

OPTION CARE INC/DE
Form 10-K
March 16, 2007

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-K

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

**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006
OR**

**o TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from to
Commission File Number: 0-19878**

OPTION CARE, INC.
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

36-3791193
(I.R.S. Employer
Identification No.)

485 Half Day Road, Suite 300
Buffalo Grove, IL
(Address of principal executive offices)

60089
(Zip Code)

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

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

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

Title of each class
Common Stock, \$0.01 par value per share

Name of each exchange on which registered
National Stock Market LLC (Nasdaq)

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☒

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

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. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of June 30, 2006, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$316,260,000 based on the closing sale price of \$11.98 as reported on the Nasdaq Stock Market LLC. Solely for purposes of the foregoing calculation of aggregate market value of voting stock held by non-affiliates, the registrant has assumed that all directors and executive officers of the registrant are affiliates of the registrant. Such assumption shall not be deemed a determination by the registrant that such persons are affiliates of the registrant for any purposes.

The number of shares of our Common Stock, \$0.01 par value per share, outstanding as of March 1, 2007 was 34,491,088.

DOCUMENTS INCORPORATED BY REFERENCE

Document	Parts Into Which Incorporated
Proxy Statement for the Annual Meeting of Stockholders to be filed by April 30, 2007 (Proxy Statement)	Part III

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FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for forward-looking statements. Certain information included or incorporated by reference in this Annual Report on Form 10-K, including information in

Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” 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, or may 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 anticipated or potential effects of future regulation and competition, as well as other statements identified by “may”, “should”, “expect” and similar words. 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 goods and services, technological developments and changes in the competitive environment in which we operate, as well as those identified under

Item 1A “Risk Factors” in this Annual Report on Form 10-K. We do not undertake any obligation to release publicly any revisions to such forward-looking statements to reflect events or circumstances occurring after the date of this Annual Report on Form 10-K or to reflect the occurrence of unanticipated events.

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PART I

Item 1. BUSINESS

GENERAL

Option Care is a leading provider of specialty pharmacy services and home infusion pharmacy services to patients with acute or chronic conditions that can be treated at home, at one of our local ambulatory infusion centers or in a physician's office. We provide these services to patients on behalf of managed care organizations, government healthcare programs and biopharmaceutical manufacturers through two company-owned, high-volume distribution facilities, 58 company-owned and managed locations and 53 franchised locations throughout the United States. Our services include the distribution and administration of infused and injectable medications, patient care coordination, clinical and compliance management and reimbursement support. For the years 2006, 2005 and 2004, we generated net revenue of \$659.4 million, \$504.6 million and \$414.4 million, respectively, and net income from continuing operations of \$22.6 million, \$20.9 million and \$16.5 million, respectively.

We are a leading provider to managed care organizations and other third party payors, patients, physicians and pharmaceutical manufacturers with a cost-effective solution for both home infusion pharmacy services and specialty pharmacy services nationwide. Our combination of national and local distribution capabilities, our sales and marketing resources, and our clinical staff and information systems support our customers as follows:

Payors We provide payors with a comprehensive approach to meeting their pharmacy services needs. Our provision of infusion pharmacy services in the patient's home or at one of our local ambulatory infusion centers offers a lower cost alternative to providing these therapies in a hospital setting. Our specialty pharmacy services offer payors a cost effective solution for the distribution of specialty pharmaceuticals directly to patients for self-administration. We also provide the direct distribution of biotech pharmaceuticals to physicians' offices for in-office administration. This provides payors with a cost-effective alternative to direct billing of biotech pharmaceuticals by physicians. We also provide payors with utilization and outcomes data to evaluate therapy effectiveness.

Patients We improve patients' quality of life by allowing them to remain at home while receiving necessary medications, supplies and services or visit one of our ambulatory infusion centers to receive care. In addition, we help manage patients' conditions through counseling and education regarding their treatment and by providing ongoing monitoring to encourage patient compliance with the prescribed therapy. We also provide services to help patients receive reimbursement benefits.

Physicians We assist physicians with time-intensive patient support by providing care management related to their patients' pharmacy needs and improving compliance with therapy protocols. We eliminate the need for physicians to carry inventories of high cost prescriptions by distributing the medications directly to patients homes or, if required, to the physicians' offices. We either bill the payor directly or assist the patient in the submission of claims to the payor.

Pharmaceutical Manufacturers We provide pharmaceutical manufacturers with a broad distribution channel for their existing pharmaceuticals and their new product launches. We implement patient monitoring programs that encourage compliance with the prescribed therapy. We also provide valuable clinical information in the form of outcomes and compliance data to manufacturers to aid in their evaluation of the efficacy of their products.

Our company was founded in 1979 and was a pioneer in the delivery of home infusion services. The industry was formed when the technology emerged allowing for the safe and cost-effective administration of infused medications in a home environment. In addition, Medicare reimbursement changes in 1984 encouraged hospitals to reduce length of stays creating increased discharges to alternate site settings. During the 1980 s, we expanded our services nationally with a franchise model targeting markets with populations of fewer than 300,000. We completed our initial public offering on April 23, 1992 and embarked on transitioning the

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company from a franchise organization to a healthcare services provider through an acquisition program targeting franchised and non-affiliated operations.

Since the mid-1990 s, we have focused on building a leadership position in the home infusion industry in markets of all sizes and have been able to leverage our local pharmacy capabilities to distribute niche, high cost therapies targeting chronic conditions. Due to the robust biotech pharmaceutical product pipeline, we have seen a significant increase in the distribution of these high cost specialty medications. As a result, we have created a specialized service offering that meets the needs of patients, product manufacturers and managed care organizations.

AVAILABLE INFORMATION

We maintain our internet website at <http://www.optioncare.com> and make available free of charge through our internet website reports we file with the SEC, including our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(c) or 15(d) of the Securities and Exchange Act of 1934, as soon as reasonably practical after we electronically file such materials with the SEC. Also available through our internet site is our Code of Ethics for our directors, officers and employees. Information on our website is not incorporated by reference into this report. Our common stock is traded on the Nasdaq Stock Market LLC under the symbol OPTN.

We were incorporated in Delaware in July 1991. Our principal executive offices are located at 485 Half Day Road, Suite 300, Buffalo Grove, Illinois 60089, and our telephone number is (847) 465-2100.

INDUSTRY

Healthcare related expenditures constitute a large and growing segment of the US economy. According to estimates by the Centers for Medicare & Medicaid Services, national health expenditures reached an estimated \$2.0 trillion in 2005, are expected to reach \$2.3 trillion in 2007 and are projected to increase to \$4.1 trillion by 2016. In 2005, prescription drug expenditures were \$200.7 billion, representing 10% of national healthcare expenditures for that year. Prescription drugs are among the fastest-growing categories of healthcare expenditure, having grown at double-digit rates each year from 1995 to 2003. Two important trends that impact our business have emerged in relation to healthcare spending. These trends are positively impacting the growth of the many services we provide:

Government programs, private insurance companies, managed care organizations and self-insured employers have implemented various cost-containment measures to limit the growth of healthcare expenditures. These cost-containment measures, together with technological advances, have resulted in a shift in the delivery of many healthcare services away from traditional hospital settings to more cost-effective settings, including patients' homes.

As a result of the proliferation of biotech research and development, biotech companies and pharmaceuticals manufacturers have developed a variety of high cost biotech pharmaceuticals. These biotech pharmaceuticals are most often used in the treatment of chronic conditions such as multiple sclerosis, growth hormone disorders, hemophilia, cancer and immune deficiency disorders. These biotech pharmaceuticals, which in many cases cost over \$10,000 per patient per year, are typically used on a recurring basis for extended periods of time and require special inventory handling, administration and patient compliance monitoring. Historically, traditional pharmacy distribution channels have not been designed to handle the additional services required by many of these medications.

Pharmacy Services

Pharmacy services include the treatment of a wide range of chronic and acute health conditions with a range of injectible and infusible specialty pharmaceuticals. Less acute, chronic conditions are generally treated with self-administered, injectible pharmaceuticals but may also be administered by a physician or nurse. These pharmaceuticals can be directly distributed to the patient or the patient's physician for in-office administration and in many cases cost over \$10,000 per patient per year. These pharmaceuticals may require refrigeration

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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 programs. This segment of the pharmacy services industry primarily treats conditions such as multiple sclerosis, growth hormone disorders, hemophilia, cancer, immune deficiency disorders, asthma and other chronic conditions. Retail pharmacies and other traditional distributors generally are designed to carry inventories of low cost, high volume products and therefore are not equipped to handle the high cost, low volume specialty pharmaceuticals that have specialized handling and administration requirements. As a result, these specialty pharmaceuticals are generally provided by pharmacies that focus primarily on filling, labeling and delivering injectible pharmaceuticals and related support services. The U.S. market for specialty pharmaceuticals is estimated to be between \$25 and \$35 billion and the market is growing rapidly. We expect several factors to contribute to the continuing growth of the specialty pharmacy services industry, including the following:

Healthcare cost containment pressures;

Development of new pharmaceuticals;

Direct to consumer advertising;

Increased acceptance of mail-order distribution; and

Growing emphasis on care management and compliance monitoring to improve outcomes for these high-cost, chronic diseases.

More acute, chronic conditions are generally treated with infusible pharmaceuticals that require administration of a more complex nature. These pharmaceuticals are primarily administered to treat infections, dehydration, cancer, pain and nutritional deficiencies. Patients are generally referred to infusion pharmacy services providers by physicians, hospital discharge planners and case managers. The medications are mixed and dispensed under the supervision of a registered pharmacist and the therapy is typically delivered in the home of the patient by a registered nurse or trained caregiver. Depending on the preferences of the patient and/or the payor, these services may also be provided at an ambulatory infusion center. The home infusion pharmacy services industry is estimated to be between \$5 and \$10 billion. We believe that several factors will contribute to the continuing growth in non-hospital based infusion therapy services, including the following:

Healthcare cost containment pressures;

Increased number of therapies that can be safely administered in patients' homes;

Patient preference for at-home treatment;

Increased acceptance of home infusion by the medical community and by managed care organizations and other payors;

Technological innovations such as implantable injection ports, vascular access devices and portable infusion control devices; and

Increased utilization of home infusion therapies due to demographic trends, in particular increasing life expectancies.

GROWTH STRATEGY

We intend to leverage our 27 years of clinical experience managing a wide range of pharmaceutical therapies with the national coverage of our high-volume distribution facilities and local pharmacy locations to deliver a single source solution for infused and injected pharmaceuticals and services to our customers. Our ability to provide a flexible distribution model which includes the delivery of our cost effective services to patients homes, physicians offices or our local ambulatory infusion centers, makes us an attractive provider to government health plans, managed care organizations, insurance companies and other third party payors and referral sources.

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We intend to increase our revenue and profitability through organic growth as well as selective acquisitions, start-ups and joint ventures that expand our geographic coverage into new markets and consolidate providers in existing markets that we serve.

Organic Growth

We intend to expand our infusion and specialty services through sales and marketing activities targeting managed care organizations, pharmaceutical manufacturers, and local referral sources.

We currently have contracts with most major managed care organizations and are actively expanding the range of infusion and specialty services under these relationships. In addition, we are actively targeting new managed care relationships to contract for a wide variety of our services.

Our pharmaceutical manufacturer strategy includes expanding our relationships with biotech and other pharmaceutical manufacturers in order to acquire distribution rights to existing and new products targeting chronic diseases or conditions.

Our local sales force continuously markets to a wide variety of referral sources stressing our clinical capabilities to meet the needs of patients with a wide range of acute and chronic conditions.

Acquisitions

The home infusion industry is highly fragmented with the majority of service providers operating primarily in local or regional markets. According to the National Home Infusion Association, there are between 3,000 and 4,000 home infusion providers operating in the United States approximately one third are small, individually owned or closely held local operations, one third are hospital based providers, and one third are national providers. We believe that few competitors possess the scale and resources to consolidate the industry and that our financial resources and operating strength affords us an advantage in this area. Additionally, our franchise network provides us with an established pipeline of potential acquisition opportunities. Our typical franchise agreement provides us with a right of first refusal for the potential acquisition of an existing franchise.

Joint Ventures

We intend to enter into joint ventures in select markets with established hospitals by merging with or partially acquiring a hospital system's home care business, or by contracting with a hospital system to jointly develop start-up operations. Hospital partners may include centers of academic excellence, regional hospitals and community hospitals.

OUR SERVICES

Home Infusion Pharmacy and Related Healthcare Services

We provide home infusion pharmacy services through our local pharmacy network of 58 company-owned and managed pharmacies throughout the United States. Our services are most typically provided in the patient's home, but may also be provided at clinics, the physician's office or at one of our ambulatory infusion centers. We offer patients and physicians the following products and services:

Medication and supplies for administration and use at home or within one of our ambulatory infusion centers;

Consultation and education regarding the patient's condition and the prescribed medication;

Clinical monitoring and assistance in monitoring potential side effects; and

Assistance in obtaining reimbursement.

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We provide the following home infusion therapies:

Total Parenteral Nutrition: intravenous therapy providing required nutrients to patients with digestive or gastro-intestinal problems, most of whom have chronic conditions requiring treatment for life;

Anti-infective Therapy: intravenous therapy providing medication for infections related to diseases such as osteomyelitis and urinary tract infections;

Pain Management: intravenous or continuous injection therapy, delivered by a pump, providing analgesic pharmaceuticals to reduce pain;

Enteral Nutrition: providing nutritional formula by tube directly into the stomach or colon;

Chemotherapy: intravenous therapy providing prescription medications to treat cancer; and

Other therapies: treating a wide range of medical conditions.

Several of our company-owned pharmacies also provide home health nursing services, respiratory therapy services and home medical equipment sales and rentals. We also have one location that provides home hospice services.

Specialty Pharmacy Services

We provide specialty pharmacy services through our two company-owned, high-volume distribution facilities and our 58 company-owned and managed local pharmacies. We purchase specialty pharmaceuticals from manufacturers and wholesale distributors, fill prescriptions provided by physicians, and label, package and deliver the pharmaceuticals to patients' homes or physicians' offices, either ourselves or through contract couriers. Depending on therapy, we may also administer the specialty pharmaceuticals to the patient at one of our ambulatory infusion centers. For selected drugs, we also supply clinical efficacy and outcomes data to the manufacturers.

We provide specialty pharmacy services to treat the following chronic diseases or conditions:

Growth Hormone Deficiency: a condition that prevents normal growth patterns in children, generally caused by disorders of the pituitary gland or kidneys. Therapy consists of daily injections of growth hormone and usually lasts seven to nine years.

Respiratory Syncytial Virus (RSV) Prevention: RSV is a major cause of respiratory disease in young children and infants. Treatment is directed toward high-risk pediatric patients, typically from infant to age two. The most common treatment consists of monthly injections of Synagis®, a specialty pharmaceutical we distribute throughout the RSV season which lasts from approximately October through April. Due to the seasonal nature of RSV treatments, Synagis sales in 2006 represented as little as 1.2% of our quarterly revenue for the quarter ended September 30 to as much as 17.5% of our quarterly revenue for the quarter ended March 31.

Hepatitis C Virus: a viral infection which results in the inflammation of the liver. Left untreated, hepatitis C virus can cause serious liver damage. Treatment includes injections of interferon alfa with the concomitant oral administration of ribavirin products. Treatment can last up to 24 months.

Multiple Sclerosis: a chronic, incurable, progressive disease of the central nervous system. The goal of treatment is to decrease the severity, intensity and duration of outbreaks and to slow the progression of the

disease. Treatment regimens involve pharmaceutical injections or infusions, and products vary widely.

Hemophilia: an inherited bleeding disorder that is caused by a blood clotting deficiency that results in a longer bleeding time. Hemophilia is one of the most costly diseases to treat. The treatment goal is to raise the level of the deficient clotting factor and maintain it in order to stop the bleeding. Treatments include infusion of the clotting factor products. The length of treatment depends on the severity of the bleeding episode, and the need for treatment continues throughout the life of the patient.

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Immune Deficiency: immune deficiencies are disorders which reduce the patient's ability to identify and destroy substances which do not belong in the human body and are characterized by reduced levels of antibodies. Intravenous immune globulins, which are infused to treat the immune deficiencies, are concentrated antibodies that have been purified from large numbers of human blood donors.

Cancer: includes a wide spectrum of tumors, abnormal growths and cellular abnormalities. Treatment includes radiation, chemotherapy and/or surgery. As a result of these treatments, patients may require therapies that combat anemia and increase white blood cell counts. Our specialty pharmacy programs provide chemotherapy and related products to physicians' offices for in-office administration and to patients' homes.

Asthma: an inflammatory condition of the bronchial airways, most commonly caused by allergies. The inflammation leads to airway obstruction, chest tightness, coughing and wheezing. Treatment focuses on controlling symptoms and typically consists of inhaled corticosteroids. Our specialty pharmacy program provides patients with an injectible drug, Xolair®, designed for adults and adolescents with moderate to severe allergic asthma that is inadequately controlled by the use of inhaled corticosteroids.

OUR SUPPLIERS

We obtain the pharmaceuticals and medical supplies and equipment that we provide to our patients through pharmaceutical manufacturers, distributors and group purchasing organizations. Most of the pharmaceuticals that we purchase are available from multiple sources and are available in sufficient quantities to meet our needs and the needs of our patients. However, some biotech drugs are only available through the manufacturer and may be subject to limits on distribution. In such cases, it is important for us to establish and maintain good working relations with the manufacturer in order to assure sufficient supply to meet our patients' needs. We utilize several national delivery companies as an important part of the local and national distribution of our products and services, particularly in the delivery of certain specialty pharmaceutical products.

