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# ACCREDITO

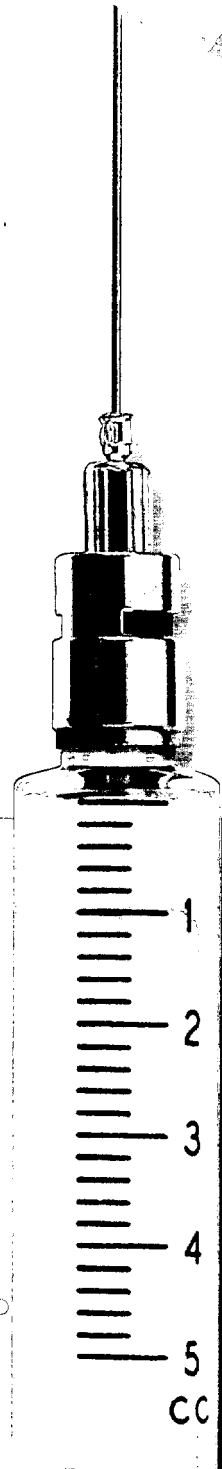
Health, Incorporated<sup>SM</sup>

PROCESSED

OCT 20 2004

THOMSON  
FINANCIAL

2004  
Annual  
Report

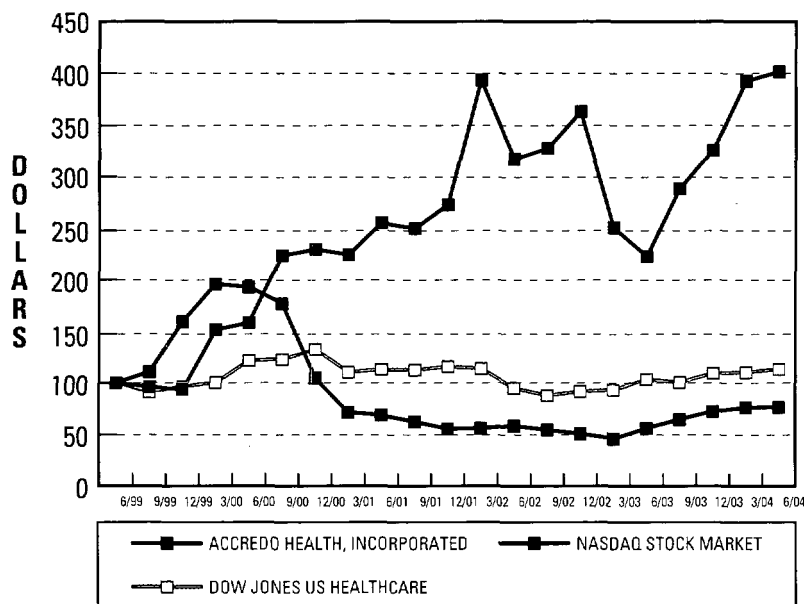


# the competitive advantage

Accredo continues to strengthen its position as a leading provider of niche retail pharmacy services to the biopharmaceutical industry. We maintain our competitive advantage through our strategy, relationships and market position.

## five year total return

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\***  
AMONG ACCREDO HEALTH, INCORPORATED, THE NASDAQ STOCK MARKET (U.S.) INDEX  
AND THE DOW JONES US HEALTHCARE INDEX



\* \$100 invested on 6/30/99 in stock or index—including reinvestment of dividends.  
Fiscal year ending June 30.

Marking Accredo's fifth year as a publicly traded company, David D. Stevens, Chief Executive Officer and Chairman of the Board, presided over the Market Open of the NASDAQ Stock Market® in New York City on April 16, 2004.



# letter to our fellow shareholders



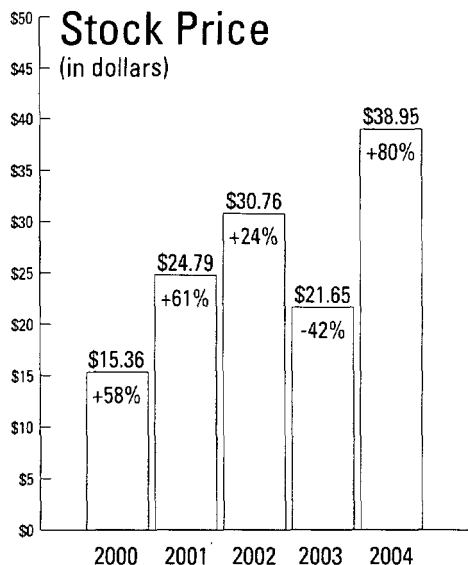
David D. Stevens  
Chairman and  
Chief Executive Officer

Fiscal year 2004 was a very successful period for Accredo Health as we made substantial progress toward our long-term corporate goals. We enhanced shareholder value as a result of continuing our historical trend of increasing revenues and net income, improving our financial position, strengthening our niche specialty pharmacy leadership position, attracting, retaining and empowering our growing workforce, and adding new biotech manufacturer relationships for new products.

In April 2004, we celebrated Accredo's fifth anniversary as a publicly traded company. During these first five years<sup>1</sup>, Accredo shareholders saw an annual compounded growth in share price in excess of 50 percent. In 2000, our first full fiscal year as a public company, we had \$353 million in revenues. In fiscal 2004, we exceeded \$1.5 billion in revenues, a 44 percent compounded annual rate of growth. In that same period, we increased net income from \$9.9 million to \$78.3 million, a 68 percent compounded annual rate of growth. We increased our employee base from 538 to 2,491, expanded our patient population to more than 54,000, and expanded operations to include four centralized dispensing facilities and 36 branch pharmacies.

Thanks to the efforts of our employees through that five-year period, we met many challenges with innovation and accomplishment as we:

- Launched 16 drugs, bringing our total to 21 product lines.
- Became the largest specialty pharmacy provider in most of our 21 product lines, thereby expanding our leading position.
- Acquired and integrated nine competing specialty pharmacy providers.
- Created a third subsidiary, Accredo Therapeutics, Inc., with a decentralized service model to serve the needs of IVIG, pulmonary arterial hypertension and alpha-1 antitrypsin deficiency patients who require local clinical support and pharmacy access.
- Expanded our physician and managed care sales forces.



## enhanced shareholder value

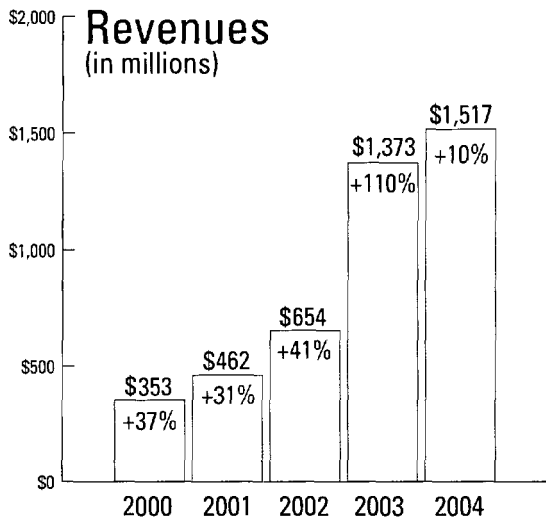
Accredo's shareholders benefited from a substantial increase in shareholder value during fiscal 2004 as our stock price increased from \$21.65 to \$38.95. This 80 percent increase occurred in a twelve-month period when the NASDAQ composite only had a 26 percent increase. Our market capitalization during the same period increased from \$1.036 billion to \$1.893 billion (+83 percent), and we were named to *Fortune* magazine's listing of America's 100 Fastest Growing Companies for 2004 and *Forbes* listing of America's Best Big Companies 2004.

Adjusted for three-for-two stock splits in February 2000, February 2001 and December 2002.

## increased revenue and net income

During fiscal 2004, revenues grew from \$1.373 billion to \$1.517 billion, a 10 percent increase. This growth occurred despite Accredo discontinuing sales of three product lines gained from acquisitions. After removing the effects of this \$65 million in revenue from the 2003 financial results, Accredo grew by 16 percent in fiscal 2004.

We experienced above market revenue growth in many of our product lines, most notably in Synagis, growth hormone, pulmonary arterial hypertension and IVIG, through organic growth and by taking market share. This growth was due in part to the refocused efforts of our physician and managed care sales teams. In addition to strong organic growth, we acquired the assets of Alpha Therapeutic Services, which strengthened our market leading positions in hemophilia and IVIG.



Net income grew from \$29.5 million in fiscal 2003 to \$78.3 million in fiscal 2004, or 165 percent. Removing the charge to bad debt expense in fiscal 2003, Accredo's net income growth was 20 percent.

## improved our financial position

From fiscal 2003 to 2004, Accredo increased gross margins from 20.9 percent to 21.0 percent, operating margins from 4.3 percent to 9.1 percent, reduced debt from \$194.7 million to \$179.3 million, reduced days sales outstanding from 84 to 81 and produced cash flow from operations of \$58.3 million.

## strengthened our niche specialty pharmacy leadership position

Accredo was selected in fiscal 2004 by three manufacturers to launch four new products: Xolair<sup>®</sup> by Genentech, Inc. for moderate to severe persistent asthma; Zemaira<sup>®</sup> by ZLB Behring for pulmonary arterial hypertension; and Raptiva<sup>®</sup> by Genentech, Inc. for chronic moderate to severe plaque psoriasis. The launch of the fourth product, Apokyn<sup>™</sup> by Bertek Pharmaceuticals Inc. for hypomobility ("off" episodes) associated with advanced Parkinson's disease, occurred in August 2004.

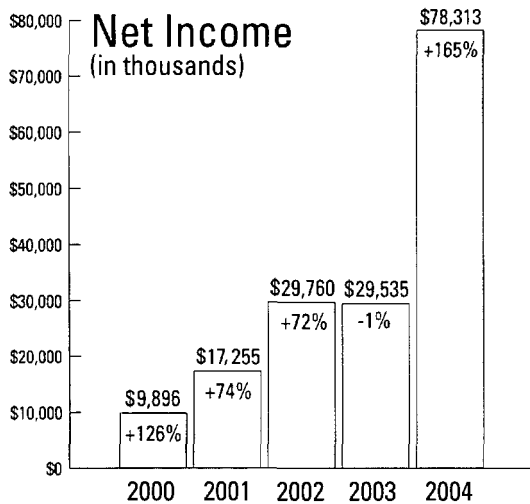
During the past 15 months, Accredo has added seven products to its current 21 product lines. In each of these seven products, the manufacturers chose a "restricted access" specialty pharmacy distribution channel, further validating the industry and Accredo's importance in delivering improved clinical outcomes.

In February, we were excited to announce the signing of a 10-year agreement with Medco Health Solutions, Inc., the nation's leading pharmacy benefits manager. Through this alliance, Accredo becomes Medco's preferred retail and home delivery pharmacy provider to its members for the product lines we currently dispense. We provide Medco a cost-effective, single source solution for our highly specialized offerings. We expect to realize \$100 million or more in additional revenues in fiscal 2005 as a result of this expanded agreement.

## expanded our board of directors

At the annual meeting of shareholders in November 2003, we recommended and our shareholders approved the election of two outside directors to succeed two Accredo employee directors. At the January 2004 meeting, the board voted to expand its size from eight to nine directors. Our board is currently composed of eight outside directors. I will continue on the board as chairman and the sole employee director. We

also created the role of Lead Director to help ensure independent board oversight. All of Accredo's outside board members meet the independent director requirements as defined by the National Association of Security Dealers, Inc.



attracted, retained and empowered a committed work force

Once again, our employees rose to the challenges the year presented, including: the launch of three new products; integration of acquisitions; implementation of new services; and installation of several major software enhancements. Our Company remains focused on our ultimate objective of providing market leading service levels to our chronic patient populations, and we salute our employees for their continued success.

looking ahead to 2005

In fiscal 2005, we face additional challenges and opportunities. The most relevant marketplace obstacle will be the significant reduction in reimbursement that has either been implemented or proposed, especially from government payors (i.e. Medicare and Medicaid). These changes will clearly be a challenge for Accredo as we explore creative ways to provide the same or higher levels of service while experiencing major reductions in reimbursement.

We expect to build on the growth Accredo has achieved, and we remain convinced that the market for our services will remain strong. We will continue to strengthen our leadership position through:

- Our new relationship with Medco, which provides opportunities to work together strategically for our present and future patient populations.
- The addition of products that have the ability to be long-term market leaders.
- Our strategic focus on providing consistent, quality services for niche products to chronic patient populations.
- The successful integration of strategic acquisitions.
- Our Clinical Business Solutions division, which delivers a full spectrum of pre- and post-launch clinical and marketing support services to a wide range of clients, including pharmaceutical and biopharmaceutical manufacturers.
- The addition of payor contracts that provide convenient solutions to the managed care community.

Our financial strength and corporate strategy are well aligned with the quality of our services and dedication of our people to best meet our customers' needs. We will continue to build on our strong foundation for long-term growth and to make our goals a reality. We believe our present initiatives along with many new opportunities will continue to strengthen Accredo's position as a marketplace leader.

Thank you for your continued interest and participation in our success.


David D. Stevens  
*Chairman and Chief Executive Officer*

<sup>1</sup> All numerical references to financial performance and stock price of the Company are made based upon fiscal years ended June 30.




## ACCREDITO

Health, Incorporated<sup>SM</sup>



Accredo Nova Factor provides nationwide distribution, pharmaceutical care management, reimbursement and information services for the biopharmaceutical industry. Accredo Nova Factor currently dispenses 14 product lines through two centralized facilities, usually into the home, where patients are typically trained to reconstitute and self-inject. Patients and physicians benefit from close relationships with clinical and reimbursement teams that specialize in their therapy and disease state.



Accredo Therapeutics is dedicated to the treatment of pulmonary arterial hypertension, alpha-1 antitrypsin deficiency and disorders requiring IVIG therapy. Through an extensive network of regional pharmacies, Accredo Therapeutics provides customized services to patients who require a substantial amount of local support, including initial training, immediate access to emergency inventory and ongoing local clinical support.



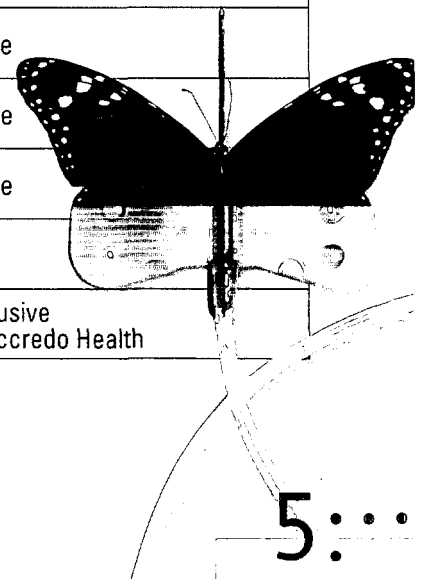
Hemophilia Health Services is the largest national healthcare company dedicated exclusively to the care of people living with bleeding disorders. It dispenses from two national facilities and also has dedicated staff in its pharmacy branches to support patients locally. Hemophilia Health Services has purchasing relationships with all manufacturers to help ensure patient choice and a constant supply of clotting factor.

# 2004 retail product portfolio

for products approved through june 30, 2004

Product	Manufacturer	Indication/Condition	Restrictions
Actimmune®	InterMune, Inc.	Chronic Granulomatous Disease, Severe Malignant Osteopetrosis	Three
Adagen®	Enzon Pharmaceuticals, Inc.	Severe Combined Immunodeficiency Disease	Exclusive to Accredo Health
Aldurazyme®	Genzyme Corporation	MPS 1 (Hurler, Hurler-Scheie, and Scheie Syndromes)	Two
Apokyn™	Bertek Pharmaceuticals Inc.	Hypomobility ("Off" Episodes) Associated with Advanced Parkinson's Disease	Three
Aralast™	Baxter International Inc.	Alpha-1 Antitrypsin Deficiency	Three
Avonex®	Biogen Idec Inc.	Multiple Sclerosis	Exclusive Preferred
Botox®	Allergan, Inc.	Blepharospasm, Cervical Dystonia, Hyperhidrosis, Strabismus	Exclusive Preferred
Cerezyme®	Genzyme Corporation	Gaucher Disease	Two
Clotting Factor	All Manufacturers	Hemophilia	Not Restricted
Enbrel®	Amgen Inc.	Rheumatoid Arthritis, Juvenile Rheumatoid Arthritis, Psoriatic Arthritis	Not Restricted
Fabrazyme®	Genzyme Corporation	Fabry Disease	Two
Flolan®	GlaxoSmithKline	Pulmonary Arterial Hypertension	Two
Growth Hormone	Genentech, Inc.	Growth Hormone Deficiency	Two
IVIG	All Manufacturers	Autoimmune Disorders & Primary Immune Deficiencies	Not Restricted
Orfadin®	Rare Disease Therapeutics, Inc.	Hereditary Tyrosinemia Type I	Exclusive to Accredo Health
Raptiva®	Genentech, Inc.	Chronic Moderate to Severe Plaque Psoriasis	Three
Remodulin®	United Therapeutics Corporation	Pulmonary Arterial Hypertension	Three
Synagis®	MedImmune, Inc.	Respiratory Syncytial Virus	Three
Tracleer®	Actelion Pharmaceuticals Ltd.	Pulmonary Arterial Hypertension	Three
Xolair®	Genentech, Inc.	Moderate to Severe Persistent Asthma	Five
Zemaira®	ZLB Behring	Alpha-1 Antitrypsin Deficiency	Exclusive to Accredo Health

\*Many biopharmaceutical manufacturers restrict dispensing privileges to one or only a few specialty pharmacies or designate a specialty pharmacy as preferred to take advantage of the dedicated service and attention of a pharmacy like Accredo Health.



# strategy

As a niche specialty pharmacy, Accredo limits the number of products it distributes to selected market leading therapies. By concentrating on and aggressively supporting this small number of niche drugs, Accredo provides patients, physicians, manufacturers and payors with enhanced levels of service. This focus allows Accredo to carefully select products that are a good fit for its service model, giving the Company the opportunity to achieve and maintain the market leading sales position.

**Accredo's business model is manufacturer centric.** With services tailored for manufacturers and their products, Accredo seeks preferred or restricted access distribution agreements. Patients and physicians benefit from these services through Accredo's therapy-dedicated teams, extensive knowledge of the products and disease states and ability to maneuver through the complicated reimbursement processes. Payors benefit through drug cost management, utilization monitoring and improved clinical outcomes.

**Accredo focuses mainly on products with restricted access.** The Company dispenses drugs in which the manufacturer restricts or limits distribution rights to only one or a few providers. This status gives Accredo the opportunity to gain a significant portion of market share.

**Accredo concentrates on life-long, clinically challenging therapies for potentially fatal diseases.** These products are primarily injectable, have potentially severe side effects or adverse reactions, require ongoing clinical monitoring and have strict shipping and handling requirements. Accredo's chronic patient populations depend on its services to provide long-term clinical and emotional support to help cope with these challenges. Therapy dedicated clinical teams counsel patients to aid in their compliance with prescribed treatment schedules and to educate them about effectively managing their complex diseases.

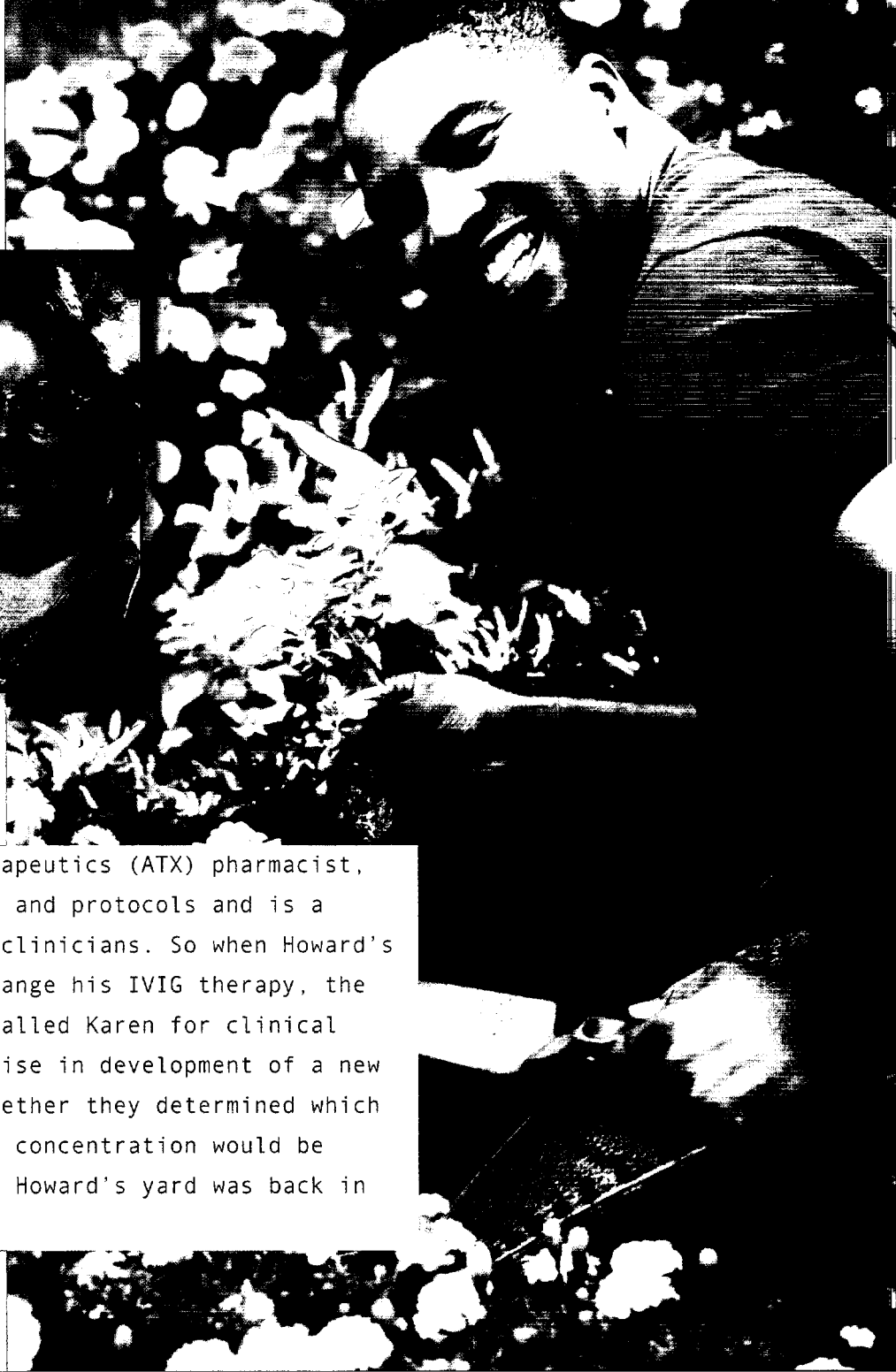
The products Accredo distributes are expensive with costs typically ranging from \$8,000 to \$300,000 per patient, per year. The long duration and high cost of therapy generally required to treat chronic diseases make reimbursement services essential to help patients maintain access to these medications. Therapy-dedicated reimbursement teams work on behalf of patients to research benefits, obtain prior authorizations, file claims and accept direct payments.

## Meet Matthew



Matthew's parents are overjoyed at his arrival. Before leaving the hospital, their joy quickly turns to concern when he is diagnosed with hemophilia, a life-long bleeding disorder.





Karen, an Accredo Therapeutics (ATX) pharmacist, studies IVIG therapies and protocols and is a resource for ATX field clinicians. So when Howard's physician needed to change his IVIG therapy, the local ATX pharmacist called Karen for clinical information and expertise in development of a new clinical protocol. Together they determined which drug, dosage, rate and concentration would be best for Howard. Soon, Howard's yard was back in showcase condition.



Matthew's hematologist prepares his parents for the challenges ahead. He refers the family to Hemophilia Health Services where Matthew is assigned a care team dedicated exclusively to the needs of people living with hemophilia. Now the family has a partner in Matthew's care and do not have to go through this alone.

# relationships

Accredo cultivates long-term relationships with drug manufacturers whose products are market leaders. Through exclusive or preferred relationships, Accredo can negotiate lower cost of goods for the products. In addition to this favorable pricing, Accredo receives field support from manufacturers' sales representatives and additional fees for value-added services.

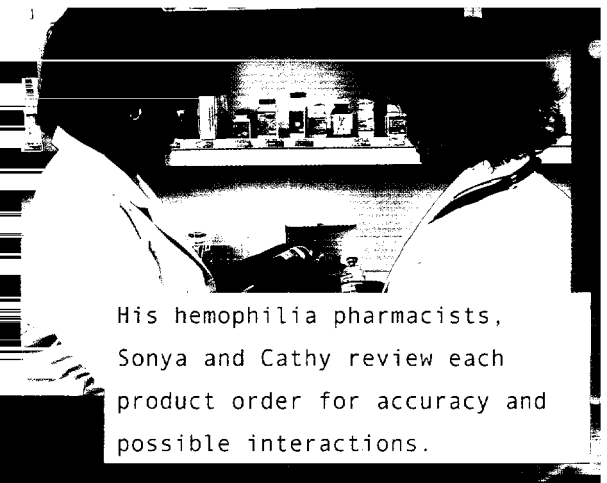
Accredo is compensated for the customized services unique to each product and disease. Through preferred agreements, the Company is paid by the manufacturer to provide specific support services including compliance and persistency monitoring, home care coordination, replacement programs and many other patient-focused services. These specialized services support the patients who rely on these drugs and help manufacturers differentiate their products in the marketplace.

Accredo's goal is to be the specialty pharmacy of choice. While therapy teams provide customized services to patients and physicians, the Company provides manufacturers and payors with valuable reporting data and educational services to their clients. This education encourages proper drug handling and utilization and prevents wastage of these expensive products.

As the largest U. S. purchaser of clotting factor and IVIG, Accredo has access to products in times of tight supply when many of its competitors do not. Accredo purchases clotting factor and IVIG from all manufacturers. The Company's sizeable market share allows for favorable pricing and gives it continuous access to all products and a wide range of assays to assure proper dosing.

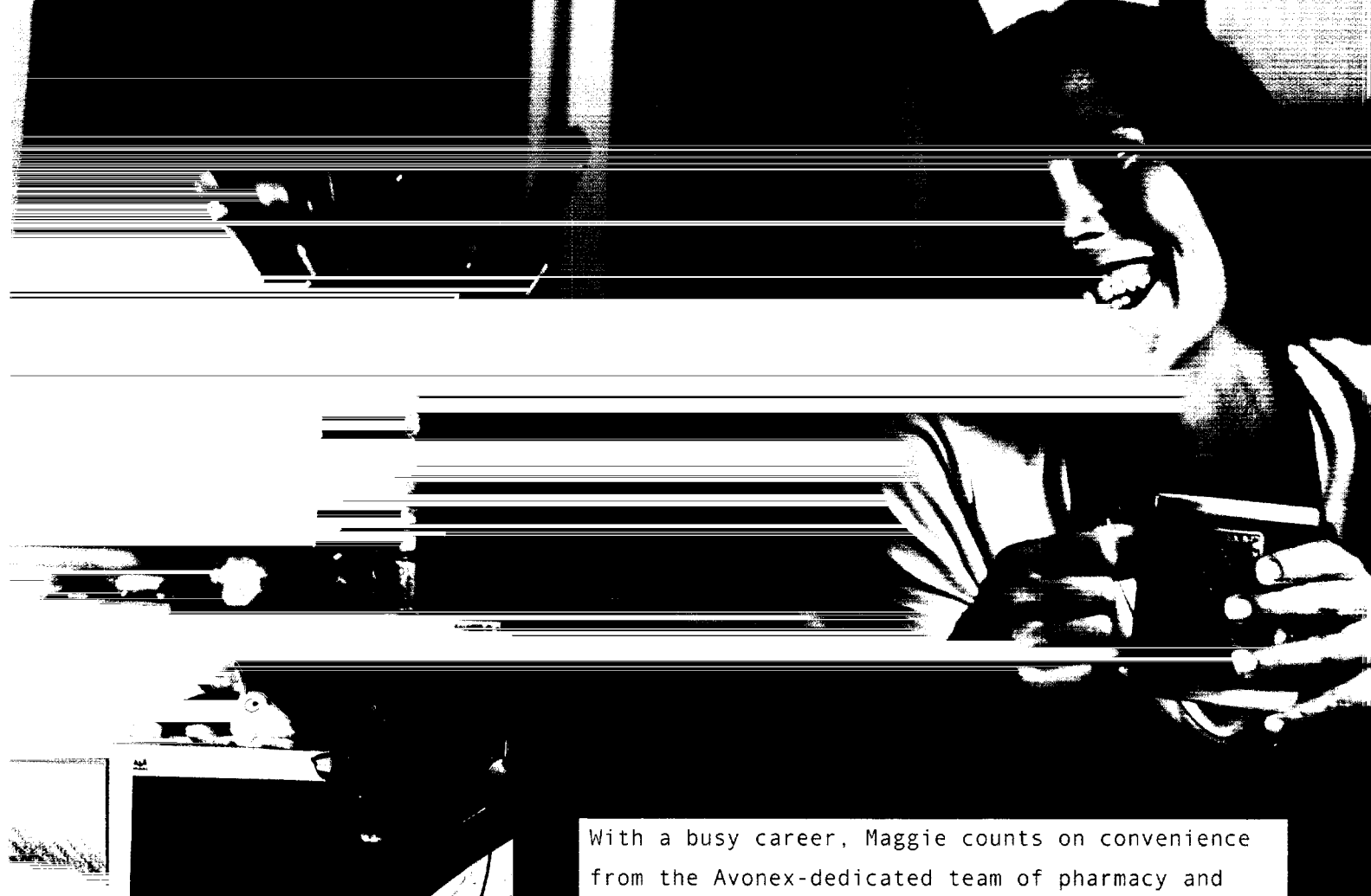
Medco Health Solutions and Accredo entered into a 10-year strategic alliance. Accredo is now the preferred specialty pharmacy provider to Medco's members for the product lines Accredo currently distributes. The Company provides Medco's clients a cost-effective, single source solution for its specialized products and services. Operating on a single integrated communications platform, Medco and Accredo provide a seamless experience for the client and patient from the moment the prescription is received through the delivery and payment process.

Hemophilia Health Services (HHS) nurse case manager completes an assessment and works with Matthew's doctor to design an individualized care plan. Matthew's pharmacy care coordinator stays in regular contact with the family and coordinates his clotting factor and supply shipments.



His hemophilia pharmacists, Sonya and Cathy review each product order for accuracy and possible interactions.





With a busy career, Maggie counts on convenience from the Avonex-dedicated team of pharmacy and reimbursement professionals to help manage her multiple sclerosis therapy. Each month she receives a phone call or email from her pharmacy team to answer any questions and schedule her next shipment, which is delivered right to her door by reliable FedEx® service. An experienced Avonex patient representative, like Fred, works behind the scenes handling all the insurance phone calls and paperwork so Maggie can spend her spare time painting.

Insurance matters are handled by HHS dedicated team's reimbursement specialist who is knowledgeable about handling Avonex hemophilia claims.

