NOVAMED EYECARE INC
Form 10-K
March 30, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2000

Commission File Number: 0-26625

NOVAMED EYECARE, INC.
(Exact name of registrant as specified in its charter)

Delaware	36-4116193
(State or other jurisdiction of incorporation or organization)	(I.R.S. EmployerIdentification No.)

980 North Michigan Avenue, Suite 1620, Chicago, Illinois 60611
(Address of principal executive offices) (zip code)

Registrant's telephone number, including area code: (312) 664-4100

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

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, par value $.01 per share
(Title of Class)

Preferred Stock Purchase Rights
(Title of Class)

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

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

The aggregate market value of the registrant's 18,265,135 shares of voting stock held by non-affiliates of the registrant, based upon the last reported sale price of the registrant's Common Stock on March 15, 2001 was $41,096,553.75. The number of shares outstanding of the registrant's Common Stock, par value $.01, as of March 15, 2001 was 24,698,640.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Definitive Proxy Statement in connection with

the registrant's 2001 Annual Meeting of Stockholders are incorporated by reference into Part III of this Report on Form 10-K.

PART I

Item 1. Business

Because we want to provide investors with more meaningful and useful information, this Annual Report on Form 10-K (the "Form 10-K") contains, and incorporates by reference, certain "forward-looking statements" (as such term is defined in Section 21E of the Securities Exchange Act of 1934, as amended) that reflect our current expectations regarding our future results of operations, performance and achievements. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We have tried, wherever possible, to identify these forward-looking statements by using words such as "anticipates," "believes," "estimates," "expects," "plans," "intends" and similar expressions. These statements reflect our current beliefs and are based on information currently available to us. Accordingly, these statements are subject to certain risks, uncertainties and contingencies which could cause our actual results, performance or achievements in 2001 and beyond to differ materially from those expressed in, or implied by, such statements. These risks and uncertainties include: our ability to acquire, develop and manage profitable surgical facilities; the acceptance of laser vision correction and other refractive surgical procedures by eye care professionals and the general public; our ability to establish and maintain profitable affiliations with eye care professionals; the adoption of competing new technologies for eye surgical procedures, including vision correction surgery; reductions in prices and reimbursement rates for surgical procedures, including prices for laser vision correction procedures; proposed health care reforms; and the factors set forth under "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations--Risk Factors." You should not place undue reliance on any forward-looking statements. We undertake no obligation to update or revise any such forward-looking statements that may be made to reflect events or circumstances after the date of this Form 10-K or to reflect the occurrence of unanticipated events.

Unless the context requires otherwise, you should understand all references to "we," "us" and "our" to include NovaMed Eyecare, Inc. and its consolidated subsidiaries.

General

We are an eye care services company and one of the nation's leading owners and operators of practice-based, single-specialty ambulatory surgery centers (ASCs). We own and operate 15 ASCs and operate 15 practice-based laser vision correction centers (LVC centers) in six core U.S. regional markets, including: Chicago, Illinois; Kansas City, Missouri; Louisville, Kentucky; Richmond, Virginia; St. Louis, Missouri; and the Atlanta, Georgia and Chattanooga, Tennessee metropolitan areas.

As of March 15, 2001, we own and operate:

- 15 practice-based, single-specialty ambulatory surgery centers where our affiliated eye care professionals perform surgical procedures, primarily cataract and refractive surgery (laser vision correction or LVC).

- an optical services and products organization that sells: eye care

products and accessories to eye care professionals; corrective lenses and eyeglasses produced by our two wholesale optical laboratories; eyeglass frames and contact lenses purchased from manufacturers by our optical products purchasing organization; and marketing products and services.

- an eye-only research organization that provides clinical and other research services to eye care device, product and pharmaceutical manufacturers.

As of March 15, 2001, we also operate under service agreements 15 laser vision correction centers, or LVC centers, where our affiliated eye care professionals perform laser vision correction surgery.

Generally, we enter into long-term business relationships, or affiliations, with eye care professionals by:

- acquiring their non-medical assets including equipment, leasehold interests and working capital
- hiring their non-medical personnel
- assuming their office leases
- entering into long-term service agreements with their professional entities

Under these service agreements, we provide business, information technology, administrative and financial services to our affiliated eye care professionals and their optical retail outlets in exchange for a management fee.

As of March 15, 2001, we have affiliated with 120 eye care professionals. Our affiliated eye care professionals provide a wide range of eye care services to patients including basic eye examinations, the diagnosis and treatment of complex eye conditions and eye surgery, primarily cataract and LVC surgery. Our affiliated eye care professionals currently practice in 66 eye care clinics which are leased and staffed by us. In addition, our affiliated eye care professionals operate 33 optical retail outlets, each of which is located within one of our affiliated eye care clinics, where they sell eyeglasses, contact lenses and other optical products and accessories to patient-consumers. In addition, we have entered into five fixed-site laser services agreements in Delaware, Illinois, Ohio and Oklahoma.

We were originally organized as a Delaware limited liability company in March 1995, under the name NovaMed Eyecare Management, LLC. In connection with a capital infusion from venture capital investors in November 1996, NovaMed Holdings Inc., an Illinois corporation, was formed to serve as a holding company, responsible for overall strategic planning, with NovaMed Eyecare Management, LLC as an operating subsidiary. In May 1999, NovaMed Holdings Inc. reincorporated as a Delaware corporation and changed its name to NovaMed Eyecare, Inc. In June 1999, we changed the name of our principal operating subsidiary to NovaMed Eyecare Services, LLC. In August 1999, we consummated our initial public offering.

Eye Care Industry

General

The eye care market consists of a large, diverse group of services and products. The eye care services market includes routine eye examinations as well as diagnostic and surgical procedures that address complex eye and vision conditions. The most common conditions addressed by eye care professionals are

nearsightedness, farsightedness and astigmatism. Other frequently treated conditions include cataracts, glaucoma, macular degeneration and diabetic retinopathy. Eye and vision conditions are typically treated with surgery, pharmaceuticals, prescription glasses, contact lenses or some combination of these treatments. Additional services offered by eye care professionals include research services for eye care devices or pharmaceuticals being developed or tested in clinical trials. The optical products market consists of the manufacture, distribution and sale of optical goods including corrective lenses, eyeglasses, frames, contact lenses and other optical products and accessories.

Eye care represents one of the largest health care service and product markets in the U.S. Projected annual spending in 2001 for health care costs associated with eye and vision conditions is expected to be $29 billion, while annual spending on retail optical products is expected to be an additional $18 billion, representing a total market of approximately $47 billion.

Ambulatory Surgery Center Market

The delivery of ambulatory surgery--procedures performed on a nonhospitalized patient who is able to return home the same day--has changed dramatically since the inception of outpatient surgery centers (ASCs) in the early 1970s. Since then, the industry has grown, with almost 3,200 ASCs in business as of June 2000, up 20% from 1998. The ASC market has capitalized on new medical technologies, including improvements in surgical lasers, anesthesiology, endoscopy and arthroscopic surgical instruments. An estimated 6.7 million surgeries were performed in ASCs in 2000, up 15% from 1998. Ophthalmology is the largest single surgical area of outpatient surgery, with approximately 1.76 million outpatient surgeries in 2000, representing

approximately 26% of all outpatient surgeries. Outpatient surgical procedures are forecasted to grow 7% annually through 2006, when approximately 9 million procedures are expected.

Cataract Surgery. Cataract surgery is currently the most widely performed surgical procedure in the U.S., with an estimated 2.7 million cataract surgeries in 2000. Cataract procedures are forecast to grow 2.2% annually over each of the next five years. A cataract occurs when the normally transparent lens of the eye becomes cloudy as part of the aging process. In cataract surgery, the ophthalmologist removes the clouded natural lens and replaces it with a synthetic intraocular lens. Cataract surgery is typically performed on an outpatient basis using local anesthesia, and the procedure time is typically less than 30 minutes. More than 63% of people over the age of 60 have some degree of cataract formation. Cataract procedures are expected to continue to increase for many years, driven primarily by the aging of the population and the introduction of improved technologies and surgical techniques. With the preponderance of cataract surgery patients being over the age of 65, the Medicare program has been the primary source of reimbursement for cataract surgery providers. In the U.S., 34.7 million people are age 65 or older, representing 12.6% of the population. By 2010, this group is expected to increase 13.5% to 39.4 million and represent 13.2% of the population.

Vision Correction Surgery. Approximately 166 million people in the U.S. require eyeglasses or contact lenses to correct refractive vision conditions that result from the improper curvature of the cornea. If the cornea's curvature is not correct, the cornea cannot properly focus the light passing through it onto the retina, and the person will see a blurred image. The three most common refractive conditions are:

- myopia, commonly referred to as nearsightedness, which is caused by a steepening of the cornea, resulting in the blurring of distant objects

- hyperopia, commonly referred to as farsightedness, which is caused by a flattening of the cornea, resulting in the blurring of close objects

- astigmatism, in which images are not focused on any point due to the varying curvature of the eye along different axes, which results in a distorted view of images

New surgical technologies and techniques have been developed over the years to correct common vision conditions that result from the improper curvature of the cornea. Laser In-Situ Keratomileusis, or LASIK, was introduced in 1996, leading to a dramatic increase in the popularity of laser vision correction surgery. The introduction of LASIK offered significant benefits to ophthalmologists over preceding refractive surgical techniques such as Radial Keratotomy, or RK, and the first vision correction surgery that used laser technology, Photorefractive Keratectomy, or PRK. Relative to the earlier refractive surgical techniques, the LASIK procedure provides significant reductions in patient pain or discomfort, patient recovery times ranging from a few hours after the procedure to two weeks, and reduced complication rates.

In the LASIK procedure, an ophthalmologist uses an automated microsurgical instrument to peel back a thin layer of corneal tissue that remains hinged to the eye. A number of laser pulses are then applied to the cornea to remove tissue and thereby correct the patient's vision by flattening the shape of the cornea in nearsighted patients and steepening the shape of the cornea in farsighted patients. After the surgeon replaces the layer of corneal tissue, no bandages are required and most patients experience virtually no discomfort. A LASIK procedure typically takes 10 to 15 minutes from set-up to completion, with the length of time of the actual laser treatment lasting 15 to 90 seconds, depending on the degree of correction required. LASIK is performed in an outpatient setting, with only topical anesthesia. Only ophthalmologists are licensed to perform LASIK, although optometrists are actively involved in identifying appropriate candidates for the procedure and in providing pre- and post-operative care.

The number of vision correction procedures performed in the U.S. has grown rapidly since 1996, primarily as a result of the advantages of the LASIK procedure. In 2000, eye care professionals performed an estimated 1.43 million laser vision correction surgery procedures in the U.S., representing an increase of approximately 50% over the approximately 950,000 procedures performed in 1999. Volume is projected to grow to approximately 1.82 million procedures in 2001. Despite this rapid growth, the number of vision correction

surgery patients in 2000 represented approximately 0.4% of the 166 million people with refractive vision conditions in the U.S. LVC procedures performed in the U.S. from 1997 through 2000 represented cumulatively less than 1% of the relevant market opportunity.

Other Eye Disorders. Other common eye disorders include glaucoma, macular degeneration and diabetic retinopathy. Glaucoma is one of the leading causes of preventable blindness in the U.S. and the single most common cause of blindness among African-Americans. By 2030, industry sources project that the number of glaucoma cases diagnosed will double, primarily as a result of the aging of the general population and an increase in the average life span. Age-related macular degeneration is the leading cause of visual impairment for persons age 75 and older, and it is the most common cause of new cases of visual impairment among those over age 65. Diabetic retinopathy is a leading cause of vision loss

and blindness. More than 40% of patients with diabetes for 15 years or more have some degree of blood vessel damage that may result in diabetic retinopathy. Incidence of this disease is expected to increase dramatically as a result of a growing number of patients diagnosed with diabetes. Medicare and other third party payors generally reimburse the treatment of these eye and vision conditions.

