AMERIPATH INC
Form 10-Q
November 14, 2005
Table of Contents

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005

or

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

Commission File Number: 000-22313

AMERIPATH, INC.

(Exact Name of Registrant as Specified in its Charter)

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

7111 Fairway Drive, Suite 400

Palm Beach Gardens, Florida	**33418**
(Address of Principal Executive Offices)	**(Zip Code)**

(561) 712-6200

(Registrant s Telephone Number, Including Area Code)

Not Applicable

(Former Name, Former Address and Formal Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act) Yes ¨ No x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.): Yes ¨ No x

The number of shares of common stock of the registrant outstanding as of November 14, 2005 was 100.

Table of Contents

AMERIPATH, INC. AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

INDEX

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AMERIPATH, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	September 30, 2005	December 31, 2004
	(Unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 2,867	$ 20,980
Restricted cash	27,027	17,940
Accounts receivable, net	85,727	76,567
Inventories	2,144	2,335
Deferred tax assets, net	13,345	13,345
Other current assets	5,566	4,823
Total current assets	136,676	135,990
PROPERTY AND EQUIPMENT, NET	45,172	30,964
OTHER ASSETS:		
Goodwill	600,932	591,819
Identifiable intangibles, net	168,659	179,903
Other	23,191	25,633
Total other assets	792,782	797,355
TOTAL ASSETS	$ 974,630	$ 964,309
LIABILITIES AND STOCKHOLDER S EQUITY		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	$ 54,368	$ 52,620
Accrued interest	18,895	9,456
Current portion of long-term debt	397	2,682
Other current liabilities	245	1,164
Total current liabilities	73,905	65,922

LONG -TERM LIABILITIES:		
Long-term debt	475,069	495,171
Other liabilities	32,404	29,220
Deferred tax liabilities, net	15,904	15,904
Total long-term liabilities	523,377	540,295
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDER S EQUITY:		
Common stock, $.01 par value, 100 shares issued and outstanding at September 30, 2005 and December 31, 2004	1	1
Additional paid-in capital	362,253	352,723
Retained earnings	15,094	5,368
Total stockholder s equity	377,348	358,092
TOTAL LIABILITIES AND STOCKHOLDER S EQUITY	$ 974,630	$ 964,309

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Table of Contents

AMERIPATH, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
NET REVENUES:				
Net patient service revenues	$ 139,868	$ 121,706	$ 407,014	$ 360,829
Net management service revenues	3,684	6,006	14,052	18,000
Net revenues	143,552	127,712	421,066	378,829
OPERATING COSTS AND EXPENSES:				
Costs of services:				
Net patient service revenues	73,355	64,144	214,703	188,240
Net management service revenues	3,440	3,651	9,868	11,175
Total costs of services	76,795	67,795	224,571	199,415
Selling, general and administrative expenses	27,347	21,816	79,699	69,275
Provision for doubtful accounts	18,017	22,455	54,457	58,279
Amortization expense	2,799	2,753	8,446	8,321
Loss on sale of managed practice	1,337		883	
Asset impairment and related charges				586
Total operating costs and expenses	126,295	114,819	368,056	335,876
INCOME FROM OPERATIONS	17,257	12,893	53,010	42,953
OTHER INCOME (EXPENSES):				
Interest expense	(12,205)	(11,130)	(36,272)	(33,297)
Write-off of deferred financing costs	(123)		(468)	(3,829)
Change in value of derivative	(221)	511	(512)	(764)
Other income, net	122	112	406	292
Total other expenses, net	(12,427)	(10,507)	(36,846)	(37,598)
INCOME BEFORE INCOME TAXES	4,830	2,386	16,164	5,355
PROVISION FOR INCOME TAXES	1,923	1,062	6,438	2,219
NET INCOME	$ 2,907	$ 1,324	$ 9,726	$ 3,136

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Table of Contents

AMERIPATH, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 9,726	$ 3,136
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	8,047	6,693
Amortization	9,940	10,014
Loss on disposal of assets	131	36
Asset impairment and related charges		586
Loss on sale of managed practice	883	
Change in value of derivative	512	764
Provision for doubtful accounts	54,457	58,279
Write-off of deferred financing costs	468	3,829
Changes in assets and liabilities (net of effects of acquisitions):		
Increase in accounts receivable, net	(66,426)	(57,390)
Increase in inventories	32	(524)
Decrease in other current assets	(943)	226
Increase in other assets	400	(1,794)
Increase in accrued interest	9,439	11,172
Increase in accounts payable and accrued expenses	4,677	8,195
Net cash provided by operating activities	31,343	43,222
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisitions of property and equipment	(22,070)	(7,334)
Cash received from sale of managed practice	5,150	(496)
Increase in restricted cash	(9,087)	(8,313)
Investment in common stock	(150)	
Payments of contingent notes	(9,892)	(10,953)
Net cash used in investing activities	(36,049)	(27,096)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Debt issuance costs	(27)	(3,109)
Net payments on long-term debt and capital leases	(1,959)	(1,253)
Payments under revolver facility	(5,000)	
Payments under term loan facility	(15,951)	(98,312)
Payment to Ameripath Holdings		(5,774)
Contingent note proceeds	9,530	10,043
Proceeds from sale of senior subordinated notes		79,500

Net cash used in financing activities	(13,407)	(18,905)
DECREASE IN CASH AND CASH EQUIVALENTS	(18,113)	(2,779)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	20,980	23,536
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 2,867	$ 20,757
SUPPLEMENTAL NON-CASH TRANSACTIONS:		
Property and equipment acquired pursuant to capital leases	$ 552	

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Table of Contents

Note 1 Basis of Presentation

The accompanying unaudited condensed consolidated financial statements, which include the accounts of AmeriPath, Inc. and its subsidiaries (collectively, AmeriPath or the Company), have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial reporting and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the financial statements do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, such interim financial statements contain all adjustments (consisting of normal recurring items) considered necessary for a fair presentation of the Company s financial position, results of operations and cash flows for the interim periods presented. The results of operations and cash flows for any interim period are not necessarily indicative of results that may be expected for the full year.

The accompanying unaudited interim financial statements should be read in conjunction with the audited consolidated financial statements, and the notes thereto, included in the Company s Form 10-K for the year ended December 31, 2004 and filed with the Securities and Exchange Commission (SEC) on March 18, 2005.

In order to maintain consistency and comparability between periods presented, certain amounts in the prior year s financial statements have been reclassified to conform to the financial statement presentation of the current period.

Note 2 The March 2003 Transaction

On December 8, 2002, Amy Holding Company and its wholly-owned subsidiary, Amy Acquisition Corp., entered into a merger agreement with AmeriPath, pursuant to which Amy Acquisition Corp. merged with and into AmeriPath, with AmeriPath continuing as the surviving corporation (the March 2003 Transaction). Amy Holding Company and Amy Acquisition Corp. are Delaware corporations formed at the direction of Welsh, Carson, Anderson & Stowe IX, L.P. (WCAS). The March 2003 Transaction was approved by the then Company s stockholders and subsequently consummated on March 27, 2003. As a result of the March 2003 Transaction, AmeriPath became a wholly-owned subsidiary of Amy Holding Company, which was renamed AmeriPath Holdings, Inc. (Holdings).

The March 2003 Transaction was accounted for under the purchase method of accounting prescribed in Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations*, (SFAS No. 141), with intangible assets recorded in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* , (SFAS No. 142). In accordance with the provisions of SFAS No. 142, no amortization of indefinite-lived intangible assets or goodwill is recorded.

As permitted under current guidance, any amounts recorded or incurred (such as goodwill or debt) by our parent as a result of the March 2003 Transaction can be pushed down and recorded on the financial statements. The following table summarizes the final allocation of the March 2003 Transaction based upon a valuation completed by an independent third-party valuation firm during September 2003.

Cash and equity contributed by WCAS	$ 319,667
Total liabilities assumed	587,801
Fair value of assets acquired	(676,458)

Excess purchase price (goodwill)	$ 231,010

In addition, Holdings issued to WCAS Capital Partners III, L.P., an investment fund affiliated with WCAS, $67.0 million in principal amount of Holdings senior subordinated notes and an agreed-upon number of shares of its common stock, for an aggregate purchase price of $67.0 million. The proceeds from this transaction were deposited into a Holdings company cash collateral account, which cash, subject to some exceptions, will be contributed to the Company from time to time to fund up to $67.0 million of future payments under the Company s contingent notes relating to acquisitions consummated prior to the March 2003 Transaction. As of September 30, 2005, approximately $37.7 million of the $67.0 million has been contributed to the Company to fund contingent note payments. The lenders under the Company s Credit Facility have a first-priority security interest in all funds held in such cash collateral account.

