TEAM INC
Form 11-K
June 05, 2008
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 11-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (FEE REQUIRED)**
For the fiscal year ended December 31, 2007

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)**
For the transition period from ______ to ______

Commission file number 1-08604

A. **Full title of the plan and the address of the plan, if different from that of the issuer named below:**

Team, Inc. Salary Deferral Plan and Trust

B. **Name of issuer of the securities held pursuant to the plan and the address of its principal executive office:**
Team, Inc.

200 Herman Dr.

Alvin, Texas 77511

(281) 331-6154

TEAM, INC. SALARY DEFERRAL PLAN AND TRUST

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All other schedules required by the Department of Labor s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 are omitted, as they are not applicable or required.

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Report of Independent Registered Public Accounting Firm

The Administrative Committee

Team, Inc. Salary Deferral Plan and Trust:

We have audited the accompanying statements of net assets available for benefits of the Team, Inc. Salary Deferral Plan and Trust (the Plan) as of December 31, 2007 and 2006, and the related statement of changes in net assets available for benefits for the year ended December 31, 2007. These financial statements are the responsibility of the Plan s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Plan as of December 31, 2007 and 2006, and the changes in net assets available for benefits for the year ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedule H, line 4a schedule of delinquent participant contributions for the year ended December 31, 2007 and schedule H, line 4i - schedule of assets (held at end of year) as of December 31, 2007 are presented for the purpose of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the Plan s management. The supplemental schedules have been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

/s/ KPMG LLP

Houston, Texas

June 5, 2008

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TEAM, INC. SALARY DEFERRAL PLAN AND TRUST

Statements of Net Assets Available for Benefits

December 31, 2007 and 2006

	2007	2006
Assets:		
Investments, at fair value	$ 68,527,953	$ 45,023,755
Total investments	68,527,953	45,023,755
Receivables:		
Participant contributions	96	300,504
Company contributions	38	75,970
Due from broker for securities sold	169,992	4,245
Total receivables	170,126	380,719
Cash, noninterest bearing	346,332	27,181
Total assets	69,044,411	45,431,655
Liabilities:		
Excess contributions payable	(80,427)	(64,151)
Due to broker for securities purchased	(517,182)	(31,345)
Total liabilities	(597,609)	(95,496)
Net assets available for benefits at fair value	68,446,802	45,336,159
Adjustment from fair value to contract value for fully benefit-responsive investment contract	17,646	32,180
Net assets available for benefits	$ 68,464,448	$ 45,368,339

See accompanying notes to financial statements.

TEAM, INC. SALARY DEFERRAL PLAN AND TRUST

Statement of Changes in Net Assets Available for Benefits

Year ended December 31, 2007

Additions to net assets available for benefits attributed to:	
Investment income:	
Interest	$ 181,894
Dividends	2,185,785
Net appreciation in fair value of common stock	15,526,110
Net appreciation in fair value of common/collective trusts	67,239
Net depreciation in fair value of mutual funds	(42,761)
Total investment income	17,918,267
Contributions:	
Participant contributions	5,619,557
Company contributions	1,677,076
Participant rollover contributions	538,868
Total contributions	7,835,501
Total additions	25,753,768
Deductions from net assets available for benefits attributed to:	
Distributions and benefits paid to participants	2,628,236
Administrative fees	29,423
Total deductions	2,657,659
Net increase in net assets available for benefits	23,096,109
Net assets available for benefits:	
Beginning of year	45,368,339
End of year	$ 68,464,448

See accompanying notes to financial statements.

TEAM, INC. SALARY DEFERRAL PLAN AND TRUST

Notes to Financial Statements

December 31, 2007 and 2006

(1) Description of the Plan

The following description of the Team, Inc. Salary Deferral Plan and Trust (the Plan) provides only general information. Participants should refer to the Plan s agreement for a more complete description of the Plan s provisions.

(a) General

The Plan is a defined contribution plan established October 1, 1984 to cover all eligible employees of Team, Inc. (the Company or Team). Employees become eligible to participate in the Plan on the first day following completion of 30 days of service. After 30 days, employees are automatically enrolled at a 2% deferral rate of eligible pay unless the employee declines participation on the 31st day. The Plan is administered by the administrative committee (the Committee) appointed by the board of directors of the Company. Wachovia Bank N.A. is the trustee of the Plan, and USI Consulting Group (USI) serves as the recordkeeper. The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA).

(b) Contributions

Each year, participants may contribute up to 100% of their pre-tax annual eligible pay, as defined in the Plan. The Internal Revenue Code of 1986, as amended (IRC) limits the maximum amount of a participant s contribution on a pre-tax basis to $15,500 in 2007. The Company makes a matching contribution of 50% of the participant s contribution, up to a limit of 6% of the participant s eligible pay. Additional amounts may be contributed at the discretion of the Company s board of directors. For the year ended December 31, 2007, no additional discretionary contributions were made. Participants age 50 and older as of December 31 are permitted to make elective catch-up deferrals in accordance with Section 414(v) of the IRC. Catch-up contributions are subject to certain IRC limitations ($5,000 for 2007). Participants may also rollover amounts from former employer s qualified plans.

(c) Participant Accounts

Individual accounts are maintained for each Plan participant. Each participant s account is credited with the participant s contribution and company matching contribution, and an allocation of the Company s discretionary contribution, if elected, and the Plan s earnings or losses net of administrative expenses. Allocations are based on participant earnings or account balances, as defined. The benefit to which a participant is entitled is the benefit that can be provided from the participant s vested account.

(d) Investments

Participants may direct the investment of their contributions into mutual funds, common/collective trusts, and/or a unitized fund comprised of Team s common stock and a money market fund. Contributions can be invested on a percentage allocation basis in any increment of 1%. Company contributions are allocated on the same basis as the participant has elected to allocate their contributions.

(Continued)

TEAM, INC. SALARY DEFERRAL PLAN AND TRUST

Notes to Financial Statements

December 31, 2007 and 2006

(e) Vesting and Forfeited Accounts

Participants are vested immediately in their contributions plus actual earnings thereon. Vesting in the Company s contributions plus actual earnings thereon is based on continuous years of service as follows:

Years of service	**Percentage of employer contribution that becomes vested**
Less than one year	%
One year	20
Two years	40
Three years	60
Four years	80
Five years or more	100

Years of service with certain predecessor employers is recognized for vesting service, as defined in the Plan Document.

Forfeited balances of terminated participants are used to reduce future Company contributions. At December 31, 2007 and 2006, forfeited nonvested accounts totaled approximately $29,198 and $11,648, respectively.

(f) Participant Loans

Participants may borrow from their account balance up to a maximum of $50,000, less the participant s highest outstanding loan balance during the preceding 12 months, or 50% of their vested account balance, whichever is less. The minimum loan amount is $1,000. The loans are secured by the balance in the participant s account and bear interest at rates commensurate with local prevailing rates as determined quarterly by the Trustee. All loans must generally be repaid within five years, except where a loan is used to purchase a principal residence. Principal and interest are paid ratably through payroll deduction. Interest rates range from 5% to 10.5% and maturity dates range from January 14, 2008 to August 6, 2027 on loans outstanding at December 31, 2007.

(g) Payment of Benefits

On termination of service due to death, total disability or retirement, a participant may elect to receive the balance in his or her account. For termination of service for other reasons, a participant may receive the value of the vested interest in his or her account. Upon reaching age 59 $^1/2$, a participant may elect one withdrawal during any six-month period from the participant s employee account and employer account. Upon furnishing proof of financial necessity, a participant is eligible for one withdrawal during any six-month period from the participant s employee account and the vested portion of the employer account. Benefits are payable either in a lump-sum amount or in monthly, quarterly, semiannual, or annual installments.

TEAM, INC. SALARY DEFERRAL PLAN AND TRUST

Notes to Financial Statements

December 31, 2007 and 2006

The Plan requires automatic distribution of participant account balances, upon a participant s termination, if account balances are less than $5,000 and greater than $1,000. If the participant does not elect to have the amount paid directly to his/her eligible retirement plan or receive a distribution directly, then the Plan will pay the distribution to an individual retirement account designated by the Plan Administrator. Amounts less than $1,000 are paid directly to the participant upon termination.

(h) Termination of the Plan

Although it has not expressed any intent to do so, the Company may discontinue contributions at any time or terminate the Plan subject to the provisions of ERISA. In the event of termination of the Plan, participants will become 100% vested in their accounts and the assets will be valued and each participant will be entitled to distributions for the balance of his or her account.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles.

(b) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and changes therein and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

(c) Risks and Uncertainties

The Plan provides for investment in mutual funds, common/collective trusts, and/or a unitized fund comprised of Team common stock and a money market fund. Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the value of investment securities will occur in the near term.

The Plan invests through its investment in the common/collective trusts in securities with contractual cash flows, such as asset backed securities, collateralized mortgage obligations and commercial mortgage backed securities, including securities backed by subprime mortgage loans. The value, liquidity and related income of those securities are sensitive to changes in economic conditions, including real estate value, delinquencies or defaults, or both, and may be adversely affected by shifts in the market s perception of the issuers and changes in interest rates.

(d) Investment Valuation and Income Recognition

The Plan s investments are stated at fair value. Quoted market prices are used to value the mutual funds and Team common stock. The common/collective trusts invest primarily in guaranteed investment contracts and synthetic investment contracts with insurance companies and third-party financial institutions which are fully benefit responsive. These investments are presented at the fair value of units held by the Plan as of December 31 in the statement of net assets available for benefits including separate disclosure of the

TEAM, INC. SALARY DEFERRAL PLAN AND TRUST

Notes to Financial Statements

December 31, 2007 and 2006

adjustment to contract value, which is equal to principal balance plus accrued interest. As provided in the Financial Accounting Standards Board, FSB AAG INV-1 and SOP 94-4-1, *Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide and Defined-Contribution Pension Plans* (the FSP), an investment contract is generally valued at contract value, rather than fair value, to the extent it is fully benefit-responsive. The fair value of fully benefit-responsive investment contracts is calculated using a discounted cash flow model which considers (i) recent fee bids as determined by recognized dealers, (ii) discount rate, and (iii) the duration of the underlying portfolio securities. Money market securities and participant loans are valued at cost, which approximates fair value.