Optical Services and Products

While the number of patient options for vision correction has increased with improved surgical vision correction technologies and techniques, the market for basic optical goods including corrective lenses, eyeglass frames, contact lenses and other optical products and accessories, remains a significant market. Projected 2001 consumer spending is expected to be approximately $18 billion on eyewear. Eyeglass frames are typically sold through retail optical outlets located in optometrist and ophthalmologist clinics, as well as through retail stores.

Our Business Model

We have focused on building regional clusters of ASCs, LVC centers and affiliated eye care professionals. We structure these regional clusters to achieve a hub and spoke configuration of affiliated eye care professionals around our ASCs and LVC centers. We believe our business model provides us with several advantages in assisting our affiliated eye care professionals, including our ability to:

- establish and maintain long-term relationships with leading ophthalmologists and optometrists through access to our ASCs and LVC centers, and through a wide range of business, information technology, administrative and financial services

- assist our affiliated eye care professionals in establishing regional market leadership in eye care through our clinical research, information technology and marketing know-how

- create multiple sources of revenue through the range of business, information technology, administrative and financial services and eye care products that we offer

We work with our affiliated eye care professionals to develop a patient-consumer approach that we believe benefits not only the growth of their practices, but all aspects of their continuum of eye care services, ranging from basic eye examinations to the treatment of complex eye and vision conditions, including surgery.

We implement our business model by building around the following key components:

Single-specialty, practice-based ASCs and LVC Centers

We own and operate 15 practice-based, single specialty ASCs, each of which is a wholly-owned, state-licensed and Medicare-certified ambulatory surgical center. Ophthalmologists perform cataract, laser vision correction and other eye related surgical procedures in our ASCs. We also operate under service agreements 15 LVC centers where our affiliated eye care professionals perform laser vision correction surgery. We also have five fixed-site laser service agreements pursuant to which we lease excimer lasers and provide various services to eye care providers in Delaware, Illinois, Ohio and Oklahoma. As of March 15, 2001, we have 30 excimer

lasers in service. We plan to selectively deploy additional excimer lasers during 2001, including replacing some currently installed lasers with newer technology models.

Effective March 1, 2001, we entered into a new five-year supply agreement with Alcon Laboratories, Inc. setting forth the terms upon which we can procure and utilize excimer lasers manufactured by Alcon. This agreement amended and superseded our previous agreement originally entered into with Summit Technology, Inc., which was acquired by Alcon in 2000. The agreement sets forth pricing terms for our existing APEX/Infinity lasers, as well as the procurement and pricing terms for Alcon's most technologically advanced laser, the LADARVision System. During the five-year term, we will pay Alcon monthly based on the number of procedures performed on each laser, with minimum annual procedure requirements for each LADARVision System procured under the agreement. As of March 15, 2001, we have twenty-one Apex/Infinity lasers and two LADARVision Systems covered by the agreement, and we have agreed to order and take installation and delivery of additional LADARVision Systems by April 15, 2001. Alcon may terminate the agreement if we fail, after reasonable cure periods, to comply with the material terms of the agreement. We may terminate the agreement if the Food and Drug Administration, or FDA, withdraws or materially restricts its approval of the use of any laser covered by the agreement or if patent issues or changes render the lasers unusable.

Management Services

As of March 15, 2001, we have long-term service agreements in place with professional entities covering 62 ophthalmologists and 58 optometrists, who provide eye care services in one or more of our 66 eye care clinics. Generally, we seek to cluster eye care clinics within regional markets that can support one or more ASCs and one or more LVC centers. Our strategy involves affiliating with leading eye care professionals within a regional market until we have achieved a cluster of eye care clinics, affiliated eye care professionals, ASCs and LVC centers in a hub and spoke configuration throughout the regional market.

We provide services, facilities and equipment to our affiliated eye care professionals under long-term service agreements. These service agreements are generally for a 40-year term and require us to provide all of the business, administrative and financial services necessary to operate the eye care clinics and optical retail outlets. These services typically include:

- billing, collection and cash management services
- procuring and maintaining all office space, equipment and supplies
- subject to federal and state law, recruiting, employing, supervising and training all non-professional personnel
- assisting our affiliated eye care professionals in recruiting additional ophthalmologists and optometrists
- all administrative and support services
- information technology services
- marketing services

Optical Services and Products

We own and operate two full-service wholesale optical laboratories that

specialize in surfacing, finishing and distributing corrective lenses and eyeglasses. Our laboratories have in excess of 500 active customers, including affiliated and non-affiliated ophthalmologists, optometrists, opticians and optical retail chains. Our optical products purchasing organization allows affiliated and non-affiliated eye care professionals to purchase optical products through us at volume discounts. We have in excess of 750 customers that utilize our optical products purchasing organization. We also provide monthly reports to our customers that allow them to identify purchasing trends and manage their optical product inventories more efficiently. Our marketing services and products company provides eye care professionals with a range of products and services including brochures, videos and advertising design.

Research

We own and operate an eye-only research organization that conducts Phase II-IV clinical trials on eye care devices and pharmaceuticals, with an emphasis on laser vision correction. Our research organization is based in Kansas City, Missouri, and currently has research sponsor agreements relating to approximately 65 clinical studies involving up to approximately 1,300 potential patients participating in clinical trials.

Our Growth Strategy

We are focused on the large and rapidly growing U.S. market for eye care, particularly around the growth in eye surgeries which we believe will result in additional procedures being performed in our surgical facilities. Our goal is to be one of the leading owners and/or operators of single-specialty, practice-based ASCs and LVC centers. We intend to achieve this goal by continuing to acquire and develop ASCs and LVC centers, maintain and/or establish contractual and other affiliations with leading eye care professionals and by continuing to implement a growth strategy which includes the following specific components:

Expanding our Presence in Existing Regional Markets. We believe that there are significant growth opportunities in our existing regional markets. These growth opportunities will be driven largely by:

- acquiring or developing ASCs and LVC centers
- continuing to affiliate with leading eye care professionals
- helping our affiliated eye care professionals grow and develop their practices

Selectively Targeting and Entering New Markets. We believe our management team's experience in acquiring, building and developing ASCs and LVC centers, as well as helping affiliated professionals build successful eye care businesses, will continue to enable us to effectively identify and enter new markets. We intend to enter new markets through multiple avenues, including:

- acquiring existing or establishing new ASCs
- opening new LVC centers
- entering into contractual affiliations with leading ophthalmologists and optometrists

Competition

Surgical Facilities. In acquiring and developing practice-based, single

specialty ASCs and LVC centers, we compete with both corporations and eye care professionals. There are several publicly held and private companies actively engaged in the acquisition, development and operation of ASCs and LVC centers. Certain of these companies may acquire and develop multi-specialty ASCs, practice-based ASCs focusing on varying specialties, or a combination of the two. Moreover, some of these companies have the acquisition and development of ASCs as their core business, while other competitors include larger publicly held companies that have subsidiaries or divisions engaged in this business. Other companies focus more exclusively on the development and operation of LVC centers. Many of these competitors have greater resources than us.

The majority of practice-based, ophthalmic ASCs continue to be owned by eye care professionals. Eye care professionals also own and operate LVC centers. Our ASCs and LVC centers compete with these provider-owned centers. In deploying excimer laser technology, eye care professionals either elect to procure this technology on their own or enter into an arrangement with a corporate entity that can provide the necessary capital. For the fourth quarter 2000, industry sources estimate that 46.6% of total laser vision correction procedures in the U.S. were performed in corporate-owned facilities, and 43.3% were performed in physician-owned centers. Laser vision correction and other refractive surgery procedures also compete with more traditional non-surgical treatments for refractive conditions, including eyeglasses and contact lenses.

Management Services. Our management services are provided to eye care professionals through long-term affiliations. The market for these management services is fragmented, and we do not face any single, dominant

U.S. national competitor. Eye care professionals may seek a corporate partner to assist them in the growth and development of their practices, as well as with the day-to-day management and administration of their businesses. Factors that may influence an eye care professional's decision to retain a corporate partner to provide management services are the corporate partner's experience and scope and quality of services offered, the eye care professional's need for these services, and the price for such services.

Optical Products and Services. Our two wholesale optical laboratories face a variety of national, regional and local competitors. We compete in the optical laboratory market on the bases of quality of service, breadth of services, reputation and price.

In the market for providing optical group purchasing services, we primarily compete with national and regional buying groups, as well as large vendors. Competition in this market is based upon service, price, and the strength of the purchasing organization, including the ability to negotiate discounts.

Employees

As of March 15, 2001, we had approximately 1,175 employees, 959 of whom are full-time employees. We are not a party to any collective bargaining agreements.

Trademarks

We have registered the name, NovaMed Eyecare Management, as a U.S. Service mark.

Governmental Regulation

As a participant in the health care industry, our operations and the

operations of our affiliated ophthalmologists and optometrists are subject to extensive and increasing regulation by governmental entities at the Federal, state and local levels. Many of these laws and regulations are subject to varying interpretations, and we believe courts and regulatory authorities generally have provided little clarification. Moreover, state and local laws and interpretations vary from jurisdiction to jurisdiction. As a result, we may not always be able to accurately predict interpretations of applicable law, and some of our activities, or the activities of our affiliated eye care professionals, could be challenged.

We cannot assure you that Federal or state regulatory authorities would not challenge any of our business operations and arrangements with our affiliated eye care professionals. If any of our activities are challenged, we may have to divert substantial time, attention and resources from running our business to defend against these challenges regardless of their merit. If we do not successfully defend these challenges, we and our affiliated eye care professionals may face a variety of adverse consequences including service agreements being terminated or rendered unenforceable, third party payor agreements being terminated, affiliated providers losing their eligibility to participate in Medicare, Medicaid or other Federal or state health care programs, or losing other contracting privileges and, in some instances, civil or criminal fines. Under some circumstances, we may be able to redesign or reformulate our relationships or arrangements to address these challenges. Any of these consequences could have a material adverse effect on our business, financial condition and results of operations.

The regulatory environment in which we and our affiliated eye care professionals operate may change significantly in the future. Numerous legislative proposals have been introduced in the U.S. Congress and in various state legislatures over the past several years that could cause major reforms of the U.S. health care system. In addition, several sets of regulations have been recently adopted that may require substantial changes in the way health care providers operate over the coming years. In response to new or revised laws, regulations or interpretations, we could be required to revise the structure of our legal arrangements or the structure of our fees, incur substantial legal fees, fines or other costs, or curtail our business activities, reducing the potential profit to us of some of our legal arrangements, any of which may have a material adverse effect on our business, financial condition and results of operations.

The following is a summary of some of the health care regulatory issues affecting us, our affiliated eye care providers and our respective operations.

Federal Law

Anti-Kickback Statute. The Federal anti-kickback statute prohibits the knowing and willful solicitation, receipt, offer or payment of any direct or indirect remuneration in return for the referral of patients or the ordering or purchasing of items or services payable under Medicare, Medicaid or other Federal health care programs. Violations of this statute may result in criminal penalties, including imprisonment or criminal fines of up to $25,000 per violation, civil penalties of up to $50,000 per violation plus up to three times the amount of the underlying remuneration, and exclusion from Federal programs including Medicare or Medicaid.

The Federal anti-kickback statute contains a number of exceptions. In order to address the problems created by the broad language of the statute, Congress directed the Department of Health and Human Services, or DHHS, to develop regulatory exceptions, known as safe harbors, to the Federal anti-kickback

statute's referral prohibitions. When possible, we have attempted to structure our business operations and our relationships with our affiliated providers within a safe harbor. However, some aspects of our business, the business of our affiliated providers, and our relationships with our affiliated providers either do not meet the prescribed safe harbor standards, or relate to practices for which no safe harbor standards have been proposed. Because there is no legal requirement that relationships fit within a safe harbor, a business arrangement that does not comply with the relevant safe harbor, or for which a safe harbor does not exist, does not necessarily violate the anti-kickback statute.