Table of Contents

Note 3 Recent Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board (FASB) issued SFAS No. 154 *Accounting Changes and Error Corrections A Replacement of APB Opinion No. 20 and FASB Statement No. 3* (SFAS No. 154) which requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented using the new accounting principle, unless it is impracticable to do so. SFAS No. 154 also provides that (i) a change in method of depreciating or amortizing a long-lived nonfinancial asset be accounted for as a change in estimate (prospectively) that was affected by a change in accounting principle, and (ii) correction of errors in previously issued financial statements should be termed a restatement . In accordance with the new rule, the Company will adopt SFAS No. 154 in the first quarter of 2006. We do not believe the effect of adopting SFAS No. 154 will have a material impact on our consolidated financial statements.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* , which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation* . Statement 123(R) supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees* , and amends SFAS No. 95, *Statement of Cash Flows* . SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. SFAS 123(R) is effective for annual periods beginning after June 15, 2005. The Company expects to adopt SFAS 123(R) effective January 1, 2006, but has not yet determined if it will use the modified prospective method or one of the modified-retrospective methods. As permitted by SFAS 123, the Company currently accounts for share-based payments to employees using the intrinsic value method in accordance with the recognition and measurement principles of APB Opinion No. 25, and, as such, generally recognizes no compensation cost for employee stock options, as options granted under the Company s plan have an exercise price equal to the fair value of the underlying common stock on the date of grant. The impact of adoption of Statement 123(R) cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. Statement 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. The Company cannot estimate what those amounts will be in the future because they depend on, among other things, when employees exercise stock options.

In April 2003, the FASB issued SFAS No. 149*, Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (SFAS No. 149). SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. It is effective for contracts entered into or modified after June 30, 2003. In April 2004, the Company entered into an interest rate swap agreement. In accordance with SFAS No. 149, the Company is recording this derivative instrument at market value and is reflecting the change in the market value in the condensed consolidated statements of income.

Note 4 Acquisitions

During the first nine months of 2005, the Company did not acquire any new practices. During the nine months ended September 30, 2004, the Company acquired one hospital-based practice in Bountiful, Utah. In December 2004, the Company acquired a dermatopathology practice located in New Rochelle, New York for a total purchase price of $44.0 million, which included cash of $34.0 million and 1,666,667 shares of the parent company s common stock valued at $10.0 million. The practice provides outpatient services to the Northeast region, and expands the Company s geographical presence in this area. The purchase price of the acquisition is summarized below:

Cash paid	$ 34,000
Holdings common stock issued	10,000
Total purchase price	$ 44,000

Table of Contents

The following table summarizes the fair value of the assets acquired and liabilities assumed in connection with this acquisition as of the date of the acquisition as accounted for under SFAS No. 141 *Business Combinations* , which requires the use of the purchase method of accounting. The final valuation was performed by an independent third-party valuation firm during June 2005. The final allocation of the purchase price is summarized below:

Cash	$ 382
Accounts receivable, net	2,018
Property & equipment, net	236
Deposits	270
Intangible assets	3,020
Goodwill	38,191
Total assets	$ 44,117
Accounts payable	5
Accrued liabilities	112
Total liabilities	$ 117
Net assets acquired	$ 44,000

During the nine months ended September 30, 2005 and 2004, the Company made contingent note payments of approximately $9.9 million and $11.0 million, respectively relating to previous acquisitions. If the maximum specified levels of income from operations for all acquired operations are achieved, the Company estimates that it would make aggregate maximum principal payments of approximately $26.4 million over the next four years. A lesser amount or no payments at all would be made if the stipulated levels of income from operations or other evaluation factors specified in each agreement were not met.

The accompanying unaudited condensed consolidated financial statements include the results of operations of the Company s acquisitions accounted for under the purchase method from the date acquired through September 30, 2005. The following unaudited pro forma information presents the consolidated results of operations for the nine months ended September 30, 2005 and 2004 as if the acquisitions had been consummated on January 1, 2005 and 2004, respectively. Such unaudited pro forma information is based on historical financial information and does not include operational or other changes that might have been effected by the Company.

The unaudited pro forma information presented below is for illustrative information purposes only and is not necessarily indicative of results which would have been achieved or results which may be achieved in the future.

	Nine months ended September 30, 2005	Nine months ended September 30, 2004
Net revenues	$ 421,066	$ 396,739
Net income	$ 9,726	$ 8,581

Note 5 Intangible Assets

Amortization expense of identifiable intangibles was approximately $2.8 million for both the three months ended September 30, 2005 and 2004. Amortization expense of identifiable intangibles was approximately $8.4 million for the nine months ended September 30, 2005 and $8.3 million for the nine months ended September 30, 2004.

Amortization expense related to identifiable intangibles for each of the five succeeding fiscal years and thereafter as of September 30, 2005 is as follows:

Remainder of 2005	$ 2,781
2006	7,923
2007	6,851
2008	6,019
2009	5,741
2010	5,563
Thereafter	97,380

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

Table of Contents

Note 6 Long-term Debt

Senior Subordinated Notes On March 27, 2003, in connection with the March 2003 Transaction, Amy Acquisition Corp. issued $275.0 million of 10 1/2% Senior Subordinated Notes due 2013. The Company assumed Amy Acquisition Corp. s obligations with respect to the notes upon consummation of the March 2003 Transaction. Interest became payable semi-annually in arrears beginning in October 2003. The notes are unconditionally guaranteed, jointly and severally and on an unsecured senior subordinated basis, by certain of the Company s current and former subsidiaries. The notes and guarantees rank junior to all of the Company s and the subsidiary guarantors existing and future senior indebtedness, on par with all of the Company s and the subsidiary guarantors existing and future senior subordinated indebtedness and senior to all of the Company s and the subsidiary guarantors existing and future subordinated indebtedness. On April 1, 2005, the Company made its semi-annual interest payment of approximately $18.4 million.

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

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

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

In February 2004, the Company issued an additional $75.0 million of its 10 1/2% Senior Subordinated Notes due 2013 at a premium price of 106% plus accrued interest. In February 2004, the Company paid down $88.2 million of the term loan borrowings. As a result of the paydown, the Company recognized a $3.5 million write-off of deferred financing costs during the nine months ended September 30, 2004.

Credit Facility On March 27, 2003, in connection with the consummation of the March 2003 Transaction, the Company terminated its existing senior credit facility and entered into a new senior credit facility (the Credit Facility) with a syndicate of financial institutions led by Credit Suisse First Boston and Deutsche Bank Securities, Inc.

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

The interest rates per annum applicable to loans under the Credit Facility are, at the Company s option, equal to either an alternate base rate or an adjusted LIBOR rate for a one, two, three or six month interest period chosen by the Company, or a nine or twelve month period if agreed to by

all participating lenders, plus an applicable margin percentage in each case.

The alternate base rate is the greater of (1) the prime rate or (2) one-half of 1% over the weighted average of rates on overnight federal funds as published by the Federal Reserve Bank of New York. The adjusted LIBOR rate will be determined by reference to settlement rates established for deposits in dollars in the London interbank market for a period equal to the interest period of the loan and the maximum reserve percentages established by the Board of Governors of the United States Federal Reserve to which the lenders are subject. Beginning approximately six months after the closing of the March 2003 Transaction, the applicable margin percentage under the term loan facility was subject to adjustments based upon the ratio of the Company s total indebtedness to the Company s consolidated EBITDA (as defined in the Credit Facility) being within certain defined ranges. The interest rate at September 30, 2005 was approximately 7.1%. The revolving credit facility also requires a commitment fee to be paid quarterly equal to 0.50% of any unused commitments under the revolving loan facility.

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

Table of Contents

The Credit Facility required scheduled quarterly payments on the term loan in amounts equal to $312,500 on each of June 30, September 30, December 31 and March 31, beginning on June 30, 2004. On June 30, 2004, the Company made its mandatory payment of $312,500 and also made a voluntary prepayment of $9,687,500. The voluntary prepayment was applied chronologically to the future mandatory quarterly payments. Therefore, the next mandatory payment on the facility will not be until 2009. As a result of the voluntary paydown, the Company recognized a $0.3 million write-off of deferred debt costs. During the three months ended September 30, 2005, the Company paid down approximately $4.3 million of the term loan borrowings, and as a result recognized a $0.1 million write-off of deferred debt costs. For the nine months ended September 30, 2005, the Company paid down approximately $16.0 million of the term loan borrowings, and as a result recognized a $0.5 million write-off of deferred debt costs.

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

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

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

Letters of Credit

As of September 30, 2005, the Company had letters of credit outstanding totaling $2.7 million. The letters of credit secure payments under certain operating leases and insurance policies and expire at various dates in 2005 through 2010. Some of the letters of credit automatically decline in value over various lease terms. The letters of credit have annual fees averaging 3.6%. Available borrowings under the $65.0 million revolving credit facility are reduced by the balance outstanding on these letters of credit. In addition, the Company had $300,000 of surety bonds outstanding on September 30, 2005 to satisfy Florida Medicaid requirements.

Note 7 Derivative Instrument

In April 2004, the Company entered into a 2 1/2 year interest rate swap transaction which involves the exchange of fixed for floating rate interest payments without the exchange of the underlying principal amount. The interest differential to be paid or received is accrued and is recognized as an adjustment to interest expense. The change in the market value of the derivative instrument is recognized in the condensed consolidated statements of income. For the nine months ended September 30, 2005, the change in the value of the derivative was a loss of approximately $0.5 million. The agreement has a notional amount of $75.0 million. The Company receives interest on the notional amount if the LIBOR rate is less than 2.405% and pays interest on the notional amount if the LIBOR rate exceeds 2.405%. The floating rate resets every October 1 and April 1.