Realized gains (losses) on the sale of investments and unrealized appreciation (depreciation) in fair value of investments held are shown as net appreciation (depreciation) in fair value of common stock, common/collective trusts, and mutual funds in the statement of changes in net assets available for benefits.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date.

(e) Expenses

Loan processing fees are charged to the accounts of the participants who have elected to take loans from their accounts. All other administrative expenses of the Plan are paid by the Company, as provided in the plan document.

(f) Payment of Benefits

Benefit payments to participants are recorded upon distribution. At December 31, 2007 and 2006, all amounts allocated to accounts of persons who have elected to withdraw from the Plan have been paid.

(g) Impact of New Accounting Standards and Interpretations

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 was effective for fiscal years beginning after December 15, 2006. The Plan s adoption of FIN 48 on January 1, 2007 did not have a material impact on the statement of net assets available for benefits or statement of changes in net assets available for benefits.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 applies only to fair value measurements already required or permitted by other accounting standards and does not impose requirements for additional fair value measures. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company does not expect the adoption of SFAS No. 157 to have a material impact on the statement of net assets available for benefits or statement of changes in net assets available for benefits.

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TEAM, INC. SALARY DEFERRAL PLAN AND TRUST

Notes to Financial Statements

December 31, 2007 and 2006

(3) Investments

The Plan s investments that represented 5% or more of the Plan s net assets available for benefits as of December 31, 2007 and 2006 are as follows:

2007:	
Team Inc. common stock	$ 28,922,464
American Growth Fund of America	4,965,416
Vanguard Index S&P 500 Portfolio	4,632,507
2006:	
Team Inc. common stock	$ 13,780,072
American Growth Fund of America	4,508,811
Vanguard Index S&P 500 Portfolio	3,967,557
Oppenheimer Global Fund	3,279,480
Alliance Bernstein Balanced Fund	2,405,889

(4) Team, Inc. Common Stock Voting Rights

At December 31, 2007 and 2006 the Plan held 790,353 and 395,638 shares of Team Inc. common stock, respectively. Participants may own units equivalent to the shares held by the Plan, however the voting rights attributable to the shares of Team Inc. common stock are voted by the Plan s trustee as directed by the Committee.

(5) Concentration of Investments

The Plan s investment in shares of Team, Inc. common stock represents 43% and 31% of total investments as of December 31, 2007 and 2006, respectively. Team is a leading provider of specialty maintenance and construction services required in maintaining high temperature and high pressure piping systems and vessels that are utilized extensively in heavy industries and offers these services in over 80 locations throughout the United States, Aruba, Belgium, Canada, Singapore, The Netherlands, Trinidad and Venezuela. As a result of this concentration, any significant fluctuation in the market value of Team stock could affect individual participant accounts and the net assets of the Plan.

(6) Federal Income Tax Status

The Plan obtained its latest determination letter on March 26, 2002, in which the Internal Revenue Service stated that the Plan qualifies under Section 401(a) of the IRC and that the trust created thereunder is exempt from Federal income taxes under Section 501(a) of the IRC. The Plan has been amended since

(Continued)

TEAM, INC. SALARY DEFERRAL PLAN AND TRUST

Notes to Financial Statements

December 31, 2007 and 2006

receiving the determination letter; however, the plan administrator believes that the Plan is designed and being operated in compliance with the applicable requirements of the IRC. Therefore, the plan administrator believes that the Plan is qualified, and the related trust is tax exempt.

During 2008, the Company identified certain operational errors and omissions deemed by the plan administrator to be immaterial. The Plan will submit an application to the Internal Revenue Service under the applicable Employee Plans Compliance Resolution System as detailed in Revenue Procedure 2006-27, in order to voluntarily correct these operational issues. The plan administrator expects that the final outcome of the submission will not have any material effect on the Plan s financial statements.

(7) Party-in-Interest Transactions

The Plan engaged in investment transactions with funds managed by the Trustee, a party-in-interest with respect to the Plan. The Plan also has investments in the Company s common stock. These transactions are covered by an exemption from the prohibited transaction provisions of ERISA and IRC.

(8) Delinquent Participant Contributions

As reported on Schedule H, Line 4a Schedule of Delinquent Participant Contributions, certain participant contributions and loan repayments were not remitted to the trust within the time frame specified by the Department of Labor s Regulation 29 CFR 2510.3-102, thus constituting nonexempt transactions between the Plan and the Company. The Company has incurred expense of $30,661 relating to remittance to the Plan of earnings on delinquent contributions. These delinquent contributions occurred during the years 2002 through 2007.

(9) Nonparticipant Directed Investments

During 2004, certain participants accounts received as a result of a 1990 merger were transferred from Company s common stock to a balanced portfolio of investments consisting of mutual funds and a common/collective trust. These accounts will be invested at the Company s direction until such time that participants are located and request a distribution of their prior account balance. Information about the net assets and the significant components of the changes in net assets relating to the nonparticipant directed investments is as follows:

	December 31	
	2007	2006
Net assets:		
Money market account	$ 12,388	12,794
Mutual funds	338,632	327,799
Common/collective trust	104,691	107,293
	455,711	447,886
Adjustment from fair value to contract value	736	2,341
Total net assets	$ 456,447	450,227

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Changes in net assets:	
Net depreciation in fair value of investments	$ (8,954)
Dividends and interest	26,196
Distributions	(36,746)
Other	25,724
	$ 6,220

(Continued)

TEAM, INC. SALARY DEFERRAL PLAN AND TRUST

Notes to Financial Statements

December 31, 2007 and 2006

(10) Reconciliation of Financial Statements to Form 5500

The following is a reconciliation of net assets available for benefits per the financial statements to the Form 5500:

	December 31	
	2007	2006
Net assets available for benefits per the financial statements	$ 68,464,448	45,368,339
Less adjustment from fair value to contract value for fully benefit responsive investment contracts	(17,646)	(32,180)
Net assets available for benefits per the Form 5500	$ 68,446,802	45,336,159

The following is a reconciliation of investment income per the financial statements to the Form 5500:

Total investment income per the financial statements	$ 17,918,267
Add: adjustment from fair value to contract value for fully benefit responsive investment contracts in 2006	32,180
Less: adjustment from fair value to contract value for fully benefit responsive investment contracts in 2007	(17,646)
Total investment income per the Form 5500	$ 17,932,801

Fully benefit responsive investment contracts are recorded on the Form 5500 at fair value but are adjusted to contract value for financial statement presentation.

The following is a reconciliation of participant contributions per the financial statements to the Form 5500:

Participant contributions per the financial statements	$ 5,619,557
Add: adjustment to employee contributions for excess contributions	80,427
Participant contributions per the Form 5500	$ 5,699,984

Excess contributions are recorded as a separate amount on the Form 5500 and as a reduction of participant contributions for financial statement presentation.

TEAM, INC. SALARY DEFERRAL PLAN AND TRUST

Notes to Financial Statements

December 31, 2007 and 2006

(11) Subsequent Events

On April 3, 2008, the board of directors of the Company voted to appoint Fidelity Management Trust Company as the trustee, Fidelity Institutional Operations Company, Inc. as the recordkeeper and UBS Financial as investment adviser for the Plan. The transition to the new providers is scheduled to be completed by the end of the third quarter 2008.

On January 9, 2008, the Aitec USA, Inc 401k Plan with current value of net assets totaling $242,234, was merged into the Plan.

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Schedule I

TEAM, INC. SALARY DEFERRAL PLAN AND TRUST

Schedule H, Line 4a Schedule of Delinquent Participant Contributions

Year ended December 31, 2007

	Relationship to plan,			
	employer, or other	**Description of transaction,**	**Amount on**	**Lost**
Identity of party involved	**party-in-interest**	**including rate of interest**	**Line 4(a)**	**interest**
TEAM, Inc.	Plan Sponsor	2007 employee deferrals and loan repayments not deposited to the Plan in a timely manner.	$ 2,776,661	$ 7,710
TEAM, Inc.	Plan Sponsor	2006 employee deferrals and loan repayments not deposited to the Plan in a timely manner.	$ 1,807,759	$ 7,693
TEAM, Inc.	Plan Sponsor	2005 employee deferrals and loan repayments not deposited to the Plan in a timely manner.	$ 1,818,688	$ 9,465
TEAM, Inc.	Plan Sponsor	2004 employee deferrals and loan repayments not deposited to the Plan in a timely manner.	$ 356,091	$ 1,187
TEAM, Inc.	Plan Sponsor	2003 employee deferrals and loan repayments not deposited to the Plan in a timely manner.	$ 534,774	$ 2,233
TEAM, Inc.	Plan Sponsor	2002 employee deferrals and loan repayments not deposited to the Plan in a timely manner.	$ 802,656	$ 2,373

On June 28, 2006, April 16, 2007, June 22, 2007, April 14, 2008, May 28, 2008, and June 3, 2008 the Company reimbursed the Plan for lost interest on the amounts of $harmacy services. The most significant Blue Cross and Blue Shield of Florida contract is for specialty distribution pharmacy services and is terminable by either party on 90 days notice. Unless terminated, this contract automatically renews each September for an additional one-year term. We signed and fully implemented a specialty distribution pharmacy services contract with Blue Cross and Blue Shield of Michigan (BCBSM) and Blue Care Network (BCN), during 2006, to be the exclusive supplier of specialty pharmacy drugs and services to their members. The Agreement shall remain in force for an initial term ending September 30, 2009, with an automatic one year renewal unless written notice of termination is given by BCBSM or BCN. We also generate revenue from government healthcare programs such as Medicare and Medicaid.

