



Building an  
**Enduring** Organization



## Company Profile

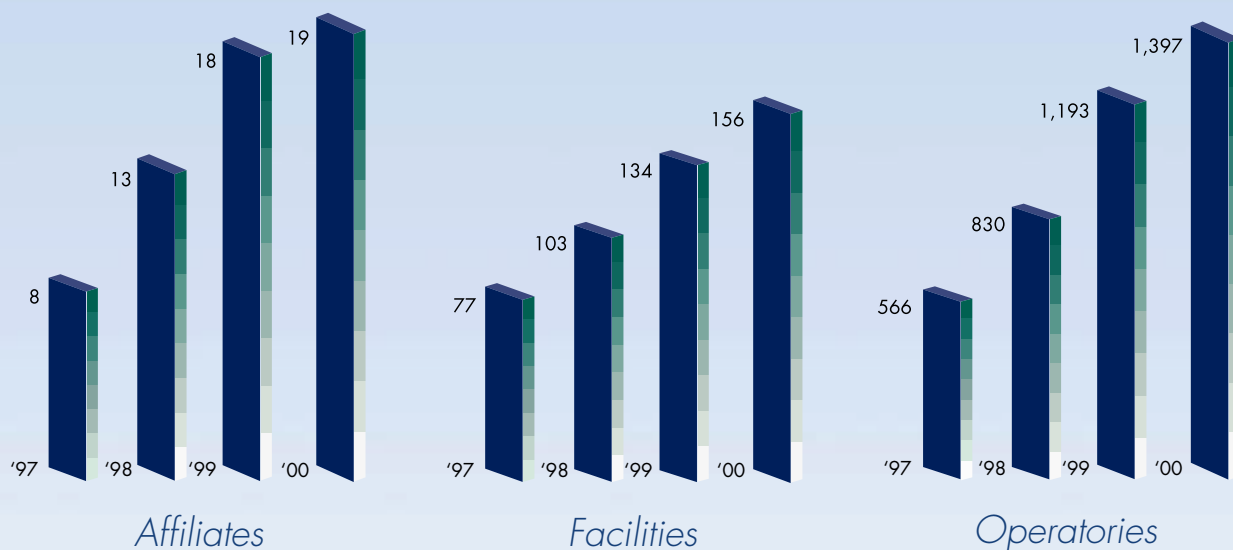
American Dental Partners is one of the nation's leading providers of business services to dental groups. Our focus on group dental practice and proven affiliation model have made American Dental Partners the business partner of choice for premier dental groups across the country. At December 31, 2000, we were affiliated with 19 dental groups, with 373 dentists, 156 dental facilities and 1,397 operatories in 14 states.

American Dental Partners is committed to the growth and success of its affiliated dental groups and makes substantial ongoing investments to support each affiliate's growth. We assist our affiliates with organizational planning and development; recruiting, retention and training programs; quality assurance initiatives; facilities development and management; employee benefits administration; procurement; information systems; marketing and payor relations; and financial planning, reporting, and analysis.

The number of dentists practicing in groups in the United States has grown from 4% in 1991 to 15% in 1999. American Dental Partners believes that the evolution of dentistry toward group practice and greater management sophistication is still at its earliest stage.

### States/Dental Facilities

California:	5	Louisiana:	2	North Carolina:	11
Arizona:	12	Minnesota:	51	New York:	4
Texas:	13	Wisconsin:	25	Pennsylvania:	8
Oklahoma:	8	Tennessee:	8	Maryland:	4
		Alabama:	3	Virginia:	2



## Financial Highlights

Years Ended December 31,

(in thousands, except per share amounts)

	1997	1998	1999	2000
Net revenue	\$53,270	\$84,090	\$117,352	<b>\$143,644</b>
Earnings from operations				
before corporate expenses	5,094	11,402	17,292	<b>20,564</b>
Earnings from operations	1,757	7,451	12,478	<b>15,200</b>
Net earnings	1,070	3,886	6,013	<b>6,169</b>
Net earnings (loss) per common share:				
Basic	\$ (0.05)	\$ 0.59	\$ 0.80	<b>\$ 0.87</b>
Diluted	\$ (0.05)	\$ 0.54	\$ 0.78	<b>\$ 0.84</b>
Selected statistical data:				
Earnings from operations margin	3%	9%	11%	<b>11%</b>
Earnings from operations growth	—	324%	67%	<b>22%</b>
Return on capital before corporate expenses	22%	19%	18%	<b>18%</b>
Return on capital	8%	13%	13%	<b>13%</b>
Return on equity	—	8%	12%	<b>11%</b>



## Dear Fellow Shareholder:

By any measure, the year 2000 was an excellent one for American Dental Partners. We continued our strong internal growth, three of our affiliates achieved national quality accreditation, and we completed affiliations with several outstanding dental groups.

This past year marked our fifth anniversary, and since our founding we have often been asked by prospective affiliates how we add value. They generally expect us to respond by saying that we help with a variety of administrative tasks, like billing and payroll. We certainly do those things. But the way we add value is much deeper and more fundamental. *We help each of our affiliates build an enduring organization.*

While there is no defining moment in the evolution of a dental group from a simple practice to a sophisticated organization, it is clear that a significant commitment of time and financial resources is required to manage a large dental group practice successfully. It is equally clear that ensuring the survival of a dental group over time requires extensive planning and investment. That is why, for example, we help our affiliates broaden the ownership of their practices and create governance structures that can survive growth and leadership changes. That is also why we invest in new facilities, information systems, and quality initiatives, including the tremendous effort required for accreditation. And that is why the finest dental groups in the country choose to affiliate with American Dental Partners.

Building an enduring organization *does not* mean that we are focused on the long term to the exclusion of the short term. We have to focus on both. Our financial results for each of the past five years demonstrate that we are building a solid, sustainable business. Our near-term success is evidenced by our 2000 results, including the following:

- We achieved same market growth of 12% for the year, compared with the dental industry's growth rate of 6%. The fourth quarter of 2000 was the twelfth consecutive quarter that our same market growth exceeded the industry average.

- Earnings from operations increased 22% to \$15.2 million from \$12.5 million.
- We achieved a return on capital before corporate expenses of 18%, our fourth year of 18% or greater.

## Attracting the Best

Given our commitment to build enduring organizations, we remain *the* business partner of choice for leading dental groups across the nation. In our five-year history, we have affiliated with some of the nation's most prestigious dental groups, and the year 2000 was no exception. We completed nine affiliations during 2000, adding 24 facilities and nearly \$24 million in annual patient revenue.

Two platform affiliations allowed us to enter new states, Western New York Dental Group in New York and American Family Dentistry in Tennessee. We also increased our in-market affiliation efforts, with several high quality independent practitioners or smaller group practices joining our existing affiliates. We significantly increased our existing North Carolina affiliate's presence through an affiliation with Nathan Bell & Associates. The merger of our two North Carolina affiliates created that state's largest dental group, with a major presence in Charlotte, Winston-Salem, and Raleigh-Durham. Our affiliation with Columbia Dental Associates allowed our existing Maryland affiliate to expand its presence in central Maryland. Five other affiliations, most notably The Dental Center in Gadsden, Alabama, allowed us to increase the market share of our Alabama, California, and Pennsylvania affiliates.

## Investing in Quality

Ensuring the delivery of high quality patient care is the foundation for building an enduring health care organization. One of our most important on-going initiatives is to help our affiliates receive accreditation from the Accreditation Association for Ambulatory Health Care ("AAAHC"), a prestigious designation that signifies quality patient care and clinical excellence. Three affiliates were awarded accreditation

“Our plan for the future is sound, our dental group affiliates are among the finest in the country, and the expertise of our management team is second to none.”

*Gregory A. Serrao, Chairman, President and Chief Executive Officer*

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since last year's annual report, Northpark Dental Group, Wilkens Dental Group, and Longhorn Dental Associates. Of the eleven dental groups accredited by the AAAHC, seven are affiliates of American Dental Partners—a remarkable achievement reflecting the high caliber of dental groups that affiliate with American Dental Partners.

### Investing in Education

Investing in the dental profession is also an important part of building an enduring organization. The objective of the American Dental Partners Foundation, established in 1999, is to help address critical educational issues in dentistry, such as the health of our nation's dental schools. In 2000, the Foundation established its governance and program structure and began soliciting donations. The Foundation expects to begin awarding student scholarships and dental school endowments in 2001.

### Investing in Research

We are also in a unique position to help our affiliates contribute to the development of new dental technologies, products, and techniques. At the end of 2000, we announced an agreement with the University of Rochester Eastman Dental Center, one of the nation's finest academic and research institutes devoted to dentistry. Eastman Dental, attracted to our group practice focus and commitment to quality, will conduct its clinical research efforts exclusively through our affiliated dental groups.

### Investing in Our Affiliates

Building enduring organizations also requires an unwavering commitment to reinvest where the business of dentistry takes place: the dental practice. Over the past four years, we have invested \$29 million in remodeling, expanding, or building new dental facilities for our affiliates, representing almost 90% of our cash flow. In 2000, we continued this commitment by investing nearly \$10 million in capital projects. This high level of reinvestment indicates not only our confidence

in the dental profession but more importantly our dedication to the long-term success of our affiliates.

### The Future

For five years we have focused on the same business strategy that has succeeded since our founding, and we have been financially disciplined about our growth. Our operating results are consistent, we generate strong cash flow, and our balance sheet is sound. We are more enthusiastic than ever about our growth opportunities and the trends in the dental profession. Our plan for the future is sound, our dental group affiliates are among the finest in the country, and the expertise of our management team is second to none. Basic industry trends will continue to support our efforts, as the demand for dental care increases, as more dentists practice in the group setting, and as long-established dental groups look for a means to create enduring organizations.

In closing, I would like to express my sincere appreciation to the dentists, practice staff and management team who were responsible for our many accomplishments in 2000. I also appreciate the support of our long-term shareholders and look forward to reporting on our continued growth and progress in the coming year.

Sincerely,



Gregory A. Serrao  
Chairman, President and Chief Executive Officer

March 15, 2001



“ We created American Dental Partners to be the premier business partner to dental groups, offering comprehensive management expertise and the resources needed to build enduring organizations.”

## *Why was American Dental Partners founded?*

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In early 1995, we set out to create a health care business with attractive growth opportunities to which we could dedicate our experience, talent, and careers. After evaluating numerous business ideas, we decided upon dentistry, and for good reason. The dental profession grows in good times and bad, and demand for dental care is robust because of the aging U.S. population, a greater number of people with dental benefits, and the increasing demand for preventive and aesthetic dentistry. Dental care expenditures increased from \$13 billion in 1980 to \$32 billion 1990, and are estimated to have reached \$60 billion in 2000. Expenditures are projected to exceed \$93 billion in 2008.

We intentionally chose to focus on group practice rather than solo practice. The number of dentists practicing in groups has steadily increased over the past decade, and we believe this trend will continue because of clinical and economic advantages of group practice. As we investigated the profession, we came to realize that most dental groups lack the governance structures, management depth, and financial resources needed to continue their record of success. We created American Dental Partners to be the premier business partner to dental groups, offering comprehensive management expertise and the resources needed to build enduring organizations.

## *Why has American Dental Partners been successful?*

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First among the factors contributing to our success is that we only affiliate with dental groups that have a long history of success. While we help our affiliates build on their past achievements by lending our expertise where needed, we remain cognizant of their unique identities, cultures, and experiences that have helped them succeed.

Our affiliation model, which creates an enduring partnership with each affiliated dental group, has also contributed to our success. We share both governance and financial incentive with our affiliates by establishing joint policy boards at each affiliate. The joint policy board, comprised of an equal number of dentists and management representatives, works as a team to establish operating strategies, growth plans, and financial performance targets.

Beyond the partnership commitment, we provide management expertise, financial resources, and information systems that truly add value to our affiliates. Our National Resource Group includes specialists in all business functions needed for helping set the strategic direction and supporting the growth of a successful dental group. We then help build or grow local management teams, or Local Resource Groups, with the capability of implementing the strategic direction and managing the daily activities of a growing group practice. And we continually invest in information systems, including practice management,

financial, and communication systems, so that the Local Resource Groups can better measure, report, and manage the operations of their multi-location group practices.

