SPECIALTY LABORATORIES
Form 10-K
March 30, 2001

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTIONS 13 OR 15 OF THE SECURITIES EXCHANGE ACT OF 1934

(MARK ONE)

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

For the fiscal year ended December 31, 2000

OR

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

For the transition period from _____ to _____

Commission file number 001-16217

SPECIALTY LABORATORIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

California	**95-2961036**
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

2211 Michigan Avenue
Santa Monica, California 90404
(Address of principal executive offices, including zip code)
Registrant's Telephone Number, Including Area Code: **(310) 828-6543**

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

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, no par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes /x/ No / /

Indicate by a check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. / /

As of March 20, 2001 the approximate aggregate market value of voting stock held by non-affiliates of the registrant was $126,479,370 (based upon the closing price for shares of the registrant's Common Stock as reported by the New York Stock Exchange on that date). Shares of Common Stock held by each officer, director, and holder of 5% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of March 20, 2001, there were approximately 20,937,507 shares of Common Stock outstanding.

Documents Incorporated By Reference

Part III incorporates certain information by reference from the registrant's definitive proxy statement (the "Proxy Statement") for the Annual Meeting of Shareholders scheduled to be held on May 11, 2001.

SPECIALTY LABORATORIES, INC.
FORM 10-K ANNUAL REPORT

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This Annual Report on Form 10-K, including information incorporated herein by reference, contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements relate to expectations concerning matters that are not historical facts. Words such as "projects," "believes," "anticipates," "will," "estimate," "plans," "expects," "intends," and similar words and expressions are intended to identify forward-looking statements. Although we believe that such forward-looking statements are reasonable, we cannot assure you that such expectations will prove to be correct. Important language regarding factors which could cause actual results to differ materially from such expectations are disclosed in this Report, including without limitation under the caption "Risk Factors" beginning on page 20 of this Report, and in our Registration Statement on Form S-1 (No. 333-45588) declared effective by the Securities and Exchange Commission ("SEC") on December 7, 2000. All forward-looking statements attributable to Specialty Laboratories are expressly qualified in their entirety by such language. We do not undertake any obligation to update any forward-looking statements.

PART I.

ITEM 1. BUSINESS

Overview

Specialty Laboratories is a leading research-based clinical laboratory predominantly focused on developing and performing esoteric clinical laboratory tests, which we refer to as assays. We believe we offer one of the industry's most comprehensive menus, comprised of more than 3,500 esoteric assays, many of which have been developed through our internal research and development efforts. Esoteric assays are complex, comprehensive or unique tests used to diagnose, evaluate and monitor patients. These assays are often performed on sophisticated instruments by highly skilled personnel and are therefore offered by a limited number of clinical laboratories.

Our primary customers are hospitals, independent clinical laboratories and physicians. We have aligned our interests with those of hospitals, our fastest growing client segment, by not competing in the routine test market that provides them with a valuable source of revenue. We educate physicians on the clinical value of our assays through our information-oriented marketing campaigns. Our technical, experienced sales force concentrates on the hospitals and independent laboratories that serve as distribution channels for physician assay orders. We use our advanced information technology solutions to accelerate and automate electronic assay ordering and results reporting with these customers.

Our principal executive offices are located at 2211 Michigan Avenue, Santa Monica, California 90404.

Recent Developments

On February 20, 2001 we completed the acquisition of substantially all of the assets of BBI Clinical Laboratories, Inc., a wholly-owned subsidiary of Boston Biomedica, Inc., a public company. We paid $9,500,000 in cash which will be accounted for as a purchase in the first quarter of 2001. BBI Clinical Laboratories, a private company founded in 1989, is a leading esoteric clinical reference laboratory specializing in infectious disease testing, such as Lyme Disease and viral hepatitis. BBI Clinical Laboratories' primary customers include hospitals, physician specialists, pharmaceutical and diagnostic companies and other clinical and research laboratories.

Clinical Laboratory Industry

Clinical laboratory testing is critical to the delivery of quality healthcare to patients. Laboratory tests are used generally by physicians to assist in the detection, diagnosis, evaluation, monitoring and treatment of diseases and other medical conditions through the measurement and analysis of chemical

and cellular components in blood, other bodily fluids and tissues. Clinical laboratory tests are frequently ordered as part of physician office visits and hospital admissions. Most clinical laboratory tests ordered are considered routine and can be performed by most clinical laboratories. Esoteric assays generally require more sophisticated instruments and highly skilled personnel, and are typically outsourced to independent clinical laboratories that specialize in such assays.

Routine Segment of Clinical Laboratory Industry

Routine tests are ordered by physicians and may be performed by clinical laboratories through the use of standardized prepared kits manufactured by diagnostic companies. Routine tests include procedures in the areas of blood chemistry, hematology, urine chemistry, bacteriology, tissue pathology and cytology. Commonly ordered individual tests include red and white blood cell counts, Pap smears, blood cholesterol level tests, urinalyses and pregnancy tests. Because routine tests often employ mass-produced commercial kits, which can be performed with limited training, they are usually more competitively priced than esoteric assays. We do not compete in the routine segment of the clinical laboratory industry.

Esoteric Segment of Clinical Laboratory Industry

Esoteric assays are typically ordered when a physician requires additional information to complete a diagnosis, establish a prognosis or to choose and monitor a therapeutic regimen. Esoteric assays include procedures in the areas of molecular diagnostics, protein chemistry, cellular immunology and advanced microbiology. Commonly ordered esoteric assays include viral and bacterial detection assays, drug therapy monitoring assays, autoimmune panels and complex cancer evaluations. In contrast to routine tests, esoteric assays generally require sophisticated instruments and materials and highly skilled personnel to perform and analyze results. Consequently, esoteric assays are generally priced substantially higher than routine tests. Because it is not cost-effective for most hospitals, independent laboratories or physician office laboratories to develop and perform a broad menu of esoteric assays, these assays are generally outsourced to independent clinical laboratories that specialize in performing these complex assays.

Our Competitive Advantages

Comprehensive Menu of Esoteric Assays

We currently offer a comprehensive menu of more than 3,500 esoteric assays, which we believe is greater than any other clinical laboratory in the United States. The breadth of our assay menu distinguishes us from large independent laboratories which typically offer only a select number of esoteric assays and smaller niche laboratories focused on specific clinical areas. Our comprehensive menu allows our customers to rely on us for substantially all of their esoteric testing needs.

Many of our assays were developed through our R & D efforts and are unique and proprietary to us. We have historically leveraged our expertise in molecular diagnostics and applied it to high growth segments of the esoteric testing industry including fields of medicine such as infectious disease, gastroenterology, oncology and cardiology. We believe that we have developed one of the most extensive menus of assays in these attractive growth areas.

We market and sell many of our esoteric assays under trademarks such as GenotypR , our assays for predicting resistance to HIV, and ANAlyzer®, our assays used to help diagnose complex autoimmune disorders. For the year ended December 31, 2000, approximately 43% of our net revenue was derived from branded esoteric assays. We believe these branding efforts have contributed to increased market share and premium pricing as physician specialists often continue to rely on our products, even after the introduction of a similar assay by a competitor.

Research and Development Expertise

We focus our R & D efforts on introducing novel assays, improving existing technologies and enhancing our reputation as an industry leader in new assay development. We have developed and introduced over 600 new or improved esoteric assays over the past five years and we have the ability to bring a new esoteric assay to market within approximately three months. As an example, in 1988, we believe we were the first commercial laboratory to capitalize on the use of polymerase chain reaction technology, or PCR, by introducing and making PCR tests for HIV widely available. In emergency situations, we endeavor to develop new assays within a shorter period of time. For example, in 1999, within two weeks of learning about the outbreak of West Nile Fever in the New York metropolitan area, we developed a breakthrough detection assay and

worked with the Centers for Disease Control and Prevention to notify physicians that this assay was available to monitor the spread of the virus causing the outbreak.

Interests Aligned With Our Hospital Customers

Our predominant focus on the esoteric segment of the clinical laboratory industry allows us to align our interests with those of our hospital customers. Many hospital-based laboratories attempt to increase revenue by marketing and performing routine tests for physicians, commonly known as laboratory "outreach." Hospitals compete with national independent clinical laboratories for these routine tests. We believe that hospitals are more inclined to refer their esoteric testing to independent clinical laboratories, which do not compete with them for routine tests.

We enhance our hospital customers' outreach capabilities by marketing our comprehensive menu of esoteric assays as a complement to their routine testing. We also emphasize our laboratory outreach advisory services that help hospitals market their outreach laboratories to their physician community. These advisory services include information technology tools that will help connect hospital laboratories to physician offices. This connectivity improves communications and logistics between the hospital laboratories and their physician clients. We potentially benefit by receiving more esoteric assay referrals from these hospitals as they may receive more routine and esoteric laboratory referrals from their physicians. Ultimately, we believe this strategy enhances our access to esoteric assays that might otherwise be referred to our competitors.

Customer-Focused Information Technology Platforms

We offer all of our customers information technology that accelerates and automates assay ordering and results reporting. We believe that many of our competitors still manage a large portion of their order and results transactions manually. In 1998, approximately 40% of our transactions were transmitted electronically, principally through direct computer to computer links with a small number of our largest customers. At that time, we began a customer-focused information technology initiative to efficiently utilize the Internet. This project reduced the implementation time and cost of providing electronic links to large and small customers alike. This led to substantial cost savings, fewer data entry errors, improved ease of assay ordering and shorter turn-around time for results reporting. Today, over 85% of our transactions with our customers are conducted electronically. Furthermore, we believe that our customer-focused information technology offerings include a number of features that cannot be easily duplicated.

Operating Efficiency and Flexibility

We continually evaluate our operations for process improvement opportunities and have made substantial investments in advanced process automation projects. In the third quarter of 2000, we began implementing an automated specimen management system known as TARO . This high speed sorting system reduces the potential for human error, increases the productivity of laboratory staff and shortens

turn-around time within the laboratory. In the first quarter of 2001, we installed a second TARO system. We believe both TARO systems will be operational and part of production in the second half of 2001. As part of our continuing emphasis on productivity improvements, we are currently developing an ancillary system to TARO that is designed for high-throughput, precise division of specimens, a process commonly known as aliquotting. This system is scheduled to be introduced by the fourth quarter of 2001.

Our research orientation affords us the flexibility to choose between standardized prepared kits, other available testing technologies, and our own internally developed methodologies depending on cost, quality and market preference. This flexibility provides us the opportunity to gain additional operating efficiencies as we are not solely dependant on platforms designed for specific commercial kits.

Products And Services

We perform all of our testing services at our laboratory facility in Santa Monica, California. We do not have patient service centers and therefore do not obtain specimens directly from patients. Typically, our customers collect a patient's specimen and forwards it directly to our laboratory facility. Our laboratory facility accepts specimens 24 hours a day, seven days a week, 365 days a year. Most specimens are analyzed and the results are reported within 48 hours of receipt.

We currently offer a comprehensive menu of more than 3,500 esoteric assays. The breadth of our assay menu distinguishes us from large independent laboratories that typically offer only a select number of esoteric assays and smaller niche laboratories focused on specific clinical areas. Our comprehensive menu allows our customers to rely on us for substantially all of their esoteric testing needs. Esoteric assays are typically ordered when a physician requires additional information to complete a diagnosis, establish a prognosis, or to choose and monitor a therapeutic regimen.

Many of our assays were designed by our R & D team and are unique and proprietary to us. We have historically leveraged our expertise in molecular diagnostics and applied it to high growth segments of the esoteric testing industry including fields of medicine such as infectious disease, gastroenterology, oncology and cardiology. Molecular diagnostic assays comprised nearly 40% of our net revenue for the year ended December 31, 2000. Broadly speaking, molecular diagnostics includes all test procedures incorporating or identifying DNA- or RNA-based targets. This includes assays detecting the presence of a gene for a given disorder such as cystic fibrosis and assays examining DNA to help predict a patient's response to different drugs, such as HIV resistance assays. These assays can also detect viruses by identifying their unique genetic profile. We believe that we have developed one of the most extensive menus of molecular diagnostics assays. As a result of this expertise, we intend to develop novel, first-to-market assays and capture additional revenues by capitalizing on recent advances in the accumulated knowledge of the human genome.

Our assays for Hepatitis B and C and cardiovascular disease illustrate our ongoing application of advanced diagnostic techniques to diseases affecting a large or growing segment of the population. Hepatitis B and C together affect approximately five million Americans, including three million with active infections. In this market, we offer over 45 assays using molecular diagnostics and other techniques to help physician specialists diagnose and monitor therapy effectiveness. In the cardiovascular disease market, we offer over 40 assays designed to help physicians identify high risk individuals. These assays help identify genetic mutations and infectious, metabolic and autoimmune markers all associated with increased cardiovascular risk.

We market and sell many of our assays under trademarked names such as GenotypR , our assays for predicting resistance to HIV, and ANAlyzer®, our assays used to diagnose complex autoimmune disorders. For the year ended December 31, 2000, approximately 43% of our net revenue was derived from branded assays. We believe these branding efforts have contributed to increased market share and

premium pricing as physician specialists often continue to rely on our products, even after the introduction of a similar assay by a competitor.

While we offer over 3,500 esoteric assays, 20 of our esoteric assays currently account for a substantial portion of our net revenue. These assays, on a net revenue basis, accounted for 54.5% of our net revenue for the year ended December 31, 2000, and 53.4% for the year ended December 31, 1999. In addition, a single assay accounted for more than 10% of our net revenue for the years ended December 31, 1998, 1999 and 2000. See "Risk Factors We rely on a few assays for a significant portion of our net revenue. If demand for these assays were to weaken for any reason, our net revenue would decrease."

Marketing And Sales

Marketing and Sales Organization

Our marketing and sales organization consists of a staff of 14 marketing professionals and over 60 technical representatives and sales managers. Our sales representatives average over ten years of selling experience, including seven years in clinical laboratory or diagnostic testing sales. Sales representatives principally focus on large accounts including hospitals or independent laboratories throughout the United States, with a small percentage of their time spent selling directly to physician specialists. We continually educate our sales representatives on the technical and clinical merits of our products. We use traditional sales meetings, technical on-line sales training and in-the-field training to ensure our sales representatives are properly informed about all areas of our product lines and selling processes.

Marketing Strategy

We intend to continue educating physician specialists on the clinical value of our assays through research publications, print advertisement, direct mail and the Internet. These targeted marketing tools are designed to be effective while minimizing the need for direct physician contact by our sales representatives. We actively pursue publication of our scientific research in peer-reviewed journals and have had nearly 800 such articles published. We have printed and continually update ten widely-used, proprietary reference manuals on the use and interpretation of our assays, focusing on medical specialties such as infectious disease, gastroenterology, oncology and cardiology. We present our research at scientific meetings and exhibit at over 50 national and regional conferences throughout the year. Our web site is another vehicle for educating physicians about our assays and contains our entire directory of services, on-line technical materials and links to other medical sites that support the role of esoteric assays in effective diagnosis and treatment of diseases.

Sales Strategy

We concentrate our selling efforts on the management teams of hospitals and other independent laboratories that serve as distribution channels for physician assay orders. These management teams typically include laboratory managers, pathologists, finance and information technology personnel. To a lesser extent, we also call directly on physician specialists who create the demand for our assays.

Increasing revenue from smaller existing accounts is an important strategy due to the large number of hospitals with whom we are already doing business. Our marketing department provides our sales representatives with a comprehensive database containing pertinent information on hospital information technology systems, key contacts and existing competition. Sales representatives are trained to find new market opportunities and provide solutions to address unmet customer needs which may include outreach support, information technology products, assay information and general servicing.

We also facilitate hospital sales through affiliations with group purchasing organizations. Although hospitals participating in group purchasing organizations are not obligated to use the group purchasing

organization contracted laboratory for their reference testing, a group purchasing organization contract may provide us with access to additional hospital business. For further discussion of our group purchasing organization relationships, see "Customers Hospitals" below.

Customers

Our customers include hospitals, independent laboratories, physician specialists and other medical providers. The following table provides percentages of our net revenue by class of customer:

	Years Ended December 31,		
	1998	**1999**	**2000**
Hospitals	38.5%	46.7%	51.3%
Independent Laboratories	45.7%	36.5%	35.7%
Physician Specialists and Others	15.8%	16.8%	13.0%
Total	100.0%	100.0%	100.0%

Hospitals

Hospitals, our fastest growing customer segment, accounted for over 51% of our net revenue for the year ended December 31, 2000. Of the estimated over 5,000 hospitals to which we target our services, approximately 2,200 are currently our customers. We are a primary provider of esoteric reference laboratory testing services for over 330 of these hospital customers.

Many of our hospital customers are part of group purchasing organizations which typically pool independent hospitals together to negotiate for pricing and services, including prices for laboratory tests. Generally, hospitals participating in group purchasing organizations are not obligated to use the group purchasing organization contracted laboratory for their reference testing and many hospitals are affiliated with multiple group purchasing organizations. We are currently under contract with the following voluntary group purchasing organizations:

Group Purchasing Organization	**Estimated Number of Member Hospitals**	**Contract Expiration Date**
AmeriNet	2,000	August 2001
Joint Purchasing Corporation	400	December 2001
Managed Healthcare Associates	300	May 2003
Novation (formerly known as VHA)	800	April 2004
Shared Services Healthcare	550	June 2003

The other material terms of these agreements are as follows: the agreements with group purchasing organizations each provide for discounted fee structures for our assays including capped price increases. Some of these contracts provide additional discounts for certain assays. Most of these contracts also provide that we pay an administrative fee to the group purchasing organization.

Independent Laboratories

For the year ended December 31, 2000, regional independent laboratories represented approximately 19% of our net revenue and national independent laboratories represented approximately 16% of our net revenue. Together, we service over 1,300 accounts in the independent laboratory segment. Regional independent laboratories typically receive test requests directly from physicians. Regional laboratories will perform the routine tests and outsource the esoteric assays to an esoteric national laboratory like us. Although other national independent laboratories perform some esoteric testing, they may outsource to us any esoteric assays they are unable to perform and also honor requests from physician specialists who specify that we perform particular assays.

In October 1999, we entered into an agreement with Unilab pursuant to which it has agreed to refer to us, until the agreement expires in October 2002, at least 90% of the esoteric laboratory services it outsources each year or, in the event of a change of control of Unilab or the purchase by Unilab of a licensed clinical laboratory with a test menu materially broader than that of Unilab, at least $800,000 of esoteric laboratory services per month. For the year ended December 31, 2000, Unilab represented less than 10% of net revenues. This agreement can only be terminated for cause and will automatically renew for successive renewal terms of one year each unless terminated by either party.

