

Priority Healthcare Corporation (Nasdaq: PHCC) is a premier healthcare services company providing innovative, high quality and cost-effective solutions that enhance quality of life. As a national specialty pharmacy and distributor, Priority Healthcare provides biopharmaceuticals, complex therapies, related disease treatment programs and a portfolio of other service offerings for patients, payors, physicians and pharmaceutical manufacturers.

- "carepaths" disease management programs
- performance and satisfaction monitoring
- pharmacy development and management
- program analytics and reporting
- quality and compliance programs
- sales and marketing support

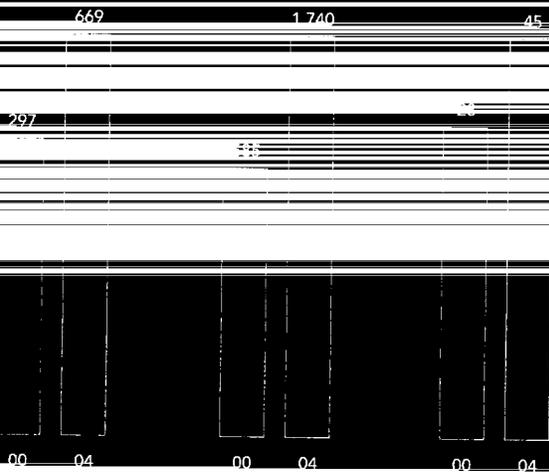
- private launch strategy
- reimbursement consulting and support
- patient assistance and foundation programs
- alliance and hub management
- coordinated specialty pharmacy and distribution
- pharmacy logistics

- express home delivery
- educational materials and individualized instruction
- 24/7 access to pharmacists and nurses
- insurance counseling and assistance
- coordination of care with physician
- patient reminders

- convenient online, fax or phone ordering
- custom dosing and packaging solutions
- continuing education programs
- specialty products for express delivery
- patient counseling and care coordination
- reimbursement assistance

- Infectious Disease
- Nephrology
- Dermatology
- Respiratory
- Primary Care
- Ambulatory Surgery
- Urology

is everywhere



- 02 Chairman's Letter
- 04 The Opportunity to Innovate
- 05 The Opportunity to Connect
- 08 The Opportunity to Grow
- 10 The Opportunity to Partner
- 13 2004 Financial Review

Everywhere we look, we see opportunity. A burgeoning biopharmaceutical pipeline. An increasing focus on clinical excellence and support. A growing demand for high-touch and high-tech healthcare solutions. Ours is an evolving marketplace where infrastructure, experience and innovation are keys to success. The opportunities are endless. And no company is in a better position to leverage all of these opportunities than Priority Healthcare.

TO OUR SHAREHOLDERS, ASSOCIATES, CUSTOMERS AND FRIENDS:

In our letter to you last year, we outlined several important objectives for 2004. These goals included the development of new growth platforms, the diversification of our product portfolio, the expansion of our services for manufacturers and payors and a renewed investment in our infrastructure. We're pleased to report that we delivered against these objectives, and, in doing so, positioned our company for sustained, scalable growth in the years ahead.

In building for the future, we also faced many challenges to our business, some of which slowed our progress toward earnings goals. In August and September, three devastating hurricanes targeted Central Florida in rapid succession, damaging our headquarters, disrupting our normal sales activities and causing personal hardships for many of our associates.

The negative impact of Medicare reimbursement changes also hurt our business, as did sluggish growth in several key pharmacy markets and continued margin compression by health plans.

SALES SUCCESS Yet in spite of these and other challenges, we met all of our major strategic objectives for the year, and achieved record sales results. Recapping our performance in several key areas:

- Net sales increased 19% to \$1.74 billion
- Net earnings were \$44.6 million and earnings per share were \$1.01
- Total assets were \$669 million
- DSOs were low at 40 days and we turned inventory 15 times

As in years past, our revenues in 2004 represented a blend of organic growth in our existing business, new business from several product launches and a series of strategic acquisitions and new ventures. We will continue to pursue this balanced growth strategy in 2005 — leveraging and solidifying our core pharmacy and distribution business, while increasing our emphasis on innovative new service and management offerings.

NEW PRODUCT GROWTH The biotech pipeline remains strong, as evidenced by the launch of several new specialty products that added to our business in 2004. In April, Priority

Healthcare was selected as a preferred specialty pharmacy and distributor for Apokyn, an important new therapy for advanced Parkinson's disease.

Ophthalmology, a relatively new category for Priority Healthcare, was an area of tremendous growth in 2004. We are a preferred distributor for both major specialty products targeting age-related macular degeneration: Visudyne from Novartis and Macugen from Pfizer and Eyetech, which was approved by the FDA at the end of 2004. Vitrase, a newly-approved product for eye surgery, will also be available from Priority Healthcare in 2005, adding to our strength in the category. Our near-term goal is to be the market leader in ophthalmic distribution.

Our performance in other disease states was mixed. Earnings were solid in several key categories including our pulmonary, neurology, oncology, rheumatology and respiratory segments as well as in hemophilia. Revenue growth in our infertility and hepatitis franchises was modest to flat, consistent with overall industry trends. Vaccine sales, a small but perennial revenue source, were severely impacted by the well-publicized U.S. flu vaccine shortage.

FULFILLMENT TO MANAGEMENT Priority Healthcare invested significantly in new service opportunities and strategic acquisitions in 2004. These investments are driving an important evolution in our business model from biopharmaceutical fulfillment to biopharmaceutical management. While our role as a distributor of specialty products is critical to our core business, we see continued growth in the development of consultative, technological and clinical care services for the biopharmaceutical marketplace.

Several of these services have come together under one roof with the launch of the Aetna Specialty Pharmacy. As announced in 2004, this pioneering joint venture will serve as the exclusive, preferred specialty pharmacy for all Aetna health plans and their 14 million members.

The benefits of this venture are significant for both partners. Priority Healthcare will gain new revenues associated with thousands of new patients, including many who are already transitioning into the Aetna Specialty Pharmacy starting in



March 2005. Aetna, in turn, will leverage our state-of-the-art pharmacy and IT infrastructure along with our Caringpaths™ clinical management programs to enhance patient care and more effectively manage their estimated \$1 billion in specialty pharmacy spending.

A GROWING PORTFOLIO Our portfolio of services for pharmaceutical manufacturers increased in 2004 with the acquisition of HealthBridge Reimbursement and Product Support, Inc. of Braintree, MA, a leading provider of reimbursement services and product launch support for biotech companies. Our improved capabilities in this area have already led to new revenue opportunities with our existing manufacturer partners, as well as new manufacturer relationships. For example, we were selected by Abbott in early 2005 to administer a Patient Assistance Program for Humira, an injectable therapy for rheumatoid arthritis.

A biotech pipeline brimming with infused therapies is behind our acquisition of Integrity Healthcare Services of Louisville, KY. With Integrity, we are building new infusion capabilities nationwide and adding a home nursing component valued by patients and payors alike. Other new ventures range from practice management services for community oncologists through our Matrix Oncology subsidiary to customized product packaging and distribution through Custom Medical Products, Inc., another 2004 acquisition. These and other innovative new programs mean new sources of revenue, but equally important, they represent building blocks for our future.

A BRIGHT OUTLOOK Looking ahead into 2005 and beyond, our focus is on the continued execution of our plan

to build the premier healthcare services company in the biopharmaceutical and chronic disease segment. To that end, we will actively pursue new business opportunities and acquisitions, honing in on the ones that diversify and strengthen our service capabilities and deliver added value for our customers.

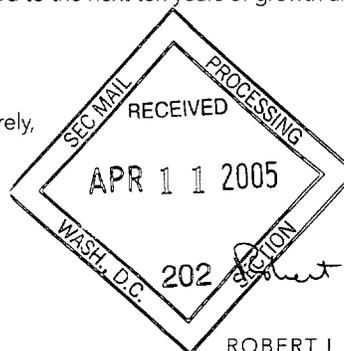
New payor partnerships, like that with Aetna, are also on the horizon, as are government opportunities. Priority Healthcare will be an active bidder in the Medicare Part B competitive acquisition program, and we believe we are well-positioned to garner our share of the significant new Medicare opportunity.

Operationally, our focus is on scalability. We're committed to investment in our infrastructure, including the ongoing development of our COMPASS system, which will bring all of our business units onto a consolidated IT platform. In light of our rapid growth, this initiative — now more than ever — is a vital component of our future success.

NEW OPPORTUNITIES In 2004, we marked our ten-year anniversary as a company. Now, as we head into our second decade, the future has never looked brighter. As you will see in the pages ahead, new opportunities abound in our industry. The management team and associates at Priority Healthcare are committed to capitalizing on those opportunities for the betterment of our shareholders and our customers.

We appreciate your continued support, and we look forward to the next ten years of growth and innovation.

Sincerely,



WILLIAM E. BINDLEY
Chairman of the Board

STEVEN D. COSLER
President and Chief Executive Officer

ROBERT L. MYERS
Vice Chairman

THE OPPORTUNITY TO

Innovate

Matrix Oncology, a Priority Healthcare company, brings practice management services and group purchasing opportunities to many of the nation's top oncologists. More than just a conduit for the steady flow of new cancer treatments, we help physicians to better manage the dynamics of a changing marketplace — enabling them to provide better patient care.

BEYOND POINT B Some view specialty pharmacy and distribution as little more than getting the right drug to the right place — moving products from Point A to Point B. At Priority Healthcare, we take a broader view. Beyond therapy delivery, our focus is on an ever-increasing portfolio of value-added services that help build long-term relationships with our customers.

For physicians, these services run the gamut from clinical support offerings, like continuing education programs or in-home patient counseling, to time-saving practice management tools, such as ePrescribing or insurance preauthorizations to verify a patient's benefits.

A VALUE-ADDED CONSULTANT Ours is a consultative approach — based on more than a decade of specialty experience. Priority Healthcare's depth of channel knowledge is invaluable in markets like oncology where physicians seek context to better understand new reimbursement realities and the increasing number of therapeutic options for cancer care.

That's why we formed Matrix Oncology, a physician-services organization. Through a blend of consultative and analytic services, we're helping community oncologists practice better and more cost-effective medicine. We also aggregate the collective buying power of Matrix physicians through an innovative group purchasing organization. It's another way we're delivering value, in addition to products, to our customers.



48%

48% of all biopharmaceuticals
in development are cancer treatments

"Priority Healthcare understands the needs of physicians.
Their practice management and therapy solutions help us deliver better care."

DR. MARTIN NICOLAU
Oncologist, Florida Cancer Specialists

THE OPPORTUNITY TO

Connect

At the center of our service model you'll find the most important component: the patient. It's why we're building new clinical capabilities and facilities with an eye toward enhancing our patient care outreach. As an example, our acquisition of Integrity Healthcare Services gives us broad new reach in infusion care — connecting our nurses to patients in their homes to deliver important new therapies and support.

CONTINUING TO EXPAND Although our patients may have complex, chronic conditions that require expensive treatment, their needs are often basic ones. They may have a question about their insurance. They may want to talk to a nurse late at night. Or they may simply need a reminder that *it's time for a refill*. At Priority Healthcare, we meet those needs with a dedicated team of care coordinators, pharmacists and nurses who understand the value of individualized care.

Integrity Healthcare expands our patient care capabilities in the growing specialty infusion marketplace. With 26 branches in 19 states, Integrity enlarges our geographic footprint and more than doubles our team of registered nurses. The continued development of high-touch clinical services is an integral part of our growth strategy.

DELIVERING HEALTHY RESULTS Measuring the success of our patient care model is an important discipline at Priority Healthcare. The proof is in the outcomes — and we're pleased with our results across a wide range of disease categories. To cite one example, our Hepatitis C adherence rates over the past three years are over 96 percent. That compares to an estimated 50 percent rate nationally.

In simple terms, we're providing the support and services that help patients remain on their therapies. As a result, their lives are healthier and happier — arguably, the truest measure of our success.



133M

33 million Americans live with
one or more chronic diseases

"The nurses and staff at Priority Healthcare are like part of my family.
They are always there when we need them."