We also have an unwavering commitment to clinical quality. Before we affiliate with a dental group, we conduct thorough clinical and operational reviews. After affiliation, we strive for continuous quality improvement, using our National Professional Advisory Forum (“NPAF”) as a vehicle for positive change. The NPAF is composed of the dentist leadership from each of our affiliates and was created to help them share best practices and achieve operational excellence.

The centerpiece of the NPAF’s operational excellence objective is to help each affiliate receive accreditation from the Accreditation Association for Ambulatory Health Care (“AAAH”). The AAAHC is a peer-based, not for profit organization that is nationally recognized for conducting extensive evaluations of ambulatory health care organizations. These evaluations cover everything from patient rights to clinical records and quality management. Accreditation is a high priority for American Dental Partners because it helps our affiliates set and maintain measurable quality benchmarks and implement continuous improvement processes, ultimately allowing them to achieve the highest possible standard of patient care.

Shared governance, management expertise, financial resources, and a commitment to clinical excellence—these are the elements we deliver to ensure the long-term success of our affiliates.

## *What are the biggest challenges facing dentistry?*

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The biggest challenges relate to people and access to care. Twenty years ago, dental schools across the United States graduated 6,000 dentists annually; today that number is 4,000. This decrease is even more dramatic on a full-time equivalent basis as a result of the changing profile of graduating dentists and the fact that many experienced professionals are approaching retirement and practicing fewer hours. The profession faces similar challenges in attracting and retaining qualified support staff, especially in the current labor market. Couple these challenges with an increasing demand for dentistry, and access to dental care is becoming a critical issue, especially in certain areas of the country. With the profession being so fragmented, the average practitioner may interpret current patient demand as being the “second golden age of dentistry.” But when viewing the profession more broadly, qualified professionals and access to care are becoming increasingly critical issues.

On a positive note, there continues to be significant interest in the profession. There are more than 6,500 applicants annually for 4,000 dental school positions. Increasing the acceptance rate, though, is not a simple answer. There are an estimated 400 unfilled faculty positions in dental schools nationwide. For this reason, we established the American Dental Partners Foundation for the betterment of dental education. The profession must also begin to make its own effort to address the people and access to care challenges.

## *What role will the American Dental Partners Foundation play?*

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The dental education system in the United States faces many critical issues. The cost of dental education has increased dramatically, faculty positions remain unfilled, and dental students often graduate with limited clinical experience. To do our part in addressing these and other issues, we created the American Dental Partners Foundation in 1999, dedicated to the betterment of dental education. This past year was spent organizing the Foundation and initiating fundraising.

In the years to come, the American Dental Partners Foundation will award scholarships to dental students in general and specialty programs based on academic achievement and financial need. The Foundation intends to sponsor practice management and clinical courses in dental schools nationally with our affiliated dental groups providing the necessary faculty. The Foundation also plans to sponsor “externships” and residency programs in our affiliated dental groups to improve the clinical skills of graduating dentists.

We believe that investing in dental education through the Foundation will contribute to the long-term health of the profession.

## *What key issues will dental groups face in the future?*

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The key issue for dental groups to face in the years to come is the challenge of building enduring organizations. Most groups are founded by one or two dentists who are progressive in their thinking and successful in their practice. As the years go by and the group grows by adding dentists and additional practice locations, it experiences a transition from being just a practice to being a business, although there is never a defining moment for this transition. We often find the leaders of these groups have not shared information, responsibility, and ownership widely, and their investment in necessary management expertise has not kept pace with the growth of their practices.

Interestingly, many dental groups are often asking the same basic questions. Can we stay as we currently are organized? What changes do we need to make to ensure our continued success? What additional investment is required and will we ever see a return on this investment? These are vital issues that need to be addressed as the founders approach the later years of their careers. Most dental groups do not realize that there is a strategic partner that can help them successfully answer these questions: American Dental Partners.

*“We add value by helping each of our affiliates build an enduring organization. Every dental group has different strengths and weaknesses and requires its own specific action plan.”*



### *How does American Dental Partners add value?*

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We add value by helping each of our affiliates build an enduring organization. That's a broad statement, but when translated into action, it means something unique for each affiliate, for as we have found "once you've seen one dental group, you've seen just that...one dental group." Every dental group has different strengths and weaknesses and requires its own specific action plan. All of our affiliates, though, hope to become the market-leading, high quality dental group in the communities they serve. To reach this goal, some affiliates may need to recruit additional dentists; some may need to strengthen their local management team; some may need to add, relocate, or remodel dental facilities.

Our September 1999 affiliation with Riverside Dental Group provides an interesting example. Riverside Dental Group was founded in 1974, and at the time of our affiliation had 22 dentists with practices in Riverside, Moreno Valley, and Corona, California. Riverside Dental Group had achieved much success during its history, but in the years leading up to the affiliation the organization showed signs of reaching a plateau. The founding partners were approaching retirement, their Local Resource Group was managing to its maximum capabilities, and growth was slowing.

Riverside Dental Group's affiliation with American Dental Partners has served to re-energize the group. A joint policy board was established immediately after the affiliation, increasing participation in governance. A new partnership structure was designed and implemented, with several existing associates accepted into partnership. The Local Resource Group was strengthened with additional personnel and expanded capabilities. The doctors began making the necessary changes required for accreditation. Further, while Riverside Dental Group had a facilities development plan at the time of our affiliation, capital, expertise, and time were limited. We have since opened a new facility in Temecula and completed a major relocation of Riverside Dental Group's Corona facility. In all, 32 operatories were added providing future growth opportunities. We also completed practice acquisitions of two high quality independent practitioners whose practices were merged with Riverside Dental Group.

As a result of these activities, revenue and profit growth has once again accelerated. More importantly, the vital steps for developing an enduring organization are firmly in place, and a vision for the future is being pursued. Quite an accomplishment in little more than a year.

# Affiliates

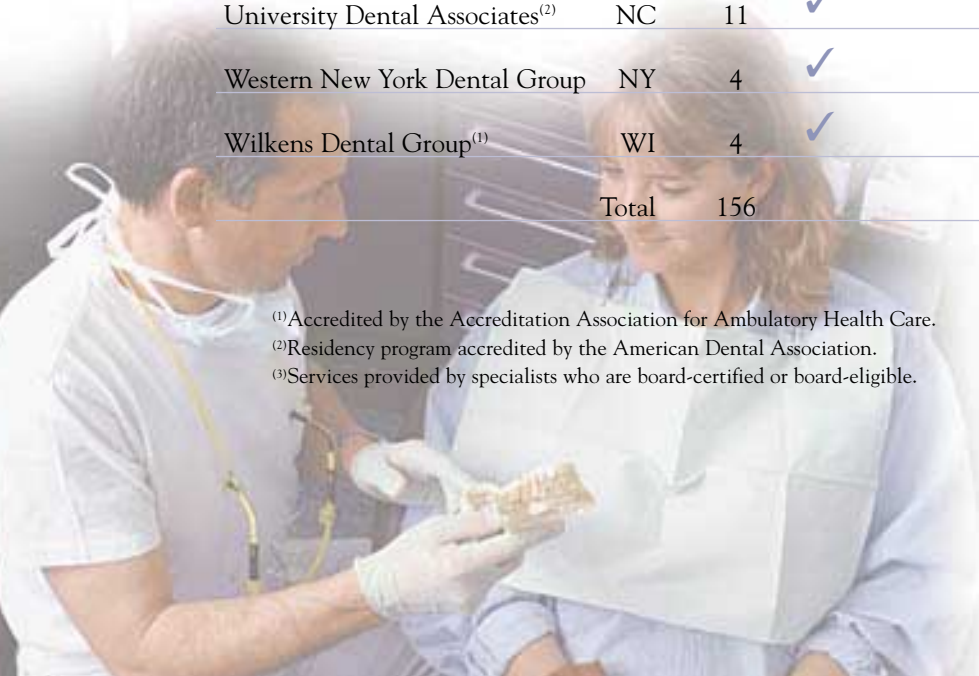
## Affiliated Dental Groups

Affiliate	State	Facilities	Dental Services <sup>(3)</sup>						
			General	Endodontics	Oral Surgery	Orthodontics	Pedodontics	Periodontics	Prosthodontics
American Family Dentistry	TN	8	✓						✓
Associated Dental Care <sup>(1)</sup>	AZ	12	✓			✓	✓		✓
Chestnut Hills Dental	PA	8	✓			✓	✓		
Dental Arts Center	VA	2	✓	✓	✓	✓	✓	✓	✓
Dental Care of Alabama	AL	3	✓			✓	✓	✓	✓
Family Care Dental Centers	WI	5	✓	✓	✓	✓	✓	✓	✓
Lakeside Dental Care	LA	2	✓			✓	✓		✓
Longhorn Dental Associates <sup>(1)</sup>	TX	8	✓	✓			✓		
Mintz & Pincus Dental Group	MD	4	✓			✓	✓	✓	✓
Northpark Dental Group <sup>(1)</sup>	WI	14	✓	✓			✓	✓	✓
Northpoint Dental Group <sup>(1)</sup>	WI	2	✓				✓		✓
OK Dental	OK	8	✓	✓			✓		
Orthodontic Care Specialists <sup>(1)</sup>	MN	20					✓		
Park Dental <sup>(1)</sup>	MN	31	✓	✓	✓			✓	✓
Riverside Dental Group	CA	5	✓			✓	✓	✓	✓
TSC Dental Centers	TX	5	✓						
University Dental Associates <sup>(2)</sup>	NC	11	✓			✓	✓		
Western New York Dental Group	NY	4	✓				✓		✓
Wilkins Dental Group <sup>(1)</sup>	WI	4	✓				✓		
		Total	156						

<sup>(1)</sup>Accredited by the Accreditation Association for Ambulatory Health Care.

<sup>(2)</sup>Residency program accredited by the American Dental Association.

<sup>(3)</sup>Services provided by specialists who are board-certified or board-eligible.



# Selected Financial Data

(in thousands, except per share amounts and statistical data)	Years Ended December 31,				2000
	1996	1997	1998	1999	
<b>CONSOLIDATED STATEMENT OF OPERATIONS DATA:</b>					
Net revenue	\$ 3,933	\$53,270	\$84,090	\$117,352	\$143,644
Operating expenses:					
Salaries and benefits	2,098	28,438	43,190	57,417	68,135
Lab fees and dental supplies	534	6,435	10,796	15,866	21,078
Office occupancy	389	4,814	7,635	11,321	14,784
Other operating expenses	773	6,264	6,840	9,235	10,990
General corporate expenses	2,395	3,337	3,951	4,814	5,364
Depreciation	177	1,580	2,495	3,642	4,708
Amortization of intangible assets	48	645	1,732	2,579	3,385
Total operating expenses	6,414	51,513	76,639	104,874	128,444
Earnings (loss) from operations	(2,481)	1,757	7,451	12,478	15,200
Interest expense (income), net	(38)	563	1,085	1,877	4,378
Earnings (loss) before income taxes	(2,443)	1,194	6,366	10,601	10,822
Income taxes	—	124	2,480	4,588	4,653
Net earnings (loss)	\$ (2,443)	\$ 1,070	\$ 3,886	\$ 6,013	\$ 6,169
Net earnings (loss) per common share <sup>(1)</sup> :					
Basic	\$ (3.45)	\$ (0.05)	\$ 0.59	\$ 0.80	\$ 0.87
Diluted	\$ (3.45)	\$ (0.05)	\$ 0.54	\$ 0.78	\$ 0.84
Weighted average common shares outstanding <sup>(1)</sup> :					
Basic	768	2,273	5,907	7,513	7,119
Diluted	768	2,273	6,867	7,745	7,320
				December 31,	
	1996	1997	1998	1999	2000
<b>CONSOLIDATED BALANCE SHEET DATA:</b>					
Cash and cash equivalents	\$ 5,836	\$ 5,265	\$ 2,420	\$ 2,325	\$ 472
Working capital	3,189	759	(2,725)	22	4,063
Total assets	25,294	48,549	70,864	110,000	132,583
Long-term debt, excluding current maturities	3,063	21,253	9,980	40,249	55,330
Redeemable and convertible preferred stock	15,105	16,297	—	—	—
Total stockholders' equity	164	909	48,305	52,229	58,486
<b>STATISTICAL DATA (END OF PERIOD):</b>					
Number of states	3	5	8	12	14
Number of dental facilities	42	77	103	134	156
Number of operatories <sup>(2)</sup>	331	566	830	1,193	1,397
Number of affiliated dentists <sup>(3)</sup>	128	171	231	324	373

(1) Net earnings (loss) per common share are computed on the basis described in Notes 2 and 12 to our Consolidated Financial Statements.