Physician Specialists and Others

For the year ended December 31, 2000, physician specialists comprised approximately 13% of our net revenue and represented over 3,200 accounts. Currently, there are more than 200,000 physician specialists in the U.S., of which approximately 120,000 fall directly into our targeted medical specialties. Although they account for a small percentage of direct net revenue, physician specialists can influence the clinical acceptance of an assay, and can specifically influence laboratory choice by specifying that a particular specimen be sent to us or by ordering a particular assay that is unique to or branded by us.

The majority of our remaining net revenue is derived from clinical trials. Our clinical trials business focuses primarily on pharmaceutical and biotechnology companies trying to develop new drugs. Testing services for the clinical trials market comprise approximately 2% of our net revenue for the year ended December 31, 2000. We believe that many companies choose us for their clinical trials because of our experience in developing new assays and offering the necessary tools to manage the resulting data.

Payors, Billing & Reimbursement

We typically bill our customers, such as hospitals or other independent laboratories, directly. In some instances, we bill the individual patient directly or third party payors such as Medicare, Medicaid or private insurance. The following table illustrates our payor mix as a percent of net revenue since 1998:

	Years Ended December 31,		
	1998	1999	2000
Customer	87.6%	84.3%	82.6%
Patient	5.6%	8.3%	10.1%
Medicare	3.2%	3.5%	4.0%
Medicaid	1.6%	2.0%	1.5%
Other Insurance	2.0%	1.9%	1.8%
Total	100%	100.0%	100.0%

All of our billing and payment functions are executed through a centralized computerized billing system. Our web-based DataPassportMD product provides required billing information for Medicare, Medicaid and other insurance reimbursements at the time of assay ordering.

Information Technology

We have invested significant resources into information technology that accelerates and automates test ordering and results reporting with our customers. Our proprietary information technology products, collectively branded as DataPassport®, are designed to take advantage of new Internet-based technologies. Although some customers only require a simple electronic transfer of orders and results, others are seeking solutions to help them connect disparate systems or connect physician practices associated with laboratory outreach programs. Compared to other currently available information technology applications designed to have similar functionality, we believe all of our information technology products have the advantages of faster system implementation, greater ease of use and

lower customer costs. We have also invested resources designed to provide patient confidentiality and compliance with all governmental regulations regarding data security.

In 1998, approximately 40% of our transactions were transmitted electronically, principally through direct computer to computer links with a small number of our largest customers. At that time, we began a customer-focused information technology initiative to effectively utilize the Internet and provide electronic connectivity to large and small customers alike. Today, over 85% of the transaction volume with our customers is transmitted electronically.

Our current offering of information technology products include DataPassport® client interface module and DataPassportMD . We are in the process of developing Outreach Express described in detail below. We believe that our evolving suite of information technology products will continue to lead to greater customer loyalty, a reduction of data entry errors, acceleration of test ordering and results reporting, and substantial cost savings. The security features on our information technology products are intended to protect the confidentiality of patient information in accordance with state and federal law.

DataPassport® Client Interface Module

Because of the volume of assays ordered, our larger accounts require a direct connection between us and their Laboratory Information System, also known as LIS, to streamline the assay ordering and results reporting process. Traditional methods of connecting directly with a customer's LIS system are generally cumbersome and require a significant amount of time to implement because such links are dependent on the involvement of a third party LIS vendor to assist in software programming. Our DataPassport® client interface module greatly decreases this implementation lag time and bypasses the need for the LIS vendor by emulating the hospital's LIS data format. Consequently, our client interface module may be operative within six to eight weeks, as compared with six months or more for traditional computer to computer links. The client interface module also provides additional features not available with traditional computer to computer links, such as assay and physician utilization reports, and a flexible architecture that can accommodate future expansion and require fewer internal customer resources.

DataPassportMD

We believe this product is the most widely used web-based laboratory order entry and resulting system in hospitals today. Currently, more than 1,200 of our customers are using DataPassportMD . One of the key benefits of DataPassportMD is that it permits electronic order entry and results reporting for our smaller volume customers, and can be used alone or as part of a flexible architecture. DataPassportMD does not require any specialized hardware at the user site, making implementation almost immediate. We have added unique features to enhance the order entry and results reporting screens, including on-line access to our proprietary "use and interpretation of tests" books, graphical reporting features and extensive report generation tools for monitoring test or customer usage. We believe this product is user friendly, requiring only simple training for system users and on-site data maintenance.

Outreach Express

We anticipate that our hospital and independent laboratory customers wishing to grow their testing business will use Outreach Express . This product is intended to allow these customers to connect with physicians directly over the Internet. Outreach Express uses the functionality of DataPassportMD and will be hosted through our servers. The advantages to these customers are that no specialized hardware needs to be purchased and the entire information technology product may be supported outside their laboratory. We are designing Outreach Express to enable physicians to access assay results from hospitals and independent laboratories electronically and thus, more quickly than receiving such information manually. We believe that Outreach Express will provide these customers with a

competitive advantage in their respective market. By aiding these customers in their outreach efforts, we believe that they will continue to utilize our services. We currently have Outreach Express in testing at eight pilot sites.

Process Automation

We are implementing an automation system known as the Total Accessioning Re-Organization system, or TARO , for our pre- and post-analytical specimen management. This high speed automated sorting system reduces the potential for human error, increases the productivity of laboratory staff and decreases overall turn-around time within the laboratory. In the first quarter of 2001, we installed a second TARO system of which we believe that both TARO systems will be operational and part of production in the second half of 2001. Specifically,

TARO automates specimen sorting to the appropriate assay batch, enhances specimen tracking applications and reduces manual set up procedures at the analytical workbench.

As part of our continuing emphasis on productivity improvements, we are currently developing an ancillary system to TARO that is designed for high-throughput, precise aliquotting. This automated system is expected to substantially reduce the traditional manual process of dividing specimens into smaller components when multiple tests are requested on a single patient. Like TARO, this system is expected to deliver higher quality service levels to our customers while at the same time reducing our operating costs. This system is scheduled to be introduced by fourth quarter of 2001.

We utilize information technology applications extensively in conjunction with automated specimen management systems at the analytical site within the laboratory. We will continue to explore other projects to enhance our processes for improved accuracy and productivity.

Research and Development

We focus our R & D efforts on accelerating new assay development, evaluating alternatives to costly diagnostics, improving existing assay performance and commercializing existing technologies developed by our strategic partners. All of our R & D efforts have been company-sponsored. No R & D efforts have been sponsored by our customers. We have spent over $2.1 million in research and development during each of the years ended 1998, 1999 and 2000. Through our efforts, we have introduced over 600 new or improved esoteric assays in the past five years. Our R & D efforts enable us to grow revenues, increase market share and command premium pricing for many of our assays.

Our process of creating a new assay begins with input from many sources, including, our scientific team, our marketing department, scientific symposiums, customers and scientific journals. A team composed of representatives from R & D, marketing and operations evaluates the potential for a proposed assay, examining issues from disease prevalence to production costs. Once an assay is approved by this team, our R & D staff initiates development and validation of that assay. Currently, our average time to internally develop and market a new esoteric assay is three months.

To advance our internal development efforts of new technology applications, we seek strategic partners whose technology can be applied to a variety of disease conditions and produce advantages related to accuracy, performance, speed of testing or cost reduction. Our adoption of the Sequenom MALDI-TOF system is an example of such an enabling platform. We expect turn-around time to be dramatically reduced by eliminating procedures typical with conventional DNA testing and we also expect lower costs by decreasing reagent use. This system has applications in many medical areas, including infectious diseases, bacterial identification and genomics.

Strategic Partnerships and Licensing Arrangements

We actively pursue strategic partnerships that provide us with technologies or intellectual property that help facilitate accelerated assay development and commercialization. In addition, such agreements may provide us with the opportunity to collect royalties from third parties for sublicensing these

technologies to others. Five important technologies that we have licensed through strategic relationships include:

- Roche's PCR technology which is the technology platform for many of our gene-based assays;
- Sequenom's MALDI-TOF technology which allows us to significantly accelerate the analytical time for our DNA assays;
- Epoch Biosciences' technology which improves performance of assay systems for molecular analysis that is used to locate and identify genes associated with cancer;
- Third Wave Technologies' novel DNA detection and quantitation system; and
- Gen Probe's patented RNA gene to be used as a screen for identifying bacterial infections.

Roche Agreement

In 1992, we entered into an agreement with Roche Molecular Systems under which we license polymerase chain reaction, or PCR, technology which is the foundation for many of our gene-based diagnostic assays. In 1999, this PCR technology was augmented by an additional license

arrangement with Roche. Our licenses to use Roche's technology are not exclusive and Roche may grant similar rights to other parties. In exchange for these licenses, we have agreed to pay Roche royalties on our sale of assays incorporating the Roche technology. Both license agreements will terminate at the expiration of the last of the PCR technology patents, which expire in 2004.

Sequenom Agreement

In June 2000, we purchased from Sequenom a high speed machine capable of detecting and characterizing pieces of DNA. In connection with this purchase, we pay Sequenom development fees to develop assays for us which we will utilize with the machine to facilitate genotyping of certain infections. In addition to the development fees, Specialty will pay royalties to Sequenom based on revenues generated from our sale of any new assays developed utilizing Sequenom's technology. For any newly developed assay for which we desire exclusive rights, a licensing agreement can be negotiated with Sequenom.

Epoch Biosciences Agreement

In May 2000, we entered into a strategic partnership with Epoch Biosciences to collaborate our research and development effort to identify and commercialize new assays to detect human leukemias. In addition to fixed fees we pay to Epoch upon the identification of successful assay probes, Specialty will pay royalties to Epoch based on revenues generated from our sale of new assays developed utilizing Epoch's technology. If the collaboration is successful in developing new assays, we will have the exclusive right to commercialize these assays for a period of one year. This agreement will continue until the expiration of any patent rights licensed from Epoch, unless earlier terminated by mutual agreement or otherwise.

Third Wave Agreement

In April 2000, we entered into a strategic relationship with Third Wave Technologies in order to utilize and incorporate Third Wave's DNA detection and quantification system in our assay menu. Our collaborative relationship will continue until terminated by either party with prior notice. There are no fees or royalties associated with this agreement.

Gen-Probe Agreement

In March 2000, we entered into an agreement with Gen-Probe under which we license technology to facilitate our development of new assays and improve existing assays which identify bacterial infections. Our license to use Gen-Probe's technology is not exclusive and Gen-Probe may grant similar

rights to other parties. In exchange for the Gen-Probe technology, we have agreed to pay Gen-Probe royalties on our sale of assays which incorporate the technology. We have granted Gen-Probe a non-exclusive license to any improvements we make upon the Gen-Probe technology. The agreement will expire in March 2002 and can be renewed for one year, on the same terms, with the mutual consent of the parties.

Proprietary Rights

We protect the proprietary methodologies for assays developed by our R & D group as our trade secrets. All of our employees and consultants sign a proprietary information and inventions agreement upon hiring. To date, we have experienced no known material theft of trade secrets. We have copyrighted the proprietary software developed for products such as DataPassport®, DataPassportMD , Outreach Express and TARO . We also have obtained copyright registrations, as appropriate, for our published books and clinical information which we provide either electronically or in print to requesting clinicians. Many of our assays are branded products and we have registered these trademarks accordingly. We also have registered our slogans used in our clinical information and other advertising materials.

On April 5, 2000, we received a letter from the National Institutes of Health, the NIH, advising us that it believes that two of our assays, HIV-1 GenotypR and HIV GenotypR-PLUS , infringe its U.S. Patent 5,252,477. The patent is generally directed to the human HIV protease amino acid and DNA sequences and methods for synthesis and purification.

We received a letter from Chiron Corporation in or about February 1998 claiming that some of our Hepatitis C, or HCV, assays may be covered by its U.S. Patent 5,714,596. As of June 23, 2000, we entered into an agreement to purchase the majority of our HCV assays from Bayer Corporation, which has represented that it has a license for U.S. Patent 5,714,596.

Neither NIH nor Chiron has filed suit against us. We intend to defend any such suit that may arise vigorously and to assert all available defenses to allegations of patent infringement that would be available to us. We do not believe the outcome of either of these matters is likely to have a material adverse effect on our business, financial condition or results of operations.

Competition

The esoteric clinical laboratory business is highly competitive and is dominated by several national laboratories, as well as many smaller niche and regional organizations. Our primary competitors include large independent laboratories, such as Quest and LabCorp, that offer a wide test and product menu on a national scale. These large national independent laboratories have significantly greater financial, sales and logistical resources than we do and may be able to achieve greater economies of scale, or establish contracts with payor groups on more favorable terms than we can. We also compete with smaller niche laboratories, like Impath or Athena Diagnostics, that occupy a narrow segment of the esoteric market by offering a very specific assay menu. Finally, institutions such as Mayo Medical Laboratories and Associated Regional University Pathologists that are affiliated with large medical centers or universities generally lack the advantages of the larger commercial laboratories but instead compete with us on the limited basis of offering a perceived higher quality.

We believe that healthcare providers consider the following factors, among others, in selecting an esoteric clinical laboratory:

accuracy, timeliness and consistency in reporting assay results;

number and types of assays performed by the laboratory;

ability to develop new and useful assays;

service capability and quality;

ability to transfer assay results electronically;

reputation in the medical community;

pricing of assay services; and

reputation as a source of clinically useful, assay-related information.

We believe that we compete favorably with our principal competitors for esoteric testing services in these areas. However, we cannot assure you that we will maintain our competitive position in the future.

Quality Assurance

We maintain a comprehensive quality assurance system that monitors performance throughout the laboratory to ensure accuracy and precision in specimen handling and daily laboratory clinical testing. We also have written protocols based upon nationally standardized guidelines to guide our test performance and results interpretation, and to monitor and evaluate our problem solving procedures. We believe that we have obtained all appropriate approvals and licenses for providing clinical laboratory testing services. We participate in numerous quality and proficiency testing programs, including the proficiency programs administered by the College of American Pathologists and the Centers for Disease Control and Prevention, along with other independent state, national and international programs. Participation in the Laboratory Accreditation Program requires periodic self-evaluation, which is monitored by the College of American Pathologists. Routine monitoring of control results and blind specimen submissions provides information necessary to identify and resolve potential problems.

All laboratory testing and associated processes are described in written standard operating procedures and procedures which follow the format of the National Committee on Clinical Laboratory Standard's clinical laboratory procedure manual. Included therein are instructions for routine monitoring of quality control data, the frequency with which tests are to be run, the tolerance limits and the corrective action which is to be taken when tolerance limits are exceeded.

Government Regulation

Antifraud Laws/Overpayments

Numerous federal and state laws provide for penalties in connection with improper billing practices involving healthcare services. Remedies under these laws include imprisonment, monetary penalties, damages and asset forfeitures. Monetary penalties may reach $10,000 for each test improperly billed. These laws include, among others, the federal False Claims Act, which prohibits the submission of fraudulent claims in connection with Medicare, Medicaid and certain other governmental programs. In addition to direct suits by the federal government, the False Claims Act authorizes private parties to bring suit on behalf of the government against providers and entitles such a person to a portion of any final recovery. In addition, the Social Security Act provides for civil monetary penalties and recovery of treble damages for services which are fraudulently billed to the Medicare program or a Medicaid program. Providers convicted of any criminal offense relating to Medicare or Medicaid covered services or of certain felonies in connection with other private or governmental healthcare programs are subject to mandatory exclusion from the Medicare and Medicaid programs. In addition, the Health Care Financing Administration may exclude from the Medicare and Medicaid programs any provider convicted under any state or federal law of certain offenses relating to fraud, or who has been subjected to a civil monetary penalty under the above described provisions of the Social Security Act. The Health Care Financing Administration also may suspend Medicare payments to any provider it believes has engaged in fraudulent billing practices. Remedies generally similar to those described above are also available to state Medicaid programs, and California law also denies Medi-Cal enrollment to any provider that has entered into a settlement in lieu of conviction for fraud or abuse in any government program and further provides that a provider that is under investigation by certain

government agencies for fraud or abuse shall be subject to temporary suspension from the Medi-Cal program.

The federal government has investigated and continues to investigate the billing practices of numerous large and small clinical laboratories. Such investigations and related litigation have involved a broad range of issues, including the practices of laboratories of grouping tests into panels for billing and ordering purposes, the marketing of tests to physicians, billing for hematology tests and indices, billing for tests not performed, double billing, billing for tests which are not medically necessary, improper coding, and numerous other potentially improper practices. These investigations have resulted in all of the largest national independent laboratory companies, as well as many regional and local laboratories, having entered into settlement agreements in amounts that in several instances have exceeded $100 million. While most fraud enforcement activity has involved the Medicare and Medicaid programs, lawsuits by private insurance companies based upon fraud theories are also common. To our knowledge, we are not subject to any investigations or lawsuits alleging fraudulent billing practices. However, there can be no assurance that our activities will not be challenged under the fraud laws in the future.

Independent of fraud allegations, Medicare and Medicaid programs and private payors may retroactively determine that certain payments for services must be repaid due to a failure to satisfy applicable payor requirements. Significant delays in or recoupments of payments could have a material adverse effect on our revenues.

Laboratory/Physician/Hospital Relationships

"Self-Referral" Legislation. We are subject to "self-referral" prohibitions under federal Medicare law, commonly known as the Stark Law and to similar restrictions of California law, the Physician Ownership and Referral Act, which apply to referrals by California physicians. When taken together, these restrictions generally prohibit us from billing the patient or any governmental or private payor for any test when the physician ordering the test, or any relative of such physician, has an investment interest in, or compensation arrangement with us.