Matthew's parents meet with John, their HHS community advocate, in their home. He reviews paperwork, coordinates education services and answers questions.



# market position

Accredo has a diversified revenue stream due to its expanded product portfolio. The Company has grown from its initial dependence on just a few products and currently dispenses products for 21 therapies. Seven of these 21 product lines each exceeded \$100 million in annual revenues in fiscal 2004.

Accredo realizes a sustainable and recurring revenue stream by focusing on and treating chronically ill patients, many of whom are on therapy for a lifetime. Through its high-touch service model, Accredo assists patients in managing their diseases, thereby boosting therapy compliance (taking their prescription as directed) and persistence (remaining on therapy). Compliance and persistence ultimately benefit the patient, physician, payor and manufacturer.

Accredo has the market leading position in many of the major product lines in which it competes. The Company is extremely selective about the drugs it chooses to dispense — focusing on drugs that treat chronic illnesses, have the potential to become market leaders and possess historical supply/demand issues. It also looks to obtain an exclusive or preferred relationship with the drugs' manufacturers.

Accredo maintains its market position by remaining true to its strategy of focusing on only a few niche biopharmaceutical products. Conversely, many of Accredo's competitors have chosen to provide all biotech drugs (250+). But with a team of clinical and reimbursement specialists dedicated exclusively to a specific disease state, the Company provides high performance levels and a wide variety of services to patients, physicians, manufacturers and payors.

Accredo's gross profit and operating margins are enhanced by its value-added service model. The diversity in product offering, the recurring revenue stream, the market leading position and the access to inventory in times of shortage strengthen Accredo's financial results and position. Manufacturers and payors continue to see the benefits of aligning with Accredo.



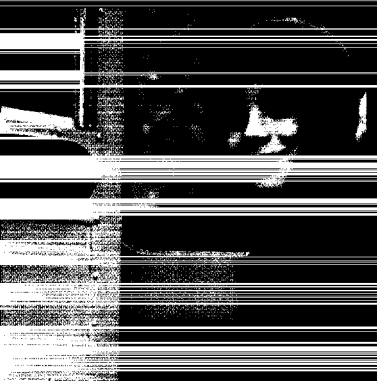
Matthew's first clotting factor shipment arrives at his home. Each of his clotting factor orders is sent in special packaging to help ensure product safety and stability. Hemophilia Health Services arranges for a nurse specially trained in hemophilia to help the family master home infusion. This education gives Matthew's family independence in caring for their son.

FRAGILE  
HANDLE  
WITH CARE

As a premature baby, Luis received Synagis to prevent Respiratory Syncytial Virus (RSV). His Synagis-dedicated pharmacist, Eulanda, coordinated Luis' monthly drug shipments to his physician and made sure Luis received the correct dosage. Today Luis is growing strong and enjoys playtime at the park with his mother.



Throughout Matthew's life, his team at Hemophilia Health Services will be here to assist with clinical, reimbursement and social issues.



It is Matthew's first day of school, and Hemophilia Health Services is there to educate his teachers about his bleeding disorder. Now Matthew's only concern is homework.

# corporate information

## shareholder information

### Stock Price

Common Stock Price Range  
Year Ended June 30

2004	High	Low
First quarter	\$30.28	\$21.35
Second quarter	\$32.99	\$27.29
Third quarter	\$39.98	\$30.00
Fourth quarter	\$40.70	\$33.75

2003	High	Low
First quarter	\$36.29	\$24.87
Second quarter	\$38.65	\$25.19
Third quarter	\$39.67	\$21.02
Fourth quarter	\$26.31	\$11.95

The Company has no plans to pay dividends in the foreseeable future.

### Transfer Agent & Registrar

American Stock Transfer & Trust Company  
6201 15<sup>th</sup> Street  
Brooklyn, NY 11219

### Auditors

Deloitte & Touche LLP  
100 Peabody Place  
Memphis, TN 38103

### Stock Listing and Shareholders

Accredo Health, Inc. is traded on the NASDAQ National Market under the symbol ACDO. The approximate number of shareholders on October 8, 2004 was 36,000.

### Annual Meeting

The Accredo Health annual meeting of shareholders will be held on Monday, November 22, 2004 at 9:00 a.m. at 7420 Goodlett Farms Boulevard, Suite 110 Cordova, TN 38018.

### Fiscal Year

Accredo Health's fiscal year ends June 30.

## supplemental information

For copies of the form 10-K report filed with the Securities and Exchange Commission, or for additional information about Accredo Health, please contact: Investor Relations, Accredo Health Incorporated  
1640 Century Center Parkway, Suite 101  
Memphis, TN 38134-8849  
901.381.7442, or [InvestorRelations@AccredoHealth.com](mailto:InvestorRelations@AccredoHealth.com).

## trademark information

Actimmune (interferon gamma 1-b) is a registered trademark of Genentech, Inc.

Adagen (pegademase bovine) is a registered trademark of Enzon, Inc.

Aldurazyme (laronidase) is a registered trademark of BioMarin/Genzyme LLC.

Apokyn (apomorphine hydrochloride injection) is a trademark of Bertek Pharmaceuticals Inc.

Aralast [alpha-1 proteinase inhibitor (human)] is a trademark of Baxter International Inc.

Avonex (interferon beta-1a) is a registered trademark of Biogen Idec MA Inc.

Botox (botulinum toxin Type A) is a registered trademark of Allergan Limited.

Cerezyme (imiglucerase for injection) is a registered trademark of Genzyme Corporation.

Enbrel (etanercept) is a registered trademark of Immunex Corporation.

Fabrazyme (agalsidase beta) is a registered trademark of Genzyme Corporation.

FedEx is a registered trademark of Federal Express Corporation.

Flolan (epoprostenol) is a registered trademark of BW USA, Inc.

Orfadin (nitisinone) is a registered trademark of Swedish Orphan International AB distributed by Rare Disease Therapeutics, Inc.

Raptiva (efalizumab) is a registered trademark of Genentech, Inc.

Remodulin (treprostinil sodium) is a registered trademark of United Therapeutics Corporation.

Synagis (palivizumab) is a registered trademark of MedImmune, Inc.

The NASDAQ Stock Market is a registered trademark of the NASDAQ Stock Market, Inc.

Tracleer (bosentan) is a registered trademark of Actelion Pharmaceuticals Ltd.

Xolair (omalizumab) is a registered trademark of Novartis AG.

Zemaira (alpha<sub>1</sub>-proteinase inhibitor [human]) is a registered trademark of Aventis Behring L.L.C.

## directors

**J. Martin Carroll**<sup>3</sup>  
*President and Chief Executive Officer*  
*Boehringer Ingelheim Corporation*

**Nancy-Ann DeParle**<sup>2</sup>  
*Senior Advisor*  
*JP Morgan Partners, LLC*

**William Edward Evans**<sup>2</sup>  
*Director*  
*St. Jude Children's Research Hospital*

**Dick R. Gourley**<sup>3</sup>  
*Dean and Professor of Pharmacy with Tenure*  
*College of Pharmacy, University of Tennessee*  
*Health Science Center*

**Kenneth R. Masterson**\*<sup>3</sup>  
*Executive Vice President, General Counsel*  
*and Secretary*  
*FedEx® Corporation*

**Kenneth J. Melkus**<sup>1,2</sup>  
*Consultant*  
*Welsh Carson Anderson & Stowe*

**Kevin L. Roberg**<sup>1</sup>  
*Partner*  
*Delphi Ventures*

**Thomas G. Rotherham**<sup>1</sup>  
*Senior Vice President*  
*West Wind, LLC*

## officers

**Thomas W. Bell, Jr.**  
*Senior Vice President, General Counsel*  
*and Secretary*  
*Accredo Health, Incorporated*

**Barbara H. Biehner**  
*Senior Vice President*  
*Accredo Health, Incorporated*

**Kyle J. Callahan**  
*President*  
*Hemophilia Health Services*

**Steven R. Fitzpatrick**  
*President*  
*Accredo Therapeutics*

**Joel R. Kimbrough**  
*Senior Vice President, Chief Financial*  
*Officer and Treasurer*  
*Accredo Health, Incorporated*

**Jon B. Peters**  
*Senior Vice President*  
*Accredo Health, Incorporated*

**David D. Stevens**  
*Chairman and Chief Executive Officer*  
*Accredo Health, Incorporated*

\*Lead Director

<sup>1</sup>Audit Committee

<sup>2</sup>Compensation Committee

<sup>3</sup>Nominating and Corporate Governance Committee

The Company's 10-K for fiscal year ended June 30, 2004 is an integral part of this Annual Report to Shareholders and is included in this pocket. The 10-K includes Selected Consolidated Financial Data, the Company's Financial Statements, Notes to the Consolidated Financial Statements, Risk Factors, Management's Discussion and Analysis of Financial Condition and Results of Operations and Business Description.

## forward looking statements

In addition to historical information, this Annual Report contains forward-looking statements within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. Such statements may be identified by words such as anticipate, believe, estimate, expect, intend, predict, hope or similar expressions. Such statements, which include estimated financial information or results, are based on management's current expectations and are subject to a number of factors and uncertainties which could cause actual results to differ materially from those described in the forward-looking statements, including, without limitation: the loss of a biopharmaceutical relationship; our inability to sell existing products; the ability to successfully integrate acquisitions; the impact of pharmaceutical industry regulation; the difficulty of predicting FDA and other regulatory authority approvals; the regulatory environment and changes in healthcare policies and structure; the outcome of litigation; acceptance and demand for new pharmaceutical products and new therapies; the impact of competitive products and pricing; the ability to obtain products from suppliers; reliance on strategic alliances; the ability to expand through joint ventures and acquisitions; the ability to maintain pricing arrangements with suppliers that preserve margins; the need for and ability to obtain additional capital; the seasonality and variability of operating results; the Company's ability to implement its strategies and achieve its objectives and the risks and uncertainties described in reports filed by Accredo with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended, including without limitation, cautionary statements made in Accredo's 2004 Annual Report on Form 10-K under the heading "Risk Factors."



☆ 4 Centralized Retail Pharmacies

⊙ 36 Branch Pharmacies

revised 9/2004

**Accredo Health, Incorporated**  
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 1640 Century Center Parkway, Suite 101  
 Memphis, TN 38134-8849  
 877.222.7336  
 901.385.3688  
[www.AccredoHealth.com](http://www.AccredoHealth.com)

**divisions**

**Accredo Nova Factor**  
 1620 Century Center Parkway, Suite 109  
 Memphis, TN 38134-8849  
 800.235.8498  
 901.385.3600  
[www.NovaFactor.com](http://www.NovaFactor.com)

**Accredo Therapeutics**  
 1640 Century Center Parkway, Suite 105  
 Memphis, TN 38134-8849  
 866.289.7577  
 901.385.3707  
[www.AccredoTX.com](http://www.AccredoTX.com)

**Hemophilia Health Services**  
 6820 Charlotte Pike  
 Nashville, TN 37209-4234  
 800.800.6606  
 615.352.2500  
[www.HemophiliaHealth.com](http://www.HemophiliaHealth.com)



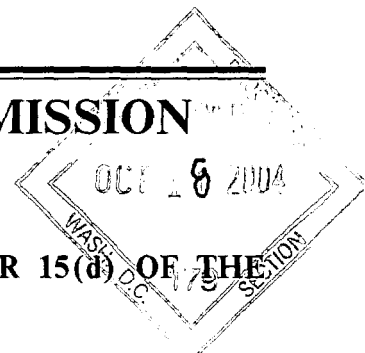
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**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-K**



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

For the fiscal year ended June 30, 2004

OR

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

Commission File Number 000-25769

**Accredo Health, Incorporated**

*(Exact name of company as specified in its charter)*

**Delaware**

*(State or other jurisdiction of  
incorporation or organization)*

**62-1642871**

*(I.R.S. Employer  
Identification No.)*

**1640 Century Center Pkwy, Suite 101, Memphis, Tennessee 38134**

*(Address, including Zip Code, of principal executive offices)*

**Registrant's telephone number, including area code: (901) 385-3688**

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

**None**

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

**Common Stock, \$.01 par value**

**Series A Junior Participating Preferred Stock Purchase Rights**

*(Title of Class)*

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

The aggregate market value of the voting stock held by non-affiliates of the Company was \$1,484,541,239 as of December 31, 2003, based upon the last sale of such stock as reported on the Nasdaq National Market System ("Nasdaq Stock Market") on that day (assuming for purposes of this calculation, without conceding, that all executive officers and directors are affiliates). There were 48,636,694 shares of common stock, \$.01 par value, outstanding at August 26, 2004.

**DOCUMENTS INCORPORATED BY REFERENCE**

Parts of the Registrant's Proxy Statement for its 2004 Annual Meeting of Stockholders are incorporated by reference in Part III of this Annual Report.

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## PART I

This report contains "forward-looking statements." Forward-looking statements relate to expectations, beliefs, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts or that necessarily depend upon future events. In some cases, you can identify forward-looking statements by terms such as "may," "will," "should," "could," "would," "expect," "plan," "anticipate," "believe," "estimate," "project," "predict," "potential," and similar expressions. Specifically, this report contains, among others, forward-looking statements about:

- our expectations regarding financial condition or results of operations for periods after June 30, 2004;
- our future sources of and needs for liquidity and capital resources;
- our critical accounting policies;
- our expectations regarding the size and growth of the market for our products and services;
- our business strategies and our ability to grow our business;
- the implementation or interpretation of current or future regulations and legislation relating to the industry in which we operate; and
- our ability to maintain contracts and relationships on terms that are satisfactory to us with biopharmaceutical manufacturers such as Biogen Idec, Inc. (Biogen); Genzyme Corporation; MedImmune, Inc.; GlaxoSmithKline, Inc.; and Genentech Inc.

The forward-looking statements contained in this report reflect our current views about future events, are based on assumptions and are subject to known and unknown risks and uncertainties. Many important factors could cause actual results or achievements to differ materially from any future results or achievements expressed in or implied by our forward-looking statements. Many of the factors that will determine future events or achievements are beyond our ability to control or predict. Important factors that could cause actual results or achievements to differ materially from the results or achievements reflected in our forward-looking statements include, among other things, the risk factors beginning on page 18 hereof.

You should read this report, the information incorporated by reference into this report and the documents filed as exhibits to this report completely and with the understanding that our actual future results or achievements may be materially different from what we expect or anticipate.

The forward-looking statements contained in this report reflect our views and assumptions only as of the date this report is signed. Except as required by law, we assume no responsibility for updating any forward-looking statements.

We qualify all of our forward-looking statements by these cautionary statements. In addition, with respect to all of our forward-looking statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

### **Item 1. *Business***

#### **Overview**

We are one of the largest providers of specialty retail pharmacy services in the United States. We sell a limited number of high cost drugs for the recurring treatment of chronic and potentially life threatening diseases. We also provide services to our patients, and we are paid for our products and services in two ways. We are paid for dispensing medications to patients similar to a typical retail pharmacy, and we are also often paid by the manufacturer to provide additional services. Our services help simplify the difficult and often challenging medication process for patients with a chronic disease and help ensure that patients receive and take their medication as prescribed. Our services benefit biopharmaceutical manufacturers and payors by accelerating patient acceptance of new drugs, facilitating patient compliance with prescribed treatments, addressing difficult reimbursement issues and capturing valuable clinical information about a new drug's effectiveness.

Our services include specialty retail pharmacy services, clinical services, reimbursement services and delivery services. We primarily provide overnight, temperature-controlled delivery of all drugs and supplies necessary for patients to self-administer their drug dosages safely and effectively in the privacy of their homes. Some of the drugs we sell are administered at physicians' offices or other alternative sites. We also provide services to patients who require our IV infused drugs. Our pharmacists and customer service staff talk frequently with patients over the telephone, help them comply with prescribed treatment schedules and educate them about ways to manage their complex diseases more effectively. Our reimbursement specialists manage the complicated paperwork that is required to collect payment for the patient's medication from insurance companies, managed care plans and governmental payors.

We sell a limited number of drugs to our patients. We mainly focus our services on injectable drugs that:

- are used on a recurring basis to treat chronic and potentially life-threatening diseases;
- are expensive, with annual costs generally ranging from approximately \$8,000 to \$300,000 per patient;
- are complex and clinically challenging with the potential for side effects or adverse reactions; and
- require temperature control or other specialized handling.

We have agreements with fifteen biopharmaceutical manufacturers to buy drugs and to provide varying degrees of specialty retail pharmacy services for our twenty-one primary product lines. Although most of our agreements that involve specialty retail pharmacy services are not exclusive, we generally are a recommended provider of the manufacturer's drug to payors, patients and physicians.

Accredo Health, Incorporated, was incorporated in Delaware in 1996. Our principal executive offices are located at 1640 Century Center Parkway, Suite 101, Memphis, Tennessee 38134. Our telephone number at that address is 901-385-3688.

## **Products and Services**

We offer the following products and services:

*Sale and Delivery of Drugs.* We sell and provide timely delivery of drugs and ancillary supplies directly to the patient or the patient's physician in packaging specially designed to maintain appropriate temperatures. The package typically contains all of the supplies required for administration in the patient's home or in other alternate sites. Substantially all products are shipped from our four primary pharmacy locations in Memphis, Tennessee; Charlotte, North Carolina; Nashville, Tennessee; and Pittsburgh, Pennsylvania. We also maintain 36 satellite pharmacy locations across the United States. We ship our products primarily via FedEx.

*Specialty Retail Pharmacy Services.* We offer customized services to biopharmaceutical manufacturers designed to meet specific needs that arise at various stages in the life cycles of their products.

Prior to product launch, we offer:

- consulting services related to strategic pricing decisions;
- analyses and information to assist manufacturers in evaluating payor mix and pricing strategies for their new drugs;
- testing of a manufacturer's packaging to assess maintenance of product temperatures and to determine whether the packaging system will meet the product's unique needs during normal shipping conditions;
- advice on injection and infusion supplies related to the drug therapy and assistance in procuring supplies and customized packaging for infusion supply kits; and
- clinical guidelines that assist nurses and caregivers in learning how to safely and effectively administer a drug, including sterilization techniques, supplies needed and infusion time required.

Following product launch, we offer:

- clinical hotlines that allow the physician or patient caregiver to inquire about product usage, adverse drug reactions and other clinical questions;
- reimbursement hotlines for patients and health care professionals;
- support for manufacturers' patient assistance programs for patients without the financial ability to otherwise acquire needed drugs and services;
- replacement drug and supply programs that replenish patients' inventory of products or supplies that become damaged;
- home care coordination programs that provide patient assistance in training, identify home care providers and transfer clinical information to all caregivers; and
- triage services that refer patients to the appropriate provider based on the patients' insurance provider network.

Results of our interaction with patients, which is primarily via telephone, are coded to protect privacy and tracked to compile valuable information, including side effects, drug interactions, administration problems, supply issues, physician prescription habits and reasons for therapy discontinuation and non-compliance.

We will also report on adverse drug reactions, log the occurrence, and complete an initial preliminary report of the occurrence to assist manufacturers in completing adverse event reports in a timely manner. We can also create a wide variety of additional reports that can be customized to meet specific manufacturers' needs. Examples of reports include sales by physician, sales by zip code, sales trending, first time patient orders, Medicaid and Medicare sales, inventory status and reasons for patient discontinuations. Due to the nature of the data we collect, we have established procedures designed to ensure compliance with laws regarding confidentiality and privacy of patient information.

*Clinical Services.* We work with the patient and the patient's physician to implement the prescribed plan of care. Each patient is assigned to a team consisting of a pharmacist, a customer service representative and a reimbursement specialist, and with certain therapies, a Registered Nurse. Generally, each patient's team members specialize only in that patient's disease and work only with payors and providers in that patient's geographic region. In helping to implement the prescribed plan of care, we:

- help patients understand their medication and treatment program;
- help patients manage potential side effects and adverse reactions that may occur so that patients are less likely to discontinue therapy;
- help coordinate backup care in the event of a medical emergency; and
- help patients establish an inventory management and record keeping system.

In addition, we assist patients and their families in coping with a variety of difficult and emotional social challenges presented by their diseases, participate in patient advocacy organizations, assist in the formation of patient support groups, advocate legislation to advance patient interests and publish newsletters for our patients.

*Reimbursement Services.* By focusing on specific chronic diseases, we have developed significant expertise in managing reimbursement issues related to the patient's condition and treatment program. Due to the long duration and high cost of therapy generally required to treat chronic disorders, the availability of adequate health insurance is a continual concern for chronically ill patients and their families. Generally, we contact the payor prior to each shipment to determine the patient's health plan coverage and the portion of costs that the payor will reimburse. Our reimbursement specialists review issues such as pre-authorization or other prior approval requirements, lifetime limits, pre-existing condition clauses, and the availability of special state programs. By identifying coverage limitations as part of an initial consultation, we can assist the patient in planning for alternate coverage, if necessary. From time to time, we negotiate with payors to facilitate or

expand coverage for the chronic diseases we serve. In addition, we accept assignment of benefits from numerous payors, which substantially eliminates the claims submission process for most patients.

### **Disease Markets and Related Products**

Many of the biopharmaceutical drugs that we sell, including growth hormones, anti-hemophilic factor, intravenous immunoglobulin (IVIG) and other blood-related products, are available from multiple sources. Currently, we sell and provide our specialty services primarily with respect to 21 product lines. The drugs we sell with respect to seven core disease markets account for approximately 90% of our revenues. These seven disease markets and the drugs that we sell to service these markets are described below.

With respect to drugs that we sell for our seven core disease therapies, Synagis® is the only treatment available for RSV and Cerezyme® is the only enzyme replacement therapy available for Gaucher Disease. We have agreed with Genzyme and Biogen to not sell drugs that compete with Cerezyme® and AVONEX®. There are other drugs that we do not sell that are similar to or that compete with some of the other drugs that we sell.

*Hemophilia.* Hemophilia is an inherited, genetic, lifelong bleeding disorder caused by the absence or inactivity of an essential blood clotting protein or "factor." Two major disease categories exist, hemophilia A, or Factor VIII deficiency, and hemophilia B, or Factor IX deficiency. It is estimated that there are approximately 20,000 people with hemophilia in the United States, and presently there is no known cure. Individuals with hemophilia may suffer from bleeding episodes that can occur spontaneously or as a result of physical activity or trauma. While small surface cuts can usually be treated with a pressure bandage, the most frequent complication of hemophilia is internal bleeding into muscles and joints, which can cause arthritis and debilitating orthopedic problems. More serious complications include internal bleeding in the head, neck, spinal cord or internal organs, which can cause death.

Hemophilia is generally treated by infusing blood clotting factor concentrates intravenously when the symptoms of a bleed are detected. This therapy is generally administered by the patient or his or her family members, without the assistance of a nurse, in response to bleeding episodes. Approximately 60% of the persons with hemophilia in the United States have a severe form of the disorder as measured by the level of factor naturally present in the body. In general, the more severe the factor deficiency, the more frequently the bleeding episodes may occur. On average, someone with severe hemophilia will need to infuse factor weekly. In many individuals with severe hemophilia, factor therapy is administered prophylactically to maintain high enough circulating factor levels to minimize the risk of bleeding.

Many hemophilia patients contracted hepatitis or human immunodeficiency virus, commonly known as HIV, as a result of contaminated blood derivative therapies they received prior to the mid-1980's. It is estimated that approximately one-half of the hemophilia population who received blood clotting factor prior to the mid-1980's was exposed to HIV and is at risk of developing acquired immune deficiency syndrome, commonly known as AIDS. We offer medications used in treating AIDS as a convenience to our hemophilia patients that have contracted HIV. In the early 1990's, recombinant clotting factor, a biotechnological alternative to plasma-derived factor, was introduced and has proved to be as effective as the blood-derived products with virtually no risk of viral transmission. Current utilization reflects increased use of recombinant products by physicians because of the advantages of increased purity. However, issues related to the development of inhibitors, or antibodies that neutralize the infused factor products and prevent clotting, may slow the increase in utilization rates of these products. Recently the Food and Drug Administration (FDA) has approved a new factor product Advate that contains no human or animal proteins or albumin.

There are currently seven major suppliers of FDA approved products used for treating hemophilia. We purchase products from all seven suppliers. The majority of our hemophilia product was purchased from Baxter Healthcare Corporation in the fiscal years ended June 30, 2002, 2003 and 2004.

We have entered into hemophilia product distribution agreements with Baxter Healthcare Corporation and ZLB Behring naming us as a non-exclusive hemophilia specialty pharmacy provider of hemophilia products to home care patients in the United States and Puerto Rico. These agreements provide for minimum

purchase commitments by us and our acquisition cost of the drugs is based upon the volume of product purchased by us.

*Pulmonary Arterial Hypertension.* Pulmonary Arterial Hypertension (PAH) is a chronic pulmonary disease for which there is no known cure. Patients with this disease experience an increase in pulmonary arterial pressure that results in symptoms such as dyspnea, palpitations and syncope. Generally, PAH impacts patients of all ages, but is commonly diagnosed between the ages of 20 and 40. It is estimated that 1 to 2 out of every 1 million Americans will develop Primary Pulmonary Hypertension, a common form of PAH. Once diagnosed, PAH patients receive therapy for the remainder of their lifetime or until they receive a lung transplant. This disease is treated with one, or a combination, of the following three products:

- Flolan<sup>®</sup>, which is an epoprostenol sodium product manufactured by GlaxoSmithKline;
- Tracleer<sup>®</sup>, which is a bosentan product manufactured by Actelion Pharmaceuticals U.S., Inc.; and
- Remodulin<sup>®</sup>, which is a treprostinil sodium product manufactured by United Therapeutics Corporation.

We have agreements with GlaxoSmithKline for the sale of Flolan<sup>®</sup>, with United Therapeutics Corporation for the sale of Remodulin<sup>®</sup>, and with Actelion Pharmaceuticals U.S., Inc. for the sale of Tracleer<sup>®</sup>. These agreements have multiple year terms, may be terminated without cause on 90 to 365 days prior notice and obligate us to provide varying degrees of specialized services.

*Autoimmune Disorders and Primary Immunodeficiency Disease.* Autoimmune disorders describe a group of chronic diseases in which the body treats its own tissues or cells as if they were foreign substances and produces antibodies to attack and destroy those tissues or cells. Most autoimmune disorders currently are incurable and tend to become progressively more severe. Various therapies, including IVIG, are administered to minimize the effects of autoimmune disorders and the severity of their associated symptoms. Although often administered via infusion in a hospital or physician's office, patients who require repeated treatment can have IVIG administered at home.

Primary Immunodeficiency Diseases (PID) are a group of disorders caused by an absence or malfunction of a component of the immune system. The component most often missing or malfunctioning is antibodies or immunoglobulins. Due to the lack of antibodies these patients have an increased susceptibility to life threatening infections and chronic lung disease. Primary immunodeficiencies can occur at any age. IVIG treatment replaces the antibodies missing or malfunctioning. Currently there is no other alternative therapy.

Because IVIG is collected and processed from human donors, the IVIG product market can be somewhat limited by supply constraints. We purchase product from all six major suppliers of IVIG in the United States. We have volume commitment purchase contracts with Baxter Healthcare Corporation and ZLB Behring. The majority of IVIG sold by us in the fiscal years ended June 30, 2003 and 2004 was acquired from Baxter.

*Multiple Sclerosis.* Multiple Sclerosis is a progressive neurological disease in which the body loses the ability to transmit messages among nerve cells, leading to a loss of muscle control, paralysis and, in some cases, death. Patients with active relapsing Multiple Sclerosis experience an uneven pattern of disease progression characterized by periods of stability interrupted by flare-ups of the disease. Industry sources estimate that Multiple Sclerosis affects between 250,000 and 350,000 people in the United States, approximately two-thirds of whom are women. Disease onset typically occurs in young adults between the ages of 20 and 40. Of the patients diagnosed with Multiple Sclerosis in the United States, about 90% of patients initially have relapsing Multiple Sclerosis and about half of those patients go on to develop a progressive form of the disease. About 10% of patients exhibit a progressive form of the disease at onset. Industry sources estimate that, of the persons currently affected by Multiple Sclerosis in the United States, approximately 50% have a

relapsing form of the disease, and approximately 50% have a progressive form. There are currently four FDA-approved products used for treating relapsing Multiple Sclerosis:

- AVONEX®, which is manufactured by Biogen Idec, Inc.;
- Betaseron®, which is manufactured by Chiron Corporation;
- Copaxone®, which is manufactured by Teva Pharmaceutical Industries Limited; and
- Rebif®, which is manufactured by Serono, S.A.

Effective September 1, 2002, we entered into amended and restated agreements with Biogen pursuant to which we are a preferred distributor of AVONEX® and provide various services and information to Biogen. The agreements are for a term ending December 31, 2005. Our agreements with Biogen are terminable by either party in the event of a breach. Our agreements provide that as long as we are the only preferred home delivery service provider approved by Biogen, we may not, without Biogen's approval, sell any products that compete with AVONEX® for the treatment of Multiple Sclerosis. In some circumstances we may not sell competing products for a year following the termination of the agreements. We do not have exclusive rights to sell AVONEX®, and Biogen has reserved the right under our agreements to sell AVONEX® directly or to appoint other providers of AVONEX®, but any such action would eliminate our exclusivity obligations. AVONEX® is generally administered via a single intramuscular injection once per week.

*Gaucher Disease.* Gaucher Disease is a seriously debilitating, sometimes fatal, genetic disorder caused by a deficiency of an important enzyme in the body called glucocerebrosidase. This deficiency results in the accumulation of the glucocerebroside lipid in the cells of organs in the body. The disease is characterized by an enlarged liver or spleen, anemia, bleeding problems, fatigue, bone and joint pain and other orthopedic complications such as repeated fractures and bone erosion. Type I Gaucher Disease is the most common form of Gaucher Disease, affecting about 90% of all Gaucher patients. Genzyme's Ceredase® and Cerezyme® products are FDA-approved products used for treating Type I Gaucher Disease. Cerezyme® is the newer product, and we have very few patients receiving Ceredase®. The FDA has approved a third product, Zavesca®, for the treatment of mild to moderate Gaucher Disease where enzyme replacement is not appropriate. We do not distribute this drug.

We have a longstanding relationship with Genzyme relating to Cerezyme®. Cerezyme® is administered by intravenous infusion. Dosing frequencies vary, but a typical dosing regimen involves administration once every two weeks. Pursuant to our current agreements with Genzyme, we are a preferred distributor of Cerezyme® in the United States and its Territories and provide various information and other services to Genzyme. The pricing of Cerezyme® under our agreements with Genzyme, as well as the scope and pricing of services that we provide, are subject to periodic review. Our agreements with Genzyme are for a term ending April 1, 2005. The Agreements automatically renew on an annual basis unless either party provides 90 days prior notice of non-renewal, and are terminable by either party for any reason with 90 days prior notice. In addition, the agreements provide that, during the term of the agreements and for a period of five years after their termination, we may not sell any prescription drug for the treatment of Gaucher Disease other than Cerezyme®. We do not have exclusive rights to sell Cerezyme®. Genzyme has reserved the right under the agreements to sell Cerezyme® directly or to appoint other distributors of this product.