(2) An operatory is an area where dental care is performed and generally contains a dental chair, a hand piece delivery system and other essential dental equipment.

(3) Includes full-time equivalent general dentists employed by the PCs and full-time equivalent specialists, some of whom are independent contractors to the PCs.

# Management's Discussion

## Overview

American Dental Partners, Inc. is a leading provider of business services to multi-disciplinary dental groups in selected markets throughout the United States. We were formed in December 1995, commenced operations in January 1996 and began providing business services to dental groups in November 1996, concurrent with the completion of our first dental group affiliation. Our rapid growth has resulted primarily from our affiliations with dental groups. From November 1996 to December 31, 2000, we completed 40 affiliation transactions, comprising 19 dental groups, and at December 31, 2000, we operated 156 dental facilities with 1,397 operatories in 14 states.

## Affiliation Summary

When affiliating with a dental group, we acquire substantially all its assets except those required by law to be owned or maintained by dentists (such as third party contracts, certain governmental receivables and patient records) and enter into a long-term service agreement with the affiliated dental group or professional corporation ("PC"). Under our service agreements, we are responsible for providing all services necessary for the administration of the non-clinical aspects of the dental operations. The PC is responsible for the provision of dental care. Each of our service agreements is for an initial term of 40 years.

During 1998, 1999 and 2000, we acquired substantially all the assets of ten, twelve and nine dental practices, respectively, and simultaneously entered into 40-year service agreements with twelve of the affiliated dental groups (19 practices joined existing affiliates). In total, these affiliations resulted in the addition of 74 dental facilities and 697 operatories. See Note 4 of "Notes to Consolidated Financial Statements" for further information on acquisitions and affiliations. We currently are in discussions with a number of dentists and owners of dental groups about possible affiliations with us. There can be no assurance, however, that we will consummate any of these possible affiliations.

## Affiliate Adjusted Gross Revenue Compared to Net Revenue

### Affiliate Adjusted Gross Revenue and Payor Mix

We do not own or control the affiliated dental groups and, accordingly, do not consolidate the financial statements of the

PCs with ours. Our affiliated dental groups generate revenue from patients and dental benefit providers under fee-for-service, PPO plans and capitated managed care plans. The affiliated dental groups record revenue at established rates reduced by contractual adjustments and allowances for doubtful accounts to arrive at adjusted gross revenue. Contractual adjustments represent the difference between gross billable charges at established rates and the portion of those charges reimbursed pursuant to certain dental benefit plan provider contracts. While payor mix varies from market to market, the aggregate payor mix percentage of our affiliated groups for the year ended December 31, 2000 was approximately 46% fee-for-service, 21% PPO plans and 33% capitated managed care plans.

The PCs reimburse us for expenses incurred on their behalf in connection with the operation and administration of the dental facilities and pay fees to us for business services. Expenses incurred for the operation and administration of the dental facilities include salaries and benefits for non-dentist personnel working at the dental facilities (the administrative staff and, where permitted by law, the dental hygienists and dental assistants), lab fees, dental supplies, office occupancy costs of the dental facilities, depreciation related to the fixed assets at the dental facilities and other expenses such as professional fees, marketing costs and general and administrative expenses. See "Business—Operations—Operating Structure."

The PCs are responsible for the salaries, benefits and other expenses of the dentists. In addition, in certain states where the PCs must employ dental hygienists and dental assistants, the PCs are responsible for salaries, benefits and other expenses of such non-dentist employees. Since 1998, we have entered into affiliation transactions with a number of dental practices located in states where dental hygienists and dental assistants are required to be employed by the PCs. In recent years, due to the increasing demand for dental services relative to a decreasing supply of dentists nationally, dentist compensation has been increasing generally and for our affiliated dental groups specifically, and we expect this trend to continue. As a result of these two factors, the percentage of affiliate adjusted gross revenue retained by the PCs has increased from 28.5% of adjusted gross revenue in 1998 to 29.3% in 1999 and 31.9% in 2000. Consequently, it is helpful to analyze operating trends as a percentage of affiliate adjusted gross revenue (as well as a percentage of our net revenue).

## **Net Revenue**

Our net revenue represents primarily reimbursement of expenses and fees charged to the affiliated dental groups pursuant to the terms of the long-term service agreements under which we agree to provide business services. Under such agreements, the affiliated dental groups reimburse us for actual expenses incurred in connection with the operation and administration of the dental facilities and pay fees to us for our business services. Under certain service agreements, our service fee consists of a variable monthly fee which is based upon a specified percentage of the amount by which the PC's adjusted gross revenue exceeds expenses incurred in connection with the operation and administration of the dental facilities. Under certain service agreements, our service fees consist of a fixed monthly fee and an additional variable fee. Under certain service agreements, our service fee consists entirely of a fixed monthly fee. The fixed monthly fees are determined by agreement of us and the affiliated dental group in a formal budgeting process. Additionally, our net revenue includes amounts from dental benefit providers related to the arrangement of the provision of care to patients. For additional information on affiliate adjusted gross revenue and components of our net revenue, see Note 3 of "Notes to Consolidated Financial Statements."

## **Results of Operations**

*Net Revenue.* Net revenue increased 40% in 1999 to \$117,352,000 and 22% in 2000 to \$143,644,000. The increases in net revenue are due to same market growth from dental groups which were our affiliates during the entirety of both the current years and the previous years and the inclusion of revenue derived from service agreements entered into in connection with affiliation transactions in the current years and from a full-year impact of affiliation transactions in the previous years. Same market growth of 16% in 1999 and 12% in 2000 resulted from the addition and expansion of our facilities, successful renegotiation of certain dental benefit provider contracts which increased the level of reimbursement for services provided by our affiliated dental groups and the addition of dentists to our affiliated dental groups.

During the fourth quarter of 2000, several of our affiliated dental groups were impacted by severe winter storms and one affiliate was impacted by a tornado. This weather occurred primarily in December 2000 and, as a result, our affiliated dental groups were unable to reschedule lost production in

2000 because of full patient schedules during the balance of the year. We estimate that these winter storms and the tornado reduced our net revenue and net earnings by approximately \$366,000.

*Salaries and Benefits Expense.* Salaries and benefits expense includes costs for personnel working for us at the dental facilities as well as local and regional management. At the facility level, we generally employ the administrative staff and, where permitted by state law, the dental hygienists and dental assistants. The local and regional operating management teams supervise and support the staff at the dental facilities.

Salaries and benefits expense as a percentage of net revenue decreased from 51.4% in 1998 to 48.9% in 1999 to 47.4% in 2000 as a result of increased business in states where the PC's are required to employ the dental hygienists and dental assistants, more efficient utilization of staff in existing facilities and leveraging of local and regional management and administrative resources in certain markets. These costs savings were partially offset by the affiliation with practices with a generally higher ratio of staffing costs to net revenue in their respective markets compared to the existing base of affiliates and wage inflation due to tight labor markets. We anticipate such wage inflation pressures will continue for the foreseeable future.

*Lab Fees and Dental Supplies Expense.* Lab fees and dental supplies expense varies from affiliate to affiliate and is affected by the volume and type of procedures performed. The increase in lab fees and dental supplies expense as a percentage of net revenue from 12.8% in 1998 to 13.5% in 1999 is due almost entirely to the affiliation with practices with a generally higher ratio of lab fees and dental supplies expense to net revenue in their respective markets compared to the existing base of affiliates. We experienced rate increases in 1999 from certain lab providers and dental supply manufacturers. This price inflation, however, was offset entirely by the successful negotiation of a national contract for the purchase of dental supplies, effectively taking advantage of economies of scale and certain manufacturer rebate programs.

The increase in lab fees and dental supplies expense from 13.5% in 1999 to 14.7% in 2000 was primarily due to price increases from certain lab providers due to increases in costs of certain precious metals and their internal wage inflation. In addition, the affiliation with practices with a generally higher ratio of lab fees and dental supplies expense to net revenue

# Management's Discussion

compared to the existing base of affiliates further increased this expense category as a percentage of net revenue. In 2000, we continued to offset dental supply manufacturer price increases with the economies of scale realized through our national dental supply purchasing and rebate programs. We believe such price inflation will continue for the foreseeable future. While the lab fees and dental supplies expense has increased, the trend is less significant when calculated as a percentage of affiliate adjusted gross revenue.

*Office Occupancy Expense.* Office occupancy expense includes rent expense and certain other operating costs such as utilities associated with dental facilities and the local administrative offices. Such costs vary based on the size of each facility and the market rental rate for dental office space in the particular geographic market.

Office occupancy expense as a percentage of net revenue increased from 9.1% in 1998 to 9.6% in 1999 and 10.3% in 2000 primarily as a result of the investment in the relocation and addition of new dental facilities. In 1998 and 1999, we added 11 new facilities in Arizona, California, Minnesota and Virginia and relocated and expanded 25 facilities in Arizona, Minnesota, Texas and Wisconsin. In 2000, we added a new facility in North Carolina and relocated and expanded 15 facilities in California, Maryland, Minnesota, Pennsylvania, Texas and Wisconsin. This investment in facilities increased our physical capacity in these markets to allow for future growth. Initially, however, the increase in office occupancy expense was not fully offset by incremental net revenue.

In addition, during 1999, we invested in regional administrative offices in Arizona, Pennsylvania and Virginia in order to accommodate the regionalization of management and administrative support in certain markets. Further increasing office occupancy expense as a percentage of net revenue in 2000 was the affiliation with practices with a generally higher ratio of office occupancy expense to net revenue in their respective markets compared to the existing base of affiliates. These increased costs were partially offset by better utilization of capacity in existing facilities in 1999 and 2000 and the leveraging of local and regional management office occupancy expense in certain markets in 2000.

We expect office occupancy expense to continue to increase as we invest in the relocation and expansion of dental facilities. These increases should be partially or fully offset by better utilization of capacity in existing dental facilities. While

office occupancy expense has increased, the trend is less significant when calculated as a percentage of affiliate adjusted gross revenue.

*Other Operating Expenses.* Other operating expenses decreased as a percentage of net revenue from 8.1% in 1998 to 7.9% in 1999 to 7.7% in 2000 primarily as a result of economies of scale as it relates to professional fees and insurance expense, the regionalization of administrative and data processing functions in certain markets, the dilution of the impact of the Minnesota Care Tax and better management of certain discretionary spending. These costs savings were partially offset by the affiliation with practices with a generally higher ratio of other operating expenses to net revenue in their respective markets compared to the existing base of affiliates.

*General Corporate Expenses.* General corporate expenses consist of compensation expenses for our corporate personnel and administrative staff, as well as facility and other administrative costs of our corporate office. General corporate expenses decreased as a percentage of net revenue from 4.7% in 1998 to 4.1% in 1999 to 3.7% in 2000. Throughout 1999 and 2000, we continued to expand our management infrastructure in the areas of finance, operations, employee benefit administration and professional recruiting. Despite these additions, we continue to leverage these costs. The level of general corporate expenses may continue to increase in the future as we continue to expand our management infrastructure. However, it is anticipated that these costs will decline as a percentage of net revenue in the future.