In August 2004, the Company locked in to a forward LIBOR rate contract for October 2004 through March 2005 at a rate of 2.08%. In April 2005, the floating rate was reset to 3.39% until October 2005. This derivative instrument is being used by the Company to reduce interest rate volatility and associated risks arising from the fixed rate structure of our Senior Subordinated Notes, and is not held or issued for trading purposes.

Note 8 Commitments and Contingencies

During the ordinary course of business, the Company has become and may in the future become subject to legal actions and proceedings. The Company may have liability with respect to its employees and its pathologists and with respect to hospital employees who are under the supervision of its hospital-based pathologists. The majority of these pending legal proceedings involve claims of medical malpractice and most of those suits relate to cytology services. Based upon investigations conducted to date, the Company believes the outcome of any pending legal actions and proceedings, individually or in the aggregate, will not have a material adverse effect on the Company s financial condition, results of operations or liquidity. If the Company is ultimately found liable under the outstanding medical malpractice claims, there can be no assurance that medical malpractice insurance arrangements will be adequate to cover all such liabilities. The Company also may, from time to time, be involved with legal actions related to the

Table of Contents

acquisition of anatomic pathology operations, the prior conduct of acquired operations or the employment and restriction on competition of physicians. There can be no assurance that any costs or liabilities for which the Company becomes responsible in connection with these claims or actions will not be material or will not exceed the limitations of any applicable indemnification provisions or the financial resources of the indemnifying parties.

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

The Company has received subpoenas issued by the United States Attorney s Office in Tampa, Florida seeking information with respect to an investigation relating to Medicare billing and possible financial inducements in connection with a Florida physician who is not an AmeriPath pathologist but is a client of AmeriPath. In addition, certain affiliates of the Company have received an investigative subpoena from the Florida Attorney General Medicaid Fraud Control Unit requesting copies of agreements that we have with certain hospitals and certain patient records. To our knowledge, numerous other hospitals and facilities have received similar subpoenas, which may indicate a state-wide audit of pathology operations. The Company is providing information to both the United States Attorney s Office and the Florida Attorney General s Office and intends to cooperate in the investigations. It is not possible at this point in either investigation to determine whether the government will pursue action against AmeriPath or to assess the merits of possible defenses AmeriPath might have to any such action. Accordingly, no assurances can be given regarding the ultimate outcome of these investigations.

Note 9 Comprehensive Income

In accordance with SFAS No. 130, *Reporting Comprehensive Income* (SFAS 130), the Company is required to report and display certain information related to comprehensive income. For the nine months ended September 30, 2005 and 2004, net income equaled comprehensive income.

Note 10 Segment Reporting

The company operates in one reportable segment, the medical laboratory industry. Medical laboratories offer a broad range of testing services to the medical profession. The company s testing services are categorized based upon the nature of the test: Anatomic Pathology testing and Dermatopathology testing. These testing services are used by physicians in the diagnosis, prognosis, monitoring and general management of diseases and other clinical conditions. The tests included in such services generally detect medically-significant abnormalities and visual patterns in blood, tissue samples and other specimens.

Note 11 Income Taxes

The Company s effective income tax rate was 39.8% and 41.4% for the nine month periods ended September 30, 2005 and 2004, respectively.

Note 12 Merger Agreement with Specialty Laboratories, Inc.

On September 30, 2005, the Company announced that it had entered into an Agreement and Plan of Merger, dated as of September 29, 2005, among AmeriPath Holdings, Inc., a Delaware corporation, the Company, Specialty Laboratories, Inc., a California corporation and Silver Acquisition Corp., a California corporation and a wholly owned subsidiary of the Company. Under the terms of the merger agreement, which was unanimously approved by the Company s board of directors, the Company will acquire all common shares of Specialty Laboratories, Inc. common stock outstanding at closing for $13.25 per share. The Company expects to complete the transaction during the first quarter of 2006. The foregoing description does not purport to be a complete statement of the parties rights and obligations under the merger agreement and the transactions contemplated thereby or a complete explanation of the material terms thereof. For additional information about the merger, see Management s Discussion and Analysis of Financial Condition and Results of Operations.

Table of Contents

Note 13 Subsequent Events

In connection with the merger with Specialty Laboratories, Inc., the Company plans to refinance its senior secured credit facility. On September 29, 2005, the Company received a commitment letter pursuant to which Wachovia Bank, National Association, Citigroup Global Markets Inc., Deutsche Bank Trust Company Americas and UBS Loan Finance LLC have committed, subject to the terms and conditions set forth in the commitment letter, to provide the Company with up to $298.5 million in senior secured credit facilities, consisting of a $203.5 million term loan and a $95.0 million revolving credit facility. It is contemplated that up to $203.5 million of the term loan and up to $52.0 million of the revolving credit facility may be used to fund a portion of the merger consideration, to pay certain transaction costs, to refinance existing indebtedness of the Company and to pay related expenses. The balance of the revolving credit facility will be available to fund ongoing working capital needs. Such refinancing will only occur if and when the merger is consummated.

On October 3, 2005, the Company made its semi-annual interest payment on the Senior Subordinated Notes of approximately $18.4 million

On October 3, 2005, the Company borrowed $12.0 million on its revolving credit facility.

On October 28, 2005, the Company increased its investment in preferred stock of Molecular Profiling Institute Inc. by investing an additional $2.5 million.

Note 14 Guarantor Subsidiaries

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

The following tables present condensed consolidated financial information at September 30, 2005 and 2004 for (i) AmeriPath, (ii) on a combined basis, the subsidiaries of AmeriPath that are guarantors of the Company s 10 1/2% Senior Subordinated Notes due 2013 (the Subsidiary Guarantors) and (iii) on a combined basis, the subsidiaries of AmeriPath that are not guarantors of the Company s 10 1/2% Senior Subordinated Notes due 2013 (the Non-Guarantor Subsidiaries). The maximum potential amount of future payments the Subsidiary Guarantors could be required to make under the Guarantee is $350.0 million. There is no recourse available to the Subsidiary Guarantors from any third parties.

Condensed Consolidating Balance Sheets:

As of September 30, 2005	AmeriPath, Inc.	Subsidiary Guarantors	Non Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
Assets					
Current assets:					
Cash and cash equivalents	$	$ 2,431	$ 436		$ 2,867
Restricted cash		27,027			27,027
Accounts receivable, net	979	64,621	20,127		85,727
Inventories	246	1,898			2,144
Other current assets	1,263	13,114	4,534		18,911
Total current assets	2,488	109,091	25,097		136,676
Property & equipment, net	12,211	32,961			45,172
Goodwill		466,444	134,488		600,932
Identifiable intangibles, net	16,995	118,910	32,754		168,659
Investment in subsidiaries	721,258	(6,632)		(714,626)	
Other assets	16,126	5,684	1,381		23,191
Total assets	$ 769,078	$ 726,458	$ 193,720	$ (714,626)	$ 974,630
Liabilities and Stockholder s Equity					
Current liabilities:					
Accounts payable and accrued expenses	$ 31,256	$ 35,520	$ 6,487		$ 73,263
Current portion of long-term debt	330	67			397
Other current liabilities		245			245
Total current liabilities	31,586	35,832	6,487		73,905
Long-term debt	474,909	160			475,069
Other liabilities	2,473	29,555	376		32,404
Deferred tax liabilities, net	535	18,689	(3,320)		15,904
Total long-term liabilities	477,917	48,404	(2,944)		523,377
Intercompany payable (receivable)	326,911	(311,710)	(15,201)		
Stockholder s equity:					
Common stock	(1,272)	1,271	25	(23)	1
Additional paid-in capital	329,715	29,547	2,991		362,253
Retained earnings (deficit)	(395,779)	923,114	202,362	(714,603)	15,094
Total stockholder s equity	(67,336)	953,932	205,378	(714,626)	377,348
Total liabilities and stockholder s equity	$ 769,078	$ 726,458	$ 193,720	$ (714,626)	$ 974,630

Table of Contents

As of December 31, 2004	AmeriPath, Inc.	Subsidiary Guarantors	Non Guarantor Subsidiaries	Consolidating Adjustments	Consolidated Total
Assets					
Current assets:					
Cash and cash equivalents	$	$ 19,513	$ 1,467		$ 20,980
Restricted cash		17,940			17,940
Accounts receivable, net	32	59,483	17,052		76,567
Inventories	123	2,157	55		2,335
Other current assets	1,040	12,527	4,601		18,168
Total current assets	1,195	111,620	23,175		135,990
Property & equipment, net	5,275	25,586	103		30,964
Goodwill		458,364	133,455		591,819
Identifiable intangibles, net	19,900	127,387	32,616		179,903
Investment in subsidiaries	721,337	(6,632)		(714,705)	
Other assets	18,129	6,216	1,288		25,633
Total assets	$ 765,836	$ 722,541	$ 190,637	$ (714,705)	$ 964,309
Liabilities and Stockholder s Equity					
Current liabilities:					
Accounts payable and accrued expenses	$ 21,596	$ 34,534	$ 5,946		$ 62,076
Current portion of long-term debt		2,682			2,682
Other current liabilities		1,164			1,164
Total current liabilities	21,596	38,380	5,946		65,922
Long-term debt	495,000	171			495,171
Other liabilities	5,128	23,282	810		29,220
Deferred tax liabilities, net	536	18,689	(3,321)		15,904
Total long-term liabilities	500,664	42,142	(2,511)		540,295
Intercompany payable (receivable)	252,842	(257,269)	4,427		
Stockholder s equity:					
Common stock	(1,272)	1,271	25	(23)	1
Additional paid-in capital	318,100	31,633	2,990		352,723
Retained earnings (deficit)	(326,094)	866,384	179,760	(714,682)	5,368
Total stockholder s equity	(9,266)	899,288	182,775	(714,705)	358,092
Total liabilities and stockholder s equity	$ 765,836	$ 722,541	$ 190,637	$ (714,705)	$ 964,309