Additionally, certain drugs may become subject to general supply shortages, as was the case in 2005 with IVIG immune globulin products. Such shortages can result in cost increases or hamper our ability to obtain sufficient quantities to meet the needs of our patients. We work diligently to obtain commitments from our suppliers, whenever possible, to secure ample supply of drugs that are potentially subject to supply shortages.

Through the coverage and clinical expertise of our two company-owned, high-volume distribution facilities, our 58 company-owned locations and our 53 franchised locations, we provide pharmaceutical manufacturers with a broad distribution channel for their existing pharmaceutical products. This strength also provides us the opportunity to become a selected partner in the launch of their new products. When providing new products to patients, we implement a monitoring program to encourage compliance with the prescribed therapy and we provide valuable clinical information to the manufacturer in the form of outcomes and compliance data to aid in their evaluation of the efficacy of the product. We may receive fees, which we record as other revenue, from certain biotech manufacturers for providing them with clinical outcomes data. Our continued growth will be dependent on maintaining our existing relationships with manufacturers and establishing new relationships with additional manufacturers as they launch new specialty products.

Through the combined purchasing power of our company-owned and franchised locations, we are able to sign pharmaceutical purchase contracts with these suppliers that provide us and our franchisees with volume discount pricing and provide us the opportunity to earn volume purchase rebates and vendor administration fees. Such fees are recorded as reductions to cost of goods sold to the extent they are earned by purchases made by our company-owned locations and as revenue to the extent that they are related to purchases made by our franchised locations, with the majority of these fees being derived from purchases made by our company-owned locations.

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BILLING & SIGNIFICANT PAYORS

We derive most of our revenue from contracts with third party payors, such as managed care organizations, insurance companies, self-insured employers and Medicare and Medicaid programs. Where permissible, we bill patients for any amounts not reimbursed by third party payors. For the most part, our infusion pharmacy revenue consists of reimbursement for both the cost of the pharmaceuticals sold and the cost of services provided. Pharmaceuticals are typically reimbursed on a percentage discount from the published average wholesale price (AWP) of each drug. Nursing services are typically paid separately, on a per visit basis, while other patient support services and ancillary medical supplies are either reimbursed separately or on a per diem basis, where applicable. Specialty pharmaceuticals are typically pre-packaged drugs that are self-injected by the patient or a trained in-home caregiver. Therefore, minimal service is provided and no per diem revenue is generated.

Our largest managed care contract is with Blue Cross and Blue Shield of Florida, Inc. (BC/BS of Florida). We provide infusion pharmacy and specialty pharmacy services to BC/BS of Florida members throughout the state of Florida. This contract renews each September for an additional one-year term and may be terminated by either party upon 90 days notice. For 2006, our contract with BC/BS of Florida produced \$84.0 million in revenue. In 2006, 2005 and 2004, respectively, approximately 13%, 13% and 15% of our total revenue was related to this contract. As of December 31, 2006 and 2005, approximately 9% of Option Care's accounts receivable were due from BC/BS of Florida. No other single managed care payor represented more than 10% of our revenue in 2006.

During 2006, we signed a new specialty pharmacy contract with Blue Cross and Blue Shield of Michigan (BC/BS MI) to be the exclusive supplier of specialty pharmacy drugs and services to their members. This contract was fully implemented early in the quarter ended December 31, 2006. We believe that this contract may represent 10% or more of our revenue in 2007.

We also provide services that are reimbursable through government healthcare programs such as Medicare and state Medicaid programs. For the twelve months ended December 31, 2006, 2005 and 2004, respectively, approximately 20%, 17% and 18% of our revenue came from government healthcare programs such as Medicare and Medicaid. The amounts due from these programs represented approximately 19% and 22% of our total accounts receivable, respectively, as of December 31, 2006 and 2005.

We bill payors and track all of our accounts receivable through computerized billing systems. These systems allow our billing staff the flexibility to review and edit claims in the system before they are submitted to payors. Claims are submitted to payors either electronically or through the mail. We utilize electronic claim submission whenever possible to expedite claim review and payment, and to minimize errors and omissions.

The net revenue that we report is based on usual and customary billing rates for the products and services we provide, less applicable contractual adjustments. In most cases, our computerized billing systems generate contractual adjustments based on the fee schedules of the underlying insurance contracts when the claims are billed. If our computerized billing systems cannot automatically generate the contractual adjustment for a given claim, we calculate the contractual adjustment manually and key the adjustment into our billing system when the claim is billed. For revenue that is not yet billed, we estimate the contractual adjustments using a claim-by-claim analysis of the unbilled charges, by applying historic contractual adjustment percentages, or a combination of the two methods.

We generate accounts receivable aging reports from our billing systems and utilize these reports to help us monitor the condition of our outstanding receivables and evaluate the performance of our billing and reimbursement staff. We also utilize these aging reports, combined with historic write-off statistics generated from our billing systems, to determine our allowance for doubtful accounts.

Our financial performance is highly dependent upon effective billing and collection practices at each of our company-owned pharmacies. The process begins with an accurate and complete patient admission process, in which all critical information about the patient, the patient's insurance and their care needs is gathered. A critical part of this process is verification of insurance coverage and authorization from insurance to provide the required care, which typically takes place before we initiate services. An exception occurs when a patient

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referral is received outside of normal business hours, but we have an existing contractual relationship with the patient's insurance carrier. In such cases, we provide the patient with sufficient drugs and services to last until the next business day, when the patient's insurance coverage can be verified.

FRANCHISE PROGRAM

Our franchise program was developed to increase our geographical presence and to provide a national network of pharmacies to service the needs of our managed care customers without requiring extensive capital expenditures. In marketing our franchise program, we target independent infusion pharmacies that would benefit from participating in our national and regional managed care and manufacturer contracts as well as in our marketing programs. Our franchised locations are sold a license to operate an Option Care branded pharmacy in a defined territory to provide infusion therapy and related products and services.

We receive a start-up fee upon execution of the franchise agreement with subsequent royalties based on a percentage of gross receipts of the franchised location. Each franchisee is required to maintain a licensed pharmacy equipped to compound medications in a sterile environment as prescribed by physicians. In the program that we are currently marketing, the franchisee must obtain specified liability insurance protecting the franchise owner and us against claims arising from the operation of the franchised business. Our franchisees may participate in our managed care and manufacturer contracts. They may also purchase pharmaceuticals and supplies from a preferred list of vendors under contract with us. This frequently allows us and the franchisee to obtain volume discount pricing. For certain pharmaceuticals, the franchise may also purchase directly from us. Most of our franchise agreements also provide us with a right of first refusal for the potential acquisition of the franchise. However, none of our current agreements grants us the option to purchase the franchise at our will.

As of December 31, 2006, we had 53 franchised pharmacy locations operating under 46 separate franchise agreements. Of the eight franchise agreements scheduled to expire in 2006, two were renewed, four have been extended for short periods and two terminated without renewal. Approximately 87% of our 46 continuing franchise agreements come up for renewal in the five-year period from 2007 through 2011. As a franchise agreement nears expiration, we expect to propose a new agreement or evaluate the franchise for possible acquisition. If we cannot reach agreement with the franchisee and the franchise expires, the franchisee is required to cease using the Option Care service mark and will not be able to access our managed care agreements or purchasing contracts. We would then be free to re-franchise the territory or to service the territory with a company-owned facility. Termination of a franchise agreement by the franchise prior to its scheduled expiration date may subject the franchisee to early termination fees. Accordingly, we may record revenue as a result of such early terminations. In addition, upon our acquisition of an existing franchise prior to the scheduled expiration of its underlying franchise agreement, we may record a gain or loss on settlement equal to the excess or shortfall of the present value of the estimated future royalties receivable under the terminated franchise agreement versus our current royalty market rates.

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The following table summarizes the 2006 royalty revenue from active franchise agreements, by termination year, as well as royalty revenue attributable to franchises terminated and acquired during 2006. (dollar amounts in thousands):

	Number of Franchise Agreements	Attributable 2006 Royalty Revenue	Percent of 2006 Royalty Revenue
Active franchise agreements, by scheduled termination year:			
2007	10	\$ 1,011	18.7%
2008	10	1,030	19.0%
2009	8	1,066	19.7%
2010	5	513	9.5%
2011	7	1,018	18.8%
2012-2016	6	502	9.2%
Total active franchise agreements	46	5,140	94.9%
Franchises terminated during 2006	5	215	3.9%
Franchises acquired during 2006	1	64	1.2%
Total	52	\$ 5,419	100.0%

DISPOSAL OF ASSETS

On August 1, 2006, we completed the sale of our home health agency in Portland, Oregon for \$500,000. We recorded a pre-tax gain of \$242,000 on this sale. In addition, during the quarter ended September 30, 2006 we ceased operations of our home health agency in Phoenix, Arizona and recorded a pre-tax loss of \$291,000 on this disposal. The operations and cash flows of these home health agencies have been eliminated from our ongoing operations as a result of these transactions, and we do not have any continuing involvement in their operations. Accordingly, the results of operations of these home health agencies, including any gains or losses on sale or disposal, are now reported as discontinued operations, net of tax, in our consolidated statements of income for all periods presented.

SALES AND MARKETING

Our sales and marketing efforts focus on three primary objectives: (1) building new relationships and expanding existing contracts with managed care organizations; (2) establishing, maintaining and strengthening relationships with local and regional patient referral sources; and (3) maintaining existing and developing new relationships with biotech drug manufacturers to gain distribution access as they release new products. Our national and regional sales directors focus primarily on establishing and expanding our contracts with managed care organizations, while our local account managers focus on pull-through from these contracts by developing and maintaining relationships with local and regional referral sources, such as physicians, hospital discharge planners and case managers. In addition, we have a sales force focused on maintaining and expanding our relationships with biotech drug manufacturers to establish our position as a participating provider when they release new products.

Most new patients are referred to us by physicians, medical groups, hospital discharge planners, case managers employed by Health Maintenance Organizations (HMOs), Preferred Provider Organizations (PPOs) or other managed care organizations, insurance companies and home care agencies. Our sales force is responsible for establishing and maintaining these referral relationships.

Our sales structure allows us to take advantage of our national managed care relationships to provide sales and contract pull-through by our local field-based sales personnel. Additionally, the existence of our contracts with national managed care organizations provides our local sales personnel with more flexibility and leverage for sales in local markets. This cross-utility enables us to market our services to numerous sources of patient referrals, including physicians, hospital discharge planners, hospital personnel, HMOs, PPOs

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or other managed care organizations, and insurance companies. Local marketing focuses on our infusion pharmacy business and our care management programs, with an emphasis on certain key therapies.

COMPETITION

Our pharmacies compete in the large and highly fragmented home infusion and specialty pharmacy markets. We compete with others for contracts with managed care organizations and other third party payors and compete to receive referrals from physicians, case managers and hospital discharge planners. Competition in the home infusion market is based on quality of care, cost of service and reputation. Competition in the specialty pharmacy market is based on price, reliability of service, compliance programs and reputation. Some of our existing and potential competitors in the home infusion market include integrated home healthcare providers such as Apria Healthcare Group Inc. and Coram Healthcare Corporation, and local providers of alternate site healthcare services such as hospitals, local home health agencies and other local providers. In the specialty pharmacy market, our existing and potential competitors include specialty pharmacy providers such as Medco Health Solutions, Caremark Rx, Express Scripts and others, specialized retail pharmacies such as PharmaCare, a division of CVS Corporation, pharmacy benefit management companies, wholesalers and retail pharmacies. In each market, some of these current competitors have, and our potential future competitors may have, greater financial, operational, sales and marketing resources than us. However, we believe that our reputation for providing quality services, the strength of our growing national presence and our ability to effectively market our services at national, regional and local levels places us in a strong position against existing and potential competitors.

GOVERNMENTAL REGULATION

The healthcare industry is subject to extensive regulation by a number of governmental entities at the federal, state and local level. The industry is also subject to frequent regulatory change. Laws and regulations in the healthcare industry are extremely complex and, in many instances, the industry does not have the benefit of significant regulatory or judicial interpretation. Moreover, our business is impacted not only by those laws and regulations that are directly applicable to us but also by certain laws and regulations that are applicable to our managed care and other clients. If we fail to comply with the laws and regulations directly applicable to our business, we could suffer civil and/or criminal penalties, and we could be excluded from participating in Medicare, Medicaid and other federal and state healthcare programs, which would have an adverse impact on our business.

If our franchisees fail to comply with the laws and regulations applicable to their businesses, they could suffer civil and/or criminal penalties and/or be excluded from participating in Medicare, Medicaid and other federal and state healthcare programs, which could have an adverse impact on our business.

Professional Licensure. Nurses, pharmacists and certain other healthcare professionals employed by us are required to be individually licensed or certified under applicable state law. We perform criminal and other background checks on employees and take steps to ensure that our employees possess all necessary licenses and certifications, and we believe that our employees comply in all material respects with applicable licensure laws.

Each of our franchisees is responsible for ensuring the licensing or certification of its employees in accordance with applicable law, performing any criminal or other background checks required by state law, and ensuring that all employees perform only those tasks which fall within their authorized scope of practice. While each franchisee is responsible for any failure or non-compliance with respect to these licensure and scope of practice issues, any such failure or non-compliance by a franchisee that impacts such franchisee's operations could have an adverse effect on our business.

Pharmacy Licensing and Registration. State laws require that each of our pharmacy locations be licensed as an in-state pharmacy to dispense pharmaceuticals in that state. Certain states also require that our pharmacy locations be licensed as an out-of-state pharmacy if we deliver prescription pharmaceuticals into those states from locations outside of the state. We believe that we substantially comply with all state licensing laws applicable to our business. If we are unable to maintain our licenses or if states place burdensome

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restrictions or limitations on non-resident pharmacies, our ability to operate in some states would be limited, which could have an adverse impact on our business.

Laws enforced by the Drug Enforcement Administration, as well as some similar state agencies, require our pharmacy locations to individually register in order to handle controlled substances, including prescription pharmaceuticals. A separate registration is required at each principal place of business where we dispense controlled substances. Federal and state laws also require that we follow specific labeling, reporting and record-keeping requirements for controlled substances. We maintain federal and state controlled substance registrations for each of our facilities that require such registration and follow procedures intended to comply with all applicable federal and state requirements regarding controlled substances.

Many states in which we operate also require home infusion companies to be licensed as home health agencies. We believe we are in compliance with these laws, as applicable.

Food, Drug and Cosmetic Act. Certain provisions of the federal Food, Drug and Cosmetic Act govern the handling and distribution of pharmaceutical products. This law exempts many pharmaceuticals and medical devices from federal labeling and packaging requirements as long as they are not adulterated or misbranded and are dispensed in accordance with and pursuant to a valid prescription. We believe that we comply with all applicable requirements.

Fraud and Abuse Laws Anti-Kickback Statute. The federal Anti-Kickback Statute prohibits individuals and entities from knowingly and willfully paying, offering, receiving, or soliciting money or anything else of value in order to induce the referral of patients or to induce a person to purchase, lease, order, arrange for, or recommend services or goods covered by Medicare, Medicaid, or other government healthcare programs. The federal courts have held that an arrangement violates the Anti-Kickback Statute if any one purpose of the remuneration is to induce the referral of patients covered by the Medicare or Medicaid programs, even if another purpose of the payment is to compensate an individual for rendered services. The Anti-Kickback Statute is broad and potentially covers many standard business arrangements. Violations can lead to significant penalties, including criminal fines of up to \$25,000 per violation and/or five years imprisonment, civil monetary penalties of up to \$50,000 per violation plus treble damages, and/or exclusion from participation in Medicare, Medicaid, and other federal government healthcare programs. In an effort to clarify the conduct prohibited by the Anti-Kickback Statute, the Office of the Inspector General (OIG) of the United States Department of Health and Human Services has published regulations that identify a limited number of safe harbors. Business arrangements that satisfy all of the elements of a safe harbor are immune from criminal enforcement or civil administrative actions. The Anti-Kickback Statute is an intent based statute and the failure of a business relationship to satisfy all of the elements of a safe harbor does not in and of itself mean that the business relationship violates the Anti-Kickback Statute. The OIG, in its commentary to the safe harbor regulations, has recognized that many business arrangements that do not satisfy a safe harbor nonetheless operate without the type of abuses the Anti-Kickback Statute is designed to prevent. We attempt to structure our business relationships to satisfy an applicable safe harbor. However, in those situations where a business relationship does not fully satisfy the elements of a safe harbor, or where no safe harbor exists, we attempt to satisfy as many elements of an applicable safe harbor as possible. The OIG is authorized to issue advisory opinions regarding the interpretation and applicability of the Anti-Kickback Statute, including whether an activity constitutes grounds for the imposition of civil or criminal sanctions. We have not, however, sought any opinions regarding our business relationships.

A number of states have statutes and regulations that prohibit the same general types of conduct as those prohibited by the Anti-Kickback Statute described above. Some state anti-fraud and anti-kickback laws apply only to goods and services covered by Medicaid. Other state anti-fraud and anti-kickback laws apply to all healthcare goods and services, regardless of whether the source of payment is governmental or private. Where applicable, we attempt to structure our business relationships to comply with these statutes.