*Depreciation.* Depreciation expense includes depreciation charges related to leasehold improvements and furniture, fixtures and equipment used to operate the dental facilities, local and regional management offices and our corporate office. Depreciation expense increased as a percentage of net revenue from 3.0% in 1998 to 3.1% in 1999 to 3.3% in 2000 primarily due to the depreciation of assets acquired and capital expenditures associated with the investment in the relocation and addition of new dental facilities in certain markets. In 1998 and 1999, we added 11 new facilities in Arizona, California, Minnesota and Virginia and relocated and expanded 25 facilities in Arizona, Minnesota, Texas and Wisconsin. In 2000, we added a new facility in North Carolina and relocated and expanded 15 facilities in California, Maryland, Minnesota, Pennsylvania, Texas and Wisconsin. These capital expenditures increased our capacity to allow

for future growth. This increase in depreciation expense as a percentage of net revenue was partially offset by leveraging the costs in existing facilities.

We expect to continue to invest in the relocation and expansion of our physical capacity, although at a lower amount than historical levels. Accordingly, depending on the amount and timing of such future capital expenditures, depreciation could increase. While depreciation expense has increased as a percentage of net revenue, it has remained unchanged as a percentage of affiliate adjusted gross revenue.

*Amortization of Intangible Assets.* Amortization increased as a percentage of net revenue from 2.1% in 1998 to 2.2% in 1999 to 2.4% in 2000 primarily as a result of intangible assets recorded in connection with the 31 affiliation transactions completed since 1998. Amortization of intangible assets could increase in the future as a result of intangibles recorded in connection with future acquisitions and affiliations, although we expect to complete fewer affiliations than we historically have. While amortization of intangible assets has increased as a percentage of net revenue, it has remained relatively unchanged as a percentage of affiliate adjusted gross revenue.

*Interest Expense, Net.* Net interest expense increased in 1999 and 2000 primarily as a result of increased average borrowings under our revolving credit facility to fund the affiliation transactions completed since mid-1998 and a portion of our capital expenditures throughout 1999 and 2000. In addition, the issuance of subordinated notes in connection with the affiliation transactions since 1998 contributed to higher interest expense in 1999 and 2000. Average borrowings in 1998 were significantly lower than in 1999 due in large part to using a portion of the proceeds from the initial public offering to repay the outstanding balance on the revolving credit facility in the second quarter of 1998. The increase in interest expense in 1999 was partially reduced due to an overall lower average market interest rate under our revolving credit facility in 1999 than in 1998.

In addition, a higher overall average market interest rate in 2000 and increased financing costs associated with amending our revolving credit facility in July 2000 further increased interest expense from 1999 to 2000. Although interest expense will likely increase in the near future due to a higher average level of indebtedness, we believe interest expense may not increase in 2001 to the extent it did in 2000 due to lower anticipated overall average market interest rates and a reduced level of affiliation transactions and capital expenditures.

*Income Taxes.* Our effective tax rate was approximately 39.0%, 43.3% and 43.0% for 1998, 1999 and 2000, respectively. The 1998 effective tax rate was impacted by the reversal of a valuation allowance for deferred tax assets established in 1996 and 1997. See Note 6 in "Notes to Consolidated Financial Statements." The effective tax rate in 1999 decreased from the normalized 1998 effective tax rate due primarily to a reduction in the proportionate amount of amortization of intangible assets which are not deductible for tax purposes, partially offset by a higher Federal statutory rate resulting from increased pre-tax income in 1999 and an increase in the proportionate amount of income in states with higher average tax rates. The effective tax rate in 2000 decreased primarily due to an increase in the proportionate amount of income in states with lower average tax rates. This reduction was partially offset by a valuation allowance for certain deferred tax assets and other permanent differences.

## **Liquidity and Capital Resources**

We have financed our operating and capital needs, including cash used for acquisitions and affiliations, capital expenditures and working capital, from sales of equity securities, borrowings under our revolving line of credit and cash generated from operations.

From January 1, 1999 through December 31, 2000, we completed 21 dental practice affiliations for aggregate consideration of \$34.9 million in cash, \$3.8 million in subordinated promissory notes, \$1.4 million in deferred payments and 50,568 shares of our Common Stock valued at approximately \$0.4 million.

For the years ended December 31, 1999 and 2000, cash provided by operating activities amounted to \$9,197,000 and \$10,207,000, respectively. The increase in cash from operations resulted primarily from an increase in cash from operations due to incremental earnings generated from affiliations and same market growth. This was partially offset by an increase in the amount of cash paid for income taxes and interest in 2000 compared to 1999. Cash from operations was further offset by an increase in receivables due from affiliated dental groups. The increase in our affiliate receivable balance is a direct result of our affiliated dental groups shifting their payor mix away from prospective pay capitation revenue and toward higher margin claims-based reimbursement plans. This shift resulted in an increase in working capital of our affiliated dental groups and, consequently, an increase in our receivables due from affiliated dental groups.

# Management's Discussion

For the years ended December 31, 1999 and 2000, cash used in investing activities amounted to \$34,337,000 and \$25,255,000, respectively. Cash used for investing activities included cash used for affiliations and for capital expenditures. Cash used for affiliations, net of cash acquired, was \$19,855,000 and \$14,912,000 for 1999 and 2000, respectively. Cash used for capital expenditures was \$11,166,000 and \$9,395,000 for 1999 and 2000, respectively. Capital expenditures for 1999 included costs associated with the addition of a new dental facility in each of Arizona, California and Virginia, four new dental facilities in Minnesota and the relocation and/or expansion of 24 dental facilities in Arizona, Minnesota, Texas and Wisconsin. Capital expenditures for 2000 included costs associated with the addition of a new dental facility in North Carolina and the relocation and/or expansion of 15 dental facilities in California, Maryland, Minnesota, Pennsylvania, Texas and Wisconsin. The construction of new dental facilities and the refurbishment, expansion or relocation of existing dental facilities in the future will require ongoing capital expenditures. Although we expect to continue to make meaningful capital expenditures, we do not expect capital expenditures in 2001 to continue at the same levels as 1999 and 2000.

For the years ended December 31, 1999 and 2000, cash provided by financing activities amounted to \$25,045,000 and \$13,195,000, respectively. Cash provided by financing activities in 1999 resulted from net borrowings under our revolving line of credit of \$29,197,000 and proceeds from the issuance of Common Stock for the employee stock purchase plan of \$491,000, offset by the repayment of certain indebtedness of \$1,673,000 and the repurchase of 430,000 shares of our Common Stock for \$2,956,000. Cash provided by financing activities in 2000 resulted from net borrowings under our revolving line of credit of \$15,560,000 and proceeds from the issuance of Common Stock for the employee stock purchase plan of \$376,000, offset by the repayment of indebtedness of \$1,645,000, payment of debt issuance costs of \$808,000 and the repurchase of 40,000 shares of our Common Stock for \$288,000.

In July 2000, we amended our existing revolving line of credit, increasing the total available amount from \$50 million to \$75 million. The credit facility is being used for general corporate purposes including affiliations and capital expenditures. Borrowings under this line of credit bear interest at either prime or LIBOR plus a margin, at our option. The margin is

based upon our debt coverage ratio and ranges from 0.00% to 0.75% for prime loans and 1.75% to 2.75% for LIBOR loans. In addition, we pay a commitment fee which ranges from 0.25% to 0.375% of the average daily balance of the unused line. Borrowings are limited to an availability formula based on adjusted EBITDA. The credit facility is secured by a first lien on substantially all of our assets, including a pledge of the stock of our subsidiaries. We are also required to comply with certain financial and other covenants. The line of credit matures in July 2004. The outstanding balance under this line as of December 31, 2000 was \$49,057,000.

We have a Shelf Registration Statement on file with the Securities and Exchange Commission (Registration No. 333-56941) covering a total of 750,000 shares of Common Stock and \$25,000,000 aggregate principal amount of subordinated promissory notes to be issued in connection with future dental practice affiliations. As of December 31, 2000, 679,878 shares and \$20,736,500 of notes remain available for issuance under this Shelf Registration Statement.

Our growth to date has resulted in large measure from our ability to affiliate with additional dental practices. Although we have affiliated with many dental practices since our initial affiliation in November 1996, there can be no assurance that additional affiliation candidates can be identified, consummated or successfully integrated into our operations. We have used a combination of cash, common stock and subordinated debt as consideration for past acquisitions and affiliations and plan to continue to use these sources in the future. In the past two years, the consideration paid has consisted of a higher percentage of cash and subordinated debt and a lower percentage of common stock.

In addition, we currently are in discussions with a number of dentists and owners of dental groups about possible affiliations with us. While we continue to evaluate new affiliation opportunities, we intend to focus more on internal operations and, therefore, potentially reduce indebtedness over the next twelve months. As a result, it is expected that the number of new affiliations over the next twelve months will be somewhat lower relative to previous years.

Furthermore, we continue to evaluate opportunities to repurchase our Common Stock through our previously announced repurchase program, pursuant to which approximately \$1.8 million remains available to repurchase additional shares.

We believe that cash generated from operations and amounts available under our current revolving credit facility

will be sufficient to fund our anticipated cash needs for working capital, capital expenditures, affiliations and Common Stock repurchases for at least the next twelve months.

### **Subsequent Event**

In January 2001, three of our affiliated dental groups, Park Dental, Associated Dental Care Providers and University Dental Associates, received notices of contract termination from Cigna Dental and Associated Dental Care Providers received notice of contract termination from Protective Life Corporation. The four contracts represented approximately \$24.1 million of affiliate adjusted gross revenue in 2000. The effective dates of termination for these four contracts are (i) July 31, 2001 for Park Dental, (ii) March 31, 2001 for University Dental Associates and (iii) March 31, 2001 (Cigna Dental) and April 8, 2001 (Protective Life) for Associated Dental Care Providers. These affiliates subsequently received proposed terms for new provider contracts from Cigna Dental. The affiliates found the proposed terms unacceptable, and we are working with them in evaluating their options in light of the termination notices. In evaluating options, we and our affiliates believe that the financial impact of not continuing as a provider with both dental benefit plan providers, while difficult to ascertain precisely, would be less severe than accepting the proposed provider relationships. While the exact outcome cannot be determined at this time, we believe the disruption being caused by the termination notices may impact net earnings for the first and second quarters of 2001 by \$0.05 to \$0.10 per share per quarter.

### **Quantitative and Qualitative Disclosures About Market Risk**

We invest our cash in money market instruments. These instruments are denominated in U.S. dollars. Due to the conservative nature of these instruments, we do not believe that we have a material exposure to interest rate or market risk.

In the ordinary course of business, we are exposed to interest rate risk. With regard to our revolving credit facility, we are also exposed to variable rate interest for the banks' applicable margins, ranging from 0.00% to 0.75% for prime loans and 1.75% to 2.75% for LIBOR loans, based upon our debt coverage ratio. As a result of amending our revolving credit facility in July 2000, the banks' margin increased by 1.00% from historical levels. For fixed rate debt, interest rate changes affect the fair value but do not impact earnings or cash flow. Conversely, for floating rate debt, interest rate changes generally do not affect the fair market value but do impact future earnings and cash flow. We do not believe a one percentage point change in interest rates would have a material impact on the fair market value of our fixed rate debt. The pre-tax earnings and cash flow impact for one year based upon the amounts outstanding at December 31, 2000 under our variable rate revolving credit facility for each one percentage point change in interest rates would be approximately \$491,000 per annum. We do not presently undertake any specific actions to cover our exposure to interest rate risk and we are not party to any interest rate risk management transactions.

*independent* **Auditors' Report**

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The Board of Directors  
American Dental Partners, Inc.:

We have audited the accompanying consolidated balance sheets of American Dental Partners, Inc. (the "Company") as of December 31, 1999 and 2000, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial

statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American Dental Partners, Inc. as of December 31, 1999 and 2000, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States of America.

The logo for KPMG LLP, featuring the letters 'KPMG' in a large, bold, blue, handwritten-style font, followed by 'LLP' in a smaller, blue, sans-serif font.