*Growth Hormone-Related Disorders.* A major treatable cause of growth delay in children is growth hormone deficiency. It is estimated that there are approximately 40,000 pediatric patients in the United States who are candidates for growth hormone therapy. The market for growth hormone products is relatively mature, and currently five manufacturers sell eleven FDA-approved growth hormone products for a variety of indications. However, a majority of patients currently being treated with growth hormone products use one of Genentech's growth hormone products, Protropin®, Nutropin®, or Nutropin AQ®, the first long-acting dosage form of recombinant human growth hormone.

We have purchasing relationships with all five manufacturers of growth hormone products used in the United States, including a long-standing relationship with Genentech. A sixth manufacturer is about to enter the market. Typically, patients or family members administer growth hormone products at home without the presence of a nurse. Most growth hormone products require administration by injection several times per

week, and in some cases daily. We have entered into an amended and restated national distribution agreement with Genentech in which we also provide compliance programs, nursing coordination, various information and other services relating to Genentech's human growth hormone products, Protropin<sup>®</sup>, Nutropin<sup>®</sup>, and Nutropin AQ<sup>®</sup> in the United States. The pricing of Protropin<sup>®</sup>, Nutropin<sup>®</sup>, and Nutropin AQ<sup>®</sup> under the distribution agreement, as well as the scope and pricing of the services provided by us, are subject to adjustment depending on the Company meeting certain performance criteria. The distribution agreement has a term expiring December 31, 2006. The agreement may be terminated by Genentech if we have a change of control and may be terminated by either party following 90-days notice. We do not have exclusive rights to distribute Protropin<sup>®</sup>, Nutropin<sup>®</sup>, and Nutropin AQ<sup>®</sup>. Genentech has reserved the right under our agreement to sell these drugs directly or to appoint other distributors of these drugs.

*Respiratory Syncytial Virus.* Respiratory Syncytial Virus (RSV) is a serious lower respiratory tract disease that primarily attacks pediatric patients. RSV is the most common cause of pneumonia and bronchiolitis in infants and children. Approximately two-thirds of infants are infected with RSV during the first year of life, and almost all have been infected by age two. It has been estimated that, nationwide, there are approximately 300,000 children at risk of requiring treatment for RSV each year and approximately 90,000 hospitalizations due to RSV infections.

Synagis<sup>®</sup> (palivizumab), a drug manufactured by MedImmune, Inc. has been shown to significantly reduce RSV hospitalizations in pediatric patients at risk of the disease. Clinical studies have shown that preventive treatment with Synagis<sup>®</sup> was associated with a 55% reduction in overall hospitalizations due to RSV. Physicians prescribe Synagis<sup>®</sup> to immunize infants who are at high risk for serious lung impairment. Synagis<sup>®</sup> is typically administered by intramuscular injection once a month over a six month period.

RSV is seasonal, with the disease striking primarily during the period of October through April. Our distribution agreement with MedImmune renews on an annual basis upon the mutual consent of the parties and is terminable by either party for any reason on 60 days notice. We do not have the exclusive right to sell Synagis<sup>®</sup>, although we were a national preferred assignment of benefits distributor of the drug for the 2003-2004 respiratory syncytial virus season. We have recently renewed our agreement with MedImmune to continue as one of three national preferred assignment of benefits distributors for the 2004-2005 season.

## **Suppliers**

We primarily dispense growth hormones, blood clotting factor, IVIG, as well as other drugs obtained from the following sources:

- Actelion Pharmaceuticals U.S., Inc., with respect to Tracleer<sup>®</sup>;
- Allergan, Inc., with respect to Botox<sup>®</sup>;
- Amgen, Inc., with respect to Enbrel<sup>®</sup>;
- Baxter Healthcare Corporation, with respect to Aralast<sup>™</sup>;
- Bertek Pharmaceuticals, Inc. with respect to Apokyn<sup>™</sup>;
- Biogen Idec, Inc., with respect to AVONEX<sup>®</sup>;
- Enzon, Inc., with respect to Adagen<sup>®</sup>;
- Genentech, Inc. with respect to Xolair<sup>™</sup> and Raptiva<sup>®</sup>;
- Genzyme Corporation, with respect to Cerezyme<sup>®</sup>, Aldurazyme<sup>®</sup> and Fabrazyme<sup>®</sup>;
- GlaxoSmithKline PLC, with respect to Flolan<sup>®</sup>;
- InterMune, Inc., with respect to Actimmune<sup>®</sup>;
- MedImmune, Inc. with respect to Synagis<sup>®</sup>;
- Rare Disease Therapeutics, Inc., with respect to Orfadin<sup>®</sup>;



- United Therapeutics Corporation, with respect to Remodulin®; and
- ZLB Behring with respect to Zemaira™.

We have supply relationships with all seven major suppliers of blood clotting factor and all six major suppliers of IVIG in the United States. The majority of our hemophilia product was purchased from Baxter Healthcare Corporation for the years ended June 30, 2002, 2003 and 2004 and the majority of IVIG sold by us in fiscal years ended June 30, 2003 and 2004 was also acquired from Baxter.

Although there are five manufacturers of FDA-approved growth hormone products currently used in the United States, Genentech's products collectively enjoy a market share that exceeds the aggregate of all other individual manufacturers of growth hormone products. In the event that one or more of our current suppliers of products were to cease selling products to us, our business, financial condition and results of operations would be materially and adversely affected.

Our agreements with our key suppliers generally may be canceled by either party, without cause, with 60 to 365 days prior notice. In addition, our agreements with our suppliers generally provide that during the term of the agreements (and, in one instance, for as much as five years after termination of the agreements), we may not distribute any competing products. We generally do not have any exclusive rights to dispense our products, and our suppliers have generally reserved the right under their agreements with us to distribute their products directly or to appoint other distributors of their products. See "Risk Factors — We are highly dependent on our relationships with a limited number of biopharmaceutical suppliers and the loss of any of these relationships could significantly impact our ability to sustain or grow our revenues." and "Business — Disease Markets and Related Products."

#### **Relationships with Medical Centers**

At June 30, 2004, we had joint ventures with four medical centers (or their affiliates):

- Children's Home Care located in Los Angeles, California;
- Alternative Care Systems, Inc. located in Dallas, Texas;
- Cook Children's Home Health located in Ft. Worth, Texas; and
- Children's National Medical Center located in Washington D.C.

In our typical joint venture arrangement, we and the medical center (or its affiliate) form a joint venture entity to provide specialty retail pharmacy services. We share in the profits and losses of the joint venture entity with the medical center (or its affiliate) in proportion to our respective capital contributions. The agreements generally have initial terms of one to five years and contain rights of first refusal.

In addition to joint venture relationships, we have entered into management agreements with other childrens hospitals and adult medical centers (or their affiliates) to provide specialty retail pharmacy services. Under our management agreements, we provide goods and services used in the hospitals' or joint ventures' specialty retail pharmacy business, including drugs and related supplies, patient education, clinical consultation, and reimbursement services. While the payment terms under such management agreements may vary, we are generally reimbursed for our costs and are paid a monthly management fee generally calculated as a percentage of revenues. These agreements usually have terms of one to five years and are terminable by either party, with or without cause, with one to twelve months prior notice. See "Risk Factors — If our relationships with some medical centers are disrupted or canceled, our business could be harmed."

#### **Acquisition of Specialty Pharmaceuticals Division of Gentiva Health Services, Inc.**

On June 13, 2002, we acquired substantially all of the assets of the Specialty Pharmaceuticals Services Division, or SPS business, of Gentiva Health Services, Inc. (Gentiva). The aggregate purchase price paid was \$463.8 million (including \$13.8 million of acquisition related costs) and consisted of \$217.1 million in cash and 7,591,464 shares of our common stock valued at \$246.7 million. As part of the acquisition, we acquired 100% of the outstanding stock of three Gentiva subsidiaries that were engaged exclusively in the SPS business.

## Payors

The following table sets forth the approximate percentages of the Company's gross patient revenue attributable to various payor categories for the fiscal years ended June 30, 2002, 2003 and 2004. This table reflects the acquisition of the SPS business only since June 14, 2002. The percentage of the SPS business reimbursed by Medicare and Medicaid was higher than the comparable percentage of Accredo's business. Therefore, the payor mix after the acquisition reflects an increase in the percentage of revenue attributable to Medicare and Medicaid and a decrease in the percentage of revenue attributable to private payors.

	<u>Year Ended June 30, 2002</u>	<u>Year Ended June 30, 2003</u>	<u>Year Ended June 30, 2004</u>
Private payors (including self pay) (1) .....	79%	73%	72%
Medicaid and other state programs .....	19%	20%	21%
Medicare and other federal programs .....	<u>2%</u>	<u>7%</u>	<u>7%</u>
Total .....	<u>100%</u>	<u>100%</u>	<u>100%</u>

(1) Includes sales to private physician practices, whose ultimate payor is typically Medicare, which accounted for approximately 3%, 1% and 1% of gross patient revenue, respectively, for the fiscal years ended June 30, 2002, 2003 and 2004.

The primary trend in the United States health care industry is toward cost containment. The increasing prevalence of managed care, centralized purchasing decisions, consolidation among and integration of health care providers, and competition for patients has affected, and continues to affect, pricing, purchasing, and usage patterns in health care. Decisions regarding the use of a particular drug treatment are increasingly influenced by large private payors, including managed care organizations, pharmacy benefit managers, group purchasing organizations, regional integrated delivery systems, and similar organizations, and are based increasingly on economic considerations including product cost and whether a product reduces the cost of treatment. Efforts by payors to eliminate, contain or reduce costs through coverage exclusions, lower reimbursement rates, greater claims scrutiny, closed provider panels, restrictions on required formularies, claim delays or denials and other similar measures could have a material adverse effect on our business, financial condition and results of operations.

Some payors set lifetime limits on the amount reimbursable to patients for medical costs. Some of our patients may reach these limits because of the high cost of their medical treatment and associated pharmaceutical regimens. Some payors may attempt to further control costs by selecting some firms to be their exclusive providers of pharmaceutical or other medical product benefits. If any such arrangements were with our competitors, we would not be reimbursed for purchases made by such patients.

We derive a significant portion of our revenue from governmental programs such as Medicare and Medicaid. Such programs are highly regulated and subject to frequent and substantial changes and cost containment measures. In recent years, changes in these programs have limited and reduced reimbursement to providers.

Many government payors, including Medicare and Medicaid, have paid, or continue to pay us directly or indirectly at the drug's average wholesale price (AWP) or at a percentage off AWP. The Department of Health and Human Services, Office of Inspector General (OIG) has raised concerns since 1992 about how certain manufacturers have established AWP for certain Medicare covered drugs. Federal and state agencies continue to examine perceived discrepancies between reported AWP of drugs and the actual manufacturers selling price.

Several states have filed lawsuits against pharmaceutical manufacturers for allegedly inflating reported AWP for prescription drugs. In addition, class action lawsuits have been brought by consumers against pharmaceutical manufacturers alleging overstatement of AWP. We are not responsible for such calculations, reports or payments, however, there can be no assurance that our ability to negotiate discounts from drug manufacturers will not be materially adversely affected by such investigations or lawsuits, in the future.

The Federal Government has also entered into settlement agreements with several drug manufacturers relating to the calculation and reporting of AWP pursuant to which the drug manufacturers, among other things, have agreed to report the "average sales price", to government healthcare programs. The average sales price is calculated differently than AWP.

To our knowledge, we have not been subject to any investigation regarding AWP or best-price discounts; however, we have recently received a subpoena to supply information in the Pharmaceutical Industry Average Wholesale Price Litigation, a case involving approximately twenty drug manufacturers pending in the United States District Court, District of Massachusetts.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (MMA) made major changes in the Medicare payment rates for certain of the drugs that we sell, including blood clotting factor, Remodulin®, Flolan® and IVIG. On July 27, 2004, Centers for Medicare and Medicaid Services (CMS) released a proposed rule setting reimbursement rates for Part B drugs and drug administration payments.

Currently, Medicare payment for blood clotting factor furnished by pharmacies and physician offices continues to be at 95% of AWP through December 31, 2004. Under Medicare Part B, the company receives 80% of this amount directly from Medicare and the remaining 20% is the patient's co-pay obligation. Effective January 1, 2005, the Company will be paid for blood clotting factor based on a new Medicare Average Sales Price (ASP) methodology. Congress has directed CMS to make a separate payment to the entity that provides blood clotting factor to a Medicare beneficiary for items and services related to the furnishing of such products. The amount of the separate payment is capped so that the total of ASP payment rate and the separate payment amount cannot exceed 95% of AWP. In the recently issued fee schedule proposed rule, CMS proposed a separate payment amount of 5 cents per unit of blood clotting factor.

We sell two part B covered drugs that are used to treat beneficiaries with pulmonary arterial hypertension, Remodulin® and Flolan®. These products are covered as necessary for the effective use of durable medical equipment (DME). These drugs are reimbursed through one of the four Medicare DME regional carriers (DMERCs). Under the MMA, Remodulin® and Flolan® are paid at 95% of the AWP in effect on October 1, 2003 until the DME competitive acquisition program is phased in from 2007 to 2010. Under Medicare Part B, we receive 80% of this amount directly from Medicare and the remaining 20% is the patients' co-payment obligation. Since January 1, 2004, the effective date of the MMA, the DMERCs have established payment rates for the 10 mg Remodulin® vial size and the 0.5 mg vial size of Flolan® at rates that are below our acquisition cost of the drugs. In addition, one regional DMERC is currently paying all Remodulin® vial sizes at the same rate per mg as that of the 10 mg vial, thus reducing our reimbursement for all Medicare recipients of Remodulin® in that region.

IVIG became a Part B covered drug as of January 1, 2004, being reimbursed through the four Medicare DMERCs at a percentage of AWP. As of January 1, 2005, IVIG will be reimbursed based on the new Medicare ASP methodology or 106% of ASP. At this point in time, this ASP amount is unknown.

Effective June 1, 2004, California's Medicaid program (MediCal) began implementation of a new reimbursement methodology for hemophilia blood clotting factor. Under this methodology, providers will be reimbursed for all factor products at a rate equal to the lesser of the provider's usual and customary charge, or a manufacturer's reported average of its selling price for that blood clotting factor, plus 20%. We have not received the final ASP rates from MediCal. We understand that the final ASP rates will include certain items, such as prompt pay discounts, in establishing product reimbursement rates. It will likely be months before the industry fully understands the MediCal rates for hemophilia because of the estimated lag on processing claims.

Some states have adopted legislation or regulations requiring that a pharmacy participating in the state Medicaid program give the state the best price that the pharmacy makes available to any third-party payor. Such legislation and regulations, referred to as "most favored nation pricing", may have a material adverse effect on the reimbursement we receive from such Medicaid programs. For example, lower reimbursement by

Medicare for some of the drugs we sell could adversely affect the rate of reimbursement paid by the Medicaid programs in these states.

The calculation of ASP by MediCal or any other state Medicaid program may or may not result in the same rate of reimbursement as the ASP methodology adopted by Medicare.

Further, we negotiate purchase discounts from drug manufacturers. State Medicaid programs also negotiate purchase discounts with drug manufacturers and generally require that such Medicaid programs receive the "best price" on such purchase discounts. Investigations involving drug manufacturers have been initiated by certain governmental entities that question whether best price discounts were properly calculated, reported and paid to the Medicaid programs. We are not responsible for such calculations, reports or payments; however, there can be no assurance that our ability to negotiate discounts from drug manufacturers will not be materially adversely effected by such investigations in the future.

At least thirteen states have implemented "preferred drug list" programs, under which drugs would not appear on an approved and reimbursable Medicaid formulary unless the Medicaid programs receive significant discounts or other concessions. The drug industry has instituted litigation to halt these programs, but the outcome of this litigation is unknown. If the states prevail in these lawsuits, then this could result in reductions in the reimbursement we receive from Medicaid programs for our services and could materially and adversely affect our business, financial condition and results of operations.

A number of states are also considering other types of legislation designed to reduce their Medicaid expenditures and provide universal coverage and additional care for some populations, including proposals to impose additional taxes on providers to help finance or expand such programs. Some states may require us to maintain a licensed pharmacy in their state in order to qualify for reimbursement under state-administered reimbursement plans. Any of these changes could result in significant reductions in payment levels for drugs handled and services provided by us, which would have a material adverse effect on our business, financial condition and results of operations.

Qualified hemophilia treatment centers may purchase blood clotting factor from manufacturers at a discount under a government program established in 1992 which extended the Medicaid best price rebate program to hemophilia treatment centers. Manufacturers that sell drugs to hemophilia treatment centers agree with the Department of Health and Human Services (DHHS) that they will not charge a price for covered drugs that is higher than a statutorily set amount. We provide contract pharmacy services to several hemophilia treatment centers, but we do not directly own or operate a hemophilia treatment center that is eligible for this special pricing. This places us at a competitive disadvantage as a provider of factor, except where our affiliated medical centers are eligible for the special pricing. Under DHHS guidelines, a qualified hemophilia treatment center may obtain blood clotting factor at this special pricing and use a contract pharmacy to dispense it to the center's patients. However, if a hemophilia treatment center does not comply with DHHS guidelines or sells blood clotting factor bought at this special pricing to patients who are not patients of the center, it may incur civil penalties or liability to drug manufacturers for the amount of the discount that the center received from the manufacturer.

We expect that these developments will reduce prices and margins on some of the drugs that we distribute.

### **Competition**

The specialty pharmacy industry is highly competitive and is undergoing consolidation. The industry is fragmented, with many public and private companies focusing on different product or customer niches. Some of our current and potential competitors include:

- specialty pharmacy distributors, such as Priority Healthcare Corporation;
- specialty pharmacy divisions of national wholesale drug distributors;
- pharmacy benefit management companies;

- hospital-based pharmacies;
- retail pharmacies;
- home infusion therapy companies;
- manufacturers that sell their products both to distributors and directly to users, including clinics and physician offices;
- comprehensive hemophilia treatment centers;
- patient support groups and payors entering the specialty pharmacy distribution business; and
- other alternative site health care providers.

Some of our competitors have greater financial, technical, marketing and managerial resources than we have.

While competition is often based primarily on price and quality of care and service, it can also be affected by the ability to develop and maintain relationships with patients and referral sources, depth of product line, technical support systems, specific patient requirements and reputation. There can be no assurance that competitive pressures will not have a material adverse affect on our business, financial condition and results of operations.

### **Government Regulation**

Federal and state governments heavily regulate the drug and medical supply industry. Manufacturers, distributors, health care providers and patients are all subject to these regulations. Particular government attention currently focuses on:

- manufacturer calculated and reported AWP and ASP amounts;
- the payment of inducements for patient referrals;
- prohibited financial relationships with physicians;
- joint venture and management arrangements;
- product discounts;
- inducements given to patients; and
- professional licensing.

The laws are very broad, the regulations are complicated, and in many cases the courts interpret them differently. This makes compliance difficult. Federal and state civil and criminal fines and penalties may be imposed on persons who violate these laws. While we structure our transactions in a manner we believe complies with all laws, a violation could result in fines or criminal penalties, which could reduce our profitability. The following are particular areas of government regulation that apply to our business.

*Licensing and Registration.* A number of state laws require that we be licensed as an in-state pharmacy. We also currently ship prescription drugs to many other states that require us to be licensed as an out-of-state pharmacy. We believe that we substantially comply with all state licensing laws applicable to our business.

Some pharmacy associations and state boards of pharmacy are attempting to protect local pharmacies by restricting the activities of out-of-state pharmacies. In addition, some insurance companies and other payors pay lower reimbursement rates to out-of-state pharmacies. Restrictions on our operations imposed by these laws could reduce our profitability.

Laws enforced by the federal Drug Enforcement Agency, as well as some similar state agencies, require our pharmacy locations to individually register in order to handle controlled substances, including prescription drugs. A separate registration is required at each principal place of business where the applicant manufactures, distributes, or dispenses controlled substances. Federal and state laws also require that we follow specific

labeling and record-keeping requirements for controlled substances. We maintain federal and state controlled substance registrations for each of our facilities that require it, and follow procedures intended to comply with all such record-keeping requirements.

*Pharmacists and Nursing Licenses.* Our nurses must obtain state licenses to provide teaching services and the hands on nursing which we provide to some of our patients, and our pharmacists must obtain state licenses to dispense drugs. Our pharmacists and nurses are licensed in those states where their activity requires it. Pharmacists and nurses must also comply with professional practice rules. We believe that the activities undertaken by our nurses or pharmacists comply with all applicable laws or rules governing the practice of pharmacy, nursing or medicine.

*Pharmacy Counseling.* Federal law requires that states offering Medicaid prescription drug benefits implement a drug use review program. The program requires "before and after" drug use reviews, the use of predetermined standards, and patient education. Its purpose is to improve the quality of care by ensuring drug prescriptions are medically necessary, and not likely to cause adverse effects. Participating states must develop standards for pharmacy counseling. These standards apply as well to non-resident pharmacies like us. We believe our pharmacists monitor these requirements, and provide the necessary counseling.

*Federal Mail Order.* Federal law imposes standards for:

- the labeling, packaging and repackaging, advertising and adulteration of prescription drugs; and
- the dispensing of controlled substances and prescription drugs.

The Federal Trade Commission and the United States Postal Service regulate mail order drug sellers. The law requires truth in advertising, a reasonable supply of drugs to fill orders, and a right to a refund if an order cannot be filled within thirty days. We believe that we substantially comply with all of these requirements.

*Prescription Drug Marketing Act.* This federal law exempts many drug and medical devices from federal labeling and packaging requirements, as long as they are not adulterated or misbranded and were prescribed by a physician. The law also prohibits the sale, purchase or trade of drug samples that are not intended for sale or intended to promote the sale of the drug. Records must be kept of drug sample distribution, and proper storage and maintenance methods used. To the extent that this law applies to us, we believe that we comply with the documentation, record-keeping and storage requirements.

*Anti-Kickback and Self-Referral.* We are subject to the federal Medicare Anti-Kickback law that prohibits offering, paying, soliciting or receiving, directly or indirectly, in cash or in kind, remuneration to induce or in exchange for:

- the referral of patients covered by Medicare, Medicaid or other government healthcare reimbursement programs; or
- the leasing, purchasing, ordering or arranging for or recommending the lease, purchase or order of any item, good, facility or service covered by the programs.

Violations by individuals or entities are punishable by criminal fines, civil penalties, imprisonment, or exclusion from participation in the reimbursement programs. Sanctions imposed under this law on us, our business partners (such as drug suppliers), or our customers could reduce our business and our profits.

Many states have similar state laws, which, if violated, could result in similar penalties. Courts have not applied the Anti-Kickback law or similar state laws consistently, and some courts have found a violation if only one purpose of an otherwise acceptable arrangement was to induce referrals.

Recently, the OIG issued a Special Advisory Bulletin focused on complex contractual joint ventures that could potentially violate the anti-kickback statute. In this bulletin, the OIG discussed the characteristics that potentially indicate a prohibited arrangement. Some of these characteristics are present in our existing joint ventures. As a result, some of our joint ventures have been restructured and others will be restructured in the future.

DHHS published a set of "safe harbor" regulations and continues to publish clarifications to the safe harbors. Arrangements that fully comply with a safe harbor are deemed not to violate the Anti-Kickback law. We have several business arrangements (for example, our joint venture and management arrangements with medical centers, service arrangements with physicians and product pricing arrangements with suppliers) that do not satisfy all of the requirements necessary to fall within the safe harbors. Failure to satisfy a safe harbor does not mean that a transaction is necessarily illegal. The law requires the government to evaluate the intent in each situation. We believe our business arrangements comply with the Anti-Kickback law, the Health Insurance Portability and Accountability Act of 1996 (HIPAA) and similar state laws. However, if we are found to violate any of these laws, we could suffer penalties, fines, or possible exclusion, which could reduce our revenues and profits.

*OIG Fraud Alerts and Advisory Opinions.* The OIG periodically issues Fraud Alerts and Advisory Opinions identifying practices it believes may violate federal fraud and abuse laws. One Fraud Alert addresses joint venture and contractual arrangements between health care providers. Another concerns prescription drug marketing practices. Drug marketing activities may implicate the federal fraud and abuse laws because the cost of drugs are often reimbursed by Medicare and Medicaid. According to the Fraud Alert, questionable practices may include payments to pharmacists to recommend a particular drug or product. One Advisory Opinion indicates that management fees calculated as a percentage of net revenues, where marketing services are included, could implicate the federal fraud and abuse laws if the fee is intended to induce patient referrals. We believe our business arrangements comply with federal fraud and abuse laws. However, if we are found to have violated any of these laws, we could suffer penalties, fines or possible exclusion from the Medicare, Medicaid or other governmental programs, which could adversely affect our results of operations.

*State Consumer Protection Laws.* A number of states are involved in enforcement actions involving pharmaceutical marketing programs, including programs offering incentives for pharmacists to dispense one product rather than another. State consumer protection laws generally prohibit false advertising, deceptive trade practices and the like. A number of the states have requested that the FDA exercise greater regulatory oversight in the area of pharmaceutical promotional activities by pharmacists. It is not possible to determine whether the FDA will act in this regard or what effect, if any, FDA involvement would have on our operations.

*The Ethics in Patient Referrals Law (Stark Law).* Federal law prohibits physicians from making a referral for certain health items or services if they, or their family members, have a financial relationship with the entity receiving the referral. No bill may be submitted in connection with a prohibited referral. Violations are punishable by civil monetary penalties upon both the person making the referral and the provider rendering the service. Such persons or entities are also subject to exclusion from Medicare and Medicaid. Many states have adopted laws similar to the Stark Law which restrict the ability of physicians to refer patients to entities with which they have a financial relationship. The Stark Law and similar state statutes apply to our products and services, and we believe our relationships comply with these laws. However, if our practices are found to violate the Stark Law or similar state statutes, we may be subject to sanctions or be required to alter or discontinue some of our practices. This could reduce our revenues or profits.

*Beneficiary Inducement.* HIPAA penalizes the offering of remuneration or other inducements to beneficiaries of federal health care programs to influence the beneficiaries' decision to seek specific governmentally reimbursable items or services, or to choose a particular provider. HIPAA excludes items provided to promote the delivery of preventive care. The statutory exception would apply where "such care is provided or directly supervised by the medical provider that has provided the incentive."

The OIG has issued final regulations concerning inducements to beneficiaries. Under the new regulations, permissible incentives are those given in connection with preventive care, including pre and post natal care, and services described in the U.S. Preventive Service Task Force's Guide to Preventive Care. OIG also believes that items of nominal value given to beneficiaries are permissible even if not related to preventive care. However, permissible incentives would not include cash or cash equivalents. We from time to time provide some items at no charge to our patients in connection with their drug therapies, not all of which are included on the list of items specifically stated not to violate the regulations. However, we believe that those

items are allowed by the underlying statute. A determination that we violated the regulations or the statute, however, could result in sanctions that reduce our revenue or profits.

*The False Claims Act.* We are also subject to federal and state laws prohibiting individuals or entities from knowingly and willfully making claims for payment to Medicare, Medicaid, or other third party payors that contain false or fraudulent information. These laws provide for both criminal and civil penalties. Health care providers who submit claims which they knew or should have known were false, fraudulent, or for items or services that were not provided as claimed, may be excluded from Medicare and Medicaid participation, required to repay previously collected amounts, and subject to substantial civil monetary penalties.

*Government Investigations.* The government increasingly examines arrangements between health care providers and potential referral sources to ensure that they are not designed to exchange remuneration for patient care referrals. Investigators are increasingly willing to look behind formalities of business transactions to determine the underlying purpose of payments. Enforcement actions have increased and are highly publicized. Any investigation may cause publicity that would cause potential customers to avoid us, reducing potential revenues and profits.

In addition to investigations and enforcement actions initiated by governmental agencies, we could be the subject of an action brought under the False Claims Act by a private individual on behalf of the government. Actions under the False Claims Act, commonly known as "whistleblower" lawsuits are generally filed under seal to allow the government adequate time to investigate and determine whether it will intervene in the action, and defendant health care providers are often without knowledge of such actions until the government has completed its investigation and the seal is lifted.

*Confidentiality, Privacy and HIPAA.* Federal and state laws protect confidentiality of medical records and privacy of patient health information. We receive and use patient health information and maintain medical records for each patient to whom we dispense drugs. We are thus subject to some of these medical record confidentiality and patient information privacy laws, including HIPAA. As part of the Administrative Simplification provision of HIPAA, DHHS published final regulations governing electronic transactions involving health information on August 17, 2000. These regulations are commonly referred to as the Transaction Standards Rule. The Transaction Standards Rule establishes standards for the most common health care transactions. Under the new standards, any party transmitting or receiving health transactions electronically must send and receive data in a single format, rather than the large number of different data formats currently used. The Transaction Standards Rule applies to us in connection with submitting and processing health claims. The Transaction Standards Rule also applies to many of our payors and to our relationships with those payors.

On December 28, 2000, DHHS published final regulations implementing HIPAA that adopted standards for the privacy of individually identifiable health information (Privacy Rule). The regulations cover health care providers, health care clearinghouses and health plans (Covered Entities). The Privacy Rule imposes significant administrative and financial obligations on companies that use or disclose individually identifiable information relating to the health of a patient.

DHHS has published final regulations implementing that portion of HIPAA governing the security of health information. Most Covered Entities will be required to comply with these regulations by April 21, 2005. We are reviewing these regulations and will adopt policies and change some of our practices to comply with them.

The HIPAA regulations impose criminal penalties on wrongful disclosure of protected health information. We maintain procedures and provide training to our employees in an effort to comply with all of the medical record confidentiality and patient information privacy laws to which we are subject. We believe that we comply with applicable privacy provisions of HIPAA. While we attempt to comply with all confidentiality requirements, a violation of any such confidentiality or privacy law could subject us to sanctions that could reduce revenues or profits.

In addition to its provisions regarding the privacy of patient health information described above, HIPAA also imposes criminal penalties for fraud against any health care benefit program, for theft or embezzlement



involving health care and for false statements in connection with the payment of any health benefits. These HIPAA fraud and abuse provisions apply not only to federal programs, but also to private health benefit programs. HIPAA also broadened the authority of the OIG to exclude participants from federal health care programs. Although we do not know of any current violations of the fraud and abuse provisions of HIPAA, if we were found to be in violation of these provisions, the government could seek penalties against us including exclusion from participation in government payor programs. Significant fines could cause liquidity problems and adversely affect our results of operations.

*Balanced Budget Act.* Each state operates a Medicaid program funded in part by the Federal government. The states may customize their programs within federal limitations. Each state program has its own payment formula and recipient eligibility criteria. In recent years, changes in Medicare and Medicaid programs have resulted in limitations on, and reduced levels of, payment and reimbursement for a substantial portion of health care goods and services. For example, a number of state Medicaid agencies have taken action to reduce their reimbursement rates in response to the changes in the reimbursement rates adopted by the Medicare Program.