Both the Physician Ownership and Referral Act and the Stark Law contain an exception for referrals made by physicians who hold investment interests in a publicly traded company that has shareholders' equity of $75 million at the end of its most recent fiscal year, and satisfies certain other requirements. California's self-referral restrictions applicable to referrals of workers' compensation testing also contain a similar exception, except that this exemption requires that total gross assets at the end of the laboratory's most recent fiscal year has to be at least $100 million. At our fiscal year end on December 31, 2000, our shareholders' equity and total assets exceeded $100 million, and we are therefore now entitled to the benefit of the public company exemptions. However, the public company exemptions most likely were not available to us prior to January 1, 2001. Because many of our shareholders hold stock in the name of their stock brokerage firm, it may not have been possible for us to fully comply with the self-referral requirements prior to our qualifying for the public company exemptions. Despite the public company exemptions, we will need to monitor our compensation relationships with physicians under the self-referral laws on an on-going basis. For example, our provision of information technology support to physician customers must be carefully structured in order to comply with the self-referral laws. Laboratories which violate the Stark Law must refund any amounts collected in connection with prohibited referrals and are also subject to monetary penalties of $15,000 for each test improperly billed for and exclusion from the Medicare and Medicaid programs. In addition, billings for services where the referral was prohibited may be actionable under false claims statutes. Substantial penalties may also be imposed in the event of Physician Ownership and Referral Act violations. Although we believe that we are in compliance in all material respects with the Physician Ownership and Referral Act and the Stark Law, there can be no assurance that we will not be found to be in violation of these laws in the future. In addition, other states have self-referral

restrictions with which we may have to comply that may differ from those imposed by federal and California law.

Regulations implementing and interpreting certain provisions of the Stark Law were released by HCFA on January 4, 2001, with an effective date of January 4, 2002. The most substantial provisions of the new regulations address the provision of services by physicians in their offices and define the services, other than laboratory services, to which the Stark Law applies. Provisions contained in the new regulations which define the types of indirect compensation relationships to which the Stark Law applies and which create new exceptions for certain types of financial relationships may have some relevance to the Company. In addition, the new regulations interpret an exception under the Stark Law which allows laboratories to provide physicians with supplies used solely to collect, transport, process or store specimens. HCFA believes this exception is limited to items of low value, such as single use needles, vials and specimen cups, and that biopsy needles, and similar items such as snares, reusable aspiration and injection needles and sterile gloves, do not function solely as specimen collection devices, and therefore trigger the self-referral restrictions if they are provided without a fair market value charge. However, California's self-referral restrictions contain no exemption which would allow such items to be sold to physicians, even at fair market value, and a laboratory complying with HCFA's new interpretations may be required to have its California physician customers obtain the restricted types of supplies from third parties. The new interpretations also acknowledge that the provision of a phlebotomist without charge is permitted so long as the phlebotomist performs solely laboratory functions for the laboratory providing the phlebotomist complying with these new HCFA interpretations may result in cost-savings for laboratories. Nevertheless, because the prior regulations largely implemented the Stark Law as it applies to clinical laboratory services, the Company does not believe that the new regulations will have any material impact on it.

Antikickback Laws. The federal Medicare/Medicaid antikickback statute prohibits laboratories from paying remuneration as inducement for referrals of patients or specimens for testing paid for by the Medicare or Medicaid programs. Based upon a federal court decision specifically considering physician ownership of laboratories and an antikickback safe harbor regulation applicable to investments in certain publicly traded companies, we believe that a challenge to physician investments in our company is unlikely.

A number of business practices in the clinical laboratory industry have been criticized by Medicare's Office of Inspector General, including the provision of phlebotomy staff to clients who perform clerical or other functions for the client which are not directly and solely related to the collection or processing of laboratory specimens, the provision of computers or fax machines to clients which are not used exclusively in connection with performance of the laboratory's work, the lease of space in a physician's office for rent which exceeds the fair rental value of such space, certain acquisition agreements where the sellers may make referrals to the buyer after the sale and other compensation relationships between laboratories and entities from which they receive referrals, or to which they make referrals, if such relationships are intended to induce referrals. In addition, Medicare's Office of Inspector General has indicated that discounts given by laboratories to clients with respect to their private pay patients and/or HMO patients must not be intended to induce referrals of Medicare or Medicaid patients by the client to the laboratory. Our business practices are governed by the antikickback laws, including our negotiated discounted pricing arrangements, our participation in group purchasing organizations and provision of information technology to our customers. Because, in most instances, we bill our customers for both their Medicare and non-Medicare testing at a uniform price, we believe the Office of Inspector General's concerns regarding discounts will not apply to us. Moreover, statutory exceptions and "safe harbor" regulations are available to protect certain discounts offered to customers and certain payments we make to group purchasing organizations.

Many states, including California, also prohibit payments from being given to physicians, hospitals or others by clinical laboratories as compensation or inducement for referrals of patients or test

specimens, regardless of the source of payment for such testing. In addition, laboratories offering pricing to their customers that is more favorable than that offered directly to patients may be deemed to pay prohibited kickbacks under state laws. However, we believe that a kickback will not result under California law if the laboratory's customer passes all of such discount to its patients in the form of lower testing charges. Because we expect our California customers to comply with the "pass through" requirements applicable to them, we do not believe that any favorable pricing we offer to California physicians or hospitals violates California's antikickback laws. However, it is possible that markups by our non-California customers who are not bound by anti-markup restrictions may implicate California's antikickback laws.

Any action taken against us under the Medicare/Medicaid antikickback statute could result in criminal penalties being imposed pursuant to the U.S. Sentencing Guidelines, civil monetary penalties of $50,000 per violation plus treble damages, and exclusion from Medicare and Medicaid participation. Laboratories that violate the California antikickback laws or similar antikickback, anti-markup, or direct billing laws of other states may be subject to loss of licensure and substantial fines.

While we believe that we are in compliance with the antikickback statutes, there can be no assurance that our relationships with physicians, hospitals and other customers will not be subject to investigation or a successful challenge under such laws. If imposed for any reason, sanctions under the antikickback laws could have a material adverse effect on our business.

Certification and Licenses

We are required to maintain various federal and state licenses, certifications and permits necessary to conduct our business. Our laboratory is certified pursuant to the Clinical Laboratory Improvement Amendments, which subject virtually all clinical laboratories to national standards for assuring quality of laboratory performance. Licensure is also required and maintained for our laboratory under the laws of the State of California. We are licensed in states which require us to be licensed in order for us to perform services for their residents, including Florida, Maryland, New York, Pennsylvania and Rhode Island. Our laboratory facilities are also certified by the College of American Pathologists.

The above programs establish standards for the day-to-day operation of a clinical laboratory, including the training and skills required of personnel and quality control. In addition, federal and state laws mandate proficiency testing, which involves testing of specimens that have been specifically prepared for the laboratory. If a laboratory is out of compliance with the Clinical Laboratory Improvements Amendments or other applicable requirements, the Health Care Financing Administration or the California Department of Health Services may assess substantial civil money penalties, restrict the tests which the laboratory may perform, impose specific corrective action plans, suspend the laboratory's approval to receive Medicare payments, and/or suspend, revoke or limit the laboratory's Clinical Laboratory Improvements Amendments certificate or state license. If a laboratory's Clinical Laboratory Improvements Amendments certificate or state license is suspended or revoked, its ability to perform further testing terminates.

In June 1999, the Health Care Financing Administration asserted that we were out of compliance with Clinical Laboratory Improvements Amendments regulations pertaining to specific quality assurance functions, and imposed certain fines in connection therewith. After the Health Care Financing Administration's resurvey in June 2000, we were able to satisfy the Health Care Financing Administration that we were in compliance with the applicable requirements. We appealed the fine imposed by the Health Care Financing Administration, and subsequently settled the matter by paying HCFA the sum of $87,400. We believe we are presently in compliance with all certification and licensure requirements.

Compliance

We have reviewed the pertinent regulations of the Clinical Laboratory Improvements Amendments and related rulings and policy guidelines and we believe that our business practices adhere to the stated requirements. We will continue to monitor legislation and implement the practices therein, but there can be no guarantee that we will pass all future inspections or otherwise be found to be in compliance with these and other regulations in the future.

The Department of Health and Human Services' Office of the Inspector General has in recent years suggested adoption of a written compliance plan to promote standards of ethics and business practice that will help to prevent fraudulent conduct. We have adopted such a compliance plan and have appointed a compliance director to assist us with our regulatory compliance.

"Corporate Practice" of Medicine

California law, as well as the laws of many other states, prohibit physicians from sharing professional fees with non-physicians such as laboratories, and prohibit non-physicians from practicing medicine, including pathology, and from employing pathologists or other physicians. California law provides that the practice of medicine without a license is a misdemeanor, and a violation of the laws governing the practice of medicine could be a basis for assessment of fines and penalties, imposition of a cease and desist order, and the suspension or revocation of a California laboratory license. State and federal law also prohibit us from being compensated for referrals we make to our pathologists. We have previously employed pathologists, and are in the process of restructuring our relationships with pathologists in a manner which we believe does not violate any prohibition against the "corporate practice" of medicine or otherwise violate state or federal law. We do not believe that any violations which we may have committed in the past are likely to result in sanctions that would have a material adverse effect on our business, financial condition or results of operations.

Increased Regulation of Genetic Testing

The federal Food and Drug Administration, or the FDA, regulates the manufacture of medical devices, including laboratory testing equipment, diagnostic kits and certain reagents. While the FDA believes that it has authority to regulate tests developed by laboratories for their own use, the FDA, to date, has allowed the development of such tests to proceed under the regulations under the Clinical Laboratory Improvements

Amendments governing a laboratory's development of its own assays. The FDA has also subjected the commercialization of certain immunohistochemical stains, tumor markers and analyte specific reagents to limited regulation, and requires us to make certain disclosures in connection with their use. The federal Centers for Disease Control and Prevention, or CDC, has published notice of its intent to revise the regulations under the Clinical Laboratory Improvements Amendments to specifically recognize and regulate a genetic testing specialty. In addition, the Department of Health and Human Services' Secretary's Advisory Committee on Genetic Testing advises the Department of Health and Human Services as to various issues raised by the development and use of genetic testing. The Secretary's Advisory Committee on Genetic Testing has published and requested comments on its preliminary recommendations for increased participation on the part of the FDA and increased regulation of genetic testing under Clinical Laboratory Improvements Amendments. As a result of the activities of the FDA, the CDC and the Secretary's Advisory Committee on Genetic Testing, it is possible that our existing and future assays may be subject to a regulatory approval similar to the pre-marketing approval process which the FDA applies to drugs and medical devices, or may be subject to other increased regulatory standards, which could have a negative effect on our business.

Other Regulations

Pursuant to the Occupational Safety and Health Act, known as OSHA, laboratories must provide a safe workplace to their employees, and OSHA has issued rules to protect workers from blood-borne pathogens and other hazards that are commonly found in laboratories. We are also subject to licensing and regulation under federal, state and local laws relating to the handling and disposal of medical specimens, hazardous waste and radioactive materials. We are also subject to regulations of the Department of Transportation, the Public Health Service's Centers for Disease Control & Prevention and the Postal Service which apply to the surface and air transportation of laboratory specimens. Although we believe that we are currently in compliance in all material respects with the above laws, failure to comply could subject us to denial of the right to conduct business, fines, criminal penalties and other enforcement actions.

Changes in Laboratory Reimbursement

Health Care Reform

A number of proposals aimed at increasing healthcare insurance coverage or reducing healthcare costs have been considered in recent years which, if enacted, would have affected major reforms of the healthcare system. Such proposals include: increased enrollment of Medicare beneficiaries in managed care systems, increased availability of health insurance to individuals and to small businesses, requirements that all businesses offer health insurance coverage to their employees, the provision of tax credits for purchase of health insurance, the formation of regional "health alliances" to act as healthcare purchasing agents and the creation of a government health insurance plan that would cover all citizens. We cannot predict whether any of these or other proposals will be adopted at the state or federal levels, or what effect, if any, such proposals would have on our business.

Reductions to Medicare or Medicaid Fee Schedules

For testing performed other than for hospitals, nursing facilities and other laboratories, laboratories are required to bill Medicare and Medicaid directly, and generally must accept reimbursement from these programs as payment in full for services performed for Medicare and Medicaid patients. Such direct billings by us to Medicare accounted for approximately 3.5% of our net revenue in 1999 and 4.0% of our net revenue in 2000. Medicaid net revenue was 2.0% of our total net revenue in 1999 and represents 1.5% of our net revenue for the year ended December 31, 2000. However, a substantial portion of the testing for which we bill our hospital and independent laboratory customers is for Medicare and Medicaid patients, and we do not know the percentages of our net revenue that are indirectly derived from these programs. Any pricing pressure exerted by these programs on our customers may cause them to reduce their payments to us.

Congress has established maximum fee schedules for clinical laboratory testing performed for Medicare beneficiaries, excluding hospital and nursing facility inpatients. Payment for in-patient laboratory services is included in the prospective payment rates paid to the patient's facility. State Medicaid programs are prohibited from paying more for testing than the Medicare fee schedule amounts and, in most instances, they pay significantly less. When initially established, the Medicare fee schedules were set at 60% of prevailing local charges. Maximum reimbursement rates for clinical laboratory testing have subsequently been substantially reduced, and it should be expected that such fee schedules will be further reduced in the future. For example, a ceiling on Medicare and Medicaid payments to laboratories commonly referred to as the "national cap" amount has been reduced numerous times in recent years. Most recently, Congress reduced the national cap to 74% of the national median of local fee schedules and eliminated consumer price index increases to the national cap and local fee schedules through the year 2002. Medicare reimbursement has also been reduced from time to time by an effective rate of between 1% and 2% pursuant to Gramm-Rudman-Hollings

sequestration. In addition, from time to time, proposals have been made that beneficiary cost sharing again be applied to laboratory testing paid for by Medicare. For example, such a recommendation is contained in the HHS Office of Inspector General's 2001 "Red Book" of suggested Medicare program improvements. The costs of billing and collecting co-payment amounts and associated bad debt could reduce the revenue actually realized by laboratories.

Medicare Reimbursement for Technical Component of Hospital Pathology Services. In the past, independent laboratories have been permitted to bill for the technical component of certain pathology services which are performed for Medicare hospital patients. The Health Care Financing Administration has promulgated regulations to end such separate billing as of January 1, 2001. Congress has enacted legislation delaying implementation of HCFA's rules until January 1, 2003 for hospitals who had qualifying outsourcing contracts for pathology services in place as of July 22, 1999. Any such services we perform for hospitals without qualifying arrangements or after the January 1, 2003 date will have to be billed to the patient's hospital. Hospitals will receive no additional reimbursement from Medicare for these pathology services provided to inpatients, and reimbursement for these services under the new outpatient prospective payment system generally may be lower than it was previously. Such changes therefore may result in a reduction in the payments we receive from hospitals for these services.

Elimination of Dual Charge Structure. Proposals have been made to restrict "dual charge" billing practices under which laboratories charge higher fees to Medicare and Medicaid than are charged to physicians, hospitals, laboratories and other purchasers who are in a position to negotiate favorable rates. Thus, it has been proposed that existing authority for the Department of Health and Human Services to exclude from Medicare and Medicaid program participation any providers that charge amounts to the Medicare program that are "substantially in excess" of their "usual charges" be used to respond to laboratory pricing practices. Similarly, the Health Care Financing Administration is permitted to adjust statutorily prescribed fees for some medical services, including clinical laboratory services, if the fees are grossly excessive and therefore not inherently reasonable. The Health Care Financing Administration has issued an interim final rule setting forth criteria to be used in determining whether the otherwise statutorily prescribed fees should be reduced which includes consideration of whether such fees are grossly higher or lower than the payment made for the services by other purchasers in the same locality. Fees payable by Medicare for clinical laboratory services may be reduced as a result of the application of the above rules or by similar restrictions which may be applied in the future.

In addition, the California Medi-Cal program is required by California regulations to pay no more for testing than the amount which a laboratory charges pursuant to any fee schedule it applies generally to its physician or hospital customers. While the extent to which this rule applies to our discounts which are negotiated on a case-by-case basis is unclear, it is possible that a recoupment action could be bought against us based upon discounts which we give to certain customers.

Contracts for Laboratory Services. Proposals have been made to require competitive bidding procurement of Medicare laboratory testing services. The Health Care Financing Administration is required to complete five Medicare bidding demonstrations involving various types of medical services by 2002, and the Health Care Financing Administration is expected to include a clinical laboratory demonstration project in a metropolitan statistical area. Similarly, California legislation requires the implementation of a program of negotiated laboratory service contracting for the Medi-Cal program. In addition, a large portion of the Medi-Cal program has been converted into a managed care system, resulting in negotiated laboratory service contracts between laboratories and other providers of healthcare services. Increased enrollment of Medicare or Medicaid beneficiaries in HMOs or negotiated contracting arrangements may also result in a larger portion of our business being subject to negotiated contracts with payors.

To obtain competitively bid contracts to perform services, it might be necessary for us to agree to substantial reductions in our payments from the Medicare and Medi-Cal programs. Such contracts may be exclusive and laboratories which do not hold such contracts may be denied access to the Medicare/Medi-Cal testing market and could have difficulty obtaining private patient testing from physicians participating in the contracting or managed care program.

"Bundling" of Medicare Services. Proposals have been made to reimburse clinical laboratory testing services as part of a larger "bundle" of healthcare services. Under one proposal, physicians would be reimbursed an additional amount for each office visit they had with a Medicare beneficiary and would be responsible for paying for any required laboratory services out of this sum. This or other "bundling" proposals, if enacted, could have an adverse effect on our operations.

Nongovernmental Efforts. Managed care arrangements may become increasingly prevalent in the clinical laboratory services market. For example, HMOs, insurance companies and self-insured employers may provide laboratory services directly or contract with laboratories at favorable fee-for-service or capitated rates and require their enrollees to obtain service only from such contracted laboratories. To the extent that we or our customers are unable to obtain contracts to provide such testing services or must discount prices to obtain such contracts, our revenues and profit margins could be adversely affected.

Requirements of Diagnosis Codes

Certain tests are only reimbursable by Medicare when the laboratory submits an appropriate diagnosis code which it has obtained from the ordering physician. California's Medicaid program, known as Medi-Cal, has adopted, and is in the process of implementing, a policy requiring that a diagnosis code be submitted in connection with all bills for laboratory tests which are submitted to the Medi-Cal program where Medicare would require a diagnosis code if it were being billed for the tests. To the extent that the requirements for such diagnosis codes are expanded to additional tests or are adopted by additional Medicaid programs or by private insurance programs, or we are unable to obtain required codes from physicians, our reimbursement could be adversely affected.

Employees

As of December 31, 2000, we employed 799 individuals. Thirty-three are engaged in research and development, 173 in administration and clerical functions, 84 in sales and marketing, 58 in information technology and 451 in our clinical laboratory and related operations. None of our employees are represented by labor unions, and we believe our employee relations are good.