Table of Contents

Condensed Consolidating Statements of Income:

For the nine months ended September 30, 2005	AmeriPath, Inc.	Subsidiary Guarantors	Non Guarantor Subsidiaries	Consolidated Total
Net revenues	$	$ 330,839	$ 90,227	$ 421,066
Costs of services		(189,109)	(35,462)	(224,571)
Selling, general and administrative expense	(3,858)	(115,127)	(15,171)	(134,156)
Loss (gain) on sale of managed practice	(1,090)	207		(883)
Amortization expense		(7,472)	(974)	(8,446)
Total operating costs and expenses	(4,948)	(311,501)	(51,607)	(368,056)
(Loss) income from operations	(4,948)	19,338	38,620	53,010
Other income (expenses):				
Interest expense	(36,126)	(146)		(36,272)
Write-off of deferred financing costs	(468)			(468)
Management fee (A)		38,619	(38,619)	
Change in value of derivative	(512)			(512)
Other income, net	36	371	(1)	406
Total other (expenses) income	(37,070)	38,844	(38,620)	(36,846)
(Loss) income before income taxes	(42,018)	58,182		16,164
Benefit (provision) for income taxes	16,723	(23,161)		(6,438)
Net (loss) income	$ (25,295)	$ 35,021	$	$ 9,726

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

For the nine months ended September 30, 2004	AmeriPath, Inc.	Subsidiary Guarantors	Non Guarantor Subsidiaries	Consolidated Total
Net revenues	$	$ 293,675	$ 85,154	$ 378,829
Cost of services		(165,972)	(33,443)	(199,415)
Selling, general and administrative expense	(5,621)	(107,349)	(14,584)	(127,554)
Amortization expense		(7,362)	(959)	(8,321)
Asset impairment & related charges			(586)	(586)
Total operating costs and expenses	(5,621)	(280,683)	(49,572)	(335,876)
(Loss) income from operations	(5,621)	12,992	35,582	42,953
Other income (expense):				
Interest expense	(33,114)	(183)		(33,297)
Management fee (A)		35,597	(35,597)	
Change in value of derivative	(764)			(764)

Write-off of deferred financing costs	(3,829)			(3,829)
Other income, net	73	204	15	292
Total other (expenses) income	(37,634)	35,618	(35,582)	(37,598)
(Loss) income before income taxes	(43,255)	48,610		5,355
Benefit (provision) for income taxes	16,748	(18,967)		(2,219)
Net (loss) income	$ (26,507)	$ 29,643	$	$ 3,136

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

Table of Contents

Condensed Consolidating Statements of Cash Flows:

For the nine months ended September 30, 2005	AmeriPath, Inc.	Subsidiary Guarantors	Non Guarantor Subsidiaries	Consolidated Total
Cash flows from operating activities:				
Net (loss) income	$ (25,295)	$ 35,021	$	$ 9,726
Adjustments to reconcile net (loss) income to net cash provided by operating activities	4,630	58,690	11,118	74,438
Changes in assets and liabilities, net of effects of acquisitions	39,366	(82,006)	(10,181)	(52,821)
Net cash provided by operating activities	18,701	11,705	937	31,343
Net cash used in investing activities	(7,253)	(26,828)	(1,968)	(36,049)
Net cash used in financing activities	(11,448)	(1,959)		(13,407)
Decrease in cash and cash equivalents		(17,082)	(1,031)	(18,113)
Cash and cash equivalents, beginning of period		19,513	1,467	20,980
Cash and cash equivalents, end of period	$	$ 2,431	$ 436	$ 2,867

For the nine months ended September 30, 2004	AmeriPath, Inc.	Subsidiary Guarantors	Non Guarantor Subsidiaries	Consolidated Total
Cash flows from operating activities:				
Net (loss) income	$ (26,507)	$ 29,643	$	$ 3,136
Adjustments to reconcile net (loss) income to net cash provided by operating activities	6,899	60,281	13,021	80,201
Changes in assets and liabilities, net of effects of acquisitions	38,812	(66,981)	(11,946)	(40,115)
Net cash provided by operating activities	19,204	22,943	1,075	43,222
Net cash used in investing activities	(1,552)	(24,249)	(1,295)	(27,096)
Net cash used in financing activities	(17,652)	(1,253)		(18,905)
Decrease in cash and equivalents		(2,559)	(220)	(2,779)
Cash and cash equivalents, beginning of period		22,652	884	23,536
Cash and cash equivalents, end of period	$	$ 20,093	$ 664	$ 20,757

Table of Contents

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

General

The condensed consolidated financial statements contained in Item 1 include the accounts of AmeriPath, Inc. and subsidiaries (collectively, AmeriPath or the Company) as of and for the three and nine months ended September 30, 2005 and 2004.

The following discussion of our financial condition and results of operations should be read together with our condensed consolidated financial statements and the accompanying notes included elsewhere in Item 1. Our fiscal year is the calendar year ending December 31.

AmeriPath is one of the leading anatomic pathology laboratory companies in the United States. We offer a broad range of anatomic pathology laboratory testing and information services used by physicians in the detection, diagnosis, evaluation and treatment of cancer and other diseases and medical conditions. We service an extensive referring physician base through our 15 regional laboratories and 41 satellite laboratories, and we provide inpatient diagnostic and medical director services at more than 200 hospitals. Our services are performed by over 430 pathologists.

Because the laws of many states restrict corporations from directly employing physicians or owning corporations that employ physicians, we often conduct our business through affiliated entities that we manage and control but do not own. In states where we are under these restrictions, we perform only non-medical administrative and support services, do not represent to the public or our clients that we offer medical services and do not exercise influence or control over the practice of medicine by our physicians. Because of the degree of non-medical managerial control we exercise over our affiliated entities, we consolidate the financial results of these entities with those of our wholly-owned operations. We collectively refer to these consolidated entities and our wholly-owned operations as our owned operations. In addition, we have also entered into management agreements with a few anatomic pathology laboratory operations over which we do not exercise non-medical managerial control and, accordingly, do not consolidate with our owned operations. We refer to these operations as our managed operations. For the nine months ended September 30, 2005, our revenues from owned operations and managed operations accounted for 96.7% and 3.3% of our total net revenues, respectively.

Acquisitions. We did not make any acquisitions during the first nine months of 2005. During the first nine months of 2004, we acquired one hospital-based practice in Bountiful, Utah. The total consideration paid by us in connection with this acquisition included cash and contingent notes. During the nine months ended September 30, 2005 and 2004, we made contingent note payments of approximately $9.9 million and $11.0 million respectively, relating to previous acquisitions.

Medical Malpractice Insurance Costs. In June 2002, we replaced our existing medical malpractice insurance coverage by third party insurance companies with a new self-insurance, or captive, arrangement. We entered into this self-insurance arrangement because we were unable to renew our existing coverage at acceptable rates, which we believe was an industry-wide situation. Under our self-insurance structure, we retain more risk for medical malpractice costs, including settlements and claims expenses, than under our previous coverage. While we have obtained excess liability coverage for medical malpractice costs, we have no aggregate excess stop loss protection, meaning there is no aggregate limitation on the amount of risk we retain under these arrangements. Our medical malpractice costs are based on actuarial estimates of our medical malpractice settlement and claims expense and the costs of maintaining our captive insurance program and excess coverage. We periodically review and update the appropriateness of our accrued liability for medical malpractice costs. Because we retain these risks, in addition to an actual increase in claims or related expenses, a change in the actuarial assumptions upon which our medical malpractice costs are based could materially affect results of operations in a particular period even if we do not experience an actual increase in claims or related expenses. For the nine months ended September 30, 2005 and 2004, our medical malpractice costs were approximately $10.8 million and $9.9 million,

respectively.

Merger Agreement with Specialty Laboratories, Inc. On September 30, 2005, the Company announced that it had entered into an Agreement and Plan of Merger, dated as of September 29, 2005 (the Merger Agreement), among AmeriPath Holdings, Inc., a Delaware corporation (Parent), the Company, Specialty Laboratories, Inc., a California corporation (Specialty) and Silver Acquisition Corp., a California corporation and a wholly owned subsidiary of the Company (Merger Sub).

The Merger Agreement contemplates that Merger Sub will be merged with and into Specialty (the Merger), with Specialty as the surviving corporation. Pursuant to the Merger Agreement, at the effective time of the Merger, each issued and outstanding share of common stock of Specialty (Specialty Common Stock), other than shares of Specialty Common Stock held in treasury, or held by Parent or any direct or indirect wholly owned subsidiary of Parent or Specialty, or held by stockholders who are entitled to and properly exercise dissent rights under California law, will be converted into the right to receive $13.25 in cash. Pursuant to the Merger Agreement, each outstanding option to purchase a share of Specialty Common Stock will be entitled to receive, unless otherwise provided in an applicable agreement with the optionee, the difference between the exercise price of the option and $13.25.