Boston, Massachusetts  
February 14, 2001

# consolidated Balance Sheets

(in thousands, except share and per share amounts)	December 31,	
	1999	2000
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 2,325	\$ 472
Accounts receivable	261	222
Receivables due from affiliated dental groups	9,637	17,331
Income taxes receivable	416	255
Inventories	1,491	1,764
Prepaid expenses and other receivables	2,436	1,962
Deferred income taxes	397	472
Total current assets	16,963	22,478
Property and equipment, net	23,006	27,840
Non-current assets:		
Intangible assets, net	69,175	81,083
Deferred income taxes	563	311
Other assets	293	871
Total non-current assets	70,031	82,265
Total assets	\$110,000	\$132,583
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 7,154	\$ 7,198
Accrued compensation, benefits and taxes	4,452	4,573
Accrued expenses	3,833	5,051
Current maturities of debt	1,502	1,593
Total current liabilities	16,941	18,415
Non-current liabilities:		
Long-term debt	40,249	55,330
Other liabilities	581	352
Total non-current liabilities	40,830	55,682
Total liabilities	57,771	74,097
Stockholders' Equity:		
Preferred stock	—	—
Common stock	75	76
Additional paid-in capital	46,584	46,959
Retained earnings	8,526	14,695
Treasury stock	(2,956)	(3,244)
Total stockholders' equity	52,229	58,486
Commitments and contingencies		
Total liabilities and stockholders' equity	\$110,000	\$132,583

See accompanying notes to consolidated financial statements.

*consolidated statements of* **Operations**

<i>(in thousands, except per share amounts)</i>	Years Ended December 31,		
	1998	1999	2000
Net revenue	\$84,090	\$117,352	<b>\$143,644</b>
Operating expenses:			
Salaries and benefits	43,190	57,417	<b>68,135</b>
Lab fees and dental supplies	10,796	15,866	<b>21,078</b>
Office occupancy	7,635	11,321	<b>14,784</b>
Other operating expenses	6,840	9,235	<b>10,990</b>
General corporate expenses	3,951	4,814	<b>5,364</b>
Depreciation	2,495	3,642	<b>4,708</b>
Amortization of intangible assets	1,732	2,579	<b>3,385</b>
Total operating expenses	76,639	104,874	<b>128,444</b>
Earnings from operations	7,451	12,478	<b>15,200</b>
Interest expense, net	1,085	1,877	<b>4,378</b>
Earnings before income taxes	6,366	10,601	<b>10,822</b>
Income taxes	2,480	4,588	<b>4,653</b>
Net earnings	\$ 3,886	\$ 6,013	<b>\$ 6,169</b>
Net earnings per common share:			
Basic	\$ 0.59	\$ 0.80	<b>\$ 0.87</b>
Diluted	\$ 0.54	\$ 0.78	<b>\$ 0.84</b>
Weighted average common shares outstanding:			
Basic	5,907	7,513	<b>7,119</b>
Diluted	6,867	7,745	<b>7,320</b>

See accompanying notes to consolidated financial statements.

consolidated statements of **Stockholders' Equity**

For the Years Ended December 31, 1998, 1999 and 2000

(in thousands)	Number of Shares		Common Stock	Additional Paid-in Capital	Unearned Compensation	Retained Earnings (Deficit)	Treasury Stock at Cost	Total Stockholders' Equity
	Common Stock Issued	Common Stock in Treasury						
Balance at December 31, 1997	2,394	—	\$24	\$ 2,307	\$(49)	\$( 1,373)	\$ —	\$ 909
Issuance of common stock in initial public offering, net	2,588	—	26	34,570	—	—	—	34,596
Issuance of common stock for acquisitions and affiliations	54	—	—	443	—	—	—	443
Amortization of unearned compensation	—	—	—	—	25	—	—	25
Dividends on Series A convertible preferred stock	—	—	—	(200)	—	—	—	(200)
Dividends on Series B redeemable preferred stock	—	—	—	(195)	—	—	—	(195)
Conversion of Series A convertible preferred stock to common stock	2,400	—	24	8,817	—	—	—	8,841
Net earnings	—	—	—	—	—	3,886	—	3,886
Balance at December 31, 1998	7,436	—	74	45,742	(24)	2,513	—	48,305
Issuance of common stock for acquisitions and affiliations	50	—	1	351	—	—	—	352
Issuance of common stock for employee stock purchase plan	51	—	—	491	—	—	—	491
Repurchase of common stock	—	(430)	—	—	—	—	(2,956)	(2,956)
Amortization of unearned compensation	—	—	—	—	24	—	—	24
Net earnings	—	—	—	—	—	6,013	—	6,013
Balance at December 31, 1999	7,537	(430)	75	46,584	—	8,526	(2,956)	52,229
Issuance of common stock for employee stock purchase plan	64	—	1	375	—	—	—	376
Repurchase of common stock	—	(40)	—	—	—	—	(288)	(288)
Net earnings	—	—	—	—	—	6,169	—	6,169
<b>Balance at December 31, 2000</b>	<b>7,601</b>	<b>(470)</b>	<b>\$76</b>	<b>\$46,959</b>	<b>\$ —</b>	<b>\$14,695</b>	<b>\$(3,244)</b>	<b>\$58,486</b>

See accompanying notes to consolidated financial statements.

*consolidated statements of* **Cash Flows**

<i>(in thousands)</i>	Years Ended December 31,		
	1998	1999	2000
<b>Cash flows from operating activities:</b>			
Net earnings	\$ 3,886	\$ 6,013	\$ 6,169
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	2,495	3,642	4,708
Amortization of intangible assets	1,732	2,579	3,385
Other amortization	106	106	156
Deferred income taxes	1,466	857	620
Changes in assets and liabilities, net of acquisitions and affiliations:			
Accounts receivable	864	621	39
Receivables due from affiliated dental groups	(764)	(4,103)	(7,889)
Other current assets	(384)	(1,590)	717
Accounts payable and accrued expenses	(679)	2,277	2,026
Accrued compensation, benefits and taxes	118	151	115
Income taxes payable and receivable, net	670	(1,356)	161
Net cash provided by operating activities	9,510	9,197	10,207
<b>Cash flows from investing activities:</b>			
Acquisitions and affiliations, net of cash acquired	(18,290)	(19,855)	(14,912)
Capital expenditures, net	(5,074)	(11,166)	(9,395)
Contingent and deferred payments	—	(794)	(501)
Other	(1,522)	(2,522)	(447)
Net cash used for investing activities	(24,886)	(34,337)	(25,255)
<b>Cash flows from financing activities:</b>			
Borrowings under (repayments of) revolving line of credit, net	(12,400)	29,197	15,560
Repayment of borrowings	(2,254)	(1,673)	(1,645)
Proceeds from issuance of common stock in initial public offering, net of underwriting discounts and commissions	36,096	—	—
Common stock issued for the employee stock purchase plan	—	491	376
Repurchase of common stock	—	(2,956)	(288)
Redemption of Series B redeemable preferred stock	(7,851)	—	—
Payment of initial public offering costs	(943)	—	—
Payment of debt issuance costs	(117)	(14)	(808)
Net cash provided by financing activities	12,531	25,045	13,195
Decrease in cash and cash equivalents	(2,845)	(95)	(1,853)
Cash and cash equivalents at beginning of year	5,265	2,420	2,325
Cash and cash equivalents at end of year	\$ 2,420	\$ 2,325	\$ 472
<b>Supplemental disclosure of cash flow information:</b>			
Cash paid during the year for interest, net	\$ 898	\$ 1,572	\$ 3,996
Cash paid during the year for income taxes, net	\$ 348	\$ 5,087	\$ 3,866
<b>Supplemental disclosure of non-cash information:</b>			
Dividends accrued on Series A convertible preferred stock and Series B redeemable preferred stock	\$ 395	\$ —	\$ —
Conversion of Series A convertible preferred stock to common stock	\$ 8,841	\$ —	\$ —
<b>Acquisitions and affiliations:</b>			
Assets acquired	\$ 26,938	\$27,630	\$ 17,714
Liabilities assumed and issued	(8,109)	(7,256)	(2,802)
Common stock issued	(443)	(352)	—
Cash paid	18,386	20,022	14,912
Less cash acquired	(96)	(167)	—
Net cash paid for acquisitions and affiliations	\$ 18,290	\$19,855	\$ 14,912

See accompanying notes to consolidated financial statements.

# notes to Consolidated Financial Statements

For the Years Ended December 31, 1998, 1999 and 2000

## (1) Description of Business

American Dental Partners, Inc. (the "Company") was formed in December 1995 to provide business services to dental groups and commenced operations in January 1996. The Company acquires substantially all the assets of the dental practices with which it affiliates, except those required by law to be owned or maintained by dentists (such as third party contracts, certain governmental receivables and patient records), and enters into long-term service agreements with these affiliated dental groups. The Company provides all services necessary for the administration of the non-clinical aspects of the dental operations. Services provided to the affiliated dental groups include sharing the best practices of its affiliates and providing assistance with organizational planning and development; recruiting, retention and training programs; quality assurance initiatives; facilities development and management; employee benefits administration; procurement; information systems; marketing and payor relations; and financial planning, reporting and analysis. The Company operates in one segment.

## (2) Summary of Significant Accounting Policies

### Basis of Presentation

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting. The Company does not own any interests in or control the activities of the affiliated dental groups. Accordingly, the consolidated financial statements of the affiliated dental groups are not consolidated with those of the Company.

Certain reclassifications have been made to the consolidated financial statements for the years ended December 31, 1998 and 1999 in order to conform with the December 31, 2000 presentation.

### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All inter-company balances and transactions have been eliminated in consolidation.

### Use of Estimates

The preparation of these consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that

affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

### Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers all highly liquid instruments with an original maturity of three months or less to be cash equivalents.

### Fair Value of Financial Instruments

The Company believes the carrying amount of cash and cash equivalents, accounts receivable, receivables due from affiliated dental groups, accounts payable and accrued expenses approximate fair value because of the short-term nature of these items. The carrying amount of long-term debt approximates fair value because the interest rates approximate rates at which similar types of borrowing arrangements could be obtained by the Company.

### Net Revenue

The Company's net revenue represents primarily reimbursement of expenses and fees charged to affiliated dental groups pursuant to the terms of the service agreements. Under such agreements, the affiliated dental groups reimburse the Company for expenses incurred on their behalf in connection with the operation and administration of the dental facilities and pay fees to the Company for its business services. The Company's service fee consists of either (i) a variable monthly fee which is based upon a specified percentage, (ii) a fixed monthly fee and an additional variable fee or (iii) a fixed monthly fee. Additionally, the Company's net revenue includes amounts from dental benefit providers related to the arrangement of the provision of care to patients. The Company records all revenue as services are provided.

### Inventories

Inventories consist primarily of dental supplies and are stated at the lower of cost or market.

### Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization are recorded using the straight-line method over the estimated useful lives of the related assets which are 30-40 years for buildings, 3-12 years for equipment and 5-7 years for furniture and fixtures.

Property and equipment under capital leases are stated at the present value of minimum lease payments at inception of the lease. Equipment held under capital leases and leasehold improvements are amortized over the shorter of the lease term or estimated useful life of the asset. Amortization of assets subject to capital leases is included in depreciation expense.

### **Intangible Assets**

Identifiable intangible assets result from service agreements with the affiliated dental groups and goodwill associated with the Company's acquisition. The estimated fair value of the service agreements is the excess of the purchase price over the estimated fair value of the tangible assets acquired and liabilities assumed of dental practices. Intangible assets associated with service agreements and goodwill are amortized on a straight-line basis over 15 to 25 years. In the event a service agreement is terminated, the related affiliated dental group is generally required to purchase, at the Company's option, the unamortized balance of intangible assets at the current book value, as well as all related other assets associated with the affiliated dental group. Accumulated amortization amounted to \$2,405,000, \$4,984,000 and \$8,369,000 at December 31, 1998, 1999 and 2000, respectively.