RISK FACTORS

Any investment in shares of our common stock involves a high degree of risk. You should consider carefully the following information about these risks, together with all of the other information contained in this Annual Report before you decide to buy our common stock. If any of the following risks actually occur, our business, financial condition, results of operations and future growth prospects could be materially adversely affected. Additional risks and uncertainties not presently known to us or that we currently believe to be immaterial also may impair our business. Any adverse effect on our business, financial condition or results of operations could result in a decline in the trading price of our common stock and the loss of all or part of your investment.

If advances in technology allow others to perform assays similar to ours, the demand for our assays may decrease.

The esoteric clinical laboratory industry is characterized by advancing technology which may enable other clinical laboratories, hospitals, physicians or other medical providers to perform assays with

properties similar to ours in a more efficient or cost-effective manner than is currently possible. Such technological advances may be introduced by, not just our competitors, but by any third party. For instance, a diagnostic manufacturing company may release an instrument or technology that would make it cost-effective for our customers to perform esoteric assays internally, rather than through us. If these or other advances in technology result in a decreased demand for our assays, our assay volume and net revenue would decline.

The esoteric clinical laboratory industry is intensely competitive. If we are unable to successfully compete, we may lose market share.

The esoteric clinical laboratory industry is highly competitive. This industry is dominated by several national independent laboratories, but includes many smaller niche and regional independent laboratories as well. Our primary competitors include:

- large commercial enterprises, such as Quest Diagnostics, or Quest, and Laboratory Corporation of America, or LabCorp, that offer a wide test and product menu on a national scale;
- smaller niche laboratories like Impath or Athena Diagnostics that focus on a narrow segment of the esoteric market; and
- institutions such as Mayo Medical Laboratories, or Mayo, and Associated Regional University Pathologists, or Associated, that are affiliated with large medical centers or universities.

Large commercial enterprises, including Quest and LabCorp, have substantially greater financial resources and may have larger research and development programs and more sales and marketing channels than we do, enabling them to potentially develop and market competing assays. These enterprises may also be able to achieve greater economies of scale or establish contracts with payor groups on more favorable terms. Smaller niche laboratories compete with us based on their reputation for offering a narrow test menu. Academic and regional institutions generally lack the advantages of the larger commercial laboratories but still compete with us on a limited basis.

Any of our competitors may successfully develop and market assays that are either superior to, or are introduced prior to, our assays. If we do not compete effectively with other independent clinical laboratories, we may be unable to maintain or grow our market share.

The premium prices that we initially charge for new assays may drop if our competitors are able to develop and market competing assays more quickly than they currently do.

Typically, we market new esoteric assays at premium prices for several years before similar assays are developed as either standardized prepared kits for broad application or as internally developed assays by competing laboratories. The opportunity to sell our products at premium prices may be reduced or eliminated if our competitors are able to develop and market competing assays more quickly than they currently do.

For example, our net revenue from one assay for HIV Quantitation was:

in 1998, $19.7 million, or 17.3% of total 1998 net revenue;

in 1999, $17.3 million, or 13.3% of total 1999 net revenue; and

in 2000, $16.3 million, or 10.7% of total 2000 net revenue.

This decreasing trend has been primarily due to competition from subsequently introduced assays. If we are unable to develop newer assays which meet market demand, our net revenue and profit margins may decrease.

Some of our customers are also our primary competitors. If they reduce or discontinue purchasing our assays for competitive reasons, it will reduce our net revenue.

Some of our customers, such as Quest, LabCorp, Mayo and Associated, also compete with us by providing esoteric testing services. They often refer to us assays that they either cannot or elect not to perform themselves. For the year ended December 31, 2000, sales to our competitors were $10.4 million or 6.8% of our net revenue. These parties may decide not to refer assays to us because they wish to develop and market assays similar to ours. For example, in July 1997, SmithKline Beecham Clinical Laboratories, or SmithKline Labs, began to significantly limit the number of assays it referred to us. We believe that SmithKline Labs terminated its relationship with us because it decided to offer assays similar to ours. In 1996, SmithKline Labs comprised 21.7% of our net revenue, whereas in 2000, after being acquired by Quest, SmithKline Labs (excluding Quest accounts prior to the acquisition) only comprised 1.5% of our net revenue. If other independent laboratories decide to reduce or discontinue purchases of our assays for competitive reasons, it will reduce our net revenue.

If we are unable to develop and successfully market new assays or improve existing assays in a timely manner, our profit margins may decline.

In order to maintain our margins and benefit from the premium prices that we typically charge for our newly introduced esoteric assays, we must continually develop new assays and improve our existing assays through licensing arrangements with third parties and through the efforts of our R & D department. There is no assurance, however, that we will be able to maintain our current pace of developing and improving assays in the future. Even if we develop such assays in a timely manner, our customers may not utilize these new assays. If we fail to develop new technologies, release new or improved assays on a timely basis, or if such assays do not obtain market acceptance, our profit margins may decline.

If we fail to acquire licenses for new or improved assay technology platforms, we may not be able to accelerate assay improvement and development, which could harm our ability to increase our net revenue.

Our ability to accelerate new assay development and improve existing performance will depend, in part, on our ability to license new or improved assay technology platforms on favorable terms. We may not be able to negotiate acceptable licensing arrangements and we cannot be certain that such arrangements will yield commercially successful assays. Further, even if we enter into such arrangements with these third parties, their devotion of resources to these efforts may not be within our control or influence. If we are unable to license these technologies at competitive rates, our research and development costs may increase. In addition, if we are unable to develop new or improved assays through such research and development efforts, our assays may be outdated when compared with our competition's assays, and our net revenue may decrease.

A significant portion of our net revenue depends on a single customer, Unilab Corporation. If our relationship with Unilab is terminated or not renewed, our business may suffer.

For the year ended December 31, 2000 and the year ended December 31, 1999, services to Unilab Corporation accounts comprised 9.6% and 7.4% of our net revenue, respectively. Although we have entered into an agreement with Unilab in which it has agreed to refer to us, until the agreement expires in October 2002, at least 90% of the esoteric laboratory services it outsources each year or, in the event of a change of control of Unilab or the purchase by Unilab of a licensed clinical laboratory with a test menu materially broader than that of Unilab, at least $800,000 of esoteric laboratory services per month, there is no assurance that it will uphold this obligation. In addition, if Unilab does not renew this agreement in October 2002, it will then no longer be under any obligation to provide us with minimum assay referrals. If, for any reason, Unilab's purchase of our services were to be materially reduced or if Unilab failed to renew its contract with us in October 2002, it may decrease our net revenue.

We rely on a few assays for a significant portion of our net revenue. If demand for these assays were to weaken for any reason, our net revenue would decrease.

A significant portion of our net revenue is derived from 20 assays. Net revenue from these 20 assays comprised approximately 54.5% of our total net revenue for the year ended December 31, 2000 and approximately 53.4% for the year ended December 31, 1999. In addition, for each of past three years, over 10% of our net revenue has been derived from one assay for HIV Quantitation. As a result, a significant portion of our net revenue is concentrated among these assays, and in particular, our HIV Quantitation assay. If competing assays are introduced by competitors or demand for these assays otherwise decreases, our net revenue would decrease.

If group purchasing organizations do not renew and maintain our contracts, we may lose an important mechanism by which to further penetrate the hospital customer base.

Many of our existing and potential hospital customers are part of group purchasing organizations, which typically pool independent hospitals together to negotiate for pricing and services, including prices for laboratory tests. These group purchasing organizations provide incentives to their participating hospitals to utilize clinical laboratories which have contracts with the group purchasing organizations.

Our participation in group purchasing organizations constitutes one aspect of our overall strategy to attract new hospital customers. We have contracts with five group purchasing organizations: AmeriNet, Joint Purchasing Organization, Managed Healthcare Associates, Novation (formerly known as VHA) and Shared Services Healthcare. We are typically granted non-exclusive provider status under these contracts. Our contract with our group purchasing organizations will expire at times from 2001 to 2004.

For the year ended December 31, 2000, sales of our services to hospitals which utilized the pricing structures under the Novation and AmeriNet group purchasing organization contracts comprised approximately $34.3 million or 22.4%, and approximately $7.6 million or 5.0% of our net revenues, respectively. Sales to hospitals within the other three group purchasing organizations comprised less than 1% of our net revenues for the same period. These group purchasing organizations offer a substantial growth opportunity to gain additional revenue from existing hospital customers. While we believe that over 1,800 of our 2,200 hospital customers are affiliated with these five group purchasing organizations, only approximately 400 of these customers qualify for discounts under these contracts.

We cannot be certain that if our agreement with Novation, AmeriNet or any other group purchasing organization is terminated or not renewed, that we will be able to retain any of the accounts of the participating hospitals. If any hospital customer affiliated with a group purchasing organization no longer uses our services, it will reduce our net revenue. In addition, if we are unable to attract new hospital customers because any group purchasing organization contract is terminated, it may adversely affect our ability to grow our business.

Failure in our information technology systems could significantly increase turn-around time, reduce our production capacity, and otherwise disrupt our operations, which may reduce our customer base and result in lost net revenue.

Our success depends, in part, on the continued and uninterrupted performance of our information technology systems, including our DataPassport® suite of products. Sustained or repeated system failures that interrupt our ability to process assay orders, deliver assay results or perform assays in a timely manner would reduce significantly the attractiveness of our products to our customers. Our business, results of operations and financial condition could be materially and adversely affected by any damage or failure that interrupts or delays our operations.

Our computer systems are vulnerable to damage from a variety of sources, including telecommunications failures, malicious human acts and natural disasters. Moreover, despite network security measures, some of our servers are potentially vulnerable to physical or electronic break-ins, computer viruses and similar disruptive problems, in part because they are located at a third party web hosting company, Exodus

Communications, in El Segundo, California, and we cannot control the maintenance and operation of the Exodus data centers. Despite the precautions we have taken, unanticipated problems affecting our systems could cause interruptions in our information technology systems.

We have insurance policies designed to cover losses arising from such interruptions. Our policies include coverage for commercial general liability with a limit of $10 million. However, these insurance policies may not adequately compene contributed to the Company from time to time to fund up to $67.0 million of future payments under the Company s contingent notes relating to acquisitions consummated prior to the March 2003 Transaction. As of March 31, 2004, approximately $23.1 million of the $67.0 million has been contributed to the Company to fund contingent note payments. The lenders under the Company s New Credit Facility have a first-priority security interest in all funds held in such cash collateral account.

During the period from January 1, 2003 through March 27, 2003, the Company recorded merger-related charges totaling $10.0 million related to the March 2003 Transaction.

Note 3 Recent Accounting Pronouncements

In April 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections* (SFAS No. 145), which, among other things, rescinded SFAS No. 4, *Reporting Gains and Losses from Extinguishment of Debt*. Previously under SFAS No. 4, all gains and losses from extinguishments of debt were required to be aggregated and, if material, classified as an extraordinary item in the statements of operations. SFAS No. 145 requires that gains and losses from extinguishments of debt be classified as extraordinary items only if they meet the criteria in *APB Opinion No. 30, Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. Any gains or losses on extinguishment of debt that were presented as extraordinary items in prior periods but which do not qualify for classification as an extraordinary item under Opinion No. 30, are to be reclassified. Companies are required to adopt SFAS No. 145 in fiscal years beginning after May 15, 2002. The adoption of SFAS No. 145 resulted in a write-off of approximately $3.5 million and $1.0 million of deferred financing costs during the first quarter of 2004 and 2003, respectively, which is included in other income (expense) in the consolidated statements of operations.

In January 2003, the FASB issued FASB Interpretation No. 46, *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51* (FIN 46). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the Company must apply the provisions of FIN 46 for the first interim or annual period beginning after March 15, 2004. The Company has determined that the provisions of FIN 46 do not apply to our entity.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (SFAS No. 149). SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. It is effective for contracts entered into or modified after June 30, 2003. In April 2004, the Company entered into an interest rate swap agreement. The Company has not yet determined the impact that the adoption of SFAS No. 149 will have on the consolidated financial statements.

Note 4 Acquisitions

During the first three months of 2004, the Company acquired one hospital-based practice in Bountiful, Utah. During the period from January 1, 2003 through March 27, 2003, the predecessor acquired a start-up operation in Charleston, South Carolina. The total consideration paid by the Company in connection with these acquisitions consisted of cash and contingent notes. During the three months ended March 31, 2004 and the

period from January 1, 2003 through March 27, 2003, the Company made contingent note payments of $7.9 million and $21.9 million, respectively, relating to previous acquisitions.

The accompanying unaudited condensed consolidated financial statements include the results of operations of the Company s acquisition during the period from January 1, 2003 through March 27, 2003 accounted for under the purchase method from the date acquired through March 31, 2004.

There is no pro forma information presented for the three months ended March 31, 2004, because of the immateriality of the one acquisition consummated during 2004. There is no pro forma information presented for the period from January 1, 2003 through March 27, 2003 due to the immateriality of the one acquisition completed, which was a start-up operation with no revenues.

Note 5 Intangible Assets

Amortization expense of identifiable intangibles was $2.8 million and $3.1 million for the three months ended March 31, 2004 and for the period from January 1, 2003 through March 27, 2003, respectively.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Amortization expense related to identifiable intangibles for each of the five succeeding fiscal years and thereafter as of March 31, 2004 is as follows:

Remainder of 2004	$ 8,261
2005	11,014
2006	7,814
2007	6,747
2008	5,967
2009	5,708
Thereafter	102,249

The weighted average amortization period for identifiable intangible assets is approximately 14.1 years.

Note 6 Restructuring Costs

During the period from January 1, 2003 through March 27, 2003, the predecessor incurred certain restructuring costs as promulgated by SFAS No. 146 of approximately $1.2 million for employee severance costs in connection with a reduction in workforce at our Southern California, Philadelphia, Central Florida and North Texas laboratories.

Note 7 Long-term Debt

Term Loan Facility On March 27, 2003, in connection with our consummation of the March 2003 Transaction, the predecessor terminated its existing senior credit facility and the Company entered into a new senior credit facility (the New Credit Facility) with a syndicate of financial institutions led by Credit Suisse First Boston and Deutsche Bank Securities, Inc. The write-off of the unamortized debt costs related to the former credit facility was approximately $1.0 million and is included in the predecessor statement of operations for the period from January 1, 2003 through March 27, 2003.

The New Credit Facility provided for senior secured financing of up to $290.0 million, consisting of a $225.0 million term loan facility with a maturity of seven years that was drawn in full in connection with the consummation of the March 2003 Transaction and a $65.0 million revolving credit facility with a maturity of six years. In February 2004, the Company paid down the term loan facility of the New Credit Facility to $125.0 million with proceeds from the issuance of $75.0 million of additional 10 1/2% Senior Subordinated Notes due 2013 and the Company s cash on hand. In connection with this reduction of the term facility, the interest rate of the term loan facility and terms and covenants of the facility were modified as reflected in the following paragraphs.

The interest rates per annum applicable to loans under the New Credit Facility are, at the Company s option, equal to either an alternate base rate or an adjusted LIBOR rate for a one, two, three or six month interest period chosen by the Company, or a nine or twelve month period if agreed to by all participating lenders, plus an applicable margin percentage in each case.

The alternate base rate is the greater of (1) the prime rate or (2) one-half of 1% over the weighted average of rates on overnight federal funds as published by the Federal Reserve Bank of New York. The adjusted LIBOR rate will be determined by reference to settlement rates established for deposits in dollars in the London interbank market for a period equal to the interest period of the loan and the maximum reserve percentages established by the Board of Governors of the United States Federal Reserve to which our lenders are subject. Beginning approximately six months after the closing of the March 2003 Transaction, the applicable margin percentage under the revolving loan facility will be subject to adjustments based upon the ratio of our total indebtedness to our consolidated EBITDA (as defined in the New Credit Facility) being within certain defined ranges. The interest rate at March 31, 2004 was 4.09%. The facility also requires a commitment fee to be paid quarterly equal to 0.50% of any unused commitments under the revolving loan facility.

Subject to exceptions, the New Credit Facility requires mandatory prepayments of term loans in amounts equal to 100% of the net cash proceeds from asset sales which are not reinvested by the Company within specific periods, 50% of the net cash proceeds from the issuance of equity securities by the Company or Holdings, 100% of the net cash proceeds from the issuance of debt securities by the Company or Holdings if the leverage ratio is 5.25 times or greater or 50% if the leverage ratio is 5.25 times or less, and 50% of our annual excess cash flow, less all voluntary prepayments made during the year.

The New Credit Facility requires scheduled quarterly payments on the term loan in amounts equal to $312,500 on each of June 30, September 30, December 31 and March 31, beginning on June 30, 2004.

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Indebtedness under the New Credit Facility is guaranteed by all of the Company s current restricted subsidiaries, certain of its future restricted subsidiaries and by Holdings. It is secured by a first priority security interest in substantially all of the Company s existing and future property and assets, including accounts receivable, inventory, equipment, general intangibles, intellectual property, investment property, other personal property, owned and material leased real property, cash and cash proceeds of the foregoing and a first priority pledge of the Company s capital stock and the capital stock of the guarantor subsidiaries.

The New Credit Facility requires that the Company comply on a quarterly basis with certain financial covenants, including an interest coverage ratio calculation, a fixed charge coverage ratio calculation and a maximum net senior leverage ratio calculation, which become more restrictive over time. In addition, the New Credit Facility includes negative covenants restricting or limiting the Company s ability and the ability of its subsidiaries to, among other things, incur, assume or permit to exist additional indebtedness or guarantees; incur liens and engage in sale leaseback transactions; make capital expenditures; make loans and investments; declare dividends, make payments or redeem or repurchase capital stock; engage in mergers, acquisitions and other business combinations; prepay, redeem or purchase certain indebtedness; amend or otherwise alter terms of our indebtedness; sell assets; transact with affiliates and alter the business that it conducts.

Such negative covenants are subject to exceptions, including, with respect to restrictions on dividends from the Company to Holdings, certain allowable dividends to pay cash interest on its parent s holding company notes beginning in the fiscal year ending December 31, 2004.

Senior Subordinated Notes On March 27, 2003, in connection with the March 2003 Transaction, Amy Acquisition Corp. issued $275.0 million of 10 1/2% Senior Subordinated Notes due 2013. The Company assumed Amy Acquisition Corp. s obligations with respect to the notes upon consummation of the March 2003 Transaction. Interest became payable semi-annually in arrears beginning in October 2003. The notes are unconditionally guaranteed, jointly and severally and on an unsecured senior subordinated basis, by certain of the Company s current and former subsidiaries. The notes and guarantees rank junior to all of the Company s and the subsidiary guarantors existing and future senior indebtedness, on par with all of the Company s and the subsidiary guarantors existing and future senior subordinated indebtedness and senior to all of the Company s and the subsidiary guarantors existing and future subordinated indebtedness. On April 1, 2004, the Company made its semi-annual interest payment of approximately $18.4 million.

