

August 13, 2002

PolyMedica's "hidden" losses surpass \$55 million. Medicare moves to cut payments.

On July 25, 2002 PolyMedica Corporation (NASDAQ: PLMD, \$27.41) announced a dubious \$592,000 increase in its reported quarterly net income. This meager \$0.6 million increase in net income was questionably accomplished with a \$3.2 million increase in accounts receivable, a \$4.4 million increase in inventories and near-record advertising expenditures estimated to have cost \$11.5 million, or 14%, of revenues. In addition PolyMedica spent \$2.4 million on prepaid expenses and other assets that were also not expensed. PolyMedica's income before income taxes would have decreased by 37% if its unexpensed advertising and pre-paid expenses, and expenditures in other assets were deducted. The resulting adjusted net income of \$5.8 million is \$2.7 million, or 32%, less than PolyMedica's reported net income in the prior quarter.

During the quarter PolyMedica did not expense an estimated \$3 million of the \$11.5 million it spent on advertising costs. This added \$3 million to PolyMedica's already inflated direct response advertising "asset" that now has a record current balance of \$55 million. The balance is now equal to 35% of PolyMedica's total net accumulated pretax income for the last five years.

PolyMedica's Property, Plant and Equipment, net of depreciation ("PP&E") continued to increase in the quarter and is now \$39.3 million. PolyMedica's PP&E turnover ratio has declined from 15.3 times on March 31, 1999 to 7.6 times on June 30, 2002. As detailed in our May 20, 2002 report, PolyMedica's asset level is out of line in comparison to its peers. We view this strong negative trend very cautiously given the Company's highly aggressive asset accounting and expense capitalization policies.

The Department of Justice ("DOJ") is actively conducting a very important criminal investigation of PolyMedica's Medicare shipping, billings, collections and handling of returns. Last August it was reported that the FBI used 85 agents to conduct a raid of PolyMedica's facilities and the homes of two of its officers. This required that a U.S. Magistrate judge find probable cause of the existence of PolyMedica criminal conduct. The DOJ criminal investigation is properly and deliberately proceeding. Based upon our review of the case, including the history of a PolyMedica manager who was involved with companies engaged in incorrect financial reporting practices and settled Federal charges of Medicare fraud, we believe that it is very reasonable to expect that the DOJ will seek and obtain a criminal indictment against PolyMedica.

We believe that a reasonable analysis of PolyMedica's financial reporting should take into account the materiality of its existing criminal liability along with the quality of its reported earnings and its management. It is Asensio & Company, Inc.'s opinion that PolyMedica's reported criminal conduct has grossly inflated its stated earnings and created liabilities that far exceed its highest-estimated asset value.

In June 2000 the Office of Inspector General ("OIG") published a report concerning fraudulent and abusive practices in the glucose test strip ("strip") market. These include shipping excessive or unrequested strips and unsupported payments to suppliers. The report questioned whether some of the products that Medicare had paid-for were even delivered. On June 12, 2002 Senator Tom Harkin, Chairman of the Senate Appropriations Labor, Health and Human

Services, and Education Subcommittee, which funds Medicare, released a new OIG report that found Medicare overpays for strips. The OIG concluded that Medicare pays 49% more for strips than the Department of Veteran Affairs and detailed the required steps to reduce Medicare payments to suppliers. In fiscal 2002 sales of strips and related products represented 72% of PolyMedica's consolidated net revenues.

Stewart Shapiro, Assistant Branch Chief at the U.S. Office of Information and Regulatory Affairs, confirmed that Secretary Tommy Thompson of the U.S. Department of Health and Human Services ("HHS") has signed the proposed regulation ("Final Rule") required to conduct an inherent reasonableness study. An inherent reasonableness study is the process by which the Centers for Medicare and Medicaid Services may reduce "grossly excessive" Medicare payment rates on durable medical equipment by up to 15% in a given year. Mr. Shapiro also confirmed that the U.S. Office of Management and Budget ("OMB") and HHS are currently working together to prepare the Final Rule for approval by October 21, 2002 and submission to the Federal Register. According to Mr. Shapiro, the Final Rule is not subject to public comment.

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.