

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

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended

June 30, 2004

Commission file number 00-19878

OPTION CARE, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or
organization)

**485 Half Day Road, Suite 300
Buffalo Grove, Illinois**

(Address of principal executive office)

36-3791193

(IRS Employer Identification No.)

60089

(zip code)

(847) 465-2100

(Registrant's telephone number, including area code)

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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 whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

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

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

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Option Care, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except per share amounts)

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

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

See notes to condensed consolidated financial statements

Option Care, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(Unaudited)

(in thousands, except per share amounts)

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

See notes to condensed consolidated financial statements

Option Care, Inc. and Subsidiaries**Condensed Consolidated Statement of Stockholders Equity**

(Unaudited)

(in thousands, except per share amounts)

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

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

See notes to condensed consolidated financial statements

Option Care, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)

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

See notes to condensed consolidated financial statements

Option Care, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

June 30, 2004

(Unaudited)

1. Basis of Presentation

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

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

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

2. Long-Term Debt

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

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

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prime rate. Our interest rate on borrowings may range from lows of prime plus 0.25% or the Eurodollar rate plus 2.25% to highs of prime plus 0.75% or the Eurodollar rate plus 2.75%.

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

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

On October 23, 2003, the Lenders agreed to amend the Credit and Security Agreement to address the \$6.8 million special

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

3. Earnings Per Share Data

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

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

4. Operating Segments

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

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

education regarding their condition and treatment program.

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

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

5. Significant Customers and Concentration of Credit Risk

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

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

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

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

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

6. Seasonal Revenue Trends

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

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

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

7. Acquisitions

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

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

8. Stock-based Compensation

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

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

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