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

	Revenue				**Accounts Receivable**	
	Three months ended		**Six Months Ended**			
	June 30,		**June 30,**		**June 30,**	**December 31,**
	2007	**2006**	**2007**	**2006**	**2007**	**2006**
Blue Cross and Blue Shield of Florida	12%	13%	11%	13%	12%	8%
Blue Cross and Blue Shield of Michigan	12%	%	11%	%	4%	4%
Medicare	8%	9%	8%	8%	9%	10%
Medicaid	10%	12%	13%	12%	7%	9%
All other payors (1)	58%	66%	57%	67%	68%	69%

Total	100%	100%	100%	100%	100%	100%

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

6. Seasonal Revenue Trends

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

Option Care s quarterly Synagis® revenue for the year 2006 and the first two quarters of 2007 was as follows (in thousands):

	Synagis® revenue	% of Total Revenue (1)
Quarter ended March 31, 2006	$ 27,102	17.5%
Quarter ended June 30, 2006	8,327	5.3%
Quarter ended September 30, 2006	1,780	1.2%
Quarter ended December 31, 2006	25,676	13.2%
Fiscal year 2006	$ 62,885	9.5%
Quarter ended March 31, 2007	$ 40,180	18.9%
Quarter ended June 30, 2007	8,552	4.5%

(1) Percent of total revenue is calculated based on total revenue from continuing operations.

7. Acquisitions

During the six months ended June 30, 2007 we paid $37.4 million for acquisitions. These payments consisted of $25.5 million of deferred purchase price obligations toward prior year acquisitions and $11.9 million toward new acquisitions.

We completed three acquisitions during the six months ended June 30, 2007. The results of operations for each business were consolidated as of the effective date of their acquisition. The purpose of each acquisition was to increase our revenue and net income by accomplishing one or both of the following goals: (1) expanding our geographic coverage, and (2) consolidating our position in the markets we serve.

On May 21, 2007 we acquired all of the outstanding stock of our franchise operating a home infusion business in Kinston and Morrisville, North Carolina. The initial purchase price was $3.2 million which was paid in cash on the date of closing. We may owe additional consideration up to $700,000, payable in 2008 based on achievement of certain financial performance targets. The total initial purchase price was allocated $2.1 million to goodwill and the remainder to accounts receivable and other working capital items. We anticipate that all of the goodwill generated from this acquisition will be deductible for tax purposes.

On May 21, 2007 we also acquired all of the outstanding stock of our franchise operating a home infusion business in Wilmington, North Carolina. The initial purchase price was $5.2 million which was paid in cash on the date of closing. We may owe additional consideration up to $1.0 million, payable in 2008 based on achievement of certain financial performance targets. The total purchase price was allocated $4.6 million to goodwill and the remainder to accounts receivable and other working capital items. We anticipate that all of the goodwill generated from this acquisition will be deductible for tax purposes.

On June 12, 2007, we acquired a home infusion business with operations in San Antonio, Texas. The initial purchase price was $3.3 million which was paid in cash on the date of closing. We may owe additional consideration up to

$2.5 million, payable in 2008 based on achievement of certain financial performance targets. The total purchase price was allocated $2.3 million to goodwill and the remainder to accounts receivable and other working capital items. We anticipate that all of the goodwill will be deductible for tax purposes.

During the six months ended June 30, 2007, we paid $25.5 in additional consideration toward prior year acquisitions based on terms contained within the underlying agreements. These payments were primarily calculated based on the post-acquisition financial performance of the acquired businesses. The largest single payment was $23.0 million paid in June 2007 in connection with our prior year acquisition of a home infusion business operating in the New York City metropolitan area. We accrued for this payment in the quarter ended March 31, 2007.

For our current year acquisitions, the allocation of purchase price is tentative and subject to adjustment. The following table sets forth the preliminary allocation of purchase price for the three and six months ended June 30, 2007 for our current year acquisitions and adjustments and additional consideration for certain prior year acquisitions (in thousands):

	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007
Purchase Price:		
Paid in Cash	$ 35,128	$ 37,427
Earn-out payable	(26,248)	1,847
Liabilities assumed	605	711
Total	$ 9,485	$ 39,985
Allocation of Purchase Price:		
Goodwill	$ 6,284	$ 36,924
Accounts receivable, net	2,632	2,564
Other tangible assets	544	472
Other intangible assets	25	25
Total	$ 9,485	$ 39,985

The following table sets forth information regarding the changes in our gross and net goodwill during the six months ended June 30, 2007 (in thousands):

	Goodwill	Accumulated Amortization	Goodwill, net
December 31, 2006	$ 169,263	$ (3,940)	$ 165,323
Current year acquisitions	9,166		9,166
Additional consideration toward prior year acquisitions	27,758		27,758
June 30, 2007	$ 206,187	$ (3,940)	$ 202,247

Financial Accounting Standards Board Interpretation No. 46 (Revised December 2003), *Consolidation of Variable Interest Entities*, addresses the consolidation of business enterprises to which customary conditions of consolidation, such as a majority voting interest, do not apply. Effective March 13, 2006 (the Effective Date), we entered into a binding purchase agreement to acquire a home infusion business with operations in New York City. We received the profits interest in this business as of March 13, 2006, but did not receive the ownership interest until the Closing Date , which was to follow receipt of approval of the sale from the New York Department of Health. Due to the delayed timing of our receipt of the full ownership interest in this business, we deemed this business to be a variable interest entity (VIE) from the Effective Date until the Closing Date, since we were the primary beneficiary of this VIE as of the Effective Date. The Closing Date was reached on May 23, 2007 when we received the required approval from the New York Department of Health. As of that date, we acquired full ownership interest in this entity and it ceased to be a VIE.

8. Discontinued Operations

On February 28, 2007, we completed the sale of a non-strategic Durable Medical Equipment (DME) business in Burlington, New Jersey for its approximate book value resulting in a gain on the sale of approximately $21,000. On August 1, 2006, we completed the sale of our home health agency in Portland, Oregon for $500,000. We recorded a pre-tax gain of $242,000 on this sale. In addition, during the quarter ended September 30, 2006 we ceased operations of our home health agency in Phoenix, Arizona and recorded a pre-tax loss of $291,000 on this disposal. The results of operations of these businesses, including any gains or losses on sale or disposal, are reported as discontinued operations, net of tax, in our condensed consolidated statements of income.

The following table sets forth operating results from all discontinued operations for the three and six months ended June 30, 2007 and 2006 (in thousands):

	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
Total Revenue	$ (39)	$ 1,834	$ 363	$ 3,938
(Loss) from discontinued operations before income taxes	(125)	(407)	(91)	(983)
Income tax provision	(49)	(156)	(35)	(346)
(Loss) from discontinued operations	$ (76)	$ (251)	$ (56)	$ (637)

9. Franchise-related Revenue

We maintain a national franchise network through which we generate a portion of our revenue. Our franchise-related revenues include: (1) royalties; (2) vendor rebates and administration fees; and (3) franchise settlement and related fees. Each of these types of revenue can fluctuate over time, with the largest potential fluctuations relating to franchise settlements. Franchise-related revenue is included within our Other revenue service line.

The following table sets forth our franchise-related revenue for the periods indicated (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Franchise-related revenue:				
Royalties	$ 1,300	$ 1,344	$ 2,550	$ 2,794
Vendor rebates and administration fees	207	179	338	429
Franchise termination and settlement fees	546	1,427	846	1,427
Total franchise-related revenue	$ 2,053	$ 2,950	$ 3,734	$ 4,650

10. Stock-based Compensation

We adopted SFAS No. 123(R), *Share-Based Payment*, utilizing the modified retrospective method, as of January 1, 2006. SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options and shares purchased under our employee stock purchase plan, to be recognized in the income statement based on their fair values. We recorded stock-based compensation expense of $500,000 in the quarter and $1.1 million in the six months ended June 30, 2007 compared to $400,000 and $500,000 in the quarter and six months ended June 30, 2006, respectively.

During the quarter and six months ended June 30, 2007, we issued 90,715 and 119,395 shares of our common stock from the exercise of options granted through our stock incentive plan. Our Board of Directors approved the grant of 281,300 non-qualified stock options during the quarter and 321,450 during the six months ended June 30, 2007.

11. Income Taxes

In June 2006, the Financial Accounting Standards Board published Interpretation 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which is an interpretation of Statement 109, *Accounting for Income Taxes.* FIN 48 provides guidance on how entities should evaluate and report on uncertain tax positions. This interpretation requires that realization of an uncertain income tax position must be more likely than not (i.e. greater than 50% likelihood of receiving a benefit) before it can be recognized in the financial statements. Further, this interpretation prescribes the benefit to be recorded in the financial statements at the amount most likely to be realized assuming a review by tax authorities having all relevant information and applying current conventions. This interpretation also clarifies the financial statement classification of tax-related penalties and interest and sets forth new disclosures regarding unrecognized tax benefits. This interpretation is effective for fiscal years beginning after December 15, 2006.

We adopted the guidance contained in FIN 48 effective January 1, 2007. Upon adoption, we recognized a decrease of approximately $1.8 million in the liability for previously recorded uncertain tax positions no longer required under the technical guidance of FIN 48 and a corresponding $1.8 million increase to beginning retained earnings. This reversal included approximately $60,000 of accrued interest expense related to the uncertain tax position. Our policy is to reflect penalties and interest related to taxes within Selling, general and administrative expenses and Interest income (expense), net , respectively, in our consolidated statements of income.

As of June 30, 2007, our total amount of unrecognized tax benefits was $570,000, of which approximately $540,000 would affect our effective tax rate, if recognized. We do not anticipate a significant decrease or increase in our unrecognized tax benefits within the next twelve months. During the quarter and six months ended June 30, 2007, we recorded $9,000 and $18,000 in interest expense, respectively, and recorded no penalties related to uncertain tax positions. Our condensed consolidated balance sheet as of June 30, 2007 contains a total of $42,000 in accrued interest related to uncertain tax positions within Other current liabilities.

Our consolidated income tax returns remain subject to examination by the Internal Revenue Service for the years 2003 through current. This is also the case for the majority of states in which we file income tax returns.

12. Quarterly Dividends

In May 2004, our Board of Directors authorized the adoption of a quarterly dividend policy. Each quarter, our Board of Directors will determine the dividend amount per share, if any. During each of the fiscal quarters beginning with the quarter ended June 30, 2004 through the quarter ended March 31, 2005, our board declared a dividend of $0.0133 per share. Our Board declared and we paid dividends of $0.02 per share in each quarter beginning with the quarter ended June 30, 2005. The $0.02 per share dividend in the quarter ended June 30, 2007 was paid June 4, 2007 to stockholders of record as of May 21, 2007.

