208
Deferred income taxes	1,473	1,346
Income tax benefit from exercise of stock options	1,148	336
Changes in assets and liabilities:		
Accounts receivable	(1,205)	4,521
Inventory	2,495	2,287
Accounts payable	(3,685)	(4,281)
Income taxes receivable/payable	715	(1,437)
Change in other assets and liabilities	(3,582)	(4,270)
Net cash provided by operating activities	11,860	12,749
Cash flows from investing activities:		
Purchases of equipment and other, net	(2,588)	(2,639)
Payments for acquisitions, net of cash acquired	(1,090)	(11,836)
Proceeds from disposals		229
Net cash used in investing activities	(3,678)	(14,246)
Cash flows from financing activities:		
Net borrowing on credit agreements		858
Payments on capital leases and other debt	(387)	(297)
Proceeds from issuance of stock	2,403	776
Payment of cash dividends	(428)	
Payments for purchase of treasury stock	(944)	
Net cash provided by financing activities	644	1,337
Net increase in cash and cash equivalents	8,826	(160)
Cash and cash equivalents, beginning of period	3,961	488
Cash and cash equivalents, end of period	$ 12,787	$ 328

See notes to condensed consolidated financial statements

Option Care, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

June 30, 2004

(Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004.

The balance sheet at December 31, 2003 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in Option Care s Annual Report on Form 10-K for the year ended December 31, 2003.

2. Long-Term Debt

We are party to a $20 million revolving Credit and Security Agreement with J.P. Morgan Business Credit Corporation, J.P. Morgan Chase Bank and LaSalle Bank, N.A. (the Lenders). Originally, on March 29, 2002, we entered into a three-year, $60 million revolving Credit and Security Agreement with the Lenders. On June 15, 2004, we agreed with the Lenders on an amendment (the Amendment) to reduce the overall facility to $20 million throughout the remaining term of the agreement, which is scheduled to expire on March 29, 2005.

Availability under the Credit and Security Agreement is related to various percentages of our outstanding accounts receivable and inventory balances, less certain capped and ineligible amounts, as defined in the agreement. Overall borrowings will be limited to the lesser of the remaining availability and the total collateral borrowing base. The facility is secured by substantially all of our assets. In addition to customary events of default, the agreement provides that a change in control would give rise to an event of default. The agreement requires us to maintain quarterly compliance with certain financial covenants. We paid a facility fee of approximately $400,000 upon signing the agreement. The agreement provided for a commitment fee, calculated and paid quarterly based on our average daily unused portion of the facility. Per the Amendment signed June 15, 2004, the commitment fee rate is 0.375%, effective June 1, 2004. Previously, the commitment fee was calculated on a sliding scale ranging from 0.45% to 0.25% based on the average unused portion of the facility. The original Credit and Security Agreement allowed us, for a fee, to secure up to $5 million in letters of credit. The Amendment reduced the letter of credit sub-limit to $2.5 million. Our interest rate under the agreement varies depending on our level of borrowing. We may select Eurodollar loans or borrow at rates indexed to the prime rate. Our interest rate on borrowings may range from lows of prime plus 0.25% or the Eurodollar rate plus 2.25% to highs of prime plus 0.75% or the Eurodollar rate plus 2.75%.

The original Credit and Security Agreement contained a prohibition against our payment of cash dividends. The Amendment dated June 15, 2004 removed this prohibition, and now allows us to pay up to $2.5 million in annual cash dividends to our shareholders. This change was made in response to the approval by our Board of Directors, at their meeting on May 4, 2004, to institute a new quarterly dividend policy and pay an initial dividend of $0.02 per share. This dividend was paid on June 15, 2004 to shareholders of record as of June 1, 2004.

As of both June 30, 2004 and December 31, 2003, we had no balance outstanding under the credit facility and had one letter of credit in place for $1.0 million. At June 30, 2004, based on our minimum ongoing availability requirements we had borrowing availability of $17.0 million. As of December 31, 2003, we had additional borrowing capacity of $37.7 million against the $60 million facility then in place, based on our accounts receivable and inventory balances on that date.