The Company reviews the carrying value of intangible assets on an entity by entity basis to determine if facts and circumstances exist which would suggest that the intangible assets may be impaired or that the amortization period needs to be modified. Among the factors the Company considers in making the evaluation are changes in the groups' market position, reputation, profitability and geographical penetration. If conditions are present which indicate impairment is probable, the Company prepares a projection of the undiscounted cash flows of the specific practice and determine if the intangible assets are recoverable based on these undiscounted cash flows. If impairment is indicated, then an adjustment is made to reduce the carrying amount of the intangible assets to their fair value based on discounted cash flows.

### **Income Taxes**

Deferred income taxes are recognized for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. The effect on deferred taxes of changes in the tax rate is recognized in operations in the period that includes the enactment date.

### **Stock Option Plans**

Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation," allows companies to recognize expense for the fair value of stock-based awards or to continue to apply the provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and disclose the effects of SFAS 123 as if the fair-value-based method defined in SFAS 123 had been applied. Under APB Opinion No. 25, compensation expense is recognized only if on the measurement date the fair value of the underlying stock exceeds the exercise price. The Company has elected to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosure provisions of SFAS 123.

### **Earnings Per Share**

Earnings per share are computed based on Statement of Financial Accounting Standards No. 128 ("SFAS 128"), "Earnings per Share." SFAS 128 requires presentation of basic earnings per share ("Basic EPS") and diluted earnings per share ("Diluted EPS") by all entities that have publicly traded common stock or potential common stock (options, warrants, convertible securities or contingent stock arrangements). Basic EPS is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted EPS gives effect to all dilutive potential common shares outstanding during the period. The computation of Diluted EPS does not assume conversion, exercise or contingent exercise of securities that would have an antidilutive effect on earnings.

## **(3) Accounts Receivable and Net Revenue**

### **Accounts Receivable**

Accounts receivable represent amounts due from dental benefit providers related to the arrangement of the provision of care to patients.

### **Receivables Due From Affiliated Dental Groups**

Receivables due from affiliated dental groups represent amounts due pursuant to the terms of the service agreements as described below.

### **Adjusted Gross Revenue—Affiliated Dental Groups**

The affiliated dental groups record revenue at established rates reduced by contractual adjustments and allowances for doubtful accounts to arrive at adjusted gross revenue. Contractual adjustments represent the difference between gross billable charges at established rates and the portion of those charges reimbursed pursuant to certain dental benefit plan provider contracts.

(continued)

The Company does not consolidate the financial statements of its affiliated dental groups with those of the Company. The adjusted gross revenue and amounts retained by the affiliated dental groups are presented below for illustrative purposes only (in thousands):

	Years Ended December 31,					
	1998		1999		2000	
	Park Dental	All Affiliated Groups	Park Dental	All Affiliated Groups	Park Dental	All Affiliated Groups
Adjusted gross revenue-affiliated dental groups	\$45,142	\$105,438	\$52,393	\$151,965	\$61,352	\$194,572
Amounts retained by affiliated dental groups	10,728	30,022	12,416	44,565	14,936	62,020
Net revenue earned by the Company under service agreements	\$34,414	\$ 75,416	\$39,977	\$107,400	\$46,416	\$132,552

### Net Revenue

The Company's net revenue represents primarily reimbursement of expenses and fees charged to affiliated dental groups pursuant to the terms of the service agreements. Under such agreements, the affiliated dental groups reimburse the Company for actual expenses incurred on their behalf in connection with the operation and administration of the dental facilities and pay fees to the Company for its business services. Under certain service agreements, the Company's service fee consists of a variable monthly fee which is based upon a specified percentage of the amount by which the PC's adjusted gross revenue exceeds expenses incurred in connection with the operation and administration of the dental facilities. Under certain service agreements, the Company's service fees consist of a fixed monthly fee and an additional variable fee. To the extent that there is operating income after payment of the fixed monthly fee, reimbursement of expenses incurred in connection with the operation and administration of the dental facilities and payment of provider expenses, an additional variable fee is paid to the Company in the amount of such excess up to budgeted operating income and 50% of such excess over budgeted operating income. Under certain service agreements, the Company's service fee consists entirely of a fixed monthly fee. The fixed monthly fees are determined by agreement of the Company and the affiliated dental groups in a formal budgeting process. Additionally, the Company's net revenue includes amounts from dental benefit providers related to the arrangement of the provision of care to patients.

For the years ended December 31, 1998, 1999 and 2000, net revenue consisted of the following (in thousands):

	1998	1999	2000
Reimbursement of expenses:			
Rent expense	\$ 5,590	\$ 8,201	\$ 10,601
Other operating expenses	50,688	71,273	88,338
Total reimbursement of expenses	56,278	79,474	98,939
Service fees:			
Monthly fee	17,306	26,335	30,460
Additional variable fee	1,832	1,591	3,153
Total service fees	19,138	27,926	33,613
Net revenue earned by the Company under service agreements	75,416	107,400	132,552
Revenue related to the arrangement of the provision of care to patients and other	8,674	9,952	11,092
Total net revenue	\$84,090	\$117,352	\$143,644

### (4) Acquisitions and Affiliations

During the year ended December 31, 1999, the Company acquired substantially all the assets of twelve dental practices and simultaneously entered into 40-year service agreements with five of the affiliated dental groups (seven practices joined existing affiliates). The aggregate purchase price paid in connection with these transactions consisted of approximately \$20.0 million in cash, \$2.5 million in subordinated promissory notes, \$0.9 million in deferred payments and 50,568 shares of Common Stock valued at approximately \$0.4 million. All transactions completed in 1999 are referred to as the "1999 Transactions."

# notes to Consolidated Financial Statements

During the year ended December 31, 2000, the Company acquired substantially all the assets of nine dental practices and simultaneously entered into 40-year service agreements with two of the affiliated dental groups (seven practices joined existing affiliates). The aggregate purchase price paid in connection with these transactions consisted of approximately \$14.9 million in cash, \$1.3 million in subordinated promissory notes and \$0.5 million in deferred payments. All transactions completed in 2000 are referred to as the "2000 Transactions."

The 1999 and 2000 Transactions are as follows:

Date	Affiliated Dental Practice	Location(s)
February 1999	Dental Care of Alabama	Birmingham and Tuscaloosa, AL
February 1999	CIGNA HealthCare of Arizona	Phoenix, AZ
March 1999	OK Dental	Oklahoma City and Tulsa, OK
March 1999	Kenneth W. Van Sickle, Jr., D.M.D.	Mt. Pleasant, PA
March 1999	Jack G. Stacker, D.D.S.	Wausau, WI
June 1999	Kevin M. Strezo, D.D.S.	Homer City, PA
June 1999	Hill Dental Group	Columbia, MD
June 1999	University Dental Associates	Winston-Salem, NC
June 1999	Karen L. Wedde, D.D.S.	Waukesha, WI
July 1999	Kenneth P. Dick, D.M.D.	Johnstown, PA
July 1999	Gary R. Christman, D.D.S.	Humble and Kingwood, TX
September 1999	Dental Associates of Corona, Dental Associates of Moreno Valley, Dental Associates of Riverside and Riverside Dental Group	Corona, Moreno Valley and Riverside, CA
January 2000	Western New York Dental Group	Buffalo, NY
February 2000	Columbia Dental Associates	Columbia, MD
February 2000	Robert E. Ford, D.M.D.	Birmingham, AL
April 2000	The Dental Center	Gadsden, AL
June 2000	Nathan Bell, D.D.S.	Charlotte and Raleigh-Durham, NC
June 2000	Ronald G. White, D.D.S.	Riverside, CA
July 2000	Ronald L. Moore, D.D.S.	Corona, CA
September 2000	American Family Dentistry	Knoxville, Memphis and Nashville, TN
November 2000	Carol E. Layton, D.M.D.	Robinson Township, PA

The accompanying consolidated financial statements include the results of operations under the service agreements from the date of acquisition. The excess of the purchase price associated with all of the 1999 and 2000 Transactions over the estimated fair value of net assets (liabilities) acquired and assumed has been recorded as intangible assets which are summarized as follows (in thousands):

	1999	2000
Total consideration paid	\$23,773	\$16,741
Fair value of net tangible assets (liabilities) acquired and assumed	(829)	(1,448)
Excess of consideration paid over the fair value of net tangible assets (liabilities) acquired	\$24,602	\$15,293

## (5) Property and Equipment

### Property and Equipment

Property and equipment consisted of the following at December 31 (in thousands):

	1999	2000
Land, buildings and leasehold improvements	\$ 17,122	\$ 20,790
Equipment	14,213	18,727
Furniture and fixtures	4,889	5,839
Total property and equipment	36,224	45,356
Less accumulated depreciation	(13,218)	(17,516)
Property and equipment, net	\$ 23,006	\$ 27,840

(continued)

## Operating Leases

The Company is obligated under non-cancelable operating leases for premises and equipment expiring in various years through the year 2012. Rent expense for the years ended December 31, 1998, 1999 and 2000 amounted to \$6,248,000, \$8,998,000 and \$11,418,000 respectively, of which \$5,590,000, \$8,201,000 and \$10,601,000 were reimbursed under service agreements. The Company has several leases with stockholders that were assumed in connection with its affiliation transactions. Such amounts are generally reimbursed pursuant to the terms of the service agreements.

Minimum future rental payments under non-cancelable operating leases and amounts to be reimbursed under service agreements as of December 31, 2000 are as follows (in thousands):

	Total Amount Due	Amount to Be Reimbursed Under Service Agreements	Net Amount
2001	\$ 9,984	\$ 9,211	\$ 773
2002	9,029	8,455	574
2003	7,954	7,608	346
2004	6,633	6,501	132
2005	5,915	5,864	51
Thereafter	22,863	22,863	—
Total minimum lease payments	\$62,378	\$60,502	\$1,876

## (6) Income Taxes

Income tax expense for the years ended December 31 consists of the following (in thousands):

	1998	1999	2000
Current:			
Federal	\$ 704	\$3,018	\$3,347
State	310	713	686
	1,014	3,731	4,033
Deferred:			
Federal	1,249	643	500
State	217	214	120
	1,466	857	620
Total income taxes	\$2,480	\$4,588	\$4,653

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities as of December 31 are as follows (in thousands):

	1999	2000
Deferred tax assets:		
Operating loss and other carryforwards	\$ 44	\$ 32
Property and equipment	620	766
Organization and start-up costs	633	484
Accrued expenses and other liabilities	801	1,038
Total deferred tax assets	2,098	2,320
Deferred tax liabilities:		
Intangibles	(884)	(1,458)
Other	(254)	(79)
Total deferred tax liabilities	(1,138)	(1,537)
Net deferred tax assets	\$ 960	\$ 783

The net deferred tax assets consisted of the following at December 31 (in thousands):

	1999		
	Federal	State	Total
Deferred tax assets:			
Current	\$ 313	\$ 84	\$ 397
Non-current	1,274	427	1,701
Total deferred tax assets	1,587	511	2,098
Deferred tax liabilities:			
Current	—	—	—
Non-current	(928)	(210)	(1,138)
Total deferred tax liabilities	(928)	(210)	(1,138)
Net deferred tax assets	\$ 659	\$ 301	\$ 960

	2000		
	Federal	State	Total
Deferred tax assets:			
Current	\$ 373	\$ 99	\$ 472
Non-current	1,402	446	1,848
Total deferred tax assets	1,775	545	2,320
Deferred tax liabilities:			
Current	—	—	—
Non-current	(1,256)	(281)	(1,537)
Total deferred tax liabilities	(1,256)	(281)	(1,537)
Net deferred tax assets	\$ 519	\$ 264	\$ 783

notes to **Consolidated Financial Statements**

In 1996, a valuation allowance for deferred tax assets of \$3,062,000 was established because, based on the limited operating history of the Company and other available evidence at the time, it was considered more likely than not that the deferred tax assets would not be realized. In 1997, the valuation allowance was reduced by \$608,000 to \$2,454,000. In 1998, the valuation allowance was reversed due to the Company's taxable earnings and management's assessment that it was more likely than not that the remaining deferred tax assets would be realized through future taxable earnings. The reversal of the valuation allowance attributable to acquired deferred tax assets reduced intangible assets by \$2,083,000. The remaining reversal of the valuation allowance provided a tax benefit of \$371,000 in the Company's consolidated statement of operations for the year ended December 31, 1998.