Fraud and Abuse Laws False Claims Act. We are subject to state and federal laws that govern the submission of claims for reimbursement. These laws generally prohibit an individual or entity from knowingly and willfully presenting a claim or causing a claim to be presented for payment from a federal healthcare program that is false or fraudulent. The standard for knowing and willful may include conduct that amounts

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to a reckless disregard for the accuracy of information presented to payors. Penalties under these statutes include substantial civil and criminal fines, exclusion from the Medicare or Medicaid programs and imprisonment. One of the most prominent of these laws is the federal False Claims Act, which may be enforced by the federal government directly or by a private plaintiff by filing a *qui tam* lawsuit on the government's behalf. Under the False Claims Act, the government and private plaintiffs, if any, may recover monetary penalties in the amount of \$5,500 to \$11,000 per false claim, as well as an amount equal to three times the amount of damages sustained by the government as a result of the false claim. A number of states, including states in which we operate, have adopted their own false claims statutes as well as statutes that allow individuals to bring *qui tam* actions. We believe that we have procedures in place to ensure the accuracy of our claims.

Ethics in Patient Referrals Law (Stark Law). The federal Stark Law generally prohibits a physician from making referrals for certain Designated Health Services (DHS), reimbursable by Medicare or Medicaid, to entities with which the physician or an immediate family member has a financial relationship, unless an exception applies. A financial relationship is generally defined as an ownership, investment or compensation relationship. DHS include, but are not limited to, outpatient pharmaceuticals, parenteral and enteral nutrition products, home health services, durable medical equipment, physical and occupational therapy services, and inpatient and outpatient hospital services. Among other sanctions, a civil monetary penalty of up to \$15,000 may be imposed for each bill or claim for a service a person knows or should know is for a service for which payment may not be made due to the Stark Law. Such persons or entities are also subject to exclusion from the Medicare and Medicaid programs. Any person or entity participating in a circumvention scheme to avoid the referral prohibitions is liable for a civil monetary penalty of up to \$100,000. A \$10,000 fine may be imposed for failure to comply with reporting requirements regarding an entity's ownership, investment and compensation arrangements for each day for which reporting is required to have been made under the Stark Law.

The Stark Law exempts certain business relationships that meet its exception requirements. However, unlike the Anti-Kickback Statute under which an activity may fall outside a safe harbor and still be lawful, a referral for DHS that does not fall within an exception is strictly prohibited by the Stark Law. We attempt to structure all of our relationships with physicians who make referrals to us in compliance with an applicable exception to the Stark Law.

In addition to the Stark Law, many of the states in which we and our franchisees operate have comparable restrictions on the ability of physicians to refer patients for certain services to entities with which they have a financial relationship. Certain of these state statutes mirror the Stark Law while others may be more restrictive. We attempt to structure all of our business relationships with physicians to comply with any applicable state self-referral laws.

Health Insurance Portability and Accountability Act of 1996 (HIPAA). To improve the efficiency and effectiveness of the healthcare system, the Health Insurance Portability and Accountability Act of 1996 included Administrative Simplification provisions that required the Department of Health and Human Services (HHS) to adopt national standards for electronic health care transactions. At the same time, Congress recognized that advances in electronic technology could erode the privacy of health information. Consequently, Congress incorporated provisions into HIPAA that mandated the adoption of federal privacy protections for individually identifiable health information.

In response to the HIPAA mandate, in December 2000, HHS published a final regulation in the form of the Privacy Rule, which became effective on April 14, 2001. This Privacy Rule set national standards for the protection of health information, as applied to the three types of covered entities: health plans, health care clearinghouses, and health care providers who conduct certain health care transactions electronically. Pursuant to the Privacy Rule, covered entities are required to have standards in place to protect and guard against the misuse of individually identifiable health information.

The Privacy Rule establishes a foundation of federal protections for the privacy of protected health information. The Privacy Rule does not replace federal, state, or other laws that grant individuals even greater privacy protections, and covered entities are free to retain or adopt more protective policies or practices. We

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have implemented the standards set forth in the Privacy Rule, and believe that we and all of our franchisees are in compliance with the Privacy Rule or any more stringent federal or state laws relating to privacy.

Additionally, the Administrative Simplification provisions address electronic health care transactions and the security of electronic health information systems. Providers are required to comply with the standards by specific compliance dates established by HHS. For standards relating to electronic health care transactions, all providers were required to comply by October 16, 2003. The security standards applicable to individually identifiable health information maintained electronically were required to be implemented by April 21, 2005. We were materially compliant with these standards by the applicable compliance date. The standards for a unique national health identifier for providers used in connection with the electronic healthcare transactions must be implemented by May 23, 2007. We expect to be able to materially comply with this requirement by the applicable compliance date.

Penalties for non-compliance with the Privacy Rule and other HIPAA Administrative Simplification provisions range from a civil penalty of \$100 for each violation (which can total up to \$25,000 per person per year), to criminal penalties, including up to \$50,000 and/or one year imprisonment, up to \$100,000 and/or five years imprisonment if the offense is committed under false pretenses and up to \$250,000 and/or ten years imprisonment for violating a standard with the intent to sell, transfer or use individually identifiable health information for commercial advantage, personal gain or malicious harm.

In addition to regulating privacy of individual health information and other provisions relating to Administrative Simplification, HIPAA includes several anti-fraud and abuse laws, extends criminal penalties to private health care benefit programs and, in addition to Medicare and Medicaid, to other federal health care programs, and expands the Office of Inspector General's authority to exclude persons and entities from participating in the Medicare and Medicaid programs.

Medicare Prescription Drug, Improvement and Modernization Act of 2003. The Medicare Prescription Drug, Improvement and Modernization Act of 2003 regulates the manner in which covered outpatient drugs are reimbursed by the Medicare program, which could result in lower reimbursement for physicians. A small portion of the infusion drugs we provide are covered under Medicare's durable medical equipment (DME) benefit. The payment rates for drugs and services administered by us in this manner generally were not affected by the enacted legislation and will continue to be 95% of the AWP in effect as of October 1, 2003.

As part of the Medicare Prescription Drug, Improvement and Modernization Act of 2003, a prescription drug benefit has been added under Medicare Part D. Under the Part D final regulations, the ingredient costs and dispensing fees associated with the provision of home infusion therapies will now be covered under Medicare. Prior to the passage of this Act, no reimbursement of these costs was available through Medicare to beneficiaries. For eligible Medicare beneficiaries, the cost of equipment, supplies and professional services associated with infused covered Part D drugs will continue to be reimbursed under Part A or Part B, as applicable. For beneficiaries who are dually eligible for benefit under Medicare and a state Medicaid program, covered infused drugs will be reimbursed under individual state coverage guidelines.

Franchise Regulation. We are subject to regulations adopted by the Federal Trade Commission (FTC), and to certain state laws that regulate the offer and sale of franchises. The FTC Franchise Rule (Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures) and certain state laws require that we furnish prospective franchise owners with a Uniform Franchise Offering Circular (UFOC) containing information prescribed by the FTC Franchise Rule and applicable state laws and regulations. There are certain states that also regulate the offer and sale of franchises and, in almost all cases, require registration of the UFOC with state authorities.

We are also subject to a number of state laws that regulate some substantive aspects of the franchisor-franchisee relationship. These laws may limit a franchisor's ability to:

terminate or not renew a franchise without good cause;

interfere with the right of free association among franchise owners;

disapprove the transfer of a franchise;

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discriminate among franchisees regarding charges, royalties and other fees; and

place new facilities near existing franchisees.

These laws also may limit the duration and scope of non-competition provisions. To date, these laws have not precluded us from seeking franchisees in any given area and have not had a material adverse effect on our operations.

Although bills intended to regulate certain aspects of franchise relationships have been introduced into Congress on several occasions, none have been enacted. We are not aware of any pending franchise legislation that in our view is likely to significantly affect our operations. We believe that our operations comply substantially with the FTC Franchise Rule and applicable state franchise laws.

SERVICE MARKS

OPTION CARE® and OptionMed®, among others, as service marks registered with the U.S. Patent Trademark Office. We have also submitted an application to register OptionCare, as one word. We believe that Option Care is becoming increasingly recognized by many referral sources as representing a reliable, cost-effective source of pharmacy services.

INSURANCE

Our business of providing specialized pharmacy services and other related home healthcare services may subject us to litigation and liability for damages. We currently maintain insurance for general and professional liability claims in the amount of \$1 million per claim and \$3 million in aggregate per policy year, plus \$5 million in umbrella coverage. Accordingly, the maximum coverage for a first claim in any policy year is \$6 million, and the maximum aggregate coverage for all claims in a policy year is \$8 million. We also require each franchisee to maintain general liability and professional liability insurance covering both the franchise and us, at coverage levels that we believe to be sufficient. These policies provide coverage on a claims-made or occurrence basis and have certain exclusions from coverage. These insurance policies generally must be renewed annually. There can be no assurance that our insurance coverage will be adequate to cover liability claims that may be asserted against us.

In addition, we carry property insurance coverage for the value of the physical assets, including drugs inventory, at all of our leased facilities. The deductible on our property policies is \$10,000 per claim, with higher deductibles applicable to certain other losses, such as wind and flood damage. These policies, which generally must be renewed annually, also include coverage for business interruption. While we believe our coverage to be sufficient, there can be no assurance that our property insurance coverage will be adequate to cover any and all property losses that we may suffer.

EMPLOYEES

As of December 31, 2006, we employed 1,954 persons on a full-time basis and 970 persons on a part-time basis. Of our full-time employees, 157 were corporate management and administrative personnel and the remaining 1,797 were employees of company-owned locations, primarily in clinical, management and administrative positions. The majority of our part-time employees are clinicians due to the nature and timing of the services we provide.

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Item 1A. RISK FACTORS

You should carefully consider the risks and uncertainties we describe below, together with all of the other information contained in this Annual Report on Form 10-K and our other filings with the Securities and Exchange Commission. Some of the following factors relate principally to our business and the industry in which we operate. Other factors relate principally to an investment in our common stock. (The risks and uncertainties described below are not the only risks and uncertainties that could develop. Other risks and uncertainties that we have not predicted or evaluated could also adversely affect our company.) If any of the following risks occur, our earnings, financial condition or business could be materially harmed, the trading price of our common stock could decline, and you could lose all or part of your investment.

Our revenue and profitability will decline if the pharmaceutical industry undergoes certain changes, including limiting or discontinuing research, development, production and marketing of the pharmaceuticals that are compatible with the services we provide.

Our business is highly dependent on the ability of biotech and other pharmaceutical companies to develop, supply and market pharmaceuticals that are compatible with the services we provide. Our revenue and profitability will decline if those companies were to sell pharmaceuticals directly to the public, fail to support existing pharmaceuticals or develop new pharmaceuticals with different administration requirements than our service offerings are currently equipped to handle. Our business could also be harmed if the pharmaceutical industry experiences any of the following developments:

supply shortages;

pharmaceutical recalls;

an inability to finance product development because of capital shortages;

a decline in product research, development or marketing;

a reduction in the retail price of pharmaceuticals;

changes in the FDA approval process; or

government or private initiatives that alter how pharmaceutical manufacturers, health care providers or pharmacies promote or sell products and services.

If we lose relationships with managed care organizations and other non-governmental third party payors, we could lose access to a significant number of patients and our revenue and profitability could decline.

We are highly dependent on reimbursement from managed care organizations and other non-governmental third party payors. For the fiscal years ended December 31, 2006, 2005 and 2004, respectively, 80%, 83% and 82% of our revenue came from managed care organizations and other non-governmental payors, including self-pay patients. Many payors seek to limit the number of providers that supply pharmaceuticals to their enrollees in order to build volume that justifies their discounted pricing. From time to time, payors with whom we have relationships require that we bid against our competitors to keep their business. As a result of such bidding process, we may not be retained, and even if we are retained, the prices at which we are able to retain the business may be reduced. The loss of a payor

relationship could significantly reduce the number of patients we serve and have a material adverse effect on our revenue and net income, and a reduction in pricing could reduce our gross margins and our net income.

Changes in the reimbursement rates or the loss of our contract with Blue Cross and Blue Shield of Florida would materially decrease our revenue.

Our largest managed care contract is with Blue Cross and Blue Shield of Florida, Inc. For the fiscal years ended December 31, 2006, 2005 and 2004, respectively, 13%, 13% and 15% of our revenue was related to this contract. The contract is terminable by either party on 90 days' notice and, unless terminated, renews annually.

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each September for an additional one-year term. The loss of this contract, or a material reduction in our pricing or pharmaceutical sales under this contract, would materially decrease our revenue and net income. Any reductions to or delays in collecting amounts reimbursable by Blue Cross and Blue Shield of Florida for our products or services could cause our revenue and profitability to decline and increase our working capital requirements.

Changes in reimbursement rates from Medicare and Medicaid for the services we provide may cause our revenue and profitability to decline.

For the fiscal years ended December 31, 2006, 2005 and 2004, respectively, 20%, 17% and 18% of our revenue came from reimbursement by federal and state programs such as Medicare and Medicaid. Reimbursement from these and other government programs is subject to statutory and regulatory requirements, administrative rulings, interpretations of policy, implementation of reimbursement procedures, retroactive payment adjustments, governmental funding restrictions and changes to or new legislation, all of which may materially affect the amount and timing of reimbursement payments to us. Changes to the way Medicare pays for our services may reduce our revenue and profitability on services provided to Medicare patients and increase our working capital requirements.

In addition, we are sensitive to possible changes in state Medicaid programs as we do business with a number of state Medicaid providers. Budgetary concerns in many states have resulted in and may continue to result in, reductions to Medicaid reimbursement as well as delays in payment of outstanding claims. Any reductions to or delays in collecting amounts reimbursable by state Medicaid programs for our products or services, or changes in regulations governing such reimbursements, could cause our revenue and profitability to decline and increase our working capital requirements.

Our actual financial results might vary from our publicly disclosed results and forecasts.

Our actual financial results might vary from those anticipated by us, and these variations could be material. From time to time we publicly provide earnings guidance. Our forecasts reflect numerous assumptions concerning our expected performance, as well as other factors, which are beyond our control, and which might not turn out to be correct. Although we believe that the assumptions underlying our projections are reasonable, actual results could be materially different. Our financial results are subject to numerous risks and uncertainties and estimates, including those identified throughout these Risk Factors and elsewhere in this report and the documents incorporated by reference.

Our gross profit could decrease if there are changes in the calculation of Average Wholesale Price (AWP) for the prescription drugs we sell, or if managed care organizations and other private payors replace AWP with a different reimbursement system.

Our gross margin margins are largely controlled by our ability to purchase prescription drugs at discounted prices and to negotiate profitable managed care contracts. Contracts for the services we provide generally reference certain published benchmarks to establish pricing for prescription drugs. These benchmarks include average wholesale price (AWP), wholesale acquisition cost (WAC) maximum allowable cost (MAC) and average sales price (ASP). Most of our contracts utilize the AWP standard as published by First DataBank and a number of other private companies. Recent events have raised uncertainties as to whether the AWP published by First DataBank will decline, resulting in a reduction of our gross profit margins.

Specifically, in the recently announced proposed settlement in the case *New England Carpenters Health Benefits Fund v. First DataBank, et al.*, (U.S. District Court, D. Mass.), a civil class action case brought against First DataBank, one of several companies that report data on prescription drug prices, First DataBank has agreed to reduce the markup to calculate AWP on over 8,000 specific pharmaceutical products by five percent. The proposed settlement has not yet received either preliminary or final court approval. We cannot predict the outcome of this case, or, if the settlement is

approved, the precise timing of any of the proposed AWP changes. In the absence of any mitigating action on our part, the proposed reduction in First DataBank's published AWP could reduce our revenue and narrow our gross profit margins.

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Some managed care organizations are adopting ASP as the standard measure for determining reimbursement rates in new or renegotiated contracts. To the extent that we are not able to negotiate new ASP-based contracts with managed care organizations that produce gross profit margins comparable to our existing AWP-based contracts, our revenue and gross profit may be reduced.

We are subject to pricing pressures and other risks involved with third party payors.

Competition for patients, efforts by traditional third party payors to contain or reduce healthcare costs, and the increasing influence of managed care payors such as health maintenance organizations, has resulted in reduced rates of reimbursement for home infusion and specialty pharmacy services. Changes in reimbursement policies of governmental third party payors, including policies relating to Medicare, Medicaid and other federal and state funded programs, could reduce the amounts reimbursed to our customers for our products and, in turn, the amount these customers would be willing to pay for our products and services, or could directly reduce the amounts payable to us by such payors. Pricing pressures by third party payors may continue, and these trends may adversely affect our business.

Also, continued growth in managed care plans has pressured healthcare providers to find ways of becoming more cost competitive. Managed care organizations have grown substantially in terms of the percentage of the population they cover and in terms of the portion of the healthcare economy they control. Managed care organizations have continued to consolidate to enhance their ability to influence the delivery of healthcare services and to exert pressure to control healthcare costs. A rapid concentration of revenue derived from individual managed care payors could harm our business.

If we do not adequately respond to competitive pressures, demand for our products and services could decrease.

The markets we serve are highly competitive and subject to relatively few barriers to entry. Local, regional and national companies are currently competing in many of the healthcare markets we serve and others may do so in the future. Some of our competitors have greater financial, technical, marketing and managerial resources than we have. Consolidation among our competitors, such as pharmacy benefit managers (PBMs) and regional and national infusion pharmacy or specialty pharmacy providers could result in price competition and other competitive factors that could cause a decline in our revenue and profitability. We expect to continue to encounter competition in the future that could limit our ability to grow revenue and/or maintain acceptable pricing levels.