The Company may redeem any of the notes at any time and from time to time beginning on April 1, 2008, in whole or in part, in cash at the specified redemption prices, plus accrued and unpaid interest to the date of redemption.

If a change in control of the Company occurs, subject to certain conditions, the Company must give holders of the notes an opportunity to sell the notes to the Company at a purchase price of 101% of the principal amount of the notes, plus accrued and unpaid interest to the date of the purchase of the notes by the Company.

The indenture governing the notes contains covenants that, among other things, limit the Company s ability and the ability of the Company s restricted subsidiaries to incur or guarantee additional indebtedness, pay dividends or make other equity distributions, purchase or redeem capital stock, make certain investments, enter into arrangements that restrict dividends from subsidiaries, transfer and sell assets, engage in certain

transactions with affiliates and effect a consolidation or merger.

In February 2004, the Company issued an additional $75.0 million of its 10 1/2% Senior Subordinated Notes due 2013 at a premium price of 106% plus accrued interest. In February 2004, the Company paid down the term loan borrowings in the amount of $88.2 million. As a result of the paydown, the Company recognized a $3.5 million write-off of deferred financing costs.

Letters of Credit

As of March 31, 2004, the Company had letters of credit outstanding totaling $2.7 million. The letters of credit secure payments under certain operating leases and expire at various dates in 2004 through 2009. Some of the letters of credit automatically decline in value over various lease terms. The letters of credit have annual fees averaging 3.6%. Available borrowings under the $65 million revolving credit facility are reduced by these letters of credit. In addition, the Company has $300,000 of surety bonds outstanding to satisfy Florida Medicaid requirements.

Note 8 Commitments and Contingencies

During the fourth quarter of 2002, two civil actions were commenced in the Circuit Court of the 15th Judicial Circuit in and for Palm Beach County, Florida. The two actions were consolidated on February 14, 2003 and an Amended Complaint was filed on

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March 6, 2003. The Amended Complaint alleges a breach of duty to stockholders in connection with the March 2003 Transaction. The plaintiffs seek to represent a putative class consisting of the former public stockholders of AmeriPath, Inc. Named as defendants in the Amended Complaint are AmeriPath, Inc. and the members of the AmeriPath, Inc. board of directors. The plaintiffs allege, among other things, that the consideration was inadequate, that the announcement was improperly timed, that AmeriPath, Inc. was not properly auctioned, that the March 2003 Transaction was unfair, that the proxy statement omitted certain information that the plaintiffs contend was material and that such AmeriPath, Inc. directors breached their fiduciary duties. The Amended Complaint seeks injunctive relief against consummation of the merger, unspecified amounts of damages, costs and expenses related to their actions and other unspecified relief. We believe the Amended Complaint lacks merit and have moved to dismiss it. Notwithstanding this motion, the plaintiffs and we have agreed in principal to a non-class settlement that will be funded by our Directors and Officers insurance carrier, is in the range of future defense costs and will not materially impact our financial statements or operations. Upon consummation of the settlement, the litigation will be dismissed.

In addition, during the ordinary course of business, we have become and may in the future become subject to legal actions and proceedings. We may have liability with respect to our employees and our pathologists and with respect to hospital employees who are under the supervision of our hospital-based pathologists. The majority of these pending legal proceedings involve claims of medical malpractice and most of those suits relate to cytology services. Based upon investigations conducted to date, we believe the outcome of any pending legal actions and proceedings, individually or in the aggregate, will not have a material adverse effect on our financial condition, results of operations or liquidity. If we are ultimately found liable under the outstanding medical malpractice claims, there can be no assurance that medical malpractice insurance arrangements will be adequate to cover all such liabilities. We also may, from time to time, be involved with legal actions related to the acquisition of anatomic pathology operations, the prior conduct of acquired operations or the employment and restriction on competition of physicians. There can be no assurance that any costs or liabilities for which we become responsible in connection with these claims or actions will not be material or will not exceed the limitations of any applicable indemnification provisions or the financial resources of the indemnifying parties.

Healthcare Regulatory Environment and Reliance on Government Programs The healthcare industry in general, and the services that the Company provides, are subject to extensive federal and state laws and regulations. Additionally, a significant portion of the Company s net revenue is from payments by government-sponsored health care programs, principally Medicare and Medicaid, and is subject to audit and adjustments by applicable regulatory agencies. Failure to comply with any of these laws or regulations, the results of increased regulatory audits and adjustments, or changes in the interpretation of the coding of services or the amounts payable for the Company s services under these programs could have a material adverse effect on the Company s financial position and results of operations. The Company s operations are continuously subject to review and inspection by regulatory authorities.

The Company has received subpoenas issued by the United States Attorney s office in Tampa, Florida seeking information with respect to an investigation relating to Medicare billing and possible financial inducements in connection with a Florida physician who is not an AmeriPath pathologist but is a client of AmeriPath. The Company is providing information to the United States Attorney s office and intends to cooperate in the investigation. The Company is conducting its own internal investigation of the matter. It is not possible at this point in the investigation to determine whether the government will pursue action against AmeriPath or to assess the merits of possible defenses AmeriPath might have to any such action. Accordingly, no assurances can be given regarding the ultimate outcome of the investigation.

Employment Agreements As part of the March 2003 Transaction, the Company entered into new or amended employment agreements with certain of its management employees, which include, among other terms, non-competition provisions and salary continuation benefits. The

Company also terminated employment contracts with certain of its management employees as a result of the March 2003 Transaction, which resulted in change in control payments to those former employees which are included in merger-related costs for the period January 1, 2003 through March 27, 2003.

Quest Contracts During 2002, Quest cancelled its contract with our Jacksonville laboratory, and during the first quarter of 2003, Quest cancelled its contract with our Orlando laboratory effective March 31, 2003. Quest is in the process of internalizing the anatomic pathology work currently subcontracted to us. Revenue from Quest for the three months ended March 31, 2004 was $0.1 million and will not be significant for the remainder of 2004.

Medicare Reimbursement The Medicare statute includes a methodology to adjust payments for services, including anatomic pathology services, under the physician fee schedule. This methodology is applied each year unless it is overridden by congressional action. The statutory methodology would have led to a 4.4% reduction in the physician fee schedule conversion factor in 2003 and a 4.5% reduction in 2004 if those reductions had not been blocked by Congress. Instead, Congress required a 1.6% increase in 2003 and a 1.5% increase in each of 2004 and 2005. In addition, because it was projected that the statutory methodology would result in additional reductions in the physician fee schedule conversion factor in future years, Congress revised the methodology through legislation enacted in December 2003. It is unclear how this revision in the methodology will affect the annual adjustments in the physician fee schedule conversion factor in future years and, if it will not prevent reductions, whether Congress will intervene to prevent decreases in the physician fee schedule conversion factor in future years.

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Note 9 Comprehensive Income

In accordance with SFAS No. 130, *Reporting Comprehensive Income* (SFAS 130), the Company is required to report and display certain information related to comprehensive income. For the three months ended March 31, 2004 and for the period from January 1, 2003 through March 27, 2003, net income equaled comprehensive income.

Note 10 Segment Reporting

The Company has two reportable segments, owned operations and managed operations. The segments were determined based on the type of service and customer. Owned operations provide anatomic pathology services to hospitals and referring physicians, while the Company s managed operations provide management services to the affiliated physician groups. The accounting policies of the segments are the same as those described in the summary of accounting policies in the Company s year end audited financial statements. The Company evaluates performance based on net revenue and income from operations.

The following is a summary of financial information for the three months ended March 31, 2004 and for the period from January 1, 2003 through March 27, 2003 for the Company s business segments and corporate offices:

	(Successor) Three months ended March 31, 2004	(Predecessor) Period from January 1, 2003 through March 27, 2003
Owned		
Net patient service revenue	$ 119,620	$ 113,478
Income from operations	25,409	26,053
Segment assets	766,617	
Managed		
Net management service revenue	$ 6,180	$ 5,479
Income from operations	690	558
Segment assets	15,874	
Corporate		
Loss from operations	$ (12,017)	$ (9,629)
Segment assets	133,483	

Elimination of intercompany accounts	9,542

Note 11 Income Taxes

Our effective income tax rate was 37.0% and 58.0% for the three-month period ended March 31, 2004 and for the period from January 1, 2003 through March 27, 2003, respectively.

This rate decreased significantly from the prior period primarily due to the non-deductibility of certain merger-related charges relating to the March 2003 Transaction.

Note 12 Subsequent Events

On April 1, 2004, the Company made its semi-annual interest payment on the Senior Subordinated Notes of approximately $18.4 million.

On April 1, 2004, the Company borrowed $5.0 million on its revolver, and in May 2004, the Company repaid the full amount borrowed on the revolver.

In April 2004, the Company entered into a 2 1/2 year interest rate swap agreement to manage its exposure to market risks related to changes in interest rates associated with its variable rate debt under its credit facility. The notional amount of the swap is $75.0

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

million. The interest differential will be paid or received as interest rates changes are calculated and paid semi-annually to the appropriate party. These payments or receipts will be recorded as adjustments to interest expense in the period in which they are incurred.

Note 13 Guarantor Subsidiaries

The following information is presented as required by regulations of the Securities and Exchange Commission in connection with the Company s 10 1/2% Senior Subordinated Notes due 2013. This information is not routinely prepared for use by management. The operating and investing activities of the separate legal entities included in the Company s consolidated financial statements are fully interdependent and integrated. Accordingly, consolidating the operating results of those separate legal entities is not representative of what the actual operating results of those entities would be on a stand-alone basis. Operating expenses of those separate legal entities include intercompany charges for management fees and other services. Certain expense items and asset and liability balances that are applicable to the Company s subsidiaries are typically recorded in the books and records of AmeriPath, Inc. For purposes of this footnote disclosure, such balances and amounts have been pushed down to the respective subsidiaries either on a specific identification basis, or when such items cannot be specifically attributed to an individual subsidiary, have been allocated on an incremental or proportional cost basis to AmeriPath, Inc. and the Company s subsidiaries.

The following tables present condensed consolidating financial information at March 31, 2004, and December 31, 2003 and for the three months ending March 31, 2004 and for the period from January 1, 2003 through March 27, 2003 for (i) AmeriPath, (ii) on a combined basis, the subsidiaries of AmeriPath that are guarantors of the Company s 10 1/2% Senior Subordinated Notes due 2013 (the Subsidiary Guarantors) and (iii) on a combined basis, the subsidiaries of AmeriPath that are not guarantors of the Company s 10 1/2% Senior Subordinated Notes due 2013 (the Non-Guarantor Subsidiaries).

Condensed Consolidating Balance Sheets:

Successor:

As of March 31, 2004	AmeriPath, Inc.	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
Assets					
Current assets:					
Cash	$	$ 27,371	$ 373		$ 27,744
Restricted cash		14,086			14,086

Accounts receivable, net	67	67,891	17,186		85,144
Inventories	149	2,037			2,186
Other current assets	1,606	12,006	4,016		17,628
Total current assets	1,822	123,391	21,575		146,788
Property & equipment, net	2,381	25,092	73		27,546
Goodwill, net		417,504	123,725		541,229
Other identifiable intangibles, net	20,200	141,710	22,249		184,159
Investment in subsidiaries	706,732	(6,632)		(700,100)	
Other assets	19,590	5,298	906		25,794
Total assets	$ 750,725	$ 706,363	$ 168,528	$ (700,100)	$ 925,516
Liabilities and Stockholder s Equity					
Current liabilities:					
Accounts payable and accrued expenses	$ 27,165	$ 27,300	$ 6,780		$ 61,245
Current portion of long-term debt	1,250	631			1,881
Other current liabilities	(127)	1,067			940
Total current liabilities	28,288	28,998	6,780		64,066
Long-term debt	474,063	2,437			476,500
Other liabilities	4,429	18,070	1,106		23,605
Deferred tax liabilities, net	122	16,032	(1,106)		15,048
Total long-term liabilities	478,614	36,539			515,153
Intercompany (receivable) payable	255,781	(244,788)	(10,993)		0
Stockholder s equity:					
Common stock	(1,382)	1,381	25	(23)	1
Additional paid-in capital	306,002	33,733	3,011		342,746
Retained earnings (deficit)	(316,579)	850,493	169,713	(700,077)	3,550
Total stockholder s equity	(11,959)	885,607	172,749	(700,100)	346,297
Total liabilities and stockholder s equity	$ 750,724	$ 706,356	$ 168,536	$ (700,100)	$ 925,516

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Successor:

As of December 31, 2003	AmeriPath, Inc.	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
Assets					
Current assets:					
Cash	$	$ 22,652	$ 884		$ 23,536
Restricted cash		12,825			12,825
Accounts receivable, net	259	66,227	15,109		81,595
Inventories	142	1,761			1,903
Other current assets	1,793	13,332	4,059		19,184
Total current assets	2,194	116,797	20,052		139,043
Property & equipment, net	2,029	25,007	67		27,103
Goodwill, net		413,301	119,574		532,875
Other identifiable intangibles, net	20,300	131,469	34,791		186,560
Investment in subsidiaries	684,593	(6,630)		(677,963)	
Other assets	20,896	5,469	807		27,172
Total assets	$ 730,012	$ 685,413	$ 175,291	$ (677,963)	$ 912,753
Liabilities and Stockholder s Equity					
Current liabilities:					
Accounts payable and accrued expenses	$ 5,505	$ 36,413	$ 5,714		$ 47,632
Current portion of long-term debt	2,149	1,301			3,450
Other current liabilities	(12)	1,885			1,873
Total current liabilities	7,642	39,599	5,714		52,955
Long-term debt	487,135	1,873			489,008
Other liabilities	5,138	11,213	881		17,232
Deferred tax liabilities, net	122	15,867	(1,106)		14,883
Total long-term liabilities	492,395	28,953	(225)		521,123
Intercompany (receivable) payable	224,996	(227,456)	2,460		
Stockholder s equity:					
Common stock	(1,382)	1,379	25	(21)	1
Additional paid-in capital	300,092	31,719	3,009		334,820
Retained earnings (deficit)	(293,731)	811,219	164,308	(677,942)	3,854
Total stockholder s equity	4,979	844,317	167,342	(677,963)	338,675

Total liabilities and stockholder s equity	$ 730,012	$ 685,413	$ 175,291	$ (677,963)	$ 912,753

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AMERIPATH, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Condensed Consolidating Statements of Operations:

Successor:

For the three months ended March 31, 2004	AmeriPath, Inc.	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Consolidated Total
Net revenues	$	$ 97,112	$ 28,688	$ 125,800
Cost of services		(54,791)	(11,902)	(66,693)
Selling, general and administrative expense	(2,638)	(34,191)	(4,796)	(41,625)
Amortization expense		(2,489)	(325)	(2,814)
Merger-related charges				
Restructuring costs				
Asset impairment & related charges			(586)	(586)
Total operating costs and expense	(2,638)	(91,471)	(17,609)	(111,718)
(Loss) income from operations	(2,638)	5,641	11,079	14,082
Other income (expense)				
Interest expense	(11,086)	(60)		(11,146)
Management fee (A)		11,079	(11,079)	
Write-off of deferred financing costs	(3,488)			(3,488)
Other, net	1	69		70
Total other expenses	(14,573)	11,088	(11,079)	(14,564)
(Loss) income before income taxes	(17,211)	16,729		(482)
Benefit (provision) for income taxes	6,663	(6,485)		178
Net (loss) income	$ (10,548)	$ 10,244	$	$ (304)

(A) In accordance with the applicable management fee agreements, the Subsidiary Guarantors are the direct beneficiary of substantially all of the pre-tax income of the Non-Guarantor Subsidiaries.

Predecessor:

For the period from January 1, 2003 through March 27, 2003	AmeriPath, Inc.	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Consolidated Total
Net revenues	$	$ 107,388	$ 11,569	$ 118,957
Cost of services		(56,354)	(5,791)	(62,145)
Selling, general and administrative expense	(939)	(33,123)	(2,661)	(36,723)
Amortization expense		(2,750)	(357)	(3,107)
Merger-related charges	(10,010)			(10,010)
Restructuring costs		(699)	(497)	(1,196)
Asset impairment & related charges		(287)	287	
Total operating costs and expense	(10,949)	(93,213)	(9,019)	(113,181)
(Loss) income from operations	(10,949)	14,175	2,550	5,776
Other income (expense)				
Interest expense	(1,115)	(65)		(1,180)
Management fee (A)		2,550	(2,550)	
Write-off of Genomics investment	(957)			(957)
Other, net	4	29		33
Total other expenses	(2,068)	2,514	(2,550)	(2,104)
(Loss) income before income taxes	(13,017)	16,689		3,672
Benefit (provision) for income taxes	2,720	(4,851)		(2,131)
Net (loss) income	$ (10,297)	$ 11,838	$	$ 1,541

(A) In accordance with the applicable management fee agreements, the Subsidiary Guarantors are the direct beneficiary of substantially all of the pre-tax income of the Non-Guarantor Subsidiaries.

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AMERIPATH, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Condensed Consolidating Statements of Cash Flows:

Successor:

For the three months ended March 31, 2004	AmeriPath, Inc.	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Consolidated Total
Cash flows from operating activities:				
Net (loss) income	$ (10,548)	$ 10,244	$	$ (304)
Adjustments to reconcile net (loss) income to cash provided by operating activities	4,301	18,222	4,537	27,060
Changes in assets and liabilities which used cash, net of effects of acquisitions	8,632	(14,054)	(3,131)	(8,553)
Net cash provided by operating activities	2,385	14,412	1,406	18,203
Cash flows from investing activities	(1,500)	(8,930)	(1,917)	(12,347)
Cash flows from financing activities	(885)	(763)		(1,648)
Increase (decrease) in cash and equivalents		4,719	(511)	4,208
Cash and cash equivalents, beginning of period		22,652	884	23,536
Cash and cash equivalents, end of period	$	$ 27,371	$ 373	$ 27,744

Predecessor:

For the period from January 1, 2003 through March 27, 2003	AmeriPath, Inc.	Subsidiary Guarantors	Non-Guarantor Subsidiaries	Consolidated Total
Cash flows from operating activities:				
Net (loss) income	$ (10,297)	$ 11,838	$	$ 1,541
Adjustments to reconcile net (loss) income to cash (used in) provided by operating activities	11,319	16,845	3,097	31,261
Changes in assets and liabilities which used cash, net of effects of acquisitions	(1,029)	(8,018)	895	(8,152)
Net cash (used in) provided by operating activities	(7)	20,665	3,992	24,650
Cash flows from investing activities	(300)	(20,510)	(4,981)	(25,791)

Cash flows from financing activities	307	(130)		177
Increase (decrease) in cash and equivalents		25	(989)	(964)
Cash and cash equivalents, beginning of period		(25)	989	964
Cash and cash equivalents, end of period	$	$	$	$

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

AmeriPath, Inc. (AmeriPath or the Company) is one of the leading anatomic pathology laboratory companies in the United States. We offer a broad range of anatomic pathology laboratory testing and information services used by physicians in the detection, diagnosis, evaluation and treatment of cancer and other diseases and medical conditions. We service an extensive referring physician base through our 15 regional laboratories and 36 satellite laboratories, and we provide inpatient diagnostic and medical director services at more than 200 hospitals. Our services are performed by over 400 pathologists.