At December 31, 1999 and 2000, the Company had net operating loss carryforwards for state income tax purposes of approximately \$1,056,000 and \$414,000, respectively. The 2000 carryforwards will expire as follows: \$12,000 in 2004, \$68,000 in 2015, \$196,000 in 2019, and \$138,000 in 2020.

The following table reconciles the Federal statutory income tax rate to the Company's effective income tax rate for the years ended December 31:

	1998	1999	2000
Income taxes at Federal statutory rate	34.0%	35.0%	35.0%
Differential due to graduated rate	—	(0.8)	(0.8)
State taxes, net of Federal benefit	5.5	5.7	4.5
Valuation allowance and other changes	(5.0)	—	0.4
Intangibles	3.9	2.7	2.9
Other permanent differences	0.6	0.7	1.0
Effective income tax rate	39.0%	43.3%	43.0%

**(7) Debt**

Long-term debt and capital lease obligations consist of the following at December 31 (in thousands):

	1999	2000
Revolving line of credit advances, collateralized by substantially all assets of the Company, LIBOR-based and prime interest rates ranging from approximately 9.2% to 10.5%	\$33,497	\$49,057
Mortgages payable, secured, interest rates ranging from 8.6% to 10.1% payable in installments through 2015	586	343
Note payable, unsecured, interest rate of 8.5% payable in installments, maturing in 2004	35	29
Subordinated notes payable to stockholders and former owners, bearing interest at 7%, maturing through 2007	7,518	7,419
Capital lease obligations	115	75
Total long-term debt and capital lease obligations	41,751	56,923
Less current maturities	1,502	1,593
Long-term debt and capital lease obligations, excluding current maturities	\$40,249	\$55,330

Annual maturities of long-term debt and future minimum lease payments under capital leases as of December 31, 2000 are as follows (in thousands):

	Long-term Debt	Capital Leases
2001	\$ 1,549	\$50
2002	1,570	31
2003	1,592	—
2004	50,286	—
2005	881	—
Thereafter	970	—
Total payments	\$56,848	81
Less amounts representing interest		6
Total obligations under capital leases		\$75

## Revolving Line of Credit

The Company has a \$75 million line of credit. The credit facility is being used for general corporate purposes including affiliations and capital expenditures. Borrowings under this line of credit bear interest at either prime or LIBOR plus a margin, at the Company's option. The margins are based upon the Company's debt coverage ratio and range from 0.00% to 0.75% for prime borrowings and 1.75% to 2.75% for LIBOR borrowings. In addition, the Company pays a commitment fee which ranges from 0.25% to 0.375% of the average daily balance of the unused line. Borrowings are limited to an availability formula based on adjusted EBITDA. The credit facility is secured by a first lien on substantially all of the Company's assets, including a pledge of the stock of the Company's subsidiaries. The Company is also required to comply with certain financial and other covenants. The line of credit matures in July 2004.

## (8) Related Party Transactions

The Company acquired PDHC, Ltd. ("Park") and Smileage Dental Care, Inc. ("Smileage") in 1996 and Innovative Practice Concepts, Inc. ("IPC") in 1998. As part of the consideration paid pursuant to these acquisitions, the Company issued subordinated promissory notes to the former stockholders of Park, Smileage and IPC in the aggregate principal amount of \$2,247,500. Certain former stockholders of Park, Smileage and IPC are current stockholders, director and officers of the Company. The aggregate principal balance outstanding to these stockholders, director and officers of the Company as of December 31, 1999 and 2000 was \$474,000 and \$379,000, respectively. These notes bear interest at 7% and mature through 2005.

In connection with the Park, Smileage and IPC transactions, the Company entered into service agreements with three affiliated dental groups owned in part by these certain stockholders, director and officers of the Company. These service agreements are on substantially the same terms and conditions as all of the Company's other service agreements. The aggregate net revenue earned by subsidiaries of the Company under the service agreements with these dental groups in 1998, 1999 and 2000 were \$49,151,000, \$62,434,000 and \$68,562,000, respectively, of which \$37,558,000, \$48,040,000 and \$53,229,000 were reimbursements for expenses incurred in connection with the operation and administration of the related dental facilities.

## (9) Stockholders' Equity

### Preferred Stock

The Company is authorized to issue up to 1,000,000 shares of Preferred Stock, \$0.01 par value. At the closing of the initial public offering, 400,000 shares of Series A Convertible Preferred Stock (which were converted into 2,399,995 shares of Common Stock) and 70,000 shares of Series B Redeemable Preferred Stock (which were redeemed for cash) were restored to the status of undesignated preferred stock available for issuance.

Preferred Stock may be issued in one or more series as determined by the Board of Directors without further stockholder approval, and the Board of Directors is authorized to fix and determine the terms, limitations and relative rights and preferences of such Preferred Stock, and to fix and determine the variations among series of Preferred Stock. Any new Preferred Stock issued would have priority over the Common Stock with respect to dividends and other distributions, including the distribution of assets upon liquidation and dissolution. Such Preferred Stock may be subject to repurchase or redemption by the Company. The Board of Directors, without stockholder approval, could issue Preferred Stock with voting and conversion rights that could adversely affect the voting power of the holders of Common Stock and the issuance of which, could be used by the Board of Directors in defense of a hostile takeover of the Company. As of December 31, 1999 and 2000, there were no shares of Preferred Stock issued or outstanding.

### Common Stock

The Company is authorized to issue up to 25,000,000 shares of Common Stock, \$0.01 par value, of which 7,537,311 shares were issued and 7,107,311 shares were outstanding at December 31, 1999; 7,600,532 shares were issued and 7,130,532 shares were outstanding at December 31, 2000. In January 1996, the Company sold 300,000 shares of its Common Stock, which were subject to certain restrictions, for \$500. In connection with this transaction, the Company has recorded compensation expense ratably as the restrictions have lapsed. Compensation expense amounted to \$24,888 and \$24,228 for the years ended December 31, 1998 and 1999, respectively.

### Initial Public Offering

During the second quarter of 1998, the Company sold 2,587,500 shares of Common Stock in an initial public offering ("IPO") at \$15.00 per share. Net proceeds to the Company after deducting underwriting discounts and commissions and offering expenses totaled approximately \$34,596,000.

### **Shelf Registration Statement**

The Company has a Shelf Registration Statement on file with the Securities and Exchange Commission covering a total of 750,000 shares of Common Stock to be issued in connection with future dental practice affiliations. As of December 31, 2000, 679,878 shares remain available for issuance under this Shelf Registration Statement.

### **Treasury Stock**

On December 16, 1999, the Board of Directors authorized the Company to repurchase up to \$5,000,000 of its Common Stock in the open market. Under this plan, the Company has repurchased 470,000 shares of its Common Stock through December 31, 2000 at a cost of \$3,244,000.

### **Dividend Restriction**

The Company has not paid any cash dividends on its Common Stock and does not plan to pay any cash dividends on its Common Stock in the foreseeable future. Additionally, the terms of the Company's revolving credit facility prohibit it from paying dividends or making other payments with respect to its Common Stock without the lenders' consent.

## **(10) Stock Compensation Plans**

### **1999 Restricted Stock Plan**

The Company's 1999 Restricted Stock Plan (the "Restricted Stock Plan") provides for the grant of restricted shares of the Company's Common Stock at a price equal to the par value of such shares (\$.01 per share). Restricted shares may be issued to key employees of the Company and shall be subject to such restrictions as the Board of Directors determines, including, but not limited to, time and performance restrictions. The maximum number of restricted shares which may be issued under the Restricted Stock Plan is 25,000, and as of December 31, 2000, there were no shares issued or outstanding under this Plan.

### **1996 Stock Option Plan**

The Company's 1996 Stock Option Plan, as amended (the "1996 Plan"), provides for the grant of stock options to key employees. The 1996 Plan permits the granting of options that qualify as incentive stock options and non-qualified options. The exercise price of such options is no less than the fair market value of the Common Stock at the time of grant. Options granted pursuant to the 1996 Plan expire ten years after the date of grant. At December 31, 2000, options for a total of 1,273,246 shares were reserved for issuance and options for 1,094,864 shares were outstanding under this Plan.

### **1996 Time Accelerated Restricted Stock Option Plan**

The Company's 1996 Time Accelerated Restricted Stock Option Plan, as amended ("TARSOP Plan"), provides for the grant of stock options to key employees. Only non-qualified options may be granted pursuant to the TARSOP Plan. The exercise price of such options is no less than the fair market value of the Common Stock at the time of grant. These options vest at the end of the ninth year, but are subject to accelerated vesting based on achievement of certain performance measures. At December 31, 2000, options for a total of 360,360 shares were reserved for issuance and options for 343,740 shares were outstanding under this Plan. All outstanding options to purchase such shares became exercisable at the completion of the IPO.

### **1996 Affiliate Stock Option Plan**

The Company's 1996 Affiliate Stock Option Plan, as amended (the "Affiliate Plan"), provides for the grant of stock options to certain persons associated with the affiliated dental groups. Only non-qualified options may be granted pursuant to the Affiliate Plan. The exercise price of such options is no less than the fair market value of the Common Stock at the time of grant. Options granted pursuant to the Affiliate Plan expire ten years after the date of grant. At December 31, 2000, options for a total of 110,000 shares were reserved for issuance and options for 80,406 shares were outstanding under this Plan.

### **1996 Directors Stock Option Plan**

The Company's 1996 Directors Stock Option Plan, as amended (the "Directors Plan"), provides for the granting of options to outside directors. Only non-qualified options may be granted pursuant to the Directors Plan. The exercise price of such options is no less than the fair market value of the Common Stock at the time of grant. Options granted pursuant to the Directors Plan expire ten years after the date of grant. At December 31, 2000, options for a total of 85,000 shares were reserved for issuance and options for 59,300 shares were outstanding under this Plan.

### **1997 Employee Stock Purchase Plan**

The 1997 Employee Stock Purchase Plan, as amended (the "Employee Stock Purchase Plan" or "ESPP"), enables eligible employees to purchase shares of Common Stock at a discount on a periodic basis through payroll deductions and is intended to meet the requirements of Section 423 of the Internal Revenue Code. Purchases occur at the end of option periods, each of six months' duration, except that the first such option period

(continued)

began concurrent with the completion of the IPO and ended on December 31, 1998. The purchase price of Common Stock under the Employee Stock Purchase Plan is 85% of the lesser of the value of the Common Stock at the beginning or the end of the option period. Prior to each option period, participants may elect to have from 2% to 10% of their pay withheld and applied to the purchase of shares at the end of the option period. The Employee

Stock Purchase Plan imposes a maximum of \$10,000 on the amount that may be withheld from any participant in any option period. A total of 400,000 shares of Common Stock has been reserved for issuance under the Employee Stock Purchase Plan, of which 113,898 shares have been issued through 2000 and 24,729 shares were committed for issuance as of December 31, 2000.