Included among the safe harbors to the anti-kickback statute are certain safe harbors for investment interests in general, and for investment interests in ASCs. While we do not currently co-own ASCs with physicians, it is foreseeable that we may do so in the future. If so, it is unlikely that our co-ownership would meet all of the parameters of the general investment interest safe harbors or the ASC investment interest safe harbors. However, as discussed above, an arrangement that does not fit squarely within a safe harbor is not per se unlawful under the anti-kickback statute. It is our intent to structure all such co-ownership arrangements in a manner that complies with as many of the safe harbor components as possible, that meets the objectives of the anti-kickback statute, and that follows the other available regulatory guidance regarding ASC co-ownership arrangements. By structuring the co-ownership arrangements in this manner, we believe that they will be in compliance with the anti-kickback statute.

Self-Referral Law. Subject to limited exceptions, the Federal self-referral law, known as the "Stark Law," prohibits physicians and optometrists from referring their Medicare or Medicaid patients for the provision of "designated health services" to any entity with which they or their immediate family members have a financial relationship. "Financial relationships" include both compensation and ownership relationships. "Designated health services" include clinical laboratory services, radiology and ultrasound services, durable medical equipment and supplies, and prosthetics, orthotics and prosthetic devices, as well as seven other categories of services. We do not provide "designated health services." Our affiliated providers, however, do provide limited categories of designated health services, specifically, ultrasound services, including A-scans and B-scans, and prosthetic devices, including eyeglasses and contact lenses furnished to patients following cataract surgery.

Violating the Stark Law may result in denial of payment for the designated health services performed, civil fines of up to $15,000 for each service provided pursuant to a prohibited referral, a fine of up to $100,000 for participation in a circumvention scheme, and exclusion from the Medicare, Medicaid and other Federal health care programs. The Stark Law is a strict liability statute. Any referral made where a financial relationship exists that fails to meet an exception constitutes a violation of the law.

On January 4, 2001, the Health Care Financing Administration published Phase I of the final Stark regulations interpreting the provisions of the Stark Law. These regulations will have an effective date of

January 4, 2002. It is anticipated that Phase II will be issued later this year and will focus on compensation issues and the statute's application to Medicaid. While Phase I of the final rule still defines eyeglasses and contact lenses to be prosthetic devices and A-scans and B-scans to be radiology services, the final rule creates certain exemptions for referrals for these services. Phase I also creates an exemption for referrals for eyeglasses and contact lenses furnished to patients following cataract surgery and for

"designated health services" that are personally performed by the referring doctor.

The Stark law does not prohibit physician ownership or investment interests in ASCs to which they refer patients. HCFA clarified this in the Phase I regulations by providing that services that would otherwise constitute a "designated health service," but that are paid by Medicare as part of bundled rate, will not be considered designated health services for purposes of the Stark Law. Thus, when an intraocular lens, or IOL, used in cataract surgery is included in an ASC bundled payment rate, the IOL will not be considered to be a "designated health service."

Civil False Claims Act. The Federal Civil False Claims Act prohibits knowingly presenting or causing to be presented any false or fraudulent claim for payment by the government, or using any false or fraudulent record in order to have a false or fraudulent claim paid. Violations of the law may result in repayment of three times the damages suffered by the government and penalties from $5,000 to $10,000 per false claim. Collateral consequences of a violation of the False Claims Act include administrative penalties and possible exclusion from participation in Medicare, Medicaid and other Federal health care programs.

Health Insurance Portability and Accountability Act. In August of 1996, Congress enacted the Health Insurance Portability and Accountability Act of 1996 (HIPAA). Included within HIPAA's health care reform provisions are its "administrative simplification" provisions, which require that health care transactions be conducted in a standardized format, and that the privacy and security of certain individually identifiable health information be protected. Proposed rules for many of the administrative simplification subject areas have been published. Final rules covering "Standards for Electronic Transactions and Code Sets" were published on August 17, 2000, and set forth the standardized billing codes and formats that our affiliated eye care professionals and we must use when conducting certain health care transactions and activities. The effective date of these final rules was October 16, 2000, and we have until October 16, 2002 to come into compliance with these rules. On December 28, 2000, the DHHS published final rules addressing "Standards for Privacy of Individually Identifiable Health Information" under HIPAA's administrative simplification provisions. Compliance with these rules is required by April 14, 2003, however, there have been recent efforts in Congress to overturn these rules, so the status of the privacy rules under HIPAA is unclear. Regardless of the final form of the rules implementing HIPAA's administrative simplification provisions, it is likely that these rules will create substantial new compliance issues for all "covered entities"--which include health care providers, health plans, and health care clearinghouses--that engage in regulated transactions and activities. The operations of our affiliated eye care professionals and certain of our operations are covered by the final rules enacted thus far, and, to the extent that the final privacy and other rules resemble those that were published in December 2000, we believe these operations will be covered by the final HIPAA rules enacted in the future. Violations of HIPAA can result in civil penalties of up to $25,000 per person per year for each violation and criminal penalties of up to $250,000 and/or up to 10 years in prison per violation.

State Law

Facility Licensure and Certificate of Need. We may be required to obtain licenses from the state departments of health in states where we open or acquire ASCs and LVC centers. We believe that we have obtained the necessary licenses in states where licenses are required. However, we believe courts and state regulatory authorities generally have provided little clarification as to some of the regulations governing licensure requirements. It is possible that a state regulatory authority could challenge our position. With respect to future

expansion, we cannot assure you that we will be able to obtain the required licenses. However, we

have no reason to believe that, in states requiring facility licenses, we will not be able to obtain this license without unreasonable expense or delay.

Some states require a Certificate of Need, or CON, prior to the construction or modification of an ASC or the purchase of specified medical equipment in excess of a dollar amount set by the state. We believe that we have obtained the necessary CONs in states where a CON is required. However, we believe courts and state regulatory authorities generally have provided little clarification as to some of the regulations governing the need for CONs. It is possible that a state regulatory authority could challenge our determination. With respect to future expansion, we cannot assure you that we will be able to acquire a CON in all states where a CON is required.

Anti-Kickback Laws. In addition to the Federal anti-kickback law, a number of states have enacted laws that prohibit the payment for referrals and other types of kickback arrangements. Some of these state laws apply to all patients regardless of their source of payment, while others limit their scope to patients whose care is paid for by particular payors.

Self-Referral Laws. In addition to the Federal Stark Law, a number of states have enacted laws that require disclosure of or prohibit referrals by health care providers to entities in which the providers have an investment interest or compensation relationship. In some states, these restrictions apply regardless of the patient's source of payment.

Corporate Practice of Medicine Laws. A number of states have enacted laws or have common law that prohibit the corporate practice of medicine. These laws are designed to prevent interference in the medical decision-making process by anyone who is not a licensed physician. Many states have similar restrictions in connection with the practice of optometry. Application of the corporate practice of medicine prohibition varies from state to state. Because the corporate practice of medicine doctrine has been seldom enforced or litigated in the states where we do business, the precise parameters of the doctrine have not been defined, particularly in terms of the management responsibilities that may be delegated to a company that provides management services. Because of this, although we neither employ doctors nor provide medical services, to the extent any act or service to be performed by us is construed by a court or enforcement agency to constitute the practice of medicine, our service agreements provide that our obligations to perform the act or service is waived. We cannot be sure that a particular state court or enforcement agency may not construe our arrangements as violating that jurisdiction's corporate practice of medicine doctrine. In such an event, we may be required to redesign or reformulate our relationships with our affiliated eye care professionals and there is a possibility that some provisions of our service agreements may not be enforceable.

Fee-Splitting Laws. The laws of some states prohibit providers from dividing with anyone, other than providers who are part of the same group practice, any fee, commission, rebate or other form of compensation for any services not actually and personally rendered. Penalties for violating these fee-splitting statutes or regulations may include revocation, suspension or probation of a provider's license, or other disciplinary action. In addition, courts have refused to enforce contracts found to violate state fee-splitting prohibitions. The precise language and judicial interpretation of fee-splitting prohibitions varies from state to state. Courts in some states have interpreted fee-splitting statutes to prohibit all percentage of gross revenue and percentage

of net profit management fee arrangements. Other state statutes apply only to prohibit fee splitting in return for referrals.

We believe our management fee arrangements differ from those invalidated as unlawful fee splits because they establish a flat monthly fee that is subject to adjustment based on the degree to which actual practice revenues or expenses vary from budget. However, there is some risk that our arrangements could be construed by a state court or enforcement agency to run afoul of state fee-splitting prohibitions. Accordingly, all of our service agreements contain either a reformation provision or a mechanism establishing an alternative fee structure, or both.

Insurance Provisions. Many states also regulate the establishment of various health care provider networks. These laws do not typically affect providers of business and administrative services to professional entities. We are aware, however, of some state insurance regulations requiring organizations involved in specified types of contracting arrangements to register with the state department of insurance and purchase surety bonds. It also is possible that a state could require our licensure as a provider network or organization, health maintenance organization or insurer. However, as long as another entity in the chain of contracts is licensed by the state department of insurance, we believe that we are unlikely to be viewed by any state where we do business as requiring a license from the department. Because we do not enter into any capitated or other risk-sharing contract without an HMO or other licensed entity in the chain of contracts, we believe that we are not required to be licensed under the insurance provisions of any states in which we currently operate. However, we believe courts and state regulatory authorities generally have provided little clarification as to some of the regulations governing the need for licensure. It is possible that a state regulatory authority could challenge our determination. We cannot assure you that we will be able to acquire an insurance license in all states where licensure is required. However, we have no reason to believe that in those states that require an insurance or other license, we will not be able to obtain one.

Excimer Laser Regulation

Medical devices, including the excimer lasers used in our eye surgery and laser centers, are subject to regulation by the U.S. Food and Drug Administration, referred to as the FDA. Medical devices may not be marketed for commercial sale in the U.S. until the FDA grants pre-market approval for the device.

Failure to comply with applicable FDA requirements could subject us, our affiliated providers or laser manufacturers to enforcement action, product seizures, recalls, withdrawal of approvals and civil and criminal penalties. Further, failure to comply with regulatory requirements, or any adverse regulatory action, could result in a limitation on or prohibition of our use of excimer lasers.

Regulation of Laser Vision Correction Marketing

The marketing and promotion of laser vision correction and other vision correction surgery procedures in the U.S. are subject to regulation by the FDA and the Federal Trade Commission, referred to as the FTC. The FDA and FTC have released a joint communique on the requirements for marketing these procedures in compliance with the laws administered by both agencies. The FTC staff also issued more detailed guidance on the marketing and promotion of these procedures and has been monitoring marketing activities in this area through a non-public inquiry to identify areas that may require further FTC attention.

The FDA has traditionally taken the position that the promotion and advertising of lasers by manufacturers and physicians should be limited to the uses approved by the FDA.

Item 2. Properties

We do not own any real property. We lease space for our corporate headquarters in Chicago, our regional offices, our ASCs and LVC centers, the clinics of our affiliated eye care professionals and our optical services operations. In some cases, these facilities are leased from our affiliated eye care professionals and other related parties. See "Item 13--Certain Relationships and Related Transactions." Our corporate offices in the Chicago metropolitan area consist of 12,824 square feet in downtown Chicago, and 10,499 square feet in Des Plaines, Illinois.

The terms and conditions of our real property leases vary. The forms of lease range from "modified triple net" to "gross" leases, with terms generally ranging from month-to-month to ten years, with certain leases having multiple five-year renewal terms at our option. Generally, our ASCs, LVC centers, eye care clinics and optical retail outlets are located in medical complexes, office buildings or free-standing buildings. The square

footage of these offices range from 300 to 22,993 square feet, and the terms of these leases have expiration dates ranging from April 30, 2001 to February 29, 2010. Any capacity constraints with our affiliated eye care clinics and optical retail outlets can generally be resolved either through a build-out of adjacent space or the leasing of additional office space in other proximate locations. Depending on state licensing and Certificate of Need issues, addressing capacity constraints in any of our ASCs in a similar manner may require state regulatory approval.