FRANCIA RINCON-SANTANA

Pictured with son, Dennis, a Priority Healthcare hemophilia patient

THE OPPORTUNITY TO

Grow

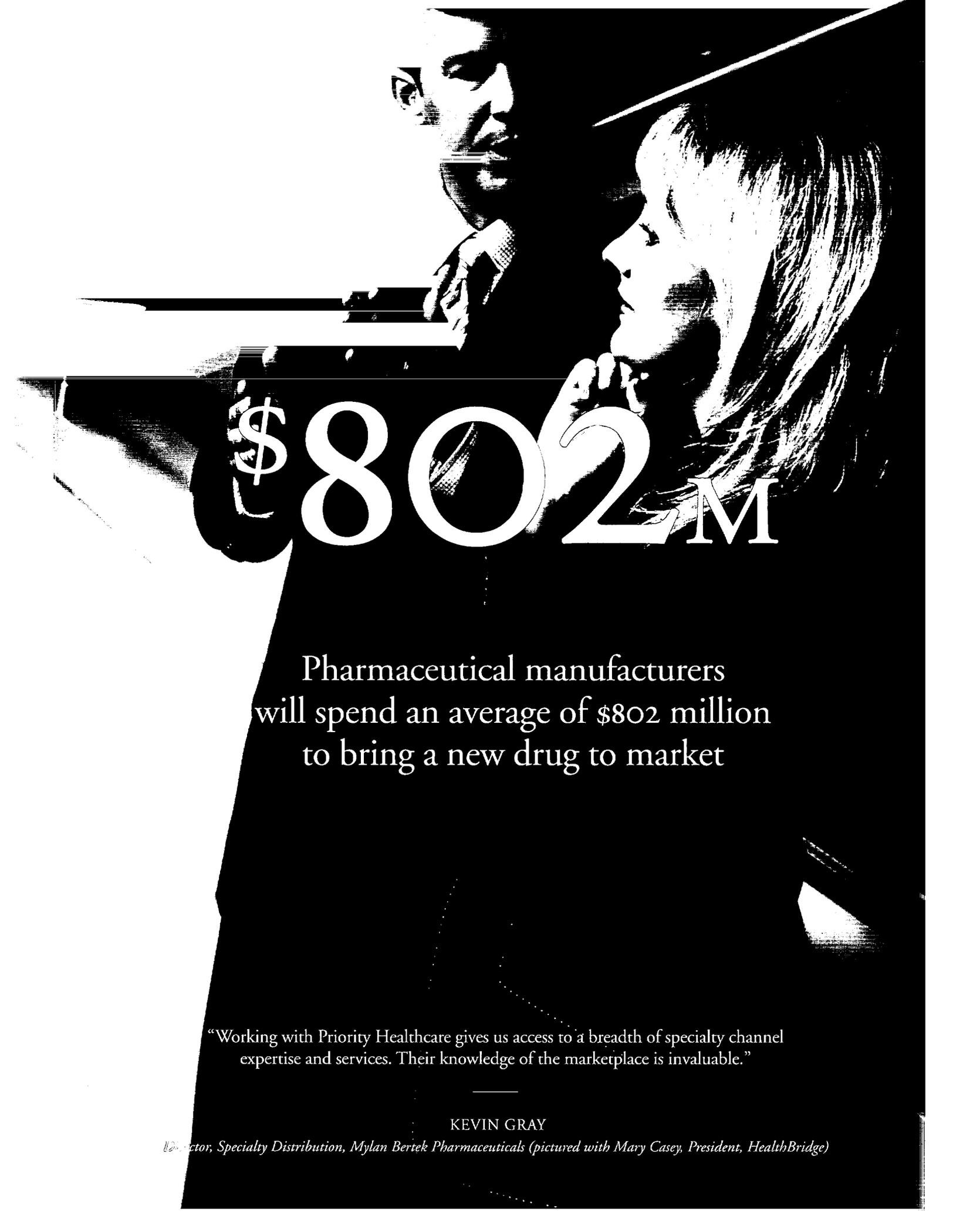
Offering comprehensive specialty solutions for pharmaceutical manufacturers is a critical driver of our growth. In 2004, for instance, Mylan Bertek selected Priority Healthcare and our HealthBridge subsidiary to provide specialty pharmacy care, distribution services and patient assistance support for Apokyn™ (apomorphine hydrochloride injection), the first FDA-approved acute therapy for off episodes in advanced Parkinson's disease.

MULTIPLE WAYS TO EXPAND Put simply, new products mean new revenue opportunities. In 2004, FDA approval of therapies such as Apokyn expanded opportunities to build our neurology business. We also entered important new specialty segments such as ophthalmology, where a growing number of therapeutic options are available for Age-Related Macular Degeneration.

A BETTER LAUNCH PAD Long before new therapies come to market, Priority Healthcare is at work. Pharmaceutical manufacturers increasingly turn to us in pre-launch mode to drive post-launch success. To that end, our acquisition of HealthBridge Reimbursement and Product Support, Inc. greatly enhances our overall service capabilities.

Combined with HealthBridge, we offer manufacturers a full continuum of consulting and support services that range from early-stage clinical trial support to product launch sales and marketing assistance to reimbursement programs that remove financial barriers to patient access.

HELPING CUSTOMERS FIND THEIR WAY Priority Healthcare's proprietary, Oracle-based enterprise management system — COMPASS — is providing pharmaceutical manufacturers with valuable business intelligence that they can't get on their own. The results are improved sales and marketing analytics, along with greater insight into their customers and markets.



\$802M

Pharmaceutical manufacturers
will spend an average of \$802 million
to bring a new drug to market

“Working with Priority Healthcare gives us access to a breadth of specialty channel expertise and services. Their knowledge of the marketplace is invaluable.”

KEVIN GRAY

Director, Specialty Distribution, Mylan Bertek Pharmaceuticals (pictured with Mary Casey, President, HealthBridge)

THE OPPORTUNITY TO

Partner

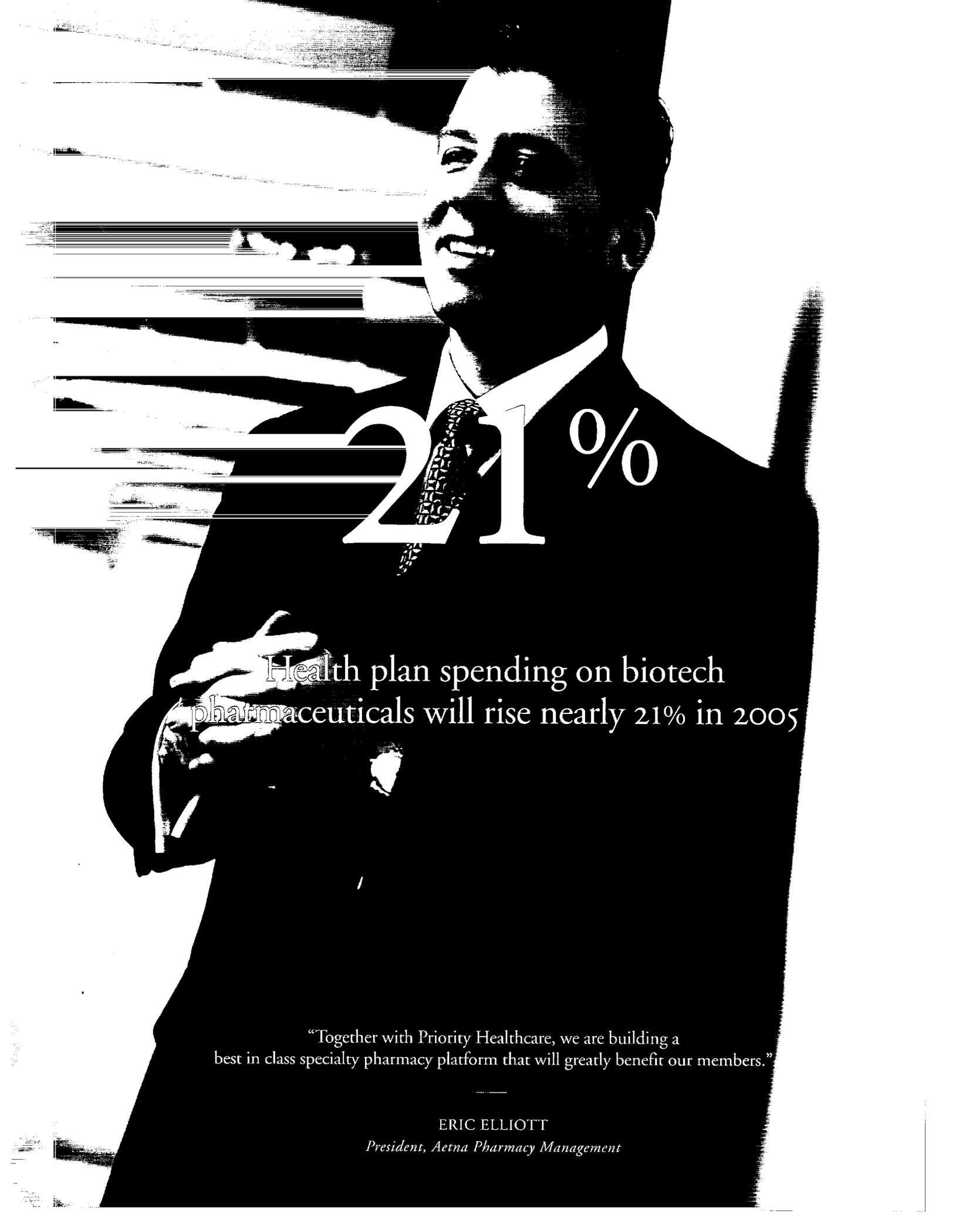
Our pioneering joint venture with Aetna creates a new paradigm for specialty pharmacy collaboration with payors. The 2005 launch of the Aetna Specialty Pharmacy will provide Aetna members with unprecedented access to specialized therapy support services. Cost management and improved clinical outcomes are key measures of success. As are happier patients.

BIG OR SMALL Whether you're a national health plan the size of Aetna or one of the hundreds of small, self-insured employers that dot the country, you share a common goal: to constrain the growth of pharmaceutical costs. Biopharmaceuticals, for many payors, represent the fastest growing segment of those costs.

At Priority Healthcare, we understand the challenges that health plans face in managing their specialty pharmacy spending. We work with health plans large and small to craft unique solutions tailored to each payor's individualized clinical and financial goals. Our depth of experience is one reason we're a preferred specialty pharmacy vendor as chosen by the Blue Cross and Blue Shield Association of America.

HELPING PATIENTS STAY ON TRACK Cost management doesn't have to equate to reduced care. Indeed, Priority Healthcare's approach encourages appropriate utilization of our expert clinical services as a means to improve therapy compliance. Our Caringpaths™ disease management programs keep patients focused on their treatment regimens, avoiding costly outcomes often associated with non-compliance, like unnecessary hospitalizations.

Our therapy management programs are the centerpiece of the Aetna Specialty Pharmacy. Working with Aetna, we'll measure longitudinal patient outcomes, which will help us improve the care we offer to all of our patients. We'll also measure patient satisfaction — an area where we already get high marks. A 2004 independent survey of patients of ten specialty pharmacies ranked Priority Healthcare well above the industry average in key performance measures such as product delivery, nursing support and overall satisfaction.



21%

Health plan spending on biotech
pharmaceuticals will rise nearly 21% in 2005

“Together with Priority Healthcare, we are building a
best in class specialty pharmacy platform that will greatly benefit our members.”

ERIC ELLIOTT

President, Aetna Pharmacy Management

If you take away one thought from this annual report, let it be this: The world of Priority Healthcare is one filled with many opportunities. New biotech drugs, new innovations, new partners and new acquisitions. We are uniquely positioned to take advantage of them all.

2004 Financial Review

CONTENTS

- 14 Management's Discussion and Analysis of Financial Condition and Results of Operations
- 20 Management's Responsibility for Financial Reporting, Disclosure Controls and Procedures and Internal Control Over Financial Reporting
- 21 Report of Independent Registered Certified Public Accounting Firm
- 22 Consolidated Statements of Earnings
- 23 Consolidated Balance Sheets
- 24 Consolidated Statements of Cash Flows
- 25 Consolidated Statements of Shareholders' Equity
- 26 Notes to Consolidated Financial Statements
- 39 Financial Statement Schedule II – Valuation and Qualifying Accounts and Reserves
- 40 Five Years in Review
- 41 Corporate Information
- 41 Board of Directors
- 41 Senior Management

Management's Discussion and Analysis of Financial Condition and Results of Operations

This discussion and analysis should be read in conjunction with our Consolidated Financial Statements and related notes included elsewhere in this Annual Report.

OVERVIEW Priority Healthcare Corporation ("Priority," the "Company," "we" or "us") was formed in June 1994 to succeed to the business operations of companies previously acquired by Bindley Western Industries, Inc. ("BWI"). From our formation through our initial public offering, or IPO, on October 24, 1997, we operated as a wholly owned subsidiary of BWI, and procured a number of services from, and engaged in a number of financial and other transactions with, BWI. After the IPO, we continued to be controlled by BWI, but operated on a stand-alone basis. On December 31, 1998, BWI distributed to the holders of BWI common stock on December 15, 1998 all of the shares of our Class A Common Stock owned by BWI, making Priority Healthcare Corporation a stand-alone public company.

Priority is a national specialty pharmacy and distributor that provides biopharmaceuticals, complex therapies and related disease treatment programs and services to individuals with chronic diseases. Priority fills individual patient prescriptions, primarily for self-administered biopharmaceuticals. These patient-specific prescriptions are filled at 32 licensed pharmacies in 17 states and are primarily shipped directly to the patient overnight in specialized packages. We also provide disease treatment programs for hepatitis, cancer, infertility, hemophilia, human growth hormone deficiency, rheumatoid arthritis, Crohn's disease, infertility, pulmonary hypertension, pain management, multiple sclerosis, sinusitis, age-related macular degeneration, idiopathic pulmonary fibrosis, immune deficiencies, psoriasis, cystic fibrosis, and others.

We also sell over 5,000 SKUs of specialty pharmaceuticals and medical supplies to office-based physicians in oncology and other specialty markets and to outpatient renal care centers. Priority offers value-added services to meet the specific needs of these markets by shipping refrigerated pharmaceuticals overnight in special packaging to maintain appropriate temperatures, offering automated order entry services and offering customized distribution for group accounts. From distribution centers in Sparks, Nevada and Grove City, Ohio, we service over 7,000 customers in all 50 states, including office-based oncologists, renal dialysis clinics, ambulatory surgery centers and primary care physicians.