On October 23, 2003, the Lenders agreed to amend the Credit and Security Agreement to address the $6.8 million special provision for doubtful accounts recorded in the quarter ended September 30, 2003 related to our Texas accounts receivable. The amendment allowed us to exclude the $6.8 million charge when calculating our fixed charge coverage ratio for the quarter ended September 30, 2003 and the next three quarters. This change in calculation method allowed us to remain in compliance with our financial covenants for the quarters ended September 30 and December 31, 2003. For the quarters ended March 31 and June 30, 2004, we were in compliance with our financial covenants before consideration of this amendment.

3. Earnings Per Share Data

The following table sets forth the computation of basic and diluted earnings per share for the periods indicated (in thousands, except per share amounts):

	Three months ended June 30, 2004	Three months ended June 30, 2003	Six months ended June 30, 2004	Six months ended June 30, 2003
	(in thousands, except per share amounts)			
Basic:				
Net income	$ 4,701	$ 3,811	$ 8,986	$ 7,776
Average shares outstanding	21,282	20,799	21,188	20,788
Basic earnings per share	$ 0.22	$ 0.18	$ 0.42	$ 0.37
Diluted:				
Net income	$ 4,701	$ 3,811	$ 8,986	$ 7,776
Average shares outstanding	21,282	20,799	21,188	20,788
Net effect of dilutive stock options Based on the treasury stock method	460	423	456	387
Total diluted shares	21,742	21,222	21,644	21,175
Diluted earnings per share	$ 0.22	$ 0.18	$ 0.42	$ 0.37

4. Operating Segments

We have one identifiable business segment, with three service lines: specialty pharmacy services; infusion and related healthcare services; and other.

Specialty pharmacy services involve the distribution of injectible and infused pharmaceuticals to treat a wide range of chronic health conditions. The pharmaceuticals can be directly distributed to the patient s home or to their physician s office for in-office administration. These pharmaceuticals may require refrigeration during shipping as well as special handling to prevent potency degradation. Patients receiving treatment usually require special counseling and education regarding their condition and treatment program.

Infusion and related healthcare services primarily involves the intravenous administration of medications at the patient s home or other non-hospital sites such as one of our infusion suites. Infusion pharmacy services treat a wide range of acute and chronic health conditions, including infections, dehydration, cancer, pain and nutritional deficiencies. All of our company-owned pharmacies provide infusion pharmacy services. Some of these pharmacies also provide related healthcare services, such as home health nursing, home hospice services, respiratory therapy services and durable medical equipment.

Other revenue consists of royalties and other fees generated from our franchised pharmacy network and the software licensing and support revenue generated by our subsidiary, Management by Information, Inc. (MBI).

5. Significant Customers and Concentration of Credit Risk

The following table presents information regarding revenue and accounts receivable attributable to our most significant payors as of the dates and for the periods presented:

	NET REVENUE				ACCOUNTS RECEIVABLE	
	Three months ended June 30,		Six month ended June 30,		June 30,	December 31,
	2004	2003	2004	2003	2004	2003
Blue Cross and Blue Shield of Florida	16%	17%	15%	17%	9%	9%
Medicare	7%	9%	7%	8%	10%	10%
Medicaid	13%	10%	13%	11%	7%	10%
Total government payors	20%	19%	20%	19%	17%	20%
All other payors (1)	64%	64%	65%	64%	74%	71%
Total	100%	100%	100%	100%	100%	100%

(1) No other payor represents 10% or more of revenue or accounts receivable as of the dates and for the periods presented.

We generate the majority of our revenue from managed care contracts and other agreements with commercial third party payors from our provision of health care services to their members. Our principal managed care contract is with Blue Cross and Blue Shield of Florida, to whose members we provide infusion pharmacy services and specialty pharmacy services. For the three and six months ended June 30, 2004, respectively, 16% and 15% of our revenue was related to this contract. In the prior year, for the three and six months ended June 30, 2003, 17% of our revenue was related to this contract. As of June 30, 2004 and December 31, 2003, 9% of our accounts receivable was due from Blue Cross and Blue Shield of Florida. The contract is terminable by either party on 90 days notice and, unless terminated, renews annually each September for an additional one-year term.

We also generate revenue from government healthcare programs such as Medicare and Medicaid. For the three and six months ended June 30, 2004, 20% of our revenue came from government healthcare programs. In the prior year, for the three and six months ended June 30, 2003, 19% of our revenue came from government healthcare programs. Of our accounts receivable, 17% and 20% was attributable to government healthcare programs as of June 30, 2004 and December 31, 2003, respectively.