Table of Contents

Simultaneously with the execution of the Merger Agreement, Parent, Specialty Family Limited Partnership, the majority stockholder of Specialty (SFLP), and related parties (collectively with SFLP, the Founder Parties) entered into a Voting Agreement (the Voting Agreement) pursuant to which, among other things, the Founder Parties agreed to vote in favor of the Merger and to vote against competing transactions unless the Merger Agreement is terminated. Upon termination of the Merger Agreement in certain circumstances, and the subsequent consummation of an alternative transaction, the Founder Parties will be required to pay to Parent 50% of any increase in consideration paid to the Founder Parties in respect of their shares of Specialty Common Stock over the amounts that would be otherwise payable pursuant to the Merger Agreement. The Founder Parties also granted an irrevocable proxy to representatives of Parent to vote on the Merger and other matters governed by the Voting Agreement. The provisions of the Voting Agreement apply to all shares of Specialty Common Stock held by the Founder Parties. The Founder Parties disclosed in the Voting Agreement that they hold 14,435,663 shares of Specialty Common Stock, which represents approximately 60% of the issued and outstanding Specialty Common Stock.

Simultaneously with the execution of the Merger Agreement, Parent, AmeriPath Group Holdings, Inc., a Delaware corporation and a wholly-owned subsidiary of Parent (Holdings), Aqua Acquisition Corp., a Delaware corporation and a wholly-owned subsidiary of Holdings (Parent Merger Sub), certain stockholders of Parent (the Parent Stockholders) and certain of the Founder Parties (including SFLP) entered into a Subscription, Merger and Exchange Agreement (the SME Agreement). Pursuant to the SME Agreement, (a) Holdings will issue shares of the common stock, par value $0.01 per share, of Holdings (Holdings Common Stock) and shares of Series A participating preferred stock, par value $0.001 per share, of Holdings (Holdings Preferred Stock) to the Parent Stockholders in exchange for cash and for shares of the common stock, par value $0.01 per share, of Parent and (b) Holdings will issue shares of Holdings Common Stock and Holdings Preferred Stock to the Founder Parties party to the SME Agreement in exchange for 9,025,000 shares of Specialty Common Stock held by such Founder Parties. Also pursuant to the SME Agreement, Parent Merger Sub will be merged with and into Parent and the remaining stockholders of Parent will have the right to receive the amount of cash set forth in the SME Agreement. As a result of this merger, Parent will become a wholly-owned subsidiary of Holdings.

The consummation of the Merger is subject to various conditions, including (i) approval of the principal terms of the Merger by the affirmative vote of the holders of a majority of the outstanding shares of Specialty Common Stock, as well as by the holders of a majority of the outstanding shares of Specialty Common Stock not held by the Founder Parties or their affiliates, (ii) receipt of required regulatory approvals, including the expiration or termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act, (iii) the absence of certain legal impediments to the consummation of the Merger, (iii) accuracy of representations and warranties and compliance with covenants, (iv) absence of a material adverse effect on Specialty, (v) receipt of financing pursuant to a bank commitment letter that the Company received on September 29, 2005, and (vi) the exercise of dissent rights with respect to no more than 10% of the outstanding Specialty Common Stock. The Company intends to finance the Merger using a combination of cash, equity and debt.

The foregoing description does not purport to be a complete statement of the parties rights and obligations under the Merger Agreement, the Voting Agreement or the SME Agreement and the transactions contemplated thereby or a complete explanation of the material terms thereof. The foregoing description is qualified in its entirety by reference to the Merger Agreement, the SME Agreement and the Voting Agreement which were filed as exhibits to the Company s Current Report on Form 8-K with the SEC on October 4, 2005, and are incorporated herein by reference.

Financial Statement Presentation

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

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

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

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

Table of Contents

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

Amortization expense. Our acquisitions have resulted in significant net identifiable intangible assets and goodwill. We record net identifiable intangible assets at fair value on the date of acquisition. Effective January 1, 2002, we adopted Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets,* which required us to cease amortizing goodwill and to perform an annual impairment analysis to assess the recoverability of goodwill. The results of the 2004 annual impairment test indicated no impairment of goodwill or other indefinite lived intangibles. We continually evaluate whether events or circumstances have occurred that may warrant revisions to the carrying values of our goodwill and other identifiable intangible assets or to the estimated useful lives assigned to such assets. Any significant impairment recorded on the carrying values of our goodwill or other identifiable intangible assets would be recorded as a charge to the income statement and a reduction of intangible assets and could materially reduce our profitability in the period in which the charge is recorded.

Critical Accounting Policies

Our critical accounting policies remain consistent with those reported in our Annual Report on Form 10-K for the year ended December 31, 2004.

Principles of Consolidation

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

Segments

The company operates in one reportable segment, the medical laboratory industry. Medical laboratories offer a broad range of testing services to the medical profession. We determine our segments based upon SFAS No. 131, *Disclosures about Segments of an Enterprise.* In previous filings the Company had listed two reportable segments, owned operations and managed operations. With the sale of two of our managed operations, the managed operation is no longer material and does not meet the definition of a reportable segment.

Table of Contents

Results of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net revenues	100.0%	100.0%	100.0%	100.0%
Operating costs and expenses:				
Costs of services	53.5%	53.1%	53.3%	52.6%
Selling, general and administrative expenses	19.1%	17.1%	18.9%	18.3%
Provision for doubtful accounts	12.6%	17.6%	12.9%	15.4%
Amortization expense	1.9%	2.2%	2.1%	2.2%
Loss on sale of managed practice	0.9%		0.2%	
Asset impairment and related charges				0.2%
Total operating costs and expenses	88.0%	90.0%	87.4%	88.7%
Income from operations	12.0%	10.0%	12.6%	11.3%
Interest expense	(8.5)%	(8.7)%	(8.6)%	(8.8)%
Write-off of deferred financing costs	(0.1)%		(0.1)%	(1.0)%
Change in value of derivative	(0.2)%	0.4%	(0.2)%	(0.2)%
Other income, net	0.1%	0.1%	0.1%	0.1%
Income before income taxes	3.3%	1.8%	3.8%	1.4%
Provision for income taxes	1.3%	0.8%	1.5%	0.6%
Net income	2.0%	1.0%	2.3%	0.8%

Net Revenues.

Net revenues increased by $15.9 million, or 12.5%, to $143.6 million for the three months ended September 30, 2005 from $127.7 million for the three months ended September 30, 2004. Same store net revenue increased $10.4 million or 8.3% to $135.5 million for the three months ended September 30, 2005 from $125.1 million for the three months ended September 30, 2004.

Net revenues increased by $42.3 million, or 11.1%, to $421.1 million for the nine months ended September 30, 2005 from $378.8 million for the nine months ended September 30, 2004. Same store net revenue increased $26.2 million or 7.0% to $399.5 million for the nine months ended September 30, 2005 from $373.3 million for the nine months ended September 30, 2004.

Costs of Services.

Costs of services increased by $9.0 million, or 13.3%, to $76.8 million for the three months ended September 30, 2005 from $67.8 million for the three months ended September 30, 2004. Costs of services as a percentage of net revenues increased to 53.5% for the three months ended September 30, 2005 from 53.1% for the three months ended September 30, 2004. Gross margin decreased to 46.5% for the three months ended September 30, 2005 from 46.9% for the three months ended September 30, 2004.

Costs of services increased by $25.2 million, or 12.6%, to $224.6 million for the nine months ended September 30, 2005 from $199.4 million for the nine months ended September 30, 2004. Costs of services as a percentage of net revenues increased to 53.3% for the nine months ended September 30, 2005 from 52.6% for the nine months ended September 30, 2004. The increase in costs of services as a percentage of net revenues is primarily due to increased physician compensation and increased courier and distribution costs associated with the increased revenue from physicians offices. Gross margin decreased to 46.7% for the nine months ended September 30, 2005 from 47.4% for the nine months ended September 30, 2004.

Table of Contents

Selling, General and Administrative Expenses.

Selling, general and administrative expenses increased by $5.5 million to $27.3 million for the three months ended September 30, 2005 from $21.8 million for the three months ended September 30, 2004. As a percentage of net revenues, selling, general and administrative expenses increased to 19.1% for the three months ended September 30, 2005 from 17.1% for the three months ended September 30, 2004.

Selling, general and administrative expenses increased by $10.4 million to $79.7 million for the nine months ended September 30, 2005 from $69.3 million for the nine months ended September 30, 2004. As a percentage of net revenues, selling, general and administrative expenses increased to 18.9% for the nine months ended September 30, 2005 from 18.3% for the nine months ended September 30, 2004. Selling, general and administrative expenses for the nine months of 2004 included severance of approximately $1.4 million for the Company s former Chief Executive Officer. The increases are primarily due to increased investments in information technology and expansion of sales and marketing efforts.

Provision for Doubtful Accounts.