Our objective is to continue to grow rapidly and enhance our market position as a leading healthcare company by capitalizing on our business strengths and pursuing the following strategy: (i) continue to focus on further penetrating the core specialty distribution and pharmacy market; (ii) develop new manufacturer relationships that provide access

to new products and services; (iii) continue to develop group purchasing organization and payor networks; (iv) enter new specialty markets; and (v) pursue acquisitions to complement existing product offerings and further penetrate markets.

Over the past three years, we have continued to grow as we have executed on our growth strategy. Due to the nature of healthcare and the pharmaceutical industry, there is constant pressure on profit margins. Competition has resulted in some margin reduction on our products. However, as we have done in the past, we expect to be able to partially offset this impact through the continuing benefits of scale, as well as cost containment measures.

CRITICAL ACCOUNTING POLICIES The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in our financial statements and accompanying notes. Actual results could differ materially from those estimates. For a summary of all of our accounting policies, including the accounting policies discussed below, see Note 1 of the Consolidated Financial Statements included in this report. The items in our financial statements that we believe are the most dependent on the applications of significant estimates and judgments are as follows:

Revenue Recognition – Revenues are recognized at the point of shipment for those sales when the risk of loss passes at the point of shipment and upon receipt for those sales when the risk of loss passes at the point of receipt as products are shipped to unaffiliated customers with appropriate provisions recorded for estimated discounts and contractual allowances. Discounts and contractual allowances are estimated based on historical collections over a recent period for the sales that are recorded at gross charges. The percentage is applied to the applicable accounts receivable balance that contains gross charges for each period. Any differences between our estimates and actual collections are reflected in operations in the year payment is received. Differences may result in the amount and timing of our revenues for any period if actual performance varies from our estimates. Allowances for returns are estimated based on historical return trends. Financing charge revenues are recognized when received.

Receivables – Receivables are presented net of the allowance for doubtful accounts and contractual allowances. Receivables include trade and patient account receivables. We regularly review and analyze the adequacy of these allowances after considering the age of each outstanding

receivable and the collection history. The allowance for doubtful accounts and contractual allowances are based on these analyses. Although doubtful accounts and contractual allowances have historically been within expectations and allowances established, there is no guarantee that we will continue to experience the same credit loss rates that we have in the past. See "Financial Statement Schedule II – Valuation and Qualifying Accounts and Reserves."

Intangibles – Effective on December 30, 2001, we adopted Statement of Financial Accounting Standard ("SFAS") No. 142, Goodwill and Other Intangible Assets, which superseded APB Opinion No. 17, Intangible Assets. This statement addresses the accounting and reporting of goodwill and other intangible assets subsequent to their acquisition. In accordance with the adoption of SFAS No. 142, we ceased amortization of goodwill effective December 30, 2001.

Goodwill and indefinite-lived intangibles are tested for impairment annually or more frequently if impairment indicators arise in accordance with SFAS No. 142. These evaluations require the use of judgment as to the effects of external factors and market conditions on our operations, and they require the use of estimates in projecting future operating results. If actual external conditions or future operating results differ from our judgments, impairment charges may be necessary to reduce the carrying value of the subject assets.

Pursuant to SFAS No. 142, we perform an annual goodwill impairment review, as defined in Note 6, "Intangibles" to the Consolidated Financial Statements included in this report, or when events or changes in circumstances indicate the carrying value may not be recoverable. In assessing the recoverability of our goodwill and intangibles, we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. The fair value of an asset could vary, depending upon the estimating method employed, as well as assumptions made. This may result in a possible impairment of the intangible assets and/or goodwill, or alternatively an acceleration in amortization expense. An impairment charge would reduce operating income in the period it was determined that the charge was needed. As a result of the January 1, 2005 impairment testing, no impairment adjustments were deemed necessary.

Variable Interest Entities – In January 2003, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 46 ("FIN 46") (revised December 2003), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51, which expands upon and strengthens existing accounting guidance concerning when a company should include in its financial statements the assets, liabilities and activities of

another entity. A Variable Interest Entity ("VIE") does not share economic risk and rewards through typical equity ownership arrangements; instead, contractual or other relationships re-distribute economic risks and rewards among equity holders and other parties. Once an entity is determined to be a VIE, the party with the controlling financial interest, the primary beneficiary, is required to consolidate it. FIN 46 also requires disclosures about VIEs that a company is not required to consolidate but in which it has a significant variable interest. We have applied the consolidation or disclosure requirements of this interpretation. We have determined that our joint venture, Aetna Specialty Pharmacy, LLC, should be consolidated under the provisions of FIN 46. Since its inception in August 2004, the results of operations of the joint venture have not been material.

Income Taxes – We recognize deferred tax liabilities and assets for the expected future tax consequences of events that have been included in our financial statements or tax returns. Deferred tax liabilities and assets are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. We estimate the degree to which tax assets and loss carryforwards will result in a benefit based on expected profitability by tax jurisdiction.

RESULTS OF OPERATIONS

2004 Compared to 2003

Net Sales. Net sales increased to \$1.74 billion in 2004 from \$1.46 billion in 2003, an increase of 19%. The growth primarily reflected the addition of new customers, new product introductions and additional sales to existing customers, which in total represented an increase of approximately 13%, the acquisitions of HealthBridge and Integrity, which represented an increase of approximately 2% and inflationary price increases which represented an increase of approximately 4%. Note that fiscal 2003 had one extra week of operations.

Gross Profit. Gross profit increased to \$192.9 million in 2004 from \$161.9 million in 2003, an increase of 19%. The increase in gross profit reflected increased sales. Gross profit as a percentage of net sales stayed the same at 11.1% in 2004 and 2003. The reason gross profit as a percentage of net sales stayed the same in 2004 compared to 2003 is because the increase from selling higher margin HealthBridge services and Integrity products was netted with the contraction on gross profit related to oncology distribution products and the change in sales mix, as lower margin products experienced increased sales. Competition continues to exert pressure on margins.

Selling, General and Administrative Expense. Selling, general and administrative, or SGA, expense increased to \$108.2 million in 2004 from \$77.9 million in 2003, an increase of 39%. SGA expense as a percentage of net sales increased to 6.2% in 2004 from 5.3% in 2003. The increase in SGA expense reflected the growth in our business, costs related to new business relationships with drug manufacturers, increased costs attributable to providing more clinically oriented services, costs related to our Sarbanes-Oxley Section 404 internal control project, incremental costs of running multiple information systems as we prepare to bring the remaining modules of our new enterprise wide information technology system live, a charge for the write off of certain receivables, and premium increases for health, property and liability insurance, which in total represented approximately \$8.7 million of the increase. \$21.6 million of the increase related to acquisitions and new joint ventures. The increase in SGA expense as a percentage of net sales resulted from costs related to new business relationships with drug manufacturers, increased costs attributable to providing more clinically oriented services, costs related to our Sarbanes-Oxley Section 404 internal control project, incremental costs of running multiple information systems as we prepare to bring the remaining modules of our new enterprise wide information technology system live, a charge for the write off of certain receivables, premium increases for health, property and liability insurance, and costs related to acquisitions and new joint ventures. Management continually monitors SGA expense and remains focused on controlling these increases through improved technology and efficient asset management.

Restructuring Charge. The restructuring charge of \$1.3 million in 2004 related to facility consolidation and certain employee and lease termination costs. We consolidated our Carpinteria, CA location into our Monrovia, CA location and eliminated certain employee positions, which included some at the Lake Mary, FL location.

Depreciation and Amortization. Depreciation and amortization, or D&A, increased to \$6.6 million in 2004 from \$4.3 million in 2003, an increase of 54%. The increase in D&A was primarily the result of depreciation on newly acquired computer hardware and software, furniture and equipment, transportation equipment, telephone equipment and leasehold improvements and amortization of intangible assets related to the acquisitions of HealthBridge and Integrity.

Third Party Payor Settlement. Third party payor settlement was \$4.4 million in 2004. The amount is related to resolving a dispute with a third party payor who claimed we were not in compliance with certain provisions of their payor contract.

Interest Expense. Interest expense was \$1.1 million in 2004. In 2004 we paid an average rate of 2.55%, plus amortization of the line of credit origination costs, on an average line of credit balance of \$23.1 million. In 2004 the interest expense was primarily related to our line of credit.

Interest Income. Interest income decreased to \$707,000 in 2004 from \$1.3 million in 2003, a decrease of 46%. In 2004, we earned an average of 1.14% on an average invested balance of \$62.4 million. In 2003, we earned an average of 1.78% on an average invested balance of \$73.2 million. The decrease in interest income was due to the lower average invested balances and lower interest rates earned. In 2004 and 2003, the interest income was primarily related to investing cash and funds received from operations in overnight repurchase agreements with major financial institutions and in marketable securities.

Income Taxes. The provision for income taxes in 2004 and 2003 represented 37.9% and 37.5%, respectively, of earnings before income taxes.

2003 Compared to 2002

Net Sales. Net sales increased to \$1.46 billion in 2003 from \$1.20 billion in 2002, an increase of 22%. The growth primarily reflected the addition of new customers, new product introductions, additional sales to existing customers, which in total represented an increase of approximately 15%, the acquisitions of HOSS effective March 11, 2002 and Sinus effective September 11, 2003, which represented an increase of approximately 1%, inflationary price increases, which represented an increase of approximately 4%, and the extra week of operations in fiscal 2003 which represented an increase of approximately 2%.

Gross Profit. Gross profit increased to \$161.9 million in 2003 from \$137.2 million in 2002, an increase of 18%. The increase in gross profit reflected increased sales and the acquisitions of Hemophilia of the Sunshine State ("HOSS") and SinusPharmacy Corporation ("Sinus"). Gross profit as a percentage of net sales decreased to 11.1% in 2003 from 11.4% in 2002. This decrease was primarily attributed to contraction on gross profit related to oncology distribution products, infertility sales and margins being negatively impacted by a change in the spread between Average Wholesale Price (AWP) and Wholesale Acquisition Cost (WAC), as published

by First Databank, during part of the year, and the change in sales mix, as lower margin products experienced increased sales. Competition continues to exert pressure on margins.

Selling, General and Administrative Expense. Selling, general and administrative, or SGA, expense increased to \$77.9 million in 2003 from \$65.0 million in 2002, an increase of 20%. SGA expense as a percentage of net sales decreased to 5.3% in 2003 from 5.4% in 2002. The increase in SGA expense reflected the growth in our business, costs related to new business relationships with drug manufacturers, significant premium increases for property and liability insurance, increased costs attributable to providing more clinically oriented services and the acquisitions of HOSS and Sinus. The decrease in SGA expense as a percentage of net sales resulted from spreading fixed costs over a larger sales base in 2003. Management continually monitors SGA expense and remains focused on controlling these increases through improved technology and efficient asset management.

Impairment of Fixed Asset. The impairment of fixed asset charge of \$2.4 million in 2002 resulted from writing off computer hardware and application software for a project that began in 2000 and was discontinued in 2002.

Depreciation and Amortization. Depreciation and amortization, or D&A, increased to \$4.3 million in 2003 from \$2.8 million in 2002, an increase of 55%. The increase in D&A was primarily the result of depreciation on newly acquired computer hardware and software, furniture and equipment, transportation equipment, telephone equipment and leasehold improvements.

Interest Income. Interest income decreased to \$1.3 million in 2003 from \$2.6 million in 2002, a decrease of 50%. In 2003, we earned an average of 1.78% on an average invested balance of \$73.2 million. In 2002, we earned an average of 2.50% on an average invested balance of \$105.1 million. The decrease in interest income was due to the lower average invested balances and lower interest rates earned. In 2003 and 2002, the interest income was primarily related to amounts earned by investing cash and funds received from operations, the secondary public offering of our Class B Common Stock and stock option exercises in overnight repurchase agreements with major financial institutions and in marketable securities.

Income Taxes. The provision for income taxes in 2003 and 2002 represented 37.5% of earnings before income taxes.

LIQUIDITY AND CAPITAL RESOURCES Our principal capital requirements have been to fund working capital

needs to support internal growth, for acquisitions and for capital expenditures. Our principal working capital needs are for inventory and accounts receivable. Management controls inventory levels in order to minimize carrying costs and maximize purchasing opportunities. We sell inventory to our customers on various payment terms. This requires significant working capital to finance inventory purchases and entails accounts receivable exposure in the event any of our major customers encounter financial difficulties. Although we monitor closely the creditworthiness of our customers, there can be no assurance that we will not incur some collection loss on accounts receivable in the future.

On January 1, 2005, we had cash and cash equivalents of \$45.5 million, marketable securities of \$17.3 million and working capital of \$215.4 million. On February 5, 2004, we entered into, and on February 27, 2004, we amended, an agreement with Suntrust Bank, as administrative agent, for an unsecured three year revolving credit facility for up to \$150 million. We intend to use the available proceeds to fund acquisitions, repurchase shares of our Class B Common Stock, provide for working capital and capital expenditures, and for other general corporate purposes. The revolving credit facility requires us, among other things, to maintain a minimum consolidated net worth, a minimum interest coverage ratio and limits our leverage ratio. We were in compliance with these covenants as of January 1, 2005. On January 1, 2005, the principal amount outstanding under this facility was \$40.0 million. We believe that cash and cash equivalents, marketable securities, working capital, our revolving credit facility and cash from operations will be sufficient to meet our working capital needs for at least one year.