6. Seasonal Revenue Trends

Synagis®, one of the specialty pharmaceuticals that we provide to patients, is seasonal. Synagis® is a drug used for the prevention of respiratory synctial virus (RSV) in high-risk pediatric patients. RSV infection is a seasonal condition, with the season generally lasting from October through April.

Option Care s quarterly Synagis® revenue for 2003 and for the first two quarters of 2004 was as follows (amounts in thousands):

		Synagis® revenue	% of Specialty Pharmacy Revenue	% of Total Revenue
Quarter ended March 31, 2003	$	11,998	21.0%	13.0%
Quarter ended June 30, 2003		3,958	8.2%	4.7%
Quarter ended September 30, 2003		435	0.9%	0.5%
Quarter ended December 31, 2003		8,867	15.5%	9.3%
Fiscal year 2003	$	25,258	12.1%	7.1%
Quarter ended March 31, 2004	$	14,251	21.9%	13.8%
Quarter ended June 30, 2004	$	3,955	6.8%	4.0%

7. Acquisitions

We completed no acquisitions during the quarter ended June 30, 2004. Subsequently, in July 2004 we completed two small acquisitions. While we anticipate that these acquisitions will be accretive to earnings, they are not expected to have a material affect on our revenue or net income.

During the quarter ended March 31, 2004, we completed two small acquisitions in existing markets that we serve. These acquisitions are not expected to have a material affect on our revenue or net income.

8. Stock-based Compensation

Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, as amended by Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, encourages, but does not require, companies to record compensation cost for stock-based compensation plans at fair value. Option Care has chosen to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Accordingly, compensation expense for stock options is measured as the excess, if any, of the quoted market price of Option Care stock at the date of grant over the amount an employee must pay to acquire the stock. Option Care grants options at fair market value and therefore recognizes no compensation expense when options are granted. Likewise, Option Care s Employee Stock Purchase Plan was structured to qualify under Section 423 of the Internal Revenue Code. Therefore, no compensation expense is recognized from employees purchase of shares under our Employee Stock Purchase Plan.

Had compensation cost for Option Care s stock-based compensation plan been determined based on FASB Statement No. 123, Option Care s net income and income per common share for the three and six months ended June 30, 2004 and 2003 on a pro-forma basis would have been (in thousands, except per share amounts):

	Three months ended June 30, 2004		Three months ended June 30, 2003		Six months ended June 30, 2004		Six months ended June 30, 2003	
Net income:								
As reported	$	4,701	$	3,811	$	8,986	$	7,776
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects		—		6		—		6
Deduct: Total stock-based employee compensation expense determined under the fair value based method for the following awards, net of related tax effects:								
Stock option grants		(367)		(580)		(699)		(1,153)
Employee stock purchase plan withholdings		(33)		(64)		(68)		(118)
Pro forma	$	4,301	$	3,173	$	8,219	$	6,511
Net income per common share basic:								
As reported	$	0.22	$	0.18	$	0.42	$	0.37
Pro forma	$	0.20	$	0.15	$	0.39	$	0.31
Net income per common share diluted:								
As reported	$	0.22	$	0.18	$	0.42	$	0.37
Pro forma	$	0.20	$	0.15	$	0.38	$	0.31

9. Quarterly Dividend Policy

At their meeting on May 11, 2004, our Board of Directors initiated a quarterly cash dividend policy and announced an initial quarterly dividend of $0.02 per share.

Each quarter, the Board will decide whether to declare a dividend. At their meeting on May 11, 2004, the Board announced an initial quarterly dividend of $0.02 per share, which was paid on June 15, 2004 to shareholders of record as of June 1, 2004. The total amount paid to stockholders was $428,000. Subsequently, at their next quarterly meeting on July 29, 2004, our Board of Directors once again declared a cash dividend of $0.02 per share, which will be paid on August 31, 2004 to shareholders of record as of August 16, 2004.

Our Credit and Security Agreement with J.P. Morgan Business Credit Corporation contained a prohibition against our payment of cash dividends throughout the term of the agreement. However, on June 15, 2004, the parties signed an amendment allowing us to pay up to $2.5 million per year in cash dividends throughout the remaining term of the agreement.