Some biotech pharmaceutical suppliers in the specialty pharmacy industry have chosen to limit the number of distributors of their products. If we are not selected as a preferred distributor of one or more of our core products, our business and results of operations could be seriously harmed.

Some biotech pharmaceutical manufacturers attempt to limit the number of preferred distributors that may market certain of their biopharmaceutical products. If this trend continues, we cannot be certain that we will be selected and retained as a preferred distributor or can remain a preferred distributor to market these products. Although we believe we can effectively meet our suppliers' requirements, there can be no assurance that we will be able to compete effectively with other specialty pharmacy companies to retain our position as a distributor of each of our core products. Adverse developments with respect to this trend could have a material adverse effect on our business and results of operations.

Any termination of, or adverse change in, our relationships with a single source product manufacturer or the loss of supply of a specific, single source specialty drug could have a material adverse effect on our operations.

We sell biotech pharmaceuticals that are supplied to us by a variety of manufacturers, many of which are the only source of that specific pharmaceutical. In order to have access to these pharmaceuticals, and to be able to participate in the launch of new biotech pharmaceuticals, we must maintain good working relations with the manufacturers. Most of the manufacturers of the pharmaceuticals we sell have the right to cancel

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their supply contracts with us without cause and after giving only minimal notice. One biotech pharmaceutical, Synagis®, which is manufactured and distributed by MedImmune, Inc., represented 9.5%, 7.3% and 6.8% of our revenue, respectively, for the fiscal years ended December 31, 2006, 2005 and 2004. The loss of our relationship with MedImmune, Inc. or with one or more other biotech pharmaceutical manufacturer would reduce our revenue and profitability.

We have recently experienced rapid growth by acquisitions. If we fail to manage our growth effectively, our business could be disrupted and our operating results could suffer.

Our ability to successfully offer our products and services in evolving markets requires an effective planning and management process. In 2006, 2005 and 2004 combined, we completed 20 separate pharmacy business acquisitions, five of which were completed during 2006. Our growth through acquisitions, combined with the internal growth of our business based on our business plan, may place a strain on our management systems and resources. This growth has resulted in, and will continue to result in an increase in responsibilities for management. To accommodate our growth and compete effectively, we will need to continue to enhance, expand and improve our management and our operational and financial information systems and controls, and to expand, train, manage and motivate our workforce. Our personnel, systems, procedures, or controls may not be adequate to support our operations in the future in light of anticipated growth. In addition, if we focus our financial resources and management attention on the expansion of our operations rather than on our ongoing operations, our financial results may suffer.

If we are unable to acquire additional pharmacy facilities on favorable terms, we will be unable to execute our acquisition and development strategy.

Our strategy includes increasing our revenue and earnings through strategic acquisitions of infusion therapy pharmacies and related businesses. Our efforts to execute our acquisition strategy may be affected by our ability to identify suitable candidates and negotiate and close acquisitions. We continue to evaluate potential acquisition opportunities, including the acquisition of certain of our franchisees, and expect to complete acquisitions in the future. The facilities we purchase may require working capital from us during the initial months of operation, depending on whether or not we acquire receivables as part of the acquisition agreement. We may acquire businesses with significant unknown or contingent liabilities, including liabilities for failure to comply with health care or reimbursement laws and regulations. While we generally obtain contractual rights to indemnification from owners of the businesses we acquire, our ability to realize on any indemnification claims will depend on many factors, including, among other things, the availability of assets of the indemnifying parties. In the future, we may not be successful in acquiring pharmacies or in achieving satisfactory operating results at acquired pharmacies, and we may not be able to acquire healthcare businesses that produce returns justifying our related investment. Furthermore, we may not be able to obtain sufficient capital resources to fund our acquisitions at terms acceptable to us, or at all.

An impairment of goodwill on our financial statements could adversely affect our financial position and results of operations.

Our acquisitions have resulted in the recording of a significant amount of goodwill on our financial statements. Goodwill was recorded because the purchase price was in excess of the fair value of the net identifiable tangible and intangible assets acquired. We may not realize the full value of this goodwill. As such, we evaluate on at least an annual basis whether events and circumstances indicate that all or some of the carrying value of goodwill is no longer recoverable, in which case we would write off the unrecoverable goodwill as a charge against our earnings.

Since our growth strategy will likely involve the acquisition of other companies, we may record additional goodwill in the future. The possible write-off of this goodwill could negatively impact our future earnings. We will also be required to allocate a portion of the purchase price of any acquisition to the value of any intangible assets other than

goodwill that meet the criteria specified in the Statement of Financial Accounting Standards No. 141, Business Combinations, such as marketing, customer or contract-based intangibles. The

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amount allocated to these intangible assets could be amortized over a fairly short period, which may negatively affect our earnings.

As of December 31, 2006, we had goodwill of \$165.3 million, or 43.5% of our total assets and approximately 75.4% of stockholders' equity.

Changes in state and federal government regulation could restrict our ability to conduct our business.

The marketing, sale and purchase of pharmaceuticals and medical supplies and provision of healthcare services generally is extensively regulated by federal and state governments. Other aspects of our business are also subject to government regulation. We believe we are operating our business in compliance with applicable laws and regulations. The applicable regulatory framework is complex, and the laws are very broad in scope. Many of these laws remain open to interpretation and have not been addressed by substantive court decisions. Accordingly, we cannot provide any assurance that our interpretation would prevail or that one or more government agencies will not interpret them differently. Changes in the law or new interpretations of existing law can have a dramatic effect on what we can do, our cost of doing business and the amount of reimbursement we receive from governmental third party payors, such as Medicare and Medicaid. Also, we could be affected by interpretations of what the appropriate charges are under government programs.

Some of the healthcare laws and regulations that apply to our activities include:

The federal Anti-Kickback Statute prohibits individuals and entities from knowingly and willfully paying, offering, receiving, or soliciting money or anything else of value in order to induce the referral of patients or to induce a person to purchase, lease, order, arrange for, or recommend services or goods covered in whole or in part by Medicare, Medicaid, or other government healthcare programs. Although there are safe harbors under the Anti-Kickback Statute, some of our business arrangements and the services we provide may not fit within these safe harbors or a safe harbor may not exist that covers the arrangement. The Anti-Kickback Statute is an intent based statute and the failure of a business arrangement to satisfy all elements of a safe harbor will not necessarily render the arrangement illegal, but it may subject that arrangement to increased scrutiny by enforcement authorities. Violations of the Anti-Kickback Statute can lead to significant penalties, including criminal penalties, civil fines and exclusion from participation in Medicare and Medicaid.

The Stark Law prohibits physicians from making referrals to entities with which the physicians or their immediate family members have a financial relationship (i.e., an ownership, investment or compensation relationship) for the furnishing of certain Designated Health Services (DHS) that are reimbursable under Medicare. The Stark Law exempts certain business relationships which meet its exception requirements. However, unlike the Anti-Kickback Statute under which an activity may fall outside a safe harbor and still be lawful, a referral for DHS that does not fall within an exception is strictly prohibited by the Stark Law. A violation of the Stark Law is punishable by civil sanctions, including significant fines and exclusion from participation in Medicare and Medicaid.

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) provides federal privacy protections for individually identifiable health information. Through the adoption of the Privacy Rule, HIPAA set national standards for the protection of health information for providers and others who transmit health information electronically. In addition to regulating privacy of individual health information, HIPAA includes several anti-fraud and abuse laws, extends criminal penalties to private health care benefit programs and, in addition to Medicare and Medicaid, to other federal health care programs, and expands the Office of Inspector General's (OIG's) authority to exclude persons and entities from participating in the Medicare and Medicaid programs.

Pharmacies and pharmacists must obtain state licenses to operate and dispense pharmaceuticals. If we are unable to maintain our licenses or if states place burdensome restrictions or limitations on non-resident pharmacies, this could limit or affect our ability to operate in some states which could adversely impact our business and results of operations.

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We may become subject to federal and state investigations.

Both federal and state government agencies have heightened and coordinated civil and criminal enforcement efforts as part of numerous ongoing investigations of healthcare companies, as well as their executives and managers. These investigations relate to a wide variety of topics, including referral and billing practices. Further, amendments to the federal False Claims Act have made it easier for private parties to bring whistleblower lawsuits against companies. Some states have adopted similar state whistleblower and false claims provisions. The Office of the Inspector General of the Department of Health and Human Services and the Department of Justice have, from time to time, established national enforcement initiatives that focus on specific billing practices or other suspected areas of abuse. Some of our activities could become the subject of governmental investigations or inquiries. For example, we have significant Medicare and Medicaid billings. In addition, our executives, some of whom have worked at other healthcare companies that are or may become the subject of federal and state investigations and private litigation, could be included in governmental investigations or named as defendants in private litigation, resulting in adverse publicity against us. We are not aware of any governmental investigations involving any of our company-owned facilities or our executives. A future investigation of us could result in significant liabilities or penalties to us, as well as adverse publicity, and could seriously undermine our ability to compete for business, negotiate acquisitions, hire new personnel and otherwise conduct our business.

We may be subject to liability for the services we offer and the products we sell.

We and other participants in the health care market are, have been and are likely to continue to be subject to lawsuits based upon alleged malpractice, product liability, negligence or similar legal theories, many of which involve large claims and significant defense costs. A successful claim not covered by our professional liability insurance or substantially in excess of our insurance coverage could cause us to pay out a substantial award. In addition, we retain liability on claims up to the amount of our deductibles, which generally are \$250,000 per occurrence. Further, our insurance policy is subject to annual renewal and it may not be possible to obtain liability insurance in the future on acceptable terms, with adequate coverage against potential liabilities, or at all. Also, claims against us, regardless of their merit or eventual outcome, could be a serious distraction to management and could harm our reputation.

Labor strikes or similar work stoppages within the companies that provide our local and national distribution services could have a negative impact on our results of operations.

We utilize several national delivery companies as an important part of the local and national distribution of our products and services, particularly in the delivery of certain specialty pharmaceutical products. A portion of the workforce utilized by these delivery companies are members of labor unions. A labor strike or similar work stoppage within any of the delivery companies that we utilize for distribution could have a negative impact on our results of operations.

Our image and reputation may be harmed by actions taken by our franchisees that are outside of our control.

The majority of our local pharmacy locations are operated by franchisees. Franchisees are independent business owners and are not our subsidiaries or employees. Consequently, the quality of a franchised operation is dependent upon its owner(s) and manager(s). Franchisees may not successfully operate facilities or they may fail to comply with federal and state health care statutes and regulations. If they do not operate their franchises effectively or do not comply with applicable industry regulations, our image and reputation may suffer which could negatively impact our results of operations.

Our gross profit margins may decline if our franchise royalties are reduced.

We rely on royalty payments from our franchisees. For the fiscal years ended December 31, 2006, 2005 and 2004, we derived 0.8%, 1.4% and 1.9%, respectively, of our revenue from franchise royalties (excluding any acquisition settlement or termination gains). Our franchisees pay royalties on their gross receipts. Because

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there is no cost of goods sold associated with this revenue, franchise royalties and other fees represent a significant portion of our gross profit. For the fiscal years ended December 31, 2006, 2005 and 2004, royalties and other franchise fees represented 3.0%, 4.8% and 6.8%, respectively, of our gross profit. If our franchisees encounter business or operational difficulties, our revenue from royalties may be adversely affected. Such difficulties may also negatively impact our ability to sell new franchises. In addition, if we are unable to successfully attract new franchisees or if our existing franchise owners either do not enter into new franchise agreements with us when their current agreements expire or enter into new franchise agreements with royalty payment rates less favorable to us than current rates, our franchise revenue, gross profit and overall profitability will decline.

The loss of one or more of our key employees could harm our operations.

Our success depends upon the availability and performance of our key executives, including our Chief Executive Officer, Rajat Rai. We do not have key person insurance for any of our key executives. The loss of the services of Mr. Rai or any of our other key executives could have a material adverse effect upon our business and results of operations.

The current or future shortage in licensed pharmacists, nurses and other clinicians could adversely affect our business.

The healthcare industry is currently experiencing a shortage of licensed pharmacists, nurses and other healthcare professionals. Consequently, hiring and retaining qualified personnel will be difficult due to intense competition for their services and employment. Any failure to hire or retain pharmacists, nurses or other healthcare professionals could impair our ability to expand or maintain our operations.

The market price of our common stock may experience substantial fluctuations for reasons over which we have little control.

Our common stock is traded on the Nasdaq National Market. The stock price and the share trading volume for companies in the healthcare and health services industry is subject to significant volatility. Both company-specific and industry-wide developments, as well as changes to the overall condition of the US economy and stock market, may cause this volatility. The market price of our common stock could continue to fluctuate up or down substantially based on a variety of factors, including the following:

future announcements concerning us, our competitors, the pharmaceutical manufacturers and managed care companies with whom we have relationships or the health care market;

changes in operating results from quarter to quarter;

sales of stock by insiders;

changes in government regulations;

changes in estimates by analysts;

news reports relating to trends in our markets;

the seasonal nature of pharmaceuticals we offer, including Synagis®;

acquisitions and financings in our industry; and

the overall volatility of the stock market.

Furthermore, stock prices for many companies fluctuate widely for reasons that may be unrelated to their operating results. These fluctuations, coupled with changes in our results of operations and general economic, political and market conditions, may adversely affect the market price of our common stock.

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Increases in the per share market price of our common stock in future periods could result in dilution of our earnings per share.

Increases in the market price of our common stock may result in dilution of our earnings per share related to the conversion feature of our 2.25% convertible senior notes. In accordance with Emerging Issues Task Force (EITF) Issue 04-8, *The Effect of Contingently Convertible Instruments on Diluted Earnings per Share*, our diluted shares must include the dilutive effect of our convertible notes for periods during which the average market price of our common stock exceeds its conversion price per the terms of the notes during a given period. The conversion price is currently set at \$11.96 per share (subject to future adjustment, as needed). If the average market price of our common stock should exceed the conversion price per share in a given period, our diluted shares would increase, which could reduce our net income per diluted share for such period. For the fiscal years ended December 31, 2006 and 2005, the average market price of our common stock exceeded the conversion price in effect at the end of each period, resulting in dilution of our earnings. Our diluted shares as of December 31, 2006 and 2005 included approximately 600,000 shares related to the dilutive effects of our 2.25% senior convertible notes.

We may not have the ability to raise the funds to purchase our outstanding convertible senior notes on the purchase dates or upon a fundamental change or to pay the cash payment due upon conversion.

On each of November 1, 2009, November 1, 2014 and November 1, 2019, holders of our convertible senior notes may require us to purchase, for cash, all or a portion of their 2.25% senior convertible notes at 100% of their principal amount, plus any accrued and unpaid interest to, but excluding, that date. If a fundamental change occurs, holders of the notes may require us to repurchase, for cash, all or a portion of their notes. In addition, upon conversion of the notes, we will be required to pay the principal, or, in certain circumstances, other amounts, in cash. We may not have sufficient funds for any required repurchase of the notes. In addition, the terms of any borrowing agreements that we may enter into from time to time may require early repayment of borrowings under circumstances similar to those constituting a fundamental change. These agreements may also make our repurchase of notes, or the cash payment due upon conversion of the notes, an event of default under the agreements. If we fail to repurchase the notes or pay the cash payment due upon conversion when required, we will be in default under the indenture for the notes.

Our leverage, primarily relating to our outstanding 2.25% convertible senior notes, may harm our financial condition and results of operations.

Our total consolidated long-term debt as of December 31, 2006 was \$86.4 million, which represents 28.2% of our total capitalization as of that date. In addition, the indenture for our convertible senior notes will not restrict our ability to incur additional indebtedness.

Our level of indebtedness could have important consequences, because:

it could affect our ability to satisfy our obligations under the notes;

a portion of our cash flows from operations will have to be dedicated to interest and principal payments and may not be available for operations, working capital, capital expenditures, expansion, acquisitions or general corporate or other purposes;

it may impair our ability to obtain additional financing in the future;

it may limit our flexibility in planning for, or reacting to, changes in our business and industry; and

it may make us more vulnerable to downturns in our business, our industry or the economy in general.

Our certificate of incorporation, our bylaws, and Delaware law contain provisions that could discourage a change in control.

Some provisions of our certificate of incorporation and bylaws, as well as Delaware law, may be deemed to have an anti-takeover effect or may delay or make more difficult an acquisition or change in control not approved by our board of directors, whether by means of a tender offer, open market purchases, a proxy

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contest or otherwise. These provisions could have the effect of discouraging third parties from making proposals involving an acquisition or change in control, although such a proposal, if made, might be considered desirable by a majority of our stockholders. These provisions may also have the effect of making it more difficult for third parties to cause the replacement of our current management team without the concurrence of our board of directors.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

Our executive offices, located at 485 Half Day Road, Suite 300, Buffalo Grove, Illinois, 60089, consist of approximately 28,800 square feet of leased space, pursuant to a ten-year and three month lease that began in June 2002. Monthly base rent payments increase from approximately \$35,000 per month for the first year of the lease to approximately \$53,000 per month for the last year, plus applicable real estate taxes and maintenance costs. We have the option to accelerate the expiration date of this lease by three years upon payment of an acceleration fee.