Our provision for doubtful accounts decreased by $4.5 million to $18.0 million for the three months ended September 30, 2005 from $22.5 million for the same period of 2004. The provision for doubtful accounts as a percentage of net revenues decreased to 12.6% for the three months ended September 30, 2005 from 17.6% for the same period of 2004.

Our provision for doubtful accounts decreased by $3.8 million to $54.5 million for the nine months ended September 30, 2005 from $58.3 million for the same period of 2004. The provision for doubtful accounts as a percentage of net revenues decreased to 12.9% for the nine months ended September 30, 2005 from 15.4% for the same period of 2004.

Amortization Expense.

Amortization expense remained constant at $2.8 million for the three months ended both September 30, 2005 and 2004.

Amortization expense increased slightly to $8.4 million for the nine months ended September 30, 2005 from $8.3 million for the same period in 2004.

Asset Impairment and Related Charges.

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

Interest Expense.

Interest expense increased by $1.1 million to $12.2 million for the three months ended September 30, 2005 from $11.1 million for the three months ended September 30, 2004. Our effective interest rate was 10.2% and 9.5% for the three months ended September 30, 2005 and 2004, respectively.

Interest expense increased by $3.0 million to $36.3 million for the nine months ended September 30, 2005 from $33.3 million for the nine months ended September 30, 2004. Our effective interest rate was 9.9% and 9.3% for the nine months ended September 30, 2005 and 2004, respectively.

Write-off of Deferred Financing Costs.

In April 2005, the Company wrote-off approximately $0.2 million of its deferred debt financing costs as a result of a $6.3 million voluntary prepayment of the term loan facility. In June 2005, the Company wrote-off approximately $0.1 million of its deferred debt financing costs as a result of a $5.0 million voluntary prepayment of the term loan facility. In August 2005, the Company wrote-off approximately $0.1 million of its deferred debt financing costs as a result of a $4.3 million voluntary prepayment of the term loan facility.

In February 2004, the Company wrote-off a portion of the balance of its deferred debt financing costs totaling approximately $3.5 million related to the amendment of its term B credit facility and the related reduction in the facility from $225.0 million to $125.0 million. The remaining balance is being amortized over the life of the term loan facility.

Table of Contents

Loss on Sale of Managed Practice.

In August 2005, the Company sold its managed practice in Memphis, Tennessee. As a result of the sale, the Company recognized a loss of approximately $1.3 million. As a result of the sale and termination of the Memphis managed service agreement, the Company performed an impairment analysis relative to the carrying value of this identifiable intangible and determined that no impairment existed at September 30, 2005.

In February 2005, the Company sold a managed practice in Los Gatos, California resulting in a gain of approximately $0.5 million**.**

Change in Value of Derivative.

In April 2004, the Company entered into a 2 1/2 year interest rate swap transaction with a notional amount of $75.0 million. The market valuation is performed quarterly by an independent third party and the change in market value of the derivative instrument is recognized in the condensed consolidated statements of income. For the nine months ended September 30, 2005, the Company recognized a $0.5 million loss in the value of the derivative. For the nine months ended September 30, 2004, the Company recognized a $0.8 million loss in the value of the derivative.

Provision for Income Taxes.

Our effective income tax rate was 39.8% and 44.5% for the three month period ended September 30, 2005 and 2004, respectively.

Our effective income tax rate was 39.8% and 41.4% for the nine month period ended September 30, 2005 and 2004, respectively.

Net Income.

Net income for the three months ended September 30, 2005, was $2.9 million compared with net income of $1.3 million for the three months ended September 30, 2004.

Net income for the nine months ended September 30, 2005, was $9.7 million compared with net income of $3.1 million for the nine months ended September 30, 2004.

Liquidity and Capital Resources

At September 30, 2005, we had working capital of approximately $62.8 million, a decrease of $7.3 million from working capital of $70.1 million at December 31, 2004.

Net cash provided by operating activities was $31.3 million and $43.2 million for the nine months ended September 30, 2005 and 2004, respectively. For the nine months ended September 30, 2005, cash flows from operations were primarily used to acquire property and equipment and to make prepayments on our outstanding debt.

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

The interest rates per annum applicable to loans under our Credit Facility are, at our option, equal to either an alternate base rate or an adjusted LIBOR rate for a one, two, three or six month interest period chosen by us, or a nine or twelve month period if agreed to by all participating lenders, in each case, plus an applicable margin percentage. The interest rate at September 30, 2005 was approximately 7.1%. The Credit Facility also requires a commitment fee to be paid quarterly equal to 0.5% of any unused commitments under the revolving loan facility.

The Credit Facility required scheduled quarterly payments on the term loan in amounts equal to $312,500 on every June 30, September 30, December 31 and March 31, beginning on June 30, 2004. On June 30, 2004, we made the mandatory payment of $312,500 and also made a voluntary prepayment of $9,687,500. The voluntary prepayment was applied chronologically to the future mandatory quarterly payments. Therefore, the next mandatory payment on the facility will not be due until 2009.

Table of Contents

On March 27, 2003, in connection with the March 2003 Transaction, Amy Acquisition Corp. issued $275.0 million of 10 1/2% Senior Subordinated Notes due 2013. We assumed Amy Acquisition Corp. s obligations under these notes upon consummation of the March 2003 Transaction. Interest became payable semi-annually in arrears beginning in October 2003. In February 2004, we issued an additional $75.0 million of our 10 1/2% Senior Subordinated Notes due 2013 at a premium price of 106%. The notes are unconditionally guaranteed, jointly and severally and on an unsecured senior subordinated basis, by certain of our current and former subsidiaries. The notes and guarantees rank junior to all of our and the guarantors existing and future senior indebtedness, on par with all of our and the guarantors existing and future senior subordinated indebtedness and senior to all of our and the guarantors existing and future subordinated indebtedness. We may redeem any of the notes at any time and from time to time beginning on April 1, 2008, in whole or in part, in cash at the specified redemption prices, plus accrued and unpaid interest to the date of redemption.

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

In connection with our acquisitions prior to the March 2003 Transaction, we generally agreed to pay a base purchase price plus additional contingent purchase price consideration to the sellers of the acquired operations. The additional payments generally were contingent upon the achievement of specified levels of income from operations (as defined by the specific purchase agreements with the seller) by the acquired operations over periods of three to five years from the date of acquisition. In certain cases, the payments were contingent upon other factors such as the retention of certain hospital contracts or relationships for periods ranging from three to five years. The amount of the payments cannot be determined until the final determination of the income from operations levels or other performance targets during the relevant periods of the respective agreements. If the maximum specified levels of income from operations for all acquired operations are achieved, we estimate that we would make aggregate maximum principal payments of approximately $26.4 million over the next four years. A lesser amount or no payments at all would be made if the stipulated levels of income from operations or other evaluation factors specified in each agreement were not met. During the first nine months of 2005, we made contingent note payments, including interest, aggregating $9.9 million. In addition, we intend to fund future payments under our contingent payment obligations relating to acquisitions completed prior to the March 2003 Transaction from contributions made to us by Holdings out of the funds from the remaining cash collateral account balance of $29.3 million and, if needed, cash flows from operations. We do not expect to use contingent notes on future acquisitions.

Historically, our capital expenditures have been primarily for laboratory equipment, information technology equipment and leasehold improvements. Total capital expenditures were $22.1 million and $7.3 million for the nine months ended September 30, 2005 and 2004, respectively.

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

In connection with the merger with Specialty, we plan to refinance the Credit Facility. On September 29, 2005, we previously received a commitment letter pursuant to which Wachovia Bank, National Association, Citigroup Global Markets Inc., Deutsche Bank Trust Company Americas and UBS Loan Finance LLC have committed, subject to the terms and conditions set forth in the commitment letter, to provide us with up to $298.5 million in senior secured credit facilities, consisting of a $203.5 million term loan and a $95.0 million revolving credit facility. It is contemplated that up to $203.5 million of the term loan and up to $52.0 million of the revolving credit facility may be used to fund a portion of the merger consideration, to pay certain transaction costs, to refinance existing indebtedness of AmeriPath and to pay related expenses. The balance of the revolving credit facility will be available to fund ongoing working capital needs. Such refinancing will only occur if and when the Merger is consummated.

Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of September 30, 2005.

Table of Contents

Contractual Obligations

The following is a summary of our contractual cash obligations, excluding contingent note payments, as of September 30, 2005, for our term loan, our revolver loan, other indebtedness and senior subordinated notes, and as of December 31, 2004 for our operating leases, the balance of which has not changed substantially since year end:

	Payments Due By Period (in millions)				
Contractual Obligations	**1 year**	**1-2 years**	**3-5 years**	**After 5 years**	**Total**
Term loan	$	$	$ 99.0	$	$ 99.0
Revolver loan			25.0		25.0
Other indebtedness	0.5	0.1			0.6
Operating leases	7.5	6.5	14.9	18.1	47.0
Senior subordinated notes				350.0	350.0
Total contractual cash obligations	$ 8.0	$ 6.6	$ 138.9	$ 368.1	$ 521.6

Interest Rate Risk

The Company is subject to market risk associated principally with changes in interest rates. Our principal interest rate exposure relates to the amount outstanding under the Company s credit facility. The balances outstanding under the credit facility are at floating rates. Based on the outstanding credit facility balance of $124.0 million at September 30, 2005, each quarter point increase or decrease in the floating rate increases or decreases interest expense by approximately $0.3 million per year.