The following tables list the locations of our surgical facilities:

Medicare-Certified and Licensed ASCs

Location	Number of Operating Rooms
Atlanta, GA	2
Columbus, GA	3
Chicago, IL	1
Maryville, IL	1
River Forest, IL	2
Hammond, IN	2
Merrillville, IN	2
New Albany, IN	2
Overland Park, KS	3
Florissant, MO	1
Kansas City, MO	2
St. Joseph, MO	1
Cincinnati, OH	2
Chattanooga, TN	1
Richmond, VA	1

LVC Centers

Athens, GA	Evansville, IN
Columbus, GA	Overland Park, KS
Duluth, GA	Wichita, KS
Kennesaw, GA	Columbia, MO
Davenport, IA	Kansas City, MO
Arlington Heights, IL	St. Louis, MO
Naperville, IL	Richmond, VA
Tinley Park, IL	

Item 3. Legal Proceedings

We are not a party to any lawsuits or administrative actions pending, or to our knowledge, threatened, which we would expect to have a material adverse effect upon our business, financial condition or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders

We did not submit any matter to a vote of our security holders during the fourth quarter of 2000.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

Price Range of Common Stock

Since August 18, 1999, our common stock has been traded on the Nasdaq National Market under the symbol NOVA. The following table sets forth, for the periods indicated, the range of high and low sale prices for our common stock on the Nasdaq National Market:

	High	Low
Fiscal year ending December 31, 2000:		
First Quarter	$18.25	$6.81
Second Quarter	$14.38	$5.81
Third Quarter	$10.00	$2.50
Fourth Quarter	$ 2.75	$0.88
Fiscal year ending December 31, 1999:		
Third Quarter (beginning August 18, 1999)	$15.63	$7.88
Fourth Quarter	$11.69	$4.81

On March 15, 2001, the last reported sale price of our common stock was $2.25, and there were approximately 346 holders of record of our common stock. This figure does not consider the number of individual holders of securities that are held in the "street name" of a securities dealer.

Dividends

We have never paid a cash dividend on our common stock. We plan to retain all future earnings to finance the development and growth of our business.

Therefore, we do not currently anticipate paying any cash dividends on our common stock. Any future determination as to the payment of dividends will be at our board of directors' discretion and will depend on our results of operations, financial condition, capital requirements and other factors our board of directors considers relevant. Moreover, our credit agreement prohibits the payment of dividends on our common stock.

Item 6. Selected Financial Data

The consolidated statement of operations data set forth below for the years ended December 31, 2000, 1999, and 1998 and the balance sheet data at December 31, 2000 and 1999, are derived from our respective audited consolidated financial statements which are included elsewhere herein. The consolidated statement of operations data set forth below with respect to the years ended December 31, 1997 and 1996 and the consolidated balance sheet data at December 31, 1998, 1997 and 1996 are derived from our audited financial statements which are not included in this Form 10-K.

The data set forth below should be read in conjunction with the consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere herein.

	Year Ended December 31,				
	2000	1999	1998	1997	1996
	(in thousands, except per share data)				
Consolidated Statement of Operations Data:					
Net revenue	$135,638	$101,143	$63,729	$42,408	$15,850
Operating expenses	125,070	92,086	58,986	40,387	16,679
Compensation expense related to stock options (a)	--	2,690	--	--	--
Income (loss) from operations	$ 10,568	$ 6,367	$ 4,743	$ 2,021	$ (829)
Net income (loss)	$ 5,344	$ 874	$ 1,706	$ 105	$ (912)
Accretion of Series C and Series D convertible preferred stock (a)	--	(2,035)	(739)	--	--
Income (loss) available to Series A and Series B convertible preferred and common stockholders	$ 5,344	$ (1,161)	$ 967	$ 105	$ (912)
Diluted earnings (loss) per common share	$ 0.21	$ (0.06)	$ 0.06	$ 0.01	$ (0.08)
Diluted weighted average common shares outstanding	26,039	17,965	16,003	17,237	11,358
Pro forma net income (a)		$ 4,523	$ 2,111		

Pro forma diluted earnings per common share	$ 0.20	$ 0.10
Pro forma weighted average number of common shares outstanding	22,476	21,649

	2000	1999	1998	1997	1996
Other Data:					
EBITDA (b)	$ 18,150	$ 13,969	$ 8,076	$ 4,247	$ (23)
EBITDA as percent of net revenue	13.4%	13.8%	12.7%	10.0%	--
Number of surgical facilities operated as of the end of period:					
ASCs	15	12	10	10	6
LVC centers	15	5	--	--	--
Number of surgical procedures performed:					
LVC	24,229	13,366	5,083	1,676	--
Cataracts	17,252	15,877	13,681	10,816	5,308
Other eye surgery procedures	13,128	10,843	8,845	6,464	1,337

	As of December 31,				
	2000	1999	1998	1997	1996
Consolidated Balance Sheet Data:					
Working capital	$ 23,728	$ 11,980	$ 9,220	$10,452	$ 7,887
Total assets	120,913	88,252	62,679	52,734	27,694
Total debt, excluding current portion	26,187	196	20,427	15,838	6,378
Redeemable convertible preferred stock	--	--	16,430	12,680	5,794
Total stockholders' equity	82,864	74,781	16,954	18,149	12,755

Notes:

(a) In connection with our initial public offering consummated on August 18, 1999 (IPO), we recorded noncash, nonrecurring charges for compensation expense related to stock options and a discount to the IPO offering price upon the exchange of subordinated notes for

common stock in 1999 and 1998. In addition, we recorded accretion of Series C and Series D convertible preferred stock to increase the carrying value of such stock to its potentially redeemable value. The pro forma net income gives effect to these noncash, nonrecurring charges, as well as the pro forma elimination of the interest expense related to the subordinated notes which were exchanged at the IPO. Please see the notes to consolidated financial statements included elsewhere in this Form 10-K for more discussion.

(b) EBITDA represents the sum of income before income taxes, interest expense and depreciation and amortization, and in 1999 noncash, stock-based compensation. We understand that industry analysts generally consider

EBITDA to be one measure of the financial performance of a company that investors find useful in analyzing the operating performance of a company and its ability to service debt. EBITDA, however, is not a measure of financial performance under generally accepted accounting principles and should not be considered an alternative to net income as a measure of operating performance or to cash flows from operating, investing or financing activities as a measure of liquidity. Given that EBITDA is not a measurement determined in accordance with generally accepted accounting principles and is thus susceptible to varying calculations, EBITDA, as presented, may not be comparable to other similarly titled measures of other companies.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion along with our consolidated financial statements and related notes included elsewhere herein. Our actual results, performance and achievements in 2001 and beyond may differ materially from those expressed in or implied by forward-looking statements contained in this discussion. Such forward-looking statements are made within the meaning of the Private Securities Litigation Reform Act of 1995.

Results of Operations

Year Ended December 31, 2000 Compared to the Year Ended December 31, 1999

Net Revenue. Net revenue increased 34.1% from $101.1 million to $135.6 million. Surgical facilities revenue increased 33.6% from $31.2 million to $41.7 million, primarily as a result of owning and operating additional ASCs and operating additional LVC centers, resulting in growth in the number of surgical procedures performed. In 2000, total surgical procedures performed in our surgical facilities increased 36% to 54,700. LVC procedures increased 81.3% and cataract surgical procedures increased 8.7%, compared to 1999. Surgical procedures in 2000 grew despite the adverse effects of particularly bad winter weather in December 2000, when surgical procedures in ASCs we owned and operated for one year or more declined 15% from December 1999. In those ASCs we owned for a year or more, our ASCs averaged 3,924 surgical procedures for the full year 2000, up from 3,860 in 1999. Management services revenue in 2000 increased 30.3% from $54.3 million to $70.8 million. The increase in management services revenue was primarily a result of overall increases in laser vision correction, cataract and other ophthalmic surgery procedures performed by our affiliated eye care professionals, as well as new affiliations with eye care professionals. Product sales revenue increased 48.5% from $15.6 million to $23.2 million, primarily as a result of higher volumes at our optical products purchasing organization, and to a lesser extent, the revenue associated with our acquisition of a marketing products and services company in May 2000.

Salaries, Wages and Benefits. Salaries, wages and benefits expense increased 35.5% from $37.4 million to $50.7 million. As a percentage of revenue, salaries, wages and benefits expense increased from 37.0% to 37.4%. The absolute increase in salaries, wages and benefits expense primarily reflects the additional payroll incurred as a result of new acquisitions and affiliations. Also contributing to the increase was approximately $320,000 of severance costs associated with the streamlining of our organizational structure during the second half of the year.

Cost of Sales and Medical Supplies. Cost of sales and medical supplies expense increased 30.7% from $26.3 million to $34.3 million. As a percentage of revenue, cost of sales and medical supplies expense decreased from 26.0% to 25.3%. The absolute increase in cost of sales and medical supplies expense is primarily a result of higher volumes at our optical products purchasing organization. Higher supply costs associated with the increase in laser vision

correction procedures also contributed to the absolute increase during the period. In general, our optical laboratories and purchasing organization have a relatively higher cost of sales percentage to revenue than the optical retail outlets of the Company's affiliated eye care professionals.

The decrease in cost of sales and medical supplies as a percentage of revenue reflects efforts during the year to negotiate corporate contracts with selected strategic suppliers.

Selling, General and Administrative. Selling, general and administrative expense increased 38.2% from $23.5 million to $32.4 million. As a percentage of revenue, selling, general and administrative expense increased from 23.2% to 23.9%. The absolute increase in selling, general and administrative expense was the result of costs incurred at new acquisitions and affiliations, along with increased marketing expenditures during the first half of 2000.

Depreciation and Amortization. Depreciation and amortization expense increased 54.4% from $4.9 million to $7.6 million. Acquisitions and affiliations, as well as increased capital expenditures, increased overall depreciation and amortization expense.

Other Expense. Interest expense increased 26.6% from $1.5 million to $1.9 million, the result of higher interest rates and higher average outstanding balances when compared with the prior year period.

Provision for Income Taxes. Our effective tax rate decreased to 39.2% from 44.8% (excluding the effect of the IPO-related items in 1999). Our effective tax rate is affected by expenses that are deducted from operations in arriving at pre-tax income that are not allowed as a deduction on our Federal income tax return, primarily goodwill amortization. The increase in income before income taxes in 2000 better covered these nondeductible expenses, resulting in a lower overall effective tax rate.

Year Ended December 31, 1999 Compared to the Year Ended December 31, 1998

Net Revenue. Net revenue increased 58.7% from $63.7 million to $101.1 million. Surgical facilities revenue increased 55.1% from $20.1 million to $31.2 million, primarily as a result of a 45% increase in procedures performed in our facilities, compared to 1998. The 163% increase in laser vision correction procedures was a result of both an increase in the overall demand for the procedure as well as an increase in the number of our affiliated eye care professionals performing the procedure. We also experienced a 16.1% increase in the number of cataract surgical procedures, compared to 1998. Management services revenue increased 50.7% from $36.1 million to $54.3 million. The increase in management services revenue was primarily a result of overall increases in laser vision correction, cataract and other ophthalmic surgery procedures performed by our affiliated eye care professionals as well as new affiliations with eye care professionals. Product sales revenue increased 106.7% from $7.5 million to $15.6 million, primarily as a result of the revenue added through the acquisition of Midwest Uncuts, Inc., a wholesale optical laboratory, in January 1999.