Net Cash Provided by Operating Activities. Our operations generated \$24.2 million in cash during 2004. Receivables, net of acquisitions, increased \$64.4 million, primarily due to support the increase in sales and due to the extension of credit terms to meet competitive conditions. Finished goods inventory, net of acquisitions, decreased \$7.7 million, partly due to our concerted effort to closely monitor inventory and maintain it at an optimal level and partly due to our taking advantage of purchasing opportunities during the fourth quarter of 2003 for certain inventory items that were sold during 2004. The \$13.8 million increase in accounts payable, net of acquisitions, was attributable to the timing of purchases and payments and credit terms negotiated with vendors. Other current assets and liabilities, net of acquisitions, increased cash by \$5.1 million, primarily due to an increase in income taxes payable, accrued expenses and a restructuring charge accrual. We anticipate that our operations may require cash to fund our growth.

Net Cash Used by Investing Activities. In 2004, we purchased \$2.0 million of marketable securities. Capital expenditures during 2004 totaled \$18.1 million. These purchases were primarily for our new enterprise wide information technology system, computer hardware and software, telecommunications equipment, furniture and equipment and leasehold improvements. We expect that capital expenditures during 2005 will be approximately \$21 to \$25 million. The 2005 capital expenditures include items related to the new joint venture with Aetna. See the \$23 million Aetna contribution to the new joint venture in financing activities below. We anticipate that the other expenditures will relate primarily to our new enterprise wide information technology system, computer hardware and software, telecommunications equipment, furniture and equipment and leasehold improvements. In 2004, other assets increased \$16.0 million due to increasing our deposit with our wholesaler. In 2004, other assets increased \$1.9 million due to making additional investments in Burrill Life Sciences Capital Fund, L.P. and our new joint venture with Aetna. In 2004, we paid \$39.6 million for the acquisition of certain assets of Partners In Care, the acquisition of the stock of HealthBridge, the acquisition of the stock of Integrity and the 2001 acquisition of InfuRx because InfuRx achieved certain predetermined financial results during the year ended January 3, 2004.

Net Cash Provided by Financing Activities. In 2004, we received proceeds of \$1.4 million from stock option exercises

and \$252,000 from the employee stock purchase plan. Also in 2004, we purchased treasury stock for \$1.3 million, borrowed \$65.3 million on our line of credit, made repayments of \$37.4 million on our line of credit and received \$23.0 million from Aetna for their contribution to the new joint venture.

INFLATION Our consolidated financial statements are prepared on the basis of historical costs and are not intended to reflect changes in the relative purchasing power of the dollar. Because of our ability to take advantage of forward purchasing opportunities, we believe that our gross profits generally increase as a result of manufacturers' price increases in the products we distribute. Gross profits may decline if the rate of price increases by manufacturers declines.

Generally, price increases are passed through to customers as we receive them and therefore they reduce the negative effect of inflation. Other non-inventory cost increases, such as payroll, supplies and services, have been partially offset during the past three years by increased volume and productivity.

OFF-BALANCE SHEET ARRANGEMENTS Except as set forth below under "Contractual Obligations", we have no material off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

CONTRACTUAL OBLIGATIONS

The following table sets forth the specified contractual obligations as of January 1, 2005:

(000's Omitted)	Payments due by period						
	Total	2005	2006	2007	2008	2009	Beyond 2009
Line of credit obligation	\$ 40,290	\$ 40,290	\$ —	\$ —	\$ —	\$ —	\$ —
Operating lease obligations	\$ 21,526	\$ 3,876	\$ 3,843	\$ 3,616	\$ 2,738	\$ 2,118	\$ 5,335

We also have an additional commitment of \$3.3 million related to our investment in Burrill Life Sciences Capital Fund, L.P. The additional commitment is due at various times depending on the growth of Burrill and upon final funding we are expected to own less than 3% of Burrill.

RECENT ACCOUNTING PRONOUNCEMENTS

In January 2003, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 46 ("FIN 46") (revised December 2003), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51, which expands upon and

strengthens existing accounting guidance concerning when a company should include in its financial statements the assets, liabilities and activities of another entity. A Variable Interest Entity ("VIE") does not share economic risk and rewards through typical equity ownership arrangements; instead, contractual or other relationships re-distribute economic risks and rewards among equity holders and other parties. Once an entity is determined to be a VIE, the party with the controlling financial interest, the primary beneficiary, is required to consolidate it. FIN 46 also requires disclosures about VIEs that a company is not required to consolidate but

in which it has a significant variable interest. We have applied the consolidation or disclosure requirements of this interpretation. We have determined that our joint venture, Aetna Specialty Pharmacy, LLC, should be consolidated under the provisions of FIN 46. Since its inception in August 2004, the results of operations of the joint venture have not been material.

In December 2003, the SEC issued Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition." SAB 104, which was effective upon issuance, updates portions of the interpretive guidance included in Topic 13 of the codification of Staff Accounting Bulletins and revises or rescinds portions of the interpretive guidance included in SAB 101 in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The principal revisions relate to the incorporation of certain sections of the staff's Frequently Asked Question ("FAQ") document on revenue recognition into Topic 13. SAB 101, "Revenue Recognition in Financial Statements," which was issued in December 1999, and provides guidance to SEC registrants on the recognition, presentation and disclosure of revenues in the financial statements. Since we already adopted all such standards upon issuance, the application of this revised guidance did not impact our consolidated financial position, results of operations, or disclosure requirements.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, or FAS 123R. FAS 123R requires us to recognize compensation cost relating to all share-based payments to our employees based on their fair values beginning the third quarter of 2005. We are evaluating the requirements of FAS 123R and expect that our adoption of FAS 123R may have a material impact on our SG&A expenses. We have not determined the method of adoption and have not determined whether the adoption will result in amounts that are similar to our current pro forma disclosures under FAS 123 (see Note 1 to our consolidated financial statements).

MARKET RISK Our primary exposure to market risk consists of a decline in the market value of our investments in marketable debt securities as a result of potential changes in interest rates. Market risk was estimated as the potential decrease in fair value resulting from a hypothetical 10% increase in interest rates on securities included in our portfolio, and given the short term maturities of all of our investments in interest-sensitive securities, this hypothetical fair value was not materially different from the period end carrying value.

We are also exposed to market risk in that the interest payable on our credit facility is based on variable interest rates and therefore is affected by changes in market rates. We do not use interest rate derivative instruments to manage exposure to changes in market interest rates. A 1% change in the weighted average interest rate charged under the credit facility would have resulted in interest expense fluctuating by approximately \$300,000 for the 2004 fiscal year. We did not have interest expense in the 2003 fiscal year.

Management's Responsibility for Financial Reporting, Disclosure Controls and Procedures and Internal Control Over Financial Reporting

FINANCIAL REPORTING The management of Priority is responsible for the integrity and accuracy of the financial statements appearing in this Annual Report. The consolidated financial statements were prepared by management in conformity with accounting principles generally accepted in the United States of America, applied on a consistent basis, and include amounts that are based on the most accurate information currently available to Priority. The consolidated financial statements have been audited by PricewaterhouseCoopers LLP, an independent registered certified public accounting firm, as stated in their report dated March 28, 2005, which also appears in this Annual Report.

DISCLOSURE CONTROLS AND PROCEDURES

Priority maintains disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15(d)-15(e)) that are designed to provide reasonable assurance that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

As of the end of the period covered by this Annual Report, management, under the supervision of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of the disclosure controls and procedures were effective at the reasonable assurance level.

INTERNAL CONTROL OVER FINANCIAL

REPORTING The Company's management is also responsible for establishing and maintaining adequate internal control over financial reporting as defined in Exchange Act Rule 13a-15(f). As of the end of the period covered by this Annual Report, management, under the supervision of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organization of the Treadway Commission. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's internal control over financial reporting was effective as of the end of the period covered by this Annual Report.

The Company's assessment of the effectiveness of the internal control over financial reporting as of January 1, 2005, has been audited by PricewaterhouseCoopers LLP, an independent registered certified public accounting firm, as stated in their report dated March 28, 2005, which also appears in this Annual Report.

The Board of Directors of Priority, acting through Priority's Audit Committee, reviews and monitors Priority's accounting, auditing, financial reporting, internal control and disclosure controls and procedures matters. The Audit Committee meets periodically with management and the independent auditors, who have free access to the Audit Committee.



Steven D. Cosler
President and Chief Executive Officer



Stephen M. Saft
Chief Financial Officer and Treasurer

Report of Independent Registered Certified Public Accounting Firm

To the Board of Directors and Shareholders of
Priority Healthcare Corporation

We have completed an integrated audit of Priority Healthcare Corporation's 2004 consolidated financial statements and of its internal control over financial reporting as of January 1, 2005 and audits of its 2003 and 2002 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

CONSOLIDATED FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULE In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Priority Healthcare Corporation and its subsidiaries at January 1, 2005 and January 3, 2004 and the results of their operations and their cash flows for each of the three years in the period ended January 1, 2005 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements 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 of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

INTERNAL CONTROL OVER FINANCIAL REPORTING Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing in Item 9A, that the Company maintained effective internal control over financial reporting as of January 1, 2005 based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of January 1, 2005,

based on criteria established in Internal Control – Integrated Framework issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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

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

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Orlando, Florida
March 28, 2005

Consolidated Statements of Earnings

	Year ended		
	January 1, 2005	January 3, 2004	December 28, 2002
<i>(000's Omitted, Except Share and Per Share Data)</i>			
Net sales	\$ 1,739,618	\$ 1,461,811	\$ 1,200,391
Cost of products sold	1,546,727	1,299,948	1,063,181
Gross profit	192,891	161,863	137,210
Selling, general and administrative expense	108,197	77,932	64,959
Impairment of fixed asset	—	—	2,386
Restructuring charge	1,317	—	—
Depreciation and amortization	6,591	4,273	2,760
Earnings from operations	76,786	79,658	67,105
Third party payor settlement	(4,401)	—	—
Minority interest	(212)	—	—
Interest expense	(1,060)	—	—
Interest income	707	1,302	2,632
Earnings before income taxes	71,820	80,960	69,737
Provision for income taxes:			
Current	24,668	25,348	25,608
Deferred	2,526	5,012	543
	27,194	30,360	26,151
Net earnings	\$ 44,626	\$ 50,600	\$ 43,586
Earnings per share:			
Basic	\$ 1.03	\$ 1.17	\$ 1.00
Diluted	\$ 1.01	\$ 1.15	\$.98
Weighted average shares outstanding:			
Basic	43,438,475	43,362,614	43,699,208
Diluted	44,023,741	43,930,042	44,384,665

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

<i>(000's Omitted, Except Share Data)</i>	January 1, 2005	January 3, 2004
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 43,465	\$ 45,719
Restricted cash	2,000	2,000
Marketable securities	17,289	15,317
Receivables, less allowance for doubtful accounts of \$6,903 and \$5,480, respectively	244,730	172,206
Finished goods inventory	112,616	117,218
Deferred income taxes	3,075	2,325
Other current assets	33,382	18,317
	456,557	373,102
Fixed assets, net	48,209	29,780
Other assets	5,886	4,000
Goodwill and other intangibles	158,741	107,127
	\$ 669,393	\$ 514,009
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	\$ 173,969	\$ 151,539
Line of credit (note 9)	40,290	—
Other current liabilities	26,906	13,124
	241,165	164,663
Deferred income taxes	9,714	6,437
Total liabilities	250,879	171,100
Minority interest (note 7)	23,212	—
Commitments and contingencies (notes 14 and 16)		
Shareholders' equity:		
Preferred stock, no par value, 5,000,000 shares authorized, none issued and outstanding	—	—
Common stock		
Class A, \$0.01 par value, 55,000,000 shares authorized, 6,590,305 and 6,677,683 issued and outstanding, respectively	66	67
Class B, \$0.01 par value, 180,000,000 shares authorized, 38,807,013 and 38,719,635 issued, respectively	388	387
Additional paid in capital	190,524	189,309
Retained earnings	232,299	187,673
	423,277	377,436
Less: Class B Common unearned restricted stock, 156,201 and 108,323 shares, respectively	(2,108)	(1,846)
Class B Common stock in treasury (at cost), 1,563,651 and 1,987,739 shares, respectively	(25,867)	(32,681)
Total shareholders' equity	395,302	342,909
	\$ 669,393	\$ 514,009

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

	Year ended		
	January 1, 2005	January 3, 2004	December 28, 2002
<i>(000's Omitted)</i>			
Cash flow from operating activities:			
Net earnings	\$ 44,626	\$ 50,600	\$ 43,586
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	6,591	4,273	2,760
Provision for doubtful accounts	6,141	2,197	2,449
Tax benefit from stock option exercises	799	672	944
Minority interest	212	—	—
Impairment of fixed asset	—	—	2,386
Loss on disposal of fixed assets	—	—	44
Compensation expense on stock grants	1,204	932	30
Deferred income taxes	2,526	5,012	543
Change in assets and liabilities, net of acquisitions:			
Receivables	(64,397)	(10,715)	(44,905)
Finished goods inventory	7,650	(8,184)	(32,189)
Accounts payable	13,777	6,770	25,642
Other current assets and liabilities	5,086	(23,263)	18,373
Net cash provided by operating activities	24,215	28,294	19,663
Cash flow from investing activities:			
(Purchases, net of sales), sales, net of purchases, of marketable securities	(1,972)	31,020	47,829
Restricted cash for acquisition of business	—	(2,000)	—
Purchases of fixed assets	(18,116)	(18,124)	(8,980)
(Increase) decrease in other assets	(17,917)	1,974	(11,870)
Acquisition of businesses, net of cash acquired	(39,648)	(23,332)	(32,896)
Net cash used by investing activities	(77,653)	(10,462)	(5,917)
Cash flow from financing activities:			
Proceeds from stock option exercises	1,386	2,209	3,716
Joint venture contribution from minority interest holder	23,000	—	—
Proceeds from employee stock purchase plan	252	—	—
Proceeds from line of credit	65,290	—	—
Repayments on line of credit	(37,422)	—	—
Payments for purchase of treasury stock	(1,322)	(11,353)	(13,189)
Net cash provided (used) by financing activities	51,184	(9,144)	(9,473)
Net (decrease) increase in cash	(2,254)	8,688	4,273
Cash and cash equivalents at beginning of period	45,719	37,031	32,758
Cash and cash equivalents at end of period	\$ 43,465	\$ 45,719	\$ 37,031
Supplemental cash flow information:			
Income taxes paid	\$ 23,542	\$ 43,238	\$ 12,227
Interest paid	\$ 770	\$ —	\$ —
Supplemental non-cash investing and financing activities:			
Acquisition liabilities	\$ 5,266	\$ 2,929	\$ 10,348
Stock issued in connection with acquisitions	\$ 5,448	\$ 1,922	\$ 5,000
Stock issued in connection with investment	\$ —	\$ 3,500	\$ —