In addition to our executive offices, we have over 77 facilities located in more than 73 cities throughout the United States, not including storage units. Our facilities, most of which contain pharmacies, warehouse space and administrative offices, are all leased, with remaining terms ranging from one month to approximately 7 years, and consist of approximately 535,000 square feet in total. The offices are in good condition, well maintained, and are adequate to fulfill our operational needs for the foreseeable future. We believe that if necessary, we could replace any of our leased facilities without significant additional cost or adverse affect on our business.

The following table provides summary information regarding our principal facilities as of December 31, 2006 with square feet of 15,000 or greater:

Location (City, State)	Approximate Square Footage	Services Provided by Facility
Ann Arbor, Michigan(1)	29,400	Specialty drug distribution; infusion pharmacy
Buffalo Grove, Illinois	28,800	Corporate headquarters
Las Vegas, Nevada	20,900	Infusion pharmacy; RT/DME
Miramar, Florida	20,500	Specialty drug distribution; infusion pharmacy; RT/DME
Wood Dale, Illinois	19,900	Infusion pharmacy; RT/DME
Dallas, Texas	15,900	Infusion pharmacy; RT/DME
Roseville, MN	15,000	Infusion pharmacy

(1) We lease two adjacent facilities in Ann Arbor, Michigan totaling 29,400 square feet.

Item 3. LEGAL PROCEEDINGS

From time to time, we are named as a party to legal claims and proceedings in the ordinary course of business. Additionally, from time to time, governmental and regulatory agencies may initiate investigations or proceedings against us in the ordinary course of business, or which have general application to the businesses we operate. Presently, we are not aware of any claims, investigations or proceedings against us or any of our franchisees that we

believe are likely to have a material adverse effect on our results of operations or financial condition.

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

There were no matters submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2006.

Table of Contents**PART II****Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER REPURCHASES OF EQUITY SECURITIES****PRICE RANGE OF COMMON STOCK**

Option Care is traded on the Nasdaq Stock Market LLC under the symbol **OPTN**. The following table shows the high and low bid prices for our common stock for the periods indicated.

Calendar Quarter	High	Low
2006		
Fourth Quarter	\$ 14.62	\$ 12.06
Third Quarter	\$ 13.85	\$ 10.97
Second Quarter	\$ 14.60	\$ 10.34
First Quarter	\$ 14.47	\$ 12.89
2005		
Fourth Quarter	\$ 14.97	\$ 11.39
Third Quarter	\$ 15.11	\$ 12.71
Second Quarter	\$ 14.72	\$ 12.47
First Quarter	\$ 14.13	\$ 10.58

On March 1, 2007, the closing price of our common stock on the Nasdaq National Market was \$13.13. As of March 1, 2007, there were 281 holders of record reported to us by our transfer agent, U.S. Stock Transfer Corporation.

All share and per share amounts in this Annual Report on Form 10-K have been adjusted to reflect the following stock splits:

3-for-2 split completed April 1, 2005 for stockholders of record as of March 17, 2005

5-for-4 split completed May 1, 2002 for stockholders of record as of April 10, 2002.

CASH DIVIDEND POLICY

In May 2004, our Board of Directors authorized the adoption of a quarterly dividend policy. Each quarter, our Board of Directors will determine the dividend amount per share. During 2006, our Board declared \$0.02 per share dividends in each quarter. During 2005, our Board declared a \$0.0133 per share dividend in the quarter ended March 31, and \$0.02 per share dividends in each of the quarters ended June 30, September 30 and December 31.

ISSUER PURCHASES OF EQUITY SECURITIES

Total Number of	Maximum Dollar
	Value of Shares

Period	Total Number of Common Shares Purchased	Average Price Paid per Share	Shares Purchased as	that May Yet Be Purchased Under the Plan or Program (In thousands)
			Part of Publicly Announced Plan or Program	
October 2006				\$
November 2006(1)	559,700	\$ 13.50		\$
December 2006				\$
TOTAL	559,700	\$ 13.50		\$

- (1) On November 9, 2006, pursuant to terms contained in our purchase agreement to acquire Trinity Homecare, LLC, we repurchased the 559,700 shares that were issued as partial consideration for the purchase. On December 1, 2006, we signed an amendment to the purchase agreement and reissued these shares at the same price we paid.

Table of Contents**STOCK PERFORMANCE GRAPH**

The graph below compare the cumulative stockholder return on our common stock with the cumulative total return on the S&P 500 and the Dow Jones U.S. Healthcare Index for the five-year period ended December 31, 2006, assuming the investment of \$100 in each on December 31, 2001. For purposes of preparing the graph, we assumed that all dividends were reinvested at the time they were paid. Past financial performance should not be considered to be a reliable indicator of future performance and investors should not use historical trends to anticipate results or trends in future periods.

	12/31/2001	12/31/2002	12/31/2003	12/31/2004	12/31/2005	12/31/2006
Option Care common stock	100	51	68	110	128	137
S&P 500 index	100	77	97	106	109	124
Dow Jones U.S. Healthcare Index	100	78	92	95	102	107

Table of Contents**Item 6. *SELECTED CONSOLIDATED FINANCIAL DATA***

The table below provides you with certain of our summary historical financial data. We have prepared this information using our consolidated financial statements for the five years ended December 31, 2006, which have been audited by Ernst & Young LLP, independent registered public accounting firm. The selected consolidated financial data reflects our acquisitions, all of which were accounted for using the purchase method of accounting. This summary should be read in conjunction with our Consolidated Financial Statements and Notes thereto, and Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations.

Consolidated Statement of Income data (in thousands, except per share data):

	Years Ended December 31,				
	2006	2005	2004	2003	2002
Revenue	\$ 659,412	\$ 504,578	\$ 414,430	\$ 355,440	\$ 320,496
Cost of revenue:					
Cost of goods	409,931	304,346	251,613	205,916	183,329
Cost of service	69,897	53,435	43,969	41,592	37,692
Total cost of revenue	479,828	357,781	295,582	247,508	221,021
Gross profit	179,584	146,797	118,848	107,932	99,475
Operating expenses	141,773	113,117	91,303	96,309	79,110
Operating income	\$ 37,811	\$ 33,680	\$ 27,545	\$ 11,623	\$ 20,365
Net income from continuing operations	\$ 22,568	\$ 20,889	\$ 16,548	\$ 6,499	\$ 12,015
Loss on discontinued operations, net of income taxes	(883)	(271)			
Net income	\$ 21,685	\$ 20,618	\$ 16,548	\$ 6,499	\$ 12,015
Net income from continuing operations per common share diluted	\$ 0.64	\$ 0.61	\$ 0.51	\$ 0.20	\$ 0.38
Net income per common share diluted	\$ 0.61	\$ 0.60	\$ 0.51	\$ 0.20	\$ 0.38
Weighted average number of shares and equivalents outstanding diluted	35,467	34,234	32,631	31,956	31,650
Dividends paid per common share	\$ 0.08	\$ 0.07	\$ 0.04	\$	\$

Consolidated Balance Sheet data (in thousands):

	As of December 31,				
	2006	2005	2004	2003	2002
Working capital	\$ 117,095	\$ 131,824	\$ 158,453	\$ 56,777	\$ 61,710
Total assets	376,385	313,448	272,840	168,997	160,472
Current portion of long-term debt	23	48	19	424	261
Other current liabilities	59,210	39,701	28,392	30,193	27,194
Long-term debt, less current portion	86,372	86,306	86,306	82	7,314
Stockholders' equity	219,363	180,166	149,556	131,483	120,223

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

The following discussion should be read in conjunction with our financial statements and related notes in Item 8. This discussion contains forward-looking statements. Please see Forward-Looking Statements and Item 1A. Risk Factors for a discussion of the uncertainties, risks and assumptions associated with these statements.

OVERVIEW

We provide specialty pharmacy services and home infusion and other healthcare services to patients at home or at other alternate sites such as infusion suites and physician's offices. We contract with managed care organizations and other third party payors who reimburse us for the services we provide to their subscribers. Our services are provided by our two company-owned, high-volume distribution facilities, 58 company-owned and managed locations and 53 franchised locations.

The year 2006 was marked by strong increases in revenue and net income, continued execution of our acquisition growth strategy, as well as a number of strategic initiatives designed to pave the way for continued growth in the year 2007 and beyond. We have developed and refined an ongoing, comprehensive growth strategy that integrates organic growth through enhanced sales and marketing activities, acquisitions of existing pharmacy businesses, start-up businesses in new and existing markets, and joint ventures with established hospital systems.

Revenue grew by 30.7% in 2006 to \$659.4 million from \$504.6 million in 2005. This growth was primarily due to business acquisitions and organic growth in our company-owned facilities. Infusion and related healthcare revenue increased by 29.7% while specialty pharmacy services revenue increased by 35.8% due in part to increased sales of Synagis®, blood clotting factor, and IVIG immune globulin products. Our revenue growth resulted in net income of \$21.7 million for the year 2006, an increase of 5.2% over the prior year.

During 2006, we used \$45.1 million in cash and \$12.7 million in stock to complete five acquisitions. During 2005, we used \$54.6 million in cash and \$1.5 million in stock to complete ten acquisitions. Our acquisitions were accretive to earnings and will solidify our positions in existing markets and establish our position in new markets.

The majority of our revenue is generated from managed care contracts and other agreements with commercial third party payors. Our largest managed care contract is with Blue Cross and Blue Shield of Florida, Inc. (BC/BS of Florida). This contract represented 13%, 13% and 15% of our revenue for the years 2006, 2005 and 2004, respectively. As of December 31, 2006 and 2005, 9% of Option Care's accounts receivable was due from BC/BS of Florida. Our contract with BC/BS of Florida is terminable by either party at any time upon 90 days' notice and, unless terminated, renews automatically each September for an additional one-year term. This contract renewed in September 2006 with no material changes.

During 2006, we signed a new managed care contract with Blue Cross and Blue Shield of Michigan to be exclusive provider of specialty pharmacy drugs and services to their members. We believe that this contract may represent 10% or more of our revenue during 2007. We prepared our operations for the added volume during the second and third quarters of 2006 and began fully delivering service under this contract in October 2006.

We generate revenue from governmental healthcare programs such as Medicare and Medicaid. For the years 2006, 2005 and 2004, respectively, 20%, 17% and 18% of our revenue came from these governmental healthcare programs. As of December 31, 2006 and 2005, respectively, 19% and 22% of total accounts receivable were due from these

programs.

On February 18, 2005, our Board of Directors authorized a 3-for-2 stock split effective March 31, 2005 for stockholders of record as of March 17, 2005. All share and per share amounts in this Annual Report on Form 10-K have been adjusted to reflect this split.

Table of Contents**RESULTS OF OPERATIONS**

Effective January 1, 2006, we adopted SFAS No. 123(R), Share-Based Payment, utilizing the modified retrospective method. Accordingly, we have restated our results of operations for the years ended December 31, 2005 and 2004. For detailed information regarding this restatement, please see Note 1(j) in our Notes to Consolidated Financial Statements.

The following table shows certain statement of income items expressed in amounts and percentage of revenue for the years ended December 31, 2006, 2005 and 2004 (amounts in thousands).

	Years ended December 31,					
	2006		2005		2004	
	Amount	% of Revenue	Amount	% of Revenue	Amount	% of Revenue
Revenue:						
Specialty pharmacy	\$ 394,901	59.9%	\$ 290,884	57.7%	\$ 249,697	60.2%
Infusion and related healthcare services	255,393	38.7%	196,893	39.0%	153,302	37.0%
Other	9,118	1.4%	16,801	3.3%	11,431	2.8%
Total revenue	659,412	100.0%	504,578	100.0%	414,430	100.0%
Cost of revenue:						
Cost of goods	409,931	62.2%	304,346	60.3%	251,613	60.7%
Cost of service	69,897	10.6%	53,435	10.6%	43,969	10.6%
Total cost of revenue	479,828	72.8%	357,781	70.9%	295,582	71.3%
Gross profit	179,584	27.2%	146,797	29.1%	118,848	28.7%
Operating expenses:						
Selling, general and administrative	122,371	18.6%	99,763	19.8%	81,878	19.8%
Depreciation and amortization	4,934	0.7%	3,687	0.7%	2,810	0.7%
Provision for doubtful accounts	14,468	2.2%	9,667	1.9%	6,615	1.6%
Total operating expenses	141,773	21.5%	113,117	22.4%	91,303	22.1%
Operating income	37,811	5.7%	33,680	6.7%	27,545	%
Other expenses, net:						
Interest income	1,364	%	2,363	0.1%	323	%
Interest expense	(2,139)	(0.1)%	(1,966)	(0.1)%	(252)	%
Other expense, net	(895)	(0.1)%	(248)	%	(307)	%
Total other income (expense), net	(1,670)	(0.2)%	149	%	(236)	%
	36,141	5.5%	33,829	6.7%	27,309	6.6%

Income from continuing operations before income taxes						
Provision for income taxes	13,573	2.1%	12,940	2.6%	10,761	2.6%
Net income from continuing operations	\$ 22,568	3.4%	\$ 20,889	4.1%	\$ 16,548	4.0%
Discontinued operations:						
Loss on discontinued operations, net of income taxes	(883)	(0.1)%	(271)	%		%
Net income	\$ 21,685	3.3%	\$ 20,618	4.1%	\$ 16,548	4.0%

Revenue:

Our revenue for 2006 was \$659.4 million, an increase of \$154.8 million, or 30.7%, over our 2005 revenue of \$504.6 million. Infusion and related healthcare services revenue increased by \$58.5 million, or 29.7%, over 2005 as a result of execution of our acquisitions growth strategy and organic growth that resulted from our continuing sales and marketing efforts. Specialty pharmacy services revenue increased by \$104.0 million, or 35.8% over the prior year. This increase was primarily related to higher sales of a variety of specialty drugs, such as Synagis®, blood clotting factor, IVIG immune globulin, and the revenue generated from the new specialty pharmacy services agreement we signed in 2006 with Blue Cross and Blue Shield of Michigan.

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In 2005, our revenue was \$504.6 million, an increase of \$90.2 million, or 21.8%, over the prior year revenue of \$414.4 million. Infusion and related healthcare services revenue increased by \$43.6 million, or 28.5%, over 2004 as a result of execution of our acquisitions growth strategy and organic growth that resulted from our continuing sales and marketing efforts. Specialty pharmacy services revenue increased by \$41.2 million, or 16.5% over the prior year. This increase was primarily related to higher sales of Synagis®, human growth hormone, Xolair® and a variety of other specialty drugs through our two company-owned, high-volume distribution facilities and our network of company-owned pharmacy locations, as well as from the effect of acquisitions.

While we are able to separately identify our costs between goods and services, we cannot separate our revenue accordingly. For our typical infusion therapy patient, we provide both pharmaceutical products and nursing and other services. Often, a portion of our revenue consists of a per diem payment that represents a combined reimbursement for certain goods and services. Therefore, discrete revenue from services versus the sale of goods is not available.

Specialty pharmacy revenue:

Specialty pharmacy revenue consists of our distribution of specialty pharmaceutical products to patients' homes or other non-hospital settings such as physicians' offices on behalf of manufacturers, managed care companies or, to a lesser extent, government healthcare programs. Our specialty pharmacy revenue is derived from sales by our two company-owned, high-volume distribution facilities and our 58 company-owned pharmacies. Specialty pharmacy revenue also includes fees received from biotech drug manufacturers for providing clinical compliance and patient outcomes data for specific products.

In 2006, our specialty pharmacy revenue was \$394.9 million, an increase of \$104.0 million, or 35.8%, over the prior year. A significant percentage of this increase was attributable to the continued growth in sales volume of Synagis®, blood clotting factor, and IVIG. Our Synagis® revenue reached \$62.9 million in 2006, representing growth of 70.9% over the prior year. In addition to the increased sales of Synagis®, blood clotting factor, and IVIG, we generated double-digit increases in several other specialty therapies due principally to our ongoing sales and marketing efforts, the effect of our acquisitions and revenue generated from the new specialty pharmacy services agreement we signed during 2006 with Blue Cross and Blue Shield of Michigan.

In 2005, our specialty pharmacy revenue was \$290.9 million, an increase of \$41.2 million, or 16.5%, over the prior year. A significant percentage of this increase was attributable to sales volume of Synagis®, as well as double-digit increases in sales of blood clotting factor and a variety of other specialty therapies throughout our network of company-owned pharmacies.

During portions of October and November 2005, our high-volume specialty distribution center located in Miramar, Florida experienced a significant business interruption due to Hurricane Wilma, which negatively impacted our specialty pharmacy revenue. We filed a business interruption insurance claim for lost revenue and gross profit for the period immediately following the hurricane and recorded settlement revenue of \$400,000 during 2005, which was recorded as Specialty pharmacy revenue in our Consolidated Statement of Income for that year in accordance with EITF Issue 01-13, *Income Statement Display of Business Interruption Insurance Recoveries*. Operations at this facility returned to normal by December 2005.

Table of Contents**Infusion and related healthcare services revenue:**

The following table sets forth our infusion and related healthcare services revenue by service type (amounts in thousands):

	Years Ended December 31,					
	2006		2005		2004	
	Amounts	% of Total Revenue	Amounts	% of Total Revenue	Amounts	% of Total Revenue
Infusion and related healthcare services:						
Infusion therapies	\$ 219,293	33.3%	\$ 170,290	33.8%	\$ 131,037	31.6%
Other related healthcare services	36,100	5.4%	26,603	5.2%	22,265	5.4%
Total	\$ 255,393	38.7%	\$ 196,893	39.0%	\$ 153,302	37.0%

Infusion and related healthcare services includes the provision of home infusion therapies, respiratory therapy and durable medical equipment sales and rentals (RT/DME) and home healthcare services provided by our company-owned pharmacies.