Salaries, Wages and Benefits. Salaries, wages and benefits expense increased 48.2% from $25.3 million to $37.4 million. As a percentage of revenue, salaries, wages and benefits expense decreased from 39.6% to 37.0%. The absolute increase in salaries, wages and benefits expense primarily reflects the additional payroll incurred as a result of new acquisitions and affiliations. The decrease in salaries, wages and benefits expense as a percentage of net revenue was a result of better utilization of staff due

primarily to the increased volume of laser vision correction, cataract and other eye-related surgical procedures.

Cost of Sales and Medical Supplies. Cost of sales and medical supplies expense increased 66.7% from $15.8 million to $26.3 million. As a percentage of revenue, cost of sales and medical supplies expense increased from 24.7% to 26.0%. The absolute increase in cost of sales and medical supplies expense is primarily a result of the January 1, 1999 acquisition of Midwest Uncuts, Inc. and of higher volumes at our optical products purchasing organization. The increase in laser vision correction procedures and the related supply costs also contributed to the absolute increase during the period.

Selling, General and Administrative. Selling, general and administrative expense increased 60.4% from $14.6 million to $23.5 million. As a percentage of revenue, selling, general and administrative expense

increased from 22.9% to 23.2%. The absolute increase in selling, general and administrative expenditures related primarily to the expansion of sales and marketing efforts in connection with our laser vision correction business. In addition, we increased our information technology expenditures related to our enterprise-wide information systems and other programs supporting our laser vision correction business.

Depreciation and Amortization. Depreciation and amortization expense increased 47.4% from $3.3 million to $4.9 million. Acquisitions and affiliations, as well as increased capital expenditures, increased overall depreciation and amortization expense.

Compensation Expense Related to Stock Options. During July 1999, we fully vested all options granted from February 1, 1999 through July 23, 1999. We issued options to acquire 1,050,800 shares of our common stock during this time period, which were granted with exercise prices below the fair market value. Accordingly, we recorded a noncash, pre-tax charge of $2.7 million as compensation expense related to those options, which became fully vested on the completion of our initial public offering.

Other Expense. Other expense decreased 8.2% from $1.4 million to $1.3 million. The decrease in other expense was primarily related to the reduction of interest expense as a result of the reduction of outstanding indebtedness from the application of the proceeds of our initial public offering, which occurred on August 18, 1999. In addition, $9.7 million of our subordinated exchangeable promissory notes were exchanged for our common stock, based upon the initial public offering price for each $0.80 worth of outstanding principal on the notes. We recorded the difference between the value of common stock and the notes as nonrecurring, noncash interest expense of $2.4 million.

Provision for Income Taxes. Our effective tax rate increased to 67.4% from 49.4%. Our effective tax rate is affected by expenses that are deducted from operations in arriving at pre-tax income that are not allowed as a deduction on our Federal income tax return, primarily goodwill amortization and the nondeductible portion of the additional interest expense resulting from the exchange of the subordinated notes for common stock, discussed above

Accretion of Series C and Series D Convertible Preferred Stock. In connection with our initial public offering, approximately 16.3 million shares of Series A, Series B, Series C and Series D preferred stock, which represented all of the issued and outstanding shares of preferred stock, converted into shares of our common stock. Prior to the initial public offering, however, the holders of the Series C and Series D convertible preferred stock had the right

to tender their stock for redemption in 2004 and 2005 at the greater of the amount originally paid for the preferred stock or its fair market value. Because the redemption right was outside of our control, generally accepted accounting principles require that until the redemption date, we increased the value of the preferred stock to its ultimate redemption value, a principle known as accretion. This accretion is deducted from net income in the accompanying consolidated statements of operations to arrive at the income available for common stockholders. Although we did not have an independent appraisal, we estimated the potential future redemption value based upon various transactions with third parties, through comparison to similar public companies and the initial price range established during the filing of our registration statement on Form S-1 in May 1999. Based upon these estimates, we recorded accretion of $2.0 million up to the effective date of the IPO on August 18, 1999, and $739,000 for the twelve months ended December 31, 1998.

Liquidity and Capital Resources

We generated cash from operating activities for the year ended December 31, 2000 of $9.0 million. We used $33.3 million in our investing activities in 2000, which included ten acquisitions and/or affiliations, the purchase of property and equipment and the issuance of certain notes receivable related to the conversion of subordinated exchangeable promissory notes in connection with our IPO. We used net bank borrowings of $23.0 million and net cash from operating activities to fund our investing activities. As of December 31, 2000 and 1999, we had cash and cash equivalents of approximately $785,000 and $1.8 million, respectively, and working capital of approximately $23.7 million and $12.0 million, respectively.

On June 28, 2000, we replaced our $35 million revolving credit agreement with a new, three-year, $50 million revolving credit agreement. Interest on borrowings under the new credit agreement is payable at an annual rate equal to our lender's published base rate plus the applicable borrowing margin ranging from 0 to 0.75% or LIBOR plus a range from 1.5% to 2.25%, varying upon our ability to meet financial covenants. The weighted average interest rate on credit line borrowings was 8.6% for the twelve months ended December 31, 2000. The new credit agreement contains covenants that include limitations on indebtedness, liens, capital expenditures, acquisitions and affiliations and ratios that define borrowing availability and restrictions on the payment of dividends. As of December 31, 2000, we were in compliance with all our credit agreement covenants. At December 31, 2000, we had outstanding borrowings under the new credit line of $26.2 million, the interest rate on which was 8.7%.

We expect our cash flow from operations and funds available under our existing revolving credit facility will be sufficient to fund our operations for at least 12 months. Our future capital requirements and the adequacy of our available funds will depend on many factors, including the timing of our acquisition activities, new affiliations with eye care professionals, capital requirements associated with our surgical facilities, expansions and the future cost of surgical equipment.

On June 15, 2000, we entered into an agreement to acquire two ASCs, contingent upon the resolution of certain requirements associated with the seller (the "Contingencies"). Certain of these Contingencies were satisfied in 2000 with respect to one of the ambulatory surgery centers, which we acquired in December 2000. Upon the resolution of the Contingencies affecting the other ambulatory surgery center and other conditions to closing, which could occur as early as May 1, 2001, we will be required to purchase the other ambulatory surgery center for approximately $9.3 million in cash consideration. We may elect to fund up to approximately $2.3 million of this purchase price in the

form of our common stock. This transaction is excluded from the acquisition limitations of the new Credit Agreement discussed above.

One of our affiliated eye care professionals has the option, exercisable through November 1, 2002, to acquire up to a 25% interest in one of our ASCs.

Effective March 1, 2001, we entered into a new five-year supply agreement with Alcon Laboratories, Inc. setting forth the terms upon which we can procure and utilize excimer lasers manufactured by Alcon. This agreement amended and superseded our previous agreement originally entered into with Summit Technology, Inc., which was acquired by Alcon in 2000. During the five-year term, we will pay Alcon monthly based on the number of procedures performed on each of our APEX/Infinity lasers and LADARVision Systems. We are required to pay for a minimum number of annual procedures on each LADARVision System during the five-year term, whether or not these procedures are performed. As of March 15, 2001, we have entered into commitments to pay Alcon up to approximately $1.4 million annually during the five-year term.

Risk Factors

Investors should consider the following risks in connection with an investment in us.

Risks Relating to Our Business

Our failure to grow, or to manage our growth, could reduce our ability to continue to achieve or sustain profitability

Our growth strategy is focused on our existing and future regional markets and involves:

- acquiring or developing additional ASCs and LVC centers
- affiliating with additional eye care professionals
- helping our affiliated eye care professionals grow and develop their practices

Pursuing the acquisition and development of ASCs and LVC centers, as well as affiliations with eye care professionals presents us with a variety of challenges. We may not experience an increase in surgical procedures at our existing ASCs or LVC centers, or management fees from our affiliated eye care professionals. We may not be able to achieve the economies of scale and patient base, or provide the business, administrative

and financial services, required to sustain profitability in our existing and future ASCs and LVC centers, or in the clinics of our affiliated eye care professionals.

If we are unable to successfully implement our growth strategy or manage our growth effectively, our business, financial condition and results of operations, including our ability to achieve and sustain profitability, could be adversely affected.

Our failure to acquire or develop a sufficient number of profitable surgical facilities could limit our profitability and revenue growth

Our success depends upon our ability to acquire or develop a sufficient number of profitable ASCs and LVC centers in our existing and future markets.

We may not be able to identify suitable acquisition or development targets, successfully negotiate the acquisition or development of these facilities on satisfactory terms, or have the access to capital to finance these endeavors. Newly acquired or developed facilities may generate losses or suffer lower operating margins than our more established facilities, or they may not generate returns that justify our investment. In addition, if vision correction technology becomes available to ophthalmologists that is less expensive than the medical equipment currently required for laser vision correction, eye care professionals might have less interest in using our ASCs and LVC centers.

We may not compete effectively with other companies that have more resources and experience than us

Competitors with substantially greater financial, technical, managerial, marketing and other resources and experience may compete more effectively than us. We and our affiliated eye care professionals compete with other businesses, including ASC companies, refractive laser center companies, hospitals, individual ophthalmologists and optometrists, other ASCs, LVC centers, eye care clinics and providers of retail optical products. Competitors with substantially greater resources may be more successful in acquiring and developing surgical facilities and/or affiliating with eye care professionals. Our wholesale optical laboratories and optical products purchasing organization also face competition on national, regional and local levels. Companies in other health care industry segments, including managers of hospital-based medical specialties or large group medical practices, may become competitors in providing ASCs and LVC centers as well as competitive eye care related services. Competition for retaining the services of highly qualified ophthalmologists and optometrists and medical, technical and managerial personnel is significant, and we may not be able to help our affiliated eye care professionals identify, hire, train, retain and affiliate with these types of individuals in the future.

Reduced prices and reimbursement rates for surgical procedures as a result of competition or Medicare and private third party payor cost containment efforts could reduce our revenue, profitability and cash flow.

We estimate that for the year ended December 31, 2000, revenue from laser vision correction procedures comprised 24% of our consolidated revenue. The market for providing laser vision correction and other refractive surgery procedures is becoming increasingly competitive. This competitiveness has resulted in many of our competitors offering laser vision correction or other refractive surgery services at lower prices than the prices charged by us and our affiliated eye care professionals. If price competition continues, however, we may choose to lower the prices we charge. If we lower prices, we could experience reductions in our revenue, profitability and cash flow.

We estimate that for the year ended December 31, 2000, government sponsored health care programs, directly or indirectly, accounted for approximately 26% of our consolidated revenue. This includes facility fees we receive directly for eye care professionals' use of our ASCs, as well as management fee revenue from affiliated eye care professionals who receive payments from these programs. This revenue does not include amounts derived from laser vision correction, which is an elective procedure that patient-consumers pay for out-of-pocket.

The health care industry is continuing to experience a trend toward cost containment as government and private third-party payors seek to impose lower reimbursement and utilization rates and to negotiate reduced payment schedules

with health care providers. For example, recent legislation requires that DHHS implement a new Medicare reimbursement rate methodology for ASCs over a four-year period beginning no earlier than January 1, 2002. These trends may result in a reduction from historical levels in per patient revenue received by our ASCs and affiliated eye care professionals. Changes in Medicare payment rates have in the past reduced payments to ophthalmologists and optometrists. Private insurance payments also could be affected to the extent that these insurance companies use payment methodologies based on Medicare rates.

Reductions in payments to our ASCs, LVC centers and affiliated eye care professionals or other changes in reimbursement for eye care services could reduce our revenue, profitability and cash flow.

If eye care professionals and the general population do not continue to accept laser vision correction and other refractive surgical procedures as alternatives to eyeglasses and contact lenses, an important source of our historical and future revenue and earnings growth will be limited

Our profitability and growth will depend, in part, upon continued acceptance by eye care professionals and the general population of laser vision correction and other refractive surgical procedures in the U.S. Eye care professionals and the general population might not continue to accept laser vision correction surgery because of the cost of the procedure that, to date, has primarily been paid directly by patients, and concerns about the safety and effectiveness of laser vision correction. If eye care professionals and the general population do not continue to accept laser vision correction and other refractive surgical procedures, an important source of our historical and future revenue and earnings growth will be limited.