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

<i>(000's Omitted, Except Share Data)</i>	Class A Common Stock		Class B Common Stock		Class B Common Stock		Class B Common Stock		Additional Paid in Capital	Retained Shareholders' Earnings Equity	
	Shares		Shares		Unearned Restricted		Treasury			Earnings	Equity
	Outstanding	Amount	Outstanding	Amount	Shares	Amount	Shares	Amount			
BALANCES AT DECEMBER 29, 2001	7,211,815	\$ 72	38,185,503	\$ 382	—	\$ —	(1,739,474)	\$ (22,419)	\$ 182,818	\$ 93,487	\$ 254,340
Net earnings										43,586	43,586
Issuance of Class B common stock:											
Stock option exercises and related tax benefit								238,546	3,192	1,468	4,660
Unearned restricted stock grant					(53,000)	(1,291)	53,000	815	476		—
Board of Directors' compensation							1,228	19	11		30
Issuance of common stock in connection with acquisition							202,922	2,615	2,385		5,000
Repurchase of common stock							(640,300)	(13,189)			(13,189)
Conversions to Class B	(331,318)	(3)	331,318	3							—
BALANCES AT DECEMBER 28, 2002	6,880,497	69	38,516,821	385	(53,000)	(1,291)	(1,884,078)	(28,967)	187,158	137,073	294,427
Net earnings										50,600	50,600
Issuance of Class B common stock:											
Stock option exercises and related tax benefit								167,617	2,677	204	2,881
Unearned restricted stock grant					(68,575)	(1,408)	68,575	1,127	281		—
Earned restricted stock					13,252	853					853
Stock option grant										42	42
Board of Directors' compensation							1,810	29	8		37
Issuance of common stock in connection with acquisition							82,905	1,315	607		1,922
Issuance of common stock in connection with investment							152,505	2,491	1,009		3,500
Repurchase of common stock							(577,073)	(11,353)			(11,353)
Conversions to Class B	(202,814)	(2)	202,814	2							—
BALANCES AT JANUARY 3, 2004	6,677,683	67	38,719,635	387	(108,323)	(1,846)	(1,987,739)	(32,681)	189,309	187,673	342,909
Net earnings										44,626	44,626
Issuance of Class B common stock:											
Stock option exercises and related tax benefit								158,318	2,615	(430)	2,185
Unearned restricted stock grant					(78,275)	(1,428)	78,275	1,295	133		—
Earned restricted stock					30,397	1,166					1,166
Employee stock purchase plan							14,111	232	20		252
Board of Directors' compensation							1,875	32	6		38
Issuance of common stock in connection with acquisition							239,802	3,962	1,486		5,448
Repurchase of common stock							(68,293)	(1,322)			(1,322)
Conversions to Class B	(87,378)	(1)	87,378	1							—
BALANCES AT JANUARY 1, 2005	6,590,305	\$ 66	38,807,013	\$ 388	(156,201)	\$ (2,108)	(1,563,651)	\$ (25,867)	\$ 190,524	\$ 232,299	\$ 395,302

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation. Priority Healthcare Corporation (the "Company") was formed by Bindley Western Industries, Inc. ("BWI") on June 23, 1994, as an Indiana corporation to focus on the distribution of products and provision of services to the specialty distribution segment of the healthcare industry. On October 29, 1997, the Company consummated an initial public offering of its Class B Common Stock (the "IPO"). On December 31, 1998, BWI distributed to its common shareholders all of the 30,642,858 shares of the Company's Class A Common Stock then owned by BWI in a spin-off transaction and BWI no longer has any ownership interest in the Company. The Company now operates as a national specialty pharmacy and distributor that provides biopharmaceuticals, complex therapies and related disease treatment programs and services. The Company operates in one operating and reportable segment.

Principles of consolidation. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries and variable interest entities. All intercompany accounts and transactions have been eliminated. The Company reports on a fiscal year basis using the 52 or 53 week period ending on the Saturday closest to December 31. The years ended January 1, 2005 and December 28, 2002 were 52 week periods. The year ended January 3, 2004 was a 53 week period.

Variable Interest Entities. In January 2003, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 46 ("FIN 46") (revised December 2003), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51, which expands upon and strengthens existing accounting guidance concerning when a company should include in its financial statements the assets, liabilities and activities of another entity. A Variable Interest Entity ("VIE") does not share economic risk and rewards through typical equity ownership arrangements; instead, contractual or other relationships re-distribute economic risks and rewards among equity holders and other parties. Once an entity is determined to be a VIE, the party with the controlling financial interest, the primary beneficiary, is required to consolidate it. VIE 46 also requires disclosures about VIEs that a company is not required to consolidate but in which it has a significant variable interest. The Company has applied the consolidation or disclosure requirements of this interpretation. The Company has determined that our joint venture, Aetna Specialty Pharmacy, LLC, should be consolidated under the provisions of FIN 46. Since its inception in August 2004, the results of operations of the joint venture have not been material.

Revenue recognition. Revenues are recognized at the point of shipment for those sales when the risk of loss passes at the point of shipment and upon receipt for those sales when the risk of loss passes at the point of receipt as products are shipped to customers with appropriate provisions recorded for estimated discounts and contractual allowances. Discounts and contractual allowances are estimated based on historical collections over a recent period for the sales that are recorded at gross charges. The percentage is applied to the applicable accounts receivable balance that contains gross charges for each period. Any differences between the estimates and actual collections are reflected in operations in the year payment is received. Differences may result in the amount and timing of revenues for any period if actual performance varies from estimates. Allowances for returns are estimated based on historical return trends. Financing charge revenue is recognized when received.

Cash and cash equivalents. The Company considers all investments with an original maturity of less than 3 months to be a cash equivalent.

Concentration of credit risk. Financial instruments which potentially subject the Company to credit risk consist primarily of cash and cash equivalents and accounts receivable. Cash balances may, at times, exceed FDIC limits on insurable amounts. The Company mitigates its risk by investing in or through major financial institutions.

Marketable securities. In accordance with provisions of Statement of Financial Accounting Standard No. 115, "Accounting for Certain Investments in Debt and Equity Securities," the Company has classified all of its investments in marketable securities as available-for-sale. These investments are stated at their market value, with any material unrealized holding gains or losses, net of tax, included as a component of shareholders' equity until realized. The cost of debt securities classified as available-for-sale is adjusted for amortization of premiums and accretion of discounts to maturity. Interest income is included as a component of current earnings.

Receivables. Receivables are presented net of the allowance for doubtful accounts and contractual allowances. Receivables include trade and patient account receivables. The Company regularly reviews and analyzes the adequacy of these allowances after considering the age of each outstanding receivable and the collection history. The allowance for doubtful accounts and contractual allowances are based on these analyses. Although doubtful accounts and contractual allowances have historically been within expectations and

allowances established, there is no guarantee that the Company will continue to experience the same credit loss rates that it has in the past.

Inventories. Inventories consist of merchandise held for resale. Inventories are stated on the basis of lower of cost or market using the first-in, first-out ("FIFO") method.

Other current assets. Other current assets consists primarily of funds held at a wholesaler.

Fixed assets. Depreciation is computed on the straight-line method for financial reporting purposes. Accelerated methods are primarily used for income tax purposes. Assets, valued at cost, are generally being depreciated over their estimated useful lives as follows:

	Estimated useful life (years)
Computer hardware and software	3 to 7
Furniture and equipment	5
Leasehold improvements	5 to 7
Transportation equipment	5

Maintenance and repairs are charged to expense in the year incurred. Cost and related accumulated depreciation for fixed assets are removed from the accounts upon sale or disposition, and the resulting gain or loss is reflected in earnings.

Capitalized software costs. The Company expenses costs incurred in the preliminary project stage of developing or obtaining internal use software, such as research and feasibility studies, as well as costs incurred in the post implementation/operational stage, such as maintenance and training. Capitalization of software development costs occurs only after the preliminary project stage is complete, management authorizes the project, and it is probable that the project will be completed and the software will be used for the function intended. The capitalized costs are amortized on a straight-line method over the estimated useful life of the software, which is generally 5 to 7 years.

Intangibles. Goodwill represents the excess of purchase price over the fair value of identifiable net assets of companies acquired. The Company adopted Statement of Financial

Accounting Standards ("SFAS") No. 142, "Goodwill and Intangibles Assets" as of December 30, 2001. This statement requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually. The Company measures impairment based on a projected discounted cash flow method using a discount rate determined by management to be commensurate with the risk inherent in its current business model or another valuation technique. Prior to fiscal 2002, goodwill was amortized over periods not exceeding 40 years. Other definite lived intangibles are amortized on a straight-line basis over periods not exceeding 15 years.

Stock-based compensation. In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation – Transition and Disclosure – an Amendment of SFAS Statement No. 123. SFAS No. 148 amends SFAS No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 is effective for annual and interim periods beginning after December 15, 2002. The Company has adopted the disclosure requirements of SFAS No. 123 and SFAS No. 148. The adoption of SFAS No. 148 did not have a material impact on the Company's consolidated financial position or results of operations.

The Company has elected to continue to measure compensation for stock options issued to its employees and outside directors pursuant to APB No. 25 under the intrinsic value method. All stock options are granted with an exercise price at or above fair market value at date of grant. Accordingly, no compensation expense has been recognized in connection with the issuance of stock options. Had compensation cost been determined based upon the fair value of the stock options at grant date, consistent with the method under SFAS No. 123, the Company's net earnings and earnings per share for fiscal 2004, 2003 and 2002 would have been reduced to the following pro forma amounts indicated.

	Year ended		
	January 1, 2005	January 3, 2004	December 28, 2002
<i>(In Thousands, Except Per Share Data)</i>			
Net earnings – as reported	\$ 44,626	\$ 50,600	\$ 43,586
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(8,034)	(11,369)	(12,254)
Pro forma net earnings	\$ 36,592	\$ 39,231	\$ 31,332
Basic earnings per share:			
Basic – as reported	\$ 1.03	\$ 1.17	\$ 1.00
Basic – pro forma	\$.84	\$.90	\$.72
Diluted earnings per share:			
Diluted – as reported	\$ 1.01	\$ 1.15	\$.98
Diluted – pro forma	\$.83	\$.89	\$.71

The fair value of each option is estimated on the date of grant using the Black-Scholes option pricing model, with the following weighted average assumptions:

	2004	2003	2002
Risk free interest rate	3.10%	2.64%	2.89%
Expected dividend yield	.00%	.00%	.00%
Expected life of options	3.82	3.80	3.45
Volatility of stock price	45.00%	58.49%	73.55%
Weighted average fair value of options	\$ 6.96	\$ 9.47	\$ 13.18

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, or FAS 123R. FAS 123R requires the Company to recognize compensation cost relating to all share-based payments to employees based on their fair values beginning the third quarter of 2005. The Company is evaluating the requirements of FAS 123R and expects that the adoption of FAS 123R may have a material impact on selling, general and administrative expenses. The Company has not determined the method of adoption and has not determined whether the adoption will result in amounts that are similar to the current pro forma disclosures under FAS 123 shown above.

Shipping and handling costs. Costs associated with shipping and handling activities are comprised of outbound freight and are included in selling, general and administrative expense. These costs were \$11.3 million, \$9.1 million and \$8.6 million for the years ended January 1, 2005, January 3, 2004 and December 28, 2002, respectively.

Income taxes. The Company recognizes deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Deferred tax liabilities and assets are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The Company estimates the degree to which tax assets and loss carryforwards will result in a benefit based on expected profitability by tax jurisdiction.

Use of estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. The most significant estimates include the allowance for doubtful accounts, contractual allowances, intangibles and income taxes.

Fair value of financial instruments. The carrying values of cash and cash equivalents, restricted cash, marketable securities, receivables, other current assets, accounts payable, line of credit and other current liabilities approximate their fair market values due to the short-term maturity of these instruments.

Comprehensive income. In accordance with SFAS No. 130, "Reporting Comprehensive Income", the Company is required to display comprehensive income and its components as part of its complete set of financial statements. Comprehensive income represents changes in shareholders' equity resulting from transactions other than shareholder investments and distributions.

