AMERIPATH INC
Form 10-K
March 29, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE YEAR ENDED DECEMBER 31, 2001

OR

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

FOR THE TRANSITION PERIOD FROM TO .

AMERIPATH, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	65-0642485
(State or Other Jurisdiction Incorporation or Organization)	(I.R.S. Employer Identification No.)

7289 Garden Road, Suite 200, Riviera Beach, Florida 33404
(Address of Principal Executive Offices)

Registrant's Telephone Number, Including Area Code: (561) 845-1850

Securities Registered Pursuant to Section 12(B) of the Act:

Securities Registered Pursuant to Section 12(G) of the Act:

Common Stock (Par Value $.01 Per Share)
(Title of Class)

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 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. [ ]

The aggregate market value of voting stock held by non-affiliates of the Registrant as of March 15, 2002 was approximately $858.7 million based on the $28.20 closing sale price for the Common Stock on the NASDAQ National Market System on such date. For purposes of this computation, all executive officers and directors of the Registrant have been deemed to be affiliates. Such determination should not be deemed to be an admission that such directors and officers are, in fact, affiliates of the Registrant.

The number of shares of Common Stock of the Registrant outstanding as of

March 15, 2002 was 30,449,989.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement relating to the Registrant's 2002 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission no later than 120 days after the end of the year covered by this Report are incorporated by reference into Part III of this Report.

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PART I

ITEM 1. GENERAL BUSINESS

AmeriPath is one of the nation's leading providers of anatomic pathology services. The Company has over 400 anatomic pathologists as of December 31,

2001 who work either in one of more than 200 hospitals to which AmeriPath provides professional pathology and medical director services or in one of AmeriPath's more than 40 outpatient laboratories. AmeriPath typically serves as the exclusive provider of professional pathology services for the hospitals in which its pathologists work. Under these arrangements, AmeriPath typically bills third-party payors for the professional component of the inpatient testing and may earn small medical director fees from the hospitals. AmeriPath's hospital arrangements provide a relatively steady stream of revenue and, while not long-term commitments, tend to continue uninterrupted. In the hospital setting, key revenue sources include the study of tissues, or surgical pathology, and the study of cells, or cytopathology. The Company also has roughly 20 large outpatient laboratories and numerous satellite labs where AmeriPath performs outpatient pathology services. These outpatient pathology services are provided to primary care physicians and other specialty physicians including dermatologists, gastroenterologists, urologists, oncologists and gynecologists. Key referral sources for the outpatient business include dermatopathology and urologic pathology, which consist principally of the study of biopsies for skin and prostate cancer, respectively.

AmeriPath generally manages and controls all of the non-medical functions of the operations, including:

- recruiting, training, employing and managing the technical and support staff;
- developing, equipping and staffing laboratory facilities;
- establishing and maintaining courier services to transport specimens;
- negotiating and maintaining contracts with hospitals, national clinical laboratories and managed care organizations and other payors;
- providing financial reporting and administration, clerical, purchasing, payroll, billing and collection, information systems, sales and marketing, risk management, employee benefits, legal, tax and accounting services;
- maintaining compliance with applicable laws, rules and regulations; and
- with respect to our ownership and operation of anatomic pathology laboratories, providing slide preparation and other technical services.

Since the first quarter of 1996, the Company has completed the acquisition of 50 physician practices located in 21 states. This includes the acquisition of Inform DX in the fourth quarter of 2000. As a result of the Inform DX acquisition, the Company now manages several pathology operations from which it derives management fees. Although the managed operations are not owned or controlled by the Company, the statistical data appearing throughout, including items such as the number of pathologists, hospitals, employees and outpatient laboratories, incorporates the statistical data from the managed operations as if they were owned by the Company. In addition, because the Inform DX transaction was accounted for as a pooling-of-interests, the information presented includes Inform DX for all periods, unless otherwise indicated. Further discussion of matters pertaining to this Item 1 is addressed in the Consolidated Financial Statements attached hereto.

Industry Overview

Pathologists are medical doctors who specialize in the study of disease. Pathologists do not treat patients, but rather assist other physicians in determining the correct diagnosis of their patient's ailments. A pathologist's

diagnosis represents a critical factor in determining a patient's future care. Pathologists perform their duties in hospital laboratories, in independent freestanding local, regional and national laboratories, in ambulatory surgery centers and in a variety of other settings.

Anatomic pathology involves evaluating tissues and cells that have been processed and mounted on slides for examination under a microscope. In surgical pathology, tissues removed from a patient during inpatient or outpatient procedures are examined to determine whether disease is present. Examples of surgical pathology include breast, prostate, skin and bone marrow biopsies. Cytopathology involves the examination of cells obtained from body fluids, from solid tissues aspirated through needles and from scrapings of body tissues. An example of cytopathology is the "Pap" smear, a test for determining cervical cancer.

According to the College of American Pathologists, there are more than 12,000 pathologists in the United States. The Company believes that many of these pathologists work in small, independent practices. However, the Company believes there has been a recent trend among pathologists to form larger practices in order to offer a broader range of outpatient and inpatient services and enhance the utilization of the practices' pathologists. The Company believes this trend can be attributed to several factors, including cost containment pressures by government and other third-party payors, increased competition and the increased costs and complexities associated with operating a medical practice. Because tissue and fluid samples are easily transportable, pathologists working in one setting may receive samples from many sources, thereby enhancing productivity and permitting a large pathology practice to service a wider geographic area. The Company believes scale leads to competitive advantages in anatomic pathology because of resulting improvements in sales, operations and contracting efficiency.

The Company believes the market for anatomic pathology, esoteric testing and related services is approximately $6.0 billion and will continue to grow for the following reasons:

Aging Population. According to the American Geriatrics Society, the number of people aged 65 and older in the United States will increase approximately 60% by the year 2020. Older populations consume a greater amount of health care services than do younger populations. The Company believes these factors will combine to drive the demand for anatomic pathology services to diagnose and treat disease.

Increasing Incidence of Cancer. The National Cancer Institute estimates that approximately 8.9 million Americans with a history of cancer were alive in 1997. The most common type of cancer is skin cancer. The American Cancer Society estimates that over 1.3 million cases of basal cell and squamous cell skin cancer are expected to be diagnosed this year. From 1981 to 1997, the incidence rate of melanoma increased about 3% per year on average, to a rate of 14.3 per 100,000 in 1997. Dermatopathology, or the study of diseases of the skin, is a growing anatomic pathology specialty because of the increasing incidence of skin cancer and the biopsies that must be performed to diagnose it.

Esoteric Testing. Esoteric tests are highly complex tests, typically ordered when a physician requires additional information to establish a diagnosis or to choose a therapeutic regimen. Esoteric tests require sophisticated instrumentation and highly skilled personnel to perform and analyze results, and consequently carry higher prices than routine tests. Commonly ordered esoteric tests include flow cytometry (leukemia/ lymphoma testing), DNA analysis, molecular genetics and cytogenetics. According to the Lab Industry

Strategic Outlook 2000, published by Washington G-2 Reports, the esoteric clinical laboratory testing market accounts for approximately $2.0 billion in annual revenue and is poised for approximately 10%-15% annual growth. We believe that the future growth in the esoteric testing market will be fueled by scientific advances facilitating the development of more sophisticated and specialized esoteric tests, increased focus on cost-effective disease prevention, detection and management and increased life expectancy.

The Genomic Revolution. Genetic and biotech companies are developing therapeutics, which allow physicians to target treatments for individuals based on their particular genetic make-up. Anatomic pathology laboratories have access to large volumes of tissue samples that contain important genetic data that is valuable to drug discovery companies in the development of new drugs. We believe a significant opportunity exists to build tissue banks with samples from normal, diseased and cancerous tissues and, subject to patient confidentiality and informed consent procedures, make such tissues available to drug testing and drug discovery companies.

Business Strategy

The Company's objective is to be the premier provider of diagnostic health care information by continuing to enhance its position as a leading provider of anatomic pathology services. Historically, the Company's growth strategy was focused primarily on acquiring leading pathology practices in order to enter new markets and expand its national presence. While acquisitions remain an important element of the Company's strategy, AmeriPath is increasingly focused on maximizing its internal, or same store, growth. The Company is pursuing the following strategies to achieve its objective:

- Enhance its regional business model with its recently augmented sales and marketing organization. The Company is utilizing its regional business model to deploy new sales people focused on general anatomic pathology markets such as urology, gastroenterology and obstetrics and gynecology (OB/GYN). Through regionally focused direct sales and marketing efforts, AmeriPath is seeking to penetrate more deeply the base of referring physicians in its markets and expand its contracts with managed care payors, hospitals and national clinical laboratories. In addition, the Company has recently established a separate sales and marketing division called Dermpath Diagnostics to market exclusively the Company's substantial dermatopathology resources, which include over 60 board certified dermatopathologists.

- Expand its exclusive relationships with hospitals and multi-hospital systems. The Company continues to seek additional exclusive hospital relationships through the acquisition of anatomic pathology practices and the expansion of existing relationships with multi-hospital systems. AmeriPath's hospital relationships provide a relatively stable and recurring source of revenue. Moreover, the Company believes that providing inpatient laboratory services to multiple hospitals within a geographic area enhances its ability to contract with managed care companies, facilitates the development and effectiveness of successful outpatient services networks and increases opportunities to perform esoteric and other specialty testing services. As of December 31, 2001, AmeriPath's pathologists were providing services in over 200 hospitals in the U.S., typically on an exclusive basis.

- Broaden its range of testing services and penetrate further the high growth esoteric testing markets. The Company has undertaken a number of

initiatives to broaden its range of testing services into the high growth market segment of esoteric testing. Because many requests for these specialty tests originate in the hospital, the Company believes its large network of hospital-based pathologists and its relationships with multi-hospital systems provide it with significant competitive advantages in pursuing this business. As part of this strategy, the Company opened the Center for Advanced Diagnostics, or CAD, in 1999 in an effort to capture specialty testing services that historically had to be performed by third parties. The success of this strategy to date is evidenced by the strong revenue growth CAD has experienced.

. Acquire leading anatomic pathology practices to further expand its national presence and support its regional growth model. The Company has successfully completed 50 acquisitions since 1996. The Company expects to increase its presence in existing markets and enter into new markets through additional acquisitions of leading pathology practices. Acquisitions are intended to enhance the Company's profitability, augment its range of subspecialties and testing services and strengthen its reputation by adding locally or nationally prominent pathologists.