### Stock Option Activity

A summary of stock option activity under all the Company's stock option plans for the years ended December 31, 1998, 1999 and 2000 follows:

	1998		1999		2000	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding at beginning of year	1,118,166	\$ 8.69	1,205,978	\$ 8.92	1,345,148	\$8.66
Granted	101,518	12.01	177,515	7.36	432,420	7.03
Cancelled	(13,706)	13.42	(38,345)	10.91	(199,258)	9.99
Outstanding at end of year	1,205,978	\$ 8.92	1,345,148	\$ 8.66	1,578,310	\$8.04
Exercisable at end of year	638,573	\$ 5.77	813,014	\$ 7.12	967,939	\$7.84

The following table summarizes information about stock options outstanding at December 31, 2000:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$ 0.33	352,770	4.3	\$ 0.33	352,770	\$ 0.33
\$ 6.44-\$ 7.13	391,840	9.5	\$ 7.03	25	\$ 7.00
\$ 7.25-\$13.00	393,267	6.7	\$ 9.11	257,874	\$ 9.33
\$14.17	440,433	6.5	\$14.17	357,270	\$14.17
	1,578,310	6.8	\$ 8.04	\$967,939	\$ 7.84

### Accounting for Stock Compensation Plans

The Company accounts for stock compensation plans in accordance with APB No. 25. Accordingly, no compensation expense has been recognized in the financial statements for stock compensation plans. Pro forma information regarding net earnings and earnings per share is required by SFAS No. 123 and has been determined as if the Company had accounted for its stock compensation plans under the fair value method. The fair value for these options and purchase rights granted was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions for the years ended December 31:

	1998		1999		2000	
	Stock Options	ESPP	Stock Options	ESPP	Stock Options	ESPP
Risk-free interest rate	5.0%	5.6%	5.3%	4.9%	6.2%	6.2%
Expected dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Expected volatility	56%	56%	53%	63%	64%	67%
Expected life (years)	4.0	0.71	4.0	0.5	4.0	0.5
Weighted average fair value of options/ purchase rights granted during the year	\$3.02	\$4.82	\$3.45	\$3.48	\$3.81	\$2.24

# notes to Consolidated Financial Statements

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's stock options and purchase rights have characteristics significantly different from those of traded options and changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options and purchase rights.

For purposes of pro forma disclosures, the estimated fair value of the options and purchase rights is amortized to expense over the options' vesting period and the purchase rights' option period. The Company's pro forma net earnings

and earnings per share are as follows (in thousands, except per share amounts) for the years ended December 31:

	1998	1999	2000
Net earnings, as reported	\$3,886	\$6,013	\$6,169
Net earnings, pro forma	\$3,768	\$5,803	\$5,860
Diluted earnings per share, as reported	\$ 0.54	\$ 0.78	\$ 0.84
Diluted earnings per share, pro forma	\$ 0.52	\$ 0.75	\$ 0.80

## (11) Employee Retirement Benefit Plans

The Company has a Savings and Retirement Plan (401(k) Plan), adopted October 1, 1996, which is the Company's principal defined contribution retirement plan, which provides for a match of up to 50% of the first 6% of an employee's eligible compensation. Additionally, at December 31, 2000, the Company had eight other defined contribution retirement plans which were acquired in connection with affiliation transactions. Total plan expense for the years ended December 31, 1998, 1999 and 2000 was \$423,000, \$682,000 and \$880,000, respectively.

## (12) Earnings Per Share

The following table provides a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations for the years ended December 31 (in thousands, except per share amounts):

	1998	1999	2000
<b>Basic Earnings Per Share:</b>			
Net earnings	\$3,886	\$6,013	\$6,169
Less: Dividends on Series A Convertible Preferred Stock	(200)	—	—
Dividends on Series B Redeemable Preferred Stock	(195)	—	—
Net earnings available to common stockholders	\$3,491	\$6,013	\$6,169
Weighted average common shares outstanding	5,907	7,513	7,119
Net earnings per share	\$ 0.59	\$ 0.80	\$ 0.87
<b>Diluted Earnings Per Share:</b>			
Net earnings	\$3,886	\$6,013	\$6,169
Less: Dividends on Series A Convertible Preferred Stock <sup>(1)</sup>	—	—	—
Dividends on Series B Redeemable Preferred Stock	(195)	—	—
Net earnings available to common stockholders	\$3,691	\$6,013	\$6,169
Weighted average common shares outstanding	5,907	7,513	7,119
Add: Dilutive effect of options <sup>(2)</sup>	237	232	201
Assumed conversion of Series A Convertible Preferred Stock <sup>(1)</sup>	723	—	—
Weighted average common shares as adjusted	6,867	7,745	7,320
Net earnings per share	\$ 0.54	\$ 0.78	\$ 0.84

(1) In connection with the IPO, all 400,000 shares of Series A Convertible Preferred Stock were converted into 2,399,995 shares of Common Stock on April 21, 1998. The Diluted EPS calculation for the year ended December 31, 1998 assumes conversion of the Series A Convertible Preferred Stock to Common Stock as of January 1, 1998.

(2) In 2000, 943,978 options were excluded from the computation of diluted earnings per share due to their antidilutive effect.

(continued)

### (13) Selected Quarterly Operating Results (unaudited)

The following table sets forth summary quarterly results of operations for the Company for the years ended December 31, 1999 and 2000 (in thousands, except per share amounts):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
<b>1999</b>				
Net revenue	\$26,234	\$28,139	\$30,512	\$32,467
Operating expenses	23,537	25,137	27,321	28,879
Earnings from operations	2,697	3,002	3,191	3,588
Earnings before income taxes	2,413	2,607	2,685	2,896
Income taxes	1,059	1,143	1,127	1,259
Net earnings	\$ 1,354	\$ 1,464	\$ 1,558	\$ 1,637
Net earnings per share:				
Basic	\$ 0.18	\$ 0.19	\$ 0.21	\$ 0.22
Diluted	\$ 0.18	\$ 0.19	\$ 0.20	\$ 0.21
Weighted average common shares outstanding:				
Basic	7,471	7,517	7,535	7,528
Diluted	7,669	7,752	7,797	7,746
<b>2000</b>				
Net revenue	\$34,130	\$35,227	\$36,901	\$37,386
Operating expenses	30,700	31,341	32,966	33,437
Earnings from operations	3,430	3,886	3,935	3,949
Earnings before income taxes	2,584	2,936	2,690	2,612
Income taxes	1,116	1,277	1,166	1,094
Net earnings	\$ 1,468	\$ 1,659	\$ 1,524	\$ 1,518
Net earnings per share:				
Basic	\$ 0.21	\$ 0.23	\$ 0.21	\$ 0.21
Diluted	\$ 0.20	\$ 0.23	\$ 0.21	\$ 0.21
Weighted average common shares outstanding:				
Basic	7,125	7,099	7,122	7,131
Diluted	7,325	7,307	7,325	7,325

### (14) Subsequent Event

In January 2001, three of the Company's affiliated dental groups, Park Dental, Associated Dental Care Providers and University Dental Associates, received notices of contract termination from Cigna Dental and Associated Dental Care Providers received notice of contract termination from Protective Life Corporation. The four contracts represented approximately \$24.1 million of affiliate adjusted gross revenue in 2000. The effective dates of termination for these four contracts are (i) July 31, 2001 for Park Dental, (ii) March 31, 2001 for University Dental Associates and (iii) March 31, 2001 (Cigna Dental) and April 8, 2001 (Protective Life) for Associated Dental Care Providers. These affiliates subsequently

received proposed terms for new provider contracts from Cigna Dental. The affiliates found the proposed terms unacceptable, and the Company is working with them in evaluating their options in light of the termination notices. In evaluating options, the Company and its affiliates believe that the financial impact of not continuing as a provider with both dental benefit plan providers, while difficult to ascertain precisely, would be less severe than accepting the proposed provider relationships. While the exact outcome cannot be determined at this time, the Company believes the disruption being caused by the termination notices may impact net earnings for the first and second quarters of 2001.

# Market Information

Our Common Stock is traded on the Nasdaq National Market® under the symbol “ADPI.” The following table sets forth the range of the reported high and low sales prices of our Common Stock for the years ended December 31, 1999 and 2000:

	High	Low	Close
<b>1999</b>			
1st Quarter	\$11.688	\$ 7.000	\$ 7.875
2nd Quarter	\$12.375	\$ 6.875	\$11.125
3rd Quarter	\$13.375	\$ 8.750	\$12.125
4th Quarter	\$12.188	\$ 6.625	\$ 7.000
	High	Low	Close
<b>2000</b>			
1st Quarter	\$ 9.375	\$ 6.250	\$6.938
2nd Quarter	\$ 7.000	\$ 6.875	\$7.000
3rd Quarter	\$ 9.000	\$ 6.375	\$6.875
4th Quarter	\$ 8.500	\$ 5.000	\$7.500

As of March 16, 2001, there were approximately 54 holders of record of Common Stock, as shown on the records of the transfer agent and registrar of Common Stock. The number of record holders does not bear any relationship to the number of beneficial owners of the Common Stock. The last reported sale price of the Common Stock on the Nasdaq National Market as of March 14, 2001 was \$7.875 per share.

## Dividend Policy

We have not paid any cash dividends on our Common Stock in the past and do not plan to pay any cash dividends on our Common Stock in the foreseeable future. In addition, the terms of our revolving credit facility prohibit us from paying dividends or making other payments with respect to our Common Stock without the lenders’ consent. Our Board of Directors intends, for the foreseeable future, to retain earnings to finance the continued operation and expansion of our business.

## Safe Harbor Statement

Some of the information in this Annual Report contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. The words “believe,” “expect,” “anticipate,” “project,” and similar expressions, among others, identify forward-looking statements. Forward-looking statements speak only as of the date the statement was made. Such forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially from those projected, anticipated or implied. Certain factors that might cause such a difference include, among others, the Company’s risks associated with its affiliated dental groups’ contracts with third party payors and the impact of any terminations or potential terminations of such contracts, the cost of and access to capital, the tight labor markets, the Company’s acquisition and affiliation strategy, management of rapid growth, dependence upon affiliated dental groups, dependence upon service agreements and government regulation of the dental industry. Additional risks, uncertainties and other factors are set forth in the “Risk Factors” section of the Company’s Registration Statement on Form S-4 (File No. 333-56941).

## Corporate Information

### Board of Directors

James T. Kelly <sup>(1)</sup>

Retired Chairman, Lincare, Inc.

A home respiratory therapy provider

Martin J. Mannion <sup>(1)(2)</sup>

General Partner, Summit Partners

A private equity capital firm

Derril W. Reeves <sup>(1)(2)</sup>

Private Investor

Retired health care executive

Gregory A. Serrao

Chairman, President and Chief Executive Officer,  
American Dental Partners, Inc.

Gregory T. Swenson, DDS

President, Park Dental

A multi-specialty dental group

<sup>(1)</sup> Member of the Audit Committee

<sup>(2)</sup> Member of the Compensation Committee

### Management Team

Ian H. Brock

Vice President, Financial Planning

Kevin M. Eichner

Vice President, Controller

Joseph V. Errante, DDS

Senior Vice President, Business Development

Breht T. Feigh

Vice President, Chief Financial Officer and Treasurer

Lee S. Feldman

Senior Vice President, Chief Administrative Officer  
and General Counsel

Michael F. Frisch

Senior Vice President, Regional Operations

Paul F. Gill

Senior Vice President, Regional Operations

Roger A. Horton, DMD

Vice President, Information Systems

Lynn R. Karcz

President, American Dental Professional Services, Inc.

Terri M. Lawler

President, Orthocare, Ltd.

Jesley C. Ruff, DDS

Vice President, Chief Professional Officer

Gregory A. Serrao

Chairman, President and Chief Executive Officer

Peter G. Swenson

Vice President, Market Development

Michael J. Vaughan

Senior Vice President, Regional Operations

### Corporate Office Address

301 Edgewater Place

Suite 320

Wakefield, Massachusetts 01880

800-838-6563 or 781-224-0880

### Investor Contact

Breht T. Feigh

Vice President, Chief Financial Officer and Treasurer

### Investor Information

To receive a free copy of the Form 10-K Annual Report filed with the Securities and Exchange Commission, write to Investor Relations at the Corporate Office Address or call 1-800-838-6563. Press releases and other investor information may also be obtained through our web site at [www.amdpi.com](http://www.amdpi.com).

### Independent Public Accountants

KPMG LLP

99 High Street

Boston, Massachusetts 02110

### Legal Counsel

Baker & Hostetler LLP

65 East State Street

Columbus, Ohio 43215

### Transfer Agent

EquiServe

150 Royall Street

Canton, Massachusetts 02021

Shareholder Inquiries: 877-282-1168

[www.EquiServe.com](http://www.EquiServe.com)

### Annual Meeting

May 4, 2001

2:00 p.m.

Summit Partners

600 Atlantic Avenue

Suite 2800

Boston, Massachusetts 02210



301 Edgewater Place, Suite 320, Wakefield, MA 01880

Tel: 781-224-0880 Fax: 781-224-4216

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