In 2006, infusion and related healthcare services revenue was \$255.4 million, an increase of \$58.5 million, or 29.7%, over the prior year. Infusion therapy increased by \$49.0 million, or 28.8%, while other related healthcare services increased by \$9.5 million, or 35.7%. These increases were driven by both acquisitions and organic growth, and were across a wide variety of therapies.

In 2005, infusion and related healthcare services revenue was \$196.9 million, an increase of \$43.6 million, or 28.5%, over the prior year. Infusion therapy increased by \$39.3 million, or 30.0%, while other related healthcare services increased by \$4.3 million, or 19.5%. We focused in 2005 on expanding our provision of infusion therapy through focused sales efforts and continued quality of service. As a result of these efforts, we generated higher revenue from most of our company-owned pharmacies. Our growth was across multiple therapies, including anti-infective, nutritional and chemotherapy.

Other revenue:

Other revenue primarily consists of franchise-related revenue and software revenue. Franchise-related revenue consists of royalties and other fees generated from our franchise network, gains recognized in connection with the settlement of pre-existing franchise relationships with franchisees we acquire, fees from the termination of a franchise from the network prior to the scheduled expiration of its underlying franchise agreement, and vendor rebates earned from our franchisees' purchases under Option Care's contracts with manufacturers and vendors. In 2005 and 2004, other revenue included software license fees, support and training fees generated by our subsidiary, MBI.

For 2006, we recorded other revenue of \$9.1 million representing a decrease of \$7.7 million, or 45.7%, compared to the prior year. Royalty revenue declined to \$5.4 million in 2006 compared to \$7.1 million in 2005 due to our

acquisition and termination of several franchises. Franchise settlement revenue recorded in connection with acquisitions and terminations declined to \$1.7 million in 2006 compared to \$6.6 million in 2005, primarily because we acquired fewer franchises in 2006. Fees related to our collection of non-acquired accounts receivable of businesses we purchased in 2005 generated \$300,000 in revenue in 2006 compared to \$1.2 million in revenue in the prior year. Our sale of MBI in December 2005 resulted in a \$1.0 million decline in other revenue from software sales and licensing. Offsetting these declines, joint venture management fees increased by \$600,000 during the year.

For 2005, we recorded other revenue of \$16.8 million representing an increase of \$5.4 million, or 47.0%, over the prior year. Of the 2005 revenue, \$13.7 million consisted of franchise royalties and related fees, of which \$7.1 million was royalties, \$4.6 million were gains recognized in connection with settlement of our pre-existing relationships with franchises we acquired and \$2.0 million was franchise early termination fees. In

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2004, royalty revenue was \$9.3 million. Software-related revenue decreased by \$300,000 in 2005 due to our disposal of MBI in December 2005.

Cost of revenue:

Our cost of revenue consists of the cost of goods sold and services provided to our patients. Cost of goods primarily consists of the cost of infusion and specialty pharmaceutical products, durable medical equipment and ancillary medical supplies provided to our patients. Cost of service includes the salaries, wages and other costs related to our provision of nursing and pharmacy services, as well as our cost to deliver pharmaceutical products and durable medical equipment to our patients.

Cost of goods:

For 2006, our cost of goods was \$409.9 million, representing an increase of \$105.5 million, or 34.7%, over the prior year's \$304.4 million cost of goods. This increase was primarily related to our \$154.8 million increase in revenue due to acquisitions and same store sales growth. As a percentage of revenue, cost of goods increased from 60.3% in 2005 to 62.2% in 2006. There were two main factors contributing to this overall change to our cost of goods as a percentage of revenue. The first factor was a higher mix of specialty pharmacy revenue in 2006 due to acquisitions, increased sales of Synagis, and our new specialty pharmacy contract with Blue Cross and Blue Shield of Michigan. Specialty pharmacy services have a higher cost of goods component than our other core business, infusion pharmacy services. The second factor was our \$7.7 million decrease in other revenue, the majority of which had no associated cost of goods.

For 2005, our cost of goods was \$304.3 million, representing an increase of \$52.7 million, or 21.0%, over the prior year's \$251.6 million cost of goods. This increase was related to our \$90.2 million increase in revenue over this period. As a percentage of revenue, cost of goods decreased from 60.7% for 2004 to 60.3% for 2005. The primary factor contributing to the reduction in cost of goods as a percentage of revenue was the higher mix of infusion therapy revenue in 2005 as a result of our acquisitions completed during the year. Another significant factor was our \$5.4 million increase in other revenue, the majority of which had no associated cost of goods. These two factors were partially offset by an increase in the cost of specialty pharmacy products due to a shift in product mix toward certain higher cost products, as well as an increase in the purchase cost for IVIG specialty pharmaceutical products in 2005 due to supply shortages.

We receive rebates and vendor administration fees from various drug and medical supply manufacturers and vendors based on the volume of purchases by our company-owned pharmacies and our franchised pharmacies and subject to the terms of our underlying agreements with these suppliers. Rebates earned from purchases by our company-owned pharmacies are recorded as reductions to cost of goods sold. In 2006, 2005 and 2004, vendor rebates reduced our cost of goods by \$3.5 million, \$2.9 million and \$3.5 million, respectively. In addition to rebates, we also receive prompt payment discounts from a number of our drug and medical supply vendors. In 2006, 2005 and 2004, we recorded prompt payment discounts of approximately \$1.8 million, \$1.1 million and \$1.0 million, respectively.

Cost of service:

Our cost of service for 2006 was \$69.9 million, an increase of \$16.5 million, or 30.8%, over the prior year. As a percentage of revenue, cost of service was equal to 10.6% in both 2006 and 2005. The consistency in cost of service as a percentage of revenue was partly due to our current year increase in infusion therapy services, which have a larger service component than specialty pharmacy services, offset by a \$7.7 million decrease in other revenue which has no associated cost of service and an increase in specialty pharmacy revenue as a percentage of total revenue.

Our cost of service for 2005 was \$53.4 million, an increase of \$9.5 million, or 21.5%, over the prior year. As a percentage of revenue, cost of service held steady at 10.6% in both 2005 and 2004. The consistency in cost of service as a percentage of revenue was due to the increase in specialty pharmacy services, which have a smaller service component than infusion and related healthcare services, offset by the \$5.4 million increase in other revenue from gains associated with the settlement of pre-existing franchise relationships with

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franchisees we acquired in 2005 and a gain from the early termination of one franchise, which had no associated cost of service.

Gross profit:

The following table sets forth the gross profit margin (defined as gross profit divided by total revenue, expressed as a percentage) for each of our service lines for the periods indicated:

	Years Ended December 31,		
	2006	2005	2004
Gross profit margin:			
Specialty pharmacy	14.6%	15.5%	16.6%
Infusion and related healthcare services	44.2%	43.3%	43.4%
Other	100.0%	97.9%	95.0%
Overall gross profit margin	27.2%	29.1%	28.7%

In 2006, our gross profit was \$179.6 million, or 27.2% of revenue, compared to \$146.8 million, or 29.1% of revenue, in the prior year. The overall decrease in our gross profit margin was primarily due to a continued shift in business mix as our growth in specialty pharmacy outpaced our growth in infusion and related services, and was also due to a decrease in other revenue. Our infusion and related healthcare services gross profit margin increased from 43.3% in 2005 to 44.2% in 2006. This was primarily due to an increase in revenue from RT/DME services and a simultaneous decrease in the related cost of goods. Our specialty pharmacy gross profit margin declined from 15.5% in 2005 to 14.6% in 2006. This continued decline in gross profit margin percentage was due to our continued growth in revenue from higher cost drugs such as Synagis® and expansion of our specialty pharmacy distribution business through our new contract with Blue Cross and Blue Shield of Michigan.

In 2005, our gross profit was \$146.8 million, or 29.1% of revenue, compared to \$118.8 million, or 28.7% of revenue, in the prior year. The overall increase in our gross profit margin was primarily due to an increase in the relative mix of infusion and related healthcare revenues, which has a lower cost of goods component than specialty pharmacy services revenue, and an increase in other revenue. Overall, our infusion and related healthcare services gross profit margin remained steady at 43.3% in 2005 compared to 43.4% in 2004. Our specialty pharmacy gross profit margin declined from 16.6% in 2004 to 15.5% in 2005. This decrease in gross profit margin percentage was due to our continued growth in revenue from higher cost drugs such as Xolair® and Synagis®, as well as a significant increase in the cost of IVIG immune globulin products in 2005.

Selling, general and administrative expenses:

For 2006, our selling, general and administrative (SG&A) expenses totaled \$122.4 million, an increase of \$22.6 million, or 22.7%, over the prior year. As a percentage of revenue, selling, general and administrative expenses decreased from 19.8% in 2005 to 18.6% in 2006 due to the growth of our specialty pharmacy services, which require less SG&A support than infusion services. Of the \$22.6 million increase, \$13.3 million was in wages and related expenses, which increased by approximately 19.0% over the prior year. Building rent and related costs increased by \$3.1 million over the prior year, as we added facilities leases assumed in connection with acquisitions completed during 2006. Fees related to outside professional services increased by \$1.4 million over the prior year.

For 2005, our selling, general and administrative expenses totaled \$99.8 million, an increase of \$17.9 million, or 21.8%, over the prior year. This increase was primarily due to an increased mix of infusion services, which have

greater infrastructure needs and produce higher SG&A costs, and an increase in corporate investments to support various strategic initiatives. Of the \$17.9 million increase, \$12.7 million was in wages and related expenses, which increased by approximately 22.2% over the prior year. The increase in wages was due in part to new hires made in connection with acquisitions completed during 2005 as well as continued growth within our existing locations as the total number of employees at company-owned locations increased by 31.0% from 2004. In addition, staffing levels at our corporate office increased by 22% in 2005 as we

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continued to expand our infrastructure to accommodate current and future growth in our business. Fees for outside professional services increased \$2.4 million over the prior year, of which \$2.0 million was attributable to various projects designed to improve operations and produce efficiencies that will benefit future periods, while \$400,000 was directly related to acquisitions we completed during 2005. Facilities rent and related costs increased by \$900,000 over the prior year, as we increased the total square footage of our facility space by approximately 35%, primarily due to facilities leases assumed in connection with acquisitions completed during 2005.

Depreciation and amortization:

Depreciation within this caption includes infrastructure items such as computers, office equipment and leasehold improvements. Depreciation of revenue-generating assets, such as medical equipment rented to patients and delivery vehicles, is included in cost of revenue.

For 2006, our depreciation and amortization expense of assets not directly utilized in the delivery of goods and services was \$4.9 million, an increase by \$1.2 million, or 33.8% over the prior year. This increase was primarily due to assets added in connection with acquisitions and start-ups completed during 2006.

For 2005, our depreciation and amortization expense of assets not directly utilized in the delivery of goods and services was \$3.7 million, an increase by \$900,000, or 31.2% over the prior year. This increase was primarily due to assets added in connection with acquisitions completed during 2005.

Provision for doubtful accounts:

In 2006, our provision for doubtful accounts was \$14.5 million, or 2.2% of revenue. This represents an increase of \$4.8 million from the \$9.7 million provision for doubtful accounts in 2005, due primarily to our increase in total revenues. In general, we record a higher provision for doubtful accounts for revenue generated from our locally delivered services than from our central distribution facilities. This difference in provision rates reflects the difference in collection risk involved in these services as the services from our central distribution facilities are billed under pharmacy benefits whereas the services from our local pharmacies are typically billed under major medical benefits and typically require higher patient co-payments and deductibles. The increase in our provision for doubtful accounts as a percentage of revenue from 1.9% in 2005 to 2.2% in 2006 was due partly to the net addition of five local pharmacy locations and the \$7.7 million decrease in other revenue, thereby increasing the relative mix of revenues with higher associated collection risk.

In 2005, our provision for doubtful accounts was \$9.7 million, or 1.9% of revenue. This represents an increase of \$3.1 million from the \$6.6 million provision for doubtful accounts in 2004, due primarily to our increase in total revenues.

Interest income:

We recorded \$1.4 million in interest income in 2006 compared to \$2.4 million in the prior year. This decline was primarily due to our use of cash reserves and liquidation of short-term investments to fund business acquisitions, for which we used \$45.1 million in cash in 2006. Due to our acquisition activities, we began 2006 with unrestricted cash and short-term investments totaling \$47.9 million and ended the year with unrestricted cash and short-term investments of \$8.9 million.

Our 2005 interest income was \$2.4 million compared to just \$300,000 in 2004. In November 2004, we completed an \$86.3 million offering of 2.25% convertible senior notes. Our interest income growth in 2005 is attributable to short-term investments purchased with the proceeds from this offering.

Interest expense:

In 2006, we recorded interest expense of \$2.1 million compared to \$2.0 million in the prior year. For each year, our interest expense consists principally of interest payable to holders of our \$86.3 million in 2.25% convertible senior notes.

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In 2005, we recorded interest expense of \$2.0 million compared to \$300,000 in 2004. In each year, our interest expense was almost entirely related to our \$86.3 million offering of 2.25% convertible senior notes, which we completed on November 2, 2004.

Income tax provision:

In 2006, we provided \$13.6 million for income taxes on our pre-tax income from continuing operations of \$36.1 million. This equates to an overall effective income tax rate of 37.6%. In the prior year, we recorded an income tax provision of \$12.9 million on pre-tax income from continuing operations of \$33.8 million, for an effective income tax rate of 38.3%. The slight decline in provision rate was primarily due to reduction of an excess provision for prior year income taxes and various tax planning initiatives. We anticipate that our effective income tax rate will increase slightly in 2007 due to increased business in states with higher statutory income tax rates.

For the year 2005, our provision for income taxes was \$12.9 million on pre-tax income of \$33.8 million, compared to provision for income taxes of \$10.8 million pre-tax income of \$27.3 million of pre-tax income in 2004. The effective income tax provision rate was 38.3% in 2005 compared to 39.4% for 2004. The decrease in our provision rate was primarily due to an increase in tax-exempt interest income from our short-term investments during 2005.

Net income and net income per share from continuing operations:

Our net income from continuing operations was \$22.6 million in 2006 compared to \$20.9 million in 2005. This increase of \$1.7 million, or 8.0%, was primarily driven by our growth through acquisitions and increased penetration of the specialty pharmacy market, the effects of which more than offset a decline in franchise settlement revenue. Net income from continuing operations per diluted share grew to \$0.64 in 2006 from \$0.61 in 2005, an increase of 4.9%. Diluted shares increased to 35.5 million in 2006 from 34.2 million in the prior year, primarily due to shares issued in connection with business combinations and shares issued to employees who exercised stock options or participated in our employee stock purchase plan. Our diluted shares in 2006 and 2005 include a 600,000 share dilutive effect of our 2.25% convertible senior notes. Our notes are considered dilutive if the average market price of our stock exceeds the conversion price.

Our net income from continuing operations for 2005 was \$20.9 million compared to \$16.5 million in the prior year, an increase of \$4.4 million, or 26.2%. The increase was principally due to our revenue growth during the year, which was the result of our focused sales and marketing efforts, the ten acquisitions we completed during 2005 and franchise settlement gains related to four of these acquisitions, which were of independent Option Care franchises. Our diluted earnings per share were \$0.61 in 2005 compared to \$0.51 in 2004, an increase of 19.6%. Total diluted shares increased to 34.2 million in 2005 from 32.6 million in 2004 due to new shares issued to employees who exercised stock options or participated in our employee stock purchase plan during the year, as well as the 600,000 share increase in the dilutive effect of our 2.25% convertible senior notes. Our notes are considered dilutive if the average market price of our stock exceeds the conversion price, which was set at \$11.99 per share as of December 31, 2005. There was no dilutive effect of these notes for 2004.

We completed a 3-for-2 split of our common stock effective March 31, 2005 for stockholders of record on March 17, 2005. All share and per share amounts disclosed in this Annual Report on Form 10-K have been adjusted to reflect the pro forma effects of this split.

Loss from discontinued operation, net of income tax:

In 2006, we adopted a plan to sell or dispose of two small and unprofitable home health agencies that did not fit into our strategic plans. We completed the sale of our home health agency in Portland, Oregon and shut down the operations of our home health agency in Phoenix, Arizona during the quarter ended September 30, 2006. In 2006 and 2005, we recorded losses, net of income tax benefit, of \$883,000 and \$271,000, respectively.

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The following table sets forth our accounts receivable and days sales outstanding as of December 31 for each year presented (dollar amounts in thousands):

	2006	2005	2004
Trade accounts receivable	\$ 133,239	\$ 100,282	\$ 76,809
Less allowance for doubtful accounts	(10,736)	(5,997)	(6,879)
Trade accounts receivable, net of allowance for doubtful accounts	\$ 122,503	\$ 94,285	\$ 69,930
Allowance for doubtful accounts, as percentage of trade accounts receivable	8.1%	6.0%	9.0%
Days sales outstanding(1)	56	60	55

- (1) Days sales outstanding (DSO) is based on trade accounts receivable, net of allowance for doubtful accounts, and is calculated using the exhaustion method, whereby the net accounts receivable balance is exhausted against each preceding month's or partial month's net revenue. The DSO calculation excludes revenue not related to patient care, such as franchise royalties and other fees and software license and support revenue, and trade accounts receivable purchased in business acquisitions.

