

OPTION CARE INC/DE
Form 10-Q
August 09, 2007

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

or

**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

(IRS Employer Identification No.)

485 Half Day Road, Suite 300

Buffalo Grove, Illinois

(Address of principal executive offices)

60089

(Zip Code)

(847) 465-2100

(Registrant's telephone number, including area code)

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

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 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. (Check one):

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

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 1, 2007
Common Stock \$0.01 par value	34,725,892

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Option Care, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(in thousands, except per share amounts)

	June 30, 2007 (Unaudited)	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents, unrestricted	\$	\$ 3,171
Cash, restricted		7,554
Short-term investments		5,700
Trade accounts receivable, net	125,976	122,503
Inventory	19,824	23,096
Deferred income tax benefit	5,600	3,883
Other current assets	13,550	10,421
Total current assets	164,950	176,328
Equipment and other fixed assets, net	26,695	24,398
Goodwill, net	202,247	165,323
Other assets, net	10,101	10,336
Total assets	\$ 403,993	\$ 376,385
Liabilities and stockholders' equity		
Current liabilities:		
Cash overdraft	\$ 1,162	\$ 43,601
Trade accounts payable	34,549	6,899
Accrued wages and related employee benefits	8,302	2,892
Deferred purchase price liability	4,739	23
Current portion of long-term debt	86,260	5,818
Other current liabilities	3,582	
Total current liabilities	138,594	59,233
Long-term debt, less current portion	16,594	86,372
Deferred income tax liability	11,099	9,377
Other liabilities	1,298	1,214
Minority interest	863	826
Total liabilities	168,448	157,022
Stockholders' equity:		

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Common stock, \$.01 par value per share, 60,000 shares authorized, 34,578 and 34,466 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively	346	345
Common stock to be issued, 218 and 134 shares at June 30, 2007 and December 31, 2006, respectively	2,497	1,550
Additional paid-in capital	150,250	148,108
Retained earnings	82,452	69,360
 Total stockholders' equity	 235,545	 219,363
 Total liabilities and stockholders' equity	 \$ 403,993	 \$ 376,385

See notes to condensed consolidated financial statements

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Option Care, Inc. and Subsidiaries
Condensed Consolidated Statements of Income

(Unaudited)

(in thousands, except per share amounts)

	Three months ended		Six months ended	
	June 30		June 30	
	2007	2006	2007	2006
Revenue:				
Home infusion and related healthcare services	\$ 67,737	\$ 64,519	\$ 132,177	121,634
Specialty infusion pharmacy services	55,142	48,496	138,227	101,707
Specialty distribution pharmacy services	63,545	40,938	127,126	83,526
Other	2,583	3,355	4,420	5,432
Total revenue	189,007	157,308	401,950	312,299
Cost of revenue:				
Cost of goods sold	122,487	93,846	266,891	192,013
Cost of services provided	18,214	17,558	37,201	33,586
Total cost of revenue	140,701	111,404	304,092	225,599
Gross profit	48,306	45,904	97,858	86,700
Selling, general and administrative expenses	32,792	31,801	65,078	60,219
Provision for doubtful accounts	3,714	3,456	8,103	6,918
Depreciation and amortization	1,346	1,225	2,613	2,370
Total operating expenses	37,852	36,482	75,794	69,507
Operating income	10,454	9,422	22,064	17,193
Interest income (expense), net	(370)	(217)	(604)	(427)
Other income (expense), net	(92)	(365)	(240)	(209)
Income before income taxes	9,992	8,840	21,220	16,557
Income tax provision	3,980	3,388	8,463	5,929
Net income from continuing operations	\$ 6,012	\$ 5,452	\$ 12,757	\$ 10,628
Discontinued operations:				
Loss on discontinued operations, net of income taxes	(76)	(251)	(56)	(637)
Net income	\$ 5,936	\$ 5,201	\$ 12,701	\$ 9,991

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Net income per basic share:				
Continuing operations	\$ 0.17	\$ 0.16	\$ 0.37	\$ 0.32
Discontinued operations		(0.01)		(0.02)
Total	\$ 0.17	\$ 0.15	\$ 0.37	\$ 0.30
Net income per diluted share:				
Continuing operations	\$ 0.16	\$ 0.15	\$ 0.35	\$ 0.30
Discontinued operations				(0.02)
Total	\$ 0.16	\$ 0.15	\$ 0.35	\$ 0.28
Shares used in computing net income per share:				
Basic	34,726	33,991	34,684	33,572
Diluted	36,875	35,198	36,526	35,161
Cash dividends per share	\$ 0.02	\$ 0.02	\$ 0.04	\$ 0.04