Pursuant to the Merger Agreement, unless we receive the written consent of Walgreens, we are prohibited from paying dividends between the date of such agreement and the earlier of (i) the effective time that we become a wholly-owned subsidiary of Walgreens, (ii) the date on which designees of Walgreens constitute the majority of our board of directors, and (iii) the termination of the Merger Agreement in accordance with its terms.

13. Comprehensive Income

Net income was our only component of comprehensive income for the three and six month periods ended June 30, 2007 and 2006.

14. Definitive Merger Agreement

On July 2, 2007, we entered into a Merger Agreement with Walgreens and Acquisition Sub. Pursuant to the Merger Agreement, (i) Acquisition Sub commenced a tender offer (the Offer) on July 17, 2007 to purchase all of the outstanding shares of our common stock at a price of $19.50 per share, net in cash without interest, and (ii) following the consummation of the Offer (which is contingent upon certain conditions, including the tender of a majority of our shares of common stock representing the majority of the shares on a fully-diluted basis, obtaining necessary regulatory approvals, and other customary conditions) Acquisition Sub will be merged with and into our company, with each outstanding share of our common stock (other than, among other things, (a) shares held by us as treasury stock or by Walgreens or Acquisition Sub (other than shares held on behalf of third parties), (b) shares held by any wholly-owned subsidiary of our company or Walgreens (other than Acquisition Sub), and (c) shares held by holders who are entitled to tender in the Offer and have properly demanded dissenters rights under Delaware law), being converted into the right to receive $19.50 in cash. The Merger Agreement provides that we will survive the merger as a wholly-owned subsidiary of Walgreens.

Under the Merger Agreement, at the effective time of the Merger (a) all of our outstanding stock options will be exchanged for a cash payment for each underlying share equal to the difference, if any, between the Merger offer price per share of $19.50 and the exercise price per share of the options, and (b) all amounts contributed to the Option Care, Inc. 2001 Employee Stock Purchase Plan (the Company ESPP) between January 1, 2007 and June 30, 2007 will be converted into shares of our common stock based upon the conversion price specified in such plan, and will subsequently be immediately redeemed in the Merger. Any amounts contributed by employees after June 30, 2007 to the Company ESPP will be returned to each such employee.

Pursuant to the terms of the Merger Agreement, effective upon the purchase of shares of our common stock pursuant to the Offer, Walgreens will be entitled to designate a number of directors, rounded up to the nearest whole number, as will give Walgreens representation on our board of directors (the Company Board) equal to the product of the total number of members of the Company Board (after giving effect to the directors elected pursuant to this sentence) multiplied by the percentage that the number of shares of our common stock beneficially owned by Walgreens or Acquisition Sub at such time bears to the total number of shares of our common stock then outstanding.

15. Subsequent Events

As described in Note 2, on July 24, 2007 our 2.25% convertible senior notes became convertible as a result of the anticipated Share Acquisition. Pursuant to the terms of the Indenture, the anticipated Share Acquisition allows holders to convert their notes, in $1,000 increments, into cash up to the principal amount of the notes and shares of our common stock equal to the excess of the notes value above $1,000 based upon the then current conversion rate and market price of our common stock. Additionally, upon the occurrence of the make-whole fundamental change , the holders will be entitled to receive a make-whole premium calculated pursuant to terms contained in the indenture. We anticipate that immediately prior to the merger being completed, a supplemental indenture will be put in place, effective upon the closing of the merger, providing that at and after the effective time of the merger, upon the surrender for conversion of any of the notes, the holder thereof shall have the right to receive, in lieu of cash and our common stock, the amount of cash that such holder would have been entitled to receive upon the merger had the notes been converted immediately prior to the merger.

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

FORWARD LOOKING STATEMENTS

The following discussion should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2006. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. Certain information included in this Quarterly Report on Form 10-Q and other materials filed or to be filed by us with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by us) contain statements that are or will be forward-looking, such as statements relating to acquisitions and other business development activities, future capital expenditures and the anticipated or potential effects of future regulation and competition. Such forward-looking information involves important risks and uncertainties that could significantly affect anticipated results in the future and, accordingly, such results may differ from those expressed in any forward-looking statements made by us, or on our behalf. These risks and uncertainties include, but are not limited to, uncertainties affecting our businesses and our franchisees relating to the anticipated merger with Walgreens, the terms of conversion of our 2.25% convertible senior notes due 2024, discussions with LaSalle Bank National Association regarding the impact of the anticipated merger on our revolving credit facility, acquisitions and divestitures (including integration issues and continuing obligations with respect to completed transactions), sales and renewals of franchises, government and regulatory policies (including federal, state and local efforts to reform the delivery of and payment for healthcare services), general economic conditions (including economic conditions affecting the healthcare industry in particular), the pricing and availability of equipment and services, technological developments and changes in the competitive environment in which we operate. For a more comprehensive description of risks applicable to our business, see Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2006 and in Item 1.A of this Quarterly Report on Form 10-Q. We do not undertake any obligation to release publicly any revisions to such forward-looking statements to reflect events or circumstances occurring after the date of this Quarterly Report or to reflect the occurrence of unanticipated events.

BUSINESS OVERVIEW

We provide infusion therapy, specialty pharmacy services and other ancillary healthcare services through a national network of company-owned and franchised locations. We contract home infusion pharmacy and related services with managed care organizations, third party payors, hospitals, physicians and other referral sources to provide pharmaceuticals and complex compounded solutions to patients for intravenous delivery in the patients homes or other non-hospital settings. Many of our locations also provide other ancillary healthcare services such as nursing, respiratory therapy and durable medical equipment. We contract specialty infusion and specialty distribution pharmacy services with managed care organizations and physicians to become their specialty pharmacy, dispensing and delivering specialty pharmaceuticals, assisting with clinical compliance information and providing pharmacy consulting services. Our services are provided through our national network of 61 company-owned and managed locations, our 39 franchise-owned pharmacies and our two company-owned, high-volume specialty pharmacy distribution facilities.

We have four service lines: home infusion and related healthcare services, specialty infusion pharmacy services, specialty distribution pharmacy services, and other. Home infusion and related healthcare services primarily involve the intravenous administration of medications treating a wide range of acute and chronic health conditions such as infections, nutritional deficiencies and cancer. These services are primarily provided in the patient s home, but may also be provided at one of our ambulatory treatment centers and involve intensive clinical coordination between our pharmacy and nursing staff, the patient, the prescribing physician, and payor case managers. Specialty infusion pharmacy services primarily involve the local distribution and administration of high cost specialty pharmaceuticals that are typically infused. Home infusion and specialty infusion pharmaceuticals treat a wide range of acute and chronic health conditions through our national network of 58 company owned pharmacies. Specialty distribution pharmacy services involve the national distribution of high cost specialty pharmaceuticals, typically injectibles, through our 2 high volume pharmacies. Both specialty services treat a wide range of chronic health conditions and the associated pharmaceuticals may require special handling including refrigeration during shipping to prevent potency degradation. Other revenue primarily consists of royalties and other fees generated from our franchised pharmacy network.

Merger Agreement

On July 2, 2007, we entered into an Agreement and Plan of Merger (the Merger Agreement) with Walgreen Co. (Walgreens) and Bison Acquisition Sub Inc, a wholly-owned subsidiary of Walgreens (Acquisition Sub). Pursuant to the Merger Agreement, (i) Acquisition Sub commenced a tender offer (the Offer) on July 17, 2007 to purchase all of the outstanding shares of our common stock, par value $0.01 per share at a price of $19.50 per share, net in cash without interest, and (ii) following the consummation of the Offer (which is contingent upon certain conditions, including the tender of shares of our common stock representing the majority of the shares on a fully-diluted basis, obtaining necessary regulatory approvals, and other customary conditions), Acquisition Sub will be merged with and into our company (the Merger), with each outstanding share of our common stock (other than, among others, (a) shares held by the us as treasury stock or by Walgreens or Acquisition Sub (other than shares held on behalf of third parties), (b) shares held by any wholly-owned subsidiary of ours or Walgreens (other than Acquisition Sub), and (c) shares held by holders who are entitled to tender in the Offer and have properly demanded dissenters rights under Delaware law) being converted into the right to receive $19.50. Pursuant to terms contained within the Merger Agreement, Option Care will survive the Merger as a wholly-owned subsidiary of Walgreens. The Offer will expire at 12:00 midnight at the end of August 13, 2007, unless the Offer is extended.

Under the Merger Agreement, at the effective time of the Merger (a) all of our outstanding stock options will be exchanged for a cash payment for each underlying share equal to the difference, if any, between the Merger offer price per share of $19.50 and the exercise price per share of the options, and (b) all amounts contributed to the Company s 2001 Employee Stock Purchase Plan (the Company ESPP) between January 1, 2007 and June 30, 2007 shall be converted into shares of our common stock based upon the conversion price specified in such plan, and will subsequently be redeemed in the Merger. Any amounts contributed by employees after June 30, 2007 to the Company ESPP shall be returned to each such employee.

Pursuant to the terms of the Merger Agreement, effective upon the purchase of shares of common stock pursuant to the Offer, Walgreens will be entitled to designate a number of directors, rounded up to the nearest whole number, as will give Walgreens representation on our board of directors (the Company Board) equal to the product of the total number of members of the Company Board (after giving effect to the directors elected pursuant to this sentence) multiplied by the percentage that the number of shares of common stock beneficially owned by Walgreens or Acquisition Sub at such time bears to the total number of shares of our common stock then outstanding.

The foregoing description of the Merger Agreement is not complete and is qualified in its entirety by reference to the Merger Agreement, which is incorporated herein by reference to Exhibit 2.1 to this quarterly report on Form 10-Q.