The following tables set forth the percentage breakdown of our trade accounts receivable by aging category and by major payor type as of December 31 for each year presented:

	2006	2005	2004
<i>Accounts receivable by aging category:</i>			
Aged 0-90 days	71%	78%	72%
Aged 91-180 days	14%	12%	13%
Aged 181-365 days	11%	7%	9%
Aged over 365 days	4%	3%	6%
Total	100%	100%	100%

	2006	2005	2004
<i>Accounts receivable by major payor type:</i>			
Managed care and other payors	81%	78%	82%
Medicare and Medicaid	19%	22%	18%
Total	100%	100%	100%

As of December 31, 2006, our trade accounts receivable, net of allowance for doubtful accounts, was \$122.5 million compared to \$94.3 million as of December 31, 2005. This 29.9% increase in accounts receivable was related to our revenue growth offset by a decrease in days sales outstanding during 2006. Our revenue grew to \$194.2 million for the quarter ended December 31, 2006, which was 36.4% higher than our revenue of \$142.4 million recorded in the corresponding prior year quarter. During 2006, we recorded provisions for doubtful accounts totaling \$14.7 million and wrote off accounts totaling \$10.0 million.

Our days sales outstanding (DSO) is calculated using the exhaustion method for our accounts receivable, net of allowance for doubtful accounts. Our DSO decreased from 60 days as of December 31, 2005 to 56 days as of December 31, 2006. This decrease was due in part to a higher mix of specialty pharmacy business, which tends to have a slightly shorter collection cycle, as well as the elimination of the non-recurrent interruptions in our billing processes at both of our company-owned, high-volume specialty pharmacy distribution centers that occurred during the fourth quarter of 2005.

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As of December 31, 2006 and 2005, respectively, 19% and 22% of our accounts receivable was related to government healthcare programs such as Medicare and Medicaid. The remaining 81% and 78% of our accounts receivable as of December 31, 2006 and 2005, respectively, was due from managed care organizations and other third party payors. Our most significant managed care contract, with Blue Cross and Blue Shield of Florida, accounted for approximately 9% of our accounts receivable as of December 31, 2006 and 2005. This contract produced 13% of our revenue for each of the years 2006 and 2005. Our accounts receivable under this contract are proportionately low relative to revenue due to quick payment terms in the contract and the fact that a high percentage of our revenue under this contract is for specialty pharmacy services.

The aging composition of our accounts receivable shifted somewhat during 2006, resulting in 71% of our accounts receivable being aged 90 days or less as of December 31, 2006 compared to 78% a year earlier. This change reflects the maturing of the accounts receivable of businesses we acquired in 2005. In many cases, we did not acquire the existing accounts receivable of these businesses, so their aging composition as of December 31, 2005 was heavily weighted toward the younger aging categories. As these acquisitions matured in 2006, our accounts receivable has shifted back to a more typical aging composition.

As of December 31, 2005, our trade accounts receivable, net of allowance for doubtful accounts, was \$94.3 million compared to \$69.9 million as of December 31, 2004. This 34.8% increase in accounts receivable was related to our revenue growth and increase in days sales outstanding during 2005. Our revenue for the quarter ended December 31, 2005 was \$142.4 million, which was 26.4% higher than our revenue of \$112.7 million recorded in the corresponding prior year quarter. During 2005, we recorded provisions for doubtful accounts totaling \$9.7 million and wrote off accounts totaling \$10.6 million. Approximately \$300,000 of the bad debt write-offs in 2005 included various accounts we reserved in 2003 when we recorded a bad debt charge of \$6.8 million related to our Texas locations.

An insignificant percentage of our accounts are due from individual patients. Co-payments tend to be small and insignificant in our business, and we typically collect any co-payments before or upon delivery of products and services to the patient in order to minimize collection risk.

Table of Contents**CONTRACTUAL OBLIGATIONS AND OTHER COMMITMENTS.**

The following table summarizes our contractual obligations and other commitments as of December 31, 2006. See Notes 4, 10 and 14 to the Consolidated Financial Statements for more detail.

	Total	2007	Payments by Period					2012+
			2008	2009	2010	2011		
			(In thousands)					
2.25% convertible senior notes, due 2024(1)	\$ 86,250	\$	\$	\$	\$	\$	\$	\$ 86,250
Interest on 2.25% convertible senior notes, due 2024(1)	34,610	1,941	1,941	1,941	1,941	1,941		24,905
Operating lease obligations	28,311	7,583	6,212	4,814	3,993	3,396		2,313
Pharmaceutical purchase obligations	24,976	13,947	11,029					
Business acquisitions obligations(2)	3,469	3,283	186					
Capital leases and other long-term debt	156	81	42	31	2			
Total contractual cash obligations	\$ 177,772	\$ 26,835	\$ 19,410	\$ 6,786	\$ 5,936	\$ 5,337	\$	\$ 113,468

(1) These notes may be redeemed by us, in whole or in part, at any time on or after November 1, 2009, and the holders may require us to purchase all or a portion of the notes on November 1, 2009, 2014 and/or 2019. Subject to certain conditions, the notes may become convertible into cash and shares of stock. The repayment schedule shown above assumes no early redemption or conversion of the notes before their due date, November 1, 2024.

(2) Represents minimum remaining obligations for purchase price adjustments, employment contracts and management agreements in connection with acquisitions made during 2006, 2005 and 2004.

LIQUIDITY AND CAPITAL RESOURCES

At various times, we have financed our operations and acquisitions from operating cash flows, common stock and debt offerings and credit facility borrowings. During 2006, we financed our operations and business acquisitions through our positive operating cash flow and by liquidating short-term investments.

In November 2004, in order to finance our growth initiatives, we raised \$86.3 million in capital by issuing 2.25% convertible senior notes. The notes, which are due 2024, pay interest semi-annually on May 1 and November 1 of each year. The notes are convertible into cash and, if applicable, shares of our common stock based on our common stock market price and other conditions. The notes cannot be redeemed by us before November 1, 2009. On each of November 1, 2009, November 1, 2014 and November 1, 2019, the holders can require us to purchase all or a portion of the notes for their principal amount plus accrued interest. At any time on or after November 1, 2009, we may

redeem the notes, in whole or in part, for a redemption price equal to 100% of the principal amount of the notes we redeem, plus any accrued and unpaid interest. We incurred deferred financing costs of \$3.2 million related to this offering, consisting of underwriting, legal and other related costs. These costs are being amortized over a five-year period.

On May 5, 2006, we signed a five-year, \$35 million revolving Credit Agreement with LaSalle Bank National Association (the Agreement). Provided there is no event of default, we have the option to increase the revolving loan commitment to a maximum of \$100 million during the first two years of the Agreement. We will pay interest on borrowings at rates ranging from prime plus zero or LIBOR plus 1.00% to a maximum of prime plus 0.25% or LIBOR plus 1.75%. We have also agreed to pay non-use fees ranging from 0.15% to 0.225% of the unused portion of the revolving loan commitment. The interest rates and non-use fee rates payable are based on our Total Debt to EBITDA Ratio, as defined in the agreement, for the applicable period. We must maintain compliance with various financial and other covenants throughout the life of the Agreement. Borrowings under the Agreement would be collateralized by substantially all our assets. We may use up to \$2.5 million of our available credit to secure Letters of Credit, as needed, payable applicable fees while the letters of credit are in place. We incurred fees of approximately \$167,000 related to negotiating this

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Agreement. We had no borrowings and wrote no letters of credit during 2006 and were in compliance with all covenants.

Our total working capital as of December 31, 2006 was \$117.1 million, a decline of \$14.7 from our working capital of \$131.8 million on December 31, 2005. This decline was primarily due to our liquidation of short-term investments to fund 2006 business acquisitions. As of December 31, 2006, we had cash, restricted cash and short-term investments totaling \$16.4 million compared to \$48.9 million as of December 31, 2005. The \$45.1 million in cash we paid for acquisitions during 2006 exceeded our \$21.1 million in positive operating cash flow during the year, resulting in the net liquidation of short-term investments and reduction in our working capital.

We have been cash flow positive from operations for each of the last five years and anticipate remaining cash flow positive from continuing operations in 2007. Our only material debt as of December 31, 2006 was our \$86.3 million of 2.25% convertible senior notes referred to above. We intend to fund our future capital needs through operating cash flows and existing cash reserves and, if needed, borrowings under our \$35 million Agreement with LaSalle Bank. In the event that additional capital is required beyond what is available through operating cash flow and our Agreement with LaSalle Bank, we may not be able to obtain such capital from other sources on terms acceptable to us, if at all.

Our business strategy includes the selective acquisition of additional infusion pharmacies and other related healthcare businesses. We continue to evaluate acquisition opportunities and view acquisitions as a key part of our growth strategy. We historically have paid between 70% and 100% of the purchase price for our acquisitions with cash, financing the remainder through the issuance of shares of our common stock. For future acquisitions, we may utilize cash, common stock, or a combination of the two to pay the purchase price. We may require additional capital in excess of our current availability in order to complete future acquisitions. It is impossible to predict the amount of capital that may be required for acquisitions, and there is no assurance that sufficient financing for these activities will be available on terms acceptable to us, if at all.

CASH FLOWS

Our unrestricted cash balance decreased from \$6.8 million at December 31, 2005 to \$3.2 million at December 31, 2006. Operating cash flows remained positive at \$21.1 million for the year. We used \$22.0 million in investing activities in 2006, of which \$45.1 million was spent on business acquisitions, partly offset by our net sale of \$35.3 million of short-term investments, such as commercial paper. In 2006, we generated \$5.1 million from the issuance of common stock primarily received through our employee stock purchase plan and the exercise of vested stock options, and paid \$2.7 million in quarterly dividends under our dividend policy established by the Board of Directors in May 2004.

Cash provided by operations:

For 2006, we generated \$21.1 million in positive cash flow from operations. The primary source of our positive operating cash flow in 2006 was our net income of \$21.7 million and improved cash collection performance, which led to a reduction in our days sales outstanding (DSO) from 60 days at December 31, 2005 to 56 days at December 31, 2006. The improved speed of cash collections was partially due to a shift in mix toward specialty pharmacy services, which tend to have a slightly shorter collection cycle than infusion and local pharmacy services.

For 2005, we generated \$13.2 million in positive cash flow from operations. The primary cause of our positive operating cash flow in 2005 was our net income of \$20.6 million, partly offset by an increase in our trade accounts receivable, as evidenced by a five-day increase in our DSO from 55 days as of December 31, 2004 to 60 days as of December 31, 2005. This DSO increase was due in part to a higher mix of infusion and local pharmacy business, which tends to have a slightly longer collection cycle, as well as non-recurrent interruptions in our billing processes at

our company-owned, high-volume specialty pharmacy distribution centers during the fourth quarter of 2005. In addition, for five of our ten acquisitions in 2005, we did not purchase accounts receivable and therefore had to finance their initial operating cash requirements, resulting in negative initial operating cash flows for those businesses.

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For 2004, we generated \$19.3 million in positive cash flow from operations. The primary cause of our positive operating cash flow in 2004 was our net income of \$16.5 million. Through effective billing and collections efforts and a continued shift in mix toward specialty pharmacy services, we were able to reduce our days sales outstanding from 61 days as of December 31, 2003 to 55 days as of December 31, 2004, helping us maintain strong operating cash flow in a year in which our revenue grew by 16.6%. Our operating cash flow in 2004 also benefited from a net increase in deferred income tax liabilities and our utilization of a large income tax overpayment from the prior year.

Cash used in investing activities:

In 2006, we used \$22.0 million in cash in investing activities. We used \$45.1 million to complete five business acquisitions, and used \$11.7 million for the purchase of equipment and other fixed assets, of which \$6.0 million was for revenue-generating medical equipment and the remainder was for infrastructure items. Offsetting these expenditures were \$35.3 million generated from the net sale of short-term investments and \$500,000 in proceeds from the disposal of two home health agencies.

In 2005, we used \$31.5 million in cash in investing activities. We used \$57.5 million to complete ten business acquisitions and invest in two joint ventures with hospitals, and used \$10.3 million for the purchase of equipment and other fixed assets, of which \$3.2 million was for revenue-generating medical equipment and the remainder was for infrastructure items. Offsetting these expenditures was \$1.6 million received from the sale of our MBI business and \$34.3 million generated from the net sale of short-term investments.

In 2004, we used \$84.9 million in cash in investing activities. We used \$75.4 million of the net proceeds generated from the 2.25% convertible senior notes to purchase short-term investments. In addition, we used \$5.3 million for the purchase of equipment and other fixed assets, of which \$2.3 million was for revenue-generating medical equipment and the remainder was for infrastructure items. We also used \$4.1 million for business acquisitions and \$100,000 to acquire other long-term assets. We completed five small acquisitions during 2004, all of which helped us consolidate our market position in existing markets that we serve.

Cash used in financing activities:

In 2006, we used \$2.8 million in cash in financing activities. We generated \$5.1 million from the issuance of stock to participants in our employee stock purchase plan and from employees who exercised vested stock options. This was offset by a \$6.6 million temporary increase in restricted cash and by our use of \$2.7 million in cash to pay dividends to our shareholders.

In 2005, we generated \$6.3 million from financing activities. During 2005, we generated \$6.8 million from the issuance of stock to participants in our employee stock purchase plan and from employees who exercised vested stock options. This was offset by our use of \$2.4 million to pay dividends to our common stockholders and \$200,000 to pay professional fees related to our \$86.3 million offering of senior notes in November 2004.

In 2004, we generated \$80.4 million from financing activities. In November 2004, we completed an \$86.3 million offering of 2.25% convertible senior notes, due 2024. The purpose of the offering was to finance acquisitions, stock repurchases, and working capital and other general corporate needs. We paid \$3.0 million in underwriting, legal and other fees related to this offering. These fees will be amortized over a five-year period. During 2004, we generated \$3.9 million from the issuance of stock related to our employee stock plans. This was offset by our use of \$5.5 million in cash to acquire treasury stock and \$1.3 million to pay dividends to our common stockholders. We also used \$400,000 for scheduled installments on capital leases and other debt.

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RECENT ACCOUNTING PRONOUNCEMENTS

Financial Accounting Standards Board published Interpretation 48, Accounting for Uncertainty in Income Taxes

In June 2006, the Financial Accounting Standards Board published Interpretation 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which is an interpretation of Statement 109, *Accounting for Income Taxes*. FIN 48 provides guidance on how entities should evaluate and report on uncertain tax positions. This interpretation requires that realization of an uncertain income tax position must be more likely than not (i.e. greater than 50% likelihood of receiving a benefit) before it can be recognized in the financial statements. Further, this interpretation prescribes the benefit to be recorded in the financial statements at the amount most likely to be realized assuming a review by tax authorities having all relevant information and applying current conventions. This interpretation also clarifies the financial statement classification of tax-related penalties and interest and sets forth new disclosures regarding unrecognized tax benefits. This interpretation is effective for fiscal years beginning after December 15, 2006, and we will be required to adopt this interpretation in the first quarter of 2007. Upon adoption, we expect to recognize a decrease of approximately \$1.8 million in the liability for previously provided accruals for uncertain tax positions no longer required under the technical guidance of FIN 48, and a corresponding increase in retained earnings. The expected impact may change based on further analysis. Subsequent to the adoption of FIN 48, any additional reserve reductions will be reflected in the provision for income taxes.

Statement of Financial Accounting Standard (SFAS) No. 157: Fair Value Measurements

In September 2006, the Financial Accounting Standards Board issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. The provisions of SFAS No. 157 are effective for financial statements issued for fiscal years beginning after November 5, 2007. We will adopt the guidance contained in SFAS No. 157 at the beginning of our fiscal year ending December 31, 2008. We do not believe that adoption of the SFAS No. 157 will have a material affect on our results of operations or financial condition.

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 we believe to be reasonable under the circumstances. Actual results may vary from these estimates under different assumptions or conditions. Management believes that of our significant accounting policies, the following policies involve a higher degree of judgment and/or complexity. The following should be read in conjunction with Note 1, *Description of Business and Summary of Significant Accounting Policies* and with the other Notes to Consolidated Financial Statements:

Healthcare services revenue recognition and contractual adjustments

Our revenue is primarily derived from the sale of pharmaceuticals and medical supplies and the provision of related nursing services to patients outside the hospital at alternate-site settings. Most of this revenue is billed under managed care or other contracts, with a smaller amount billed under government healthcare programs, such as Medicare and Medicaid. We bill upon receipt of all required documentation from payors, physicians and our staff. At the end of any period, a portion of our earned revenue remains unbilled awaiting completion of all documentation requirements.

Billed and unbilled revenue is recorded net of contractual adjustments based on our interpretation of the terms of each managed care contract or government contract or pricing schedule, as loaded into our computerized billing and pharmacy management software systems. In most cases, our contractual adjustments are calculated automatically by our billing system when the claim is

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billed, subject to review by the biller. If our billing system cannot automatically generate the contractual adjustment for a given claim, we calculate the contractual adjustment manually and key the adjustment into our billing system when the claim is billed. The contractual adjustments on unbilled amounts must be estimated manually through claim-by-claim analysis of the unbilled claims, by applying historical contractual adjustment percentages to the gross unbilled amounts, or a combination of the two methods. The accuracy of our recorded net revenue is subject to the accuracy of payor information on file for each patient, and is also subject to our correct interpretation of each underlying contract with respect to reimbursement rates for the drugs and services we provided. If changes or corrections to our estimates of net revenue prove to be necessary, we adjust net revenue in the period that such changes or corrections are identified. Such adjustments may have a positive or negative impact on the revenues and results of operations reported for those subsequent periods. Historically, such adjustments have not been significant to our statements of income.