See notes to condensed consolidated financial statements

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Option Care, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(in thousands)

	Six Months Ended	
	June 30	
	2007	2006
Cash flows from operating activities:		
Net income	\$ 12,701	\$ 9,991
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,255	3,975
Provision for doubtful accounts	8,142	7,079
Deferred income taxes	5	209
Income from equity investees	149	243
Non-cash stock compensation expense	1,097	452
Changes in assets and liabilities, net of effect of acquisitions		
Accounts and notes receivable	(8,784)	(125)
Inventory	3,532	(1,248)
Accounts payable	(8,215)	(10,853)
Income taxes payable	(1,082)	(114)
Change in other assets and liabilities	(3,280)	3,748
 Net cash provided by operating activities	 8,520	 13,357
Cash flows from investing activities:		
Purchases of short-term investments	(4,000)	(4,000)
Sales of short-term investments	9,700	41,042
Purchases of equipment and other, net	(5,748)	(5,823)
Payments for acquisitions, net of cash acquired	(37,427)	(38,778)
 Net cash used in investing activities	 (37,475)	 (7,559)
Cash flows from financing activities:		
Cash overdraft	1,162	
Decrease in restricted cash	7,554	882
Increase in financing costs		(70)
Income tax benefit from exercise of stock options	32	618
Payments on capital leases and other debt	(42)	(10)
Net borrowings on credit agreement	16,500	
Proceeds from issuance of stock	1,961	2,627
Payments of dividends to common stockholders	(1,383)	(1,335)
 Net cash provided by financing activities	 25,784	 2,712

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Net increase (decrease) in cash and cash equivalents	(3,171)	8,510
Cash and cash equivalents, beginning of period	3,171	6,816
Cash and cash equivalents, end of period	\$	\$ 15,326

See notes to condensed consolidated financial statements

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Option Care, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
June 30, 2007
(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 Quarterly Report on 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, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

The balance sheet at December 31, 2006 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, 2006.

2. Short-Term and Long-Term Debt

As of June 30, 2007, our short-term debt consists principally of \$86.3 million of 2.25% convertible senior notes, due 2024 and our long-term debt primarily consists of borrowings under our revolving Credit Agreement with LaSalle Bank, N.A.

2.25% Convertible Senior Notes, due 2024

We issued \$75 million of 2.25% convertible senior notes on November 2, 2004 through a private placement to qualified institutional buyers. The initial purchasers were granted the option to purchase up to an additional \$11.25 million principal amount of notes and exercised this option in full on November 9, 2004. We filed a Registration Statement on Form S-3 on January 24, 2005, as subsequently amended, to register the notes under the Securities Act of 1933.

The notes are convertible into cash and, if applicable, shares of our common stock based on a conversion rate of 83.6741 per \$1,000 principal amount of notes (which represents a conversion price of \$11.95 per share). The conversion rate, which was initially set at 55.5278 shares per \$1,000 principal amount of notes, was adjusted as a result of our 3-for-2 common stock split on March 31, 2005 and \$0.02 per share dividends paid in each quarter following the stock split. Holders may convert their notes into cash and, if applicable, shares of our common stock prior to the stated maturity only under the following circumstances: (1) during any calendar quarter after the calendar quarter ended December 31, 2004, if the closing sale price of our common stock for each of 20 or more consecutive trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 120% of the conversion price in effect on the last trading day of the immediately preceding calendar quarter; (2) during the five business day period after any five consecutive trading day period (the "note measurement period") in which the average trading price per \$1,000 principal amount of notes was equal to or less than 97% of the average conversion value of the notes during the note measurement period; (3) upon the occurrence of specified corporate transactions, such as a change in control of the company; or (4) if we have called the notes for redemption. In general, upon conversion, the holder of each note will receive the conversion value of the note payable in cash, up to the principal amount of the note, and common stock for the note's conversion value in excess of such principal amount (plus an additional cash payout in lieu of fractional shares). If the notes are surrendered for conversion in connection with certain fundamental changes (including a change in control of the company) that occur before November 1, 2009, holders will in certain circumstances also receive a make-whole premium in addition to the cash and shares to which holders are otherwise entitled to receive upon conversion. The convertible senior notes were issued with a maturity date of November 1, 2024 and will not be redeemable by us prior to November 1, 2009. Holders of the convertible notes may require us to repurchase all or a portion of the convertible notes for cash on November 1, 2009, November 1, 2014 and November 1, 2019. Interest will be paid at 2.25% per annum, payable