NOTE 2 EARNINGS PER SHARE

Basic earnings per share ("EPS") computations are calculated utilizing the weighted average number of common shares outstanding during the applicable fiscal year. Diluted EPS include the weighted average number of common shares outstanding and the effect of common stock equivalents. The following is a reconciliation between basic and diluted EPS:

<i>(In Thousands)</i>	2004	2003	2002
Weighted average number of Class A and Class B Common shares outstanding used as the denominator in the basic earnings per share calculation	43,438	43,363	43,699
Additional shares assuming exercise of dilutive stock options	501	508	634
Additional shares assuming unearned restricted stock is earned	75	39	10
Additional shares assuming contingently issuable shares related to acquisitions are issued	10	20	42
Weighted average number of Class A and Class B Common and equivalent shares used as the denominator in the diluted earnings per share calculation	<u>44,024</u>	<u>43,930</u>	<u>44,385</u>

NOTE 3 ACQUISITIONS

On March 11, 2002, the Company acquired the majority of the operating assets of Hemophilia of the Sunshine State ("HOSS") for approximately \$30.4 million, comprised of approximately \$24.5 million in cash, \$5 million of Class B Common Stock and approximately \$900,000 of liabilities assumed. The acquisition was financed by cash from operations. HOSS was the leading provider of hemophilia products and services in the State of Florida. The transaction complements the Company's existing specialty pharmacy and specialty distribution operations. The acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, Business Combinations. Under the purchase method of accounting, the total purchase price was allocated to the tangible and intangible assets acquired based upon their estimated fair values. The fair values assigned to the tangible and intangible assets acquired were based upon estimates and assumptions provided and compiled by management. The excess purchase price, including other acquisition costs, of \$25.1 million was recorded as goodwill.

The following table summarizes the estimated fair values of the assets acquired at the date of acquisition (000's omitted):

Accounts receivable	\$ 2,890
Inventories	2,357
Property, equipment and other assets	36
Goodwill	<u>25,132</u>
Total assets acquired	<u>\$ 30,415</u>

Options to purchase 4.0 million, 3.1 million and 3.4 million shares with exercise prices greater than the average market prices of common stock were outstanding at January 1, 2005, January 3, 2004 and December 28, 2002, respectively. These options were excluded from the respective computations of diluted earnings per share because their effect would be anti-dilutive.

The results of operations of HOSS prior to the date of acquisition were not material to the results of the Company for the periods presented in these financial statements. The results of operations after the acquisition date are included in the consolidated financial statements.

On September 11, 2003, the Company acquired the majority of the operating assets of SinusPharmacy Corporation ("Sinus") for approximately \$13 million, comprised of approximately \$12.3 million in cash (\$2 million of which was paid in January 2005 and represented the restricted cash on the consolidated balance sheet at January 1, 2005 and January 3, 2004), \$500,000 of Class B Common Stock and approximately \$200,000 of liabilities assumed. The acquisition was financed by cash from operations. Sinus was the leading provider of intranasal nebulized therapies for the treatment of chronic sinusitis. The transaction complements the Company's existing specialty pharmacy and specialty distribution operations. The acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, Business Combinations. Under the purchase method of accounting, the total purchase price was allocated to the tangible and intangible assets acquired based upon their estimated fair values. The fair values assigned to the tangible assets acquired and liabilities assumed were based upon estimates and assumptions provided and compiled by management. The intangible assets consist primarily of trademarks. The fair values assigned to the trademarks (\$865,000) were based upon management estimates. The excess purchase price, including other acquisition costs, of \$11.8 million was recorded as goodwill.

The following table summarizes the estimated fair values of the assets acquired at the date of acquisition (000's omitted):

Inventories	\$ 257
Property and equipment	37
Intangible assets	865
Goodwill	<u>11,822</u>
Total assets acquired	<u>\$ 12,981</u>

The results of operations of Sinus prior to the date of acquisition were not material to the results of the Company for the periods presented in these financial statements. The results of operations after the acquisition date are included in the consolidated financial statements.

On April 2, 2004, the Company acquired certain assets of Partners In Care Pharmacy, LLC ("Partners In Care") for approximately \$6.1 million in cash. The acquisition was financed by cash from operations. Partners In Care was an infertility specialty pharmacy. The transaction complements the Company's existing infertility specialty pharmacy operations. The acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, Business Combinations. Under the purchase method of accounting, the total purchase price was allocated to the tangible and intangible assets acquired based upon their estimated fair values. The fair values assigned to the tangible and intangible assets acquired were based upon estimates and assumptions provided and compiled by management. The excess purchase price of \$5.8 million was recorded as goodwill.

The following table summarizes the estimated fair values of the assets acquired at the date of acquisition (000's omitted):

Current assets	\$ 245
Property, equipment and other assets	47
Goodwill	<u>5,791</u>
Total assets acquired	<u>\$ 6,083</u>

In addition, the former owners of Partners In Care are eligible to receive additional consideration based upon revenues received from new customers under a certain contract. The Company does not expect to pay any additional consideration to the former owners of Partners In Care related to this provision of the asset purchase agreement.

The results of operations of Partners In Care prior to the date of acquisition were not material to the results of the Company for the periods presented in these financial statements. The results of operations after the acquisition date are included in the consolidated financial statements.

On June 14, 2004, the Company acquired all of the outstanding common shares of HealthBridge Reimbursement and Product Support, Inc. ("HealthBridge") for approximately \$9 million in cash. The acquisition was financed by cash from operations. HealthBridge is a service company specializing in drug launch and reimbursement support for the biotech and pharmaceutical industry. The transaction complements the Company's existing specialty pharmacy and specialty distribution operations. The acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, Business Combinations. Under the purchase method of accounting, the total purchase price was allocated to the tangible and intangible assets acquired and the liabilities assumed based upon their estimated fair values. The fair values assigned to the tangible assets acquired and liabilities assumed were based upon estimates and assumptions provided and compiled by management. The intangible assets consist primarily of trademarks and non-compete agreements. The fair values assigned to the trademarks (\$210,000) and non-compete agreements (\$140,000) were based upon management estimates. The excess purchase price of \$7.4 million was recorded as goodwill.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition (000's omitted):

Current assets	\$ 1,704
Property and equipment	390
Intangible assets	350
Goodwill	<u>7,390</u>
Total assets acquired	<u>9,834</u>
Current liabilities	730
Other long-term liabilities	<u>100</u>
Total liabilities assumed	<u>830</u>
Net assets acquired	<u>\$ 9,004</u>

In addition, the former owners of HealthBridge are eligible to receive additional consideration up to a maximum of \$1.5 million if HealthBridge achieves certain predetermined financial results during the 12-month periods ending May 31, 2005 and May 31, 2006. In the event that HealthBridge fails to achieve certain predetermined financial results for the 12-month period ending May 31, 2005, the former owners are obligated to repay consideration up to a maximum of \$500,000 to the Company.

The results of operations of HealthBridge prior to the date of acquisition were not material to the results of the Company for the periods presented in these financial statements. The results of operations after the acquisition date are included in the consolidated financial statements.

On July 6, 2004, the Company acquired all of the outstanding common shares of Integrity Healthcare Services, Inc. ("Integrity"). The aggregate purchase price for the outstanding common shares of Integrity was approximately \$33 million, comprised of approximately \$27.6 million in cash (including \$5 million that will be paid in July 2005), \$5 million of Class B Common Stock and approximately \$400,000 of direct acquisition costs. In addition, as part of the closing process, the Company paid approximately \$12 million to repay Integrity's line of credit balance in full. The acquisition was financed by the Company's existing line of credit. Integrity is a specialty infusion pharmacy with 23 branches in 16 states located throughout the Midwest and Southeast states. The transaction expands the Company's specialty pharmacy capabilities and geographic operating locations. The acquisition was accounted for using the purchase method of accounting in

accordance with SFAS No. 141, Business Combinations. Under the purchase method of accounting, the total purchase price was allocated to the tangible and intangible assets acquired and the liabilities assumed based upon their estimated fair values. The fair values assigned to the tangible assets acquired and liabilities assumed were based upon estimates and assumptions provided and compiled by management. The intangible assets consist primarily of trademarks, non-compete agreements and certificates of need. The fair values assigned to the trademarks (\$1.7 million), non-compete agreements (\$200,000) and the certificates of need (\$570,000) were based upon management estimates. The excess purchase price of \$34.6 million was recorded as goodwill.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition (000's omitted):

Accounts receivable	\$ 12,716
Inventories	2,439
Other current assets	370
Property, equipment and other assets	714
Intangible assets	2,470
Goodwill	<u>34,603</u>
Total assets acquired	<u>53,312</u>
Current maturities of debt	524
Line of credit	12,422
Accounts payable and accruals	3,956
Other current liabilities	2,495
Long-term debt	<u>921</u>
Total liabilities assumed	<u>20,318</u>
Net assets acquired	<u>\$ 32,994</u>

The results of operations of Integrity prior to the date of acquisition were not material to the results of the Company for the periods presented in these financial statements. The results of operations after the acquisition date are included in the consolidated financial statements.

During 2004, the Company paid \$448,000 in cash and \$448,000 in Class B Common Stock related to the 2001 acquisition of InFuRx because InFuRx achieved certain predetermined financial results during the year ended January 3, 2004. These payments complete the purchase of InFuRx and no further consideration is due to the former owners.

NOTE 4 MARKETABLE SECURITIES

Marketable securities are carried on the balance sheet at their market value. Marketable securities at January 1, 2005 and January 3, 2004 consist of the following:

<i>(In Thousands)</i>	2004	2003
Mutual funds	\$ 13,931	\$ 2,890
Corporate bonds	3,358	12,427
	<u>\$ 17,289</u>	<u>\$ 15,317</u>

These investments had a fair value of approximately \$43.3 million (which included approximately \$26.0 million classified as cash equivalents) and \$50.9 million (which included approximately \$35.6 million classified as cash equivalents) at January 1, 2005 and January 3, 2004, respectively. At January 1, 2005 and January 3, 2004, the book value of these investments approximated their market value. There were no significant gross realized gains or losses on sales of available-for-sale securities in 2004 or 2003. All available-for-sale securities are due in one year or less.

NOTE 5 FIXED ASSETS

Fixed assets at January 1, 2005 and January 3, 2004 consist of the following:

<i>(In Thousands)</i>	2004	2003
Computer hardware and software	\$ 21,281	\$ 14,505
Furniture and equipment	14,772	8,166
Leasehold improvements	3,964	2,604
Transportation equipment	1,167	631
	<u>41,184</u>	<u>25,906</u>
Less: accumulated depreciation	(15,311)	(8,785)
	<u>25,873</u>	<u>17,121</u>
Construction in progress	22,336	12,659
	<u>\$ 48,209</u>	<u>\$ 29,780</u>

Depreciation expense was \$6.3 million, \$4.2 million and \$2.7 million for the years ended January 1, 2005, January 3, 2004 and December 28, 2002, respectively. The impairment of fixed asset charge of \$2.4 million in 2002 resulted from writing off computer hardware and application software for a project that began in 2000 and was discontinued in 2002.

NOTE 6 INVESTMENTS

During the year ended January 3, 2004, the Company made a \$3.5 million equity investment of about 10% in SinusPharma, Inc., which is carried at cost. SinusPharma, Inc. was the parent company of SinusPharmacy Corporation. The Company purchased the majority of the operating assets of SinusPharmacy Corporation on September 11, 2003. See Note 3 – Acquisitions.

During the year ended January 3, 2004, the Company made a \$500,000 investment in Burrill Life Sciences Capital Fund, L.P. ("Burrill"), which is carried at cost. During the year ended January 1, 2005, the Company made additional investments in Burrill totaling \$1.2 million. The total investment in Burrill at January 1, 2005 is \$1.7 million. The Company has an additional commitment of \$3.3 million related to this investment. The additional commitment is due at various times depending on the growth of Burrill and upon final funding the Company is expected to own less than 3% of Burrill.

The Company performs annual impairment tests of investments carried at cost. During the years ended January 3, 2004 and January 1, 2005, the tests did not result in any impairment charges.

NOTE 7 AETNA SPECIALTY PHARMACY, LLC

In August 2004, the Company and Aetna Inc. formed a new joint venture, Aetna Specialty Pharmacy, LLC, which is an Aetna-branded specialty pharmacy operation. The joint venture is owned 60% by the Company and 40% by Aetna. Aetna has an option to purchase the Company's 60% interest beginning in 2008, subject to acceleration under certain circumstances. Aetna funded its ownership interest in the joint venture with cash and the Company contributed cash and an interest in certain intellectual property for its 60% interest in the joint venture. The amount of the Company's contribution was not material to its financial condition.

The terms of the joint venture require the Company to build, develop and staff on behalf of the joint venture a stand-alone specialty pharmacy capable of handling certain specialty pharmacy needs of Aetna. The specialty pharmacy must be completed in accordance with a specified development schedule and within certain cost limitations. The Company also entered into a drug supply agreement with the joint venture and a specialty pharmacy back-up provider agreement with Aetna to provide specialty pharmacy services in instances where the joint venture is unable to do so.

Pursuant to its policy, the Company has determined that the joint venture should be consolidated under the provisions of FIN 46, Consolidation of Variable Interest Entities. Since its inception, the results of operations of the joint venture (which were not material) have been included in the Company's financial statements.

Aetna Inc., accounted for approximately 7%, 8% and 10% of the Company's net sales in 2004, 2003 and 2002, respectively.