Accounts receivable and allowances for doubtful accounts

Our accounts receivable are reported net of contractual adjustments and allowances for doubtful accounts. The majority of our accounts receivable are due from private insurance carriers and government healthcare programs such as Medicare or Medicaid. Third party reimbursement is a complicated process, with each payor having its own claim requirements. The ultimate collection of our accounts receivable is dependent upon complete and accurate patient intake, timely submission of clean claims to payors, and timely and effective follow-up on outstanding claims. Our collection process involves multiple steps. The first step is to bill each claim correctly, with proper coding, after having received all prerequisite authorizations from the patient's physician and insurance company, as applicable. For claims submitted electronically, we receive electronic acceptance of the claim from the insurance company or governmental agency responsible for paying the claim. This helps to assure collection of the account. For mailed insurance claims or those for which electronic confirmation of acceptance is unavailable, the billing staff member responsible for that claim will contact the payor if payment is not received promptly. The billing staff member will inquire as to the status of the claim, and will re-bill the claim or provide additional information as requested by the payor. Upon rebilling, the billing staff member will contact the payor to confirm receipt of the re-billed claim, and will follow up periodically until payment is received.

We write off accounts receivable as bad debts after all collection efforts have been exhausted, according to the following procedures. Our billing staff members review the status of their unpaid claims on a regular basis. During that review, the billing staff member will identify the reason for non-payment of a given claim. Should the reason relate to a correctable error with the claim itself, or incomplete or inadequate documentation provided to the payor, the billing staff member will attempt to address those issues and re-submit a corrected claim or provide additional information to the payor, as appropriate. In the event the claim error or documentation error cannot be corrected, the allowed time to correct and re-submit the claim has expired, or the claim is not paid due to a payor-related issue such as bankruptcy, the billing staff member will submit a formal request for write-off. The appropriate supervisor will review the request and authorize the claim to be written off if that supervisor agrees that the account is truly uncollectable. The identity of the appropriate supervisor to authorize a write-off is determined based on the reporting structure within each office and based on the dollar amount to be written off, with higher-level authorization required for larger dollar write-offs.

Our allowance for doubtful accounts is estimated based on several factors, including our past accounts receivable collection history, the aging of our accounts receivable at the end of each period as reported to us through our computerized billing systems, our mix of business, and the financial condition of our payors. We evaluate historical write-off percentages by aging category to help us determine the appropriate reserve needed at each balance sheet date based on the aging of our receivables at that date. We also take into account certain internal factors, such as computer systems conversions, office acquisitions and consolidations, and operational changes within our billing and reimbursement function. Although we believe that our estimation of the net value of our accounts receivable is

reasonable, we continually monitor our accounts receivable and our methods for calculating the appropriate allowance for doubtful accounts, and we adjust our allowances and calculation methods as needed. If actual collections differ from our estimates, we may need to establish an

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additional allowance for doubtful accounts, which could materially impact our financial condition and results of operations in future periods.

Goodwill and other intangible assets

We record goodwill from our acquisitions equal to the excess of the total cost of the acquisitions over the fair value of all identified tangible and intangible assets acquired. In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Intangible Assets*, effective January 1, 2002 we no longer amortize goodwill but instead test our goodwill at least annually for impairment. Since we operate in one business segment, we test for goodwill impairment on a company-wide basis. Therefore, our method of impairment testing consists of comparing the market value of our company to its book value. The market value is equal to the current value per share of our common stock, times the total number of shares outstanding. We test goodwill for impairment each October 1st, or whenever we identify events or conditions that could potentially result in impairment of our goodwill.

Other intangible assets primarily consist of non-compete agreements and managed care contracts. The managed care contracts are amortized straight-line over periods of generally three years and the non-compete agreements are amortized straight-line over their contractual terms. These amortization periods equal the shorter of the estimated useful lives or their contractual term.

Franchise settlement gains and losses

We periodically acquire existing franchise locations prior to the termination of their franchise agreements. In accordance with EITF 04-01, *Accounting for Preexisting Relationships between the Parties to a Business Combination*, we are required to separately value the settlement of our preexisting relationship with the franchise location prior to accounting for the business combination. A gain or loss on the settlement should be recorded as it would be absent the business combination. These gains or losses are measured as the difference between the present value of estimated future royalty payments foregone under the terminated franchise agreements and the estimated market value of a new franchise agreement. Any excess over the current market value is recorded as a gain in other revenue and any shortfall is recorded as a loss within operating expenses.

The present value of the future royalty payments is measured from the date of the acquisition through the remaining life of the terminated franchise agreement, is based on contractual royalty fee rates contained within the franchise agreement and is discounted at a rate that approximates our average cost of capital. Included in the calculation of the future royalty payments are estimated growth rates based on historical trends. The market value of a new franchise agreement is measured as the present value of future royalty payments calculated utilizing current market royalty fee rates over the remaining life of the seller's franchise agreement, also discounted at a rate that approximates our average cost of capital. To the extent that the present value of the royalty fee rates in the terminating franchise agreement differs from the current market fee rates at the time of the acquisition, a gain or loss on settlement is recorded.

Computer software developed costs

Software developed for internal use only

We have developed and are developing various software products and modifications to products designed exclusively for use by us in the operation of our business. This includes modifications and enhancements we have made and continue to make to our customized version of the iEmphysys[™] software. Such software development projects are accounted for in accordance with *Statement of Position 98-1 (SOP 98-1) Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, issued by the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants. We account for software development costs for internal-use

software accounting to the following criteria:

- (a) Computer software costs that are incurred in the preliminary project stage are expensed;

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- (b) Once the capitalization criteria under the SOP have been met, external direct costs of materials and services consumed in developing or obtaining internal-use computer software; payroll and payroll-related costs for employees who are directly associated with and who devote time to the internal-use computer software project; and interest costs incurred when developing computer software for internal use are capitalized; and
- (c) Once the product is operative, internal and external training costs and maintenance costs are expensed as incurred.

We amortize capitalized costs of computer software developed or obtained for internal use on a straight-line basis over the estimated useful life of the software. We will recognize impairment on the capitalized computer software developed for internal use, if one of the following conditions is present:

- (a) The internal use software is not expected to provide substantive service potential;
- (b) A significant change occurs in the extent or manner in which the software is used or is expected to be used;
- (c) A significant change is made or will be made to the software program; and
- (d) Costs of developing or modifying internal-use computer software significantly exceed the amount originally expected to develop or modify the software.

Vendor Administration Fees Revenue

We receive vendor administration fees and rebates from various vendors, pharmaceutical manufacturers and group purchasing organizations (GPOs) based on the volume of drug and medical supply purchases made by us and our franchisees. Our accounting for such administration fees and rebates is in accordance with the consensus reached in EITF 02-16, *Consideration Received from a Vendor by a Customer or Reseller*. A portion of the vendor administration fees and rebates that we receive is related to our purchases, while a lesser portion is earned from purchases made by our franchisees. The portion related to *our* purchases is accounted for as a reduction to cost of goods sold in the period in which we completed the applicable purchases, while the portion related to purchases made by our *franchisees* is accounted for as revenue in our statements of income, because these rebates are not related to our cost of goods sold.

We also receive fees from certain biotech manufacturers for providing patient compliance and clinical outcomes data to them to aid in their evaluation of the efficacy of their products and treatment protocols. These fees are not based on our purchase of product from these manufacturers, but rather based on the data we return to them. Since these fees relate to services that we are providing to the biotech manufacturers, we account for these fees as revenue in accordance with the guidance in EITF 02-16.

We often need to estimate the amount of our expected rebates and vendor administration and other fees earned in a given period based on our and our franchisees' volume of purchases during the applicable period. Further, we may need to estimate the allocation of rebates and vendor administration fees between revenue and cost of goods based on our estimation of the purchases made by us versus the purchases made by our franchisees during the applicable period. Likewise, we may need to estimate the fees due from biotech manufacturers based on the volume of patient compliance and clinical outcomes data that we have provided, or may provide, to them. We may adjust our estimates in subsequent periods based on amounts paid by and supporting documentation received from our vendors and manufacturers. Such adjustments could have a material effect on our results of operations in subsequent periods, though historically such adjustments have not been material.

Variable Interest Entity

Effective March 13, 2006 (the Effective Date), we entered into a binding purchase agreement to acquire a home infusion business with operations in New York. The purchase price was \$25.0 million, of which \$16.5 million was paid in cash on the Effective Date, \$7.5 million was paid in unregistered shares of our common stock and \$1.0 million is payable pursuant to the terms of a note. Under the terms of the purchase

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agreement and subsequent amendment signed December 1, 2006, we will receive the acquired interest in the business at the Closing Date, which will be the earliest of: (1) two days following the receipt of required consent from the New York Department of Health; (2) forty-five days following final, non-appealable denial of such required consent; (3) as of the date specified by written notice from us to the sellers; or (4) January 1, 2008. The total cost of the acquisition is subject to working capital and earn-out adjustments. The total purchase price has been allocated \$22.1 million to goodwill and the remainder to accounts receivable and other working capital items. Upon closing the acquisitions, we anticipate that all of the goodwill will be deductible for tax purposes. Financial Accounting Standards Board Interpretation No. 46 (Revised December 2003), Consolidation of Variable Interest Entities, addresses the consolidation of business enterprises to which customary conditions of consolidation, such as a majority voting interest, do not apply. As a result of the purchase agreement and related joint coordination agreement, the acquired business is deemed to be a variable interest entity (VIE) and we are the primary beneficiary of this VIE as of the Effective Date. Accordingly, we have included the business in our consolidated financial reporting as of the Effective Date. Prior to the closing date, and subsequent to the Effective Date, creditors of the VIE will not have recourse to the assets of our company. Subsequent to the closing date, the acquired business will cease to be a VIE and will become a wholly-owned subsidiary of our company.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to market risk primarily in relation to our cash and short-term investments. As of December 31, 2006, we had no variable-rate debt. We had fixed-rate debt as of that date primarily comprised of \$86.3 million offering of 2.25% convertible senior notes, due 2024. The interest rate we may earn on the cash we invest in short-term investments is subject to market fluctuations. We utilize a mix of investment maturities based on our anticipated cash needs and evaluation of existing interest rates and market conditions. As of December 31, 2006, our cash and cash equivalents and short-term investments were as follows:

	Balance (In thousands)
Cash and cash equivalents:	
Cash, unrestricted	\$ 3,171
Cash, restricted(1)	7,554
Total cash and cash equivalents	\$ 10,725
Short-term investments(2)	\$ 5,700
Total cash and cash equivalents and short-term investments	\$ 16,425

- (1) The restricted cash was related to our re-issuance of 559,700 shares of stock to the sellers of Trinity Homecare, LLC, which is a business we acquired during 2006. The restriction was subsequently lifted upon our registration of the re-issued shares on January 31, 2007.
- (2) Short-term investments consists of commercial paper and other investments having a maturity of greater than three months at time of acquisition. Short-term investments also consists of municipal variable rate demand notes, preferred stock and similar instruments with maturities greater than ten years, but which contain provisions for the periodic adjustment of interest rate to market, generally each 28 or 35 days.

While we attempt to minimize market risk and maximize return, changes in market conditions may significantly affect the income we earn on our cash and cash equivalents and short-term investments. Based on our actual cash and cash equivalents and short-term investment balances at December 31, 2006, a 100 basis point decline in interest rates would reduce our interest income by \$164,000 on an annualized basis.

Item 8. *FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA*

The Consolidated Financial Statements immediately follow. The Financial Statement Schedule is included in Part IV, Item 15 of this Annual Report on Form 10-K.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Board of Directors and Stockholders of Option Care, Inc.:

We have audited management's assessment, included in Management's Report on Internal Control over Financial Reporting, appearing under Item 9A, that Option Care, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Option Care, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Option Care, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Option Care, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Option Care, Inc. as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006 of Option Care, Inc. and our report dated March 15, 2007 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Chicago, Illinois
March 15, 2007

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of
Option Care, Inc.:

We have audited the accompanying consolidated balance sheets of Option Care, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule included in the Index at Item 15. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Option Care, Inc. and subsidiaries at December 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, on January 1, 2006 the company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payments.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Option Care, Inc.'s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 15, 2007 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Chicago, Illinois
March 15, 2007

Table of Contents**Option Care, Inc.****CONSOLIDATED BALANCE SHEETS****(In thousands, except per share amounts)**

	December 31,	
	2006	2005
		(Restated-Note 1)
Assets		
Current assets:		
Cash and cash equivalents, unrestricted	\$ 3,171	\$ 6,816
Cash, restricted	7,554	1,000
Short-term investments	5,700	41,042
Trade accounts receivable, less allowance of \$10,736 and \$5,997, respectively	122,503	94,285
Inventory	23,096	15,490
Income tax receivable	2,799	1,302
Deferred income tax benefit	3,883	2,856
Prepaid expenses	2,045	1,797
Other current assets	5,577	6,985
Total current assets	176,328	171,573
Equipment and other fixed assets, net	24,398	19,278
Goodwill, net	165,323	112,220
Other intangible assets, net	1,173	1,002
Investment in affiliates	4,496	4,911
Other long-term assets	4,667	4,464
Total assets	\$ 376,385	\$ 313,448
Liabilities and Stockholders' Equity		
Current liabilities:		
Trade accounts payable	\$ 43,601	\$ 29,958
Accrued wages and related employee benefits	6,899	5,666
Current portion of long-term debt	23	48
Other current liabilities	8,710	4,077
Total current liabilities	59,233	39,749
Long-term debt, less current portion	86,372	86,306
Deferred income tax liability	9,377	5,969
Minority interest	826	665
Other long-term liabilities	1,214	593
Total liabilities	157,022	133,282
Stockholders' equity:		

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Preferred stock, \$.01 par value, 30,000 shares authorized, no shares issued or outstanding		
Common stock, \$.01 par value, 60,000 shares authorized, 34,466 and 32,838 shares issued and outstanding, respectively	345	328
Common stock to be issued, 139 and 134 shares, respectively	1,550	1,311
Additional paid-in capital	148,108	128,157
Retained earnings	69,360	50,370
Total stockholders' equity	219,363	180,166
Total liabilities and stockholders' equity	\$ 376,385	\$ 313,448

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**Option Care, Inc.****CONSOLIDATED STATEMENTS OF INCOME****(In thousands, except per share amounts)**

	Years ended December 31,		
	2006	2005	2004
		(Restated-Note 1)	(Restated-Note 1)
Revenue:			
Specialty pharmacy	\$ 394,901	\$ 290,884	\$ 249,697
Infusion and related healthcare services	255,393	196,893	153,302
Other	9,118	16,801	11,431
Total revenue	659,412	504,578	414,430
Cost of revenue:			
Cost of goods	409,931	304,346	251,613
Cost of service	69,897	53,435	43,969
Total cost of revenue	479,828	357,781	295,582
Gross profit	179,584	146,797	118,848
Operating expenses:			
Selling, general and administrative expenses	122,371	99,763	81,878
Depreciation and amortization	4,934	3,687	2,810
Provision for doubtful accounts	14,468	9,667	6,615
Total operating expenses	141,773	113,117	91,303
Operating income	37,811	33,680	27,545
Other expense, net:			
Interest income	1,364	2,363	323
Interest expense	(2,139)	(1,966)	(252)
Other expense, net	(895)	(248)	(307)
Total other income (expense), net	(1,670)	149	(236)
Income from continuing operations before income taxes	36,141	33,829	27,309
Provision for income taxes	13,573	12,940	10,761
Net income from continuing operations	\$ 22,568	\$ 20,889	\$ 16,548
Discontinued operations:			
Loss on discontinued operations, net of income tax benefit of \$499 and \$165 for 2006 and 2005, respectively	(883)	(271)	
Net income	\$ 21,685	\$ 20,618	\$ 16,548

Net income per basic share:						
Continuing operations	\$	0.66	\$	0.64	\$	0.52
Discontinued operations		0.02		0.01		
Total	\$	0.64	\$	0.63	\$	0.52
Net income per diluted share:						
Continuing operations	\$	0.64	\$	0.61	\$	0.51
Discontinued operations		0.03		0.01		
Total	\$	0.61	\$	0.60	\$	0.51
Shares used in computing net income per common share:						
Basic		33,962		32,590		31,938
Diluted		35,467		34,234		32,631
Cash dividends per share	\$	0.08	\$	0.07	\$	0.04

The accompanying notes are an integral part of these consolidated financial statements.

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Option Care, Inc.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands)

	Common Stock		Common	Additional	Retained	Treasury	Stockholders
	Shares	Amount	Stock to be Issued	Paid-In Capital (Restated-Note 1)	Earnings (Restated-Note 1)	Stock	Equity (Restated-Note 1)
January 1, 2004	31,390	\$ 313	\$ 834	\$ 113,626	\$ 16,872	\$ (161)	\$ 131,484
Net income					16,548		16,548
Common stock to be issued, net			1,085				1,085