In April 2004, the Company entered into a 2 1/2 year interest rate swap transaction which involves the exchange of fixed for floating rate interest payments without the exchange of the underlying principal amount. The interest differential to be paid or received is accrued and is recognized as an adjustment to interest expense. The change in the market value of the derivative instrument is recognized in the condensed consolidated statements of income. For the nine months ended September 30, 2005, the change in the value of the derivative was a loss of approximately $0.5 million. The agreement has a notional amount of $75.0 million. The Company receives interest on the notional amount if the LIBOR rate is less than 2.405% and pays interest on the notional amount if the LIBOR rate exceeds 2.405%. The floating rate resets every October 1 and April 1. In August 2004, the Company locked in to a forward LIBOR rate contract for October 2004 through March 2005 at a rate of 2.08%. In April 2005, the floating rate reset at 3.39% until October 2005. This derivative instrument is being used by the Company to reduce interest rate volatility and associated risks arising from the fixed rate structure of our Senior Subordinated Notes, and is not held or issued for trading purposes.

Inflation

Inflation was not a material factor in either revenues or operating expenses during the first nine months of 2005.

21

Table of Contents

Qualification of Forward-Looking Statements

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

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

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

Table of Contents

RISK FACTORS

The risks described below are not the only ones we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially and adversely affect our business, financial condition or results of operations. Any of the following risks could materially and adversely affect our business, financial condition or results of operations.

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

We have a significant amount of indebtedness. As of September 30, 2005, our total debt was $475.5 million, excluding unused revolving loan commitments under our senior credit facility, which would have represented approximately 55.8% of our total anticipated capitalization. This debt does not include our obligations under our existing contingent notes.

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

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

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

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

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

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

incur additional debt,

pay dividends and make restricted payments,

create liens,

use the proceeds from sales of assets and subsidiary stock,

enter into sale and leaseback transactions,

make capital expenditures,

change our business,

enter into transactions with affiliates and

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

Table of Contents

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

- incur additional debt,
- pay dividends or purchase our capital stock,
- make investments,
- enter into transactions with affiliates,
- sell or otherwise dispose of assets and
- merge or consolidate with another entity.

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

- a minimum interest coverage ratio,
- a minimum fixed charge coverage ratio and
- a maximum senior leverage ratio.

These financial covenants will become more restrictive over time.

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

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

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

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

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

federal and state anti-kickback laws,

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

federal and state false claims laws,

Table of Contents

state laws regarding prohibitions on the corporate practice of medicine,

state laws regarding prohibitions on fee-splitting,

federal and state anti-trust laws,

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

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

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

These laws and regulations are extremely complex. In many instances, the industry does not have the benefit of significant regulatory or judicial interpretation of these laws and regulations. It also is possible that the courts could ultimately interpret these laws in a manner that is different from our interpretations. While we believe that we are currently in material compliance with applicable laws and regulations, a determination that we have violated these laws, or the public announcement that we are being investigated for possible violations of these laws, would have an adverse effect on our business, financial condition and results of operations. For a more complete description of these regulations, see Business Government Regulation in our Form 10-K for the year ended December 31, 2004.

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

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

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

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

Federal and state anti-kickback laws prohibit the offer, solicitation, payment and receipt of remuneration in exchange for referrals of products and services for which payment may be made by Medicare, Medicaid or other federal and state healthcare programs. Federal and state

anti-referral laws, including the Stark Law, prohibit physicians from referring their patients to healthcare providers with which the physicians or their immediate family members have a financial relationship for designated services when such services are subject to reimbursement by Medicare or Medicaid. A violation of any of these laws could result in monetary fines, civil and criminal penalties and exclusion from participation in Medicare, Medicaid and other federal or state healthcare programs, which accounted for approximately 22% of our revenues during the first nine months of 2005.

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

Table of Contents

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

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

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

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

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

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

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

Government programs account for approximately 22% of our revenues, so a decline in reimbursement rates from government programs would harm our revenues and profitability.

We derived approximately 22% of our net revenue during the first nine months of 2005 from payments made by government programs, principally Medicare and Medicaid. These programs are subject to substantial regulation by federal and state governments. Any changes in reimbursement policies, practices, interpretations or statutes that place limitations on reimbursement amounts or change reimbursement coding practices could materially harm our business by reducing revenues and lowering profitability. Increasing budgetary pressures at both the federal and state levels and concerns over escalating costs of healthcare have led, and may continue to lead, to significant reductions in healthcare reimbursements, which would have an adverse effect on our business, financial condition and results of operations.

Table of Contents

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

Substantially all of our net revenues are derived from services for which our operations charge on a fee-for-service basis. Accordingly, we assume the financial risk related to collection, including potential write-offs of doubtful accounts, and long collection cycles for accounts receivable, including reimbursements by third-party payors, such as governmental programs, private insurance plans and managed care organizations. Our provision for doubtful accounts for the first nine months of 2005 was 12.9% of net revenues. If our revenue from hospital-based services increases as a percentage of our total net revenues, our provision for doubtful accounts as a percentage of total net revenues may increase. Increases in write-offs of doubtful accounts, delays in receiving payments or potential retroactive adjustments and penalties resulting from audits by payors could have an adverse effect on our business, financial condition and results of operations.

In addition to services billed on a fee-for-service basis, our hospital-based pathologists in their capacities as medical directors of hospitals clinical laboratories, microbiology laboratories and blood banking operations bill non-Medicare patients according to a fee schedule for their clinical professional component, or CPC, services. Our historical collection experience for CPC services is significantly lower than other anatomic pathology procedures. See Business-Billing in our Form 10-K for the year ended December 31, 2004. Hospitals and third party payors are continuing to increase pressure to reduce our revenues from CPC services, including but not limited to encouraging their patients not to pay us for such services.

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

The number of individuals covered under managed care contracts or other similar arrangements has grown over the past several years and may continue to grow in the future. In addition, Medicare and Medicaid and other government healthcare programs may continue to shift to managed care. For the nine month periods ended September 30, 2005 and 2004, approximately 55%, and 57%, respectively, of our net revenue was derived from reimbursements from managed care organizations and third party payors. Entities providing managed care coverage have reduced payments for medical services in numerous ways, including entering into arrangements under which payments to a service provider are capitated, limiting testing to specified procedures, denying payment for services performed without prior authorization and refusing to increase fees for specified services. These trends reduce our revenues and limit our ability to pass cost increases to our customers. Also, if these or other managed care organizations do not select us as a participating provider, we may lose some or all of that business, which could have an adverse effect on our business, financial condition and results of operations.

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

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

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

Table of Contents

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

HCA Inc., or HCA, has been under investigation with respect to fraud and abuse issues. As of September 30, 2005, we provided medical director services for 25 HCA hospital laboratories. As a result, the government s investigation of HCA could result in investigations of one or more of our operations. Furthermore, the Company has received subpoenas issued by the United States Attorney s Office in Tampa, Florida seeking information with respect to an investigation relating to Medicare billing and possible financial inducements in connection with a Florida physician who is not an AmeriPath pathologist but was a client of AmeriPath. In addition, certain affiliates of the Company have received an investigative subpoena from the Florida Attorney General Medicaid Fraud Control Unit requesting copies of agreements that we have with certain hospitals and certain patient records. To our knowledge, numerous other hospitals and facilities have received similar subpoenas, which may indicate a state-wide audit of pathology operations. The Company is providing information to both the United States Attorney s Office and the Florida Attorney General s Office and intends to cooperate in the investigations. It is not possible at this point in either investigation to determine whether the government will pursue action against AmeriPath or to assess the merits of possible defenses AmeriPath might have to any such action. Accordingly, no assurances can be given regarding the ultimate outcome of these investigations.

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

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

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

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

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

We perform due diligence investigations with respect to potential liabilities of acquired operations and typically obtain indemnification from the sellers of such operations. Nevertheless, undiscovered claims may arise, and liabilities for which we become responsible may be material and may exceed either the limitations of any applicable indemnification provisions or the financial resources of the indemnifying parties. Claims or liabilities of acquired operations may include matters involving compliance with laws, including healthcare laws. While we believe, based on our due diligence investigations that our acquired operations were generally in compliance with applicable healthcare laws prior to their

acquisition, they may not have been in full compliance and we may become accountable for their non-compliance. A violation of the healthcare laws could result in monetary fines, government recoupment of fees previously paid to us, forfeiture of revenues due to us, or civil and criminal penalties. In such situations, we may also be excluded from participation in Medicare, Medicaid and other federal and state healthcare programs. Any one of these consequences could have an adverse effect on our business, financial condition and results of operations.

Table of Contents

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

In connection with our past acquisitions, we typically have agreed to pay the sellers additional consideration in the form of contingent note obligations. Payment on these contingent notes typically depends upon the financial performance of the acquired operation or the retention of specified hospital contracts over periods ranging from three to five years after the acquisition. The amount of these contingent note payments cannot be determined until the contingency periods terminate and the level of the performance is ascertainable. As of September 30, 2005, if the minimum performance that would result in the maximum amount being payable for existing contingent notes were achieved, we would be obligated to make principal payments of approximately $26.4 million over the next four years. Lesser amounts would be paid if the maximum criteria are not met. Although we believe we will be able to make payments on contingent note obligations existing prior to the March 2003 Transaction from the remaining balance in the cash collateral account held by our parent, it is possible that such payments, or payments on additional contingent notes issued as part of subsequent acquisitions, could cause significant liquidity problems for us.