Rapid technological advances may reduce our sources of revenue and our profitability

Adoption of new technologies that may be comparable or superior to existing technologies for excimer lasers and other surgical equipment could reduce the amount of the facility fees we receive from eye care professionals who use our surgical facilities and management fees we receive from affiliated professional entities. Reduction of these sources of revenue could decrease our profitability. In this case, we might have to expend significant capital resources to deploy new technology and related equipment to remain competitive. Our inability to provide access to new and improving technology could deter eye care professionals from using our surgical facilities or affiliating with us.

Our failure to maintain or establish profitable affiliations with a sufficient number of eye care professionals could limit our profitability and revenue growth

Our success depends, in part, upon our ability to establish and maintain affiliations with eye care professionals in our existing and future markets. We may not be able to enter into contractual arrangements with ophthalmologists or optometrists on satisfactory terms, and these affiliations may not be profitable for us. In addition, if vision correction technology becomes available to ophthalmologists that is less expensive than the medical equipment currently required for laser vision correction, eye care professionals might have less interest in our services and our surgical facilities. If we fail to establish or maintain profitable affiliations with a sufficient number of qualified ophthalmologists and optometrists, we could experience reductions in our profitability and revenue growth.

For the years ended December 31, 2000, 1999 and 1998, the management

services revenue of one of our affiliated professional entities accounted for 12.8%, 15.4% and 15.4% of our consolidated net revenue, respectively. Another affiliated professional entity, created during 1999 from a combination of a group of our affiliated practices, accounted for 11.5% and 8.6% of our consolidated net revenue in the years ended December 31, 2000 and 1999, respectively. If we fail to maintain our existing affiliations with these and other affiliated professional entities, we could experience reductions in our profitability and revenue growth.

Loss of the services of ophthalmologists or optometrists could impair our sources of revenue and our ability to grow our business

Our success depends, in part, on the services of the ophthalmologists and optometrists with whom we affiliate. Our inability to attract and retain eye care professionals could limit our sources of revenue and our ability to grow our business. Generally, our affiliated ophthalmologists enter into five-year employment agreements with our affiliated professional entities. These agreements generally contain noncompete and nonsolicitation covenants and often require the ophthalmologist to pay liquidated damages that are generally in excess of $500,000 in the event that he or she quits prior to the end of the initial term. Our affiliated optometrists enter into employment contracts with our affiliated professional entities which also contain noncompete and nonsolicitation covenants. The noncompete and nonsolicitation covenants generally preclude the ophthalmologist or optometrist from competing with his or her employer within a specified geographic area, or soliciting the employer's patients or employees, during the employment term and for a one-year period following termination. The damages provisions and restrictive covenants may not effectively deter affiliated eye care professionals from quitting if they elect to pay the liquidated damages or establish a practice outside the geographic scope of the noncompete covenant.

The enforceability of restrictive covenants of these types will depend upon a variety of equitable factors, including public policy concerns regarding broad restrictions that might limit the availability of medical care. If a court deems the scope or duration of the restrictive covenants or liquidated damages provisions excessive, they may not be enforceable.

Loss of the services of key management personnel could adversely affect our business

Our success depends, in part, on the services of key management personnel, including Stephen J. Winjum, our Chairman of the Board, President and Chief Executive Officer; Ronald G. Eidell, our Executive Vice President and Chief Financial Officer; and E. Michele Vickery, our Executive Vice President of Operations. We do not know of any reason why we might be likely to lose the services of any of these officers. However, in light of the role that each of these officers has played in our growth to date, if we lost the services of any of these officers, we believe that our business could be adversely affected.

Lack of adequate financing could limit our growth

Successful implementation of our growth strategy will require continued access to capital. If we do not have sufficient cash resources, our growth could be limited unless we are able to obtain capital through additional equity or debt financings. We intend to finance future acquisitions, affiliations and our other strategic initiatives by using a combination of cash, debt and capital stock. However, if our stock is not at a sufficient value, or is not deemed to be an acceptable form of consideration, we may be required to use more of our cash resources or obtain other financing. Capital may not be available to us for acquisitions, affiliations or other needs. Further, if financing is available, it may not be on terms that are favorable

to us or sufficient for our needs.

The nature of our business could subject us to potential malpractice, product liability and other claims

The provision of eye care services entails the potentially significant risk of physical injury to patients and an inherent risk of potential malpractice, product liability and other similar claims. Our insurance may not be adequate to satisfy claims or protect us or our affiliated eye care professionals and this coverage may not

continue to be available at acceptable costs. A partially or completely uninsured claim against us could reduce our earnings and working capital.

If a change in events or circumstances causes us to write-off a large portion of intangible assets, our total assets would be reduced significantly and we could incur a substantial charge to earnings

Our assets include substantial intangible assets in the form of service agreements with our affiliated eye care professionals and goodwill. At December 31, 2000, intangible assets represented approximately 51% of total assets and 75% of stockholders' equity. The intangible asset value represents the excess of cost over the fair value of the separately identifiable net assets acquired in connection with rights we receive under our service agreements. The value of these assets may not be realized. We regularly evaluate whether events and circumstances have occurred that indicate all or a portion of the carrying amount of the asset may no longer be recoverable, in which case an additional charge to earnings may become necessary. If, during our evaluation, we determine that the undiscounted cash flow from an ASC, an LVC center or an affiliated practice is not sufficient to recover the unamortized intangible asset, we will reduce the unamortized balance to its realizable amount and incur a corresponding charge to earnings. To date, we have not written off a significant portion of unamortized intangible assets attributable to service agreements or goodwill. If, in the future, we determine that our unamortized intangible assets have suffered an impairment which requires us to write off a large portion of unamortized intangible assets due to a change in events or circumstances, this write off would significantly reduce our total assets and we could incur a substantial charge to earnings.

Risks Relating to Our Industry

Application of existing or proposed government regulation could impair our sources of revenue and limit our ability to grow our business

We are subject to extensive government regulation and supervision, including:

. Federal and State:

--anti-kickback statutes

--self-referral laws

--civil false claims acts

--privacy laws

. State:

--facility license requirements and certificates of need

--corporate practice of medicine restrictions

--fee-splitting laws

. Food and Drug Administration regulation of medical devices, including laser vision correction and other refractive surgery equipment, and pharmaceuticals and related clinical trials

. Federal Trade Commission guidelines for marketing and promoting laser vision correction and other refractive surgery procedures

Many of these laws and regulations are subject to varying interpretations, and courts and regulatory authorities generally have provided little clarification. Moreover, state and local laws and interpretations vary from jurisdiction to jurisdiction. As a result, we may not always be able to accurately predict interpretations of applicable law, and Federal and state authorities could challenge some of our activities. If any of our activities are challenged, we may have to divert substantial time, attention and resources from running our business to defend our activities against these challenges, regardless of their merit. If we do not successfully defend these challenges, we may face a variety of adverse consequences, including:

. loss of use of, or a decline in the revenue and profitability of, our ASCs and LVC centers

. our affiliated eye care professionals terminating their service agreements or having these agreements rendered unenforceable

. third party payors terminating their agreements with our affiliated eye care professionals

. our affiliated eye care professionals losing their eligibility to participate in Medicare or losing other contracting privileges

. in some instances, civil or criminal fines

Any of these results could impair our sources of revenue and our profitability and limit our ability to grow our business.

Becoming compliant with federal regulations enacted under the Health Insurance Portability and Accountability Act could require us to expend significant resources and capital, and could impair our profitability and limit our ability to grow our business

Recently released federal regulations adopted under the Health Insurance Portability and Accountability Act of 1996 (HIPAA) require that our affiliated eye care professionals and we be capable of conducting certain standardized health care transactions, including billing and other claims transactions, by October 16, 2002. In addition, on December 28, 2000, HIPAA regulations governing patient privacy were released, and compliance with those regulations is required by April 15, 2003. Due to efforts in Congress to overturn these privacy rules, their status is currently unclear. Regardless of Congress' actions on these privacy rules, HIPAA requires that patient privacy regulations must be enacted. Depending on their ultimate form, these privacy regulations may require substantial compliance efforts on behalf of our affiliated eye care professionals and us. Although difficult to predict at this time, the amount of

time, effort and expense associated with becoming compliant with existing and expected HIPAA regulations could require us to divert time, attention and resources from our business operations, and/or require us to spend substantial sums that could impair our profitability. HIPAA violations could also expose us to civil penalties of up to $25,000 per person per year for each violation and criminal penalties with fines of up to $250,000 and/or up to 10 years in prison per violation.

Risks Relating to our Common Stock

Any return on your investment in our stock will depend on your ability to sell our stock at a profit

Some investors favor companies that pay dividends. We have never declared or paid any dividends and our credit agreement prohibits payment of dividends on our common stock. We anticipate that we will not declare dividends at any time in the foreseeable future. Instead we will retain earnings for use in our business. As a result, your return on an investment in our stock likely will depend on your ability to sell our stock at a profit.

In addition, the stock market has, from time to time, experienced extreme price and volume fluctuations. These broad market fluctuations may adversely affect the market price of our common stock.

Fluctuations in our quarterly operating results may make it difficult to predict our future results of operations and may cause volatility in our stock price

During 2000, the market price of our common stock has been volatile, fluctuating from a high trading price of $18.25 to a low trading price of $0.88 per share. Our results of operations have varied and may continue to fluctuate from quarter to quarter. We have a high level of fixed operating costs, including compensation costs and minimum usage commitments on our excimer lasers. As a result, our profitability depends to a large degree on the volume of surgical procedures performed in, and on our ability to utilize the capacity of, our surgical facilities and on the volume of patients treated in the clinics of our affiliated eye care professionals.

We experience some seasonality in our operating results during the first calendar quarter. The timing and degree of fluctuations in our operating results will depend on several factors, including:

. general economic conditions

. decreases in demand for non-emergency procedures due to severe weather

. availability or sudden loss of the services of our affiliated eye care professionals

. availability or shortages of laser and other vision correction surgery-related products and equipment

. the timing and relative size of acquisitions and affiliations with eye care professionals

These kinds of fluctuations in quarterly operating results may make it difficult for you to assess our future results of operations and may cause a decline or volatility in our stock price.

Provisions of our charter and bylaws, Delaware law and our Rights Agreement could deter takeover attempts

Provisions of our Restated Certificate of Incorporation, our Bylaws, Delaware law and our Rights Agreement may have the effect of delaying, deterring or preventing a change in control, even if a change in control would be beneficial to you. Members of our board of directors may have interests in a change of control that differ from you. These interests could cause them to resist a change in control that would help you better realize the value of your investment.

Our existing stockholders will have the ability to control our affairs and to deter a change in control and their interests in a change in control may differ from your interests

As of March 15, 2001, our Rule 144 Affiliates and affiliated eye care professionals owned approximately 53% of the outstanding shares of our stock. As a result, if these persons act together, they will have the ability to exercise substantial control over our affairs and to elect a sufficient number of directors to control our board of directors. Because of their relationships with us, many of these persons may have interests in a change in control that differ from your interests.

For example, our affiliated eye care professionals may have an interest in the quality and nature of management services to be rendered following a change in control. This interest could cause them to resist a change in control that they perceive will result in new, different or less desirable management services being offered to them.

In addition, our affiliated eye care professionals who were also stockholders as of our initial public offering in August 1999 have entered into lock-up agreements with our underwriters that subject any sale of common stock through August 18, 2001, to volume limitations. Consequently, the ownership position of our Rule 144 Affiliates and affiliated eye care professionals, as well as the contractual restrictions agreed to by our affiliated eye care professionals, may also have the effect of delaying, deterring or preventing a change in control, even if a change in control would be beneficial to you.