. The Company intends to build upon its leadership position in anatomic pathology to participate in the rapidly growing genomics and genomics testing market. The Company is aggressively exploring ways to build upon its national scale, leading market position and access to tissue samples. The Company's objective is to create new revenue streams distinct from its anatomic, esoteric and genomic testing revenues. In the third quarter of 2000, the Company formed an alliance with Genomics Collaborative, Inc. ("GCI") to provide fresh frozen samples from normal, diseased, and cancerous tissue to GCI for subsequent sale to researchers in industry and academic laboratories who are working to discover genes associated with certain common disease categories. Under this alliance, the Company will be paid a fee for each sample it supplies to researchers and will be compensated for developing new laboratory tests for use in research or clinical settings. In addition to providing the Company with

expected new revenue streams, this alliance should give it a "first look" at genetic markers and tests resulting from the research and should provide a corresponding competitive advantage with respect to the commercialization of such markers and tests.

Sales and Marketing

Outpatient Market

The Company's marketing efforts are focused on physicians, hospital and ambulatory surgery center administrators, national clinical laboratories and managed care organizations. With the exception of Inform DX, the pre-acquisition marketing efforts of operations acquired by the Company were primarily based on the professional reputations and the individual efforts of pathologists. The Company believes that there is an opportunity to capitalize on these professional reputations by hiring experienced personnel and utilizing professional sales and marketing techniques. Historically, some of the outpatient operations marketed outpatient services primarily to dermatologists, over a broad geographic area including neighboring states. The Company continues to expand its sales and marketing team with additional sales personnel and management staff to accommodate new acquisitions, develop and introduce new products, as well as increase same store growth. These field representatives are supervised by regional sales managers who coordinate the

implementation of regional contracting efforts, leverage operational capabilities, support national sales strategies and provide ongoing training and field sales support. The regional sales managers report to the Vice President of Sales and Marketing to ensure the implementation of consistent and effective sales activities nationwide. In addition, the Company's Vice President of Managed Care directs regional managers of managed care in negotiating additional contracts. In 2001, the Company added 21 people to the sales and marketing organization, including managed care. This brings the total sales and marketing organization to 84 people as of December 31, 2001, compared to 63 at the end of the prior year.

After examining its current business model and conducting market research, including customer focus groups and an analysis of the demographic distribution of patients and referring physicians, AmeriPath created two distinct field sales divisions to provide dedicated service and support to referring physicians along specialty lines. Dermpath Diagnostics will focus on servicing and growing the national skin pathology market comprised of dermatologists, plastic surgeons, family practitioners, otolaryngologists and podiatrists. This division, which promotes AmeriPath's dermatopathologists, will expand its sales and marketing initiative throughout the U.S. market. The other field sales division, General Anatomic, has the responsibility for servicing and growing the outpatient anatomic pathology market with urologists, gastroenterologists, gynecologists, surgery centers, oncologists and any specialist requiring esoteric laboratory testing, which is provided through CAD. AmeriPath's managed care and national clinical laboratory contracting organization will support both organizations in an effort to expand such contracts.

National Clinical Laboratory Marketing

The national clinical laboratories contract with managed care organizations to provide clinical laboratory services, as well as anatomic pathology and cytology services. The clinical laboratory market is primarily dominated by two laboratories, Quest and LabCorp. Their contracts with managed care organizations are typically capitated, meaning they generally get paid a fixed fee per covered member per month to provide all necessary testing services for such members regardless of the number of tests actually performed. Ten of AmeriPath's operations have subcontracts with national clinical laboratories to provide anatomic pathology and cytology services. Under these contracts, which typically run from one to three years with automatic renewals unless terminated earlier, the operations bill the national clinical laboratories on a discounted fee-for-service basis. The reduced fee is partially offset by the national clinical laboratories provision of courier services, supplies, and reduced billing costs and lower bad debts, since the national clinical laboratories bear the capitation risk. Net revenues from these contracts constituted 9.0% and 7.0% of the Company's net revenues in 2000 and 2001, respectively. The Company is directing its marketing efforts to national clinical laboratories to expand these contracts on a regional basis to additional operations as well as to enter into new contracts. At the same time, the Company is seeking to secure new contracts and expand existing provider contracts with managed care

organizations for the provision of anatomic pathology services directly to their members and is prepared to negotiate flexible arrangements with managed care organizations, including discounted fee- for-service or capitated contracts. There can be no assurance that the Company's effort to contract directly with managed care organizations will not adversely affect the Company's relationship with the national clinical laboratories.

AmeriPath Corporate Structure

AmeriPath's revenues are derived primarily from two segments: owned operations and managed operations. In the owned operations, AmeriPath either directly employs physicians or, in states with laws that restrict the direct employment of physicians by for-profit corporations, contracts with an affiliated operation which, in turn, employs physicians. As a result of the corporate practice of medicine restrictions, the affiliated physicians in these states retain ownership of a separate affiliated operation through which they practice medicine, but the Company enters into contractual arrangements that generally (1) prohibit the affiliated physicians from transferring their ownership interests in the affiliated operation, except in very limited circumstances, and (2) require the affiliated physicians to transfer their ownership interests in the affiliated operation to designees of AmeriPath upon the occurrence of specified events. Through these contractual arrangements, AmeriPath, either directly or through its designees, has a controlling voting or financial interest in the separate affiliated operations and, therefore, refers to them as owned operations. Managed operations are operations that are not owned by AmeriPath and that are not subject to contractual arrangements that give AmeriPath a controlling interest in the practice. Rather, the managed operations are controlled by the physicians who own them, and the Company provides management services to them under long-term management services agreements.

The manner in which AmeriPath operates a particular operation is determined primarily by whether it is an owned or managed operation and the corporate practice of medicine restrictions of the respective state and other applicable regulations. The Company exercises care in structuring its operations and arrangements with hospitals, physicians and other providers in an effort to comply with applicable federal and state laws and regulations, and the Company believes that its current structure and arrangements do comply in all material respects with applicable laws and regulations. However, due to uncertainties in the law there can be no assurance that the Company's legal structure and arrangements would be deemed to be in compliance with applicable laws and regulations, and any noncompliance could result in a material adverse effect on the Company.

Owned operations are owned and operated by AmeriPath through one or more subsidiaries or physician-owned operations controlled by AmeriPath through contractual arrangements. The financial statements of the owned operations are included in the consolidated financial statements of AmeriPath.

Managed operations refers to AmeriPath's management of pathology practices under long-term management services agreements with physician groups. Generally, the Company acquires the operation's assets, and the physician groups maintain their separate corporate or partnership entities that enter into employment agreements with the practicing physicians. The management service agreements give AmeriPath the exclusive right to manage the operations during the term of the agreements. Pursuant to the management services agreements, the Company provides the managed operations with equipment, supplies, support personnel, and management and financial advisory services. The managed operations are responsible for the recruitment and hiring of physicians and all other personnel who provide pathology services, and for all issues related to the professional, clinical and ethical aspects of the business. As part of the management services agreements, managed operations are required to maintain medical malpractice insurance that names the Company as an additional insured. The Company is required to maintain general liability insurance and name the physician groups as additional insureds. Upon termination of the management services agreements, the respective physician groups are required to obtain continuing liability insurance coverage under either a "tail policy" or a "prior acts policy."

The management services fees charged under the management services agreements are based on a predetermined percentage of net operating income of the managed operations. The Company also participates to varying degrees in non-physician revenues generated from ancillary services offered through the managed operations' laboratories. The Company charges a capital fee for the use of depreciable assets owned by the

Company and recognizes revenue for all operation expenses that are paid on behalf of the operations and reimbursed to the Company pursuant to the management service agreements. Such operation expenses exclude the salaries and benefits of the physicians.

AmeriPath manages and controls all of the non-medical functions of the owned and managed operations. AmeriPath is not licensed to practice medicine. The practice of medicine is conducted solely by the physicians in the owned and managed operations.

In operating the owned operations, the Board of Directors and management of AmeriPath formulate strategies and policies that are implemented locally on a day-to-day basis by each owned operation. Each owned operation has a pathologist managing director who is responsible for overseeing the day-to-day management, who reports to one of six regional managing directors, two of whom are pathologists, who in turn report to executive officers of the Company. AmeriPath's Medical Director develops and reviews standards for the practicing physicians and reviews quality and peer review matters with each owned operation's medical director (or a medical review committee).

Pursuant to its management services agreements with managed operations, AmeriPath manages all aspects of the managed operations other than the provision of medical services, which is controlled solely by the physicians. The managed operations have joint policy boards, equally represented by the managed operation's physicians and employees of AmeriPath, that focus on strategic and operational planning, marketing, managed care arrangements and other major issues facing the managed operation.

AmeriPath's owned and managed operations typically serve as the exclusive provider of professional pathology services for the hospitals in which AmeriPath's pathologists work. The operations staff each hospital with appropriate pathologist staffing, and our pathologist will generally serve as the medical director of the hospital laboratory and facilitate the hospital's compliance with licensing requirements. The operations are generally responsible for recruiting, staffing and scheduling the operation's affiliated physicians in the hospital's inpatient laboratories. The medical director of the laboratory is generally responsible for: (1) the overall management of the laboratory, including quality of care, professional discipline and utilization review; (2) serving as a liaison to the hospital administrators and medical staff; and (3) maintaining professional and public relations in the hospital and the community. Several operations have both outpatient laboratories and hospital contracts or relationships, which allow outpatient specimens to be examined by the hospital pathologists, enhancing the utilization of pathologists in inpatient facilities. In the hospitals, technical personnel are typically employed by the hospital, rather than by the operations.

As of December 31, 2001, the owned and managed operations had contracts or relationships with over 200 hospitals. Substantially all of the operations' hospital contracts are short-term in nature and allow for termination by either party with relatively short notice. In many cases, the operations' relationships with hospitals are not subject to written contracts. Accordingly, AmeriPath's hospital contracts and relationships can easily be

terminated. AmeriPath believes, however, that the long-standing associations that many of its pathologists have with hospitals generally tend to cause AmeriPath's contracts and relationships with hospitals to continue uninterrupted. Loss of any particular hospital contract or relationship would not only result in a loss of net revenue to the Company, but also a loss of outpatient net revenue that may be derived from the relationship with a hospital and its medical staff. Continuing consolidation in the hospital industry may result in fewer hospitals or fewer laboratories as hospitals move to combine their operations.

In the past, the Company provided services at four hospitals and an ambulatory care facility owned by Primary Health Systems ("PHS"), a regional hospital network in Cleveland, Ohio. During the first quarter of 2000, PHS began implementing a plan of reorganization, filed under Chapter 11 with the U.S. Bankruptcy Court for the District of Delaware, and closed one hospital. During the second quarter, the bankruptcy court approved the sale of two hospitals and the ambulatory care facility to local purchasers in the Cleveland area. The purchasers, who elected to employ their own pathologists, did not accept the Company's contracts with these two hospitals and the ambulatory care facility. One hospital has not been sold and continues to do business with

the Company. This resulted in asset impairment and related charges of $5.2 million in 2000. In addition, during the fourth quarter of 2000, a hospital in South Florida where AmeriPath had the pathology contract, requested proposals for its pathology services, and AmeriPath was unsuccessful in retaining this contract. Based upon the remaining projected cash flow from this hospital network, the Company determined that the intangible assets were impaired and recorded a pre-tax non-cash charge of approximately $1.0 million.