SUMMARIZED INFORMATION ABOUT REVENUE AND GROSS PROFIT

Summarized information about revenues and gross profit from continuing operations for each of our service lines is provided in the following table (amounts in thousands):

	Three Months Ended June 30				**Six Months Ended June 30**			
	2007		**2006**		**2007**		**2006**	
REVENUE	Revenue	% of Total	Revenue	% of Total	Revenue	% of Total	Revenue	% of Total
Home infusion and related healthcare services	$ 67,737	35.8%	$ 64,519	41.1%	$ 132,177	32.9%	$ 121,634	39.0%
Specialty infusion pharmacy services	55,142	29.2%	48,496	30.9%	138,227	33.9%	101,707	32.6%
Specialty distribution pharmacy services	63,545	33.6%	40,938	26.0%	127,126	32.1%	83,526	26.7%
Other	2,583	1.4%	3,355	2.1%	4,420	1.1%	5,432	1.7%
Total	$ 189,007	100.0%	$ 157,308	100.0%	$ 401,950	100.0%	$ 312,299	100.0%

	Three Months Ended June 30				Six Months Ended June 30			
	2007		2006		2007		2006	
GROSS PROFIT	Gross Profit	Gross Profit %	Gross Profit	Gross Profit %	Gross Profit	Gross Profit %	Gross Profit	Gross Profit %
Home infusion and related healthcare services	$ 30,825	45.5%	$ 28,415	44.0%	$ 59,210	44.8%	$ 53,953	44.4%
Specialty infusion pharmacy services	11,143	20.2%	10,887	22.4%	26,148	18.9%	20,569	20.2%
Specialty distribution pharmacy services	3,755	5.9%	3,247	7.9%	8,081	6.4%	6,746	8.1%
Other	2,583	100.0%	3,355	100.0%	4,419	100.0%	5,432	100.0%
Total	$ 48,306	25.6%	$ 45,904	29.2%	$ 97,858	24.3%	$ 86,700	27.8%

We derive most of our revenue from contracts with third party payors, such as managed care organizations, insurance companies, self-insured employers and Medicare and Medicaid programs. We have significant managed care contracts with Blue Cross Blue Shield of Florida (BCBSF) and Blue Cross Blue Shield of Michigan (BCBSM) for the provision of specialty pharmacy services and infusion pharmacy services to their members. For the six months ended June 30, 2007 approximately 22% of our revenue was generated from the combination of these two contracts (11% and 11%, BCBSF and BCBSM contracts, respectively). In the prior year first six months, we generated approximately 13% and 0% of our revenue, respectively, from the BCBSF and BCBSM contracts.

As of June 30, 2007 approximately 12% and 4% of our accounts receivable was due from BCBSF and BCBSM, respectively. As of December 31, 2006, approximately 8% and 4% of our accounts receivable was due from BCBSF and BCBSM, respectively. No other single managed care payor represents more than 10% of our revenue.

We also provide services that are reimbursable through government healthcare programs such as Medicare and state Medicaid programs. For the six months ended June 30, 2007 and 2006, respectively, approximately 21% and 20% of our revenue was generated from government healthcare programs. As of June 30, 2007 and December 31, 2006, respectively, 16% and 19% of our total accounts receivable was due from these government healthcare programs.

RESULTS OF OPERATIONS

The following table shows the results of our operations for the six months ended June 30, 2007 and 2006, expressed in amounts and percentages of revenue (in thousands):

	Three months ended June 30,				Six months ended June 30,			
	2007		2006		2007		2006	
	Amount	% of Revenue	Amount	% of Revenue	Amount	% of Revenue	Amount	% of Revenue
Revenue:								
Home infusion and related healthcare services	$ 67,737	35.8%	$ 64,519	41.0%	$ 132,177	32.9%	$ 121,634	39.0%
Specialty infusion pharmacy services	55,142	29.2%	48,496	30.9%	138,227	33.9%	101,707	32.6%
Specialty distribution pharmacy services	63,545	33.6%	40,938	26.0%	127,126	32.1%	83,526	26.7%
Other	2,583	1.4%	3,355	2.1%	4,420	1.1%	5,432	1.7%
Total revenue	189,007	100.0%	157,308	100.0%	401,950	100.0%	312,299	100.0%
Cost of revenue:								
Cost of goods sold	122,487	64.8%	93,846	59.6%	266,891	66.4%	192,013	61.4%
Cost of services provided	18,214	9.6%	17,558	11.2%	37,201	9.3%	33,586	10.8%
Total cost of revenue	140,701	74.4%	111,404	70.8%	304,092	75.7%	225,599	72.2%
Gross profit	48,306	25.6%	45,904	29.2%	97,858	24.3%	86,700	27.8%
Selling, general and administrative expenses	32,792	17.4%	31,801	20.2%	65,078	16.2%	60,219	19.3%
Provision for doubtful accounts	3,714	2.0%	3,456	2.2%	8,103	2.0%	6,918	2.2%
Depreciation and amortization	1,346	0.7%	1,225	0.8%	2,613	0.7%	2,370	0.8%
Total operating expenses	37,852	20.1%	36,482	23.2%	75,794	18.9%	69,507	22.3%

Operating income	10,454	5.5%	9,422	6.0%	22,064	5.5%	17,193	5.5%
Interest income (expense), net	(370)	(0.2)%	(217)	(0.1)%	(604)	(0.1)%	(209)	(0.1)%
Other expense, net	(92)	%	(365)	(0.3)%	(240)	(0.1)%	(427)	(0.1)%
Income from continuing operations before income taxes	9,992	5.3%	8,840	5.6%	21,220	5.3%	16,557	5.3%
Income tax provision	3,980	2.1%	3,388	2.1%	8,463	2.1%	5,929	1.9%
Net income from continuing operations	$ 6,012	3.2%	$ 5,452	3.5%	$ 12,757	3.2%	$ 10,628	3.4%
Discontinued operations:								
Loss on discontinued operations, net of income taxes	(76)	(0.1)%	(251)	(0.2)%	(56)	(0.0)%	(637)	(0.2)%
Net income	$ 5,936	3.1%	$ 5,201	3.3%	$ 12,701	3.2%	$ 9,991	3.2%

Three and Six Months Ended June 30, 2007 and 2006

During the quarter ended June 30, 2007, we generated revenue from continuing operations of $189.0 million, representing an increase of $31.7 million, or 20.2% over the corresponding prior year quarter. Our revenue from continuing operations for the six months ended June 30, 2007 was $402.0 million, representing an increase of $90.0 million, or 28.7% over the prior year. Revenues increased due to a combination of internal growth, significant new contracts, and acquisitions. Our total gross profit margin was 25.6% for the quarter and 24.3% for the six months ended June 30, 2007, compared to 29.2% and 27.8% for the corresponding prior year periods. Our overall gross profit margin declined due to a shift in mix of business between our service lines and a decline in other revenue. Net income from continuing operations increased to $5.9 million in the quarter ended June 30, 2007, an increase of 14.1% over the corresponding prior year period. Our net income from continuing operations for the six months ended June 30, 2007 was $12.7 million, an increase of 27.1% over the prior year period. As a result of our increased revenues, net income from continuing operations per diluted share increased to $0.16 for the quarter ended June 30, 2007 compared to $0.15 in the prior year quarter.

Our operating cash flow was positive for both the quarter and six months ended June 30, 2007. We generated $8.5 million in cash from operations during the six months ended June 30, 2007. We used $37.4 million in cash for acquisitions during the six months ended June 30, 2007, $25.5 million of this total was used to pay additional consideration toward prior year acquisitions and $11.9 million was used to acquire 3 additional businesses. This use of cash for acquisitions required us to borrow against our credit facility with LaSalle Bank National Association. We ended the quarter with no cash and cash equivalents or short term investments and an outstanding loan balance on our credit facility of $16.5 million. As of June 30, 2007, our primarily debt consisted of $86.3 million of 2.25% convertible senior notes (due 2024). These notes became eligible for conversion at the end of the quarter as a result of our common stock s market price exceeding the required level.

Revenue:

We report our operating results in one segment, consisting of four service lines: home infusion and related healthcare services; specialty infusion pharmacy services; specialty distribution pharmacy services; and other. Our home infusion and related healthcare services and specialty infusion pharmacy services are delivered locally through our 61 company-owned and managed pharmacies. Our specialty distribution pharmacy service line distributes through our two high-volume facilities in Michigan and Florida. Total revenue was $189.0 million for the quarter and $402.0 million for the six months ended June 30, 2007 compared to $157.3 million and $312.3 million in the corresponding prior year periods. Revenue increased $31.7 million, or 20.2% over the corresponding prior year quarter and $90.0 million, or 28.7% over the corresponding prior year six month period. These increases are due to the growth in sales for multiple products and therapies, including Synagis®, the effects of acquisitions completed in 2006 and 2007 and the implementation of significant new managed care relationships.

Home infusion and related healthcare services revenue:

Home infusion and related healthcare services revenue was $67.7 million for the quarter and $132.2 million for the six months ended June 30, 2007 compared to $64.5 million and $121.6 million in the corresponding prior year periods. Revenue increased $3.2 million, or 5.0% over the corresponding prior year quarter and $10.5 million, or 8.7% over the corresponding prior year six month period primarily due to organic sales growth and business acquisitions**.**

Specialty infusion pharmacy services revenue:

Specialty infusion pharmacy services revenue was $55.1 million for the quarter and $138.2 million for the six months ended June 30, 2007 compared to $48.5 million and $101.7 million in the corresponding prior year periods. Revenue increased $6.6 million, or 13.7% over the corresponding prior year quarter and $36.5 million, or 35.9% over the corresponding prior year six month period. . Our specialty infusion pharmacy revenue grew primarily due to organic growth and business acquisitions, throughout our network of company-owned pharmacies across a wide variety of therapies including our largest revenue-producing specialty drug which was Synagis®. Synagis® is a seasonal drug for the prevention of respiratory syncytial virus (RSV) in premature and other high-risk infants. RSV season runs through the cold months, generally from October through April. Accordingly, our Synagis® revenue declined in our quarter ending June 30, 2007 as the Synagis® season reached its conclusion.

Specialty distribution pharmacy services revenue:

Specialty distribution pharmacy services revenue was $63.5 million for the quarter and $127.1 million for the six months ended June 30, 2007 compared to $40.9 million and $83.5 million in the corresponding prior year periods. Revenue increased $22.6 million, or 55.2% over the corresponding prior year quarter and $43.6 million, or 52.2% over the corresponding prior year six month period. Our specialty distribution pharmacy services revenue grew due to organic growth in our Miramar distribution center and through the implementation of a significant contract with Blue Cross and Blue Shield of Michigan (BCBSM) and Blue Care Network (BCN) contract which is serviced by our Ann Arbor distribution center.