semi-annually in arrears on May 1 and November 1 of each year to the holders of record at the close of business on the preceding April 15 and October 15, respectively. The notes are senior unsecured obligations and rank equally with all of our existing and future senior unsecured indebtedness. The holders of the notes possess no stockholder rights, such as dividend or voting rights, unless and until they convert their notes into cash and shares of our common stock. Our 2.25% convertible senior notes are convertible at the option of each holder during the quarter beginning July 1, 2007 and ending September 30, 2007 due to one of the conditions for conversion being met. The closing sale price of our common stock exceeded 120% of the conversion price for each of at least 20 consecutive trading days within the last 30 consecutive trading days of the quarter ended June 30, 2007. In accordance with the terms of the indenture under which the notes were issued, holders surrendering their notes for conversion would be eligible to receive the conversion value of the notes in a combination of cash equal to the principal amount of the notes and common stock for any excess value. As of August 1, 2007, no holders had presented their notes for

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conversion based on the market price condition being met.

On July 2, 2007, we entered into an Agreement and Plan of Merger (Merger Agreement) with Walgreen Co. (Walgreens) and Bison Acquisition Sub, Inc., a wholly-owned subsidiary of Walgreens (Acquisition Sub), pursuant to which, Acquisition Sub commenced a tender offer to purchase all outstanding shares of our common stock for \$19.50 per share, net in cash without interest, on July 17, 2007. The tender offer will expire at 12:00 midnight at the end of August 13, 2007, unless extended. On July 24, 2007 our convertible senior notes became convertible at the option of each holder as a result of the anticipated acquisition of over 50% of our outstanding shares of common stock (the Share Acquisition) pursuant to the tender offer. The notes will also be convertible as a result of the anticipated second step cash merger that will take place following completion of the tender offer pursuant to the Merger Agreement, and the related anticipated termination of trading of our common shares of stock. Pursuant to the Indenture, the notes are convertible, at the option of the holders, beginning fifteen business days prior to the anticipated effective date of the fundamental change, transaction or event, until fifteen business days after the actual effective date of such fundamental change, transaction or event. In accordance with the terms of the Indenture, holders surrendering their notes for conversion as a result of the anticipated fundamental change would be eligible to receive the conversion value of the notes in a combination of cash equal to the principal amount of the notes and common stock for any excess value. In addition, upon the occurrence of a fundamental change, holders will be entitled to receive a make-whole premium. The make-whole premium will vary based on the actual effective date of the Share Acquisition. If the Share Acquisition occurs on August 14, 2007, the make-whole premium will equal approximately 7.7% of the principal value of the notes. The make-whole premium will be payable in cash on a date selected by us in accordance with the terms of the Indenture, which date will be after the acquisition of our common stock in the tender offer. Additionally, as a result of the tender offer, there shall be an adjustment to the conversion rate pursuant to the Indenture, which adjustment shall not be effective until the first business day following the expiration of the tender offer. We anticipate that prior to the second step cash merger being completed, a supplemental indenture will be put in place, effective upon the closing of the merger, providing that at and after the effective time of the merger, upon the surrender for conversion of any of the notes, the holder thereof shall have the right to receive, in lieu of cash and our common stock, the amount of cash that such holder would have been entitled to receive upon the merger had the notes been converted immediately prior to the merger.

\$35 Million Revolving Credit Facility with LaSalle Bank National Association

In May 2006, we signed a five-year, \$35 million revolving Credit Agreement with LaSalle Bank National Association (the Agreement). The initial revolving loan commitment under the Agreement is \$35 million. Provided there is no continuing 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% based on our total debt to EBITDA ratio for the applicable period. We will also pay a non-use fee 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 are 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. We incurred fees of approximately \$167,000 related to negotiating this Agreement. As of June 30, 2007, our loan balance under this Agreement was \$16.5 million. We were in compliance with all affirmative covenants referenced in the Credit Agreement as of June 30, 2007. We were in violation of certain negative covenants of the Agreement as of this date, which may have constituted an event of default under the Credit Agreement, however we have obtained a waiver from LaSalle Bank National Association regarding this violation. In addition, consummation of the transactions contemplated by the Merger Agreement with Walgreens would cause us to violate other covenants in the future resulting in an event of default, in which case LaSalle Bank National Association could terminate the Credit Agreement and accelerate the balance of all loans outstanding there-under.