As of December 31, 2001, the Company had contracts or relationships with 31 hospitals that are owned by HCA. Net revenues generated from contracts with HCA hospitals were $39.4 million in 1999, $43.5 million in 2000 and $50.5 million in 2001. HCA has been under government investigation for some time and we believe that it is evaluating its operating strategies, including the possible sale, spin-off or closure of certain hospitals. Closures and/or sales of HCA hospitals and/or terminations or non-renewals of one or more of our contracts or relationships with HCA hospitals could have a material adverse effect on our financial position and results of operations.

All of AmeriPath's outpatient laboratories are licensed and certified under the guidelines established by the Clinical Laboratory Improvement Amendments, or CLIA, and applicable state statutes and are managed by a medical director of the laboratory. AmeriPath's corporate compliance, quality assurance and quality improvement programs are designed to assure that all laboratories and other operations are in compliance in all material respects with applicable laws, rules and regulations.

Regional Business Model

The Company believes that its strategy of developing integrated networks of anatomic pathology operations on a regional basis benefits the Company, its pathologists, referring physicians, third-party payors and patients. These networks, which generally will be modeled on the Company's existing Florida network, will consist of a number of operations that together: (i) have a substantial regional market presence; (ii) offer a broad range of services; (iii) have extensive physician contacts; and (iv) possess complementary strengths and opportunities for operational and production efficiencies. The Company continues to integrate the operations' administrative and technical

support functions, including accounting, payroll, purchasing, risk management, billing and collections, and expects such integration to result in enhanced operational efficiencies. The Company's courier system for transporting specimens enables the operations to penetrate areas outside their current markets and enhance the utilization of their laboratory facilities. The Company also integrates and coordinates the sales and marketing effort targeting physicians, hospitals, surgery centers, managed care organizations and national clinical laboratories, on a local and regional basis. This marketing effort is based upon promoting the broad geographic coverage, professional pathologist expertise and the extensive professional services offered by the Company. The Company's strategy is to leverage its size to expand its contracts with national clinical laboratories to all of the areas covered by its operations. The Company markets its services under the name "AmeriPath" and "Dermpath Diagnostics" in order to develop brand identification of products and services to payors and other clients. The Company plans to integrate the operations' management information systems into a single system (or at a minimum consolidate the information resident on the various lab information systems) that will expand the financial and diagnostic reporting capabilities of each of the operations and the Company. Based on the foregoing, the Company believes that implementation of this regional model increases the revenues and profitability of the operations in the region, and the Company is applying this regional business model, in whole or in part, to other states in which it operates.

The Company has developed its regional business model in Florida and is replicating its model in Texas and the Midwest. The Florida regional model has been an effective tool in building the Company's business. Net revenues for the Florida region have increased from $93 million to $118 million over the past three years while adding three pathologists to the region. Operating margins as a percent of net revenue for the region have declined, primarily due to an increase in laboratory staffing costs, including physicians, and a higher percentage of revenue from national clinical laboratory contracts which have lower revenue per unit. However, this lower net revenue per unit from national lab contracts has been offset in part by increased efficiencies attributable to the Florida regional business model. The Florida region's operating margin was 28.0% for the year ended

December 31, 2001 compared to the Company's overall operating margin, excluding corporate expenses, of 27.6% for the same period.

The Company believes that its improving performance in Florida, as reflected in the following table, is due in part to the favorable results of its regional model in Florida:

	As of December 31,		
	1999	2000	2001
	(dollars in millions)		
Florida Statistics:			
Pathologists	80	83	83
Hospital relationships	31	32	31
Net revenues	$92.5	$104.0	$118.4
Operating profit before amortization	$27.7	$ 30.4	$ 33.1
Operating margin as a percent of net revenues	30.0%	29.2%	28.0%

The Company has a higher concentration of operations, laboratories and administrative offices in Florida than in any other region. In addition, Florida is an attractive market due to its population and demographics, including the growth of the general population and the large elderly population, and the Company's familiarity and understanding of the anatomic pathology market in Florida. Accordingly, there can be no assurance that the Company's regional business model will be as effective outside of Florida as it has been in Florida, or that it will be effective at all outside of Florida.

Information Technology

The Company's Information Technology ("IT") Group was reorganized in 2000 to better serve the Company's information needs. During 2000, IT staffing was increased, including the hiring of a Chief Information Officer, Director of IT Operations, Director of Software Development, and the establishment of a Project Management Office. The new team established a "Best Practice" approach to managing services to the Company's laboratories. The Company believes these services have resulted in better performing information systems, increased focus on centralization of information and a greater level of standardization across the Company's businesses. IT has several major development efforts underway. These efforts include building enhanced reporting capabilities, creating a data mart, developing a customer information system and converting to a new billing system.

The Company recognized the opportunity in the market for enhanced reporting to customers and has launched a technology initiative to produce reports that include organ maps, photomicrographs and patient education. Enhanced reports in gastroenterology, obstetrics and gynecology and urology are available in most of the Company's markets and this technology initiative has been implemented at four regional sites. The Company believes its software programs for acquiring the images and producing the reports are efficient and the Company intends to implement additional software programs as customer sales increase.

Because information management systems for our operations are not integrated, it is difficult to access consolidated operating data for the Company. The creation of a data mart involves the consolidation, from numerous information systems, of select utilization data for services provided by all specialties and includes inpatient and outpatient information. Approximately 90% of the Company's pre-Inform DX merger data for 2000 and 2001 has been loaded into a single database. The Company intends to use this database to help develop new products and services for its customers. Also, this system provides a better opportunity to benchmark the Company's laboratories and monitor the use of CAD, the Company's esoteric testing facility in Orlando. There have been several reports developed using the data mart including Commissions, Revenue by Customer, Revenue Variance, Revenue by Payor, and Lab Utilization. The Company is currently reconciling and validating its data,

organizing the effort to consolidate the remaining locations and establishing the procedures and processes to make the data mart operational. The Company intends to make all reports web enabled.

The AmeriPath Customer Information System is in the early stages of planning and currently the Company has outlined a set of goals and objectives that were defined by personnel in the Company's sales and marketing and operations departments as well as certain of the Company's pathologists. The plans for

this system are under development, and process with the Company's customers is being established. Generally, the Company initially will build on-line reporting and then use the data mart and program interfaces in an effort to meet demand by customers for improved interoperability and information.

Billing for the Company's operations is currently performed by several different internal billing systems and outsourcing billing arrangements. Approximately 70% of the Company's billed revenue in 2001 was done through four of these billing systems. Conversion from current billing systems to one of these four billing systems is anticipated to be completed by the second quarter of 2003. Once converted to four billing platforms, the Company will evaluate the feasibility and necessity of converting to one system. The Company has installed a complete general ledger and financial reporting system to handle accounting for the operations and to consolidate all accounting and financial information. As of March 2002, all of the operations have been integrated onto one common accounting system.

The Company believes that its increasing integration and consolidation of its laboratory information, billing and collections and financial reporting systems enable it to monitor the operations, enhance utilization of the pathologists, develop practice protocols and archives and provides the Company with a competitive advantage in negotiating national clinical laboratory and managed care contracts. Each of the Company's laboratories has a laboratory information system that enables laboratory personnel to track, process, report and archive patient diagnostic information.

The Company is also focused on being compliant with new regulations under the Health Insurance Portability and Accountability Act of 1996 ("HIPAA") regarding privacy, security and transmission of health information. The Company's sensitivity to these new regulations will increase as the Company moves its information systems on-line. The Company is currently in the planning stages of a compliance assessment and has engaged an outside consulting firm to assist in the assessment and measurement of its existing standards and policies, and in determining which requirements remain to be implemented. At this time, the Company is not able to determine the full consequences of the HIPAA regulations to the Company's business or the total cost of complying with these regulations. However, the HIPAA regulations are expected to significantly impact the Company operationally and financially.

Client and Payor Relationships

The operations also provide services to a wide variety of other health care providers and payors including physicians, government programs, indemnity insurance companies, managed care organizations and national clinical laboratories. Fees for anatomic pathology services rendered to physicians are billed either to the physicians, the patient's third party payor, or the patient. The following table provides the percentages of cash collections from the identified sources:

	Years Ended December 31,		
	1999	2000	2001
Source of cash collections:			
Government payors	18%	18%	21%
National clinical laboratories	9%	10%	8%
Management services	11%	8%	9%

Other.....	62%	64%	62%

Other sources of cash collections consists primarily of third-party payors, such as preferred provider organizations (PPOs), health maintenance organizations (HMOs) and indemnity insurance companies.

Contracts and Relationships with Physicians of Owned Operations

For the owned operations, the Company employs pathologists, or controls the operation that employs pathologists, who provide medical services in hospitals or in other inpatient and outpatient laboratories. While the Company or its designee exercises legal control over the owned operations, the Company does not exercise control over, or otherwise influence, the medical judgment or professional decisions of any pathologist associated with the owned operations. Although pathologist employment agreements typically have terms of three to five years, they generally can be terminated at any time, without cause, upon 60 to 180 days' notice. The pathologists generally receive a base salary, fringe benefits and may be eligible for an incentive performance bonus. In addition to compensation, the Company provides its pathologists with uniform benefit plans, such as disability, supplemental retirement, life and group health insurance and medical malpractice insurance. The pathologists are required to hold a valid license to practice medicine in the jurisdiction in which they practice and, with respect to inpatient or hospital services, to become a member of the medical staff at the contracting hospital with privileges in pathology. The Company is responsible for billing patients, physicians and third party payors for services rendered by the pathologists. Most of the employment agreements prohibit the physician from competing with the Company within a defined geographic area and prohibit solicitation of pathologists, other employees or clients of the Company for a period of one to two years after termination of employment.

The Company's business is dependent upon the recruitment and retention of pathologists, particularly those with subspecialties, such as dermatopathology. While the Company has been able to recruit (principally through practice acquisitions) and retain pathologists, no assurance can be given that the Company will be able to continue to do so successfully or on terms similar to its current arrangements. The relationship between the Company's pathologists and their respective local medical communities is important to the operation and continued profitability of the Company. In the event that a significant number of pathologists terminate their relationships with the Company or become unable or unwilling to continue their employment, the Company's business could be materially harmed.