Other revenue:

Other revenue consists of royalties and other fees generated from our franchised pharmacy network. Other revenue was $2.6 million for the quarter and $4.4 million for the six months ended June 30, 2007 compared to $3.4 million and $5.4 million in the corresponding prior year periods. The decreases of $800,000 and $1.0 million in the quarter and six months ended June 30, 2007 were primarily due to a decline in our franchise termination fees and royalty revenue as a result of franchise terminations and acquisitions.

Cost of revenue:

Cost of revenue consists of the cost of goods sold and the cost of service provided. Our cost of revenue from continuing operations was $140.7 million for the quarter and $304.1 million for the six months ended June 30, 2007, representing increases of 26.3% and 34.8% over the corresponding prior year periods as a result of the revenue increases of 20.2% and 28.7% during these periods.

Cost of goods sold from continuing operations was $122.5 million, or 64.8% of revenue, for the quarter ended June 30, 2007 and $266.9 million, or 66.4% of revenue, for the six months ended June 30, 2007. In the prior year periods, cost of goods sold was $93.8 million, or 59.7% of revenue for the quarter ended June 30, 2006 and $192.0 million, or 61.5% of revenue, for the six months ended June 30, 2006. The increase in cost of goods sold as a percentage of revenue in the current year periods was primarily due to a higher mix of specialty infusion pharmacy services and specialty distribution pharmacy services revenue which have lower margins.

Cost of service consists of salaries and related costs for employees directly involved in patient care, including pharmacists, nurses, therapists and delivery drivers. Cost of service also includes the cost of shipping or delivering products and services to the patient. Our cost of service from continuing operations was $18.2 million, or 9.6% of revenue, for the quarter ended June 30, 2007 and $37.2 million, or 9.3% of revenue, for the six months ended June 30, 2007. In the prior year periods, our cost of service was $17.6 million, or 11.2% of revenue, for the quarter ended June 30, 2006 and $33.6 million, or 10.8% of revenue, for the six months ended June 30, 2006. This decrease in cost of service as a percentage of revenue was due to a higher mix of specialty infusion pharmacy services and specialty distribution pharmacy services revenue over the prior year quarter which has a lower cost of service.

Gross profit margin:

The following table sets forth the gross profit margin for each of our three service lines: specialty pharmacy services; infusion and related healthcare services; and other:

	Three months ended June 30		Six months ended June 30	
	2007	2006 (restated)	2007	2006 (restated)
Gross Margin:				
Home infusion and related healthcare services	45.5%	44.0%	44.8%	44.4%
Specialty infusion pharmacy services	20.2%	22.4%	18.9%	20.2%
Specialty distribution pharmacy services	5.9%	7.9%	6.4%	8.1%
Gross profit margin, excluding other revenue	24.5%	27.6%	23.5%	26.5%
Other revenue	100.0%	100.0%	100.0%	100.0%
Total gross profit margin	25.6%	29.2%	24.3%	27.8%

Gross profit margins were 25.6% for the quarter and 24.3% for the six months ended June 30, 2007 compared to 29.2% and 27.8% in the corresponding prior year periods. The decline in gross profit margins primarily reflects a higher mix of specialty infusion pharmacy services and specialty distribution pharmacy service revenue which have lower margins. Within our services lines, our home infusion and related healthcare services gross profit margin from continuing operations was essentially the same as prior year periods with margins of 45.5% and 44.8% for the most recent quarter and six month periods respectively. Gross profit margins for our specialty infusion pharmacy services were 20.2% for the quarter and 18.9% for the six months ended June 30, 2007 compared to 22.4% and 20.2% in the corresponding prior year periods due to a shift in mix. Gross profit margins for our specialty distribution pharmacy services were 5.9% for the quarter and 6.4% for the six months ended June 30, 2007 compared to 7.9% and 8.1% in the corresponding prior year periods. This decrease is due to an unfavorable plan mix within our Blue Cross and Blue Shield of Florida contract and the launch of the Blue Cross and Blue Shield of Michigan / Blue Cross Network relationship.

Selling, general and administrative expenses:

For the quarter ended June 30, 2007, selling, general and administrative expenses from continuing operations were $32.3 million, an increase of $1.0 million, or 3.1% over the prior year period. For the six months ended June 30, 2007, selling, general and administrative expenses were $65.1 million, an increase of $4.9 million, or 8.1%, over the prior year period. The largest increase was in wages and related costs, which increased by $5.5 million during the six months ended June 30, 2007 compared with the corresponding period in 2006. The increase in wages and related costs was due to our increase in staff from business acquisitions completed in 2006 and 2007 as well as an increase in staff to manage our continued growth. Selling, general and administrative expenses as a percentage of revenue were 16.2% and 19.3% for the six months ended June 30, 2007 and 2006 respectively. This decrease as a percentage of revenue is primarily related to the shift in mix toward our high volume specialty distribution pharmacy services and improved operating efficiencies across all service lines.

Provision for doubtful accounts:

Our provision for doubtful accounts for the quarter ended June 30, 2007 was $3.7 million, or 2.0% of revenue, compared to $3.5 million, or 2.2% of revenue, in the prior year quarter. For the six months ended June 30, 2007, our provision for doubtful accounts was $8.1 million, or 2.0% of revenue, compared to $6.9 million, or 2.2% of revenue, in the corresponding prior year period. In general, we record a higher provision for doubtful accounts for revenue generated from our locally delivered services than from our central distribution facilities. This difference in provision rates reflects the difference in collection risk involved in these services as many of our services from our central distribution facilities are billed under pharmacy benefits whereas the services from our local pharmacies are typically billed under major medical benefits and typically require higher patient co-payments and deductibles. The decrease in our provision for doubtful accounts as a percentage of revenue was primarily due to a higher mix of specialty distribution pharmacy services revenue over the prior year quarter.

Depreciation and amortization:

For the quarter ended June 30, 2007, depreciation and amortization expense from continuing operations was $1.3 million, an increase of $.1 million, or 9.9%, over the corresponding prior year period. For the six months ended June 30, 2007, , depreciation and amortization expense was $2.6 million, an increase of $.2 million, or 10.3%, over the prior year period. This increase is primarily related to depreciation of tangible assets and amortization of intangible assets purchased in 2006 and 2007. The depreciation expense contained within this line item relates to non-revenue producing assets only, such as furniture and fixtures and leasehold improvements. Depreciation for revenue-producing equipment such as rental medical equipment and delivery vehicles is included in cost of revenue.

Operating income:

Our operating income from continuing operations was $10.5 million in the quarter ended June 30, 2007 representing an increase of $1.0 million, or 11.0%, over the prior year quarter. For the six months ended June 30, 2007, operating income was $22.1 million, an increase of $4.9 million, or 28.3%, over the prior year period. This increase resulted primarily from an increase in total revenues. As a percentage of revenue, our operating income was 5.5% for the quarter ended June 30, 2007 compared to 6.0% for the corresponding prior year quarter. For the six months ended June 30, 2007, our operating income was 5.5% of revenue and was equal to the prior year period.

Interest income/(expense):

Our interest expense from continuing operations was $370,000 for the quarter and $604,000 for the six months ended June 30, 2007 compared with $217,000 and $427,000 for the corresponding prior year periods. Our short-term debt consists principally of $86.3 million of 2.25% convertible senior notes, due 2024. Our interest expense on these notes for the quarters ended June 30, 2007 and 2006 was approximately $485,000. Our long-term debt consists principally of $16.5 million in borrowings drawn on our $35 million credit facility with LaSalle. Excess short term cash balances are invested in commercial paper, variable-rate bonds and preferred stocks and other related instruments.

Income taxes:

Our income tax provision from continuing operations was $4.0 million for the quarter and $8.5 million for the six months ended June 30, 2007 compared with $3.4 million and $5.9 million for the corresponding prior year periods. As a percentage of pre-tax income, our provision for income taxes was 39.8% for the quarter and 39.9% for the six months ended June 30, 2007 compared to 38.3% for the quarter and 35.8% for the six months ended June 30, 2006. The lower provision rate of 35.8% in the six months ended June 30, 2006 was primarily due to adjustments recorded to reduce an excess provision from the end of 2005. Additionally, we experienced an increase in income taxes as a percentage of pre-tax income in the six months ended June 30, 2007 due to a shift in income toward states with higher tax rates.

Net income from continuing operations:

Our net income from continuing operations was $5.9 million for the quarter and $12.7 million for the six months ended June 30, 2007 compared to $5.2 million for the quarter and $10.0 million for the six months ended June 30,

2006. This 14.1% increase quarter over quarter and 27.1% increase six months over six months was primarily due to the growth in revenue from organic growth, significant new contracts, and revenues from acquisitions in 2006. As a percentage of revenue, our net income was 3.1% for the quarter and 3.2% for six months ended June 30, 2007 compared to 3.3% for the quarter and 3.2% for the six months ended June 30, 2006.

Diluted shares & earnings per share:

For the quarter ended June 30, 2007, our diluted shares were 36.9 million compared to 35.2 million for the corresponding prior year quarter. For the six months ended June 30, 2007, diluted shares were 36.5 million compared to 35.2 million for the corresponding prior year period. The increase of 1.7 million diluted shares outstanding for the quarter ended June 30, 2007 compared with the corresponding quarter ended June 30, 2006 was primarily due to an increase of approximately 1.0 million shares related to our $86.3 million of 2.25% convertible senior notes due 2024. These notes are dilutive to the extent that the weighted average market price of our common stock exceeds the conversion price of the notes, currently $11.96 per share. Other increases in shares outstanding were due to shares issued and issuable under the employee stock purchase plan and stock option plan and shares issued for acquisitions. Our earnings per diluted share from continuing operations were $0.16 for the quarter and $0.35 for the six months ended June 30, 2007, compared to $0.15 and $0.30 per diluted share for the corresponding periods in the prior year. These increases were due to our increases in net income from continuing operations.