Laws governing Medicare, Medicaid, TriCare/CHAMPUS and other governmental programs may change, and various administrative rulings, interpretations and determinations make compliance difficult. Any changes may materially increase or decrease program payments or the cost of providing services. Final determinations of government program reimbursement often require years, because of audits, providers' rights of appeal and numerous technical requirements. We believe we make adequate provision for adjustments. However, future reductions in reimbursement could reduce our revenues and profits.

*Reform.* The U.S. health care industry continues to undergo significant change. We anticipate that Congress and state legislatures will continue to review and assess alternative health care delivery systems and payment methods and that public debate of these issues will likely continue in the future. We cannot predict which, if any, reform proposals will be adopted. Future changes in the nature of the health care system could reduce revenues and profits.

## **Employees**

As of June 30, 2004, we had 1,977 full-time and 514 part-time employees. Our employees include approximately 145 full-time and 53 part-time pharmacists. Our employees are not represented by a labor union, and we believe we have good relations with our employees.

## **Liability Insurance**

Providing health care services and products entails an inherent risk of liability. In recent years, participants in the health care industry have become subject to an increasing number of lawsuits, many of which involve large claims and significant defense costs. We may from time to time be subject to such suits as a result of the nature of our business. We maintain general liability insurance, including professional and product liability, in an amount deemed adequate by our management. There can be no assurance, however, that claims in excess of, or beyond the scope of, our insurance coverage will not arise. In addition, our insurance policies must be renewed annually. Although we have not experienced difficulty in obtaining insurance coverage in the past, there can be no assurance that we will be able to do so in the future on acceptable terms or at all.

## **Internet Website**

The Company's Internet website can be found at [www.accredohhealth.com](http://www.accredohhealth.com). Our internet website provides free access to our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after such material is filed, or furnished, to the Securities and Exchange Commission.

**Code of Ethics**

We have adopted a code of ethics that applies to all of our directors, officers and employees. This code is publicly available in the investor relations area of our website at [www.accredtohealth.com](http://www.accredtohealth.com). Copies of our code of ethics may also be requested in print by writing to Investor Relations at 1640 Century Center Parkway, Suite 100, Memphis, Tennessee 38134.

## RISK FACTORS

*You should carefully consider the risks and uncertainties we describe below before investing in Accredo Health, Incorporated. 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 affect our company.*

*If any of the following risks occur, our earnings, financial condition or business could be materially harmed, and the trading price of our common stock could decline, resulting in the loss of all or part of your investment*

**We are highly dependent on our relationships with a limited number of biopharmaceutical suppliers and the loss of any of these relationships could significantly impact our ability to sustain or grow our revenues.**

Approximately 36% of our revenue for the year ended June 30, 2004 was derived from the sale of IVIG and blood clotting factor product. The majority of our IVIG and blood clotting factor products were purchased from Baxter Healthcare Corporation. We also derive a substantial percentage of our revenue and profitability from our relationships with Biogen Idec, Inc., Genzyme Corporation, GlaxoSmithKline, Inc. and MedImmune, Inc. Our revenue derived from these relationships represented approximately 39% of our revenue during the year ended June 30, 2004.

Our agreements with these suppliers are short-term and cancelable by either party without cause on 60 to 365 days prior notice. These agreements also generally limit our ability to handle competing drugs during and, in some cases, after the term of the agreement, but allow the supplier to distribute through channels other than us. Further, these agreements provide that pricing and other terms of these relationships be periodically adjusted for changing market conditions or required service levels. Any termination or modification to any of these relationships could have a material adverse effect on a significant portion of our business, financial condition and results of operations.

**Our ability to grow could be limited if we do not expand our existing base of drugs or if we lose patients.**

We primarily sell 21 product lines. We focus almost exclusively on a limited number of complex and expensive drugs that serve small patient populations. The drugs that we sell with respect to the following core disease markets accounted for approximately 90% of our revenues for the year ended June 30, 2004, with the drugs for hemophilia, autoimmune disorders and PID constituting approximately 36% of our revenue for the same period:

- Hemophilia, Autoimmune Disorders and PID;
- Pulmonary Arterial Hypertension;
- Multiple Sclerosis;
- Gaucher Disease;
- Growth Hormone-Related Disorders; and
- Respiratory Syncytial Virus, or RSV.

Due to the small patient populations that use the drugs we handle, our future growth is highly dependent on expanding our base of drugs. Further, a loss of patient base or reduction in demand for any reason of the drugs we currently handle could have a material adverse effect on a significant portion of our business, financial condition and results of operations.

**Our business would be harmed if demand for our products and services is reduced.**

Reduced demand for our products and services could be caused by a number of circumstances, including:

- patient shifts to treatment regimens other than those we offer;
- new treatments or methods of delivery of existing drugs that do not require our specialty products and services;
- a recall of a drug;
- adverse reactions caused by a drug;
- the expiration or challenge of a drug patent;
- competing treatment from a new drug or a new use of an existing drug;
- the loss of a managed care or other payor relationship;
- the expansion of product-only service models;
- changes in sites of service;
- the cure of a disease we service; or
- the death of a high-revenue patient.

**There is substantial competition in our industry, and we may not be able to compete successfully.**

The specialty pharmacy industry is highly competitive and is continuing to become more competitive. Most of the drugs, supplies and services that we provide are also available from our competitors. Our current and potential competitors include:

- other specialty pharmacy distributors;
- specialty pharmacy divisions of wholesale drug distributors;
- pharmacy benefit management companies or PBMs;
- hospital-based pharmacies;
- retail pharmacies;
- home infusion therapy companies;
- manufacturers that sell their products both to distributors and directly to users;
- comprehensive hemophilia treatment centers;
- patient support groups and payors entering the specialty pharmacy distribution business; and
- other alternative site health care providers.

Many of our competitors have substantially greater resources and more established operations and infrastructure than we have. We are particularly at risk from any of our suppliers deciding to pursue their own distribution and services instead of outsourcing these needs to companies like us. A significant factor in effective competition will be our ability to maintain and expand relationships with managed care companies, PBMs and other payors who can effectively determine the pharmacy source for their enrollees.

**Entry by PBMs into the specialty pharmacy market, our strategic alliance with Medco Health Solutions, and consolidation in the industry could affect our ability to serve patients.**

Caremark Rx, Inc. and AdvancePCS recently combined to form the nation's second largest pharmacy benefit manager, processing drug claims for about 95 million individuals with about 600 million prescriptions filled per year. Express Scripts, Inc., which provides PBM services to over 50 million members, acquired

Curascripts on January 30, 2004. All of these firms are our customers and competitors. On February 9, 2004, we entered into a 10-year strategic alliance with Medco Health Solutions, Inc. where we became the preferred retail and home delivery pharmacy provider to Medco's members for our specialty pharmacy products. As a result of our new relationship with Medco, other PBMs may be reluctant to do business with us. As PBMs acquire specialty pharmacy capability, it is likely that they will attempt to cancel their relationships with entities, including us, that compete with the PBM specialty pharmacy operations, and to cause the PBM patients to obtain their drugs from the PBM's own specialty pharmacy. We also expect there will be further consolidation among specialty pharmacy providers, such as the recently proposed merger of Chronimed and MIM Corporation. Such events could materially and adversely affect our financial condition and results of operations.

**Our business could be harmed by changes in Medicare or Medicaid.**

Changes in Medicare, Medicaid or similar government health benefit programs or the amounts paid by those programs for our services may adversely affect our earnings. Such programs are highly regulated and subject to substantial changes and cost containment measures. In recent years, changes in these programs have modified payments to providers both positively and negatively. The Medicare Prescription Drug, Improvement and Modernization Act of 2003, or MMA, is having a significant impact on the U.S. drug delivery system and, correspondingly, on our business. The MMA expands drug benefits for Medicare beneficiaries. The MMA changes drug pricing methodologies resulting in both increases and decreases in drug payments. The MMA changes Medicare's payment methodology over the next three years from a system based on average wholesale price, or AWP, to one based on average sales price, or ASP, and provided for Medicare rate reductions that were effective January 1, 2004. These changes include new rates for Remodulin® and Flolan® that for certain vial concentrations are currently reimbursed at below our acquisition cost. The amount of Medicare reimbursement that we receive for blood clotting factor will also be changed effective January 1, 2005 to an ASP methodology. Although the MMA impacted the Company in 2004, we expect potentially significant impact in 2005, 2006 and thereafter, but the effect of which is not readily ascertainable at this time. We expect that the effect of the MMA will be to reduce prices and margins on some of the drugs that we distribute. If we are unsuccessful in obtaining changes in the Medicare reimbursement for Remodulin® and Flolan®, we may reevaluate whether we continue to distribute those products in the future.

At least one Medicaid program has adopted, and we expect other Medicaid programs, some states and some commercial payors, to adopt those aspects of the MMA that either result in or appear to result in price reductions for drugs covered by such programs. Adoption of ASP as the measure for determining reimbursement by state Medicaid programs for the drugs we sell could materially reduce our revenue and gross margins.

In order to deal with budget shortfalls, some states are attempting to create state administered prescription drug discount plans, to limit the number of prescriptions per person that are covered, to raise Medicaid co-pays and deductibles, and are proposing more restrictive formularies and reductions in pharmacy reimbursement rates. For example, California's Medicaid program, MediCal, recently adopted a plan that shifted away from use of acquisition cost plus 1% and instead uses ASP plus 20% for blood clotting factor products. Although California has not yet disclosed exactly how it is calculating ASP, it appears that the ASP rates established by MediCal could be significantly below our original estimates. Prior to adoption of the ASP methodology, the State of California adopted a 5% reimbursement rate reduction paid to providers of the state's MediCal program, which was scheduled to take effect on January 1, 2004. On December 23, 2003, the United States District Court for the Eastern District of California issued an injunction enjoining the State from implementing the 5% rate reduction. The subsequent change in the law, adopting the new ASP methodology, caused the 5% rate reduction to expire June 30, 2004. This reduction and any further reductions in the reimbursement from MediCal could adversely impact revenues and profitability from the sale of drugs by us or by our two partnerships in California to patients covered by MediCal. Any reductions in amounts reimbursable by other government programs for our services or changes in regulations governing such reimbursements could materially and adversely affect our business, financial condition and results of operations.

### **Changes in average wholesale prices could reduce our pricing and margins.**

Many government payors, including Medicare and Medicaid, have paid, or continue to pay, us directly or indirectly at a percentage off a drug's AWP. We have also contracted with a number of private payors to sell drugs at AWP or at a percentage off AWP. AWP for most drugs is compiled and published by several private companies, including First DataBank, Inc. Several states have filed lawsuits against pharmaceutical manufacturers for allegedly inflating reported AWP for prescription drugs. In addition, class action lawsuits have been brought by consumers against pharmaceutical manufacturers alleging overstatement of AWP. We are not responsible for such calculations, reports or payments, however, there can be no assurance that our ability to negotiate discounts from drug manufacturers will not be materially adversely affected by such investigations or lawsuits, in the future.

The Federal Government has also entered into settlement agreements with several drug manufacturers relating to the calculation and reporting of AWP pursuant to which the drug manufacturers, among other things, have agreed to report new pricing information, the "average sales price", to government healthcare programs. The average sales price is calculated differently than AWP.

The recently enacted MMA changes the way the federal government pays for certain Part B drugs. While the majority of our revenue is reimbursed by private payors, as CMS implements the ASP methodology of reimbursement, it may affect our current AWP based reimbursement structure with our private payors. If private payors adopt the ASP methodology, it could have a material effect on reimbursement rates that we are able to negotiate with these payors.

While we cannot predict the eventual results of these law changes, government proposals, investigations, or lawsuits, the effect of the MMA has been and will be to reduce prices and margins on some of the drugs that we distribute. If government payors or private payors revise their pricing based on new methods of calculating the AWP for drugs we handle or implement reimbursement methodology based on some value other than AWP, this could have a material adverse effect on our business, financial condition and results of operation, including reducing the pricing and margins on certain of our products.

### **Our business will suffer if we lose relationships with payors.**

We are highly dependent on reimbursement from non-governmental payors. For the fiscal years ended June 30, 2002, 2003 and 2004, we derived approximately 79%, 73% and 72% respectively of our gross patient revenue from non-governmental payors (including self-pay), which included 3%, 1% and 1%, respectively for those periods, from sales to private physician practices whose ultimate payor is typically Medicare.

Many payors seek to limit the number of providers that supply drugs to their enrollees. For example, we were selected by Aetna, Inc. as one of three providers of injectable medications. We received approximately 10% of our total revenues from Aetna in the fiscal year ended June 30, 2004. Aetna has recently indicated that during 2005, it will be transferring patients and therapies from us to a new joint venture between Aetna and one of our competitors. From time to time, payors with whom we have relationships require that we and our competitors bid to keep their business, and there can be no assurance that we will be retained or that our margins will not be adversely affected when that happens. Further, significant consolidation has occurred among non-government payors, and we expect there will be further consolidation in the future. If payors with whom we have relationships are part of this consolidation, our relationships with those payors could be terminated. The loss of a payor relationship, for example, our relationship with Aetna, Inc. and affiliates (which is terminable on 90 days notice), or an adverse change in the financial condition of a payor, could result in the loss of a significant number of patients and have a material adverse effect on our business, financial condition and results of operations.

### **Our business could be harmed if payors decrease or delay their payments to us or seek to recoup payments already made.**

Our profitability depends on payment from governmental and non-governmental payors, and we could be materially and adversely affected by cost containment trends in the health care industry or by financial

difficulties suffered by non-governmental payors. Cost containment measures affect pricing, purchasing and usage patterns in health care. Payors also influence decisions regarding the use of a particular drug treatment and focus on product cost in light of how the product may impact the overall cost of treatment. Further, some payors, including large managed care organizations and some private physician practices, have recently experienced financial trouble. The timing of payments and our ability to collect from payors also affects our revenue and profitability. Payors also have contractual rights to audit our books and records to determine if they have overpaid us. We had a contractual relationship through a joint venture with a pharmacy currently involved in an ongoing reimbursement audit by the California agency that administers MediCal. If the audit finds that the pharmacy received overpayments from MediCal, we could be required, under the terms of our prior contractual relationship, to reimburse the pharmacy for a portion of any amounts recouped by the State of California. Subject to the outcome of the audit, we could be required to make a significant payment in order to satisfy our alleged contractual obligations. If we are unable to collect from payors or if payors fail to pay us in a timely manner, or if payors seek to recoup payments already made to us, it could have a material adverse effect on our business and financial condition.

**If any of our relationships with medical centers are disrupted or canceled, our business could be harmed.**

We have joint venture relationships with four medical centers that provide services primarily related to hemophilia, growth hormone-related disorders and RSV. For the fiscal years ended June 30, 2002, 2003 and 2004, we derived approximately 4%, 4% and 2%, respectively, of our income before income taxes from equity in the net income of unconsolidated joint ventures.

We own 80% of one of our joint ventures with Children's Home Care, Inc. and the financial results of this joint venture are included in our consolidated financial results. This consolidated joint venture represented approximately 10% of our income before income taxes for the fiscal year ended June 30, 2002, 17% of our income before income taxes for the fiscal year ended June 30, 2003 and 7% of our income before income taxes in the current fiscal year ended June 30, 2004.

Recently, the OIG issued a Special Advisory Bulletin focused on complex contractual joint ventures that could potentially violate the anti-kickback statute. In this bulletin, the OIG discussed the characteristics that potentially indicate a prohibited arrangement. Some of these characteristics are present in our existing joint ventures. As a result, our joint ventures will be restructured.

Further, the Department of Health and Human Services, or DHHS, published a set of "safe harbor" regulations and continues to publish clarifications to the safe harbors under the federal anti-kickback statute. Arrangements that fully comply with a safe harbor are deemed not to violate the anti-kickback statute. We have several business arrangements (for example, our joint venture and management arrangements with medical centers, service arrangements with physicians and product pricing arrangements with suppliers) that do not satisfy all of the requirements necessary to fall within the safe harbors. Failure to satisfy a safe harbor does not mean that an arrangement is necessarily illegal. We believe our business arrangements comply with the anti-kickback statute, the Health Insurance Portability and Accountability Act, or HIPPA, the federal Stark Law and similar state laws. However, if we are found to violate any of these laws, we could suffer penalties, fines or possible exclusion, which could adversely affect our revenues and earnings.

In addition to joint venture relationships, we also provide pharmacy management services to several medical centers. Our agreements with medical centers have terms of between one and five years, and may be cancelled by either party without cause upon notice of between one and twelve months. Adverse changes in our relationships with those medical centers could be caused, for example, by:

- changes caused by consolidation within the hospital industry;
- changes caused by regulatory uncertainties inherent in the structure of the relationships; or
- restrictive changes to regulatory requirements.

Any termination or adverse change of these relationships could have a material adverse effect on our business, financial condition and results of operations.

**If additional providers obtain access to favorable Public Health Service, or PHS, pricing for drugs we handle, our business could be harmed.**

The federal pricing program of the Public Health Service, commonly known as PHS, allows qualified hospitals and hemophilia treatment centers to obtain discounts on blood clotting factor products. While we are able to access PHS pricing through our contracts to provide contract pharmacy services to hemophilia treatment centers, we are not eligible to participate directly in these programs. Increased competition from hospitals and hemophilia treatment centers that have the right to participate directly in these discount programs may reduce our profit margins.

**Our acquisition and joint venture strategy may not be successful, which could cause our business and future growth prospects to suffer.**

As part of our growth strategy, we continue to evaluate acquisition and joint venture opportunities, but we cannot predict or provide assurance that we will complete any future acquisitions or joint ventures. Acquisitions and joint ventures involve many risks, including:

- difficulty in identifying suitable candidates and negotiating and consummating acquisitions on attractive terms;
- difficulty in assimilating the new operations;
- increased transaction costs;
- diversion of our management's attention from existing operations;
- dilutive issuances of equity securities that may negatively impact the market price of our stock;
- increased debt; and
- increased amortization expense related to intangible assets that would decrease our earnings.

We could also be exposed to unknown or contingent liabilities resulting from the pre-acquisition operations of the entities we acquire, such as liability for failure to comply with health care or reimbursement laws, including an obligation to recoup reimbursement payments previously received by the companies we acquire. We also face exposure if any seller of an entity which we acquire, is not able to fulfill its indemnification obligations under the terms of the purchase agreement. We may suffer impairment of assets or have to bear a liability for which we are entitled to indemnification but are unable to collect.

**Our debt incurred from recent acquisitions may limit our future financial flexibility.**

The current level of our debt will have several important effects on our future operations, including, among others:

- A portion of our cash flow from operations will be dedicated to the payment of principal on the debt and will not be available for other purposes;
- Our debt covenants will require us to meet financial tests, and may impose other limitations that may limit our flexibility in planning for and reacting to changes in our business, including possible acquisition opportunities;
- Our ability to obtain additional financing for working capital, capital expenditures, acquisitions, general corporate and other purposes may be limited;
- Failure to meet our debt covenants could result in foreclosure by our lenders or an increase in the interest rate or administrative fees associated with our debt;



- We may be at a competitive disadvantage to similar companies that have less debt; and
- Our vulnerability to adverse economic and industry conditions may increase.

**Fluctuations in our quarterly financial results may cause our stock price to decline.**

Our results of operations may fluctuate on a quarterly basis, which could adversely affect the market price of our common stock. Our results may fluctuate as a result of:

- lower prices paid by Medicare or Medicaid for the drugs that we sell, including lower prices resulting from the MMA and other state and federal legislation and revisions in pricing methods, or the method of establishing AWP or ASP;
- below-expected sales or delayed launch of a new drug;
- price and term adjustments with our drug suppliers;
- increases in our operating expenses in anticipation of the launch of a new drug;
- product shortages or an oversupply of product;
- inaccuracies in our estimates of the costs of ongoing programs;
- the timing and integration of our acquisitions;
- changes in our estimates used to prepare our financial statements;
- effectiveness of our sales force;
- changes in governmental regulations;
- the annual renewal of deductibles and co-payment requirements that affect patient ordering patterns;
- our provision of drugs to treat seasonal illnesses, such as RSV;
- physician prescribing patterns;
- general political and economic conditions;
- interest rate fluctuations; and
- adverse experience in collection of accounts receivable.

**Our business would be harmed if the biopharmaceutical industry reduces research, development and production of the types of drugs that are compatible with the services we provide.**

Our business is highly dependent on continued research, development, manufacturing and marketing expenditures of biopharmaceutical companies, and the ability of those companies to develop, supply and generate demand for drugs that are compatible with the services we provide. Our business would be materially and adversely affected if those companies stopped outsourcing the services we provide or failed to support existing drugs or develop new drugs. Our business could also be harmed if the biopharmaceutical industry undergoes any of the following developments:

- supply shortages;
- adverse drug reactions;
- drug recalls;
- increased competition among biopharmaceutical companies;
- an inability of drug companies to finance product development because of capital shortages;
- a decline in product research, development or marketing;
- a reduction in the retail price of drugs from governmental or private market initiatives;

- changes in the FDA approval process; or
- governmental or private initiatives that would alter how drug manufacturers, health care providers or pharmacies promote or sell products and services.

**Our business could be harmed if the supply of any of the products that we distribute becomes scarce.**

The biopharmaceutical industry is susceptible to product shortages. Some of the products that we distribute, such as some of our hemophilia products, IVIG and some other blood-related products, are collected and processed from human donors. Accordingly, the supply of these products is highly dependent on human donors and their availability has been constrained from time to time. Our suppliers of IVIG have announced initiatives that could result in decreases in the future supply of IVIG, which, in addition to other factors, may cause the pricing of IVIG to rise. There was also an industry wide recombinant factor VIII product shortage that existed for some time, as a result of the manufacturers being unable to increase production to meet rising global demand. Supply of this drug has only recently returned to normal levels. If these products, or any of the other drugs that we distribute, are in short supply for long periods of time and we are unable to acquire an amount of the drug sufficient to service our patients, our business could be harmed.

**Our industry is subject to extensive government regulation and noncompliance by us, physicians who prescribe our products and services or our suppliers could harm our business.**

The marketing, sale and purchase of drugs and medical supplies is extensively regulated by federal and state governments, and if we fail or are accused of failing to comply with laws and regulations, we could suffer a material adverse effect on our business, financial condition and results of operations. Our business could also be materially and adversely affected if the suppliers or others we work with are accused of violating laws or 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.

The health care laws and regulations that especially apply to our activities include:

- The federal “Anti-Kickback Law” prohibits the offer or solicitation of compensation in return for the referral of patients covered by almost all governmental programs and billing for services rendered pursuant to such referrals, or the arrangement or recommendation of the purchase of any item, facility or service covered by those programs. The Health Insurance Portability and Accountability Act (“HIPAA”) created new violations for fraudulent activity applicable to both public and private health care benefit programs and prohibits inducements to Medicare or Medicaid eligible patients. The potential sanctions for violations of these laws range from significant fines, to exclusion from participation in the Medicare and Medicaid programs, to criminal sanctions. Although some “safe harbor” regulations attempt to clarify when an arrangement will not violate the Anti-Kickback Law, our business arrangements and the services we provide may not fit within these safe harbors. Failure to satisfy a safe harbor requires analysis of whether the parties intended to violate the Anti-Kickback Law. Allegations, investigations, or findings of a violation of the Anti-Kickback Law or similar state laws could have a material adverse effect on our business.
- The Department of Health and Human Services (DHHS) has issued regulations implementing the Administrative Simplification provisions of HIPAA concerning the maintenance of privacy and security of individually identifiable health information. These new regulations require the development and implementation of measures to maintain the privacy and security of health information and require that certain health claims transactions be conducted in accordance with uniform standards. These regulations govern health care providers, health plans and health clearinghouses. Failure to comply with these regulations, or wrongful disclosure of confidential patient information could result in the imposition of administrative or criminal sanctions, including exclusion from the Medicare and state Medicaid programs. In addition, if we choose to distribute drugs through new distribution channels such as the Internet, we will have to comply with government regulations that apply to those distribution channels, which could have a material adverse effect on our business.

- The Ethics in Patient Referrals Act of 1989, as amended, commonly referred to as the “Stark Law,” prohibits physician referrals to entities with which the physician or their immediate family members have a “financial relationship.” Many states have adopted laws similar to the Stark law. A violation of the Stark Law or similar state laws is punishable by civil sanctions, including significant fines and exclusion from participation in Medicare and Medicaid.
- State laws prohibit the practice of medicine, pharmacy and nursing without a license. To the extent that we assist patients and providers with prescribed treatment programs, a state could consider our activities to constitute the practice of medicine. If we are found to have violated those laws, we could face civil and criminal penalties and be required to reduce, restructure, or even cease our business in that state.
- Pharmacies and pharmacists must obtain state licenses to operate and dispense drugs. Pharmacies must also obtain licenses in some states to operate and provide goods and services to residents of those states. Our entities that provide nursing for our patients and our nurses must obtain licenses in certain states to conduct our business. If we are unable to maintain our licenses or if states place burdensome restrictions or limitations on non-resident pharmacies or nurses, this could limit or affect our ability to operate in some states which could adversely impact our business and results of operations.
- Federal and state investigations and enforcement actions continue to focus on the health care industry, scrutinizing a wide range of items such as joint venture arrangements, referral and billing practices, product discount arrangements, home health care services, dissemination of confidential patient information, clinical drug research trials and gifts for patients. Recently, the OIG issued a Special Advisory Bulletin focused on complex contractual joint ventures that could potentially violate the anti-kickback statute. In this bulletin, the OIG discussed the characteristics that potentially indicate a prohibited arrangement. Some of these characteristics are present in our existing joint ventures. Accordingly, some of our existing joint ventures have been restructured and others may be restructured in the future.
- The False Claims Act encourages private individuals to file suits on behalf of the government against health care providers such as us. Such suits could result in significant financial sanctions or exclusion from participation in the Medicare and Medicaid programs.

**If some of the drugs that we provide lose their “orphan drug” status, we could face more competition.**

Our business could be adversely affected by the expiration or challenge to the orphan drug status that has been granted by the FDA to some of the drugs that we handle. When the FDA grants orphan drug status, it will not approve a second drug for the same treatment for a period of seven years unless the new drug is chemically different or clinically superior. Not all of the drugs that we sell which are related to our core disease states have orphan drug status. The loss of orphan drug status, the approval of new drugs notwithstanding orphan drug status or the development of drugs that are superior to the drugs we sell could result in additional competitive drugs entering the market, which could harm our business.

**We rely heavily on a single shipping provider, and our business would be harmed if our rates are increased or our provider is unavailable.**

Almost all of our revenues result from the sale of drugs we deliver to our patients and a single carrier, FedEx, ships principally all of our products. We depend heavily on these outsourced shipping services for efficient, cost effective delivery of our product. The risks associated with this dependence include:

- any significant increase in shipping rates, including rate increases resulting from higher fuel prices;
- strikes or other service interruptions by our primary carrier, FedEx, or by another carrier that could affect FedEx; or
- spoilage of high cost drugs during shipment, since our drugs often require special handling, such as refrigeration.

**Disruptions in commercial activities such as those following the September 2001 terrorist attacks on the U.S. may adversely impact our results of operations, our ability to raise capital or our future growth.**

Our operations have been and could again be harmed by terrorist attacks on the U.S. For example, transportation systems and couriers that we rely upon to deliver our drugs have been and could again be disrupted, thereby causing a decrease in our revenues. In addition, we may experience a rise in operating costs, such as costs for transportation, courier services, insurance and security. We also may experience delays in payments from payors, which would harm our cash flow. The U.S. economy in general may be adversely affected by terrorist attacks or by any related outbreak of hostilities. Any such economic downturn could adversely impact our results of operations, impair our cost of or ability to raise debt or equity capital or impede our ability to continue growing our business.

**If we are unable to manage our growth effectively, our business will be harmed.**

Our rapid growth over the past several years has placed a strain on our resources, and if we cannot effectively manage our growth, our business, financial condition and results of operations could be materially and adversely affected. We have experienced a large increase in the number of our employees, the size of our programs and the scope of our operations. Our ability to manage this growth and be successful in the future will depend partly on our ability to retain skilled employees, which has become more difficult due to the national health care professional shortage. Our ability to manage our growth is also dependent upon our ability to enhance our management team and improve our management information and financial control systems.

**We could be adversely affected by an impairment of the significant amount of goodwill and other intangibles on our financial statements.**

Our formation and our acquisitions have resulted in the recording of a significant amount of goodwill on our financial statements. The goodwill was recorded because the fair value of the tangible net assets acquired was less than the purchase price. There can be no assurance that we will realize the full value of this goodwill. We evaluate on an on-going 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 to our earnings. As of June 30, 2004, we had goodwill, net of accumulated amortization, of approximately \$383 million, or 38% of total assets and 64% of stockholders' equity.

Since our growth strategy may 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 non-competition agreements, patient base and contracts that are acquired. The amount allocated to these items could be amortized over a fairly short period. As a result, our earnings and the market price of our common stock could be negatively impacted.

**We rely on a few key employees whose absence or loss could adversely affect our business.**

We depend on a few key executives, and the loss of their services could cause a material adverse effect to our company. We do not maintain "key person" life insurance policies on any of those executives. As a result, we are not insured against the losses resulting from the death of our key executives. Further, we must be able to attract and retain other qualified, essential employees for our technical operating and professional staff, such as pharmacists and nurses. If we are unable to attract and retain these essential employees, our business could be harmed.

**We have been named in several shareholder class action lawsuits and a shareholders' derivative lawsuit asserting claims under the securities laws.**

The uncertainty associated with these unresolved lawsuits could harm our business and financial condition. The defense of these lawsuits also could result in litigation fees and costs, as well as the diversion of resources. Negative developments with respect to the lawsuits could cause our stock price to decline significantly. The indemnification provisions contained in our Certificate of Incorporation and Bylaws require

us to indemnify our current and former officers and directors who are named as defendants against the allegations contained in these suits. Even though we maintain directors and officers insurance applicable to the lawsuits, there can be no guarantee that the proceeds of such insurance will be available for defense fees and costs, or payment of any settlement or judgment in the lawsuits or, if available, will be sufficient to cover the fees and costs and any settlement or judgment imposed against us.

The ultimate cost and effect of these lawsuits on our financial condition, results of operations, customer relations and management is unknown at this time.

In addition to the securities litigation currently pending against us and our officers and directors, we may also in the future be the target of similar litigation. Additional securities litigation could result in substantial costs and divert our attention and resources.

**We may need additional capital to finance our growth and capital requirements, which could prevent us from fully pursuing our growth strategy.**

In order to implement our growth strategy, we will need substantial capital resources and will incur, from time to time, short- and long-term indebtedness, the terms of which will depend on market and other conditions. We cannot be certain that existing or additional financing will be available to us on acceptable terms, if at all. As a result, we could be unable to fully pursue our growth strategy. Further, additional financing may involve the issuance of equity or debt securities that would reduce the percentage ownership of our then current stockholders.

**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 System. The market price of our common stock could fluctuate substantially based on a variety of factors, including the following:

- future announcements concerning us, our competitors, the drug manufacturers with whom we have relationships or the health care market;
- changes in government regulations;
- overall volatility of the stock market;
- changes in the financial estimates we provide to the market;
- changes in estimates by analysts;
- changes in operating results from quarter to quarter; and
- loss of key executives.