Government Regulations

The Company's business is subject to the governmental and regulatory requirements relating to health care matters as well as laws and regulations that relate to business corporations. The Company believes that it exercises care to structure its operations and arrangements with hospitals and physicians to comply with relevant federal and state law. It also believes such current arrangements and practices are in material compliance with applicable statutes and regulations. However, the Company has not received or applied for legal opinions from counsel or from any federal or state regulation authority to this effect, and many aspects of the Company's business operations have not been the subject of federal or state regulatory interpretation. As a result, there can be no assurance that the Company's current or prior practices or arrangements will not be found to be in noncompliance with applicable laws and regulations, or that any such

occurrence will not result in a material adverse effect to the Company.

The Company derived approximately 18%, 18% and 21% of its collections for the years ended December 31, 1999, 2000, and 2001, respectively, from payments made by government sponsored health care programs (principally Medicare and Medicaid). These programs are subject to substantial regulation by the federal and state governments. Any change in payment regulations, policies, practices, interpretations or statutes that places limitations on reimbursement amounts, or changes in reimbursement coding or practices could materially and adversely affect the Company's financial condition and results of operations. Increasing budgetary pressures at both the federal and state level and concerns over the continued increase of the costs of health care have led, and may continue to lead, to significant reductions in health care payments. State concerns over the growth in Medicaid also could result in payment reductions. Although governmental payment reductions have not materially affected the Company in the past, it is possible that such changes in the future could have a

material adverse effect on the Company's financial condition and results of operations. In addition, Medicare, Medicaid and other government sponsored health care programs are increasingly shifting to some form of managed care. Some states have recently enacted legislation to require that all Medicaid patients be converted to managed care organizations, and similar legislation may be enacted in other states, which could result in reduced payments to the Company for such patients. In addition, a state-legislated shift in a Medicaid plan to managed care could cause the loss of some, or all, Medicaid business for the Company in that state if the Company were not selected as a participating provider. Additionally, funds received under all health care reimbursement programs are subject to audit with respect to the proper billing for physician services. Retroactive adjustments of revenue from these programs could occur. The Company expects that there will continue to be proposals to reduce or limit Medicare and Medicaid payment for services.

In connection with acquisitions, the Company performs certain due diligence investigations with respect to the potential liabilities of acquired operations and obtains indemnification with respect to certain liabilities from the sellers of such operations. Nevertheless, there can be undiscovered claims that subsequently arise. There can be no assurance that any liabilities for which the Company becomes responsible (despite such indemnification) will not be material or will not exceed either the limitations of any applicable indemnification provisions or the financial resources of the indemnifying parties. Furthermore, the Company, through its Corporate Compliance Program, regularly reviews the acquired operations' compliance with federal and state health care laws and regulations and revises, as appropriate, the operations" policies and procedures to conform to the Company's policies and procedures and applicable law. While the Company believes that the operations prior to their acquisition were generally in compliance with such laws and regulations, there can be no assurance that the prior operations were in full compliance with such laws, as such laws may ultimately be interpreted. Moreover, although the Company maintains an active compliance program, it is possible that the government might challenge some of the current practices of the Company as not being in full compliance with such laws and regulations. A violation of such laws by the Company could result in civil and criminal penalties, exclusion of the physician, the operation or the Company from participation in Medicare and Medicaid programs and/or loss of a physician's license to practice medicine.

Fraud and Abuse. Federal anti-kickback law and regulations prohibit any knowing and willful offer, payment, solicitation or receipt of any form of remuneration, either directly or indirectly, in return for, or to induce: (i) the referral of an individual for a service for which payment may be made by

Medicare and Medicaid or certain other federal health care programs; or (ii) the purchasing, leasing, ordering or arranging for, or recommending the purchase, lease or order of, any service or item for which payment may be made by Medicare, Medicaid or certain other federal health care programs. Violations of federal anti-kickback rules are punishable by monetary fines, civil and criminal penalties and exclusion from participation in Medicare, Medicaid and other federal health care programs. Several states have laws that are similar.

The federal government has published regulations that provide "safe-harbors" that protect from prosecution under federal anti-kickback laws business transactions that meet certain requirements. Failure to meet the requirements of a safe harbor, however, does not necessarily mean a transaction violates the anti-kickback law. The Company believes its operations are in material compliance with applicable Medicare and fraud and abuse laws and seeks to structure arrangements to comply with applicable safe harbors where reasonably possible. There is a risk that the federal government might investigate such arrangements and conclude they do not satisfy safe harbor requirements or violate the anti-kickback statute. If any of the Company's arrangements were found to be illegal, the Company and/or the individual physicians could be subject to civil and criminal penalties, including exclusion from the participation in government reimbursement programs, which could materially adversely affect the Company.

The Department of Health and Human Services Office of Inspector General ("OIG") issues advisory opinions that provide advice on whether proposed business arrangements violate the anti-kickback law. In Advisory Opinion 99-13, the OIG opined that when prices for laboratory services for non-governmental patients are discounted below Medicare reimbursable rates, the anti-kickback law may be implicated. The OIG found prices discounted below the laboratory supplier's costs to be particularly problematic. In the same opinion, OIG

suggested that a laboratory may be excluded from federal health care programs if it charges the Medicare or Medicaid programs amounts substantially in excess of discounted charges to other customers. In the OIG's opinion, charges are likely excessive if the profit margin for Medicare business exceeds the profit margin for non-federally reimbursed business.

The OIG also has addressed physician practice management arrangements in an advisory opinion. In Advisory Opinion 98-4, the OIG found that management fees based on a percentage of practice revenues may violate the anti-kickback statute. These Advisory Opinions suggest that OIG might challenge certain prices below Medicare reimbursement rates or arrangements based on a percentage of revenues. While the Company believes its arrangements are in material compliance with applicable law and regulations, OIG's advisory opinions suggest there is a risk of an adverse OIG finding relating to practices reviewed in the advisory opinions. Any such finding could have a material adverse impact on the Company.

Self-Referral and Financial Inducement Laws. The Company is also subject to federal and state statutes and regulations banning payments for referral of patients and referrals by physicians to health care providers with whom the physicians have a financial relationship. The federal Stark Physician Anti-Self-Referral Law applies to Medicare and Medicaid and prohibits a physician from referring patients for certain designated health services, including laboratory services, to an entity with which the physician has a financial relationship. Financial relationships include both investment interests in an entity and compensation arrangements with an entity. If an arrangement or

relationship is covered by the Stark Law, all of the requirements of a Stark Law exception must be satisfied. The state laws and regulations vary significantly from state to state, are often vague and, in many cases, have not been interpreted by courts or regulatory agencies. The state statutes and regulations generally apply to services reimbursed by both governmental and private payors. Violations of these laws may result in prohibition of payment for services rendered, loss of licenses as well as fines and criminal penalties. In addition, violation of the Stark Law may result in exclusion from Medicare and Medicaid. State statutes and regulations affecting the referral of patients to health care providers range from statutes and regulations that are substantially the same as the federal laws and safe harbor regulations to a simple requirement that physicians or other health care professionals disclose to patients any financial relationship the physicians or health care professionals have with a health care provider that is being recommended to the patients. These laws and regulations vary significantly from state to state, are often vague and, in many cases, have not been interpreted by courts or regulatory agencies. Adverse judicial or administrative interpretations of any of these laws could have a material adverse effect on the operating results and financial condition of the Company. In addition, expansion of the Company's operations to new jurisdictions, or new interpretations of laws in existing jurisdictions, could require structural and organizational modifications of the Company's relationships with physicians to comply with that jurisdiction's laws. Such structural and organizational modifications could have a material adverse effect on the operating results and financial condition of the Company.

Some pathologists affiliated with the Company may make referrals for services that are covered by the Stark Law. Many of these physicians have financial relationships with the Company in the form of compensation arrangements, ownership of Company stock or ownership of contingent promissory notes issued by the Company. The Company believes, however, that its current operations comply in all material respects with the Stark Law due to, among other things, various exceptions stated in the Stark Law and regulations that except either the referral or the financial relationship involved. For example, many referrals fall within exceptions applicable to pathologists or to ancillary services performed by members of a common group practice. The Company believes that its existing compensation arrangements with its pathologists are structured to comply with an applicable Stark Law exception. With respect to the ownership of stock, the Company believes that the ownership of Company stock by physicians should fall within the publicly traded stock exception to the Stark Law's definition of financial relationship. However, certain physician-owned shares were acquired prior to the Company's initial public offering and, as a result, the government could take the position that all of the requirements for this exception are not met. With respect to contingent notes, the Company believes that an exception to the Stark Law's definition of financial relationship is available. The contingent notes do contain provisions that permit the Company to modify or replace them if necessary to comply with law. Nevertheless, to the extent pathologists

affiliated with the Company make referrals to the Company and a financial relationship exists between the Company and the referring physicians, the government might take the position that the arrangement does not comply with the Stark Law. Any such finding could have a material adverse impact on the Company.

False Claims Laws. Under the federal False Claims Act, the government may fine any person who knowingly submits, or participates in submitting, claims for payment to the federal government that are false or fraudulent, or that

contain false or misleading information. In addition, knowingly making or using a false record or statement to avoid paying the federal government is also a violation. Entities found to have violated the False Claims Act may be required to make significant payments to the government (including damages and penalties in addition to the reimbursements previously collected) and may be excluded from participating in Medicare, Medicaid and other federal health care programs. Many states have similar false claims statutes.

Health care fraud is a priority of the United States Department of Justice and the FBI. They have devoted a significant amount of resources to investigating health care fraud. Medicare carriers and state Medicaid agencies also have certain fraud and abuse authority. In addition, private insurers may bring actions under false claim laws. In certain circumstances, federal and some state laws authorize private whistleblowers to bring false claim suits on behalf of the government against providers and reward the whistleblower with a portion of any final recovery. In addition, the federal government has engaged a number of nongovernmental-audit organizations to assist it in tracking and recovering false claims for health care services. The practices targeted include: billing for tests not performed; billing for tests not medically necessary or not ordered by the physician; "upcoding" tests to realize higher reimbursement than what is owed; offering inducements to physicians to induce them to refer testing; and duplicate billing. These practices have led to governmental investigations and whistleblower suits that have resulted in financially significant payments made by a number of health care providers in the past decade.

Since investigations relating to false claims have increased in recent years, it is more likely companies conducting business in the health care industry could become the subject of a federal or state civil or criminal investigation or action, could be required to defend the results of such investigation, be subjected to possible civil and criminal fines, be sued by private payors and be excluded from Medicare, Medicaid or other federally funded health care programs. Although the Company monitors its billing practices for compliance with prevailing industry practice under applicable laws, such laws are complex and constantly evolving and there can be no assurance that governmental investors, private insurers or private whistleblowers will not challenge the Company's or industry practice. For example, the announcement of a governmental investigation into the billing practices of one of the Company's practices in the fourth quarter of 1998 resulted in a significant decrease in the market price of the Company's common stock, even though the issue was eventually resolved to the Company's satisfaction and resulted only in the repayment of a small overpayment.