LIQUIDITY AND CAPITAL RESOURCES

During the six months ended June 30, 2007, we financed our operations and business acquisitions through operating cash flows, the use of our cash reserves, sales of our short-term investments and borrowing under our credit facility. During the six months ended June 30, 2007, we generated $8.5 million in positive cash flow from operations. We used $37.4 million in cash during this period for business acquisitions. As of June 30, 2007, we had no cash or short-term investments and had revolving debt totaling $16.5 million and total long-term debt of $86.3 million.

On May 5, 2006, we signed a $35 million revolving Credit Agreement with LaSalle Bank National Association. This agreement grants us the option to increase the credit commitment from $35 million to a maximum of $100 million during the first two years of the agreement. During the quarter ended June 30, 2007, we financed our operations and acquisition activities in part through borrowings of $16.5 million from this credit facility. Our cash and cash equivalents decreased by $7.5 million during the quarter ended June 30, 2007 as our payments for acquisitions exceeded the cash proceeds from our positive operating cash flows and cash generated from the issuance of common stock.

Operating Cash Flows:

We generated $8.5 million in positive cash flow from operations in the six months ended June 30, 2007. This positive cash flow was primarily the result of our net income of $12.7 million in the current year period, plus non-cash expenses of $13.6 million, partially offset by increased account receivable levels of $8.8 million and our payment of accounts payable of $8.2 million. Additionally, timing of income tax payments resulted in a decrease of $1.1 million.

Investing Cash Flows:

Overall, we used $37.5 million in investing activities during the six months ended June 30, 2007. We used $37.4 million in cash to complete business combinations and pay additional consideration due on prior year acquisitions. We generated $5.7 million in cash from the net sale of short-term investments to provide the cash to complete these acquisitions. We also used $5.7 million in the six months ended June 30, 2007 to acquire depreciable assets, of which $3.5 million was used for infrastructure items such as furniture and fixtures and computer hardware and software, while $2.2 million was used to acquire revenue-generating medical equipment such as infusion pumps and durable medical equipment.

We used $7.6 million in cash in investing activities during the six months ended June 30, 2006. Of this total, we used $38.8 million in cash to complete business combinations and pay additional consideration due on prior year acquisitions. We generated $37.0 million in cash from the net sale of short-term investments to provide the cash to complete these acquisitions. We also used $5.8 million in the six months ended June 30, 2006 to acquire depreciable assets, of which $4.1 million was used for infrastructure items such as furniture and fixtures and computer hardware and software, while $1.7 million was used to acquire revenue-generating medical equipment such as infusion pumps and durable medical equipment.

Financing Cash Flows:

We generated $18.2 million from financing activities in the six months ended June 30, 2007. We generated $16.5 million in borrowings under our $35 million credit agreement with LaSalle Bank National Association, we generated $2.0 million from issuance of stock related to employee stock option exercises and purchases under our employee stock purchase plan, and we recognized $32,000 in income tax benefit from employee stock option exercises. These positive cash flow items were offset by our payment of $1.4 million in dividends to our shareholders.

Financing activities generated a net $1.8 million in positive cash flow during the six months ended June 30, 2006. We generated $2.6 million from issuance of stock related to employee stock option exercises and purchases under our employee stock purchase plan, and recognized $600,000 in income tax benefit from employee stock option exercises. These positive cash flow items were offset by our payment of $1.3 million in dividends to our shareholders and payment of $100,000 in fees related to completing our $35 million credit agreement with LaSalle Bank National Association.

Convertible Senior Notes:

Our short-term debt consists principally of $86.3 million of 2.25% convertible senior notes, due 2024. On November 2, 2004, we completed the offering of $75 million of these notes through a private placement to qualified institutional buyers. The initial purchasers were granted the option to purchase up to an additional $11.25 million principal amount of notes and exercised this option in full on November 9, 2004. We incurred deferred financing costs of $3.2 million related to this offering, consisting of underwriting, legal and other related costs. These costs are being amortized over a five-year period. See Note 2, Short-Term Debt in our Notes to Condensed Consolidated Financial Statements for additional information.

Credit Agreement with LaSalle Bank N.A.:

As of June 30, 2007, the outstanding debt balance pursuant to our Credit Agreement with LaSalle Bank N.A. was $16.5 million. We borrowed these funds in the quarter ended June 30, 2007 primarily to cover business acquisition payments. In the quarter ended June 30, 2007, we recorded interest expense of $79,000 related to our outstanding borrowings and recorded non-use fees of $12,000 related to the unused portion of the $35 million revolving credit facility. See Note 2, Short-term and Long-Term Debt in our Notes to Condensed Consolidated Financial Statements for additional information.

Accounts Receivable:

The following table sets forth information regarding our accounts receivable as of the dates indicated (dollar amounts in thousands):

	June 30, 2007	March 31, 2007	December 31, 2006
Accounts receivable	$137,373	$142,845	$ 133,239
Less allowance for doubtful accounts	(11,397)	(12,234)	(10,736)
Accounts receivable, net of allowance for doubtful accounts	$125,976	$130,611	$ 122,503
Days sales outstanding (DSO)(1)	63 days	55 days	56 days

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

Our accounts receivable, net of bad debt reserves, was $126.0 million as of June 30, 2007 compared to $122.5 million as of December 31, 2006. This increase in accounts receivable was due to lower cash collections in the quarter ended June 30, 2007. Our days sales outstanding (DSO) increased to 63 days for the quarter ended June 30, 2007 from 56 days for quarter ended March 31, 2007.

The following table sets forth the percentage breakdown of our trade accounts receivable by aging category and by major payor as of the dates indicated:

	June 30, 2007	March 31, 2007	December 31, 2006
By Aging Category (1):			
Aged 0-90 days	65%	71%	71%
Aged 91-180 days	17%	14%	14%

Aged 181-365 days	12%	10%	11%
Aged over 365 days	6%	5%	4%
Total	100%	100%	100%
By Payor Type:			
Managed care and other payors	84%	81%	81%
Medicare and Medicaid	16%	19%	19%
Total	100%	100%	100%

(1) Accounts receivable by aging category considers only accounts of our home infusion and related healthcare services, specialty infusion pharmacy services, and our specialty distribution pharmacy services lines. The shift in accounts receivable toward older aging categories was due to a number of factors, primary of which was an increased aging of our Blue Cross Blue Shield of

Florida accounts receivable due to that payers failure to timely adjudicate claims. OptionCare is working with the payer to resolve this issue.

Capital Resources:

As of June 30, 2007, we had a cash overdraft of $1.2 million, no short-term investments and a balance of $16.5 million owed under our credit facility with LaSalle Bank. As of December 31, 206, we had cash and cash equivalents of $3.2 million, short-term investments of $5.7 million and no balance under our credit facility. Our move from a net cash position to a net borrowing position during the six months ended June 30, 2007 was due to our business acquisition activities during this period.

We expect that cash flow from operations, plus available credit under our $35 million revolving Credit Agreement with LaSalle Bank, N.A. will be sufficient to meet our operating cash needs for the immediate future, including any interest due on our $86.3 million of 2.25% convertible senior notes, due 2024. However, pursuant to the Credit Agreement, LaSalle Bank National Association could accelerate the balance of all loans under the Credit Agreement if we convert more than $15 million in principal amount of our convertible senior notes. All of our convertible senior notes are currently convertible at the option of the holders. (See Note 2, Short-term and Long-term Debt in our Notes to Condensed Consolidated Financial Statements for additional information.) In the event that additional capital is required, there can be no assurance that such capital can be obtained from other sources on terms acceptable to us, if at all.

Our business strategy includes the selective acquisition of additional local pharmacy facilities and specialty pharmacy operations. Accordingly, we may require additional capital in order to complete these acquisitions. It is impossible to predict the amount of capital that may be required for acquisitions, and there is no assurance that sufficient financing for these activities will be available on terms acceptable to us, if at all. We anticipate utilizing our revolving credit facility with LaSalle Bank National Association to finance future growth initiatives.

Goodwill and Other Intangible Assets

The following table sets forth the net value of our goodwill and other intangible assets as of June 30, 2007 and December 31, 2006 (in thousands):

	June 30, 2007	**December 31, 2006**
Goodwill, net of accumulated amortization	$ 202,247	$ 165,323
Other intangible assets, net of accumulated amortization	$ 1,057	$ 1,173
Total intangible assets, net of accumulated amortization	$ 203,304	$ 166,496

Other intangible assets consist of non-compete agreements, contracts and patient records acquired through business acquisitions. For the six months ended June 30, 2007, goodwill increased $36.9 million as a result of additional consideration paid and payable related to prior year acquisitions. For the six months ended June 30, 2007, other intangible assets decreased by approximately $116,000 primarily as a result of amortization during the period.

As required by Statements of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets (SFAS No. 142)*, we do not amortize goodwill, but test our goodwill for impairment annually each October 1, or whenever we identify events or conditions that could potentially result in impairment of our goodwill. During the quarter ended June 30, 2007, no indicators of impairment of goodwill were identified.

Regulatory and other developments:

Average Wholesale Price litigation update. The case New England Carpenters Health Benefits Fund, et al. v. First DataBank, et al., (U.S. District Court, D. Mass), a civil class action case brought against First DataBank, one of several companies that report data on prescription drug prices, alleges that the company colluded with a prescription drug wholesaler to artificially raise the average wholesale prices (AWP) of various prescription drugs to increase pharmacy profits. As part of a proposed settlement in the case, First DataBank has agreed to reduce the reported AWP of over 8,000 specific pharmaceutical products by five percent. The presiding court has not approved the proposed settlement. We cannot predict the outcome or timing of any such settlement.

Health Insurance Portability and Accountability Act of 1996 (HIPAA). To improve the efficiency and effectiveness of the health care system, the Health Insurance Portability and Accountability Act (HIPAA) of 1996, Public Law 104-191, included Administrative Simplification provisions that required the Department of Health and Human Services (HHS) to adopt national standards for electronic health care transactions. At the same time, Congress recognized that advances in electronic technology could erode the privacy of health information. Consequently, Congress incorporated provisions into HIPAA that mandated the adoption of Federal privacy protections for individually identifiable health information.

