

October 31, 2002

Rules affecting PolyMedica's pricing scheduled for November release.

A study conducted by the U.S. Department of Health and Human Services ("HHS") Office of Inspector General ("OIG") released on June 12, 2002 found that Medicare paid higher than market prices for some medical supplies. According to Senator Tom Harkin's office the study shows that Medicare "wasted" \$958 million in 2000 due to overpayments on 16 commonly purchased medical supplies. Blood glucose test strips ("strips") were the single largest source of "wasted" taxpayers' dollars of the 16 medical supplies studied. Strips accounted for \$244 million or more than 25% of the total overpayments disclosed in the study. Additional information about the OIG report is available in Asensio & Company, Inc.'s June 14, 2002 and August 13, 2002 PolyMedica Corporation (NASDAQ: PLMD, \$28.50) research reports.

The HHS' Centers for Medicare and Medicaid Services ("CMS") is responsible for administering the Medicare program. The Balanced Budget Act of 1997 grants CMS "Inherent Reasonableness" ("IR") authority. IR gives CMS the ability to adjust prices of items and services it deems to be grossly excessive or deficient.

CMS may conduct an IR study and use its findings to adjust (up or down) the prices Medicare pays for items and services by up to 15% in a given year. Generally, IR studies involve surveying price data for a particular item or service, comparing the price data to current Medicare payment levels and developing a plan to adjust Medicare's reimbursement. The price changes are then published in the Federal register for public comment. After the public's comments are considered the price changes may be effected.

CMS used its IR authority to reduce the prices Medicare paid for home blood glucose monitors and other medical items in early 1998. In September 1998 CMS again invoked its IR authority in proposing a reduction of Medicare reimbursement levels for strips and several other items. The affected durable medical equipment ("DME") manufacturers and suppliers objected to the methodology used in the IR study. CMS then suspended the proposed payment reductions. Then in November 1999 Congress passed legislation prohibiting CMS from using its IR authority until the U.S. General Accounting Office ("GAO") issued a report evaluating CMS' use of the IR process and a new Final Rule detailing the specific procedures for an IR study was published in the Federal Register.

In July 2000 the GAO completed its report. The GAO found that CMS used its IR process in a "generally appropriate" manner. The GAO's report recommended three changes to be incorporated into the new Final Rule to be developed by CMS. In July 2002 Administrator Tommy Thompson of the HHS signed and submitted a proposed Final Rule to the U.S. Office of Management and Budget ("OMB") for approval prior to publication in the Federal Register. In July 2002 Stewart Shapiro, Assistant Branch Chief of the OMB, Office of Information and Regulatory Affairs ("OIRA"), stated that the Final Rule would be approved, returned or withdrawn within 90 days, or by October 21, 2002. During this period OMB and HHS prepared the Final Rule for publication in the Federal Register.

On October 18, 2002 HHS withdrew the Final Rule. HHS reportedly resubmitted the same Final Rule to allow an additional 90 days for HHS and OMB to conduct further work on procedures. (On October 18th PolyMedica stock rose as high as 10% from the prior day's close.) Joel Kaiser, Health Insurance Specialist in CMS' Office for Chronic

Care Policy, stated that on Tuesday, October 22, 2002 Sec. Thompson hosted an informal open forum for DME manufacturers, distributors and supply companies. (We found no public notice for the forum.) At the forum Sec. Thompson announced that he expected the Final Rule to be published in the Federal Register by the end of November 2002. According to Mr. Shapiro, the Final Rule will not be subject to public comment and should become effective within 60 days after publication.

Approximately \$201 million, or 72%, of PolyMedica Corporation's total net revenues in fiscal 2002 came from sales of strips and related products. PolyMedica is reimbursed by Medicare. Congress and CMS are aware Medicare reimbursements are excessive for strips and other DME. CMS had already proposed a 3.4% decrease in reimbursement for strips in 1999 before Congress blocked CMS from using its IR authority.

OMB OIRA reviews all major national health, safety, and environmental standards. Stewart Shapiro is the OIRA Assistant Branch Chief under OIRA Branch Chief John F. Morrall III. Mr. Morrall is scheduled to sign the Final Rule if it is approved to be published in the Federal Register. John D. Graham, Ph.D., is the OMB, OIRA Administrator and is ultimately responsible for the Final Rule. Adm. Graham was nominated by President George W. Bush and was confirmed by Congress in July 2001.

The Federal Register is the official daily publication for Rules, Proposed Rules, and Notices of Federal agencies and organizations, Executive Orders and other Presidential Documents. The terms "rules" and "regulations" are used interchangeably in the Federal Register publication system. A Final Rule takes final action without a prior proposed rule.

The Department of Justice is currently conducting a criminal investigation of PolyMedica's Medicare billings. The investigation commenced on or about June 24, 1999. On August 21 and 22, 2001, pursuant to a Federal court order, the FBI conducted a search of PolyMedica's facilities and the homes of two of its officers. The allegations against PolyMedica reported in its August 14, 2002 form 10-Q filing expanded to include obstruction of justice.

Asensio & Company, Inc. believes PolyMedica's results are not sustainable and that its stock is grossly overvalued. Our reports on PolyMedica are available at www.asensio.com.