In August 2001, we received two letters from the United States Attorney for the Southern District of Ohio (the "U.S. Attorney") requesting information regarding billing practices and documentation of gross descriptions on skin biopsy reports. We provided documentation to the U.S. Attorney regarding the tests that were the subject of its requests for information. Requests for information such as these are often the result of a qui tam, or whistleblower, action filed by a private party relator. In February 2002, we received notification that the U.S. Attorney would not pursue this matter any further. In addition, we were notified that there were then no presently pending lawsuits in the Southern District of Ohio against the Company relating to the request by any private party relator bringing a qui tam action.

Government Investigations of Hospitals and Hospital Laboratories. Significant media and public attention has been focused on the health care industry due to ongoing federal and state investigations reportedly related to certain referral and billing practices, laboratory and home health care services and physician ownership and joint ventures involving hospitals. Most notably, HCA is under investigation with respect to such practices. The Company provides medical director services for numerous

hospital laboratories, including 31 HCA hospital laboratories as of December 31, 2001. The government's ongoing investigation of HCA could result in a governmental investigation of one or more of the Company's operations that have arrangements with HCA. In

addition, the OIG and the Department of Justice have initiated hospital laboratory billing review projects in certain states and are expected to extend such projects to additional states, including states in which the Company operates hospital laboratories. These projects increase the likelihood of governmental investigations of laboratories owned and operated by the Company. Although the Company monitors its billing practices and hospital arrangements for compliance with prevailing industry practices under applicable laws, such laws are complex and constantly evolving and there can be no assurance that the governmental investigators will not challenge the Company's or industry practices. The government's investigations of entities with which the Company contracts may have other effects which could materially and adversely affect the Company, including termination or amendment of one or more of the Company's contracts or the sale of hospitals potentially disrupting the performance of services under such contracts.

Corporate Practice of Medicine. The Company is not licensed to practice medicine. The practice of medicine is conducted solely by its licensed pathologists. The manner in which licensed physicians can be organized to perform and bill for medical services is governed by the laws of the state in which medical services are provided and by the medical boards or other entities authorized by such states to oversee the practice of medicine. Business corporations are generally not permitted under certain state laws to exercise control over the medical judgments or decisions of physicians, or engage in certain practices such as fee-splitting with physicians. In states where the Company is not permitted to directly own a medical practice, the Company performs only non-medical and administrative and support services, does not represent to the public or its clients that it offers medical services and does not exercise influence or control over the practice of medicine. See discussion "AmeriPath Corporate Structure", above.

The Company believes that it currently is in material compliance with the corporate practice laws in the states in which it operates. Nevertheless, there can be no assurance that regulatory authorities or other parties will not assert that the Company is engaged in the corporate practice of medicine. If such a claim were successfully asserted in any jurisdiction, the Company, and its pathologists could be subject to civil and criminal penalties under such jurisdiction's laws and could be required to restructure their contractual and other arrangements. Alternatively, some of the Company's existing contracts could be found to be illegal and unenforceable. In addition, expansion of the operations of the Company to other states may require structural and organizational modification of the Company's form of relationship with physicians, practices or hospitals. Such results or the inability to successfully restructure contractual arrangements could have a material adverse effect on the Company's financial condition and results of operations.

Fee-Splitting. Many states prohibit the splitting or sharing of fees between physicians and non-physicians. These laws vary from state to state and are enforced by courts and regulatory agencies, each with broad discretion. Most of the states with fee-splitting laws only prohibit a physician from sharing fees with a referral source. However, some states have interpreted management agreements between entities and physicians as unlawful fee-splitting.

The Company believes its arrangements with pathologists comply in all

material respects with the fee-splitting laws of the states in which it operates. Nevertheless, it is possible regulatory authorities or other parties could claim the Company is engaged in fee-splitting. If such a claim were successfully asserted in any jurisdiction, the Company and its pathologists could be subject to civil and criminal penalties and the Company could be required to restructure its contractual and other arrangements. Any restructuring of the Company's contractual and other arrangements could result in lower revenues, increased expenses and reduced influence over the business decisions of its operations. Alternatively, some of the Company's existing contracts could be found to be illegal and unenforceable, which could result in the termination of those contracts and an associated loss of revenue. In addition, expansion of the Company's operations to other states with fee-splitting prohibitions may require structural and organizational modification to the form of relationships that the Company currently has with pathologists, affiliated operations and hospitals. Any modifications could result in less profitable relationships with pathologists, affiliated operations and hospitals, less influence over the business decisions of pathologists and affiliated operations and failure to achieve the Company's growth objectives.

Medicare Fee Schedule Payment for Clinical Diagnostic Laboratory Testing. Medicare reimburses hospitals based on locality-specific fee schedules on the basis of a reimbursement methodology with Consumer Price Index ("CPI") related adjustments. Medicare includes payment for services performed for clinical diagnostic laboratory inpatients within the prospectively determined Diagnosis Related Group rate paid to the hospital. Additionally, state Medicaid programs may pay no more than the Medicare fee schedule amount. Congress also has implemented a national cap on Medicare clinical diagnostic laboratory fee schedules. This national cap has been lowered several times and is now at approximately 74% of the national median. In addition, Congress frequently has either limited or eliminated the annual CPI adjustments of the Medicare clinical diagnostic laboratory fee schedules. The Omnibus Budget Reconciliation Act of 1993 eliminated the adjustment for the years 1994 and 1995. In 1996 and 1997, however, the fee schedule adjustments were 3.2% and 2.7%, respectively. Even these modest increases were reduced in some areas due to a recalculation of national medians and by conversion in some carrier areas to a single statewide fee schedule. In the Balanced Budget Act of 1997 ("BBA"), Congress again eliminated the annual adjustments, this time for the years 1998 through 2002. The adjustment limitations and changes in the national cap made to date have not had, and are not expected by the Company to have, a material adverse effect on the Company's results of operations. Any further significant decrease in such fee schedules could have a material adverse effect on the Company.

Due to uncertainty regarding the implementation of the above-described Medicare developments, the Company currently is unable to predict their ultimate impact on the laboratory industry generally or on the Company in particular. Reforms may also occur at the state level (and other reforms may occur at the federal level) and, as a result of market pressures, changes are occurring in the marketplace as the number of patients covered by some form of managed care continues to increase. In the past, the Company has offset a substantial portion of the impact of price decreases and coverage changes through the achievement of economies of scale, more favorable purchase contracts and greater operational efficiencies. However, if further substantial price decreases or coverage changes were to occur, or if the government were to seek any substantial repayments or penalties from the Company, such developments would likely have an adverse impact on gross profits from the Company's testing services unless management had an opportunity to mitigate such impact.

Reevaluations and Examination of Billing. Payors periodically reevaluate the services they cover. In some cases, government payors such as Medicare also may seek to recoup payments previously made for services determined not to be covered. Any such action by payors would have an adverse affect on the Company's revenues and earnings.

Moreover, in recent months the federal government has become more aggressive in examining laboratory billing and seeking repayments and penalties as the result of improper billing for services (e.g., using an improper billing code for a test to realize higher reimbursement), regardless of whether carriers had furnished clear guidance on this subject. The primary focus of this initiative has been on hospital laboratories and on routine clinical chemistry tests which comprise only a small part of the Company's revenues. Although the scope of this initiative could expand, it is not possible to predict whether or in what direction the expansion might occur. The Company believes its practices are proper and do not include any allegedly improper practices now being examined. However, no assurance can be given that the government will not broaden its initiative to focus on the type of services furnished by the Company or, if this were to happen, on how much money, if any, the Company might be required to repay.

Furthermore, the Health Insurance Portability and Accountability Act ("HIPAA") and the joint federal and state anti-fraud initiative commenced in 1995 called Operation Restore Trust have strengthened the powers of the OIG and increased the funding for Medicare and Medicaid audits and investigations. As a result, the OIG has expanded and continues to expand the scope of its health care audits and investigations. State enforcement actions are similarly expanding. Federal and state audits and inspections, whether on a scheduled or unannounced basis, are conducted from time to time at the Company's facilities.

Due to the uncertain nature of coding for pathology services, the Company cannot assure that issues such as those addressed in the government investigation it announced in the fourth quarter of 1998, which was related to

the Operation Restore Trust initiative, will not arise again. If a negative finding is made as a result of such an investigation, the Company could be required to change coding practices or repay amounts paid for incorrect practices either of which could have a materially adverse effect on the operating results and financial condition of the Company.

Laboratory Compliance Plan. In February 1997, the OIG released a model compliance plan for laboratories that is based largely on the corporate integrity agreements negotiated with the laboratories which settled a number of government enforcement actions against laboratories under Operation Restore Trust. The Company adopted and maintains a compliance plan, which includes components of the OIG's model compliance plan, as the Company deemed appropriate to the conduct of its business. The Company's Senior Vice President of Operations serves as the Company's Chief Compliance Officer and reports directly to the Audit Committee of the Board of Directors.

Anti-trust Laws. In connection with state corporate practice of medicine laws discussed above, the operations with which the Company is affiliated in some states are organized as separate legal entities. As such, the physician practice entities may be deemed to be persons separate both from the Company and from each other under the anti-trust laws and, accordingly, subject to a wide range of federal and state laws that prohibit anti-competitive conduct among separate legal entities. In addition, the Company also is seeking to

acquire or affiliate with established and reputable operations in its target geographic markets and any market concentration could lead to anti-trust claims. The Company believes it is in compliance with federal and state anti-trust laws and intends to comply with any state and federal laws that may affect its development of integrated health care delivery networks. There can be no assurance, however, that a review of the Company's business by courts or regulatory authorities would not adversely affect the operations of the Company and its affiliated operations.

HIPAA Criminal Penalties. HIPAA created criminal provisions, which impose criminal penalties for fraud against any health care benefit program for theft or embezzlement involving health care and for false statements in connection with the payment of any health benefits. HIPAA also provided broad prosecutorial subpoena authority and authorized property forfeiture upon conviction of a federal health care offense. Significantly, the HIPAA provisions apply not only to federal programs, but also to private health benefit programs as well. HIPAA also broadened the authority of the OIG to exclude participants from federal health care programs. Because of the uncertainties as to how the HIPAA provisions will be enforced, the Company currently is unable to predict their ultimate impact on the Company. If the government were to seek any substantial penalties against the Company, this could have a material adverse effect on the Company.