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.

**Some provisions of our charter documents and the Stockholder Protection Rights Plan may have anti-takeover effects that could discourage a change in control, even if an acquisition would be beneficial to our stockholders.**

Our certificate of incorporation, our bylaws and Delaware law contain provisions that could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. In addition, our Board of Directors has adopted a Stockholder Protection Rights Plan, sometimes referred to as a poison pill, which would substantially dilute the interest sought by an acquirer.

**In the event we are unable to satisfy regulatory requirements relating to internal controls, or if these internal controls over financial reporting are not effective, our business and our stock price could suffer.**

Section 404 of Sarbanes-Oxley requires companies to do a comprehensive and costly evaluation of their internal controls. As a result, during our fiscal year ending June 30, 2005, we will be required to perform an evaluation of our internal controls over financial reporting and have our auditor publicly attest to such evaluation. We have prepared an internal plan of action for compliance, which includes a timeline and scheduled activities with respect to preparation of such evaluation. Our efforts to comply with Section 404 and related regulations regarding our management's required assessment of internal control over financial reporting and our independent auditors' attestation of that assessment has required, and continues to require, the commitment of significant financial and managerial resources. If we fail to timely complete this evaluation, or if our auditors cannot timely attest to our evaluation, we could be subject to regulatory scrutiny and a loss of public confidence in our internal controls, which could have an adverse effect on our business and our stock price.

## **Item 2. Properties**

### **Facilities**

Our corporate headquarters are located in Memphis, Tennessee and our other principal facilities are located in Nashville, Tennessee, Charlotte, North Carolina, Warrendale, Pennsylvania, Pittsburgh, Pennsylvania and Overland Park, Kansas. In addition, we have many smaller satellite pharmacy locations in other states.

*Memphis, Tennessee.* We currently lease approximately 214,000 square feet of space in an office/warehouse business park in Memphis. The leases on this space expire December 31, 2009, but we have an option to extend our lease terms for one additional five-year period.

*Nashville, Tennessee.* We currently lease approximately 35,000 square feet of space in Nashville. Our lease expires in December 2005.

*Charlotte, North Carolina.* We currently lease approximately 25,000 square feet of space in Charlotte, North Carolina. Our lease expires in July 2006.

*Warrendale, Pennsylvania.* We currently lease approximately 29,000 square feet of space in Warrendale, Pennsylvania. Our lease expires in March 2005.

*Pittsburgh, Pennsylvania.* We currently lease approximately 38,000 square feet of space in Pittsburgh, Pennsylvania. Our lease expires in September 2007.

*Overland Park, Kansas.* We currently lease approximately 122,000 square feet of space in Overland Park, Kansas. We sublease approximately 40% of this space to Gentiva. Our lease expires in August 2005.

## **Item 3. Legal Proceedings**

Commencing April 8, 2003, the Company and certain officers and directors were named as defendants in several substantially similar putative class action lawsuits filed in the United States District Court for the Western District of Tennessee, Memphis Division. The various complaints have been consolidated into a single action, and the Court appointed co-Lead Plaintiffs on July 1, 2004. A Consolidated Complaint is currently due to be filed no later than September 15, 2004. The lawsuits filed to date name the Company, David D. Stevens, Joel Kimbrough and in one case John R. Grow, as Defendants. One of the lawsuits also named Ernst & Young LLP as a defendant. The lawsuits allege violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)(5) promulgated thereunder, and Section 20 of the Securities Exchange Act of 1934. Based on the lawsuits filed to date, the putative class representatives seek to represent a class of individuals and entities that purchased Company stock during the period June 16, 2002 through April 7, 2003 and who supposedly suffered damages from the alleged violations of the securities laws. The Company believes that the claims asserted in the putative class action lawsuits are without merit and intends to defend these lawsuits vigorously.

In addition, two purported derivative lawsuits were filed in the Circuit Court of Shelby County, Tennessee for the Thirtieth Judicial District at Memphis. These actions were consolidated and a Consolidated Derivative Complaint was filed on July 28, 2003. The derivative action names David D. Stevens, John R. Grow, Kyle J. Callahan, Kevin L. Roberg, Kenneth R. Masterson, Kenneth J. Melkus, Dick R. Gourley, Nancy-Ann Deparle, Joel R. Kimbrough, Thomas W. Bell, Jr., and Patrick J. Welsh as defendants. The derivative lawsuit alleges that the defendants breached fiduciary duties owed to the Company by engaging in the same alleged conduct that is the basis of the putative class action lawsuits. On behalf of the Company, the derivative complaint seeks compensatory damages from the defendants and the disgorgement of profits, benefits and other compensation received by the defendants. The Company believes that the claims asserted in the derivative lawsuit are without merit and intends to defend this lawsuit vigorously. A motion to dismiss is currently pending.

A joint venture in California which is 80% owned by us provided contract pharmacy and related billing services to a local California pharmacy currently under audit by the California Department of Health Services concerning its MediCal billings for blood clotting factor supplied by our joint venture. Although our joint venture is not currently involved with the audit, the contract pharmacy relationship is implicated, and the pharmacy is seeking indemnification from our joint venture. Pending completion of the audit, the state agency has temporarily withheld MediCal payments from the pharmacy and has alleged, among other things, overbilling and false claims. Although we believe these allegations are without merit and expect the pharmacy and our joint venture to vigorously defend against these allegations through judicial proceedings if necessary, we also expect the California state agency to pursue a refund of some or all of the payments made by MediCal to the pharmacy. If state or federal false claim statutes are implicated, the pharmacy could also be assessed fines and penalties. At this time, we do not believe that we will incur any such fines and penalties. Due to the uncertainty about the issues involved in this matter, based on the facts and circumstances known to date, we believe some amount of monetary loss to us is reasonably possible in the range of zero to \$20 million, absent any finding of false claims and incurrence of related fines and penalties.

Also, from time to time, the Company is involved in lawsuits, claims, audits and investigations arising in the normal course of its business. In the Company's opinion, in the aggregate these lawsuits, claims, audits and investigations should not have a material adverse effect on the Company's business, financial condition, or results of operations. In addition, the business that the Company acquired from Gentiva Health Services, Inc. has several lawsuits and claims related to its historic operation by Gentiva, which are being controlled by Gentiva and for which the Company is entitled to indemnification from liability by Gentiva.

**Item 4. *Submission of Matters to a Vote of Security Holders***

None

## PART II

### Item 5. *Market for Company's Common Equity and Related Stockholder Matters.*

#### *Price Range of Common Stock*

The Company's common stock is traded on the Nasdaq National Market System under the symbol "ACDO." The following table sets forth the quarterly high and low sales prices as reported on the Nasdaq National Market System for the fiscal years ended June 30, 2003 and 2004.

<u>Fiscal Years 2003 and 2004</u>	<u>High</u>	<u>Low</u>
Fourth Quarter ended June 30, 2004 .....	\$40.70	\$33.75
Third Quarter ended March 31, 2004 .....	39.98	30.00
Second Quarter ended December 31, 2003 .....	32.99	27.29
First Quarter ended September 30, 2003 .....	30.28	21.35
Fourth Quarter ended June 30, 2003 .....	26.31	11.95
Third Quarter ended March 31, 2003 .....	39.67	21.02
Second Quarter ended December 31, 2002 .....	38.65	25.19
First Quarter ended September 30, 2002 .....	36.29	24.87

#### *Holdings*

As of August 26, 2004, the approximate number of registered stockholders was 35,049 including 1,116 stockholders of record and approximately 33,933 persons or entities holding common stock in nominee name.

#### *Dividend Policy*

We have never paid any cash dividends on our common stock. We currently anticipate that all of our earnings will be retained to finance the growth and development of our business, and therefore, do not anticipate that any cash dividend will be declared or paid on our common stock in the foreseeable future. Any future declaration of dividends will be subject to the discretion of our Board of Directors and their review of our earnings, financial condition, capital requirements and surplus, contractual restrictions to pay such dividends and other factors they deem relevant.

#### *Securities Authorized for Issuance Under Equity Compensation Plans*

The following table summarizes our equity compensation plans as of June 30, 2004:

<u>Plan Category</u>	<u>(a)</u> Number of shares to be issued upon exercise of outstanding options, warrants and rights	<u>(b)</u> Weighted-average exercise price of outstanding options, warrants and rights	<u>(c)</u> Number of shares remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by Stockholders .....	4,289,212	\$26.71	773,568
Equity compensation plans not approved by Stockholders .....	—	—	—
Total .....	<u>4,289,212</u>	<u>\$26.71</u>	<u>773,568</u>



### Sales of Unregistered Securities

None.

### Purchases of Equity Securities by the Company and Affiliated Purchasers

During the year ended June 30, 2004, we did not repurchase any shares of our common stock.

### Item 6. Selected Consolidated Financial Data

#### SELECTED FINANCIAL DATA

You should read the following selected financial data in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our Financial Statements and the Notes thereto included elsewhere in this Annual Report on Form 10-K. The selected financial data as of and for the fiscal years ended June 30, 2000, 2001, 2002, 2003 and 2004 have been derived from our audited financial statements. The information set forth below is not necessarily indicative of the results of future operations.

	Years Ended June 30,				
	2000	2001	2002(1)	2003	2004
	(in thousands, except per share data)				
<b>Statements of Operations Data:</b>					
Revenues:					
Net patient revenue .....	\$335,601	\$446,007	\$633,249	\$1,337,414	\$1,475,036
Other revenue .....	15,432	14,985	18,257	33,982	38,761
Equity in net income of joint ventures ..	2,002	1,148	2,067	1,940	3,071
Total revenues .....	353,035	462,140	653,573	1,373,336	1,516,868
Operating expenses:					
Cost of sales .....	300,973	395,365	544,902	1,086,334	1,197,836
General and administrative .....	23,831	29,871	45,571	129,803	138,521
Bad debts(2) .....	6,117	6,131	5,833	87,418	29,745
Restructuring charge .....	—	—	3,893	—	—
Depreciation and amortization .....	3,397	4,263	3,675	10,386	12,866
Total operating expenses .....	334,318	435,630	603,874	1,313,941	1,378,968
Operating income .....	18,717	26,510	49,699	59,395	137,900
Interest expense (income), net .....	2,136	(2,770)	(359)	9,564	8,125
Income before minority interest in income of consolidated joint venture and income taxes .....	16,581	29,280	50,058	49,831	129,775
Minority interest in income of consolidated joint venture .....	(177)	(692)	(1,273)	(2,044)	(2,338)
Income before income taxes .....	16,404	28,588	48,785	47,787	127,437
Income tax expense .....	6,508	11,333	19,025	18,252	49,124
Net income .....	<u>\$ 9,896</u>	<u>\$ 17,255</u>	<u>\$ 29,760</u>	<u>\$ 29,535</u>	<u>\$ 78,313</u>
Diluted earnings per common share:					
Net income .....	<u>\$ 0.30</u>	<u>\$ 0.44</u>	<u>\$ 0.73</u>	<u>\$ 0.61</u>	<u>\$ 1.60</u>
Cash dividends declared on common stock	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

	June 30,				
	2000	2001	2002	2003	2004
<b>Balance Sheet Data:</b>					
Cash and cash equivalents .....	\$ 10,204	\$ 54,520	\$ 42,913	\$ 48,006	\$ 42,743
Working capital .....	35,639	88,288	309,780	295,874	356,574
Total assets .....	205,229	289,244	924,829	914,783	998,182
Long-term debt .....	37,000	—	224,688	178,438	174,866
Stockholders' equity .....	77,544	189,170	471,054	512,708	601,943

- (1) Our results for the fiscal year ended 2002 include the operations of the SPS division from June 14, 2002 through June 30, 2002.
- (2) Bad debts expense for our fiscal year 2003 includes the effect of a significant change in estimate as described below in the heading "Change in Accounting Estimate" in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations".

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion and analysis should be read in conjunction with the "Selected Financial Data" and our Financial Statements and the Notes thereto included elsewhere in this Annual Report on Form 10-K. The discussion in this Form 10-K contains forward-looking statements that involve risks and uncertainties, such as statements regarding our plans, objectives, expectations and intentions. The cautionary statements made in this Form 10-K should be read as being applicable to all forward-looking statements wherever they appear in this Report. Our actual results could differ materially from those discussed here. Factors that could cause or contribute to such differences include those discussed in Item 1 under the heading "Risk Factors," as well as those discussed elsewhere herein.*

#### **Overview**

We provide specialty retail pharmacy services for the treatment of patients with costly, chronic diseases. We derive revenues primarily from the sale of drugs to patients. We focus almost exclusively on a limited number of complex and expensive drugs that serve small patient populations. The following table presents the percentage of our total revenues generated from sales with respect to the diseases that we primarily served in the years ended June 30:

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Hemophilia, Autoimmune Disorders and PID .....	27%	38%	36%
Multiple Sclerosis .....	31%	14%	14%
Pulmonary Arterial Hypertension .....	2%	14%	16%
Gaucher Disease .....	18%	10%	9%
Growth Hormone-Related Disorders .....	9%	7%	8%
Respiratory Syncytial Virus .....	10%	6%	7%

The increases in revenues from the diseases hemophilia and autoimmune disorders, PID and PAH and the related decreases in revenues from the diseases multiple sclerosis, Gaucher, growth hormone related disorders and RSV from fiscal year 2002 to fiscal year 2003 are due to the acquisition of the SPS division in June 2002. The majority of the revenues of the SPS division related to hemophilia and autoimmune disorders, PID and PAH.

Sales and services with respect to Multiple Sclerosis, Gaucher Disease, RSV, PAH and growth hormone-related disorders are dependent upon our relationships with Biogen, Genzyme, MedImmune, GlaxoSmithKline, Actelion Pharmaceuticals U.S., United Therapeutics and Genentech. Our agreements with these

manufacturers describe the services to be provided by us, including contract pharmacy, information, clinical, reimbursement and customized delivery services. These agreements generally:

- allow the manufacturer to distribute directly or through other parties; and
- are short-term and may be cancelled by either party, without cause, with 60 to 365 days prior notice.

These agreements vary in level of exclusivity and scope of services provided. We typically purchase products at prices at or below the manufacturers' average wholesale sales prices, and our resulting contribution margins vary for each product line. Pricing is customized to reflect specific services to be provided by us and in some cases is subject to periodic adjustments to reflect changing market conditions. A few of these agreements limit our ability to supply competing drugs during (and in one case up to five years after) the term of the agreement.

We purchase drugs for hemophilia and immune disorders from all available sources. We are one of the national assignment of benefits providers selected by MedImmune, Inc. to distribute drugs for RSV. During 2002, we began providing specialty retail pharmacy services for the treatment of patients with PAH. We distribute all three of the FDA approved drug therapies for this disease.

We recognize revenue in the period the drugs are delivered or when we have performed the contractual service. While we may experience revenue changes from price fluctuations on our existing product lines, our revenue growth will depend principally on the introduction of new drugs and on volume growth in existing drug lines.

Reimbursement for the products we sell comes from governmental payors, Medicare and Medicaid, and non-governmental payors. The following table presents the percentage of our total revenues reimbursed by these payors:

	<u>Year Ended June 30, 2002</u>	<u>Year Ended June 30, 2003</u>	<u>Year Ended June 30, 2004</u>
Non-governmental .....	79%	73%	72%
Governmental:			
Medicaid .....	19%	20%	21%
Medicare .....	2%	7%	7%

The increase in Medicare reimbursement and the related decrease in non-governmental reimbursement from fiscal year 2002 to fiscal year 2003 is due to the revenues from hemophilia factor and the PAH products, Flolan® and Remodulin®, as a result of the acquisition of the SPS division. These are the only products we distribute for which we were reimbursed directly by Medicare in fiscal year 2002 and 2003. We anticipate that our payor mix for fiscal year 2005 will be similar to the payor mix achieved in fiscal year 2004.

We have five joint venture agreements with various medical centers (or their affiliates) in which we own 50% of each venture and one joint venture agreement with a medical center affiliate in which we own 80% of the joint venture. Many of our patient populations have diseases that are discovered before or during adolescence and require ongoing care from physician specialists, many of whom are based at pediatric, academic and other acute care medical centers. To date, these ventures have primarily derived revenues from the treatment of patients with hemophilia, growth hormone-related disorders and RSV. We share profits and losses with our joint venture partners in equal proportion to our respective equity ownership. We account for our interests in the net income or loss in our 50% owned joint ventures under the equity method of accounting; we consolidate our 80% owned joint venture. Our equity interest in the net income of the 50% owned joint ventures represented approximately 4% of our income before income taxes in each of the years ended June 30, 2002 and 2003, and 2% of our income before income taxes in the year ended June 30, 2004.

Cost of sales include drug acquisition costs, pharmacy and warehouse personnel costs, freight and other direct costs associated with the delivery of our products and costs of clinical services provided. General and administrative expenses include the personnel costs of the reimbursement, sales, marketing, administrative and support staffs as well as corporate overhead and other general expenses. Bad debts include our provision

for patient accounts receivable, which we estimate will prove to be uncollectible after routine collection efforts have been exhausted. We typically hire personnel and incur legal, recruiting, marketing and other expenses in anticipation of the commercial launch of a new biopharmaceutical drug. In some instances, a portion of these expenses are reimbursed to us by the biopharmaceutical manufacturer. We have not historically capitalized any of these start-up expenses.

Due to the increasing sensitivity to drug cost within governmental and non-governmental payors, we are continuously susceptible to reimbursement and operating margin pressures. In recent years, pharmacy benefit managers and other non-governmental payors have aggressively attempted to discount their reimbursement rates for our products. This aggressive discounting has resulted in some reduced margins for some of our products and services.

Many government payors, including Medicare and Medicaid, historically paid us directly or indirectly for some of the drugs that we sell at the drugs' AWP or a percentage discount off AWP. Medicare reduced their reimbursement rates effective January 1, 2004 from AWP less 5% to AWP less 15%, however blood clotting factor was excluded from this change. Effective January 1, 2005, blood clotting factor will be reimbursed by Medicare using a formula of Average Selling Price ("ASP") plus 6% plus a proposed separate payment of \$0.05 per unit. In addition, MediCal changed its reimbursement formula to ASP plus 20% effective June 1, 2004.

Both federal and state legislators are continuing to scrutinize the healthcare industry for the purpose of reducing healthcare costs. While we are unable to predict what, if any, future healthcare-reform legislation may be enacted at the federal or state level, we expect continuing pressure to limit expenditures by governmental healthcare programs, which could impact the amount of revenue we receive. Approximately 21%, 27% and 28% of gross patient revenues (excluding the acute business acquired from Gentiva) for the years ended June 30, 2002, 2003 and 2004, respectively, was from Medicare and state-sponsored Medicaid programs. With the purchase of the SPS division, the percentage of our revenue reimbursed by Medicare and Medicaid was higher in 2003 when compared to the percentages experienced by us prior to the acquisition.

### **Strategic Alliance**

On February 9, 2004, we signed a long-term agreement with Medco Health Solutions, Inc. ("Medco") to become the preferred retail and home delivery pharmacy provider to Medco members for our specialty product lines that we currently dispense to treat patients with long-term, chronic diseases. The agreement includes drugs to treat hemophilia, PAH, RSV, multiple sclerosis, growth hormone related disorders and Gaucher's disease. We have historically provided our drugs to some Medco members, however, we expect an increase in the number of prescriptions for Medco members resulting from the agreement.

### **Acquisition**

On June 13, 2002, we acquired the SPS division of Gentiva. We acquired substantially all of the assets used in the SPS division including 100% of the outstanding stock in three of Gentiva's subsidiaries that were exclusively engaged in the business conducted by the SPS division. The SPS business provides specialty retail pharmacy and related services relating to the treatment of patients with certain costly chronic diseases. In addition to the diseases previously served by us, the SPS business was also a leading provider of specialty pharmacy and related services to patients with PAH. As a result of the acquisition, we became a leading provider of specialty retail pharmacy and related services, as measured by revenue. The aggregate purchase price was \$463.8 million (including \$13.8 million of acquisition related costs) and consisted of \$217.1 million of cash and 7,591,464 shares of common stock valued at \$246.7 million. The results of the SPS business have been included in the consolidated financial statements since June 14, 2002.

## Results of Operations

The following table sets forth for the periods indicated, the percentages of total revenues represented by the respective financial items:

	Years Ended June 30,		
	2002	2003	2004
Revenues:			
Net patient revenue .....	96.9%	97.4%	97.2%
Other revenue .....	2.8	2.5	2.6
Equity in net income of joint ventures .....	0.3	0.1	0.2
Total revenues .....	100.0	100.0	100.0
Operating expenses:			
Cost of sales .....	83.4	79.1	79.0
General and administrative .....	7.0	9.4	9.1
Bad debts .....	0.9	6.4	2.0
Restructuring charge .....	0.6	—	—
Depreciation and amortization .....	0.5	0.8	0.8
Total operating expenses .....	92.4	95.7	90.9
Operating income .....	7.6	4.3	9.1
Interest income (expense), net .....	0.1	(0.7)	(0.5)
Income before minority interest and income taxes .....	7.7	3.6	8.6
Minority interest .....	(0.2)	(0.1)	(0.2)
Income before income taxes .....	7.5	3.5	8.4
Income tax expense .....	2.9	1.3	3.2
Net income .....	4.6%	2.2%	5.2%

## Critical Accounting Policies and Estimates

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. In preparing our financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We evaluate our estimates and judgments on an ongoing basis. We base our estimates and judgments on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Our actual results may differ from these estimates, and different assumptions or conditions may yield different estimates. The items in our financial statements requiring significant estimates and judgments are as follows:

### Revenue Recognition

Net patient revenues are from the sales of biopharmaceutical drugs to patients and are reported at the net amount billed to patients, third-party payors and others in the period the products are delivered. We have agreements with certain third-party payors that provide for payments to us at amounts discounted from our established rates.

From time to time we enter into management contracts with hemophilia treatment centers, medical centers and joint ventures in which we have an interest. Pursuant to these contracts, we will provide certain billing, pharmacy dispensing, inventory management, shipping, reimbursement, collection and other manage-

ment services in exchange for fees that range from a reimbursement of our costs to a percentage of the managed entities billed charges, less contractual allowances. These contracts are for terms of up to five years and are usually cancelable on short notice. Revenue from the management contracts is recognized when the services are rendered and is included in other revenue.

#### ***Allowance for Doubtful Accounts***

The procedure for estimating the allowance for doubtful accounts requires significant judgment and assumptions. Our primary collection risks are for patient co-payments and deductibles. The risk of collection varies based upon the product, the payor and the patient's ability to pay the amounts not reimbursed by the payor. Some of the drugs we distribute are primarily reimbursed by prescription card benefit plans, which reimbursement is subject to lower co-payment and deductible amounts (typically \$15-\$30 per prescription). Other drugs are primarily reimbursed through major medical benefit plans, which reimbursement is subject to higher deductible amounts. We estimate the allowance for doubtful accounts based upon a variety of factors including the age of the outstanding receivables and our historical experience of collecting the patient co-payments and deductibles. However, economic and other factors could result in collections that differ from our estimates. We continually review the estimation process and make changes to the estimates as necessary.

#### ***Allowance for Contractual Discounts***

We are reimbursed for the drugs we sell by many different payors including insurance companies, Medicare and all of the state Medicaid programs. The revenues and related accounts receivable are recorded net of payor contractual discounts to reflect the estimated net billable amounts for the products delivered. We estimate the allowance for contractual discounts on a payor-specific basis, given our interpretation of the contract terms or applicable regulations. However, the reimbursement rates are often subject to interpretation that could result in payments that differ from our estimates. Additionally, updated regulations and contract negotiations occur frequently, necessitating our continual review and assessment of the estimation process.

#### ***Patient Credit Balance Liability***

Patient credit balances arise due to many factors including overpayments from payors, unapplied payments due to insufficient information and payments against invoices that have previously been written off. We estimate the amount of credit balances that relate to overpayments from payors based upon historical trends and other available information and classify those credit balances as accounts payable in the consolidated financial statements.

#### ***Self Insurance Reserves***

We maintain self-insured workers' compensation, medical and dental plans for employees. Claims expense is accrued under these plans as the incidents that give rise to them occur. We use a third-party administrator to process all such claims. Unpaid claim accruals are estimated based on historical costs of settlement and average lag times. We believe that the estimation methodology used effectively captures our claims costs, however, payments could differ from our estimates due to changes in the healthcare cost structure or changes in the volume of claims filed.

#### ***Asset Impairment***

Management periodically evaluates the carrying values of long-lived assets, including property and equipment, to determine whether events and circumstances indicate that these assets have been impaired. An asset is considered impaired when undiscounted cash flows to be realized from such asset are less than its carrying value. In that event, a loss is determined based on the amount the carrying value exceeds the fair market value of such asset.

Effective on July 1, 2001, we adopted Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets*. This statement addresses the accounting and reporting of goodwill and

other intangible assets subsequent to their acquisition. Since adoption of SFAS No. 142 in July 2001, amortization of goodwill was discontinued, and we began reviewing goodwill at least annually for impairment.

We evaluate goodwill for impairment based on a two-step process. The first step compares the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not impaired and the second step of the impairment test is unnecessary. If the carrying amount of the reporting unit exceeds its fair value, the second step of the goodwill impairment test is necessary to measure the amount of impairment loss, if any. The second step compares the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss would be recognized in an amount equal to that excess. We have one reporting unit and the fair value of the reporting unit exceeded its carrying amount resulting in no impairment charges in fiscal year 2004.

### ***Income Taxes***

We are subject to audit by federal and state tax authorities. These audits could result in proposed assessments that challenge certain tax positions, which, if upheld through the administrative and legal process, could have a material impact on our earnings and cash flow. We believe that our tax positions comply with applicable tax law, and we do not anticipate any material impact on earnings or cash flows.

### ***Change in Accounting Estimate***

In preparing our financial statements, we are required to make certain estimates, including those related to the allowance for doubtful accounts, refundable credit balances, self-insurance accruals, income tax liabilities, litigation and impairment tests on goodwill. We periodically review our estimates to ensure that the estimates appropriately reflect changes in our business or as new information becomes available.

During the March 2003 quarter, we analyzed historical collection rates and other data used in estimating the allowance for doubtful accounts. Our calculations indicated that the accounts receivable reserve needed to be increased. As a result of the new information obtained through the analysis completed subsequent to the March 2003 quarter, in the third quarter of fiscal year 2003 we recorded a net \$49 million charge to bad debt expense and increased the allowance for doubtful accounts related to the accounts receivable of the SPS division.

### ***Fiscal Year Ended June 30, 2004 Compared to Fiscal Year Ended June 30, 2003***

**Revenues.** Total revenues increased 10% from \$1.373 billion to \$1.516 billion from fiscal year 2003 to fiscal year 2004. Net patient revenues increased 10% from \$1.337 billion to \$1.475 billion from fiscal year 2003 to fiscal year 2004. During fiscal 2003, we began distributing certain wholesale products on a consignment basis for the manufacturer and sold our infertility business thus eliminating revenues from the sale of these products from our business. Revenues from these products amounted to approximately \$65.9 million in fiscal 2003. Excluding the \$65.9 million from fiscal 2003 results, our revenues increased 16% from fiscal year 2003 to fiscal year 2004. The increase in revenues is primarily due to volume growth in our products for the treatment of RSV, PAH, growth hormone disorders, hemophilia, autoimmune disorders and PID as a result of the addition of new patients and additional sales of product to existing patients. In addition, we experienced growth in revenues from Avonex® due to product pricing increases. We also benefited from the addition of new and expanded contracts with managed care organizations.

**Cost of Sales.** Cost of sales increased 10% from \$1.086 billion to \$1.198 billion from fiscal year 2003 to fiscal year 2004, which is commensurate with the increase in our revenues discussed above. As a percentage of revenues, cost of sales decreased from 79.1% to 79.0% from fiscal year 2003 to fiscal year 2004 resulting in gross margins of 20.9% in fiscal year 2003 and 21.0% in fiscal year 2004. The composite gross margin was relatively flat from fiscal 2003 to fiscal 2004, and the gross margins for the individual products were relatively stable as well. There were some changes in product mix from fiscal 2003 to fiscal 2004; however, the decrease in revenues from the higher margin products for the treatment of hemophilia and immune disorders was offset by an increase in revenues from the products for the treatment of PAH. Similarly, a decrease in revenues from

the lower margin products for the treatment of multiple sclerosis and Gaucher disease was offset by an increase in revenues from the products for the treatment of RSV and growth hormone. These changes resulted in a 0.1% increase in gross margin from fiscal 2003 to fiscal 2004.

*General and Administrative.* General and administrative expenses increased from \$129.8 million to \$138.5 million, or 7%, from fiscal year 2003 to fiscal year 2004. As a percentage of revenues, general and administrative expenses decreased from 9.4% to 9.1% from fiscal 2003 to fiscal 2004. The increase in expense is primarily due to the increase in audit fees as a result of the change to Deloitte & Touche LLP for the fiscal 2003 audit, increased salaries and benefits associated with the expansion of our support staffs to support the revenue growth and increased insurance premiums. Although there has been a 7% increase in general and administrative expense, the expense as a percentage of revenue has decreased 0.3% due to the leveraging of the some of our general and administrative expenses over increased revenues.

*Bad Debts.* Bad debts decreased from \$87.4 million to \$29.7 million from fiscal year 2003 to fiscal year 2004. As a percentage of revenues, bad debt expense decreased from 6.4% to 2.0% from fiscal year 2003 to fiscal year 2004. The decrease in expense is primarily due to the change in fiscal 2003 described above in Change in Accounting Estimate resulting in additional bad debt expense recorded in fiscal 2003.

*Depreciation and Amortization.* Depreciation expense increased from \$5.8 million to \$8.2 million from fiscal year 2003 to fiscal year 2004 as a result of purchases of property and equipment associated with our revenue growth including additional computer hardware and enhancements to our fully integrated pharmacy and reimbursement system. Amortization expense related to other intangible assets increased from \$4.6 million to \$4.7 million from fiscal year 2003 to fiscal year 2004, due to additional amortization related to the purchase of the assets from Alpha Therapeutic Services, Inc. in October 2003.

*Interest Expense, Net.* Interest expense, net decreased from \$9.6 million in fiscal year 2003 to \$8.1 million in fiscal year 2004 due to a decrease in the average amount of debt outstanding and lower interest rates during fiscal 2004.

*Income Tax Expense.* Our effective tax rate increased from 38.2% to 38.6% from fiscal year 2003 to fiscal year 2004. The difference between the recognized effective tax rate and the statutory tax rate is primarily attributed to state income taxes.