On December 8, 2002, AmeriPath Holdings, Inc. (Holdings) formerly known as Amy Holding Company, and its wholly-owned subsidiary Amy Acquisition Corp., entered into a merger agreement providing for the merger of Amy Acquisition Corp. with and into AmeriPath, with AmeriPath continuing as the surviving corporation and a wholly-owned subsidiary of Holdings. The merger was consummated on March 27, 2003. We refer to the merger as the March 2003 Transaction.

Because the laws of many states restrict corporations from directly employing physicians or owning corporations that employ physicians, we often conduct our business through affiliated entities that we manage and control but do not own. In states where we are under these restrictions, we perform only non-medical administrative and support services, do not represent to the public or our clients that we offer medical services and do not exercise influence or control over the practice of medicine by our physicians. Because of the degree of non-medical managerial control we exercise over our affiliated entities, we consolidate the financial results of these entities with those of our wholly-owned operations. We collectively refer to these consolidated entities and our wholly-owned operations as our owned operations. In addition, we have also entered into management agreements with a few anatomic pathology laboratory operations over which we do not exercise non-medical managerial control and, accordingly, do not consolidate with our owned operations. We refer to these operations as our managed operations. For the three months ended March 31, 2004, our revenues from owned operations and managed operations accounted for 95.1% and 4.9% of our total net revenues, respectively. For the period from January 1, 2003 through March 27, 2003, our revenues from owned operations and managed operations accounted for 95.4% and 4.6% of our total net revenues, respectively.

Financial Statement Presentation

The following paragraphs provide a brief description of the most important items that appear in our financial statements and general factors that impact these items.

Net Revenues. Net revenues consist of revenues received from patients, third-party payors and others for services rendered. Our same store net revenue is affected by changes in customer volume, payor mix and reimbursement rates. References to same store refer to operations that have been included in our financial statements throughout the periods compared.

Cost of Services. Cost of services consists principally of the compensation and fringe benefits of pathologists, medical malpractice insurance, licensed technicians and support personnel, laboratory supplies, shipping and distribution costs and facility costs. Historically, acquisitions, and the costs associated with additional personnel and facilities, have been the most significant factor driving increases in our cost of services. Also, increases in medical malpractice insurance have affected our cost of services.

Selling, General and Administrative Expense. Selling, general and administrative expense primarily includes the cost of field operations, corporate support, sales and marketing, information technology and billing and collections. As we have developed our national sales and marketing infrastructure, our selling, general and administrative expense has increased. In addition, spending on new information technology initiatives historically has contributed to increased expenses in this category.

Provision for Doubtful Accounts. Provision for doubtful accounts is affected by our mix of revenue from outpatient and inpatient services. Provision for doubtful accounts typically is higher for inpatient services than for outpatient services due primarily to a larger concentration of indigent and private pay patients, greater difficulty gathering complete and accurate billing information and longer billing and collection cycles for inpatient services. Management service revenue generally does not include a provision for doubtful accounts.

Amortization Expense. Our acquisitions have resulted in significant net identifiable intangible assets and goodwill. We record net identifiable intangible assets at fair value on the date of acquisition. Effective January 1, 2002, we adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, which required us to cease amortizing goodwill and instead perform a transitional impairment test as of January 1, 2002 and an annual impairment analysis to assess the recoverability of goodwill. The results of the transitional and annual impairment tests indicated no impairment of goodwill or other indefinite lived intangibles. We continually evaluate whether events or circumstances have occurred that may warrant revisions to the carrying values

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of our goodwill and other identifiable intangible assets or to the estimated useful lives assigned to such assets. Any significant impairment recorded on the carrying values of our goodwill or other identifiable intangible assets would be recorded as a charge to income from operations and a reduction of intangible assets and could materially reduce our profitability in the period in which the charge is recorded.

Recent Trends and Events

Acquisitions During the first three months of 2004, we acquired a hospital-based practice in Bountiful, Utah. The total consideration paid by us in connection with this acquisition included cash and contingent notes. During the period from January 1, 2003 through March 27, 2003, we acquired a start-up operation in Charleston, South Carolina. The total consideration paid by us in connection with this acquisition included cash and the assumption of certain liabilities. During the first three months of 2004, we made contingent note payments of approximately $7.9 million relating to previous acquisitions.

Medical Malpractice Costs. In June 2002, we replaced our existing medical malpractice insurance coverage with third party insurance companies with a new self-insurance, or captive, arrangement. We entered into this self-insurance arrangement because we were unable to renew our existing coverage at acceptable rates, which we believe was an industry-wide situation. Under our self-insurance structure, we retain more risk for medical malpractice costs, including settlements and claims expense, than under our previous coverage. While we have obtained excess liability coverage for medical malpractice costs, we have no aggregate excess stop loss protection, meaning there is no aggregate limitation on the amount of risk we retain under these arrangements. Our medical malpractice costs are based on actuarial estimates of our medical malpractice settlement and claims expense and the costs of maintaining our captive insurance program and excess coverage. We periodically review and update the appropriateness of our accrued liability for medical malpractice costs. Because we retain these risks, in addition to an actual increase in claims or related expenses, a change in the actuarial assumptions upon which our medical malpractice costs are based could materially affect results of operations in a particular period even if we do not experience an actual increase in claims or related expenses. For fiscal year 2003, our medical malpractice costs were approximately $12.4 million. For the three months ended March 31, 2004, our medical malpractice costs were approximately $3.1 million.

Quest Contracts. During 2002, Quest cancelled its contract with our Jacksonville laboratory, and Quest cancelled its contract with our Orlando laboratory effective March 31, 2003. Quest is in the process of internalizing the anatomic pathology work currently subcontracted to us. Our revenues from Quest for the three months ended March 31, 2004 were $0.1 million.

Medicare Reimbursement. The Medicare statute includes a methodology to adjust payments for services, including anatomic pathology services, under the physician fee schedule. This methodology is applied each year unless it is overridden by congressional action. The statutory methodology would have led to a 4.4% reduction in the physician fee schedule conversion factor in 2003 and a 4.5% reduction in 2004 if those reductions had not been blocked by Congress. Instead, Congress required a 1.6% increase in 2003 and a 1.5% increase in each of 2004 and 2005. In addition, because it was projected that the statutory methodology would result in additional reductions in the physician fee schedule conversion factor in future years, Congress revised the methodology through legislation enacted in December 2003. It is unclear how this revision in the methodology will affect the annual adjustments in the physician fee schedule conversion factor in future years and, if it will not prevent reductions, whether Congress will intervene to prevent decreases in the physician fee schedule conversion factor in future years.

Critical Accounting Policies

Our critical accounting policies remain consistent with those reported in our Annual Report on Form 10-K.

Principles of Consolidation

Our consolidated financial statements include our accounts and those of our owned operations. As part of the consolidation process, we have eliminated intercompany accounts and transactions. We do not consolidate the results of operations of our managed operations.

Segments

Our two reportable segments are our owned operations and our managed operations. We determine our segments based upon the type of service performed and our customers. Our owned operations provide anatomic pathology services to hospitals and referring physicians, while our managed operations provide management services to the affiliated physician groups.

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Results of Operations

The following table outlines, for the periods indicated, selected operating data as a percentage of net revenues.

	(Successor) Three Months Ended March 31, 2004	(Predecessor) Period from January 1, 2003 through March 27, 2003
Net revenue	100.0%	100.0%
Operating costs and expenses:		
Cost of services	53.0%	52.2%
Selling, general and administrative expenses	19.3%	18.3%
Provision for doubtful accounts	13.8%	12.6%
Amortization expense	2.2%	2.6%
Asset impairment & related charges	0.5%	
Merger-related charges		8.4%
Restructuring costs		1.0%
Total operating costs and expenses	88.8%	95.1%
Income from operations	11.2%	4.9%
Interest expense	(8.9)%	(1.0)%
Write-off of deferred financing costs	(2.8)%	(0.8)%
Other income, net	0.1%	0.0%
(Loss) income before income taxes	(0.4)%	3.1%
Provision for income taxes	0.1%	(1.8)%
Net (loss) income	(0.3)%	1.3%

Net Revenues.

Net revenues increased by $6.8 million, or 5.7%, from $119.0 million for the period from January 1, 2003 through March 27, 2003 to $125.8 million for the three months ended March 31, 2004. Same store net revenue increased $7.6 million or 6.5% from $116.5 million for the period from January 1, 2003 through March 27, 2003 to $124.1 million for the three months ended March 31, 2004. Same store net revenue, excluding revenue from national laboratory companies, for the first quarter of 2004 increased 8.9%, or $10.2 million, compared to the period from January 1, 2003 through March 27, 2003. For the first quarter of 2004, revenue from our contracts with national laboratory companies was $0.1 million, down from $2.7 million from the period from January 1, 2003 through March 27, 2003. The national labs continue to reduce the amount of volume they subcontract. Revenue from our contracts with national laboratory companies is expected to be minimal during the remainder of 2004. The remaining increase in net revenue resulted from acquired operations, less any dispositions, during 2003. Our mix of revenue for the first quarter of 2004 was 51% outpatient, 44% inpatient (hospital-based), and 5% management services. This compares to a mix of 47% outpatient, 48% inpatient (hospital based) and 5% management services in the period from January 1, 2003 through March 27, 2003.

Cost of Services.

Cost of services increased by $4.6 million, or 7.4%, from $62.1 million for the period from January 1, 2003 through March 27, 2003 to $66.7 million for the three months ended March 31, 2004. Cost of services as a percentage of net revenues increased from 52.2% for the period from January 1, 2003 through March 27, 2003 to 53.0% for the three months ended March 31, 2004. The increase in cost of services as a percentage of net revenues is primarily due to increased physician compensation and increased courier and distribution costs associated with the increased revenue from physician s offices. Gross margin decreased from 47.8% for the period from January 1, 2003 through March 27, 2003 to 47.0% for the three months ended March 31, 2004.

Selling, General and Administrative Expenses.

Selling, general and administrative expense increased by $2.6 million, or 12.0%, from $21.7 million for the period from January 1, 2003 through March 27, 2003 to $24.3 million for the three months ended March 31, 2004. As a percentage of net revenues, selling, general and administrative expense increased from 18.3% for the period from January 1, 2003 through March 27, 2003 to 19.3% for the first quarter of 2004. The increase was primarily due to the severance of approximately $1.4 million for the Company s former Chief Executive Officer, investments in information technology and the expansion of the sales and marketing efforts.

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Provision for Doubtful Accounts.

Our provision for doubtful accounts increased by $2.4 million, or 16.0%, from $15.0 million for the period from January 1, 2003 through March 27, 2003 to $17.4 million for the first quarter of in 2004. The provision for doubtful accounts as a percentage of net revenues increased from 12.6% for the period from January 1, 2003 through March 27, 2003 to 13.8% for the first quarter of 2004.

Amortization Expense.

Amortization expense decreased by $0.3 million, or 9.7%, from $3.1 million for the period from January 1, 2003 through March 27, 2003 to $2.8 million for the three months ended March 31, 2004.

Merger-related Charges.

The merger-related charges of $10.0 million for the period from January 1, 2003 through March 27, 2003 relate to the March 2003 Transaction. These costs were primarily legal, accounting, advisory services and employee change in control payments related to the March 2003 Transaction. There were no merger-related costs for the three months ended March 31, 2004.

Restructuring Costs.

In the period from January 1, 2003 through March 27, 2003, we incurred certain restructuring costs as promulgated by SFAS No. 146 of approximately $1.2 million for employee severance costs in connection with a reduction in workforce at our Southern California, Philadelphia, Central Florida and North Texas laboratories.

Write-off of Deferred Financing Costs.

In March 2003, the Company wrote off the remaining balance of its deferred financing costs of approximately $1.0 million related to the termination of its former credit facility as part of the March 2003 Transaction.

In February 2004, the Company wrote off a portion of the balance of its deferred debt financing costs totaling approximately $3.5 million related to the amendment of its term B credit facility. The remaining balance is being amortized over the life of the term loan facility.

Asset impairment & related charges.

In March 2004, the Company sold a practice in Michigan resulting in an impairment charge of approximately $0.6 million.

Interest Expense.

Interest expense increased by $9.9 million from $1.2 million for the period from January 1, 2003 through March 27, 2003 to $11.1 million for the three months ended March 31, 2004. This increase was attributable to increased interest of $7.7 million on the senior subordinated notes outstanding and interest of $2.0 million on the new credit facility, along with a higher effective interest rate. Our effective interest rate was 9.2% and 5.3% for the three-month period ended March 31, 2004 and the period from January 1, 2003 through March 27, 2003, respectively.

Income Taxes.

Our effective income tax rate was 37.0% and 58.0% for the three-month period ended March 31, 2004 and for the period from January 1, 2003 through March 27, 2003, respectively. The 2003 rate was due to the non-deductibility of certain charges relating to the March 2003 Transaction. The effective tax rate for the period from January 1, 2003 through March 27, 2003, excluding the non-deductibility of merger related charges, would have been approximately 39.2%.

Net (Loss) Income.

Net loss for the three months ended March 31, 2004, was $0.3 million, compared with net income of $1.5 million for the period from January 1, 2003 through March 27, 2003. The difference was primarily due to the write-off of $3.5 million in deferred financing costs during the three months ended March 31, 2004 compared to a write-off of $1.0 million of deferred financing costs for the period from January 1, 2003 through March 27, 2003.

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Liquidity and Capital Resources

At March 31, 2004, we had working capital of approximately $82.7 million, a decrease of $3.4 million from working capital of $86.1 million at December 31, 2003. The decrease in working capital for the first three months of 2004 was due primarily to an increase in accrued interest of $11.3 million, partially offset by an increase in cash and cash equivalents of $4.2 million, an increase in restricted cash of $1.3 million, and an increase in accounts receivable of $3.5 million.

For the three months ended March 31, 2004, net cash provided by operating activities was $18.2 million, compared to $24.7 million for the period from January 1, 2003 through March 27, 2003. For the three months ended March 31, 2004, cash flows from operations were primarily used to make term note payments of $8.8 million, and acquire property and equipment of $2.7 million.

Our new credit facility provides for senior secured financing of up to $190.0 million, consisting of a $125.0 million term loan facility with a maturity of March 27, 2010 and a $65.0 million revolving loan facility with a maturity of March 27, 2009.

The interest rates per annum applicable to loans under our new credit facility are, at our option, equal to either an alternate base rate or an adjusted LIBOR for a one, two, three or six month interest period chosen by us, or a nine or twelve month period if agreed by all participating lenders, in each case, plus an applicable margin percentage.

On March 27, 2003, in connection with the March 2003 Transaction, Amy Acquisition Corp. issued $275.0 million of 10 1/2% Senior Subordinated Notes due 2013. We assumed Amy Acquisition Corp. s obligations under these notes upon consummation of the March 2003 Transaction. Interest became payable semi-annually in arrears beginning in October 2003. The notes are unconditionally guaranteed, jointly and severally and on an unsecured senior subordinated basis, by certain of our current and former subsidiaries. The notes and guarantees rank junior to all of our and the guarantors existing and future senior indebtedness, on par with all of our and the guarantors existing and future senior subordinated indebtedness and senior to all of our and the guarantors existing and future subordinated indebtedness.

The indenture governing the notes contains covenants that, among other things, limit our ability and the ability of our restricted subsidiaries to incur or guarantee additional indebtedness, pay dividends or make other equity distributions, purchase or redeem capital stock, make certain investments, enter into arrangements that restrict dividends from subsidiaries, transfer and sell assets, engage in certain transactions with affiliates and effect a consolidation or merger.

In connection with our acquisitions, we generally agree to pay a base purchase price plus additional contingent purchase price consideration to the sellers of the acquired operations. The additional payments generally are contingent upon the achievement of specified levels of income from operations (as defined by the specific purchase agreements with the seller) by the acquired operations over periods of three to five years from the date of acquisition. In certain cases, the payments are contingent upon other factors such as the retention of certain hospital contracts or relationships for periods ranging from three to five years. The amount of the payments cannot be determined until the final determination of the income from operations levels or other performance targets during the relevant periods of the respective agreements. If the maximum specified levels of income from operations for all acquired operations are achieved, we estimate that we would make aggregate maximum principal payments of approximately $85.9 million over the next five years. A lesser amount or no payments at all would be made if the stipulated levels of income from operations or other evaluation factors specified in each agreement were not met. During the first three months of 2004, we made contingent note payments, including interest, aggregating $7.9 million. In addition, we intend to fund future payments under our contingent payment obligations relating to acquisitions completed prior to the transaction from contributions made to us by Holdings out of the funds from the remaining cash collateral account balance of $44.6 million and, if needed, cash flows from operations.

Historically, our capital expenditures have been primarily for laboratory equipment, information technology equipment and leasehold improvements. Total capital expenditures were $2.7 million and $2.6 million for the three months ended March 31, 2004 and the period from January 1, 2003 through March 27, 2003, respectively.

We intend to fund our ongoing capital and working capital requirements, including our internal growth and acquisitions, through a combination of cash flows from operations and borrowings under our new $65.0 million revolving loan facility. In addition, we intend to fund payments under our contingent payment obligations from contributions made to us by our parent out of the funds that will be held in the cash collateral account and, if needed, cash flows from operations.