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

The Privacy Rule established a foundation of Federal protections for the privacy of protected health information. The Privacy Rule does not replace federal, state, or other laws that grant individuals even greater privacy protections, and covered entities are free to retain or adopt more protective policies or practices. We have implemented the standards set forth in the Privacy Rule, and believe that we and all of our franchisees are in compliance with the Privacy Rule or any more stringent federal or state laws relating to privacy.

Additionally, the Administrative Simplification provisions address electronic health care transactions and the security of electronic health information systems. Providers are required to comply with the standards by specific compliance dates established by HHS. For standards relating to electronic health care transactions, all providers were required to comply by October 16, 2003. The security standards applicable to individually identifiable health information maintained electronically were required to be implemented by April 21, 2005. We were materially compliant with these standards by the applicable compliance date. The standards for a unique national health identifier for providers used in connection with the electronic healthcare transactions were originally required to be implemented by May 23, 2007, by when we were materially compliant with this requirement. HHS extended the deadline for full compliance to May 23, 2008, and stated that it will not impose penalties on covered entities that deploy contingency plans (in order to ensure the smooth flow of payments) if they have made reasonable and diligent efforts to become compliant.

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

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

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

We are subject to market risk primarily in relation to borrowing pursuant to our revolving Credit Agreement with LaSalle Bank, N.A. In prior periods, we have also been subject to market risk related to our cash and short-term investments. As of June 30, 2007, we had $86.3 million in fixed rate debt, primarily related to our 2.25% senior convertible notes and $16.5 million in variable-rate debt related to borrowings under our LaSalle Bank Credit Agreement. We pay interest under our Credit Agreement based on either prime or LIBOR rates and utilize a mix of LIBOR maturities based on our anticipated cash flow needs to minimize our interest expense. The following table sets forth our cash and cash equivalents, short-term investments and variable-rate debt as of June 30, 2007, March 31, 2007 and December 31, 2006 (in thousands):

	June30,	March 31,

			December 31,
	2007	2007	2006
Cash and cash equivalents, unrestricted	$	$ 7,542	$ 3,171
Cash, restricted (1)			7,554
Total cash and cash equivalents		7,542	10,725
Short-term investments (2)		9,500	5,700
Total cash and cash equivalents and short-term investments	$	$ 17,042	$ 16,425
Variable-rate debt (3)	$16,500	$	$

(1) The restricted cash was related to our issuance of 559,700 shares of stock to the sellers of Trinity Homecare, LLC, which is a business we acquired during 2006. The restriction was subsequently lifted upon our registration of the issued shares on January 31, 2007.

(2) Short-term investments consisted of commercial paper and other investments having a maturity of greater than three months at time of purchase. Short-term investments also consists of municipal variable rate demand notes, preferred stock and similar instruments with maturities greater than ten years, but which contain provisions for the periodic adjustment of interest rate to market, generally each 28 or 35 days.

(3) Variable-rate debt consisted of borrowings under our revolving Credit Agreement with LaSalle Bank, N.A.

While we attempt to minimize market risk and maximize return, changes in market conditions may significantly affect the interest expense we incur on our variable-rate debt. Based on our variable-rate debt balance at June 30, 2007, a 1% percent increase in interest rates would increase our interest expense by $165,000 on an annualized basis.

ITEM 4. Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) as of June 30, 2007. Based upon that evaluation, the chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective as of June 30, 2007 to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, and (ii) is accumulated and communicated to management, including our chief executive officer and chief financial officer, to allow timely decisions regarding required disclosure.

In addition, no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) occurred during our fiscal quarter ended June 30, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

We are subject to claims and legal actions that may arise in the ordinary course of business. However, we maintain insurance to protect against such claims or legal actions. We are not aware of any litigation, either pending or filed, that we believe is likely to have a material adverse effect on our results of operation or financial condition.

We currently maintain insurance for general and professional liability claims in the amount of $1 million per claim and $3 million in aggregate per policy year, plus $10 million in umbrella coverage. Accordingly, the maximum coverage for a first claim in any policy year is $6 million, and the maximum aggregate coverage for all claims in a policy year is $8 million. We also require each franchisee to maintain general liability and professional liability insurance covering both the franchisee and us, at coverage levels that we believe to be sufficient. These policies provide coverage on a claims-made or occurrence basis and have certain exclusions from coverage. These insurance policies generally must be renewed annually. There can be no assurance that our insurance coverage will be adequate to cover liability claims that may be asserted against us.

ITEM 1A. Risk Factors

Our Annual Report on Form 10-K for the year ended December 31, 2006 includes a detailed discussion of certain risk factors in Part I, Item 1A. The risk factors in our Annual Report on Form 10-K for the year ended December 31, 2006 are not the only risks and uncertainties that we face or that could develop. Other risks and uncertainties that we have not predicted or evaluated could also adversely affect our company. If any of these risks and uncertainties actually occurs, our business, financial condition, operating results or liquidity could be materially and adversely affected.

In addition to the risk factors in our Annual Report on Form 10-K for the year ended December 31, 2006, following are additional risk factors that were identified during the current period.

The entry into the Merger Agreement, the Offer and the anticipated Merger may be disruptive to our business.

The public announcement of the entrance into the Merger Agreement with Walgreens and Acquisition Sub, as described above under Part I. Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations Overview, may adversely affect our ability to attract new customers, may cause our current customers to make purchases from our competitors, or may result in confusion and uncertainty for our customers, potential customers, suppliers and other business partners. Any of these actions may cause these companies to change or terminate their business relationship with us. Any of these actions could potentially adversely affect our financial condition and results of operations.

In addition, our key employees may seek other employment opportunities as a result of the proposed transactions. Further, we may not be able to attract and retain key management, sales, marketing, professional, financial and other personnel in the event that key employees leave as a result of these actions. If we are unable to retain or attract qualified personnel, there could be a material adverse effect on our business and results of operations.

If our planned acquisition by Walgreens is not completed, our business, operating results and stock price may be adversely affected.

If the Offer and the Merger are not completed, we could suffer a number of consequences that could adversely affect our business, operating results and stock price, including the following:

the market price of our common stock could be materially adversely affected following an announcement that the Offer and the Merger have been abandoned;

we could, under certain circumstances, be required to pay Walgreens a termination fee of $25.8 million and/or reimbursement of its expenses, up to a maximum of $5 million, however any amount received by Walgreens as expense reimbursement will reduce the amount of the termination fee, if subsequently payable;

we could, under certain circumstances, remain liable for all of our costs related to the transaction, such as legal, accounting and certain investment banking fees, and we expect these costs to be significant; and

activities relating to the Offer and the Merger may divert our management s attention from our business and cause disruptions among our employees and our relationships with customers and business partners, thus detracting from our

ability to grow revenue and minimize costs and possibly leading to a loss of revenue and market position that we may not be able to regain if the transaction does not occur.

The transactions contemplated under the Merger Agreement result in certain required notices and application filings with and approvals by various governmental agencies which may affect our licenses, permits and other authorizations to operate.

Where new licenses are required in connection with the transactions contemplated under the Merger Agreement and we cannot continue to operate under our existing licenses until the new licenses are issued, continuing to operate under our existing licenses could subject us to monetary sanctions or suspension from, or revocation of our licenses by, the applicable governmental agency and may result in nonpayment or recoupment by private and governmental payors. Furthermore, if we are required to close locations until new licenses are issued, in loss of revenue will result and may render it difficult to reestablish patient, provider and employee relationships upon re-opening.

The transactions contemplated under the Merger Agreement may result in required notice and application filings with and approvals by various governmental payors, which may result in delay in recognition or loss of revenues from such governmental payors.

We participate in and receive reimbursement from various governmental payor programs (e.g., State Medicaid programs). In the event that the transactions contemplated under the Merger Agreement result in a governmental payor requiring us to submit an application for a new billing number and deactivating our existing billing number, we will only be entitled to bill such governmental payor to the extent that a billing number is active for the date a particular service is rendered. If the governmental payor deactivates the existing billing number and activates the new billing number effective as of the same date, we may have a delay in recognizing revenues to the extent that the delay in issuance of the new billing number causes us to hold bills we otherwise would have submitted in the normal course. Alternatively, in the event that there is a lag between the time that the existing billing number is deactivated and the new billing number is activated, we will not be able to bill such governmental program for services rendered during such time.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Submission of Matters to a Vote of Securities Holders

We held our annual meeting of our stockholders on May 4, 2007. At that meeting, our stockholders were asked to consider and vote upon the following matters.

1. Election of one member to the Board of Directors to hold office for a three-year term or until a successor is duly elected and qualified. The nominee, who was listed in our proxy statement, was elected for a three-year term, with the results of voting as follows:

	VOTES FOR	**VOTES WITHHELD**
Jerome F. Sheldon	25,255,440	2,448,204

There were no broker non-votes.

2. Approve the adoption of the Option Care, Inc. 2007 Incentive Plan, replacing the expiring Amended and Restated Stock Incentive Plan (1997). The proxy voting results were as follows:

VOTES FOR	**VOTES AGAINST**	**ABSTAIN**	**BROKER NON-VOTES**
14,473,474	10,163,958	14,265	3,051,947

3. Ratification of the appointment of Ernst & Young LLP as our independent auditors for the fiscal year 2007. The proxy voting results were as follows:

VOTES FOR	VOTES AGAINST	ABSTAIN
27,529,579	162,883	11,181

ITEM 5. Other Information

None.

ITEM 6. Exhibits

See Exhibit Index.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

OPTION CARE, INC.

Date: August 9, 2007

By: /s/ Paul Mastrapa
Senior Vice President and Chief Financial Officer
(Principal Accounting Officer and Principal
Financial Officer)

EXHIBIT INDEX

Exhibit Number	
2.1	Agreement and Plan of Merger, dated as of July 2, 2007, among Option Care, Inc., Walgreen Co. and Bison Acquisition Sub Inc. Filed as Exhibit 2.1 to our Current Report on Form 8-K filed July 3, 2007 and incorporated by reference herein.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Senior Vice President and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of Chief Executive Officer and Senior Vice President and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, and Rule 13a-14(b) of the Exchange Act.