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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	
	2007	2006	2007	2006
Basic:				
Net income from continuing operations	\$ 6,012	\$ 5,452	\$ 12,757	\$ 10,628
Net (loss) from discontinued operations	(76)	(251)	(56)	(637)
Net income	\$ 5,936	\$ 5,201	\$ 12,701	\$ 9,991
Average shares outstanding	34,726	33,991	34,684	33,572
Basic earnings from continuing operations per share	\$ 0.17	\$ 0.16	\$ 0.37	\$ 0.32
Basic (loss) from discontinued operations per share		(0.01)		(0.02)
Basic earnings per share	\$ 0.17	\$ 0.15	\$ 0.37	\$ 0.30
Diluted:				
Net income from continuing operations	\$ 6,012	\$ 5,452	\$ 12,757	\$ 10,628
Net (loss) from discontinued operations	(76)	(251)	(56)	(637)
Net income	\$ 5,936	\$ 5,201	\$ 12,701	\$ 9,991
Average shares outstanding	34,726	33,991	34,684	33,572
Net effect of dilutive stock options based on the treasury stock method (1)	858	906	812	979
Net effect of dilutive contingently convertible debt (2)	1,291	301	1,030	610
Total diluted shares	36,875	35,198	36,526	35,161
Diluted earnings from continuing operations per share	\$ 0.16	\$ 0.15	\$ 0.35	\$ 0.30
Diluted loss from discontinued operations per share				(0.02)
Diluted earnings per share	\$ 0.16	\$ 0.15	\$ 0.35	\$ 0.28

(1)

For the quarter ended June 30, 2007, there were no anti-dilutive stock options.

For the six months ended June 30, 2007, there were 531,000 anti-dilutive options. For the quarter and six months ended June 30, 2006, there were 316,000 and 235,000 anti-dilutive stock options, respectively.

- (2) Weighted average shares issuable upon conversion of all \$86.3 million of our 2.25% convertible senior notes due 2024.

4. Operating Segments

We report our results of operations from one identifiable segment, with four service lines: home infusion and related healthcare services, specialty infusion pharmacy services, specialty distribution pharmacy services, and other.

Home infusion and related healthcare services primarily involve the intravenous administration of medications treating a wide range of acute and chronic health conditions such as infections, nutritional deficiencies and cancer. These services offer health plans a proven, reliable and cost effective alternative to intravenous administration of medications within a hospital setting or physician office. These services are primarily provided in the patient's home, but may also be provided at one of the Company's ambulatory treatment centers and involve intensive clinical coordination between our pharmacy and nursing staff, the patient, the prescribing physician, and payor case managers. All of our company-owned home infusion pharmacies provide infusion pharmacy services. 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.

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Specialty pharmacy services, which include **specialty infusion pharmacy services** and **specialty distribution pharmacy services**, involve the distribution of high cost pharmaceuticals, as well as related support services, to treat a wide range of chronic health conditions. These services provide patients with a comprehensive program to effectively manage their illness, provide payors with a cost effective solution to manage fast growing and very expensive therapies, and provide drug manufacturers with improved drug utilization and patient compliance. We are the leading integrated provider of nationwide delivery of specialty distribution pharmacy services and locally delivered specialty infusion pharmacy services. Our operations provide the necessary national and local capabilities to manage the entire spectrum of low-touch to high touch specialty pharmacy medications including orals, injectables, and infused products. 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. These pharmaceuticals may require refrigeration during shipping as well as special handling to prevent potency degradation.

Specialty infusion pharmacy services are those specialty pharmaceuticals that are delivered through our local pharmacies. These therapies may require administration to the patient at the patient's home or at one of our ambulatory infusion centers. Patients receiving treatment are often provided special counseling and education regarding their condition and treatment program as well as on-going compliance support.

Specialty distribution pharmacy services are designed to provide cost effective pharmaceutical distribution and support services for the management of high cost injectable and oral therapies treating many chronic health conditions. The Company's specialty distribution pharmacy facilities provide a centralized source for patient intake, customer service, pharmaceutical management and distribution, and compliance and reimbursement support. The operations are designed to maximize throughput through the effective utilization of automation, call center technology, and a dedicated information technology platform customized for the operating requirements of the specialty marketplace.

Other revenue primarily consists of royalties and other fees generated from our franchised pharmacy network.

5. Significant Customers and Concentration of Credit Risk

We generate the majority of our revenue from managed care contracts and other agreements with commercial third party payors by our provision of health care services to their members. We have multiple managed care contracts with Blue Cross and Blue Shield of Florida and Blue Cross and Blue Shield of Michigan, to whose members we provide infusion pharmacy services and specialty p