Licensing. CLIA extends federal oversight to virtually all clinical laboratories by requiring that laboratories be certified by the government. Many laboratories must also meet governmental quality and personnel standards, undergo proficiency testing and be subject to biennial inspection. Rather than focusing on location, size or type of laboratory, this extended oversight is based on the complexity of the test performed by the laboratory. The CLIA quality standards regulations divide all tests into three categories (waived, moderate complexity and high complexity) and establish varying requirements depending upon the complexity of the test performed. The Company's outpatient laboratories are licensed by Health and Human Services ("HHS") under CLIA to perform high complexity testing. Generally, the HHS regulations require laboratories that perform high complexity or moderate complexity tests to implement systems that ensure the accurate performance and reporting of test results, establish quality control systems, have proficiency testing conducted by approved agencies and have biennial inspections. The Company is also subject to state regulation. CLIA provides that a state may adopt more stringent regulations than federal law. For example, some states in which the Company operates require that laboratory personnel meet certain qualifications, specify certain quality controls, maintain certain records and undergo proficiency testing.

Persons engaged in the practice of medicine must be licensed by each state in which they practice. The professional practice of physicians is regulated in each state by the state board of medicine. Each board of medicine has rules enumerating the activities that constitute unprofessional conduct. A board may sanction

unprofessional conduct by suspending, restricting or revoking a professional's license. Other possible sanctions include restraining orders, injunctions, imprisonment and fines.

HIPAA Regulations Relating to the Privacy, Security, and Transmission of Health Information. Congress passed HIPAA in 1996. Among other things, HIPAA established several requirements regarding the privacy, security and transmission of health information. The Department of Health and Human Services, or HHS, has issued several sets of regulations in accordance with

its authority under HIPAA. In general, these regulations apply to health care providers, health plans, and health care clearinghouses. Some operations of the Company will be subject to the HIPAA regulations.

Pursuant to HIPAA, HHS issued final privacy regulations establishing comprehensive federal standards relating to the use and disclosure of protected health information. These regulations, among other things, establish limits on the use and release of protected health information, provide for patients' rights to access, amend, and receive an accounting of the uses and disclosures of protected health information, and require certain safeguards to protect identifiable health information. The federal privacy regulations do not supersede state laws that are more stringent. Thus, the Company must reconcile both the federal privacy regulations and other state privacy laws that are more stringent than the federal laws. Those operations of the Company that are regulated by HIPAA must be in compliance with the federal privacy regulations by April 2003. Prior to the compliance date, it is expected that HHS will release several guidance documents addressing questions or concerns raised by the privacy regulations. On July 6, 2001, HHS issued its first guidance document relating to these regulations.

Like the privacy regulations, the electronic transaction standards are also final. These regulations establish uniform standards relating to data reporting, formatting, and coding that covered entities must use in conducting certain transactions. The electronic transaction standards presently apply to eight different transactions, including transactions relating to health care claims and health care payment and remittance advice. Upon the compliance date, health care providers must use these standards when electronically conducting a covered transaction with health plans or other health care providers. The compliance date for these regulations is October 2002, unless an entity files for a one-year extension with HHS.

The security regulations promulgated pursuant to HIPAA have not been finalized. The purpose of the proposed security regulations is to establish a minimum standard for the protection of individual health information that is stored or transmitted electronically. The regulations provide administrative procedures, physical safeguards, and technical mechanisms that may be implemented to satisfy the regulations.

The HIPAA regulations could result in significant financial obligations for the Company and will pose increased regulatory risk. The privacy regulations could limit the Company's use and disclosure of patient health information. For example, HHS has indicated that cells and tissues are not protected health information, but that analyses of them are protected. HHS has stated that if a person provides cells to a researcher and tells the researcher that the cells are an identified individual's cancer cells, that accompanying statement is protected health information about that individual. At this time, the Company is not able to determine the full consequences of the HIPAA regulations to the Company's business or the total cost of complying with these regulations. However, the HIPAA regulations are expected to significantly impact the Company operationally and financially.

Violations of the privacy regulations are punishable by civil and criminal penalties. State privacy laws may impose similar sanctions on the Company. Violations of the standards for electronic transaction are punishable by civil penalties.

Other Regulations. In addition, the Company is subject to licensing and regulation under federal, state and local laws relating to the collecting, storing, handling and disposal of medical specimens, infectious and hazardous waste and radioactive materials as well as the safety and health of laboratory employees. The Company believes its laboratory operations are in material compliance with applicable federal and state laws and regulations relating to

the generation, storage, treatment and disposal of all laboratory specimens and other biohazardous waste. Nevertheless, there can be no assurance that the Company's current or past laboratory

operations would be deemed to be in compliance with applicable laws and regulations, and any noncompliance could result in a material adverse effect on the Company. The Company utilizes licensed vendors for the disposal of such specimen and waste.

In addition to its comprehensive regulation of safety in the workplace, the federal Occupational Safety and Health Administration ("OSHA") has established extensive requirements relating to workplace safety for health care employees, including clinical laboratories, whose workers may be exposed to blood-borne pathogens, such as HIV and the hepatitis B virus. These regulations require work practice controls, protective clothing and equipment, training, medical follow-up, vaccinations and other measures designed to minimize exposure to, and transmission of, blood-borne pathogens. Regulations of the Department of Transportation, the Public Health Services and the U.S. Postal Service also apply to the transportation of laboratory specimens.

Competition

The Company's operations and pathologists provide pathology and cytology diagnostic services and pathology practice management services. Competition may result from other anatomic pathology practices, companies in other health care industry segments, such as other hospital-based specialties, national clinical laboratories, large physician group practices or pathology physician practice management companies that may enter the Company's markets, some of which may have greater financial and other resources than the Company.

The Company competes primarily on the basis of service capability and convenience of facilities, scope of testing services performed, accuracy, timeliness and consistency in reporting test results, reputation in the medical community, and pricing of testing services. The Company believes that its principal competitive advantages are its pathologist leadership, subspecialty focus, sales and marketing expertise and administrative support capabilities (e.g., billing, collections, accounting and financial reporting, information systems, and human resources). The Company competes with several other companies, and such competition can reasonably be expected to increase. In addition, companies in other health care segments, such as hospitals, national clinical laboratories, third party payors, and HMOs, many of which have greater financial resources than the Company, may become competitive with the Company in the employment of pathologists and management of pathology practices. The Company competes for acquisitions and affiliations on the basis of its reputation, management experience, status and resources as a public company and its single focus on anatomic pathology. There can be no assurance that the Company will be able to compete effectively or that additional competitors will not enter the Company's markets or make it more difficult for the Company to acquire or affiliate with practices on favorable terms.

Intellectual Property

The Company has registered the service marks "AmeriPath", "CAD-The Center for Advanced Diagnostics" and the AmeriPath logo with the United States Patent and Trademark Office.

To date, the Company has not relied heavily on patents or other intellectual property in operating its business. Nevertheless, some of the tests or related diagnostic products or the information technology purchased or used by the

Company may be patented or subject to other intellectual property rights. As a result, the Company may be found to be, or actions may be brought against it alleging that it is, infringing on the patent or other intellectual property rights of others, which could give rise to substantial claims against the Company. In addition, the Company's expansion into the genomics testing market may result in its obtaining or developing patent or other intellectual property. However, other practice and public entities, including universities, may have filed applications for (or have been issued) patents that may be the same as or similar to those developed or otherwise obtained by the Company or that it may need in the development of its own products. The scope and validity of such patent and other intellectual property rights, the extent to which the Company may wish or need to acquire such rights, and the cost or availability of such rights are presently unknown. In addition, the Company cannot provide assurance that others will not obtain access to its intellectual property or independently develop the same or similar products, tests or other intellectual property to that developed or otherwise obtained by the

Company. This may impede the Company's ability to achieve its overall growth strategy, including its ability to broaden the range of testing services it offers and to penetrate the genomic and genomic testing markets.

Employees

At December 31, 2001, the Company's owned and managed operations employ 2,515 people, including 423 physicians. In addition to physicians, the employees of the Company and the managed practices include 732 laboratory technicians, 169 couriers and 1,191 billing, marketing, transcription and administrative staff, of which 124 personnel are located at the Company's executive offices. None of the Company's employees or prospective employees is subject to collective bargaining agreements.

ITEM 2. PROPERTIES

The Company leases its executive offices located in Riviera Beach, Florida (approximately 24,000 square feet) and its centralized billing office in Fort Lauderdale, Florida (approximately 18,000 square feet) and the Company and its managed operations lease 65 other facilities: 25 in Florida, eight in Texas, five in Pennsylvania, four in Ohio, three in Kentucky, two in Mississippi, New York, Oklahoma, Alabama, Tennessee and North Carolina, and one in Indiana, Massachusetts, Colorado, Wisconsin, West Virginia, Georgia, California and Missouri. These facilities are used for laboratory operations, administrative and billing and collections operations and storage space. The 67 facilities encompass an aggregate of approximately 335,000 square feet, have an aggregate annual rent of approximately $5.2 million and have lease terms expiring from 2002 to 2006. As laboratory leases are scheduled to expire, the Company will consider whether to extend or renegotiate the existing lease or move the facility to another location within the defined geographic area of the operation.

ITEM 3. 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 pending legal proceedings involve claims of medical malpractice. These claims

are generally covered by insurance. Based upon investigations conducted to date, 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. The Company may also, from time to time, be involved with legal actions related to the acquisition of and affiliation with physician practices, the prior conduct of such practices, or the employment (and restriction on competition of) physicians. There can be no assurance 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.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of security holders during the fiscal quarter ended December 31, 2001.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

AmeriPath's Common Stock, is listed for quotation on the NASDAQ National Market System under the symbol "PATH". The following table sets forth, the high and low sales prices for the Common Stock, as reported on the NASDAQ National Market System during the Company's fiscal quarters indicated below. The Common Stock first began trading on October 21, 1997. As of March 15, 2002, there were approximately 300 shareholders of record and over 7,000 beneficial owners based upon broker searches conducted for solicitation purposes.

	High	Low
First Quarter 2000	$10.00	$ 7.50
Second Quarter 2000	$ 9.50	$ 7.00
Third Quarter 2000	$14.88	$ 8.00
Fourth Quarter 2000	$27.13	$13.25
First Quarter 2001	$27.75	$16.00
Second Quarter 2001	$32.00	$20.06
Third Quarter 2001	$37.16	$24.26
Fourth Quarter 2001	$32.86	$23.64

The Company has not during the past two fiscal years and presently has no plans to pay any dividends on its Common Stock. All earnings will be retained for the foreseeable future to support operations and to finance the growth and development of the Company's business. The payment of future cash dividends, if any, will be at the discretion of the Board of Directors of the Company and will depend upon, among other things, future earnings, capital requirements, the Company's financial condition, any applicable restrictions under credit agreements existing from time to time and on such other factors as the Board of Directors may consider relevant. The terms of the Company's existing credit

facility prohibit the payment of dividends without the lenders' consent.