10. Comprehensive Income

Net income was our only component of comprehensive income for the three and six month periods ended June 30, 2004 and 2003.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

FORWARD LOOKING STATEMENTS

The following discussion should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2003. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. Certain information included in this Quarterly Report on Form 10-Q and other materials filed or to be filed by us with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by us) contain statements that are or will be forward-looking, such as statements relating to acquisitions and other business development activities, future capital expenditures and the effects of future regulation and competition. Such forward-looking information involves important risks and uncertainties that could significantly affect anticipated results in the future and, accordingly, such results may differ from those expressed in any forward-looking statements made by us, or on our behalf. These risks and uncertainties include, but are not limited to, uncertainties affecting our businesses and our franchisees relating to acquisitions and divestitures (including continuing obligations with respect to completed transactions), sales and renewals of franchises, government and regulatory policies (including federal, state and local efforts to reform the delivery of and payment for healthcare services), general economic conditions (including economic conditions affecting the healthcare industry in particular), the pricing and availability of equipment and services, technological developments and changes in the competitive environment in which we operate.

OVERVIEW

We provide pharmacy services to patients on behalf of managed care organizations and other third party payors. We contract with payors to provide specialty pharmacy services, infusion pharmacy and other related healthcare services to patients at home or at other alternate-site settings, such as physicians offices or infusion suites at our pharmacy locations. Our services are provided through our national network of company-owned and franchise-owned pharmacies.

We have three service lines: specialty pharmacy services, infusion and related healthcare services, and other. Specialty pharmacy services involve the distribution of injectible and infused pharmaceuticals to treat a wide range of chronic health conditions. The pharmaceuticals can be directly distributed to the patient s home or to their physician s office for in-office administration. These pharmaceuticals may require refrigeration during shipping as well as special handling to prevent potency degradation. Patients receiving treatment usually require special counseling and education regarding their condition and treatment program. Infusion and related services primarily involves the intravenous administration of medications at the patient s home or other non-hospital site such as one of our infusion suites. Infusion pharmacy services treat a wide range of acute and chronic health conditions, including infections, dehydration, cancer, pain and nutritional deficiencies. All of our company-owned pharmacies provide infusion therapies. Some of these pharmacies also provide related healthcare services, such as home health nursing, home hospice services, respiratory therapy services and durable medical equipment. Other revenue consists of royalties and other fees generated from our franchised pharmacy network and the software licensing and support revenue generated by our subsidiary, MBI.

Summarized information about revenues and gross profit for each service line is provided in the following tables (amounts in thousands):

REVENUE

	Three months ended June 30,				Six months ended June 30,			
	2004		2003		2004		2003	
	Revenue	% of total	Revenue	% of total	Revenue	% of total	Revenue	% of total
Specialty pharmacy services	$ 58,407	59.2%	$ 48,172	56.8%	$ 123,339	61.1%	$ 105,206	59.3%
Infusion and related healthcare services	37,450	38.0%	34,126	40.3%	72,396	35.9%	67,199	37.9%
Other	2,794	2.8%	2,484	2.9%	6,065	3.0%	4,939	2.8%
Total revenue	$ 98,651	100.0%	$ 84,782	100.0%	$ 201,800	100.0%	$ 177,344	100.0%

GROSS PROFIT

	Three months ended June 30,				Six months ended June 30,			
	2004		2003		2004		2003	
	Gross profit	**Gross profit margin%**	**Gross profit**	**Gross profit margin%**	**Gross profit**	**Gross profit margin%**	**Gross profit**	**Gross profit margin%**
Specialty pharmacy services	$ 10,059	17.2%	$ 10,533	21.9%	$ 20,585	16.7%	$ 21,567	20.5%
Infusion and related healthcare services	16,334	43.6%	14,814	43.4%	31,363	43.3%	28,693	42.7%
Other	2,645	94.7%	2,308	92.9%	5,787	95.4%	4,675	94.7%
Total gross profit	$ 29,038	29.4%	$ 27,655	32.6%	$ 57,735	28.6%	$ 54,935	31.0%

The majority of our revenue is generated from managed care contracts and other agreements with commercial third party payors. Our principal managed care contract is with Blue Cross Blue Shield of Florida for the provision of specialty pharmacy services and infusion pharmacy services to their members. For the three and six months ended June 30, 2004, 16% and 15% of our revenue was generated from this contract. In the prior year, for the three and six months ended June 30, 2003, 17% of our revenue was generated from this contract. As of June 30, 2004 and December 31, 2003, 9% of our accounts receivable was due from Blue Cross Blue Shield of Florida. The contract is terminable by either party on 90 days notice and, unless terminated, renews annually each September for an additional one-year term.