#### ***Fiscal Year Ended June 30, 2003 Compared to Fiscal Year Ended June 30, 2002***

*Revenues.* Total revenues increased 110% from \$0.654 billion to \$1.373 billion from fiscal year 2002 to fiscal year 2003. Net patient revenues increased 111% from \$0.633 billion to \$1.337 billion from fiscal year 2002 to fiscal year 2003. The increase in revenues is attributable to the SPS acquisition completed on June 13, 2002 and volume growth in our products for the treatments of growth hormone disorders, hemophilia, Gaucher disease and immune disorders as a result of the addition of new patients and additional sales of product to existing patients. We also had a significant increase in our seasonal drug Synagis® for the treatment of RSV as a result of increased patient volume. We also benefited from the addition of new and expanded contracts with managed care organizations.

*Cost of Sales.* Cost of sales increased 99% from \$0.545 billion to \$1.086 billion from fiscal year 2002 to fiscal year 2003, which is commensurate with the increase in our revenues discussed above. As a percentage of revenues, cost of sales decreased from 83.4% to 79.1% from fiscal year 2002 to fiscal year 2003 resulting in gross margins of 16.6% in fiscal year 2002 and 20.9% in fiscal year 2003. Gross margins for the individual products remained relatively stable; however, a change in product mix resulted in an increase in the composite gross margin in fiscal year 2003. The primary drivers were increased revenues from hemophilia factor, IVIG for the treatment of immune disorders and Flolan® for the treatment of PAH, which have lower acquisition costs as a percentage of revenue than most of the other products we distribute.

*General and Administrative.* General and administrative expenses increased from \$45.6 million to \$129.8 million, or 185%, from fiscal year 2002 to fiscal year 2003. The increase is due to the SPS acquisition completed on June 13, 2002 and increased salaries and benefits associated with the expansion of our reimbursement, sales and marketing, administrative and support staffs and the addition of office space and



related furniture and fixtures to support the revenue growth. General and administrative expenses represented 7.0% and 9.4% of revenues for fiscal years 2002 and 2003, respectively. The increase to 9.4% in fiscal year 2003 is due to product mix changes. The higher margin products, which were a higher percentage of our total revenues in fiscal year 2003, have higher general and administrative expenses associated with them than many of the other product lines that we distribute.

*Bad Debts.* Bad debts increased from \$5.8 million to \$87.4 million from fiscal year 2002 to fiscal year 2003. As a percentage of revenues, bad debt expense increased from 0.9% to 6.4% from fiscal year 2002 to fiscal year 2003. The increase in expense is primarily due to the change described above in Change in Accounting estimate. During the March 2003 quarter, we analyzed historical collection rates and other data used in estimating the allowance for doubtful accounts. Our calculations indicated that the accounts receivable reserve needed to be increased. As a result of the new information obtained through the analysis completed subsequent to the March 2003 quarter, in the third quarter of fiscal year 2003 we recorded a net \$49 million charge to bad debt expense and increased the allowance for doubtful accounts related to the accounts receivable of the SPS division.

*Depreciation and Amortization.* Depreciation expense increased from \$2.3 million to \$5.8 million from fiscal year 2002 to fiscal year 2003 as a result of the assets acquired in the SPS acquisition, purchases of property and equipment associated with our revenue growth and the expansion of our leasehold facility improvements. Amortization expense related to other intangible assets increased from \$1.3 million to \$4.6 million from fiscal year 2002 to fiscal year 2003 due to the SPS acquisition.

*Interest Income/Expense, Net.* Interest income, net was \$0.4 million in fiscal year 2002 and interest expense, net was \$9.6 million in fiscal year 2003. The change, amounting to \$10.0 million, is primarily due to the debt outstanding during fiscal year 2003 that was incurred in June 2002 to finance the cash portion of the SPS acquisition and the related acquisition costs.

*Income Tax Expense.* Our effective tax rate decreased from 39.0% to 38.2% from fiscal year 2002 to fiscal year 2003. The difference between the recognized effective tax rate and the statutory tax rate is primarily attributed to state income taxes.

## **Liquidity and Capital Resources**

As of June 30, 2004 and June 30, 2003, we had working capital of \$356.6 million and \$295.9 million, respectively. Our net cash provided by operating activities was approximately \$58.3 million for the year ended June 30, 2004 and \$71.1 million for the year ended June 30, 2003. This decrease is primarily due to the increase in inventory from \$90.0 million as of June 30, 2003 to \$128.3 million as of June 30, 2004. As a percentage of cost of sales, inventory increased from 8.3% in fiscal 2003 to 10.7% in fiscal 2004. This increase is due to the growth in our business, the purchase of inventory to fulfill certain purchase commitments and the purchase of certain inventory at a lower acquisition cost. This increased level of inventory does not exceed our demand, and we do not expect to have any obsolescence adjustments related to this additional inventory. As a percentage of net patient revenue, net patient accounts receivable decreased from 23% in fiscal 2003 to 22% in fiscal 2004 resulting in days sales outstanding of approximately 84 in fiscal 2003 and 81 in fiscal 2004.

Net cash used by investing activities was \$55.6 million for the year ended June 30, 2004 and \$38.0 million for the year ended June 30, 2003. Cash used by investing activities in the year ended June 30, 2004 consisted primarily of \$35.9 million for acquisitions and \$19.7 million for purchases of property and equipment. Cash used by investing activities in the year ended June 30, 2003 consisted primarily of \$22.0 million for acquisitions, which included a \$16.0 million earn out payment related to a fiscal year 2002 acquisition and \$16.0 million for purchases of property and equipment.

Net cash used in financing activities was \$8.0 million for the year ended June 30, 2004 and \$28.0 million for the year ended June 30, 2003. Cash used in financing activities for the year ended June 30, 2004 consisted primarily of \$15.4 million of repayments on our credit facility and \$1.4 million in distributions to our minority interest partner less \$8.8 million from the issuance of common stock. Cash used in financing activities for the year ended June 30, 2003 consisted primarily of \$35.3 million of repayments on our credit facility and

\$0.5 million in distributions to our minority interest partner less \$7.8 million from the issuance of common stock.

Historically, we have funded our operations and continued internal growth through cash provided by operations. Capital expenditures amounted to \$19.7 million in fiscal year 2004 and \$16.0 million in fiscal year 2003. We anticipate that our capital expenditures for the fiscal year ending June 30, 2005 will consist primarily of additional computer hardware, enhancements to our fully integrated pharmacy and reimbursement software system and costs to build out and furnish additional space needed to meet the needs of our growth. We expect the cost of our capital expenditures in fiscal year 2005 to be approximately \$20.0 million, exclusive of any acquisitions of businesses. We expect to fund these expenditures through cash provided by operating activities and/or borrowings under the revolving credit facility with our bank.

As of June 30, 2004, our \$325 million revolving credit facility with Bank of America, N.A. and other participating banks (collectively the "Lenders") consisted of a \$125 million revolving commitment expiring June 2007, a \$75 million term loan (Tranche A Term Loan) due in periodic principal payments through March 2007, and a \$125 million term loan (Prior Tranche B Term Loan) due in periodic principal payments through March 2009. On November 18, 2003, we amended our credit facility to lower the margin on the Prior Tranche B Term Loan to 2.25% for London Inter-Bank Offered Rate (LIBOR) based loans and 0.75% for prime rate based loans effectively reducing the margin by 50 basis points through May 2004 and 25 basis points for the remaining term of the loan. We paid Bank of America, N.A. \$175,000 in administrative fees to obtain the amendment. Since June 30, 2004, we have amended our credit facility to increase the size of the credit facility to \$550 million, consisting of a \$175 million revolving commitment expiring July 2009 and a \$375 million term loan (Tranche B Term Loan) due in periodic principal payments through June 2011. The terms of the amended agreement are similar to and no less favorable than those contained in the \$325 million credit facility as in effect on June 30, 2004.

Amounts outstanding under the credit facility bear interest at varying rates based upon a LIBOR or prime rate of interest (as selected by us), plus a variable margin rate based upon our leverage ratio as defined by the credit agreement. The combination of a variable rate margin and LIBOR base rate resulted in an effective rate of 3.67% and 3.39% at June 30, 2003 and 2004, respectively. Our obligations under the credit facility are secured by a lien on substantially all of our assets, including a pledge of all of the common stock or partnership interest of each of our domestic subsidiaries. The Lenders' security interest in a portion of our inventory is subordinate to the liens on that inventory under the terms of a security agreement between one of our vendors and us. The same vendor has a security interest in certain accounts receivable, which is subordinate to the rights of the Lenders.

The credit facility documentation contains financial covenants, including requirements to maintain certain ratios with respect to leverage, fixed charge coverage, net worth and asset coverage, each as defined in the credit agreement. The credit facility documentation also includes customary affirmative and negative covenants, including covenants relating to transactions with affiliates, uses of proceeds, restrictions on subsidiaries, limitations on indebtedness, limitations on mergers, acquisitions and asset dispositions, limitations on investments, limitations on payment of dividends and stock repurchases, and other distributions. The credit facility documentation also contains customary events of default, including events relating to changes in control of the Company.

On June 4, 2003, we entered into an interest rate swap agreement effectively converting for a period of one year beginning July 21, 2003, \$120 million of floating-rate borrowings to fixed-rate borrowings with a fixed rate of 1.14%, plus the applicable margin rate as determined by the credit agreement.

On February 6, 2003, the Securities and Exchange Commission (SEC) declared effective our shelf registration statement on Form S-3 providing for the offer, from time to time, of various securities, up to an aggregate of \$500 million. The shelf registration statement may enable us to more efficiently raise funds from the offering of securities covered by the shelf registration statement, subject to market conditions and our capital needs.

Our liquidity needs currently arise primarily from working capital requirements, capital expenditures, commitments related to financing obtained through the issuance of long-term debt and inventory purchase obligations. We believe that our cash from operations, cash available under the recently increased revolving credit facility and the proceeds from any offering of debt or equity securities allowed by the shelf registration statement will be sufficient to meet our internal operating and working capital requirements and growth plans for at least the next 12 months.

#### *Commitments and Contractual Obligations*

The following table sets forth a summary of our contractual cash obligations as of June 30, 2004. Certain of these contractual obligations are reflected in our balance sheet, while others are disclosed in the notes to the financial statements as future obligations under accounting principles generally accepted in the United States of America. Excluding long-term debt, this table does not include amounts already recorded on our balance sheet.

	Payments Due Under Contractual Obligations by Fiscal Year						Total
	2005	2006	2007	2008	2009	Thereafter	
	(in thousands)						
Long-Term Debt . . . . .	\$ 4,445	\$ 3,928	\$ 3,750	\$3,750	\$163,438	\$ —	\$179,311
Operating Leases . . . . .	7,464	5,077	3,662	2,359	1,741	808	21,111
Purchase Obligations . . . .	262,192	161,584	30,126	—	—	—	453,902
Capital Leases . . . . .	—	—	—	—	—	—	—
Other Long-Term Liabilities . . . . .	—	—	—	—	—	—	—
	<u>\$274,101</u>	<u>\$170,589</u>	<u>\$37,538</u>	<u>\$6,109</u>	<u>\$165,179</u>	<u>\$ 808</u>	<u>\$654,324</u>

The long-term debt obligations in the table reflect the maturities pursuant to credit facility amendments since June 30, 2004.

#### *Off-Balance Sheet Arrangements*

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

#### **Impact of Recently Issued Accounting Standards**

In December 2003, the FASB issued FIN No. 46(R), *Consolidation of Variable Interest Entities*, which clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*. FIN No. 46(R) requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not provide sufficient equity at risk for the entity to support its activities. FIN No. 46(R) is effective for the first interim or annual period ending after March 15, 2004. We have determined that we do not have any variable interest entities and therefore, the adoption of the provisions of FIN No. 46(R) in fiscal year 2004 did not have a material effect on our financial position or results of operations.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. This Statement amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, by requiring that contracts with comparable characteristics be accounted for similarly and clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003 and must be applied prospectively. The adoption of the provisions of SFAS No. 149 in fiscal year 2004 did not have a material effect on our financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. This statement established standards for how an issuer classifies

and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 13, 2003 and must be applied prospectively by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the Statement and still existing at the beginning of the interim period of adoption. The adoption of the provisions of SFAS No. 150 in fiscal year 2004 did not have a material effect on our financial position or results of operations.

#### **Impact of Inflation**

Changes in prices charged by the biopharmaceutical manufacturers for the drugs we dispense, along with increasing labor costs, freight and supply costs and other overhead expenses, affect our cost of sales and general and administrative expenses. Changes due to inflation have not had significant adverse effects on our operations.

#### **Forward Looking Information**

Certain matters discussed in the preceding pages of this Form 10-K, particularly regarding implementation of our strategy, development of new drugs by the pharmaceutical and biotechnology industries, anticipated growth and revenues, anticipated working capital and sources of funding for growth opportunities, expenditures, interest, costs and income constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (See Item 1 — "Risk Factors").

#### **Item 7A. *Quantitative and Qualitative Disclosures about Market Risk***

Our exposure to the impact of financial market risk is significant. Our primary financial market risk exposure consists of interest rate risk related to interest that we are obligated to pay on our variable-rate debt.

We sometimes use derivative financial instruments to manage our exposure to rising interest rates on our variable-rate debt, primarily by entering into variable-to-fixed interest rate swaps. We had fixed the interest rate through July 21, 2004 on \$120 million of our variable-rate debt through the use of a variable-to-fixed interest rate swap. As a result, we did not benefit from any decrease in interest rates nor were we subjected to any detriment from rising interest rates on this portion of our debt during the period of the swap agreement.

We have not yet hedged against our interest rate risk exposure after July 21, 2004. As a result, we will benefit from decreasing interest rates, but rising interest rates on our debt will also harm us. Accordingly, if we maintain our current level of total debt, including additional debt incurred in July 2004, a 100 basis point decrease in interest rates along the entire yield curve would result in an increase in pre-tax income of approximately \$3.75 million for the year. However, a 100 basis point increase in interest rates would result in a decrease in pre-tax income of \$3.75 million for the same period.

Actual changes in rates may differ from the hypothetical assumptions used in computing the exposures in the examples cited above.

#### **Item 8. *Financial Statements and Supplementary Data***

The Consolidated Financial Statements and financial statement schedule in Part IV, Item 14(a)(1) and (2) of the report are incorporated by reference into this Item 8.

#### **Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

On May 5, 2003, the Company dismissed Ernst & Young LLP as its independent public accountant. The decision to terminate the engagement of Ernst & Young LLP was recommended and approved by the Audit Committee of the Company's Board of Directors, which determined that such termination was in the best interests of the Company, and approved by the Company's Board of Directors.

Ernst & Young LLP was retained as the Company's independent auditor at the time of the Company's formation on May 29, 1996. Ernst & Young LLP's report on the financial statements of the Company for the year ended June 30, 2002 did not contain an adverse opinion or disclaimer of opinion, nor was it qualified or modified as to uncertainty, audit scope, or accounting principles.

During the year ended June 30, 2002 and the interim period between June 30, 2002 and May 5, 2003, there were no disagreements between the Company and Ernst & Young LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Ernst & Young LLP, would have caused it to make reference to the subject matter of the disagreements in connection with its report for such period. During the year ended June 30, 2002 and the interim period between June 30, 2002 and the date of Ernst & Young LLP's dismissal on May 5, 2003, there were no reportable events (as defined in Item 304(a)(1)(v) of Regulation S-K promulgated by the Securities and Exchange Commission).

The Company requested that Ernst & Young LLP furnish it with a letter addressed to the Securities and Exchange Commission stating whether or not it agreed with the above statements. A copy of the letter from Ernst & Young LLP dated May 19, 2003 was filed as Exhibit 16.1 to the Form 8-K/A filed May 19, 2003.

On June 10, 2003, the Audit Committee of the Board of Directors of the Company approved the engagement of Deloitte & Touche LLP to serve as the Company's new independent auditors, effective June 10, 2003.

During the fiscal year ended June 30, 2002, and the interim period between June 30, 2002 and the date of the Company's engagement of Deloitte & Touche LLP, the Company did not consult with Deloitte & Touche LLP with respect to any matters described in paragraphs (a)(2)(i) or (ii) of Item 304 of Regulation S-K.

#### **Item 9A. Controls and Procedures**

The Company's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. The Company's Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this report, the Company maintains disclosure controls and procedures that provide reasonable assurance that information required to be disclosed in the Company's reports under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and its Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

There have been no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2004 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART III

### **Item 10. *Directors and Executive Officers of the Company***

The information required by this item will appear in, and is incorporated by reference from, the sections entitled “Proposals for Stockholder Action — Election of Directors,” “Section 16(a) Beneficial Ownership Reporting Compliance,” “Management” and “Compensation Committee Interlocks and Insider Participation” included in the Company’s definitive Proxy Statement relating to the 2004 Annual Meeting of Stockholders.

### **Item 11. *Executive Compensation***

The information required by this item will appear in the section entitled “Executive Compensation” included in the Company’s definitive Proxy Statement relating to the 2004 Annual Meeting of Stockholders, which information, other than the Compensation Committee Report and Performance Graph required by Items 402(k) and (l) of Regulation S-K, is incorporated herein by reference.

### **Item 12. *Security Ownership of Certain Beneficial Owners and Management***

Securities Authorized for Issuance Under Equity Compensation Plans in Part II, Item 5, of the report are incorporated by reference into this Item 12.

The information required by this item will appear in, and is incorporated by reference from, the section entitled “Security Ownership of Directors, Officers and Principal Stockholders” included in the Company’s definitive Proxy Statement relating to the 2004 Annual Meeting of Stockholders.

### **Item 13. *Certain Relationships and Related Transactions***

The information required by this item will appear in, and is incorporated by reference from, the sections entitled “Compensation Committee Interlocks and Insider Participation” and “Certain Relationships and Related Transactions” included in the Company’s definitive Proxy Statement relating to the 2004 Annual Meeting of Stockholders.

### **Item 14. *Principal Accounting Fees and Services***

The information required by this item will appear in, and is incorporated by reference from, the sections entitled “Principal Accounting Fees and Services” included in the Company’s definitive Proxy Statement relating to the 2004 Annual Meeting of Stockholders.

## PART IV

### Item 15. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a) Document filed as part of this Report:

	<u>Page</u>
(1) Financial Statements:	
Reports of Independent Registered Public Accounting Firms . . . . .	F-1
Consolidated Balance Sheets at June 30, 2003 and 2004 . . . . .	F-3
Consolidated Statements of Income for the years ended June 30, 2002, 2003 and 2004 . . . . .	F-4
Consolidated Statements of Stockholders' Equity for the years ended June 30, 2002, 2003 and 2004 . . . . .	F-5
Consolidated Statements of Cash Flows for the years ended June 30, 2002, 2003 and 2004 . . . . .	F-6
Notes to Consolidated Financial Statements . . . . .	F-7
(2) Financial Statement Schedule:	
Schedule II — Consolidated Schedule — Valuation and Qualifying Accounts . . . . .	F-26
All other schedules for which provision is made in the applicable accounting Regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and therefore have been omitted	
(3) The Index of Exhibits Required by Item 601 of Regulation S-K included herewith, which is incorporated herein by reference	

(b) Reports filed by the Company on Form 8-K:

We filed a report on Form 8-K on May 3, 2004, to furnish as an exhibit, the press release reporting our financial results for the quarter ended March 31, 2004.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Accredo Health, Incorporated  
Memphis, TN

We have audited the accompanying consolidated balance sheets of Accredo Health, Incorporated and subsidiaries ("Company") as of June 30, 2004 and 2003, and the related consolidated statements of income, stockholders' equity and cash flows for the years then ended. Our audits also included the financial statement schedule as of June 30, 2004 and 2003, and for the years then ended, listed in the Index at Item 15(a) (2). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. The Company's consolidated financial statements for the year ended June 30, 2002, were audited by other auditors whose report, dated August 16, 2002, expressed an unqualified opinion on those statements.

We conducted our audits in accordance with 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, such consolidated financial statements present fairly, in all material respects, the financial position of Accredo Health, Incorporated and subsidiaries as of June 30, 2004 and 2003, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the 2004 and 2003 basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Deloitte & Touche LLP

Memphis, Tennessee  
September 10, 2004



## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors  
Accredo Health, Incorporated

We have audited the accompanying consolidated statements of income, stockholders' equity and cash flows of Accredo Health, Incorporated for the year ended June 30, 2002. Our audit also included the financial statement schedule listed in the Index at Item 15(a) for the year ended June 30, 2002. 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 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 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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of Accredo Health, Incorporated's operations and its cash flows for the year ended June 30, 2002, 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.

/s/ERNST & YOUNG LLP

Memphis, Tennessee  
August 16, 2002

**ACCREDO HEALTH, INCORPORATED**  
**CONSOLIDATED BALANCE SHEETS**  
(000's omitted, except share data)

	June 30	
	2003	2004
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents .....	\$ 48,006	\$ 42,743
Receivables:		
Patient accounts .....	434,523	406,693
Allowance for doubtful accounts .....	(126,541)	(81,051)
	307,982	325,642
Due from affiliates .....	3,933	4,191
Other .....	21,226	28,584
	333,141	358,417
Inventories .....	89,985	128,323
Prepaid expenses and other current assets .....	4,625	5,084
Income taxes receivable .....	1,546	382
Deferred income taxes .....	24,579	14,129
Total current assets .....	501,882	549,078
Property and equipment, net .....	31,681	41,283
Other assets:		
Joint venture investments .....	5,908	7,713
Goodwill, net .....	352,509	382,628
Other intangible assets, net .....	22,803	17,480
Total assets .....	\$ 914,783	\$998,182
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable .....	\$ 169,664	\$164,780
Accrued expenses .....	19,518	22,625
Due to affiliates .....	576	654
Current portion of long-term debt .....	16,250	4,445
Total current liabilities .....	206,008	192,504
Long-term debt .....	178,438	174,866
Deferred income taxes .....	14,810	25,112
Minority interest in consolidated joint venture .....	2,819	3,757
Commitments .....	—	—
Stockholders' equity:		
Undesignated preferred stock, 5,000,000 shares authorized, no shares issued .....	—	—
Common stock, \$.01 par value; 100,000,000 shares authorized; 47,838,257 shares in 2003 and 48,603,341 shares in 2004 issued and outstanding .....	478	486
Additional paid-in capital .....	425,183	436,021
Accumulated other comprehensive income (loss) .....	(68)	8
Retained earnings .....	87,115	165,428
Total stockholders' equity .....	512,708	601,943
Total liabilities and stockholders' equity .....	\$ 914,783	\$998,182

See accompanying notes to consolidated financial statements.

**ACCREDITO HEALTH, INCORPORATED**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(000's omitted, except share data)

	Years Ended June 30		
	2002	2003	2004
Revenues:			
Net patient revenue .....	\$ 633,249	\$ 1,337,414	\$ 1,475,036
Other revenue .....	18,257	33,982	38,761
Equity in net income of joint ventures .....	2,067	1,940	3,071
Total revenues .....	<u>653,573</u>	<u>1,373,336</u>	<u>1,516,868</u>
Operating expenses:			
Cost of sales .....	544,902	1,086,334	1,197,836
General and administrative .....	45,571	129,803	138,521
Bad debts .....	5,833	87,418	29,745
Restructuring charge .....	3,893	—	—
Depreciation .....	2,338	5,834	8,210
Amortization .....	1,337	4,552	4,656
Total operating expenses .....	<u>603,874</u>	<u>1,313,941</u>	<u>1,378,968</u>
Operating income .....	49,699	59,395	137,900
Interest income (expense):			
Interest expense .....	(662)	(10,281)	(8,986)
Interest income .....	1,021	717	861
	<u>359</u>	<u>(9,564)</u>	<u>(8,125)</u>
Income before minority interest in income of consolidated joint venture and income taxes .....	50,058	49,831	129,775
Minority interest in income of consolidated joint venture .....	(1,273)	(2,044)	(2,338)
Income before income taxes .....	48,785	47,787	127,437
Income tax expense .....	19,025	18,252	49,124
Net income .....	<u>\$ 29,760</u>	<u>\$ 29,535</u>	<u>\$ 78,313</u>
Net income per common share:			
Basic .....	<u>\$ 0.75</u>	<u>\$ 0.62</u>	<u>\$ 1.63</u>
Diluted .....	<u>\$ 0.73</u>	<u>\$ 0.61</u>	<u>\$ 1.60</u>
Weighted average shares outstanding:			
Basic .....	39,547,712	47,509,682	48,165,855
Diluted .....	40,919,625	48,442,723	49,042,676

See accompanying notes to consolidated financial statements.

**ACCREDO HEALTH, INCORPORATED**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
(000's omitted, except share data)

	Common Stock Shares	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Retained Earnings	Total Stockholders' Equity
Balance at June 30, 2001 . . . . .	38,931,027	\$389	\$160,961	\$ —	\$ 27,820	\$189,170
Issuance of common stock:						
In connection with an acquisition . . . . .	7,591,464	76	246,647	—	—	246,723
Exercise of stock options . . . . .	427,442	4	2,193	—	—	2,197
Employee stock purchase plan	43,328	1	895	—	—	896
Tax benefit of exercise of stock options . . . . .	—	—	2,204	—	—	2,204
Compensation resulting from stock transactions, net of income tax benefit . . . . .	—	—	104	—	—	104
Net income . . . . .	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>29,760</u>	<u>29,760</u>
Balance at June 30, 2002 . . . . .	46,993,261	470	413,004	—	57,580	471,054
Issuance of common stock:						
Exercise of stock options . . . . .	762,250	7	6,008	—	—	6,015
Employee stock purchase plan	82,746	1	1,794	—	—	1,795
Tax benefit of exercise of stock options . . . . .	—	—	4,377	—	—	4,377
Mark to market interest rate swap, net of taxes of \$43 . . . . .	—	—	—	(68)	—	(68)
Net income . . . . .	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>29,535</u>	<u>29,535</u>
Balance at June 30, 2003 . . . . .	47,838,257	478	425,183	(68)	87,115	512,708
Issuance of common stock:						
Exercise of stock options . . . . .	699,410	7	7,306	—	—	7,313
Employee stock purchase plan	65,674	1	1,458	—	—	1,459
Tax benefit of exercise of stock options . . . . .	—	—	2,074	—	—	2,074
Mark to market interest rate swap, net of taxes of \$48 . . . . .	—	—	—	76	—	76
Net income . . . . .	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>78,313</u>	<u>78,313</u>
Balance at June 30, 2004 . . . . .	<u>48,603,341</u>	<u>\$486</u>	<u>\$436,021</u>	<u>\$ 8</u>	<u>\$165,428</u>	<u>\$601,943</u>

See accompanying notes to consolidated financial statements.

**ACCREDITO HEALTH, INCORPORATED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(000's omitted)

	Years Ended June 30		
	2002	2003	2004
<b>Operating activities</b>			
Net income .....	\$ 29,760	\$29,535	\$78,313
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization .....	3,675	13,761	16,454
Restructuring charge .....	3,893	—	—
Provision for losses on accounts receivable .....	5,833	87,418	29,745
Deferred income taxes .....	949	(8,198)	20,752
Compensation resulting from stock transactions .....	164	—	—
Tax benefit of exercise of stock options .....	2,204	4,377	2,074
Undistributed earnings of joint ventures .....	(1,827)	(1,270)	(1,805)
Minority interest in income of consolidated joint venture .....	1,273	2,044	2,338
Changes in operating assets and liabilities, net of effect from business acquisitions:			
Patient and other receivables .....	(34,703)	(62,960)	(52,042)
Due from affiliates .....	185	(1,102)	(180)
Inventories .....	(34,577)	30,825	(37,078)
Prepaid expenses and other current assets .....	(1,945)	(1,155)	(458)
Income taxes receivable .....	589	(2,507)	1,870
Accounts payable and accrued expenses .....	56,804	(19,698)	(1,668)
Net cash provided by operating activities .....	32,277	71,070	58,315
<b>Investing activities</b>			
Purchases of marketable securities .....	(6,000)	—	—
Proceeds from sales and maturities of marketable securities .....	8,000	—	—
Purchases of property and equipment .....	(8,858)	(16,005)	(19,671)
Business acquisitions and joint venture investments .....	(256,172)	(21,970)	(35,902)
Net cash used in investing activities .....	(263,030)	(37,975)	(55,573)
<b>Financing activities</b>			
(Payment of) proceeds from notes payable and line of credit .....	223,889	(35,313)	(15,377)
Payment of deferred financing costs .....	(6,737)	—	—
Issuance of common stock .....	3,094	7,811	8,772
Distributions to minority interest partner .....	(1,100)	(500)	(1,400)
Net cash provided by (used in) financing activities .....	219,146	(28,002)	(8,005)
Increase (decrease) in cash and cash equivalents .....	(11,607)	5,093	(5,263)
Cash and cash equivalents at beginning of year .....	54,520	42,913	48,006
Cash and cash equivalents at end of year .....	\$ 42,913	\$48,006	\$42,743
<b>Supplementary cash flow disclosures</b>			
Income taxes paid .....	\$ 15,279	\$20,578	\$24,570
Interest paid .....	\$ 395	\$ 8,936	\$ 7,455

See accompanying notes to consolidated financial statements.

**ACCREDITO HEALTH, INCORPORATED**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Description of Business**

The consolidated financial statements and related notes to the consolidated financial statements include the accounts of Accredo Health, Incorporated (the "Company"), its wholly-owned subsidiaries and its 80% owned joint venture. Significant inter-company accounts have been eliminated in consolidation.

The Company provides specialty retail pharmacy and related services pursuant to agreements with biotechnology drug manufacturers relating to the treatment of patients with certain costly chronic diseases. Because of the unique needs of patients suffering from chronic diseases, biotechnology drug manufacturers have recognized the benefits of customized programs to facilitate alternate site drug administration, ensure compliance with treatment regimens, provide reimbursement assistance and capture valuable clinical and patient demographic information. The Company addresses the needs of the manufacturers, payors and patients by providing specialized services that facilitate product launch and patient acceptance including the collection of timely drug utilization and patient compliance information, patient education and monitoring through the use of written materials and telephonic consultation, reimbursement expertise and overnight drug delivery.

The Company has designed its specialty retail pharmacy services to focus primarily on biotechnology injectable drugs that: (i) are used on a recurring basis to treat chronic, and potentially life threatening diseases; (ii) are expensive; and (iii) require temperature control or other specialized handling as part of their distribution process. Currently, the Company provides specialty retail pharmacy and related services that primarily address the needs of patients with chronic diseases including Multiple Sclerosis, Gaucher Disease, hemophilia, pulmonary arterial hypertension, growth hormone-related disorders, primary immune deficiencies, autoimmune disorders and respiratory syncytial virus.

**2. Significant Accounting Policies**

**Cash Equivalents**

The Company considers all highly liquid investments with an initial maturity of three months or less to be cash equivalents.

**Concentrations of Risks**

The Company's primary concentration of credit risk is patient accounts receivable, which consists of amounts owed by various governmental agencies, insurance companies and private patients. The Company manages the receivables by regularly reviewing its accounts and contracts and by providing appropriate allowances for uncollectible amounts. Significant concentrations of gross patient accounts receivable consist of the following at June 30:

	<u>2003</u>	<u>2004</u>
Medicare .....	7%	9%
Medicaid .....	18%	16%

Concentration of credit risk relating to accounts receivable is limited to some extent by the diversity and number of patients and payors and the geographic dispersion of the Company's operations. The Company grants credit without collateral to its patients and payors.