Recent Sales of Unregistered Securities

Recent Sales of Unregistered Securities--In connection with the one acquisition completed during the fourth quarter of 2001, the Company issued the following shares of Common Stock pursuant to Regulation D promulgated under the Securities Act of 1933, as amended:

	Location	Effective Date	Shares Issued
Dermatopathology Services, PC and Histology Services, Inc.....	Birmingham, AL	November 1, 2001	113,899

ITEM 6. SELECTED FINANCIAL DATA

The selected Consolidated Financial Data set forth below have been derived from the Company's consolidated financial statements and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," the Consolidated Financial Statements and the related Notes thereto and the other financial information included elsewhere in this Annual Report on Form 10-K. All information for the prior years has been restated to reflect the acquisition of Inform DX, which has been accounted for as a pooling of interests.

CONSOLIDATED STATEMENT OF OPERATIONS DATA:
YEAR ENDED DECEMBER 31,

(in thousands, except per share data)

	1997	1998	1999	2000	2001
Net revenue.....	$108,406	$193,316	$257,432	$330,094	$418,732
Operating costs:					
Cost of services.....	48,833	87,700	122,685	163,390	200,102
Selling, general and administrative expense.....	21,386	36,709	47,159	58,411	71,856
Provision for doubtful accounts.....	10,892	18,698	25,289	34,040	48,287
Amortization expense.....	5,763	9,615	12,827	16,172	18,659
Merger-related costs (1)..	--	--	--	6,209	7,103
Asset impairment and related charges (2).....	--	--	--	9,562	3,809
Total.....	86,874	152,722	207,960	287,784	349,816
Income from operations.....	21,532	40,594	49,472	42,310	68,916
Interest expense.....	(8,772)	(8,560)	(9,573)	(15,376)	(16,350)
Termination of interest rate swap agreement (3).....	--	--	--	--	(10,386)

Nonrecurring charge (4).....	(1,289)	--	--	--	--
Other (expense) income, net.....	(96)	150	286	226	145
Income before income taxes and extraordinary loss.....	11,375	32,184	40,185	27,160	42,325
Provision for income taxes..	5,522	13,941	17,474	14,068	18,008
Income before extraordinary loss.....	5,853	18,243	22,711	13,092	24,317
Extraordinary loss, net of tax (5).....	--	--	--	--	(965)
Net income.....	5,853	18,243	22,711	13,092	23,352
Induced conversion and accretion of redeemable preferred stock (6).....	--	(75)	(131)	(1,604)	--
Net income available to common shareholders.....	$ 5,853	$ 18,168	$ 22,580	$ 11,488	$ 23,352
Basic earnings per common share.....	$ 0.66	$ 0.87	$ 1.03	$ 0.49	$ 0.90
Diluted earnings per common share.....	$ 0.42	$ 0.84	$ 1.00	$ 0.47	$ 0.86
Basic weighted average shares outstanding.....	8,880	20,911	21,984	23,473	25,974
Diluted weighted average shares outstanding.....	13,986	21,610	22,516	24,237	27,049

Earnings per share data (7)

CONSOLIDATED BALANCE SHEET DATA:
DECEMBER 31,

(in thousands)

	1997	1998	1999	2000	2001
Cash and cash equivalents...	$ 2,030	$ 6,383	$ 1,713	$ 2,418	$ 4,808
Total assets.....	272,532	390,413	478,896	562,166	604,462
Long-term debt, including current portion.....	77,630	123,917	168,614	201,747	93,322
Redeemable equity securities (8).....	--	15,373	15,504	--	--
Stockholders' equity.....	145,603	180,378	206,214	249,665	399,190

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(1) In connection with the Inform DX merger, the Company recorded $6.2 million and $7.1 million for 2000 and 2001, respectively, of costs related to transaction fees, change in control payments and various exit costs associated with the consolidation of certain operations.

(2) During 2000, the Company recorded asset impairment and related charges totaling $9.6 million in connection with Quest Diagnostics' termination of its contract in South Florida, the loss of a contract with a hospital in South Florida and the loss of three hospital contracts and an ambulatory care facility contract in Cleveland, Ohio. The charges were based on the remaining projected cash flows from these contracts in which the Company determined that the intangible assets that were recorded from acquisitions in these areas had been impaired. During the fourth quarter of 2001, the Company recorded an asset impairment charge of $3.8 million related to the closure of an Alabama laboratory acquired in 1996.

(3) In connection with the extinguishment of the Company's former credit facility during the fourth quarter of 2001, the Company made a one-time pre-tax payment of $10.4 million to terminate the Company's interest rate swap agreements.

(4) In the year ended December 31, 1997, the Company recorded a nonrecurring charge of $1.3 million, primarily attributable to professional fees and printing costs, as a result of the postponement of the Company's planned initial public offering of Common Stock.

(5) During the fourth quarter of 2001, the Company terminated its former credit facility and recorded an extraordinary loss, net of tax of $965,000 in connection with the write-off of previously deferred financing costs.

(6) In connection with an acquisition by Inform DX completed on June 30, 2000, Inform DX provided for an induced conversion of preferred stock. The induced conversion resulted in the issuance of 642,640 shares of common stock. Inform DX estimated, based on a third party valuation, the fair market value of its common stock at June 30, 2000 to be $6.22 per share. Based on this valuation, in the second quarter of 2000 Inform DX recorded a charge for the induced conversion of approximately $1.5 million, or $5.22 per share times the additional common shares issued of 247,169.

(7) Earnings per share for all periods are computed and presented in accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share". Basic earnings per share excludes dilution and is computed by dividing income attributable to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. Prior reported earnings per share data have been restated in accordance with SFAS No. 128.

(8) For December 31, 1998 and 1999 amounts included Convertible Preferred Stock of $15.4 million and
$15.5 million, respectively.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of the Company's results of operations and financial condition should be read together with the consolidated financial statements and other financial information included elsewhere in this Report.

General

We are one of the leading national providers of anatomic pathology services. The more than 400 pathologists in our owned and managed operations as of

December 31, 2001 provide medical diagnostic services in outpatient laboratories owned, operated and managed by us, in hospitals, and in ambulatory surgery centers. Under our ownership or employment model, we acquire a controlling equity (i.e., voting) interest or have a controlling financial interest in pathology operations. We refer to these operations as our owned operations. Under our management or equity model, we acquire certain assets of, and operate pathology laboratories under long-term management services agreements. We refer to these as our managed operations. Under the management services agreements, we provide facilities and equipment as well as administrative and technical

support for the managed operations. As of December 31, 2001, we had seven managed operations. When we refer to "companies" generally, we mean our owned and managed operations as a group.

As of December 31, 2001, our companies had contracts or business relationships with more than 200 hospitals pursuant to which we manage their clinical pathology and other laboratories and provide professional pathology services. The majority of these hospital contracts and relationships are exclusive provider relationships. We also have more than 40 licensed outpatient laboratories.

Generally, we manage and control all of the non-medical functions of the companies, including:

- recruiting, training, employing and managing the technical and support staff;
- developing, equipping and staffing laboratory facilities;
- establishing and maintaining courier services to transport specimens;
- negotiating and maintaining contracts with hospitals, national clinical laboratories and managed care organizations and other payors;
- providing financial reporting and administration, clerical, purchasing, payroll, billing and collection, information systems, sales and marketing, risk management, employee benefits, legal, tax and accounting services;
- maintaining compliance with applicable laws, rules and regulations; and
- with respect to our ownership and operation of outpatient anatomic pathology laboratories, providing slide preparation and other technical services.

Acquisitions

Since the first quarter of 1996, we have completed the acquisition of 50 pathology organizations located in 21 states. These acquisitions included the acquisition of Inform DX, during the fourth quarter of 2000. We accounted for the Inform DX transaction as a pooling of interests and, therefore, we have restated all historical information to reflect the acquisition of Inform DX. As a result of the Inform DX acquisition, we now have managed operations from which we derive management fees. Prior to the Inform DX transaction, we only had owned operations.

During 2001, we acquired one small anatomic pathology operation located in Alabama. The total consideration paid by us in connection with this

acquisition included cash, 113,899 shares of common stock, and consideration in the form of contingent notes. During 2000, we acquired nine anatomic pathology organizations, including two acquired by the former Inform DX. The total consideration paid by us in connection with these acquisitions included cash of $32.5 million, 1.5 million shares of common stock (with an aggregate value of $12.2 million based upon amounts recorded on our consolidated financial statements) and subordinated debt of $2.8 million. In addition, we issued additional purchase price consideration in the form of contingent notes.

During the year ended December 31, 2001, we made contingent note payments of $36.1 million and other purchase price adjustments of approximately $565,000 in connection with certain post-closing adjustments and acquisition costs. During the year ended December 31, 2000, we made contingent note payments of $26.6 million and other purchase price adjustments of approximately $2.9 million in connection with certain post-closing adjustments and acquisition costs.

While we regularly explore additional acquisition opportunities and are in various stages of discussions with a number of acquisition candidates, we currently have no material agreements or commitments with any third party regarding any potential acquisition.

Business Collaborations

We have commenced our transition to becoming a fully integrated health care diagnostic information provider. As part of this transition, we have entered into business collaborations intended to generate additional

revenues through leveraging our personnel, technology and resources. Three examples of such endeavors, including one with Genomics Collaborative, Inc. ("GCI"), one with Molecular Diagnostics, Inc. ("Molecular Diagnostics" (f/k/a Ampersand Medical of Chicago)), and one with TriPath Oncology, Inc. ("TriPath Oncology"), are described below. Although we believe such new endeavors are promising, we cannot assure you that they will be profitable.

During the third quarter of 2000, we formed an alliance with GCI to provide fresh frozen samples from normal, diseased, and cancerous tissue to GCI for subsequent sale to researchers in industry and academic laboratories who are working to discover genes associated with more common disease categories, such as heart disease, hypertension, diabetes, osteoporosis, depression, dementia, asthma and cancer, with a special focus on breast, colon and prostate tumors. This alliance utilizes our national network of hospitals, physicians and pathologists and GCI's capabilities in large-scale DNA tissue analysis and handling, tied together by proprietary information systems and bioinformatics. In connection with our alliance, we made a $1.0 million investment in GCI in exchange for 333,333 shares of Series D Preferred Stock, par value $0.01. The net revenue resulting from our alliance with GCI was not material to our operations during 2000 or 2001. Working with GCI, we have developed procedures to comply with informed consent requirements and other regulations regarding the taking and processing of specimens from donors and related records. Failure to comply with such regulations could result in adverse consequences including potential liability to us.