NOTE 8 INTANGIBLES

The carrying amount of acquired intangible assets at January 1, 2005 and January 3, 2004 is as follows:

<i>(In Thousands)</i>	2004	2003
Goodwill	\$ 154,984	\$ 105,829
Other intangibles	5,185	2,404
Accumulated amortization	(1,428)	(1,106)
Other intangibles, net	3,757	1,298
Goodwill and other intangibles	<u>\$ 158,741</u>	<u>\$ 107,127</u>

The \$49.2 million increase in the carrying amount of goodwill relates to acquisitions made during 2004. The \$2.8 million increase in the carrying amount of other intangibles relates to trademarks, non-compete agreements and certificates of need.

Amortization expense was \$322,000, \$119,000 and \$100,000 for the years ended January 1, 2005, January 3, 2004 and December 28, 2002, respectively. Amortization expense is expected to aggregate approximately \$439,000 during each of the next five years.

NOTE 9 REVOLVING CREDIT FACILITY

On February 5, 2004, the Company entered into, and on February 27, 2004, the Company amended, an agreement with Suntrust Bank, as administrative agent, and the lenders named therein, for an unsecured three year revolving credit facility for up to \$150 million. The revolving credit facility requires the Company, among other things, to maintain a minimum consolidated net worth, a minimum interest coverage ratio and limits the Company's leverage ratio. At January 1, 2005 the Company was in compliance with these covenants. The Company may use the entire \$150 million credit facility for letters of credit or direct borrowings. At January 1, 2005 the Company had an outstanding principal balance of \$40.0 million and an outstanding interest payable balance of \$290,000.

Interest rates charged on borrowings can vary depending on the interest rate option utilized. Options for the interest rate are based upon the greater of prime rate or federal funds rate plus 50 basis points for the swing line commitment and base rate borrowing or an adjusted LIBOR rate for Eurodollar borrowing. At January 1, 2005 the borrowing rate was 2.565% on the outstanding balance of \$40.0 million. The Company is also required to pay a quarterly facility fee on the total revolving commitment (whether used or unused). At January 1, 2005 the facility fee was .15%. The applicable margin for the adjusted LIBOR rate Eurodollar loans and the applicable percentage for the facility fee are based upon the Company's leverage ratio, which is calculated quarterly in the loan covenants and compliance reporting. In addition, the Company incurred credit facility origination costs of \$541,000 which are being amortized to interest expense over the life of the credit facility. The principal and interest was due in January 2005 and subsequently extended to July 2005.

NOTE 10 INCOME TAXES

The provision for income taxes includes state income taxes of \$2.4 million, \$2.4 million and \$2.7 million for the years ended January 1, 2005, January 3, 2004 and December 28, 2002, respectively.

The following table indicates the significant elements contributing to the difference between the U.S. federal statutory tax rate and the effective tax rate:

	2004	2003	2002
Percentage of earnings before taxes:			
U.S. federal statutory rate	35.0%	35.0%	35.0%
State and local taxes on income, net of federal income tax benefit	2.9%	2.5%	2.5%
Effective rate	37.9%	37.5%	37.5%

Presented below are the significant elements of the net deferred tax balance sheet accounts at January 1, 2005 and January 3, 2004:

<i>(In Thousands)</i>	2004	2003
Deferred tax asset:		
Receivables	\$ 2,623	\$ 2,055
Finished goods inventories	54	78
Investments	723	659
Deferred compensation	1,174	875
Restricted stock	428	213
Accrued expenses	398	192
Total deferred tax assets	5,400	4,072
Deferred tax liabilities:		
Fixed assets	(4,063)	(3,695)
Intangibles	(7,717)	(4,489)
Other	(259)	—
Total deferred tax liabilities	(12,039)	(8,184)
Total net deferred income taxes	(6,639)	(4,112)
Less current deferred tax assets	(3,075)	(2,325)
Non current deferred income taxes	\$ (9,714)	\$ (6,437)

NOTE 11 PROFIT SHARING PLAN

All employees are generally eligible to participate in the Profit Sharing Plan as of the first January 1, April 1, July 1 or October 1 after having completed at least three months of service (as defined in the Profit Sharing Plan) and having reached age 18 ("Participant"). Participants are generally eligible to receive an annual contribution from the Company after having completed at least one year of service (as defined in the Profit Sharing Plan) and having reached age 18. The annual contribution of the Company to the Profit Sharing Plan is at the discretion of the Board of Directors of the Company and during the last three years has been between 1.5% and 7.0% of the Participant's compensation. The employer contribution for a year is allocated among the Participants employed on the last day of the year, and who completed at least 1,000 hours of service during the year, in proportion to their relative compensation for the portion of the year in which they were eligible to participate. The Profit Sharing Plan expense (net of forfeitures) for the years ended January 1, 2005, January 3, 2004 and December 28, 2002 was \$111,000, \$530,000 and \$1.8 million, respectively.

NOTE 12 CAPITAL STOCK

The two classes of Common Stock entitle holders to the same rights and privileges, except that holders of shares of Class A Common Stock are entitled to three votes per share on all matters submitted to a vote of holders of Common Stock and holders of Class B Common Stock are entitled to one vote per share on such matters. The Class A Common Stock will automatically be converted into shares of Class B Common Stock on a share-for-share basis upon any transfer or purported transfer to any person other than: (i) a dividend or other distribution of the shares of Class A Common Stock to the shareholders of BWI; or (ii) family members of the holder of Class A Common Stock, or trusts for the benefit of or entities controlled by the holder of Class A Common Stock or family members of the holder.

Shares of restricted stock as to which restrictions have not lapsed are not transferable other than pursuant to the laws of descent and distribution.

On July 18, 2002, the Company's Board of Directors approved the purchase of up to 1,000,000 shares of the Company's outstanding shares of Class B Common Stock. On August 14, 2002 the Board of Directors approved an additional purchase of up to 1,000,000 shares of the Company's outstanding shares of Class B Common Stock. These purchases were approved through July 17, 2003. In 2002, 585,300 shares were purchased in the open market pursuant to these

authorizations at an average price of \$20.45 and were included in treasury stock. In 2003, 179,200 shares were purchased in the open market pursuant to these authorizations at an average price of \$19.16 and were included in treasury stock. The Company purchased the treasury stock because management believed the market undervalued the stock.

On July 17, 2003, the Company's Board of Directors approved the purchase of up to 3,000,000 shares of the Company's outstanding shares of Class B Common Stock. The purchases were approved through July 16, 2004. In 2003, 394,100 shares were purchased in the open market pursuant to this authorization at an average price of \$19.89 and were included in treasury stock. In 2004, 60,000 shares were purchased in the open market pursuant to this authorization at an average price of \$19.28 and were included in treasury stock. The Company purchased the treasury stock because management believed the market undervalued the stock.

On October 27, 2004, the Company's Board of Directors approved the purchase of up to 2,000,000 shares of the Company's outstanding shares of Class B Common Stock. The purchases are approved through October 31, 2005. In 2004, no shares were purchased pursuant to this authorization.

NOTE 13 STOCK OPTION AND INCENTIVE PLANS

On August 25, 1997, the Board of Directors and BWI, as sole shareholder of the Company, adopted the 1997 Stock Option and Incentive Plan (the "1997 Stock Option Plan"). Under the 1997 Stock Option Plan, the Company may award stock options and shares of restricted stock to officers, key employees and consultants of the Company. The aggregate number of shares of Class B Common Stock that may be awarded under the 1997 Stock Option Plan is 7,900,000, subject to adjustment in certain events. No individual participant may receive awards for more than 300,000 shares in any calendar year.

Under the 1997 Stock Option Plan, awards of restricted shares may be made, in which case the grantee would be granted shares of Class B Common Stock, subject to any determined forfeiture or transfer restrictions. During the year ended January 1, 2005, 9,000 and 69,275 restricted shares were granted with a grant date fair value of \$21.30 and \$17.85 per share, respectively. During the year ended January 3, 2004, 68,575 restricted shares were granted with a grant date fair value of \$20.53 per share. During the year ended December 28, 2002, 53,000 restricted shares were granted with a grant

date fair value of \$24.35 per share. 156,201 and 108,323 unearned restricted shares were outstanding at January 1, 2005 and January 3, 2004, respectively. The value of these restricted shares are charged to compensation expense over the vesting periods of 4 to 5 years. During the years ended January 1, 2005, January 3, 2004 and December 28, 2002, \$1.2 million, \$853,000 and \$0, respectively, was charged to compensation expense for the restricted shares.

The Compensation Committee of the Board of Directors administers the 1997 Stock Option Plan and has the authority to select those officers and key employees to whom awards will be made, to designate the number of shares to be covered by each award, to establish vesting schedules, and to specify all other terms of the awards. With respect to stock options that are intended to qualify as "incentive stock options" under Section 422 of the Internal Revenue Code, the option price must be at least 100% (or, in the case of a holder of more than 10% of the total combined voting power of the Company's stock, 110%) of the fair market value of a share of Class B Common Stock on the date of the grant of the stock option. The Compensation Committee will establish the exercise price of options that do not qualify as incentive stock options ("non-qualified stock options"). No options may be exercised more than 10 years from the date of grant, or for such shorter period as the Compensation Committee may determine at the date of grant. Awards of options are not transferable other than pursuant to the laws of descent and distribution.

On August 25, 1997, the Board of Directors and BWI, as sole shareholder of the Company, approved the adoption of the Outside Directors Stock Option Plan. Subsequently, the name was changed to Outside Directors Stock Plan (the "Directors Plan"). The Directors Plan reserves for issuance 175,000 shares of the Company's Class B Common Stock, subject to adjustment in certain events. Pursuant to the Directors Plan, each non-employee director is automatically granted an option to purchase 4,000 shares of Class B Common Stock on June 1 of each year beginning June 1, 2004. From June 1, 1998 to June 1, 2003, each non-employee director was automatically granted an option to purchase 3,000 shares of Class B Common Stock each year. The option exercise price per share will be the fair market value of one share of Class B Common Stock on the date of grant. Each option becomes exercisable six months following the date of grant and expires 10 years following the date of grant.

On September 15, 1998, the Board of Directors of the Company approved the adoption of the Broad Based Stock Option Plan (the "Broad Based Plan"). The Broad Based Plan reserves for issuance 1,837,323 shares of the Company's Class B Common Stock, subject to adjustment in certain events. The number of shares which may be granted under the Broad Based Plan during any calendar year shall not exceed 50,000

shares to any one person. The Compensation Committee of the Board of Directors administers the Broad Based Plan and establishes vesting schedules. Each option expires 10 years following the date of grant.

Changes in stock options under all of the Company's plans are shown below:

	Number of shares	Weighted average price per share
Options outstanding at December 29, 2001 (756,435 shares exercisable)	5,155,232	\$ 22.40
Forfeited during 2002	(337,258)	\$ 27.23
Granted during 2002	995,540	\$ 24.88
Exercised during 2002	<u>(238,546)</u>	\$ 15.58
Options outstanding at December 28, 2002 (2,100,353 shares exercisable)	5,574,968	\$ 22.83
Forfeited during 2003	(578,795)	\$ 27.36
Granted during 2003	902,340	\$ 20.60
Exercised during 2003	<u>(167,617)</u>	\$ 13.18
Options outstanding at January 3, 2003 (3,950,585 shares exercisable)	5,730,896	\$ 22.24
Forfeited during 2004	(286,595)	\$ 24.90
Granted during 2004	818,500	\$ 18.19
Exercised during 2004	<u>(158,324)</u>	\$ 8.75
Options outstanding at January 1, 2005 (4,621,382 shares exercisable)	<u>6,104,477</u>	\$ 21.91
Available for grant (including restricted share awards) at January 1, 2005	<u>1,254,005</u>	

Additional information regarding the Company's options outstanding at January 1, 2005 is shown below:

Range of Exercise Prices	Number Outstanding	Outstanding Weighted Average Remaining Contractual Life	Outstanding Weighted Average Exercise Price	Number Exercisable	Exercisable Weighted Average Exercise Price
\$ 4.63 to \$ 12.79	861,845	4.08 Years	\$ 9.11	861,845	\$ 9.11
\$ 13.63 to \$ 17.85	1,276,124	6.08 Years	\$ 17.30	541,624	\$ 16.55
\$ 20.53 to \$ 21.88	1,066,810	8.26 Years	\$ 20.84	652,431	\$ 20.96
\$ 22.58 to \$ 24.38	708,225	7.90 Years	\$ 24.29	533,017	\$ 24.28
\$ 25.13 to \$ 27.66	1,174,339	6.98 Years	\$ 27.43	1,133,492	\$ 27.48
\$ 30.15 to \$ 38.38	1,017,134	6.71 Years	\$ 31.61	898,973	\$ 31.54

NOTE 14 COMMITMENTS

The Company leases specialty pharmacy, warehouse and office space under noncancelable operating leases expiring at various dates through 2014, with options to renew for various periods. Future minimum commitments (excluding real estate taxes and maintenance costs) under the leases at January 1, 2005 are as follows:

Year ending	<i>(In Thousands)</i>
2005	\$ 3,876
2006	3,843
2007	3,616
2008	2,738
2009	2,118
Thereafter	<u>5,335</u>
Total	<u>\$ 21,526</u>

The operating lease rent expense (including real estate taxes and maintenance costs) for the years ended January 1, 2005, January 3, 2004 and December 28, 2002 was \$3.2 million, \$2.1 million and \$1.7 million, respectively.