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

Our acquisitions have resulted in significant increases in net identifiable intangible assets and goodwill. Net identifiable intangible assets, which include hospital contracts, management service agreements and laboratory contracts acquired in acquisitions, were approximately $168.7 million at September 30, 2005, representing approximately 17.3% of our total assets. Goodwill, which relates to the excess of cost over the fair value of the net assets of the businesses acquired, was approximately $600.9 million at September 30, 2005, representing approximately 61.7% of our total assets. Goodwill and net identifiable intangible assets are recorded at fair value on the date of acquisition and, under Financial Accounting Standards Board Statement No. 142, will be reviewed at least annually for impairment. Impairment may result from, among other things, deterioration in performance of the acquired company, adverse market conditions, adverse changes in applicable laws or regulations, including changes that restrict the activities of the acquired business, and a variety of other circumstances. The amount of any impairment must be written off. We evaluated our recorded goodwill and identifiable intangible assets during December 2004, during June 2005 relative to the sale of the Los Gatos practice, and during August 2005 relative to the sale of the Memphis managed practice, and determined that there was no asset impairment charge required with respect to our intangible assets. We may not ever realize the full value of our intangible assets. Any future determination requiring the write-off of a significant portion of intangible assets would have an adverse effect on our financial condition and results of operations.

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

Our business is dependent upon recruiting and retaining pathologists, particularly those with subspecialties, such as dermatopathology, hematopathology, immunopathology and cytopathology. While we have been able to recruit and retain pathologists in the past, we may be unable to continue to do so in the future as competition for the services of pathologists increases. In addition, we may need to provide more compensation to our pathologists in order to enhance our recruitment and retention efforts and may be unable to recover these increased costs through price increases. The relationship between the pathologists and their respective local medical communities is important to the operation and continued profitability of each of our local operations. Loss of even one of our pathologists could lead to the loss of hospital contracts or other sources of revenue derived from our relationship with the pathologist. For the years ending 2002, 2003 and 2004, turnover rates for our pathologists were 8.8%, 13.3% and 8.1%, respectively. If turnover rates were to increase, our revenues and earnings could be adversely affected.

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

Our Chief Executive Officer, Donald E. Steen and a number of the other members of our senior management team have been with our Company for less than two years. Given the limited experience that our new management team has working together, it is possible that these officers will not integrate well within our organization. The failure of our new management team to integrate well within our organization would have a significant effect on our future operations.

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

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

Table of Contents

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

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

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

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

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

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

Among many other factors complicating our billing are:

- disputes between payors as to which party is responsible for payment,

disparity in coverage among various payors, and

difficulty satisfying the specific compliance requirements and CPT coding of and other procedures mandated by various payors.

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

Table of Contents

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

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

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

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

The Company is subject to market risk associated principally with changes in interest rates. Our principal interest rate exposure relates to the amount outstanding under the Company s credit facility. The balances outstanding under the credit facility are at floating rates. Based on the outstanding credit facility balance of $124.0 million at September 30, 2005, each quarter point increase or decrease in the floating rate increases or decreases interest expense by approximately $0.3 million per year.

In April 2004, the Company entered into a 2 1/2 year interest rate swap transaction which involves the exchange of fixed for floating rate interest payments without the exchange of the underlying principal amount. The interest differential to be paid or received is accrued and is recognized as an adjustment to interest expense. The change in the market value of the derivative instrument is recognized in the condensed consolidated statements of income. For the nine months ended September 30, 2005, the change in the value of the derivative was a loss of approximately $0.5 million. The agreement has a notional amount of $75.0 million. The Company receives interest on the notional amount if the LIBOR rate is less than 2.405% and pays interest on the notional amount if the LIBOR rate exceeds 2.405%. The floating rate resets every October 1 and April 1. In August 2004, the Company locked in to a forward LIBOR rate contract for October 2004 through March 2005 at a rate of 2.08%. In April

2005, the floating rate was reset to 3.39% until October 2005. This derivative instrument is being used by the Company to reduce interest rate volatility and associated risks arising from the fixed rate structure of our Senior Subordinated Notes, and is not held or issued for trading purposes.

ITEM 4. CONTROLS AND PROCEDURES

We are currently in the process of reviewing and formalizing our internal controls and procedures for financial reporting in accordance with the SEC s rules implementing the internal control reporting requirements included in Section 404 of the Sarbanes-Oxley Act of 2002. Changes have been and will be made to our internal controls over financial reporting as a result of these efforts. We are dedicating significant resources, including senior management time and effort, in connection with our ongoing Section 404 assessment in order to allow us to comply with applicable SEC rules and regulations by the filing deadline for our annual report for the calendar year ended December 31, 2007. The evaluation of our internal controls is being conducted under the direction of our senior management in consultation with an independent third party consulting firm. In addition, our senior management is regularly discussing the results of our testing and any proposed improvements to our control environment with our Audit Committee. We will continue to assess our controls and procedures on a regular basis and we will continue to work to improve our controls and procedures and educate and train our employees on our existing controls and procedures in connection with our efforts to maintain an effective controls infrastructure at our Company.

Table of Contents

During the course of their audit of our consolidated financial statements for the calendar year ended December 31, 2004, our independent registered public accounting firm, Ernst & Young LLP, advised management and the Audit Committee of our Board of Directors that they had identified four deficiencies in internal controls that they considered to be material weaknesses as defined under standards established by the American Institute of Certified Public Accountants. The material weaknesses relate to the following: (i) number of audit differences and processes and controls in place to prevent or detect such differences given the number of different systems and processes within the Company, (ii) the Company s information system limitations and the inherent subjectivity in estimating its allowance for doubtful accounts and contractual allowances, (iii) coordination and agreement with third party actuarial firms regarding the estimation of reserves for professional liability insurance, and (iv) the adequacy of general controls relating to an information technology system.

Prior to the identification of such deficiencies, we had already undertaken, or were in the process of undertaking, a number of steps to improve the Company s control environment, including:

- Significant investments in new systems for the Company, including the recent purchase of an Oracle financial reporting system to replace the Company s current system.

- Retention of outside consulting firms to assist in the Company s Section 404 initiative, including the engagement of a firm to provide guidance specific to IT concerns.

- Development of an internal billing information system that will interface with the Oracle financial reporting system.

We have discussed our corrective actions and future plans with our Audit Committee and Ernst & Young LLP. While we believe that the remedial actions that have been or will be taken will result in correcting the conditions that are considered to be material weaknesses as soon as practicable, the exact timing of when the conditions will be corrected is dependent upon future events which may or may not occur.

Senior management of the Company, including our Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2005. Our management, including our Chief Executive Officer and Chief Financial Officer, has concluded that, except for the internal control deficiencies described above and taking into account the efforts to address those deficiencies described above, as of the evaluation date, our disclosure controls and procedures are designed, and are effective, to give reasonable assurance that information we must disclose in reports filed with the SEC is properly recorded, processed, and summarized, and then reported within the time periods specified in the rules and forms of the SEC.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we receive subpoenas from government officials. While to date none of these investigations has resulted in liability, investigations are expensive and take valuable management time. In addition, during the ordinary course of business, we have become and may in the future become subject to legal actions and proceedings. We may have liability with respect to our employees and our pathologists and with respect to hospital employees who are under the supervision of our hospital-based pathologists. The majority of these pending legal proceedings involve claims of medical malpractice. Based upon investigations conducted to date, we believe the outcome of pending legal actions and proceedings, individually or in the aggregate, will not have a material adverse effect on our financial condition, results of operations or liquidity.

There can be no assurance that our captive insurance arrangements and our excess liability insurance coverage will be adequate to cover all potential medical malpractice liabilities that we may incur. We have no aggregate excess stop loss protection, meaning once our claim limits have been reached, we are subject to loss for any excess amounts. We also may, from time to time, be involved with legal actions related to the acquisition of anatomic pathology operations, the prior conduct of acquired operations or the employment and restriction on competition of physicians. There can be no assurance that any costs or liabilities for which we become responsible in connection with these claims or actions will not be material or will not exceed the limitations of any applicable indemnification provisions or the financial resources of the indemnifying parties.

Table of Contents

ITEM 6. EXHIBITS

10.1	Amendment No. 1, Waiver and Consent dated as of November 8, 2005, to the Amended and Restated Credit Agreement dated as of February 17, 2004 among AmeriPath, Inc., AmeriPath Holdings, Inc., the lenders from time to time party thereto and Credit Suisse, as administrative agent and collateral agent
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
32.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350
32.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350

Table of Contents

SIGNATURES

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

AMERIPATH, INC.

Date: November 14, 2005 By: /S/ DONALD E. STEEN

Donald E. Steen

Chief Executive Officer

Date: November 14, 2005 By: /S/ DAVID L. REDMOND

David L. Redmond

Executive Vice President and

Chief Financial Officer

Table of Contents

EXHIBIT INDEX

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