On March 27, 2001, we announced an agreement with Molecular Diagnostics which illustrates another example of leveraging our existing resources. In this alliance, we will be performing clinical trial work for Molecular Diagnostics' cytology platform that utilizes proteomic biomarkers to help pathologists and cytologists identify abnormal and cancerous cells in pap

smears and other body fluids, such as sputum and urine. We will be paid on a fee-for-service basis for each clinical trial we conduct. The agreement also calls for us to assist Molecular Diagnostics with the development of associated products and tests. We would receive equity in Molecular Diagnostics for the developmental work and would be entitled to royalty payments based on future sales of these products and tests. One of the Molecular Diagnostics products we are currently evaluating is a new test for human papilloma virus or HPV, which causes over 99% of all cervical dysplasia and cancer. This new test involves the application of genomic and proteomic markers directed against the specific oncogenes and oncoproteins of HPV that are directly responsible for the virus's ability to cause cancer. Preliminary studies indicate superior performance of these markers compared to currently available tests. However, there can be no assurance that such tests or such markers will be successful or become commercially viable.

On February 5, 2002, AmeriPath signed a letter of intent with TriPath Oncology to validate and offer exclusively a novel gene expression assay for Melastatin, a prognostic marker for melanoma. Melanoma represents the deadliest skin cancer whose incidence is rapidly increasing. Given our outstanding team of dermatopathologists and our market leadership in this field, we believe that this agreement may provide revenue to the Company as well as lead to additional opportunities.

Sources of Net Revenue

We derive our net revenue primarily from our owned and managed operations. Net revenue was comprised of net patient service revenue from our owned operations and net management service revenue from our managed operations.

The percent of our net revenue from outpatient and inpatient pathology and management services is presented below. The type and mix of business among these three categories, which can change from period to period as a result of new acquisitions and other factors, may change our ratio of operating costs to net revenue, particularly the provision for doubtful accounts as discussed below in our results of operations.

	Years Ended December 31,		
	1999	2000	2001
Revenue Type			
Outpatient	39%	42%	46%
Inpatient	51%	51%	47%
Management service revenues	10%	7%	7%

Net patient revenues

The majority of services furnished by our pathologists are anatomic pathology diagnostic services. We typically bill government programs, principally Medicare and Medicaid, indemnity insurance companies, managed care organizations, national clinical laboratories, physicians and patients. Net patient revenue differs from amounts billed for services due to:

. Medicare and Medicaid reimbursements at annually established rates;

- payments from managed care organizations at discounted fee-for-service rates;

- negotiated reimbursement rates with national clinical laboratories and other third-party payors; and

- other discounts and allowances.

In many instances, the national clinical laboratories contract directly under capitated agreements with managed care organizations to provide clinical as well as anatomic pathology services. We, in turn, subcontract with national clinical laboratories to provide anatomic pathology services at a discounted fee-for-service rate and are, in most cases, attempting to increase the number of such subcontracts to increase test volume. Since the majority of our operating costs--principally the compensation of physicians and non-physician technical personnel--are relatively fixed, increases in test volume generally enhance our profitability. Historically, net patient service revenue from capitated contracts has represented an insignificant amount of total net patient service revenue. However, we may be required to enter into more capitated arrangements in order to compete effectively for managed care contracts in the future.

Virtually all of our net patient service revenue is derived from charging for services on a fee-for-service basis. Accordingly, we assume the financial risk related to collection, including potential uncollectability of accounts, long collection cycles for accounts receivable and delays in reimbursement by third-party payors, such as governmental programs, private insurance plans and managed care organizations. Increases in write-offs of doubtful accounts, delays in receiving payments or potential retroactive adjustments and penalties resulting from audits by payors may require us to borrow funds to meet current obligations or may otherwise have a material adverse effect on our financial condition and results of operations.

In addition to services billed on a fee-for-service basis, the hospital-based pathologists have supervision and oversight responsibility for their roles as Medical Directors of the hospitals' clinical, microbiology and blood banking operations. For this role, we bill non-Medicare patients according to a fee schedule for what is referred to as clinical professional component charges. For Medicare patients, the pathologist is typically paid a director's fee or a "Part A" fee by the hospital. Hospitals and third-party payors are continuing to increase pressure to reduce the payment of these clinical professional component charges and "Part A" fees, and in the future we may sustain substantial decreases in these payments.

Approximately 21% of our collections in 2001 was from 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 services under these programs could have a material adverse effect on our financial position and results of operations.

The impact of legislative changes on our results of operations will depend upon several factors, including the mix of inpatient and outpatient pathology services, the amount of Medicare business, and changes in reimbursement levels which are published in November of each year. Management continuously monitors changes in legislation impacting reimbursement.

In prior years, we have been able to mitigate the impact of reductions in Medicare reimbursement rates for anatomic pathology services through the achievement of economies of scale and production efficiencies. Despite any

offsets, the recent substantial modifications to the physician fee schedule, along with additional adjustments by Medicare, could have a material adverse effect on average unit reimbursement in the future. In addition, other

third-party payors could adjust their reimbursement based on changes to the Medicare fee schedule. Any reductions made by other payors could also have a material negative impact on average unit reimbursement.

Net management service revenue

Net management service revenue is based on a predetermined percentage of operating income of the managed operations, before physician group retainage, plus reimbursement of certain practice expenses as defined in each management service agreement. Management fees are recognized at the time the net physician group revenue is recorded by the physician group.

Generally, net management service revenue equates to net physician group revenue less amounts retained by the physician groups, which we refer to as physician group retainage. Net physician group revenue is equal to billed charges reduced by provisions for bad debt and contractual adjustments. Contractual adjustments represent the difference between amounts billed and amounts reimbursable by commercial insurers and other third-party payors pursuant to their respective contracts with the physician group. The provision for bad debts represents an estimate of potential credit issues associated with amounts due from patients, commercial insurers, and other third-party payors. Net physician group revenue, which underlies our management service revenue, is subject to the same legislative and regulatory factors discussed above with respect to net patient revenue.

Medicare Reimbursement

Since 1992 the Centers for Medicare and Medicaid Services ("CMS") (formerly known as the Health Care Financing Administration, or "HCFA") had paid for physician's services under section 1848 of the Social Security Act. CMS calculates and reimburses fees for all physician services ("Part B" fees), including anatomic pathology services, based on a fee schedule methodology known as the resource-based relative value system ("RBRVS"). The RBRVS initially was phased in over a four-year period. Subsequently, CMS proposed changes in the computation of the malpractice portion and practice expense portion of the relative value units ("RVUs"). Although these changes have changed reimbursement to some extent, they are not expected to have a material impact on the Company's revenues. Overall, anatomic pathology reimbursement rates declined during the fee schedule phase-in period, despite an increase in payment rates for certain pathology services performed by us.

The Medicare Part B fee schedule payment for each service is determined by multiplying the total RVUs established for the service by a Geographic Practice Cost Index ("GPCI"). The sum of this value is multiplied by a statutory conversion factor. The number of RVUs assigned to each service is in turn calculated by adding three separate components: work RVU (intensity of work), practice exposure RVU (expense related to performing the service) and malpractice RVU (malpractice costs associated with the service).

CMS reviews annually the RBRVS payment schedule in conjunction with its budgeting process. The resulting payment schedule is published each year in the Federal Register in November. The blended payment rates for services provided by AmeriPath to Medicare patients, based on our values and locations of services, increased by 11.3% from 1999 to 2000, and by 6.8% from 2000 to 2001. However, there can be no assurance that we will receive similar

increases in the future, and it is possible that our blended rates may decrease at some point in the future.

A final rule published in the Federal Register on November 1, 2001 indicates that the conversion factor used in the Medicare Physician Fee Schedule will be reduced by 5.4%. The RVUs will also be changing in 2002, with certain services getting an increase in RVUs, while others are decreased. We estimate the overall impact to be neutral for 2002.

In 1999, CMS announced that it would cease the direct payment by Medicare for the technical component of inpatient physician pathology services to an outside independent laboratory because they concluded payment for the technical component is included already in the payment to hospitals under the hospital inpatient prospective payment system. Implementation of this change commenced January 1, 2001. Under these rules,

independent pathology laboratories would be required to bill the hospital directly for technical services on hospital Medicare inpatients. Congress, however, "grandfathered," for a period of two years, certain existing hospital-lab arrangements in effect before July 22, 1999. Effective January 2001, hospital arrangements that were not grandfathered are not reimbursed by Medicare for the technical component. The majority of our hospital arrangements were grandfathered under the proposed rules. Upon expiration of the two years, the grandfather provision is scheduled to expire.

Additionally, with the implementation of the hospital outpatient prospective payment system ("PPS") during 2000, independent pathology laboratories providing technical services to Medicare hospital outpatients generally are no longer able to bill Medicare for the technical component ("TC") of those services. Rather, they need to bill the hospital for the TC. The hospital is reimbursed as part of the new Ambulatory Payment Classification ("APC") payment system. Laboratories providing these services now need to contract directly with hospitals for reimbursement. As the amount paid to hospitals for the most common pathology services is less than the technical component under the RBRVS, it is likely that those laboratories will incur substantial reductions in reimbursement under PPS. However, services provided by us which are subject to PPS are not material to our total net revenue.

Recent Developments

During the fourth quarter of 2001, we completed a secondary offering of 4.7 million shares of common stock. The net proceeds from the offering of $115.8 million were used to repay a portion of the outstanding indebtedness under our prior credit facility. In addition, we put in place a new $200.0 million credit facility, with commitments of $175.0 million, which was used to repay the remaining balance of our former credit facility. In connection with the termination of the former credit facility, we terminated our three interest rate swaps with a combined notional amount of $105 million and wrote-off the associated unamortized debt costs of approximately $1.6 million ($965,000, net of tax). The termination of these interest rate swaps resulted in a charge of approximately $10.4 million, ($6.0 million, net of tax). By breaking these interest rate swaps, we have been able to lower our effective interest rate as well as obtain greater flexibility to pursue our strategic objectives, including further acquisitions.

During the third quarter of 2001, two pathologists in our Birmingham, Alabama practice terminated their employment with us and opened their own pathology laboratory. During the fourth quarter, we were unable to retain most of these customers. Consequently, we recorded a non-cash asset impairment

charge of $3.8 million. We have implemented a strategy to retain our Alabama customers and service them through other AmeriPath facilities and in November 2001 purchased a lab in Birmingham, Alabama to help regain and service these customers.

The Company was recently notified by its medical malpractice carrier that they will no longer be underwriting medical malpractice insurance and has placed the Company on non-renewal status effective July 1, 2002. The Company is currently evaluating other potential carriers for medical malpractice coverage and conducting a feasibility study of a captive insurance company. There can be no assurance the Company will be able to obtain medical malpractice insurance on terms consistent with our current coverage, which may increase our cost.

Critical Accounting Policies and Methods

Intangible Assets

As of December 31, 2001 we had net identifiable intangible assets and goodwill of $253.6 million and $2