ACCREDITO HEALTH, INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company derives a substantial portion of its revenue from the sale of drugs provided by a limited number of single-source suppliers. The table below shows the concentration of the Company's revenue derived from the sale of drugs provided by these suppliers for the years ended June 30:

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Biogen .....	31%	14%	14%
Genzyme .....	18%	10%	9%
MedImmune .....	10%	6%	7%

The Company derived approximately 15% of its revenue from a single non-governmental payor in the year ended June 30, 2002. No payor represented more than 10% of the Company's revenue in the year ended June 30, 2003. The Company derived approximately 10% of its revenue from a single non-governmental payor in the year ended June 30, 2004.

Cash, cash equivalents and marketable securities are placed with major high credit quality financial institutions and issuers. Management believes that there is minimal credit risk associated with these financial institutions and issuers.

**Receivables**

Receivables are presented net of allowance for doubtful accounts and contractual allowances. Receivables include trade and patient accounts receivable. The Company regularly reviews and analyzes the adequacy of the allowances based on a variety of factors including the age of the outstanding receivable and the collection history. If circumstances related to specific customers change, estimates of the recoverability of receivables could be further adjusted.

**Inventories**

Inventories are stated at the lower of cost, determined by the first-in, first-out method, or market value.

**Fair Value of Financial Instruments**

The carrying value of accounts receivable, accounts payable and long-term debt approximates fair value of these financial instruments at June 30, 2003 and 2004.

**Property and Equipment**

Property and equipment is stated at cost. Provisions for depreciation are computed primarily by the straight-line method based on the estimated useful lives of the related assets of two to seven years.

**Valuation of Long-Lived Assets**

Management periodically evaluates carrying values of long-lived assets, including property and equipment, to determine whether events and circumstances indicate that these assets have been impaired. An asset is considered impaired when undiscounted cash flows to be realized from such asset are less than its carrying value. In that event, a loss is determined based on the amount the carrying value exceeds the fair market value of such asset, which is based on discounted cash flows.

**Goodwill and Other Intangible Assets**

Goodwill represents the excess of the cost of businesses acquired over fair value of net tangible and identifiable intangible assets at the date of acquisition. Prior to the adoption of Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets*, goodwill was amortized

**ACCREDITO HEALTH, INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

using the straight-line method over their estimated useful lives of 40 years. Since adoption of SFAS No. 142 in July 2001, amortization of goodwill was discontinued and goodwill is reviewed at least annually for impairment. Accumulated amortization of goodwill was \$7.0 million at June 30, 2003 and 2004. Other intangible assets consist primarily of non-compete agreements and acquired patient relationships in connection with business acquisitions. Other intangibles are being amortized using the straight-line method over their estimated useful lives of two to ten years for the non-compete agreements, four to eight years for acquired patient relationships and five to seven years for the deferred financing costs. Absent any impairment indicators, the Company performs the annual impairment tests during the fourth quarter each year.

**Income Taxes**

Deferred income taxes are provided for the tax effect of temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. The liability method is used to account for income taxes, which requires deferred taxes to be recorded at the statutory rate to be in effect when the taxes are paid.

**Stock-Based Compensation**

The Company recognizes stock-based compensation using the intrinsic value method as permitted by SFAS No. 123, *Accounting for Stock-Based Compensation*. Accordingly, no compensation expense is recorded for employee stock-based awards issued at market value at the date such awards are granted.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma information for the years ended June 30 is as follows (in thousands, except share data):

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Net income, as reported .....	\$29,760	\$29,535	\$78,313
Less stock-based employee compensation cost, net of related tax effects, applying the fair value method to all rewards .....	<u>(3,860)</u>	<u>(10,949)</u>	<u>(11,855)</u>
Pro forma net income .....	<u>\$25,900</u>	<u>\$18,586</u>	<u>\$66,458</u>
Earnings per share:			
Basic – as reported .....	\$ 0.75	\$ 0.62	\$ 1.63
Basic – pro forma .....	\$ 0.65	\$ 0.39	\$ 1.38
Diluted – as reported .....	\$ 0.73	\$ 0.61	\$ 1.60
Diluted – pro forma .....	\$ 0.64	\$ 0.39	\$ 1.37

**Revenue Recognition**

Net patient revenues are from the sales of biopharmaceutical drugs to patients and are reported at the net amount billed to patients, third-party payors and others in the period the products are delivered. The Company has agreements with certain third-party payors that provide for payments to the Company at amounts discounted from its established rates.

The revenues and related accounts receivable are recorded net of payor contractual discounts to reflect the estimated net billable amounts for the products delivered. We estimate the allowance for contractual discounts on a payor-specific basis, given our interpretation of the contract terms or applicable regulations. However, the reimbursement rates are often subject to interpretation that could result in payments that differ from our estimates. Additionally, updated regulations and contract negotiations occur frequently, necessitating our continual review and assessment of the estimation process.



**ACCREDO HEALTH, INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Approximately 21%, 27% and 28% of gross patient revenues for the years ended June 30, 2002, 2003 and 2004, respectively, is from participation in the Medicare and state-sponsored Medicaid programs.

The Company from time to time enters into management contracts with hemophilia treatment centers, medical centers and joint ventures in which the Company has an interest. Pursuant to these contracts, the Company will provide certain billing, pharmacy dispensing, inventory management, shipping, reimbursement, collection and other management services in exchange for fees that range from a reimbursement of the Company's costs to a percentage of the managed entities billed charges, less contractual allowances. These contracts are for terms of up to five years and are usually cancelable on short notice. Revenue from the management contracts is recognized when the services are rendered and is included in other revenue.

**Shipping and Handling Costs**

Shipping and handling costs are included in cost of sales.

**Interest Rate Swap Agreements**

The Company enters into interest rate swap agreements as a means of managing its interest rate exposure. The differential to be paid or received is recognized over the life of the agreement as an adjustment to interest expense. The interest rate swap is designated as an effective cash-flow hedge. The fair value of the swap is recorded on the balance sheet, with changes in the fair value included in accumulated other comprehensive income (loss).

**Segment Disclosures**

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, establishes standards for the way that public business enterprises that are required to file financial statements with the Securities and Exchange Commission report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. SFAS No. 131 also establishes standards for related disclosures about products and services, geographic areas and major customers. The Company manages its business in one operating segment.

**Earnings Per Share**

The Company presents earnings per share in accordance with SFAS No. 128, *Earnings Per Share*. All per share amounts have been calculated using the weighted average number of shares outstanding during each period. Diluted earnings per share are adjusted for the impact of common stock equivalents using the treasury stock method when the effect is dilutive. A reconciliation of the basic and diluted weighted average shares outstanding is as follows at June 30:

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Weighted average number of common shares outstanding used as the denominator in the basic earnings per share calculation.....	39,547,712	47,509,682	48,165,855
Additional shares assuming exercise of dilutive stock options.....	<u>1,371,913</u>	<u>933,041</u>	<u>876,821</u>
Weighted average number of common and equivalent shares used as the denominator in the diluted earnings per share calculation.....	<u>40,919,625</u>	<u>48,442,723</u>	<u>49,042,676</u>

## ACCREDITO HEALTH, INCORPORATED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

#### Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and the accompanying notes to the consolidated financial statements. Management makes its best estimate of the ultimate outcome for these items based on historical trends and other information available when the financial statements are prepared. Actual results could differ from those estimates. Changes in estimates are recognized in accordance with accounting principles for the estimate, which is typically in the period when the new information becomes available to management. Estimates are used primarily in recording the allowance for doubtful accounts, refundable credit balances, self-insurance accruals, income tax liabilities and impairment tests on goodwill.

During the March 2003 quarter, we analyzed historical collection rates and other data used in estimating the allowance for doubtful accounts. Our calculations indicated that the accounts receivable reserve needed to be increased. As a result of the new information obtained through the analysis completed subsequent to the March 2003 quarter, we recorded a net \$49 million charge to bad debt expense and increased the allowance for doubtful accounts related to the accounts receivable of the SPS division in the third quarter of fiscal year 2003.

#### Risk Management

The Company maintains self-insured workers' compensation, medical and dental plans for employees. Claims are accrued under these plans as the incidents that give rise to them occur. Unpaid claim accruals are based on the estimated ultimate cost of settlement, including claim settlement expenses. The Company has entered into reinsurance agreements with independent insurance companies to limit its losses on claims. Under the terms of the agreements, the insurance companies will reimburse the Company for individual claims generally in excess of \$200,000 in respect to medical or dental claims, \$250,000 in respect to workers' compensation claims and when total claims exceed an aggregate amount based on the number of covered lives. These reimbursements are included in general and administrative expense in the accompanying consolidated statements of income.

#### Recent Accounting Pronouncements

In December 2003, the FASB issued FIN No. 46(R), *Consolidation of Variable Interest Entities*, which clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*. FIN No. 46(R) requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not provide sufficient equity at risk for the entity to support its activities. FIN No. 46(R) is effective for the first interim or annual period ending after March 15, 2004. We have determined that we do not have any variable interest entities and therefore, the adoption of the provisions of FIN No. 46(R) in fiscal year 2004 did not have a material effect on the financial position or results of operations.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. This statement amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, by requiring that contracts with comparable characteristics be accounted for similarly and clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003, and must be applied prospectively. The adoption of the provisions of SFAS No. 149 in fiscal year 2004 did not have a material effect on the financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. This Statement established standards for how an issuer

## ACCREDITO HEALTH, INCORPORATED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 13, 2003 and must be applied prospectively by reporting the cumulative effect of a change in an accounting principle for financial instruments created before the issuance date of the Statement and still existing at the beginning of the interim period of adoption. The adoption of the provisions of SFAS No. 150 in fiscal year 2004 did not have a material effect on the financial position or results of operations.

#### Reclassifications

Certain prior year amounts in the consolidated financial statements have been reclassified to conform to the current year classification.

#### 3. Business Acquisitions

The Company acquired all of the outstanding stock of Pharmacare Resources, Inc. ("Pharmacare") and its sister company, NCL Management, Inc. effective May 1, 2001. Pharmacare is headquartered in Elmsford, New York, and is a provider of pharmaceutical care for certain chronic, long-term patient populations, including those requiring intravenous immunoglobulin ("IVIG"). This transaction was accounted for using the purchase method of accounting. The price paid by the Company for this acquisition was \$25,074,000. The Company also paid an additional \$6,325,000 for a related earn-out payment based upon the achievement of certain financial results for the twelve-month period ended December 31, 2001, resulting in a total purchase price of \$31,399,000. Total assets acquired and liabilities assumed were \$3,659,000 and \$1,030,000, respectively. The excess of the total purchase price, including acquisition costs of \$63,000, over the fair value of the net assets acquired of \$2,629,000 was allocated as follows: \$28,153,000 to goodwill and \$617,000 to acquired patient relationships. The acquired patient relationship intangible is being amortized over five years. The Company also paid \$500,000 as consideration for an agreement with the selling shareholders not to compete with the Company in certain product lines for a period of six years.

The Company acquired all of the outstanding stock of BioPartners in Care, Inc. ("BioPartners") from its shareholders effective December 1, 2001. BioPartners is headquartered in Dayton, Ohio, and is a provider of pharmaceutical care for certain chronic, long-term patient populations, including those requiring hemophilia clotting factor and IVIG. As a result of the acquisition, the Company was able to increase its market share for the distribution of these products. The purchase price paid by the Company for this acquisition was \$36,600,000. In addition, the Company also paid an additional \$16,000,000 during fiscal 2003 for a related earn-out payment based upon the achievement of certain financial results for the twelve-month period ended December 31, 2002, resulting in a total purchase price of \$52,600,000. Total assets acquired and liabilities assumed were \$15,160,000 and \$11,750,000, respectively. The excess of the total purchase price, including acquisition costs of \$275,000, over the fair value of the net assets acquired of \$3,410,000 was allocated as follows: \$48,487,000 to goodwill and \$703,000 to acquired patient relationships. The acquired patient relationship intangible is being amortized over five years. The entire amount allocated to goodwill is expected to be deductible for tax purposes. The Company also paid \$1,000,000 as consideration for an agreement with the selling shareholders not to compete with the Company in certain product lines for periods of five to seven years.

On June 13, 2002, the Company acquired the Specialty Pharmaceutical Services Division ("SPS division") of Gentiva Health Services, Inc. ("Gentiva"). The Company acquired substantially all of the assets used in the SPS division including 100% of the outstanding stock in three of Gentiva's subsidiaries that were engaged exclusively in the business conducted by the SPS division. The SPS division provides specialty retail pharmacy and related services relating to the treatment of patients with certain costly chronic diseases. In addition to the diseases served by the Company, the SPS division is also a leading provider of contract

**ACCREDITO HEALTH, INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

pharmacy and related services to patients with pulmonary hypertension. As a result of the acquisition, management expected the Company to become the leading provider of specialty retail pharmacy and related services.

The aggregate purchase price paid for the SPS division was \$463.8 million (including \$13.8 million of acquisition related costs) and consisted of \$217.1 million of cash and 7,591,464 shares of common stock valued at \$246.7 million. The value of the common stock issued was determined in accordance with EITF issue 99-12, *Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination*. Accordingly, January 31, 2002, became the measurement date, as this was the first date on which the number of shares became fixed without subsequent revision. The value per share was based upon the average market price over the period including two days before and after the measurement date. The following table summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition of the SPS division (in thousands).

Cash .....	\$ 19
Receivables:	
Patient accounts, net of allowance for doubtful accounts of \$68,949 .....	223,173
Other .....	1,991
Inventories .....	50,087
Prepaid expenses and other current assets .....	<u>836</u>
Total current assets .....	276,106
Property and equipment .....	12,086
Other assets:	
Intangible assets subject to amortization (5.1 year weighted-average useful life):	
Acquired patient relationships (5.0 year weighted-average useful life) .....	15,163
Non-compete agreements (6.4 year weighted-average useful life) .....	2,000
Goodwill .....	207,780
Other .....	<u>129</u>
Total assets acquired .....	513,264
Accounts payable .....	39,577
Accrued expenses .....	<u>9,842</u>
Total liabilities assumed .....	<u>49,419</u>
Net assets acquired .....	<u>\$463,845</u>

The entire amount allocated to goodwill is expected to be deductible for tax purposes.

As planned, the Company exited the acute pharmacy business acquired as part of the SPS division in December 2002. The Company retained the accounts receivable of the acute pharmacy business and disposed of certain of the other assets of the business, which were immaterial. The Company has accounted for the acute division in accordance with EITF 87-11, *Allocation of Purchase Price to Assets to be Sold*. In accordance with EITF 87-11, the net proceeds from the sale of the acute division, the results of the acute operations during the period from acquisition to disposal and the interest expense during the holding period on the incremental debt incurred to finance the acute business have been recorded as an adjustment to the purchase price. The results of operations of the acute division, amounting to a \$4,000 and \$3,919,000 loss (net of tax benefit) during the periods ended June 30, 2002 and 2003, respectively, are excluded from the Company's results of operations in the accompanying financial statements. The amount of interest expense

**ACCREDITO HEALTH, INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

allocated to the acute pharmacy business was \$53,000 and \$616,000, net of tax benefit, during the periods ended June 30, 2002 and 2003, respectively.

On October 17, 2003, the Company acquired certain assets of Alpha Therapeutic Services, Inc. (“ATS”) from Baxter Healthcare Corporation. ATS is a provider of pharmaceutical care for certain chronic, long-term patient populations, including those requiring hemophilia clotting factor and IVIG. As a result of the acquisition, the Company was able to increase its market share for the distribution of these products. The aggregate purchase price paid by the Company for this acquisition was \$35,700,000. Total assets acquired were \$4,157,000, which included accounts receivable of \$2,721,000, inventory of \$1,261,000 and fixed assets of \$175,000. The excess of the total purchase price, including acquisition costs of \$14,000, over the fair value of the net assets acquired was allocated as follows: \$30,825,000 to goodwill and \$652,000 to acquired patient relationships. The acquired patient relationship intangible is being amortized over five years. The entire amount allocated to goodwill is expected to be deductible for tax purposes. The Company also paid \$100,000 as consideration for an agreement with the selling shareholders not to compete with the Company in certain product lines for five years. The results of the ATS operations have been included in the consolidated financial statements since October 18, 2003.

The following pro forma financial information presents results as if the 2002 acquisitions (including the results of the acute pharmacy business of the SPS division) had occurred on July 1, 2001 (in thousands, except share data):

	2002
Total revenues .....	\$1,401,192
Net income .....	40,279
Net income per common share:	
Basic .....	\$ 0.86
Diluted .....	\$ 0.84

The results of these acquisitions have been included in the Company’s results from their respective dates of acquisition.

**4. Restructuring Charge**

In connection with the acquisition of the SPS division, the Company recorded a restructuring charge of \$3,893,000 (\$2,355,000, or \$0.06 per diluted share, after tax) for the year ended June 30, 2002. The charge includes a \$3,553,000 write-off (of which \$3,193,000 is non-cash) of a software application that was being developed by the Company that was not implemented as a result of the decision to enhance and implement company-wide the software application acquired with the SPS division. The restructuring charge also includes \$340,000 for future lease commitments related to facilities that were abandoned upon completion of the integration plan related to the acquisition.

**ACCREDO HEALTH, INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**5. Property and Equipment**

Property and equipment consists of the following at June 30 (in thousands):

	2003	2004
Equipment .....	\$29,798	\$50,795
Furniture and fixtures .....	16,037	14,727
	45,835	65,522
Accumulated depreciation .....	(14,154)	(24,239)
	\$31,681	\$41,283

**6. Goodwill and Other Intangible Assets**

Amortizable intangible assets consist of the following at June 30 (in thousands):

	2003		2004	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Patient relationships .....	\$19,072	\$5,872	\$19,724	\$ 9,507
Non-compete agreements .....	5,900	2,139	6,000	3,159
Deferred financing costs .....	7,818	1,976	7,993	3,571
	\$32,790	\$9,987	\$33,717	\$16,237

Estimated amortization expense consists of the following for the years ending June 30 (in thousands):

2005 .....	\$4,298
2006 .....	4,173
2007 .....	3,738
2008 .....	500
2009 .....	328

The change in the carrying amount of goodwill consists of the following (in thousands):

Balance as of June 30, 2002 .....	\$334,919
Goodwill acquired during the year, net of tax basis adjustment .....	17,590
Balance as of June 30, 2003 .....	352,509
Goodwill acquired during the year, net of tax basis adjustment .....	30,119
Balance as of June 30, 2004 .....	\$382,628

**ACCREDO HEALTH, INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

**7. Long-Term Debt**

Long-term debt consists of the following at June 30 (in thousands):

	2003	2004
Credit facility:		
Revolving commitment .....	\$ —	\$ —
Tranche A Term Loan .....	71,250	56,250
Tranche B Term Loan .....	<u>123,438</u>	<u>122,187</u>
	194,688	178,437
Other .....	<u>—</u>	<u>874</u>
	194,688	179,311
Less amounts due within one year .....	<u>16,250</u>	<u>4,445</u>
	<u>\$178,438</u>	<u>\$174,866</u>

On June 13, 2002, the Company amended and restated its credit agreement with Bank of America, N.A. and other participating banks (collectively the “Lenders”) to increase the size of the credit facility to \$325 million. The credit facility consists of a \$125 million revolving commitment expiring June 2007, a \$75 million term loan (“Tranche A Term Loan”) due in periodic principal payments through March 2007, and a \$125 million term loan (“Tranche B Term Loan”) due in periodic principal payments through March 2009. Amounts outstanding under the credit agreement bear interest at varying rates based upon a LIBOR or prime rate of interest at the periodic election of the Company, plus a variable margin rate based on the Company’s leverage ratio as defined by the credit agreement. The combination of a variable rate margin and LIBOR base rate resulted in an effective rate of 3.67% and 3.39% at June 30, 2003 and 2004, respectively. The credit facility is secured by substantially all assets of the Company, including a pledge of all of the common stock or partnership interest of each of our subsidiaries in which we own an 80% or more interest. The Lenders’ security interest in a portion of the Company’s inventory is subordinate to the liens on that inventory under the terms of a security agreement between the Company and one of its vendors. The same vendor has a security interest in certain accounts receivable of the Company, which is subordinate to the rights of the Lenders. At June 30, 2003 and 2004, the balances outstanding under the credit facility were \$194,687,500 and \$178,437,500, respectively.

The credit agreement contains financial covenants, which require the Company to maintain certain ratios with respect to leverage, fixed charge coverage, net worth, and asset coverage, as defined in the agreement. The credit agreement also includes customary affirmative and negative covenants, including covenants relating to transactions with affiliates, uses of proceeds, restrictions on subsidiaries, limitations on indebtedness, limitations on mergers, acquisitions and asset dispositions, limitations on investments, limitations on payment of dividends and stock repurchases, and other distributions. The credit agreement also contains customary events of default, including relating to changes in control of the Company.

The credit agreement required the Company to enter into a one-year interest rate swap agreement within 60 days of June 13, 2002, to protect against fluctuations in interest rates. The credit agreement required the interest rate swap to provide coverage in an amount equal to at least 50% of the outstanding principal amount of the loans. On July 17, 2002, the Company entered into an interest rate swap agreement effectively converting for a period of one year \$120 million of floating-rate borrowings to fixed-rate borrowings with a fixed rate of 2.175%, plus the applicable margin rate as determined by the credit agreement. On June 4, 2003, the Company entered into an interest rate swap agreement effectively converting for a period of one year beginning July 21, 2003, \$120 million of floating-rate borrowings to fixed-rate borrowings with a fixed rate of 1.14%, plus the applicable margin rate as determined by the credit agreement.

**ACCREDITO HEALTH, INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

On May 5, 2003, the Company amended the credit agreement to exclude the charges, as defined in the amendment to the credit agreement, taken in the March 2003 quarter in connection with the additional accounts receivable reserves of the SPS division from the calculation of Consolidated EBITDA, as defined in the credit agreement, and to reduce the Consolidated Net Worth requirement, as defined in the credit agreement, to allow for a reduction in the minimum net worth requirement equal to the net loss incurred in the March 2003 quarter. The amendment also included a 25 basis point increase in interest rates per the credit agreement for a period of twelve months beginning May 15, 2003. The Company paid fees of \$607,000 in connection with this amendment which have been capitalized in deferred financing costs.

Principal maturities of long-term debt consist of the following for the years ending June 30 (in thousands):

2005 .....	\$ 4,445
2006 .....	3,928
2007 .....	3,750
2008 .....	3,750
2009 .....	163,438
After 2009 .....	<u>—</u>
	<u>\$179,311</u>

Since June 30, 2004, the Company amended its credit facility. See footnote 17 – Subsequent Events. The maturities in the preceding table reflect the effect of the aforementioned credit facility amendment.

**8. Income Taxes**

The liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Income tax expense (benefit) consists of the following for the years ended June 30 (in thousands):

	<u>2002</u>	<u>2003</u>	<u>2004</u>
<b>Current:</b>			
Federal .....	\$15,434	\$22,115	\$25,523
State .....	<u>2,642</u>	<u>4,335</u>	<u>2,849</u>
	18,076	26,450	28,372
<b>Deferred:</b>			
Federal .....	764	(6,705)	16,892
State .....	<u>185</u>	<u>(1,493)</u>	<u>3,860</u>
	<u>949</u>	<u>(8,198)</u>	<u>20,752</u>
	<u>\$19,025</u>	<u>\$18,252</u>	<u>\$49,124</u>



**ACCREDITO HEALTH, INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

The provision for income taxes differed from the amount computed by applying the statutory federal income tax rates for the years ended June 30 due to the following (in thousands):

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Income tax expense at statutory rate .....	\$17,075	\$16,725	\$44,590
State income tax expense, net of federal income tax benefit .....	1,838	1,847	4,361
Goodwill amortization .....	19	18	16
Other .....	<u>93</u>	<u>(338)</u>	<u>157</u>
Income tax expense .....	<u>\$19,025</u>	<u>\$18,252</u>	<u>\$49,124</u>

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities at June 30 are as follows (in thousands):

	<u>2003</u>	<u>2004</u>
Deferred tax assets:		
Accounts receivable allowances .....	\$22,829	\$ 11,191
Accrued expenses .....	1,375	1,901
Intangible assets .....	—	360
Joint venture investments .....	125	150
Other .....	<u>250</u>	<u>527</u>
	24,579	14,129
Deferred tax liabilities:		
Property and equipment .....	(3,543)	(5,477)
Intangible assets .....	(11,027)	(19,217)
Joint venture investments .....	<u>(240)</u>	<u>(418)</u>
	<u>(14,810)</u>	<u>(25,112)</u>
Net deferred tax asset (liability) .....	<u>\$ 9,769</u>	<u>\$(10,983)</u>

Management has evaluated the need for a valuation allowance for the deferred tax assets and believes that no valuation allowance is necessary because it is more likely than not that the assets will ultimately be realized through future taxable income from operations.

**9. Commitments**

The Company leases office space and equipment under various operating leases. Rent expense for all operating leases was approximately \$2,838,000, \$7,774,000 and \$8,150,000 for the years ended June 30, 2002, 2003 and 2004, respectively.

**ACCREDO HEALTH, INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

Future minimum payments, by year and in the aggregate, under non-cancelable operating leases with initial terms of one year or more consist of the following at June 30, 2004 (in thousands):

2005 .....	\$ 7,464
2006 .....	5,077
2007 .....	3,662
2008 .....	2,359
2009 .....	1,741
Thereafter .....	<u>808</u>
	<u>\$21,111</u>

**10. Investment in Joint Ventures**

Texas Health Pharmaceutical Resources, Teddy Bear Home Care/Drug Therapies, Childrens Home Services, Childrens Biotech Pharmacy Services and Childrens National Hemophilia Care are partnerships in which the Company has a 50% ownership interest. The Company uses the equity method of accounting for these joint ventures. Amounts due to and from these joint ventures to the Company are classified as due to and from affiliates in the accompanying consolidated balance sheets. The portion of the Company's retained earnings at June 30, 2003 and 2004 attributable to undistributed earnings of these joint ventures is \$5,187,000 and \$6,993,000, respectively.

The Company received fees for management services from the joint ventures of \$1,184,000, \$1,289,000 and \$1,435,000 for the years ended June 30, 2002, 2003 and 2004, respectively, which are recorded as other revenues in the accompanying consolidated statements of income.

Summary financial information for 50% owned joint ventures accounted for by the equity method is as follows as of and for the years ended June 30 (in thousands):

	2002	2003	2004
Current assets .....	\$12,394	\$14,625	\$16,915
Property and equipment, net and other assets .....	55	26	22
Current liabilities .....	4,090	3,568	2,223
Total revenues .....	26,963	33,173	43,013
Net income .....	4,131	3,893	6,142

**11. Defined Contribution Retirement Plan**

The Company sponsors a qualified, defined contribution retirement plan under Section 401(k) of the Internal Revenue Code in which substantially all employees qualify for participation. The Company matches employee contributions, as defined in the plan. The Company made annual matching contributions of approximately \$234,000, \$708,000 and \$775,000 for the years ended June 30, 2002, 2003 and 2004, respectively.

**12. Stockholders' Equity**

**Common Stock**

In 2003, the Company effected a stock split in the form of a stock dividend. All share and per share data in the consolidated financial statements and the notes hereto have been retroactively adjusted for the splits.

## ACCREDITO HEALTH, INCORPORATED

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

On June 13, 2002, the Company issued 7,591,464 shares of its common stock to the shareholders of Gentiva in connection with the acquisition of the SPS division.

#### Preferred Stock

In April 1999, the Company's Board of Directors and Stockholders authorized the establishment of a new class of undesignated preferred stock.

#### Accumulated Other Comprehensive Loss

Accumulated other comprehensive income (loss) includes the change in fair value of the interest rate swap that qualifies for hedge accounting. Comprehensive income is as follows for the years ended June 30 (in thousands):

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Reported net income .....	\$29,760	\$29,535	\$78,313
Unrealized income (loss) on interest rate swap, net of tax benefit.....	<u>—</u>	<u>(68)</u>	<u>76</u>
Comprehensive income.....	<u>\$29,760</u>	<u>\$29,467</u>	<u>\$78,389</u>

#### Stockholder Protection Rights Agreement

On April 21, 2003, the Company adopted a stockholder protection rights agreement ("Rights Plan") and issued Rights in connection with the Rights Plan in the event of a proposed takeover of the Company. The Rights Plan is not intended to prevent transactions that provide full and fair value to stockholders. It is intended to discourage abusive takeover tactics and to provide time for the Company's Board of Directors to review and evaluate what is in the best interests of the stockholders.

The Rights Plan provided that a dividend of one share purchase Right be issued for each outstanding share of common stock to stockholders of record as of the close of business on April 28, 2003. Generally, the Rights are exercisable only if a group (other than certain existing shareholders) acquires 15% or more of the Company's common stock or announces a tender offer upon consummation of which, such person or group would beneficially own 15% or more of the Company's common stock. Each Right entitles stockholders to buy one ten-thousandth of a share of a new share of junior participating preferred stock at an exercise price of \$100.

If the Rights become exercisable, a Rights holder (other than the person or group acquiring 15% or more) will be entitled to purchase, at the Right's then-current price, a number of shares of the Company's common stock having a market value of twice such price. If after a person has acquired 15% or more of the Company's common stock, such person acquires the Company, each Right will entitle its holder to purchase, at the Right's then-current exercise price, a number of shares of the acquiring company's common stock having a market value of twice such price. Following the acquisition of 15% or more of the Company's common stock, but less than 50% by any person or group, the Board of Directors may exchange the Rights (other than Rights owned by such person or group) at an exchange ratio of one share of the Company's common stock for each Right.

#### 13. Employee Stock Purchase Plan

In April 1999, the Company's Board of Directors adopted and the stockholders approved the Accredo Health, Incorporated 1999 Employee Stock Purchase Plan ("ESPP"). Under the ESPP, employees may purchase shares of common stock at 85% of market price on the first day of an offering period (usually

**ACCREDITO HEALTH, INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

consisting of a six-month period beginning January 1 or July 1) or the last day of an offering period, whichever is lower. The shares are purchased at the end of each period with funds withheld from employees' pay during the period. A total of 455,625 shares of the Company's common stock have been reserved for issuance under the ESPP. Participation in the ESPP commenced on the effective date of the Company's initial public offering in April 1999. There were 43,328, 82,746 and 65,674 shares of common stock issued during the years ended June 30, 2002, 2003 and 2004, respectively, pursuant to the ESPP.

**14. Stock Option Plans**

The Company's Amended and Restated Stock Option and Restricted Stock Purchase Plan authorizes the grant of options to selected employees, officers and directors for up to 3,256,875 shares of the Company's common stock. As of June 30, 2004, options to purchase 3,251,691 shares of stock have been granted under this plan. All options granted have ten-year terms and generally vest and become fully exercisable over a period of four years.