50% of our total outstanding shares are restricted from resale but may be sold into the market in the future, which could cause our stock price to drop significantly

As of March 15, 2001, there were 24,698,640 shares of our common stock outstanding. This includes the 4,600,000 shares sold in our initial public offering in August 1999, which can be resold in the public market immediately unless acquired by our affiliates, as that term is defined under the Securities Act of 1933. Our affiliated eye care professionals who were also stockholders as of our initial public offering in August 1999 have entered into lock-up agreements with the Company's underwriters that restrict their ability to sell our common stock. These lock-up agreements limit the volume of shares an affiliated eye care professional can sell until August 19, 2001. Until August 19, 2001, an affiliated eye care professional cannot, without the written consent of Credit Suisse First Boston, sell in any ninety-day period an amount greater than the lesser of 40,000 shares or 10% of the amount of common stock beneficially owned by such individual.

As of March 15, 2001, approximately 12.3 million shares of common stock held in certificate form are subject to these lock-up agreements. There may be additional shares of common stock owned by our affiliated eye care professionals that are subject to these lock-up agreements that are held in "street name."

As restrictions on resale end, our stock price could drop significantly if the holders of these restricted shares sell them or if the market perceives that these holders intend to sell shares. This could occur without regard to the performance of our business.

If our common stock is delisted from the Nasdaq National Market, the liquidity, visibility and price of our common stock may decrease

Since our initial public offering our common stock has been listed on the Nasdaq National Market (NNM). Shares of our common stock could be delisted from the NNM if we fail to satisfy the continued listing requirements of the NNM, including a minimum bid price of $1.00. If our common stock is delisted from the NNM, we would be forced to list our common stock on the OTC Bulletin Board or some other quotation medium, depending on our ability to meet the specific listing requirements of those quotation systems. If this happens, an investor might find it more difficult to buy and sell, or to obtain accurate price quotations for, shares of our common stock. This lack of visibility and liquidity could further decrease the price of our common stock. In addition, delisting from the NNM might negatively impact our reputation and, as a consequence, our business.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Our exposure to interest rate risk relates primarily to our debt obligations and temporary cash investments. Interest rate risk is managed through variable rate borrowings under our credit facility. On December 31, 2000, we had $26.2 million of debt outstanding under our credit facility. Our revolving line of credit bears interest at an annual rate equal to our lender's published base rate plus applicable borrowing margin ranging from 0 to 0.75% or LIBOR plus a range from 1.5% to 2.25%, varying upon our ability to meet financial covenants.

We do not use any derivative financial instruments relating to the risk associated with changes in interest rates.

Item 8. Financial Statements and Supplementary Data

The consolidated financial statements and financial statement schedules, with the report of independent public accountants, listed in Item 14 are included in this Form 10-K.

Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information in response to this item is incorporated by reference from the "Proposal 1 -- Election of Directors," "Other Directors" and "Executive Officers" sections of the Definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with our 2001 Annual Meeting of Stockholders (the "2001 Proxy Statement").

Item 11. Executive Compensation

The information in response to this item is incorporated by reference from the "Executive Compensation" section of the 2001 Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The information in response to this item is incorporated by reference from the "Security Ownership of Certain Beneficial Owners and Management" section of the 2001 Proxy Statement.

Item 13. Certain Relationships and Related Transactions

The information in response to this item is incorporated by reference from the "Certain Relationships and Related Transactions" section of the 2001 Proxy Statement.

PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) The following documents are filed as part of this Form 10-K:

1. The following consolidated financial statements of the Company, with the report of independent public accountants, are filed as part of this Form 10-K:

. Report of Independent Public Accountants

. Consolidated Balance Sheets

. Consolidated Statements of Operations

. Consolidated Statements of Stockholders' Equity

. Consolidated Statements of Cash Flows

. Notes to Consolidated Financial Statements

2. The following consolidated financial statement schedules of the Company are filed as part of this Form 10-K:

Schedule I--Rule 12-09 Valuation Reserves

3. The following exhibits are filed with this Form 10-K or incorporated by reference as set forth below.

Exhibit Number	Exhibit
3.1+	Amended and Restated Certificate of Incorporation of the Registrant
3.2	Amended and Restated Bylaws of the Registrant
4.1+	Specimen stock certificate representing Common Stock
4.2+	Registrant's Rights Agreement
10.1++	Registrant's Amended and Restated Stock Incentive Plan
10.2+	Registrant's Amended and Restated 1999 Stock Purchase Plan
10.3+	Indemnification Agreement
10.4+	Registration Rights Agreement
10.5+	Subordinated Registration Rights Agreement
10.6+	Employment Agreement

10.8++	$50,000,000 Credit Agreement dated as of June 28, 2000
10.12+*	Management Services Agreement (SureVision Eye Centers, L.L.C.)
10.13+*	Management Services Agreement (Hunkeler Eye Centers. P.C.)
10.15+	Registrant's 401(k) Plan
21	Subsidiaries of the Registrant
23	Consent of Arthur Andersen LLP

\+ Incorporated by reference to the corresponding Exhibit of the Registrant's Registration Statement on Form S-1 (Reg. No. 333-79271).

++ Incorporated by reference to the corresponding Exhibit of the Registrant's Form 10-Q filed with the Securities and Exchange Commission on August 14, 2000.

* Portions of this Exhibit have been omitted based upon a request for confidential treatment of this document; omitted portions have been separately filed with the Commission.

(b) Reports on Form 8-K:

We did not file any reports on Form 8-K during 2000.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board Directors of
NovaMed Eyecare, Inc.:

We have audited the accompanying consolidated balance sheets of NOVAMED EYECARE, INC. AND SUBSIDIARIES as of December 31, 2000 and 1999 and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2000. These consolidated financial statements and the schedule referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

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

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Rule 12-09 Valuation Reserve Schedule is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This information has been subject to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in

relation to the basic financial statements taken as a whole.

Arthur Andersen LLP

Chicago, Illinois
February 7, 2001

NOVAMED EYECARE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

ASSETS	December 31, 2000	December 31, 1999
Current assets:		
Cash and cash equivalents	$ 785	$ 1,828
Accounts receivable, net of allowances of $17,023 and $12,714, respectively	23,287	14,501
Due from affiliated providers, net	878	1,931
Notes receivable from affiliated providers	3,225	342
Inventory	3,651	3,427
Other current assets	2,263	2,113
Total current assets	34,089	24,142
Property and equipment, net	22,536	16,065
Intangible assets, net	62,205	47,852
Other assets, net	2,083	193
Total assets	$120,913	$88,252
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 5,432	$ 3,608
Accrued expenses	4,680	4,662
Income taxes payable	--	275
Current maturities of long-term debt	249	3,617
Total current liabilities	10,361	12,162
Long-term debt, net of current maturities	26,187	196
Deferred income tax liability	1,501	1,113
Commitments and contingencies		
Stockholders' equity:		
Series E Junior Participating Preferred Stock, $0.01 par value, 1,912,000 shares authorized, none outstanding at December 31, 2000 and 1999, respectively	--	--
Common stock, $0.01 par value, 81,761,465 shares authorized, 24,679,357 and 24,159,199 shares		

issued and outstanding at December 31, 2000 and 1999, respectively	247	242
Additional paid-in-capital	77,362	74,628
Retained earnings (deficit)	5,255	(89)
Total stockholders' equity	82,864	74,781
Total liabilities and stockholders' equity	$120,913	$88,252

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

NOVAMED EYECARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except per share data)

	Years Ended December 31,		
	2000	1999	1998
Net revenue:			
Surgical facilities	$ 41,720	$ 31,223	$20,131
Management services	70,759	54,321	36,053
Product sales and other	23,159	15,599	7,545
Total net revenue	135,638	101,143	63,729
Operating expenses:			
Salaries, wages and benefits	50,733	37,437	25,266
Cost of sales and medical supplies	34,346	26,278	15,762
Selling, general and administrative	32,409	23,459	14,625
Depreciation and amortization	7,582	4,912	3,333
Compensation expense related to stock options	--	2,690	--
Total operating expenses	125,070	94,776	58,986
Income from operations	10,568	6,367	4,743
Other (income) expense:			
Interest expense	1,915	1,513	1,546
Interest income	(137)	(214)	(273)
Minority interests in earnings of consolidated entities	--	--	132
Other	--	(39)	(32)
Discount to initial public offering price upon the exchange of subordinated notes for common stock	--	2,425	--
Total other expense	1,778	3,685	1,373
Income before income taxes	8,790	2,682	3,370
Provision for income taxes	3,446	1,808	1,664

Net income	5,344	874	1,706
Less--Accretion of Series C and Series D convertible preferred stock	--	(2,035)	(739)
Income (loss) available to Series A and Series B convertible preferred and common stockholders	$ 5,344	$ (1,161)	$ 967
Earnings (loss) per common share:			
Basic	$ 0.22	$ 0.19	$ 0.07
Diluted	$ 0.21	$ (0.06)	$ 0.06
Weighted average common shares outstanding:			
Basic	24,495	10,464	2,751
Diluted	26,039	17,965	16,003

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

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NOVAMED EYECARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Dollars and shares in thousands)

	Series A Preferred		Series B Preferred		Common Stock					Tr
	Shares	Par Value	Shares	Par Value	Shares	Par Value	Additional Paid-In Capital	Deferred Compensation	Retained Earnings (Deficit)	Sh
Balance, December 31, 1997	11,733	$ 117	400	$ 4	2,748	$ 27	$18,083	$ --	$ 105	
Stock options exercised/sold	7	--	--	--	3	1	32	--	--	
Redemption of Series A preferred stock, net	--	--	--	--	--	--	(71)	--	--	(1
Issuance of Treasury stock in conjunction with practice affiliations	--	--	--	--	--	--	(89)	--	--	
Accretion of Series C and D preferred stock	--	--	--	--	--	--	--	--	(739)	
Net income	--	--	--	--	--	--	--	--	1,706	
Balance,										

December 31, 1998	11,740	117	400	4	2,751	28	17,955	--	1,072	
Common stock issuances, net	--	--	--	--	3,202	32	22,257	--	--	
Conversion of preferred stock to common stock	(11,740)	(117)	(400)	(4)	16,464	165	18,422	--	--	
Conversion of subordinated notes to common stock	--	--	--	--	1,516	15	12,110	--	--	
Common stock reacquired from affiliates	--	--	--	--	--	--	--	--	--	
Deferred compensation expense	--	--	--	--	--	--	2,690	(2,690)	--	
Amortization of deferred compensation expense	--	--	--	--	--	--	--	2,690	--	
Issuance of stock in conjunction with affiliations and acquisitions	--	--	--	--	60	1	656	--	--	
Stock options exercised/sold	--	--	--	--	166	1	538	--	--	
Accretion of Series C and Series D preferred stock	--	--	--	--	--	--	--	--	(2,035)	
Net income	--	--	--	--	--	--	--	--	874	
Balance, December 31, 1999	--	--	--	--	24,159	242	74,628	--	(89)	
Issuance of stock in conjunction with affiliations and acquisitions	--	--	--	--	88	1	596	--	--	
Stock options exercised/sold	--	--	--	--	371	4	1,876	--	--	
Shares issued--employee stock purchase plan	--	--	--	--	61	--	262	--	--	
Net income	--	--	--	--	--	--	--	--	5,344	
Balance, December 31, 2000	--	$ --	--	$--	24,679	$247	$77,362	$ --	$ 5,255	

The accompanying notes are an integral part of this consolidated financial statement

NOVAMED EYECARE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands, except share data)