We expect to use our new revolving loan facility to fund internal growth and acquisitions and for working capital. We anticipate that funds generated by operations, funds available under our new revolving loan facility and funds in the cash collateral account will be sufficient to meet working capital requirements and anticipated contingent note obligations and to finance capital expenditures over the next twelve months. Further, in the event payments under the contingent payment obligations exceed the amounts held in the cash collateral account, we believe that the incremental cash generated from operations would exceed the cash required to satisfy those additional payments. Such additional payments, if any, will result in a corresponding increase in goodwill.

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Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of March 31, 2004.

Contractual Obligations

The following is a summary of our contractual cash obligations, excluding contingent payments, as of March 31, 2004 (in millions):

	Payments Due By Period				
Contractual Obligations	**1 year**	**1-2 years**	**3-5 years**	**After 5 years**	**Total**
Term loans under our new credit facility	$ 1.3	$ 1.3	$ 3.8	$ 118.6	$ 125.0
Other indebtedness	0.6	2.6	0.2		3.4
Operating leases	5.6	10.2	9.4	12.6	37.8
Senior subordinated notes				350.0	350.0
Total contractual cash obligations	$ 7.5	$ 14.1	$ 13.4	$ 481.2	$ 516.2

Interest Rate Risk

We are subject to market risk associated principally with changes in interest rates. Our principal interest rate exposure relates to the term loans outstanding under our new credit facility. We have $125.0 million of outstanding term loans subject to variable rates. Each quarter point increase or decrease in the applicable interest rate would change our interest expense by approximately $0.3 million per year. In April 2004, we entered into an interest rate swap agreement to manage its exposure to market risks related to changes in interest rates associated with our variable rate debt under our credit facility.

Inflation

Inflation was not a material factor in either revenue or operating expenses during the first three months of 2004.

Qualification of Forward-Looking Statements

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act, Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and the Private Securities Litigation Reform Act of 1995 that are subject to risks and uncertainties. All statements other than statements of historical facts included in this Form 10-Q that address activities, events or developments that we expect, believe or anticipate will or may occur in the future are forward-looking statements. Forward-looking statements give our current expectations and projections relating to the financial condition, results of operations, plans, objectives, future performance and business of AmeriPath, and its subsidiaries. You can identify these statements by the fact that they do not relate strictly to historical or current facts. These statements may include words such as anticipate, estimate, expect, project, intend, plan, believe and o and terms of similar meaning in connection with any discussion of the timing or nature of future operating or financial performance or other events.

These forward-looking statements are based on our expectations and beliefs concerning future events affecting us. They are subject to uncertainties and factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control. Although we believe that the expectations reflected in our forward-looking statements are reasonable, we do not know whether our expectations will prove correct. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this Form 10-Q, including the risks outlined under Risk Factors, will be important in determining future results.

Because of these factors, we caution that investors should not place undue reliance on any of our forward-looking statements. Further, any forward-looking statement speaks only as of the date on which it is made and except as required by law we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which it is made or to reflect the occurrence of anticipated or unanticipated events or circumstances.

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RISK FACTORS

You should carefully consider each of the following risks and all of the other information set forth in this Form 10-Q. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently believe to be immaterial may also adversely affect our business. If any of the following risks actually occur, our business prospects, financial condition and results of operations could be materially adversely affected. You should also review the risk factors and cautionary statements we make in other filings we make with the Securities and Exchange Commission.

Our substantial indebtedness could adversely affect our financial condition and prevent us from fulfilling our obligations under our term loans and subordinated debt.

We have a significant amount of indebtedness. As of March 31, 2004, as adjusted to give effect to the refinancing of the term loan outstanding under our senior credit facility and the issuance of additional senior subordinated notes, our total debt was $478.4 million, excluding unused revolving loan commitments under our senior credit facility, which would have represented approximately 58.0% of our total anticipated capitalization. This debt does not include our obligations under our existing contingent notes.

Our substantial indebtedness could have important consequences by adversely affecting our financial condition and thus making it more difficult for us to satisfy our obligations. Our substantial indebtedness could:

- increase our vulnerability to adverse general economic and industry conditions,
- require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, payments under our contingent notes and other general corporate purposes,
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate,
- place us at a competitive disadvantage compared to our competitors that have less debt and
- limit our ability to borrow additional funds.

Despite our level of indebtedness, we will be able to incur substantially more debt. This could further exacerbate the risks to our financial condition described above.

We will be able to incur significant additional indebtedness in the future. Although the indenture governing the notes and the credit agreement governing our senior credit facility contain restrictions on the incurrence of additional indebtedness, these restrictions are subject to a number of qualifications and exceptions and the indebtedness incurred in compliance with these restrictions could be substantial. Moreover, the restrictions also do not prevent us from incurring obligations that do not constitute indebtedness. To the extent new debt is added to our currently anticipated debt levels, the substantial leverage risks described above would increase.

The terms of our senior credit facility and the indenture relating to our notes may restrict our current and future operations, particularly our ability to respond to changes or to take certain actions.

Our senior credit facility contains a number of restrictive covenants that impose significant operating and financial restrictions on us and may limit our ability to engage in acts that may be in our long-term best interests. Our senior credit facility includes covenants restricting, among other things, our ability to:

incur additional debt,

pay dividends and make restricted payments,

create liens,

use the proceeds from sales of assets and subsidiary stock,

enter into sale and leaseback transactions,

make capital expenditures,

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change our business,

enter into transactions with affiliates and

transfer all or substantially all of our assets or enter into merger or consolidation transactions.

The indenture relating to the notes also contains numerous operating and financial covenants including, among other things, restrictions on our ability to:

incur additional debt,

pay dividends or purchase our capital stock,

make investments,

enter into transactions with affiliates,

sell or otherwise dispose of assets and

merge or consolidate with another entity.

Our senior credit facility, as amended, also includes financial covenants, including requirements that we maintain:

a minimum interest coverage ratio,

a minimum fixed charge coverage ratio and

a maximum senior leverage ratio.

These financial covenants will become more restrictive over time.

A failure by us to comply with the covenants contained in our senior credit facility or the indenture could result in an event of default. In the event of any default under our senior credit facility, the lenders under our senior credit facility could elect to declare all borrowings outstanding, together with accrued and unpaid interest and fees, to be due and payable, enforce their security interest, require us to apply all of our available cash to repay these borrowings (even if the lenders have not declared a default) or prevent us from making debt service payments on the notes, any of which would result in an event of default under the notes. In addition, future indebtedness could contain financial and other covenants more restrictive than those applicable to our senior credit facility and the notes.

We may not be able to generate sufficient cash flow to meet our debt service obligations.

Our ability to generate sufficient cash flow from operations to make scheduled payments on our debt obligations will depend on our future financial performance, which will be affected by a range of economic, competitive, regulatory, legislative and business factors, many of which are outside of our control. If we do not generate sufficient cash flow from operations to satisfy our debt obligations, including payments on the notes, we may have to undertake alternative financing plans, such as refinancing or restructuring our debt, selling assets, reducing or delaying capital investments or seeking to raise additional capital. We cannot assure you that any refinancing would be possible or that any assets could be sold on acceptable terms or otherwise. Our inability to generate sufficient cash flow to satisfy our debt obligations, or to refinance our obligations on commercially reasonable terms, would have an adverse effect on our business, financial condition and results of operations, as well as on our ability to satisfy our obligations under the notes.

We conduct business in a heavily regulated industry, and changes in regulations or violations of regulations may, directly or indirectly, reduce our revenues and harm our business.

The healthcare industry is highly regulated, and there can be no assurance that the regulatory environment in which we operate will not change significantly and adversely in the future. Several areas of regulatory compliance that may affect our ability to conduct business include:

federal and state anti-kickback laws,

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federal and state self-referral and financial inducement laws, including the federal physician anti-self referral law, or the Stark Law,

federal and state false claims laws,

state laws regarding prohibitions on the corporate practice of medicine,

state laws regarding prohibitions on fee-splitting,

federal and state anti-trust laws,

the Health Insurance Portability and Accountability Act of 1996, or HIPAA,

federal and state regulation of privacy, security and electronic transactions and code sets and

federal, state and local laws governing the handling and disposal of medical and hazardous waste.

These laws and regulations are extremely complex. In many instances, the industry does not have the benefit of significant regulatory or judicial interpretation of these laws and regulations. It also is possible that the courts could ultimately interpret these laws in a manner that is different from our interpretations. While we believe that we are currently in material compliance with applicable laws and regulations, a determination that we have violated these laws, or the public announcement that we are being investigated for possible violations of these laws, would have an adverse effect on our business, financial condition and results of operations. For a more complete description of these regulations, see Business - Government Regulation in our Form 10-K for the year ended December 31, 2003.

Our business could be materially harmed by future interpretation or implementation of state laws regarding prohibitions on the corporate practice of medicine.

The manner in which licensed physicians can be organized to perform and bill for medical services is governed by state laws and regulations. Under the laws of some states, business corporations generally are not permitted to employ physicians or to own corporations that employ physicians or to otherwise exercise control over the medical judgments or decisions of physicians.

We believe that we currently are in compliance with the corporate practice of medicine laws in the states in which we operate in all material respects. Nevertheless, there can be no assurance that regulatory authorities or other parties will not assert that we are engaged in the corporate practice of medicine or that the laws of a particular state will not change. If such a claim were successfully asserted in any jurisdiction, or as a result of such a change in law, we could be required to restructure our contractual and other arrangements, our company and our pathologists could be subject to civil and criminal penalties and some of our existing contracts, including non-competition provisions, could be found to be illegal and unenforceable. In addition, expansion of our operations to other states may require structural and organizational modification of our form of relationship with pathologists, operations or hospitals. These results or the inability to successfully restructure contractual arrangements would have an adverse effect on our business, financial condition and results of operations.

We could be hurt by future interpretation or implementation of federal and state anti-kickback and anti-referral laws.

Federal and state anti-kickback laws prohibit the offer, solicitation, payment and receipt of remuneration in exchange for referrals of products and services for which payment may be made by Medicare, Medicaid or other federal and state healthcare programs. Federal and state anti-referral laws, including the Stark Law, prohibit physicians from referring their patients to healthcare providers with which the physicians or their immediate family members have a financial relationship for designated services when such services are subject to reimbursement by Medicare or Medicaid. A violation of any of these laws could result in monetary fines, civil and criminal penalties and exclusion from participation in Medicare, Medicaid or other federal or state healthcare programs, which accounted for approximately 21% of our revenues during the first three months of 2004.

We owe some of our physicians contingent payment obligations entered into in connection with acquisitions we have completed and some of our physicians are party to compensation arrangements with us and own common stock of our parent. Although we have attempted to structure our businesses so that our financial relationships with our physicians and our referral practices comply in all material respects with federal and state anti-referral laws, including the Stark Law, the government may take the position that they do not comply, or a prohibited referral may be made by one of our physicians without our knowledge. If our financial relationships with our physicians were found to be unlawful or unlawful referrals were found to have been made, we or they could be fined, become subject to government recoupment of fees previously paid to us and forfeiture of revenues due to us or become subject to civil and criminal penalties. In such situations, we also may be excluded from participation in Medicare, Medicaid and other federal and state healthcare programs. Any one of these consequences could have an adverse effect on our business, financial conditions and results of operations.

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Our business could be harmed by future interpretation or implementation of state law prohibitions on fee-splitting.

Many states prohibit the splitting or sharing of fees between physicians and non-physicians. We believe our arrangements with pathologists and operations comply in all material respects with the fee-splitting laws of the states in which we operate. Nevertheless, it is possible that regulatory authorities or other parties could claim we are engaged in fee-splitting. If such a claim were successfully asserted in any jurisdiction, our pathologists could be subject to civil and criminal penalties, including loss of licensure, and we could be required to restructure our contractual and other arrangements. In addition, expansion of our operations to new states with fee-splitting prohibitions may require structural and organizational modification to the form of our current relationships which may be less profitable. A claim of fee-splitting or modification of our business to avoid such a claim could have an adverse effect on our business, financial condition and results of operations.

Federal and state regulation of privacy could cause us to incur significant costs.

The Federal Trade Commission, or FTC, pursuant to consumer protection laws, and the Department of Health and Human Services, or HHS, pursuant to HIPAA, regulate the use and disclosure of information we may have about our patients. Many states also have laws regarding privacy of health information. While we believe that we are in compliance with FTC and state laws regarding privacy, and with the HIPAA privacy regulations, these laws are complex and will have an impact upon our operations. Violations of the HIPAA privacy regulations are punishable by civil and criminal penalties. In addition, while individuals do not have a private right of action under HIPAA, the privacy regulations may be viewed by the courts as setting a standard of conduct, and the failure to comply could serve as the basis for a private claim. In addition, HIPAA regulations regarding the security of health information and standards for electronic transactions have also been issued. While many of our systems have already been configured to comply with these regulations, to achieve compliance we may need to modify or replace systems in certain of our locations and incur related expenses.

We are subject to significant professional or other liability claims and we cannot assure you that insurance coverage will be available or sufficient to cover such claims.

We may be sued under physician liability or other liability law for acts or omissions by our pathologists, laboratory personnel and hospital employees who are under the supervision of our hospital-based pathologists. We and our pathologists periodically become involved as defendants in medical malpractice and other lawsuits, some of which are currently ongoing, and are subject to the attendant risk of substantial damage awards.

Through June 30, 2002, we were insured for medical malpractice risks on a claims made basis under traditional professional liability insurance policies. In July 2002, we began using a captive insurance program to partially self-insure our medical malpractice risk. Under the captive insurance program we retain more risk for medical malpractice costs, including settlements and claims expenses, than under our prior coverage. We have no aggregate excess stop loss protection under our captive insurance arrangements, meaning there is no aggregate limitation on the amount of risk we retain under these arrangements. Because of our self-insurance arrangements and our lack of aggregate excess stop loss protection, professional malpractice claims could result in substantial uninsured losses. In addition, it is possible that the costs of our captive insurance arrangements and excess insurance coverage will rise, causing us either to incur additional costs or to further limit the amount of our coverage. Further, our insurance does not cover all potential liabilities arising from governmental fines and penalties, indemnification agreements and certain other uninsurable losses. For example, from time to time we agree to indemnify third parties, such as hospitals and national clinical laboratories, for various claims that may not be covered by insurance. As a result, we may become responsible for substantial damage awards that are uninsured. We are currently subject to indemnity claims, which if determined adversely to us, could result in substantial uninsured losses. Therefore, it is possible that pending or future claims will not be covered by or will exceed the limits of our insurance coverage and indemnification agreements or that third parties will fail or otherwise be unable to comply with their obligations to us.

Government programs account for approximately 21% of our revenues, so a decline in reimbursement rates from government programs would harm our revenues and profitability.

We derived approximately 21% of our net revenue during the first quarter of 2004 from payments made by government programs, principally Medicare and Medicaid. These programs are subject to substantial regulation by federal and state governments. Any changes in reimbursement policies, practices, interpretations or statutes that place limitations on reimbursement amounts or change reimbursement coding practices could materially harm our business by reducing revenues and lowering profitability. Increasing budgetary pressures at both the federal and state levels and concerns over escalating costs of healthcare have led, and may continue to lead, to significant reductions in healthcare reimbursements, which would have an adverse effect on our business, financial condition and results of operations.

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We incur financial risk related to collections as well as potentially long collection cycles when seeking reimbursement from third-party payors.

Substantially all of our net revenues are derived from services for which our operations charge on a fee-for-service basis. Accordingly, we assume the financial risk related to collection, including potential write-offs of doubtful accounts, and long collection cycles for accounts receivable, including reimbursements by third-party payors, such as governmental programs, private insurance plans and managed care organizations. Our provision for doubtful accounts for the first three months of 2004 was 13.8% of net revenues, with net revenues from inpatient services having a provision for doubtful accounts of approximately 21.6%. If our revenue from hospital-based services increases as a percentage of our total net revenues, our provision for doubtful accounts as a percentage of total net revenues may increase. Increases in write-offs of doubtful accounts, delays in receiving payments or potential retroactive adjustments and penalties resulting from audits by payors could have an adverse effect on our business, financial condition and results of operations.

In addition to services billed on a fee-for-service basis, our hospital-based pathologists in their capacities as medical directors of hospitals clinical laboratories, microbiology laboratories and blood banking operations bill non-Medicare patients according to a fee schedule for their clinical professional component, or CPC, services. Our historical collection experience for CPC services is significantly lower than other anatomic pathology procedures. See Business-Billing in our Form 10-K for the year ended December 31, 2003. Hospitals and third party payors are continuing to increase pressure to reduce our revenue from CPC services, including but not limited to encouraging their patients not to pay us for such services.

The continued growth of managed care may have a material adverse effect on our business.

The number of individuals covered under managed care contracts or other similar arrangements has grown over the past several years and may continue to grow in the future. In addition, Medicare and Medicaid and other government healthcare programs may continue to shift to managed care. For the first quarter of 2004 and for the period from January 1, 2003 through March 27, 2003, approximately 59%, and 58%, respectively, of our net revenue was derived from reimbursements from managed care organizations and third party payors. Entities providing managed care coverage have reduced payments for medical services in numerous ways, including entering into arrangements under which payments to a service provider are capitated, limiting testing to specified procedures, denying payment for services performed without prior authorization and refusing to increase fees for specified services. These trends reduce our revenues and limit our ability to pass cost increases to our customers. Also, if these or other managed care organizations do not select us as a participating provider, we may lose some or all of that business, which could have an adverse effect on our business, financial condition and results of operations.

There has been an increasing number of state and federal investigations of healthcare companies, which may increase the likelihood of investigations of our business practices and the possibility that we will become subject to lawsuits.

Prosecution of fraudulent practices by healthcare companies is a priority of the United States Department of Justice, HHS s Office of the Inspector General, or OIG, and state authorities. The federal government has become more aggressive in examining laboratory billing practices and seeking repayments and penalties allegedly resulting from improper billing practices, such as using an improper billing code for a test to realize higher reimbursement. While the primary focus of this initiative has been on hospital laboratories and on routine clinical chemistry tests, which comprise only a small portion of our revenues, the scope of this initiative could expand, and it is not possible to predict whether or in what direction the expansion might occur. In certain circumstances, federal and some state laws authorize private whistleblowers to bring false claim or qui tam suits against providers on behalf of the government and reward the whistleblower with a portion of any final recovery. In addition, the federal government has engaged a number of non-governmental audit organizations to assist in tracking and recovering false claims for healthcare services.