During 2004, the Company received a letter from a payor alleging that one of the Company's subsidiaries was in violation of certain provisions of the payor's contract. The payor demanded \$8.6 million in overcharges, going back to 1997, and threatened to terminate that subsidiary's participation in the payor's network. The Company resolved the dispute during the fourth quarter of 2004 for approximately \$4.4 million, which included related costs of the settlement.

NOTE 15 MAJOR CUSTOMERS AND OTHER CONCENTRATIONS

The Company services customers in all 50 states. During the years ended January 1, 2005, January 3, 2004 and December 28, 2002 the Company had one third party payor which accounted for 7%, 8% and 10%, respectively, of the Company's net sales. In August 2004, the Company formed a new joint venture with this third party payor. See Note 7—Aetna Specialty Pharmacy, LLC. The Company sells goods and services to its customers on various payment terms which entail accounts receivable exposure. Although the Company monitors closely the creditworthiness of its customers, there can be no assurance that the Company will not incur a write-off or writedown in the future.

Product provided by one of the Company's largest vendors accounted for approximately 10%, 11% and 11% of net sales in the years ended January 1, 2005, January 3, 2004 and December 28, 2002, respectively. The Company has

another vendor whose products accounted for approximately 3%, 10% and 16% of net sales in 2004, 2003 and 2002, respectively. The Company has another vendor whose products accounted for approximately 14%, 11% and 15% of net sales in 2004, 2003 and 2002, respectively. These products are available only from these manufacturers and the Company must maintain a good working relationship with these manufacturers.

NOTE 16 LEGAL PROCEEDINGS

In November 2004, the Company received a subpoena from the U.S. Department of Justice (the "DOJ") requiring the Company to provide the DOJ with certain information regarding the promotion and marketing of Actimmune, a product manufactured by InterMune, Inc. The Company believes that the materials sought by the DOJ are part of an ongoing investigation being conducted by the United States Attorney's Office for the Northern District of California. The Company is fully cooperating with the DOJ, however should the DOJ find that the Company acted improperly, it could subject the Company to fines and/or sanctions, which could have a material adverse effect on the Company's business or financial condition.

The Company is also subject to ordinary and routine lawsuits and governmental inspections, investigations and proceedings incidental to its business, none of which is expected to be material to the Company's results of operations, financial condition or cash flows.

NOTE 17 FACILITY CONSOLIDATION AND EMPLOYEE TERMINATION COSTS

During the second quarter of 2004, the Company recorded a restructuring charge of approximately \$1.3 million related to facility consolidation and certain employee and lease termination costs. The Company consolidated its Carpinteria, CA location into its Monrovia, CA location and eliminated certain employee positions, which included some in the Lake Mary, FL location, to streamline operations. The lease termination costs end in 2007. A total of 68 employees were impacted in the Carpinteria, CA and Lake Mary, FL locations.

The following is a reconciliation of the beginning and ending liability balances showing separately the changes during the three-month periods ended July 3, 2004, October 2, 2004 and January 1, 2005 attributable to restructuring costs incurred and charged to expense and restructuring costs paid:

<i>(000's Omitted)</i>	Employee Termination Costs	Lease Termination Costs
April 3, 2004 liability balance	\$ —	\$ —
Costs incurred and charged to expense	828	489
Costs paid	(645)	(20)
July 3, 2004 liability balance	183	469
Costs paid	(183)	(125)
October 2, 2004 liability balance	\$ —	\$ 344
Costs paid	—	(44)
January 1, 2005 liability balance	\$ —	\$ 300

NOTE 18 SELECTED QUARTERLY FINANCIAL DATA (Unaudited)

	Quarter ended April 3, 2004	Quarter ended July 3, 2004	Quarter ended October 2, 2004	Quarter ended January 1, 2005
<i>(In Thousands, Except Share and Per Share Data)</i>				
Net sales	\$ 401,243	\$ 438,452	\$ 440,159	\$ 459,764
Gross profit	43,013	45,867	51,827	52,184
Net earnings	12,239	12,164	12,641	7,582
Earnings per share:				
Basic	\$.28	\$.28	\$.29	\$.17
Diluted	\$.28	\$.28	\$.29	\$.17
Weighted average shares outstanding:				
Basic	43,322,604	43,288,606	43,531,489	43,611,206
Diluted	44,056,295	43,797,690	44,160,814	44,070,517
	Quarter ended March 29, 2003	Quarter ended June 28, 2003	Quarter ended September 27, 2003	Quarter ended January 3, 2004
<i>(In Thousands, Except Share and Per Share Data)</i>				
Net sales	\$ 351,529	\$ 350,507	\$ 362,855	\$ 396,920
Gross profit	40,285	37,784	39,372	44,422
Net earnings	13,184	11,407	12,194	13,815
Earnings per share:				
Basic	\$.30	\$.26	\$.28	\$.32
Diluted	\$.30	\$.26	\$.28	\$.32
Weighted average shares outstanding:				
Basic	43,521,657	43,577,129	43,259,781	43,258,876
Diluted	44,010,503	44,289,419	43,773,728	43,813,506

During the fourth quarter of 2004, the Company recorded a charge of approximately \$4.4 million related to a settlement, and the related costs of the settlement, with a payor. Also during the fourth quarter of 2004, the Company recorded a charge of approximately \$3.0 million primarily related to Sinus accounts receivable.

The Company believes that the financial statements for the quarterly periods shown above reflect all necessary adjustments for fair presentation. Results for any interim period may not be indicative of the results for the entire year.

Financial Statement Schedule II – Valuation and Qualifying Accounts and Reserves

<i>(000's Omitted)</i>	Balances at Beginning of Year	Charged to Costs and Expenses	Charged to Other Accounts	Accounts Written Off Net of Recoveries	Balances at End of Year
Allowances for doubtful accounts:					
Year ended December 28, 2002	\$ 3,239	\$ 2,449	\$ —	\$ (251)	\$ 5,437
Year ended January 3, 2004	5,437	2,197	—	(2,154)	5,480
Year ended January 1, 2005	5,480	6,141	—	(4,718)	6,903

	Balances at Beginning of Year	Provision Related to Sales	Actual Amounts Charged Off	Balances at End of Year
Discounts and Contractual Allowances:				
Year ended December 28, 2002		\$ 8,107	\$ 13,090	\$ 8,773
Year ended January 3, 2004		8,773	11,248	6,205
Year ended January 1, 2005		6,205	6,009	3,337

Market Prices and Dividends

MARKET PRICES The Company's Class B Common Stock trades on The Nasdaq Stock Market ("Nasdaq") under the symbol PHCC. The prices set forth below reflect the high and low sales prices for the Company's Class B Common Stock as reported by Nasdaq for each fiscal quarter in the years ended January 3, 2004 and January 1, 2005. As of March 1, 2005, there were 92 holders of record of the Company's Class B Common Stock.

	High	Low
2003:		
First Quarter	\$ 26.88	\$ 19.64
Second Quarter	27.80	17.54
Third Quarter	23.70	17.81
Fourth Quarter	25.00	19.35
2004:		
First Quarter	\$ 26.80	\$ 18.85
Second Quarter	25.01	19.52
Third Quarter	24.68	19.95
Fourth Quarter	22.37	17.66

The Company's Class A Common Stock is not listed for trading. However, because the Class A Common Stock is automatically converted into Class B Common Stock upon transfer (except in limited circumstances), the Class A Common Stock is freely tradable except by affiliates of the Company. As of March 1, 2005, there were 544 holders of record of the Company's Class A Common Stock.

DIVIDENDS The Company does not intend to pay cash dividends on its Common Stock in the foreseeable future, but rather intends to use future earnings principally to support operations and to finance expansion and possible acquisitions. The payment of cash dividends in the future will be at the discretion of the Company's Board of Directors and will depend on a number of factors, including the Company's financial condition, capital requirements, future business prospects, the terms of any documents governing indebtedness of the Company (including the Company's revolving credit agreement, which imposes limitations on dividends and other distributions), and such other factors as the Board of Directors of the Company may deem relevant. Subject to the terms of any preferred stock created by the Company's Board of Directors, each outstanding share of Common Stock will be entitled equally to such dividends as may be declared from time to time by the Board of Directors.

Five Years In Review

	Year ended				
	January 1, 2005	January 3, 2004	December 28, 2002	December 29, 2001	December 30, 2000
<i>(000's Omitted, Except Share and Per Share Data)</i>					
STATEMENT OF EARNINGS DATA:					
Net sales	\$ 1,739,618	\$ 1,461,811	\$ 1,200,391	\$ 805,120	\$ 584,657
Cost of products sold	1,546,727	1,299,948	1,063,181	712,971	514,360
Gross profit	192,891	161,863	137,210	92,149	70,297
Selling, general and administrative expense	108,197	77,932	64,959	48,349	31,313
Impairment of fixed asset	—	—	2,386	—	—
Restructuring charge	1,317	—	—	—	—
Depreciation and amortization	6,591	4,273	2,760	3,400	1,335
Earnings from operations	76,786	79,658	67,105	40,400	37,649
Impairment of investment	—	—	—	(2,019)	—
Third party payor settlement	(4,401)	—	—	—	—
Minority interest	(212)	—	—	—	—
Interest expense	(1,060)	—	—	—	—
Interest income	707	1,302	2,632	5,972	6,920
Earnings before income taxes	71,820	80,960	69,737	44,353	44,569
Provision for income taxes	27,194	30,360	26,151	16,633	16,490
Net earnings	\$ 44,626	\$ 50,600	\$ 43,586	\$ 27,720	\$ 28,079
Earning per share:					
Basic	\$ 1.03	\$ 1.17	\$ 1.00	\$.64	\$.66
Diluted	\$ 1.01	\$ 1.15	\$.98	\$.62	\$.65
Weighted average shares outstanding:					
Basic	43,438,475	43,362,614	43,699,208	43,542,518	42,254,841
Diluted	44,023,741	43,930,042	44,384,665	44,555,586	43,096,956
Dividends					
	—	—	—	—	—
	January 1, 2005	January 3, 2004	December 28, 2002	December 29, 2001	December 30, 2000
BALANCE SHEET DATA:					
Working capital	\$ 215,392	\$ 208,439	\$ 185,434	\$ 188,680	\$ 194,724
Total assets	669,393	514,009	484,862	396,016	297,101
Long-term obligations	—	—	—	—	—
Total liabilities	250,879	171,100	190,435	141,676	86,498
Minority interest	23,212	—	—	—	—
Shareholders' equity	395,302	342,909	294,427	254,340	210,603

CORPORATE INFORMATION

Annual Meeting

The Company will hold its Annual Meeting of Shareholders at 9:00 a.m. on May 16, 2005, at the Aetna Specialty Pharmacy, 503 Sunport Lane, Orlando, Florida 32809.

Common Stock Price

The Class B Common Stock of the Company is traded on The Nasdaq Stock Market under the symbol PHCC. The number of shareholders of record as of March 1, 2005 was 636. The total number of beneficial owners was approximately 23,000.

Form 10-K

A copy of the Company's Annual Report on Form 10-K (including financial statements but without exhibits) filed with the Securities and Exchange Commission may be obtained, without charge, from: Stephen M. Saft, Chief Financial Officer and Treasurer, Priority Healthcare Corporation
250 Technology Park
Lake Mary, Florida 32746
407-804-6700

Stock Transfer Agent and Registrar

Computershare Services
Islander One
7550 Lucerne Drive, Suite 103
Cleveland, Ohio 44130-6503
312-360-5279

Independent Accountants

PricewaterhouseCoopers LLP
Orlando, Florida

Legal Counsel

Baker & Daniels
Indianapolis, Indiana

Corporate Offices

250 Technology Park
Lake Mary, Florida 32746
Telephone: 407-804-6700
www.priorityhealthcare.com

BOARD OF DIRECTORS

William E. Bindley

Chairman of the Board,
Priority Healthcare Corporation
Chairman, Bindley Capital Partners, LLC
Indianapolis, Indiana

Robert L. Myers

Vice Chairman,
Priority Healthcare Corporation
Lake Mary, Florida

Steven D. Cosler

President and Chief Executive Officer,
Priority Healthcare Corporation
Lake Mary, Florida

Michael D. McCormick

Partner, Bindley Capital Partners, LLC
Indianapolis, Indiana

Thomas J. Salentine

Partner, Bindley Capital Partners, LLC
Indianapolis, Indiana

Richard W. Roberson

President, Sand Dollar Partners, Inc.
Clearwater, Florida

Kathleen R. Hurtado, R.Ph.

President and Chief Executive Officer of
Health Research Association, Inc.
Los Angeles, California

Glenn D. Steele, Jr., M.D.

President and Chief Executive Officer,
Geisinger Health System
Danville, Pennsylvania

SENIOR MANAGEMENT



Guy F. Bryant

Executive Vice President and
General Manager, Distribution Services

Rebecca M. Shanahan

Executive Vice President
of Administration, General
Counsel and Secretary

Stephen M. Saft

Chief Financial Officer
and Treasurer

Steven D. Cosler

President and
Chief Executive Officer

Kim K. Rondeau

Executive Vice President
of Specialty Pharmacy Sales and
Marketing

Tracy R. Nolan

Executive Vice President and
Chief Operating Officer



PRIORITY HEALTHCARE[®]

Priority Healthcare Corporation 250 Technology Park Lake Mary, Florida 32746
Telephone 407.804.6700 www.priorityhealthcare.com