We also generate revenue from government healthcare programs such as Medicare and Medicaid. For the three and six months ended June 30, 2004, 20% of our revenue was generated from these programs. In the prior year, for the three and six months ended June 30, 2003, 19% of our revenue was generated from government healthcare programs. As of June 30, 2004 and December 31, 2003, respectively, 17% and 20% of our total accounts receivable was due from these government healthcare programs.

Many of the pharmaceuticals we provide are reimbursed at some percentage of the Average Wholesale Price (AWP) for those pharmaceuticals. AWP for most pharmaceuticals is compiled and published by private companies, including First DataBank, Inc. In recent years, we have seen reductions to AWP for certain of the pharmaceuticals that we provide to patients in the aftermath of government investigations and other legal and regulatory actions. Any modifications to the AWP system or reductions in AWP for the products we provide to patients could narrow our gross profit margins.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 changed the way in which covered outpatient drugs are reimbursed by the Medicare program. In January 2004, payment for most drugs covered by Medicare decreased to 85% of the AWP, determined as of April 1, 2003. Beginning in 2005, reimbursement for non-self administered drugs furnished to patients in conjunction with other Medicare covered services will be set at either 106% of the average sales price (ASP) or through a competitive acquisition program to be phased in beginning in 2006. The competitive acquisitions program will be established by the Center for Medicare and Medicaid Services (CMS) and will enable physicians in designated competitive acquisition areas to purchase drugs through contractors that have successfully bid for that right. Each physician will elect annually whether to obtain drugs through the competitive acquisition program. CMS will re-bid the contracts at least every three years. For infusion drugs administered in connection with covered durable medical equipment, the payment rate generally will continue to be 95% of the AWP as of October 1, 2003, until such drugs are subject to the implementation of the competitive acquisition program discussed above. While the majority of our revenue is reimbursed by managed care organizations and other non-government payors, these changes to the way in which Medicare pays for outpatient drugs and biologicals may have some impact on us or our franchisees. In addition, as CMS implements the ASP reimbursement model, managed care organizations may push for adoption of ASP as the basis of pharmaceutical reimbursement as well. If managed care organizations do adopt the ASP model, our future financial condition and results of operations could be materially affected based on our ability to renegotiate pricing using the ASP methodology.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management s discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and their related disclosures. On an ongoing basis, we evaluate our estimates and judgments based on historical experience and various other factors that are believed to be reasonable. Actual results may vary from these estimates under different assumptions or conditions. We annually review our financial reporting and disclosure practices and accounting policies to ensure that our financial reporting and disclosures provide accurate and transparent information relative to our financial condition and results of operations, as well as our current business environment. Management believes that of our significant accounting policies, the following policies involve a higher degree of judgment and/or complexity: revenue recognition and contractual adjustments; accounts receivable and allowances for doubtful accounts; goodwill and other intangible assets; and computer software development costs. For a complete discussion of these accounting policies, please refer to our Annual Report on Form 10-K for the year ended December 31, 2003.

RESULTS OF OPERATIONS

The following table shows the results of our operations for the three and six months ended June 30, 2004 and 2003, expressed in amounts and percentages of revenue (amounts in thousands):

	Three months ended June 30,				Six months ended June 30,			
	2004		2003		2004		2003	
	Amount	% of Revenue	Amount	% of Revenue	Amount	% of Revenue	Amount	% of Revenue
Revenue:								
Specialty pharmacy services	$ 58,407	59.2%	$ 48,172	56.8%	$ 123,339	61.1%	$ 105,206	59.3%
Infusion and related healthcareservices	37,450	38.0%	34,126	40.3%	72,396	35.9%	67,199	37.9%
Other	2,794	2.8%	2,484	2.9%	6,065	3.0%	4,939	2.8%
Total revenue	98,651	100.0%	84,782	100.0%	201,800	100.0%	177,344	100.0%