Since investigations relating to false claims have increased in recent years, it is more likely that companies in the healthcare industry, like us, could become the subject of a federal or state civil or criminal investigation or action. While we believe that we are in compliance in all material respects with federal and state fraud and abuse statutes and regulations, and we monitor our billing practices and hospital arrangements for compliance with prevailing industry practices under applicable laws, these laws are complex and constantly evolving, and it is possible that governmental investigators may take positions that are inconsistent with our practices. Moreover, even when the results of an investigation or a qui tam suit are favorable to a company, the process is time consuming and legal fees and diversion of company management focus are expensive. Any lengthy investigation could have an adverse effect on our business, financial condition and results of operations.

Investigations of entities with which we do business could adversely affect us.

HCA Inc., or HCA, has been under investigation with respect to fraud and abuse issues. As of March 31, 2004, we provided medical director services for 27 HCA hospital laboratories. As a result, the government s investigation of HCA could result in

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investigations of one or more of our operations. Furthermore, we have received subpoenas from the United States Attorney s office in Tampa, Florida to deliver Medicare billing records and other documents relating to alleged financial inducements received by a Florida physician who is not a pathologist with our company but is one of our clients. We are providing information to the United States Attorney s office and intend to cooperate in the investigation. We also are conducting our own internal investigation of the matter. It is not possible at this point in the investigation to determine whether the government will pursue action against us or to assess the merits of possible defenses we may have to any such action. Accordingly, no assurances can be given regarding the ultimate outcome of the investigation.

We derive a significant portion of our revenues from short-term hospital contracts and hospital relationships that can be terminated without penalty.

Many of our hospital contracts may be terminated prior to the expiration of the initial or any renewal term by either party with relatively short notice and without cause. We also have business relationships with hospitals that are not governed by written contracts and may be terminated by the hospitals at any time. Loss of a hospital contract or relationship would not only result in a loss of net revenue but may also result in a loss of the outpatient net revenue derived from our association with the hospital and its medical staff. Any such loss could also result in an impairment of the balance sheet value of the assets we have acquired or may acquire, requiring substantial charges to earnings. Continuing consolidation in the hospital industry resulting in fewer hospitals and fewer laboratories enhances the risk that some of our hospital contracts and relationships may be terminated, which could have an adverse effect on our business, financial condition and results of operations.

If we cannot effectively implement our internal growth strategy, it would materially and adversely affect our business and results of operations.

Our focus on internal growth, which is based upon our existing relationships and services offered, is a departure from our prior focus on growth through acquisitions. The success of our strategy rests upon increasing testing volumes, improving the mix of our services and obtaining more favorable pricing, all of which will result in a greater focus on our sales and marketing function. The success of this strategy also is dependent upon our ability to hire and retain qualified personnel, including pathologists, to develop new areas of expertise and new customer relationships and to expand our current relationships with existing customers. There can be no assurance that we will be able to make our new strategy a success.

We may inherit significant liabilities from operations that we have acquired or acquire in the future.

We perform due diligence investigations with respect to potential liabilities of acquired operations and typically obtain indemnification from the sellers of such operations. Nevertheless, undiscovered claims may arise, and liabilities for which we become responsible may be material and may exceed either the limitations of any applicable indemnification provisions or the financial resources of the indemnifying parties. Claims or liabilities of acquired operations may include matters involving compliance with laws, including healthcare laws. While we believe, based on our due diligence investigations that our acquired operations were generally in compliance with applicable healthcare laws prior to their acquisition, they may not have been in full compliance and we may become accountable for their non-compliance. A violation of the healthcare laws could result in monetary fines, government recoupment of fees previously paid to us, forfeiture of revenues due to us, or civil and criminal penalties. In such situations, we may also be excluded from participation in Medicare, Medicaid and other federal and state healthcare programs. Any one of these consequences could have an adverse effect on our business, financial condition and results of operations.

We have significant contingent liabilities payable to many of the sellers of operations that we have acquired.

In connection with our past acquisitions, we typically have agreed to pay the sellers additional consideration in the form of contingent note obligations. Payment on these contingent notes typically depends upon the financial performance of the acquired operation or the retention of specified hospital contracts over periods ranging from three to five years after the acquisition. The amount of these contingent note payments cannot be determined until the contingency periods terminate and the level of the performance is ascertainable. As of March 31, 2004, if the minimum performance that would result in the maximum amount being payable for existing contingent notes were achieved, we would be obligated to make principal payments of approximately $85.9 million over the next five years. Lesser amounts would be paid if the maximum criteria is not met. Although we believe we will be able to make payments on contingent note obligations existing prior to the March 2003 Transaction from the remaining balance in the cash collateral account held by our parent, it is possible that such payments, or payments on additional contingent notes issued as part of subsequent acquisitions, could cause significant liquidity problems for us.

We have recorded a significant amount of intangible assets, which may never generate the returns we expect.

Our acquisitions have resulted in significant increases in net identifiable intangible assets and goodwill. Net identifiable intangible assets, which include hospital contracts, management service agreements and laboratory contracts acquired in acquisitions,

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were approximately $184.2 million at March 31, 2004, representing approximately 19.9% of our total assets. Goodwill, which relates to the excess of cost over the fair value of the net assets of the businesses acquired, was approximately $541.2 million at March 31, 2004, representing approximately 58.5% of our total assets. Goodwill and net identifiable intangible assets are recorded at fair value on the date of acquisition and, under Financial Accounting Standards Board Statement No. 142, will be reviewed at least annually for impairment. Impairment may result from, among other things, deterioration in performance of the acquired company, adverse market conditions, adverse changes in applicable laws or regulations, including changes that restrict the activities of the acquired business, and a variety of other circumstances. The amount of any impairment must be written off. We evaluated our recorded goodwill and identifiable intangible assets during the fourth quarter of 2003 and determined that there was no asset impairment charge required with respect to our intangible assets. We may not ever realize the full value of our intangible assets. Any future determination requiring the write-off of a significant portion of intangible assets would have an adverse effect on our financial condition and results of operations.

Our business is highly dependent on the recruitment and retention of qualified pathologists.

Our business is dependent upon recruiting and retaining pathologists, particularly those with subspecialties, such as dermatopathology, hematopathology, immunopathology and cytopathology. While we have been able to recruit and retain pathologists in the past, we may be unable to continue to do so in the future as competition for the services of pathologists increases. In addition, we may need to provide more compensation to our pathologists in order to enhance our recruitment and retention efforts and may be unable to recover these increased costs through price increases. The relationship between the pathologists and their respective local medical communities is important to the operation and continued profitability of each of our local operations. Loss of even one of our pathologists could lead to the loss of hospital contracts or other sources of revenue derived from our relationship with the pathologist. For the years ending 2001, 2002 and 2003, turnover rates for our pathologists were 10.0%, 8.8% and 13.3%, respectively. If turnover rates were to increase, our revenues and earnings could be adversely affected.

Our success is dependent on the ability of our new management team to work together effectively.

A number of the members of our senior management team, including David Redmond, our Chief Financial Officer, and Martin Stefanelli, our Chief Operating Officer, have been with our company for less than a year. Other senior officers, including Joseph Sonnier, our President, and Jeffrey Mossler, our Chief Medical Officer, have also been in their current positions for less than a year. Given the limited experience that our new management team has working together, it is possible that these officers will not integrate well within our organization. In addition, we are currently looking to hire a new Chief Executive Officer. Once hired, there is no guarantee that our new Chief Executive Officer will integrate well with the other members of management. The failure of our new management team to integrate well within our organization would have a significant effect on our future operations.

We may be unable to enforce non-competition provisions with departed pathologists.

We either directly employ our pathologists or control a physician-owned entity that employs our pathologists. Each of our pathologists typically enters into an employment agreement with us or a company we control. Most of these employment agreements prohibit the pathologist from competing with our company within a defined geographic area and prohibit solicitation of other pathologists, employees or clients for a period of one to two years after termination of employment. We attempt to structure all of these contracts in accordance with applicable laws and to maintain and enforce these contracts as necessary. However, agreements not to compete are subject to many limitations under state law and these limitations may vary from state to state. We cannot predict whether a court will enforce the non-competition covenants in our various employment agreements. A finding that these covenants are unenforceable could have an adverse effect on our business, financial condition and results of operations.

Competition from other providers of pathology services may materially harm our business.

We have numerous competitors, including anatomic pathology practices, large physician group practices, hospital laboratories, specialized commercial laboratories and the anatomic pathology divisions of some national clinical laboratories. Moreover, companies in other healthcare segments, some of which have previously been customers of ours, such as hospitals, national clinical laboratories, managed care organizations and other third-party payors, may enter our markets and begin to compete with us. For example, Quest Diagnostics, Incorporated, or Quest, a national clinical laboratory company and former customer of ours, has begun to compete with us in some markets. Some of our competitors may have greater financial resources than us, which could further intensify competition. Increasing competition may erode our customer base, reduce our sources of revenue, cause us to reduce prices, enter into more capitated contracts in which we take on greater pricing risks or increase our marketing and other costs of doing business. Increasing competition may also impede our growth objectives by making it more difficult or more expensive for us to acquire or affiliate with additional pathology operations.

We depend on numerous complex information systems, and any failure to successfully maintain those systems or implement new systems could materially harm our operations.

We depend upon numerous information systems for operational and financial information, test reporting for our physicians and our complex billing operations. We currently have several major information technology initiatives underway, including the

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integration of information from our operations. No assurance can be given that we will be able to enhance existing or implement new information systems that can integrate successfully our disparate operational and financial information systems. In addition to their integral role in helping our operations realize efficiencies, these new systems are critical to developing and implementing a comprehensive enterprise-wide management information database. To develop an integrated network, we must continue to invest in and administer sophisticated management information systems. We may experience unanticipated delays, complications and expenses in implementing, integrating and operating our systems. Furthermore, our information systems may require modifications, improvements or replacements as we expand and as new technologies become available. These modifications, improvements or replacements may require substantial expenditures and may require interruptions in operations during periods of implementation. Moreover, implementation of these systems is subject to the availability of information technology and skilled personnel to assist us in creating and implementing the systems. The failure to successfully implement and maintain operation, financial, test reports, billing and physician practice information systems would have an adverse effect on our business, financial condition and results of operations.

Failure to timely or accurately bill for our services may have a substantial negative impact on our revenues, cash flow and bad debt expense.

Billing for laboratory testing services involves numerous parties and complex issues and procedures. The industry practice is to perform tests in advance of payment and without certainty as to the outcome of the billing process. We bill various payors, such as patients, government programs, physicians, hospitals and managed care organizations. These various payors have different billing information requirements and typically reimburse us only for medically necessary tests and only after we comply with a variety of procedures, such as providing them with Current Procedural Terminology, or CPT, codes and other information. If we do not meet all of the payors stringent requirements, we may not be reimbursed, which would increase our bad debt expense.

Among many other factors complicating our billing are:

- disputes between payors as to which party is responsible for payment,
- disparity in coverage among various payors, and
- difficulty satisfying the specific compliance requirements and CPT coding of and other procedures mandated by various payors.

The complexity of laboratory billing also tends to cause delays in our cash collections. Confirming incorrect or missing billing information generally slows down the billing process and increases the age of our accounts receivable. We assume the financial risk related to collection, including the potential write-off of doubtful accounts and delays due to incorrect or missing information.

Our tests and business processes may infringe on the intellectual property rights of others, which could cause us to engage in costly litigation, pay substantial damages or prohibit us from selling our services.

Other companies or individuals, including our competitors, may obtain patents or other property rights that would prevent, limit or interfere with our ability to develop, perform or sell our tests or operate our business. As a result, we may be involved in intellectual property litigation and may be found to infringe on the proprietary rights of others, which could force us to do one or more of the following:

- cease developing and performing services that incorporate the challenged intellectual property,
- obtain and pay for licenses from the holder of the infringed intellectual property right,
- redesign or reengineer our tests,
- change our business processes or
- pay substantial damages, court costs and attorneys fees, including potentially increased damages for any infringement determined to be willful.

Infringement and other intellectual property claims, whether with or without merit, can be expensive and time-consuming to litigate. In addition, any requirement to reengineer our tests or change our business processes could substantially increase our costs, force us to interrupt the delivery of our services or delay new test releases.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

The Company is subject to market risk associated principally with changes in interest rates. Our principal interest rate exposure relates to the amount outstanding under the Company s new credit facility. Currently the balances outstanding under the credit facility are at floating rates. Based on the outstanding balance of $125.0 million at March 31, 2004, each quarter point increase or decrease in the floating rate increases or decreases interest expense by approximately $0.3 million per year, respectively.

ITEM 4. CONTROLS AND PROCEDURES

The Company s management, with the participation of the Company s Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company s disclosure controls and procedures as of March 31, 2004. Based on that evaluation, the Company s Chief Executive Officer and Chief Financial Officer have concluded that the Company s disclosure controls and procedures as of March 31, 2004 were effective to provide reasonable assurance that the information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

There have been no changes in the Company s internal controls over financial reporting during the quarter ended March 31, 2004 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

During the ordinary course of business, the Company has become and may in the future become subject to pending and threatened legal actions and proceedings. The Company may have liability with respect to its employees and its pathologists as well as with respect to hospital employees who are under the supervision of the hospital based pathologists. The majority of the Company s pending legal proceedings involve claims of medical malpractice. Most of these relate to cytology services. Based upon current information, the Company believes the outcome of such pending legal actions and proceedings, individually or in the aggregate, will not have a material adverse effect on the Company s financial condition, results of operations or liquidity. If the Company is ultimately found liable under these medical malpractice claims, there can be no assurance that the Company s medical malpractice insurance coverage will be adequate to cover any such liability, and thus, the Company s financial condition, results of operations and liquidity could suffer a material adverse effect. The Company may also, from time to time, be involved with legal actions related to the acquisition of and affiliation with physician operations, the prior conduct of such practices, or the employment (and restriction on competition of) physicians. There can be no assurance that any costs or liabilities for which the Company becomes responsible in connection with such claims or actions will not be material or will not exceed the limitations of any applicable indemnification provisions or the financial resources of the indemnifying parties.

During the fourth quarter of 2002, two civil actions were commenced in the Circuit Court of the 15th Judicial Circuit in and for Palm Beach County, Florida. The two actions were consolidated on February 14, 2003 and an Amended Complaint was filed on March 6, 2003. The Amended Complaint alleges a breach of duty to stockholders in connection with the March 2003 Transaction. The plaintiffs seek to represent a

putative class consisting of the former public stockholders of AmeriPath, Inc. Named as defendants in the Amended Complaint are AmeriPath, Inc. and the members of the AmeriPath, Inc. board of directors. The plaintiffs allege, among other things, that the consideration was inadequate, that the announcement was improperly timed, that AmeriPath, Inc. was not properly auctioned, that the March 2003 Transaction was unfair, that the proxy statement omitted certain information that the plaintiffs contend was material and that such AmeriPath, Inc. directors breached their fiduciary duties. The Amended Complaint seeks injunctive relief against consummation of the merger, unspecified amounts of damages, costs and expenses related to their actions and other unspecified relief. We believe the Amended Complaint lacks merit and have moved to dismiss it. Notwithstanding this motion, the plaintiffs and we have agreed in principal to a non-class settlement that will be funded by our Directors and Officers insurance carrier, is in the range of future defense costs and will not materially impact our financial statements or operations. Upon consummation of the settlement, the litigation will be dismissed.

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

4.1	Supplemental Indenture dated as of February 13, 2004 among AmeriPath, Inc., AmeriPath Holdings, Inc., the Guarantors and U.S. Bank National Association (Incorporated by reference to Exhibit 4.2 filed with AmeriPath s registration statement on Form S-4 on April 14, 2004 (File No. 333-114470))
10.1	Purchase Agreement, amended and restated as of February 11, 2004 between AmeriPath, Inc., the Guarantors and Credit Suisse First Boston LLC on behalf of the Initial Purchasers (Incorporated by reference to Exhibit 10.1 filed with AmeriPath s registration statement on Form S-4 on April 14, 2004 (File No. 333-114470))
10.2	Registration Rights Agreement, dated as of February 17, 2004, among AmeriPath, Inc., the Guarantors and Credit Suisse First Boston LLC on behalf of the Initial Purchasers (Incorporated by reference to Exhibit 10.2 filed with AmeriPath s registration statement on Form S-4 on April 14, 2004 (File No. 333-114470))
10.3	Amendment Agreement dated as of February 17, 2004, to the Credit Agreement dated as of March 27, 2003, and AmeriPath, Inc., AmeriPath Holdings, Inc., the Guarantors, the lenders party thereto and Credit Suisse First Boston (Incorporated by reference to Exhibit 10.3 filed with AmeriPath s registration statement on Form S-4 on April 14, 2004 (File No. 333-114470))
10.4	Amended and Restated Credit Agreement, dated as of February 17, 2004, among AmeriPath, Inc., AmeriPath Holdings, Inc., the Lenders, and Credit Suisse First Boston (Incorporated by reference to Exhibit 10.4 filed with AmeriPath s registration statement on Form S-4 on April 14, 2004 (File No. 333-114470))
10.5	Supplement to the Guarantee and Collateral Agreement, dated as of February 17, 2004, among AmeriPath Florida, LLC, AmeriPath Pennsylvania, LLC, AmeriPath Wisconsin, LLC, Regional Pathology Consultants, LLC and Credit Suisse First Boston LLC (Incorporated by reference to Exhibit 10.6 filed with AmeriPath s registration statement on Form S-4 on April 14, 2004 (File No. 333-114470))
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350
32.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350

(b) Reports on Form 8-K

A current report on Form 8-K, dated January 21, 2004, was filed by the Company with the Securities and Exchange Commission announcing the retirement of James C. New, the Company s Chairman and Chief Executive Officer.

A current report on Form 8-K, dated February 3, 2004, was filed by the Company with the Securities and Exchange Commission announcing the proposed offering of $75.0 million principal amount of 10 1/2% senior subordinated notes due 2013.

A current report on Form 8-K, dated February 3, 2004, was furnished to the Securities and Exchange Commission announcing that the offering circular to be disseminated in connection with the proposed offering of $75.0 million principal amount of 10 1/2% senior subordinated notes due 2013 would contain preliminary financial data regarding the Company s fiscal 2003 operating results.

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SIGNATURES

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

AMERIPATH, INC.

Date: May 13, 2004 By: /s/ JOSEPH A. SONNIER, M.D.

Joseph A. Sonnier, MD
President

Date: May 13, 2004 By: /s/ DAVID L. REDMOND

David L. Redmond
Executive Vice President and

Chief Financial Officer

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EXHIBIT INDEX

Exhibit Number	Description
31.1	Certification of Chief Executive pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350
32.2	Certification of Chief Financial Officer, as required by Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350