The Company's 1999 Long-Term Incentive Plan authorizes the grant of options to selected employees, officers and directors for up to 1,687,500 shares of the Company's common stock. As of June 30, 2004, options to purchase 1,549,424 shares of common stock have been granted under this plan under terms similar to those discussed above. All options granted have ten-year terms and generally vest and become fully exercisable over a period of four years of continued employment.

The Company's 2002 Long-Term Incentive Plan authorizes the grant of options to selected employees, officers and directors for up to 3,900,000 shares of the Company's common stock. As of June 30, 2004, options to purchase 3,269,692 shares of stock have been granted under this plan. All options granted have ten-year terms and generally vest and become fully exercisable over a period of four years of continued employment.

Pro forma information regarding net income is required by SFAS 123 and has been determined as if the Company had accounted for its employee stock options under the fair value method of SFAS 123. Significant assumptions used by the Company in the Black-Scholes option pricing model computations are as follows for the years ended June 30:

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Risk-free interest rate .....	3.56% to 4.41%	1.89% to 3.15%	2.68% to 2.87%
Dividend yield .....	0%	0%	0%
Volatility factor .....	.65	.66	.64
Weighted-average expected life .....	4.0 years	4.0 years	4.0 years
Estimated turnover .....	8%	8%	8%

The Black-Scholes option model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

**ACCREDITO HEALTH, INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma information for the years ended June 30 is as follows (in thousands, except share data):

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Net income, as reported .....	\$29,760	\$29,535	\$78,313
Less stock-based employee compensation cost, net of related tax effects, applying the fair value method to all rewards .....	<u>(3,860)</u>	<u>(10,949)</u>	<u>(11,855)</u>
Pro forma net income .....	<u>\$25,900</u>	<u>\$18,586</u>	<u>\$66,458</u>
Earnings per share:			
Basic - as reported .....	\$ 0.75	\$ 0.62	\$ 1.63
Basic - pro forma .....	\$ 0.65	\$ 0.39	\$ 1.38
Diluted - as reported .....	\$ 0.73	\$ 0.61	\$ 1.60
Diluted - pro forma .....	\$ 0.64	\$ 0.39	\$ 1.37

A summary of the Company's stock option activity and related information for the years ended June 30 is as follows:

	<u>2002</u>		<u>2003</u>		<u>2004</u>	
	<u>Options</u>	<u>Weighted-Average Exercise Price</u>	<u>Options</u>	<u>Weighted-Average Exercise Price</u>	<u>Options</u>	<u>Weighted-Average Exercise Price</u>
Outstanding at beginning of year	2,695,772	\$ 9.02	4,486,022	\$20.18	4,023,732	\$23.38
Granted .....	2,281,614	30.54	677,150	30.81	1,361,453	28.95
Exercised .....	<u>(427,423)</u>	5.15	<u>(762,616)</u>	7.90	<u>(699,410)</u>	10.45
Forfeited .....	<u>(63,941)</u>	19.97	<u>(376,824)</u>	29.90	<u>(396,563)</u>	28.94
Outstanding at end of year .....	<u>4,486,022</u>	<u>\$20.18</u>	<u>4,023,732</u>	<u>\$23.38</u>	<u>4,289,212</u>	<u>\$26.71</u>
Exercisable at end of year .....	<u>1,585,907</u>	<u>\$ 6.95</u>	<u>1,707,472</u>	<u>\$16.60</u>	<u>1,752,195</u>	<u>\$23.42</u>
Weighted-average fair value of options granted during the year ..	<u>\$ 15.96</u>		<u>\$ 15.54</u>		<u>\$ 15.07</u>	

ACCREDO HEALTH, INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Range of Exercise prices (150% increment)	Options Outstanding			Options Exercisable	
	Number Outstanding June 30, 2004	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable June 30, 2004	Weighted-Average Exercise Price
\$ 0.89 – 0.89	128,589	2.1 years	\$ 0.89	128,589	\$ 0.89
1.78 – 1.78	94,250	3.8 years	1.78	94,250	1.78
8.59 – 8.70	49,881	5.4 years	8.61	49,881	8.61
12.99 – 18.81	641,417	6.4 years	18.36	432,578	18.44
20.03 – 29.25	1,322,933	8.9 years	27.01	119,305	23.12
30.33 – 38.46	2,052,142	8.2 years	32.33	927,592	31.91
<u>\$ 0.89 – 38.46</u>	<u>4,289,212</u>	<u>7.8 years</u>	<u>\$26.71</u>	<u>1,752,195</u>	<u>\$23.42</u>

15. Contingencies

Commencing April 8, 2003, the Company and certain officers and directors were named as defendants in several substantially similar putative class action lawsuits filed in the United States District Court for the Western District of Tennessee, Memphis Division. The various complaints have been consolidated into a single action. The lawsuits filed to date name the Company, David D. Stevens, Joel R. Kimbrough and in one case John R. Grow, as defendants. One of the lawsuits also named the Company's former independent auditor, Ernst & Young LLP, as a defendant. The lawsuits allege violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)(5) promulgated thereunder, and Section 20 of the Securities Exchange Act of 1934. The putative class representatives seek to represent a class of individuals and entities that purchased Company stock during the period June 16, 2002 through April 7, 2003 and who supposedly suffered damages from the alleged violations of the securities laws. The Company believes that the claims asserted in the putative class action lawsuits are without merit.

In addition, two purported derivative lawsuits were filed in the Circuit Court of Shelby County, Tennessee for the Thirtieth Judicial District at Memphis. These actions were consolidated and a Consolidated Derivative Complaint was filed on July 28, 2003. The derivative action names Company officers, directors and a former director; David D. Stevens, John R. Grow, Kyle J. Callahan, Kevin L. Roberg, Kenneth R. Masterson, Kenneth J. Melkus, Dick R. Gourley, Nancy-Ann Deparle, Joel R. Kimbrough, Thomas W. Bell, Jr., and Patrick J. Welsh; as defendants. The derivative lawsuit alleges that the defendants breached fiduciary duties owed to the Company by engaging in the same alleged conduct that is the basis of the putative class action lawsuits. On behalf of the Company, the derivative complaint seeks compensatory damages from the defendants and the disgorgement of profits, benefits and other compensation received by the defendants. The Company has filed a motion to dismiss the Consolidated Derivative Complaint and the parties are awaiting the Court's ruling on this motion. The Company believes that the claims asserted in the derivative lawsuit are without merit.

The Company's 80% owned joint venture in California provided contract pharmacy and related billing services to a local California pharmacy currently under audit by the California Department of Health Services concerning its MediCal billing for clotting factor supplied by the joint venture. Although the joint venture is not currently involved with the audit, the contract pharmacy relationship is implicated and the pharmacy is seeking indemnification from the joint venture. Pending completion of the audit, the state agency has temporarily withheld MediCal payments from the pharmacy and has alleged, among other things, overbilling and false claims. Although the Company believes these allegations are without merit and expects the pharmacy and the joint venture to vigorously defend against these allegations through judicial proceedings if necessary, the Company also expects the California state agency to pursue a refund of some or all of the payments made by MediCal to the pharmacy. If state or federal false claim statutes are implicated, the

**ACCREDITO HEALTH, INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

pharmacy could also be assessed fines and penalties. At this time, the Company does not believe that it will incur any such fines or penalties. Due to the uncertainty about the issues involved in this matter, based on the facts and circumstances known to date, the Company believes some amount of monetary loss is reasonably possible in the range of zero to \$20 million, absent any finding of false claims and incurrence of related fines and penalties.

Also, from time to time, the Company is involved in lawsuits, claims, audits, and investigations arising in the normal course of business. In the Company's opinion, in the aggregate these lawsuits, claims, audits and investigations should not have a material adverse effect on the Company's business, financial condition, or results of operations. In addition, the business that the Company acquired from Gentiva Health Services, Inc. has several lawsuits and claims related to its historical operations by Gentiva, which are being controlled by Gentiva and for which the Company is entitled to indemnification from liability by Gentiva.

**16. Quarterly Financial Information (Unaudited)**

Quarterly financial information for the years ended June 30, 2003 and 2004, is summarized below (in thousands, except share data):

	2004			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total revenues .....	\$334,984	\$389,781	\$409,308	\$382,795
Operating income .....	31,406	35,066	37,033	34,395
Income before income taxes .....	28,648	32,370	34,381	32,038
Net income .....	17,508	19,909	21,127	19,769
Net income per common share:				
Basic .....	0.37	0.41	0.44	0.41
Diluted .....	0.36	0.41	0.43	0.40
	2003			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total revenues .....	\$316,661	\$369,506	\$358,113	\$329,056
Operating income (loss) .....	25,427	31,582	(27,997)	30,383
Income (loss) before income taxes .....	22,497	28,698	(30,851)	27,443
Net income (loss) .....	13,463	17,556	(18,723)	17,239
Net income (loss) per common share:				
Basic .....	0.29	0.37	(0.39)	0.36
Diluted .....	0.28	0.36	(0.39)	0.36

**17. Subsequent Events**

Since June 30, 2004, the Company amended its \$325 million credit facility to increase the size of the facility to \$550 million. The amended facility consists of a \$175 million revolving commitment expiring July 2009 and a \$375 million term loan due in periodic principal payments through June 2011. Principal maturities for the \$375 million term loan are \$3,750,000 in fiscal years 2005 through 2009 and \$178,125,000 in fiscal years 2010 and 2011. The terms of the amended agreement are similar to and no less favorable than those in the \$325 million credit facility in place on June 30, 2004. As a result of this amendment, the Company will expense in the September 2004 quarter \$4.4 million of unamortized debt issuance costs associated with the 2002 amended credit facility.

**ACCREDITO HEALTH, INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**

On July 21, 2004, the Company acquired all of the outstanding stock of HRA Holding Corporation and its wholly owned subsidiary, Hemophilia Resources of America, Inc.. The purchase price paid for this acquisition was \$159 million and was funded by the increased credit facility.



**ACCREDITO HEALTH, INCORPORATED**  
**SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS**  
**(IN THOUSANDS)**

Col. A	Col. B	Col. C		Col. D	Col. E
Description	Balance at Beginning of Period	Additions		Deductions	Balance at End of Period
		Charged to Costs and Expenses	Charged to Other Accounts		
Year ended June 30, 2002:					
Allowance for doubtful accounts . . .	\$ 10,808	\$ 5,833	\$69,412(1)	\$ 4,295(2)	\$ 81,758
Year ended June 30, 2003:					
Allowance for doubtful accounts . . .	81,758	87,418		42,635(2)	126,541
Year ended June 30, 2004:					
Allowance for doubtful accounts . . .	126,541	29,745		75,235(2)	81,051

(1) Allowance as a result of acquisitions

(2) Uncollectible accounts written off, net of recoveries

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized in the City of Memphis, State of Tennessee, on the 13th day of September, 2004.

ACCREDO HEALTH, INCORPORATED

By:           /s/ DAVID D. STEVENS          

David D. Stevens  
*Chairman of the Board and  
Chief Executive Officer*

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints David D. Stevens and Joel R. Kimbrough and either of them (with full power in each to act alone) as true and lawful attorneys-in-fact with full power of substitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that said attorneys-in-fact, or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed by the following persons in the capacities and on the dates indicated.

<u>/s/ DAVID D. STEVENS</u> David D. Stevens	Chairman of the Board, Chief Executive Officer and Director (Principal Executive Officer)	September 13, 2004
<u>/s/ JOEL R. KIMBROUGH</u> Joel R. Kimbrough	Senior Vice President, Chief Financial Officer, and Treasurer (Principal Financial and Accounting Officer)	September 13, 2004
<u>/s/ KENNETH R. MASTERSON</u> Kenneth R. Masterson	Director	September 13, 2004
<u>/s/ KENNETH J. MELKUS</u> Kenneth J. Melkus	Director	September 13, 2004
<u>/s/ KEVIN L. ROBERG</u> Kevin L. Roberg	Director	September 13, 2004
<u>/s/ DICK R. GOURLEY</u> Dick R. Gourley	Director	September 13, 2004
<u>/s/ NANCY-ANN DEPARLE</u> Nancy-Ann DeParle	Director	September 13, 2004
<u>/s/ THOMAS G. ROTHERHAM</u> Thomas G. Rotherham	Director	September 13, 2004
<u>/s/ WILLIAM E. EVANS</u> William E. Evans	Director	September 13, 2004
<u>/s/ J. MARTIN CARROLL</u> J. Martin Carroll	Director	September 13, 2004

## EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Description of Exhibits</u>
2.1	— Asset Purchase Agreement, dated as of January 2, 2002, by and between Accredo Health, Incorporated, Gentiva Health Services, Inc. and the Sellers named therein (incorporated by reference to Annex A of the joint proxy statement-prospectus included in our Registration Statement on Form S-4 (File Number 333-82396)).
3.1	— Amended and Restated Certificate of Incorporation of Accredo Health, Incorporated (incorporated by reference to Exhibit 3.1 to our Registration Statement on Form S-1 (File Number 333-62679)).
3.2	— Certificate of Amendment of the Certificate of Incorporation of Accredo Health, Incorporated (incorporated by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2000).
3.3	— Certificate of Amendment of the Certificate of Incorporation of Accredo Health, Incorporated (incorporated by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2002).
3.4	— Amended and Restated Bylaws of Accredo Health, Incorporated (incorporated by reference to Exhibit 3.2 to our Registration Statement on Form S-1 (File Number 333-62679)).
3.5	— Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of the Company (incorporated by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2003).
4.1	— Form of Common Stock Certificate (incorporated by reference to Exhibit 4.1 to our Registration Statement on Form S-1 (File Number 333-62679)).
4.2	— Stockholder Protection Rights Agreement, dated April 17, 2003, between the Company and American Stock Transfer & Trust Company, As Rights Agent (incorporated by reference to Exhibit 4.1 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2003).
10.1	— Accredo Health 1999 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.6 to our Registration Statement on Form S-1 (File Number 333-62679)).
10.2	— Accredo Health, Incorporated 2002 Long-Term Incentive Plan (incorporated by reference to Annex E of the joint proxy statement-prospectus included in our Registration Statement on Form S-4 (File Number 333-82396)).
10.3	— Accredo Health 1999 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.7 to our Registration Statement on Form S-1 (File Number 333-62679)).
10.4	— Nova Holdings, Inc. and its Subsidiaries Stock Option and Restricted Purchase Plan, as amended and restated (incorporated by reference to Exhibit 10.8 to our Registration Statement on Form S-1 (File Number 333-62679)).
10.5	— Registration Rights Agreement dated May 31, 1996 among the Company, Welsh, Carson, Anderson & Stowe VII, L.P. and certain other investors (incorporated by reference to Exhibit 10.10 to our Registration Statement on Form S-1 (File Number 333-62679)).
10.6	— Amendment Number One to the Registration Rights Agreement dated October 27, 1997 among the Company, Welsh, Carson, Anderson & Stowe VII, L.P. and certain other investors (incorporated by reference to Exhibit 10.11 to our Registration Statement on Form S-1 (File Number 333-62679)).
10.7	— Amendment Number Two to the Registration Rights Agreement dated July 24, 1998 among the Company, Welsh, Carson, Anderson & Stowe VII, L.P. and certain other investors (incorporated by reference to Exhibit 10.12 to our Registration Statement on Form S-1 (File Number 333-62679)).
10.8	— Stock Purchase Agreement dated as of June 5, 1997 among Dianne R. Martz, A.B. Charlton, III, the Company and Horizon Health Systems, Inc. (incorporated by reference to Exhibit 10.17 to our Registration Statement on Form S-1 (File Number 333-62679)).

Exhibit  
Number

Description of Exhibits

- 10.9 — Non-Disclosure and Non-Compete Agreement dated as of June 5, 1997 by and among Horizon Health Systems, Inc., the Company and Dianne R. Martz (incorporated by reference to Exhibit 10.18 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.10 — Grant Agreement dated as of June 5, 1997 by and between Kyle Callahan and the Company (incorporated by reference to Exhibit 10.19 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.11 — Subscription and Restriction Agreement dated as of June 5, 1997 by and between the Company and Kyle Callahan (incorporated by reference to Exhibit 10.20 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.12 — Refunds Payable Escrow Agreement dated June 5, 1997 among First American National Bank, Nova Holdings, Inc. and Dianne Martz and A.B. Charlton, III (incorporated by reference to Exhibit 10.26 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.13 — Amended and Restated Credit Agreement dated as of June 13, 2002 among Accredo Health, Incorporated as Borrower, Certain Subsidiaries of the Borrower as Guarantors and The Lenders Named Therein and Bank of America, N.A. as Agent (incorporated by reference to Exhibit 10.13 to our Annual Report on Form 10-K for the fiscal year ended June 30, 2002).
- 10.14 — Amended and Restated Pledge Agreement dated as of June 13, 2002 by and among the parties identified as "Pledgors" and Bank of America, N.A. as collateral agent (incorporated by reference to Exhibit 10.13 to our Annual Report on Form 10-K for the fiscal year ended June 30, 2002).
- 10.15 — Amended and Restated Security Agreement dated as of June 13, 2002 by and among the parties identified as "Grantors" and Bank of America, N.A. as collateral agent (incorporated by reference to Exhibit 10.13 to our Annual Report on Form 10-K for the fiscal year ended June 30, 2002).
- 10.16 — ISDA Master Agreement dated August 7, 1997 between NationsBank of Tennessee, N.A. and Nova Holdings, Inc. (incorporated by reference to Exhibit 10.40 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.17 — Amended and Restated General Partnership Agreement of Children's Hemophilia Services (incorporated by reference to Exhibit 10.61 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.18 — Amendment Number One to Amended and Restated General Partnership Agreement of Children's Hemophilia Services and Restrictive Agreement dated January 5, 2000 (incorporated by reference to Exhibit 10.28 to our Annual Report on Form 10-K for the fiscal year ended June 30, 2000).
- 10.19 — First Amendment to Amended and Restated General Partnership Agreement of Children's Hemophilia Services dated June 30, 2000 (incorporated by reference to Exhibit 10.29 to our Annual Report on Form 10-K for the fiscal year ended June 30, 2000).
- 10.20 — Hemophilia Therapy Business Management, Services and Sales Agreement, dated November 10, 1998 between Horizon Health Systems, Inc., a Tennessee corporation, and Children's Hemophilia Services, a California general partnership (The Company has obtained confidential treatment with respect to certain portions of this Exhibit.) (incorporated by reference to Exhibit 10.63 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.21 — Amended and Restated Distribution and Services Agreement effective as of January 1, 2000 by and between Biogen, Inc. and Nova Factor, Inc. (The Company has obtained confidential treatment with respect to certain portions of this Exhibit.) (incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2000).
- 10.22 — Additional Services Agreement dated January 1, 2000 by and between Biogen, Inc. and Nova Factor, Inc. (The Company has obtained confidential treatment with respect to certain portions of this Exhibit.) (incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2000).

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- 10.23 — Amendment to Amended and Restated Distribution and Services Agreement and Additional Services Agreement dated as of May 1, 2001 between Biogen, Inc. and Nova Factor, Inc. (The Company has obtained confidential treatment with respect to certain portions of this Exhibit.) (incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2001).
- 10.24 — Amended and Restated Distribution Agreement, dated January 1, 1998, by and between Nova Factor, Inc. and Genzyme Corporation (The Company has obtained confidential treatment with respect to certain portions of this Exhibit.) (incorporated by reference to Exhibit 10.65 to our Annual Report on Form 10-K for the fiscal year ended June 30, 1999).
- 10.25 — Incentive Stock Option Agreement of David Stevens dated May 31, 1996 (incorporated by reference to Exhibit 10.46 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.26 — Incentive Stock Option Agreement of Joel R. Kimbrough dated May 31, 1996 (incorporated by reference to Exhibit 10.47 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.27 — Incentive Stock Option Agreement of John R. Grow dated May 31, 1996 (incorporated by reference to Exhibit 10.48 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.28 — Incentive Stock Option Agreement of Kyle Callahan dated September 3, 1997 (incorporated by reference to Exhibit 10.49 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.29 — Non-Qualified Stock Option Agreement of Patrick J. Welsh dated February 9, 1998 (incorporated by reference to Exhibit 10.50 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.30 — Non-Qualified Stock Option Agreement of Ken Melkus dated February 9, 1998 (incorporated by reference to Exhibit 10.51 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.31 — Incentive Stock Option Agreement of Kyle Callahan dated February 9, 1998 (incorporated by reference to Exhibit 10.52 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.32 — Non-Qualified Stock Option Agreement of Kenneth R. Masterson dated April 30, 1998 (incorporated by reference to Exhibit 10.54 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.33 — Incentive Stock Option Agreement of Thomas W. Bell, Jr. dated July 10, 1998 (incorporated by reference to Exhibit 10.55 to our Registration Statement on Form S-1 (File Number 333-62679)).
- 10.34 — Non-Qualified Stock Option Agreement of Patrick J. Welsh dated November 10, 1999 (incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 1999).
- 10.35 — Non-Qualified Stock Option Agreement of Kenneth J. Melkus dated November 10, 1999 (incorporated by reference to Exhibit 10.4 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 1999).
- 10.36 — Non-Qualified Stock Option Agreement of Kenneth R. Masterson dated November 10, 1999 (incorporated by reference to Exhibit 10.5 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 1999).
- 10.37 — Non-Qualified Stock Option Agreement of Kevin L. Roberg dated November 10, 1999 (incorporated by reference to Exhibit 10.6 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 1999).
- 10.38 — Non-Qualified Stock Option Agreement of Kevin L. Roberg dated November 18, 1999 (incorporated by reference to Exhibit 10.7 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 1999).

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- 10.39 — Non-Qualified Stock Option Agreement of Patrick J. Welsh dated November 1, 2000 (incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2000).
- 10.40 — Non-Qualified Stock Option Agreement of Kevin L. Roberg Dated November 1, 2000 (incorporated by reference to Exhibit 10.3 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2000).
- 10.41 — Non-Qualified Stock Option Agreement of Kenneth J. Melkus dated November 1, 2000 (incorporated by reference to Exhibit 10.4 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2000).
- 10.42 — Non-Qualified Stock Option Agreement of Kenneth R. Masterson dated November 1, 2000 (incorporated by reference to Exhibit 10.5 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2000).
- 10.43 — Non-Qualified Stock Option Agreement of Dick R. Gourley dated November 1, 2000 (incorporated by reference to Exhibit 10.6 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2000).
- 10.44 — Non-Qualified Stock Option Agreement of Dick R. Gourley dated November 16, 2000 (incorporated by reference to Exhibit 10.7 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2000).
- 10.45 — Non-Qualified Stock Option Agreement of Patrick J. Welsh dated November 1, 2001 (incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2001).
- 10.46 — Non-Qualified Stock Option Agreement of Kevin L. Roberg dated November 1, 2001 (incorporated by reference to Exhibit 10.3 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2001).
- 10.47 — Non-Qualified Stock Option Agreement of Kenneth J. Melkus Dated November 1, 2001 (incorporated by reference to Exhibit 10.4 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2001).
- 10.48 — Non-Qualified Stock Option Agreement of Kenneth R. Masterson dated November 1, 2001 (incorporated by reference to Exhibit 10.5 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2001).
- 10.49 — Non-Qualified Stock Option Agreement of Dick R. Gourley dated November 1, 2001 (incorporated by reference to Exhibit 10.6 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2001).
- 10.50 — Incentive Stock Option Agreement of David Stevens dated November 1, 2000 (incorporated by reference to Exhibit 10.8 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2000).
- 10.51 — Incentive Stock Option Agreement of John R. Grow dated November 1, 2000 (incorporated by reference to Exhibit 10.9 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2000).
- 10.52 — Incentive Stock Option Agreement of Joel R. Kimbrough dated November 1, 2000 (incorporated by reference to Exhibit 10.10 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2000).
- 10.53 — Incentive Stock Option Agreement of Thomas W. Bell, Jr. dated November 1, 2000 (incorporated by reference to Exhibit 10.11 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2000).
- 10.54 — Incentive Stock Option Agreement of Kyle J. Callahan dated November 1, 2000 (incorporated by reference to Exhibit 10.12 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2000).
- 10.55 — Stock Option Agreement of David Stevens dated September 3, 2002 (incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2002).

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- 10.56 — Stock Option Agreement of John R. Grow dated September 3, 2002 (incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2002).
- 10.57 — Stock Option Agreement of Joel R. Kimbrough dated September 3, 2002 (incorporated by reference to Exhibit 10.3 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2002).
- 10.58 — Stock Option Agreement of Kyle J. Callahan dated September 3, 2002 (incorporated by reference to Exhibit 10.4 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2002).
- 10.59 — Stock Option Agreement of Barbara H. Biehner dated June 24, 2002 (incorporated by reference to Exhibit 10.5 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2002).
- 10.60 — Stock Option Agreement of Barbara H. Biehner dated September 3, 2002 (incorporated by reference to Exhibit 10.6 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2002).
- 10.61 — Employment Agreement effective as of September 1, 2001 between Accredo Health, Incorporated and David D. Stevens (incorporated by reference to Exhibit 10.7 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2002).
- 10.62 — Employment Agreement effective as of September 1, 2002 between Accredo Health, Incorporated and John R. Grow (incorporated by reference to Exhibit 10.8 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2002).
- 10.63 — Employment Agreement effective as of September 1, 2001 between Accredo Health, Incorporated and Joel R. Kimbrough (incorporated by reference to Exhibit 10.9 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2002).
- 10.64 — Employment Agreement effective as of September 1, 2002 between Accredo Health, Incorporated and Kyle J. Callahan (incorporated by reference to Exhibit 10.10 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2002).
- 10.65 — Non-Qualified Stock Option Agreement of Nancy-Ann DeParle dated November 1, 2002 (incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2002).
- 10.66 — Non-Qualified Stock Option Agreement of Nancy-Ann DeParle dated November 19, 2002 (incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2002).
- 10.67 — Non-Qualified Stock Option Agreement of Kevin L. Roberg dated November 1, 2002 (incorporated by reference to Exhibit 10.3 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2002).
- 10.68 — Non-Qualified Stock Option Agreement of Kenneth J. Melkus dated November 1, 2002 (incorporated by reference to Exhibit 10.4 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2002).
- 10.69 — Non-Qualified Stock Option Agreement of Kenneth R. Masterson dated November 1, 2002 (incorporated by reference to Exhibit 10.5 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2002).
- 10.70 — Non-Qualified Stock Option Agreement of Dick R. Gourley dated November 1, 2002 (incorporated by reference to Exhibit 10.6 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2002).
- 10.71 — Employment Agreement dated as of January 7, 2002 between Accredo Health, Incorporated and Steve Fitzpatrick (incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2002).
- 10.72 — Employment Agreement dated as of January 21, 2002 between Accredo Health, Incorporated and Barbara H. Biehner (incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2002).



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- 10.73 — Stock Option Agreement of Thomas W. Bell, Jr. dated September 3, 2002 (incorporated by reference to Exhibit 10.73 to our Annual Report on Form 10-K for the fiscal year ended June 30, 2003).
- 10.74 — Employment Agreement effective as of September 1, 2001 between Accredo Health, Incorporated and Thomas W. Bell, Jr. (incorporated by reference to Exhibit 10.74 to our Annual Report on Form 10-K for the fiscal year ended June 30, 2003).
- 10.75 — Stock Option Agreement of Steve Fitzpatrick dated August 1, 2001 (incorporated by reference to Exhibit 10.75 to our Annual Report on Form 10-K for the fiscal year ended June 30, 2003).
- 10.76 — Stock Option Agreement of Steve Fitzpatrick dated January 7, 2002 (incorporated by reference to Exhibit 10.76 to our Annual Report on Form 10-K for the fiscal year ended June 30, 2003).
- 10.77 — Stock Option Agreement of Steve Fitzpatrick dated September 3, 2002 (incorporated by reference to Exhibit 10.77 to our Annual Report on Form 10-K for the fiscal year ended June 30, 2003).
- 10.78 — Stock Option Agreement of David D. Stevens dated September 5, 2003 (incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2003).
- 10.79 — Stock Option Agreement of John R. Grow dated September 5, 2003 (incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2003).
- 10.80 — Stock Option Agreement of Joel R. Kimbrough dated September 5, 2003 (incorporated by reference to Exhibit 10.3 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2003).
- 10.81 — Stock Option Agreement of Kyle J. Callahan dated September 5, 2003 (incorporated by reference to Exhibit 10.4 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2003).
- 10.82 — Stock Option Agreement of Thomas W. Bell, Jr. dated September 5, 2003 (incorporated by reference to Exhibit 10.5 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2003).
- 10.83 — Stock Option Agreement of Barbara H. Biehner dated September 5, 2003 (incorporated by reference to Exhibit 10.6 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2003).
- 10.84 — Stock Option Agreement of Steve Fitzpatrick dated September 5, 2003 (incorporated by reference to Exhibit 10.7 to our Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2003).
- 10.85 — Non-Qualified Stock Option Agreement of Nancy-Ann DeParle dated November 25, 2003 (incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2003).
- 10.86 — Non-Qualified Stock Option Agreement of Kevin L. Roberg dated November 25, 2003 (incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2003).
- 10.87 — Non-Qualified Stock Option Agreement of Kenneth J. Melkus dated November 25, 2003 (incorporated by reference to Exhibit 10.3 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2003).
- 10.88 — Non-Qualified Stock Option Agreement of Kenneth R. Masterson dated November 25, 2003 (incorporated by reference to Exhibit 10.4 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2003).
- 10.89 — Non-Qualified Stock Option Agreement of Dick R. Gourley dated November 25, 2003 (incorporated by reference to Exhibit 10.5 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2003).

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- 10.90 — Non-Qualified Stock Option Agreement of Thomas G. Rotherham dated November 25, 2003 (incorporated by reference to Exhibit 10.6 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2003).
- 10.91 — Non-Qualified Stock Option Agreement of Thomas G. Rotherham dated November 25, 2003 (incorporated by reference to Exhibit 10.7 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2003).
- 10.92 — Non-Qualified Stock Option Agreement of William E. Evans dated November 25, 2003 (incorporated by reference to Exhibit 10.8 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2003).
- 10.93 — Non-Qualified Stock Option Agreement of William E. Evans dated November 25, 2003 (incorporated by reference to Exhibit 10.9 to our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2003).
- 10.94 — Non-Qualified Stock Option Agreement of J. Martin Carroll dated January 27, 2004.
- 10.95 — Non-Qualified Stock Option Agreement of J. Martin Carroll dated January 27, 2004.
- 10.96 — Stock Option Agreement of Jon Peters dated January 2, 2004.
- 16.1 — Letter from Ernst & Young LLP regarding change in certifying accountant (incorporated by reference to Exhibit 16.1 to our Current Report on Form 8-K/A dated May 19, 2003).
- 21.1 — Subsidiaries
- 23.1 — Consent of Deloitte & Touche LLP
- 23.2 — Consent of Deloitte & Touche LLP
- 23.3 — Consent of Ernst & Young LLP
- 24.1 — Power of Attorney (contained on the signature pages of this report)
- 31.1 — Certification pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 — Certification pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 — Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 — Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002