	Years Ended December 31,		
	2000	1999	1998
Cash flows from operating activities:			
Net income	$ 5,344	$ 874	$ 1,706
Adjustment to reconcile net income to net cash provided by operating activities, net of effects of purchase transactions--			
Depreciation and amortization	7,582	4,912	3,333
Non-cash employee stock option compensation	--	2,690	--
Discount from conversion of subordinated exchangeable notes to common stock	--	2,425	--
Deferred taxes	566	(631)	1,237
Minority interests	--	--	(46)
Changes in working capital items--			
Accounts receivable and due (to) from affiliated providers, net	(4,960)	(4,152)	(3,204)
Inventory	(149)	(1,251)	(374)
Other current assets	302	(1,452)	(260)
Other noncurrent assets	(108)	221	(70)
Accounts payable, accrued expenses and income taxes payable	415	(2,636)	65
Net cash provided by operating activities	8,992	1,000	2,387
Cash flows from investing activities:			
Purchases of property and equipment	(9,964)	(8,744)	(4,466)
Acquisitions of and affiliations with entities, net	(20,069)	(10,305)	(3,649)
Receipt (issuance) of notes receivable from(to) affiliated providers	(3,218)	452	1,491
Net cash used in investing activities	(33,251)	(18,597)	(6,624)
Cash flows from financing activities:			
Borrowings under revolving line of credit	83,534	26,600	14,735
Payments under revolving line of credit	(60,550)	(31,885)	(6,250)
Payments of subordinated debt	--	(2,200)	(3,700)
Proceeds from the issuance of stock, net of issuance costs	972	25,718	3,044
Payments for the redemption of preferred stock, net of transaction costs	--	--	(5,262)
Other long-term debt and capital lease obligations	(740)	(683)	(464)
Net cash provided by financing activities	23,216	17,550	2,103
Net decrease in cash and cash equivalents	(1,043)	(47)	(2,134)
Cash and cash equivalents, beginning of year	1,828	1,875	4,009

Cash and cash equivalents, end of year.....	$ 785	$ 1,828	$ 1,875

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

NOVAMED EYECARE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL INFORMATION

Description of the Business

NovaMed Eyecare, Inc. (NovaMed) along with its wholly-owned subsidiaries (collectively, the Company), is an eye care services company engaged in the business of: (i) owning, operating and/or managing ambulatory surgery centers, laser vision correction centers, optical retail outlets, wholesale optical laboratories, and an optical products purchasing organization; (ii) providing financial, administrative, information technology, marketing and other business services to ophthalmic and optometric providers; and (iii) providing clinical and other research services to eye care device, product and pharmaceutical manufacturers. The Company operates within the United States in six core regional markets including Chicago, Illinois; Kansas City, Missouri; Louisville, Kentucky; Richmond, Virginia; St. Louis, Missouri; and the Atlanta, Georgia and Chattanooga, Tennessee metropolitan areas.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Statement Presentation

The consolidated financial statements have been prepared on the accrual basis of accounting and include the accounts of NovaMed and its wholly owned subsidiaries. The Company acquires certain net operating assets and assumes certain liabilities of physician groups (the Affiliated Professional Entities). The Company provides services, facilities and equipment to affiliated eye care professionals under long-term service agreements (SA). The Company does not consolidate the financial statements of the Affiliated Professional Entities, because it does not have a "controlling financial interest" in them as defined by EITF 97-2, "Applications of FASB Statement No. 94 and APB No. 16 to Physician Practice Management Entities and Certain Other Entities under Contractual Management Arrangements." All significant intercompany accounts and transactions have been eliminated. Certain prior year immaterial amounts have been reclassified as required by EITF 00-14 "Accounting for Certain Sales Incentives," issued in May 2000, or to conform to current year presentation.

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid instruments with an original maturity of three months or less from the date of purchase.

Due (To) From Affiliated Providers

Amounts due (to) from affiliated providers, which are unsecured, non-interest-bearing and due on demand, include amounts owed to Affiliated Professional Entities for services performed under SAs, receivables from Affiliated Professional Entities and affiliated providers for expenses paid on

their behalf and certain other receivables.

Inventory

Inventory consists primarily of optical products such as spectacle frames and lenses as well as surgical supplies used in connection with the operation of the Company's ambulatory surgery centers (ASCs) and laser vision correction (LVC) centers. Inventory is valued at the lower of cost or market, with cost determined using the first-in, first-out (FIFO) method. The Company routinely reviews its inventory for obsolete, slow moving or otherwise impaired inventory and records a related expense in the period such impairment is known and quantifiable.

Property and Equipment

Property and equipment are stated at cost or fair market value at the date of acquisition. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the related assets, generally three to seven years for equipment, computer software, furniture and fixtures, and the lesser of the lease term or 10 years for leasehold improvements. Routine maintenance and repairs are charged to expense as incurred.

Intangible Assets

The Company's affiliations involve the purchase of tangible and intangible assets and the assumption of certain liabilities. As part of the purchase price allocation, the Company allocates the purchase price to the tangible assets acquired and liabilities assumed, based on estimated fair market values. Because the Company does not practice medicine, maintain patient relationships, hire physicians or enter into employment agreements with the physicians, the intangible asset created in the affiliation is solely with the SA for the Affiliated Professional Entity and there are no other significant, identifiable intangible assets. In connection with the determination of the appropriate life of the SAs' identifiable intangible assets, the Company analyzes the nature of each Affiliated Professional Entity with which an SA is entered into, including the Affiliated Professional Entity's historical profitability, the number of physicians in each Affiliated Professional Entity, number of service sites, ability to recruit additional physicians, relative market position, the length of time each Affiliated Professional Entity has been in existence, and the term of the SA. Based on this evaluation, the Company's SAs are amortized over a composite period ranging between 5 and 25 years. For practices with a 25-year amortization period, the Company believes that the related physician groups are long-lived entities with an indeterminate life and that the physicians, patient demographics and customer relationships will be continuously replaced. In addition, for these practices, none of the Affiliated Professional Entities or physicians, individually, are material to the results of operations of the Company. Also, each Affiliated Practice Entity has had positive operating income and/or positive operating cash flow since the date of affiliation. The Company also has the right to require the Affiliated Professional Entity to purchase the assets (including unamortized intangible assets) and assume the liabilities and obligations of the practice upon the involuntary termination of the SA. Through December 31, 2000, there have been no involuntary terminations.

Impairment of Long-Lived Assets

The Company reviews the carrying value of the identifiable intangible assets and goodwill at least quarterly on an entity-by-entity basis to determine if facts and circumstances exist which would suggest that assets might be impaired or that the amortization period needs to be modified. Among the factors the Company considers in making the evaluation are changes in the Affiliated Professional Entity or SLC's market position (including an evaluation of the regional density position created through a series of acquisitions and affiliations in a market), reputation, profitability and geographical penetration. If facts and circumstances are present which may indicate impairment is probable, the Company will prepare a projection of the undiscounted cash flows of the specific Affiliated Professional Entity/ASC/LVC center/regional market position and determine if the identifiable intangible assets and/or goodwill are recoverable based on these undiscounted cash flows. If impairment is indicated, then an adjustment will be made to reduce the carrying amount of these assets to their fair value. To date, no such impairments have been incurred.

Income Taxes

The Company uses the liability method of accounting for income taxes in accordance with Statement of Financial Statement Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes." Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities

for financial reporting purposes and the amounts used for income tax purposes, using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

Fair Value of Financial Instruments

The carrying value of all financial instruments such as accounts receivable, amounts due (to) from affiliated providers, accounts payable and accrued expenses are reasonable estimates of their fair value because of the short maturity of these items. The Company believes the carrying amounts of the Company's notes receivable from related parties, line of credit and obligations under capital leases approximate fair value because the interest rates on these instruments are subject to change with, or approximate, market interest rates.

Minority Interests

Until November 1998, the Company owned 75% of two ASCs, and recorded the results of their operations under the consolidation method of accounting. The interests of the minority owners in the earnings of these ASCs were reflected as minority interests in the consolidated balance sheets. In November 1998, the Company purchased the remaining minority interests of two ASCs held by certain persons associated with Affiliated Professional Entities for 160,000 shares of the Company's Series A convertible preferred stock. Accordingly, the Company now owns 100% of 15 ASCs. The acquisition of the minority interests was accounted for under the purchase method of accounting.

One of the Company's affiliated eye care professionals has the option, exercisable through November 1, 2002, to acquire up to a 25% interest in one of our ASCs.

Revenue Recognition

Surgical Facilities

Revenue in the Company's ASCs and LVC centers is based on fees charged to patients, third-party payors or others for use of the facilities and relate primarily to cataract, laser vision correction and other surgery procedures. Revenue from fixed-site laser services installations is the fee charged to the doctor for use of the laser placed in that doctor's facility. ASC and LVC center revenue is net of contractual adjustments and a provision for doubtful accounts. Although the Company does not separately track contractual adjustments and provisions for doubtful accounts, management believes that the amounts related to bad debts are immaterial for all periods presented. This revenue is recognized by the Company and is not subject to SAs.

Management Services

The Company generally acquires certain net operating assets and assumes certain liabilities of its Affiliated Professional Entities. The Company provides services, facilities and equipment to affiliated eye care professionals under the SAs. Each of the SAs is generally for a 40-year term and requires the Company to provide all of the business, administrative and financial services necessary to operate the eye care clinics and optical dispensaries.

The SAs provide that the Affiliated Professional Entities retain sole and exclusive control over the dispensing of all medical and other professional services to their patients. The SAs also provide that the Affiliated Professional Entities retain control over all decisions relating to the selecting, hiring, compensating and terminating of eye care professionals; retain control over all corporate governance decisions and other internal matters affecting the operation of their legal entities; and employ or otherwise retain a sufficient number of ophthalmologists and optometrists to provide professional eye care services to their patients.

Under the SAs, the Company is generally required to pay all expenses incurred in connection with the business and medical operations of the eye care clinics and optical dispensaries, except for the salaries and benefits of those eye care professionals who have an ownership interest in the professional entity employing them. The Affiliated Professional Entities then reimburse the Company on a monthly basis for those expenses that are paid on the Affiliated Professional Entities' behalf.

In addition to being reimbursed for eye care clinic and optical dispensary overhead, the Company is paid a monthly fee for its services. This fee is generally based on a fixed monthly amount established in an annual budget that the Company negotiates each year with its Affiliated Professional Entities. If the revenue or expenses of the eye care clinics and retail optical outlets in

any month vary from the budget for that month, then the fee is adjusted to reflect the actual results of the eye care clinics and retail optical outlets. There are no limitations on the amount of these fee adjustments. On average, the fees paid to the Company in 2000 represented approximately 32.9% of the earnings before interest and taxes of the Affiliated Professional Entities, compared to 36.6% and 35.5% in 1999 and 1998, respectively.

The SAs are generally not terminable by the Affiliated Professional Entities unless a court makes a final determination that the Company has breached a material fiduciary duty owed to the eye care professionals, or that the Company has misappropriated or misapplied funds of the eye care professionals. The Company generally can not terminate the SAs unless one or a group of Affiliated Professionals loses their medical license; the professional entity loses its Medicare provider number or ability to treat Medicare patients; the professional entity is dissolved or goes bankrupt; or the affiliated eye care professionals default in the performance of any of their material duties.

Management services revenue is equal to the net revenue of the Affiliated Professional Entities, less amounts retained by the Affiliated Professional Entities. The amounts retained by the Affiliated Professional Entities represent the net billings of the Affiliated Professional Entities less operating expenses and the Company's management fee. Management services revenue is recognized when the Affiliated Professional Entities render services and recognize operating expenses under the accrual method of accounting. Net revenue is recorded by the Affiliated Professional Entities at established rates reduced by a provision for contractual adjustments and doubtful accounts. Contractual adjustments arise due to the terms of certain reimbursement contracts. Such adjustments represent the difference between the charges at established rates and estimated recoverable amounts and are recognized in the period the services are rendered. Any differences between estimated contractual adjustments and actual final settlements under reimbursement contracts, which are immaterial, are recognized as contractual adjustments in the period of final settlements.

For the years ended December 31, 2000, 1999 and 1998, management services revenue was as follows (in thousands):

	Years Ended December 31,		
	2000	1999	1998
Net revenue of the Affiliated Professional Entities	$ 82,973	$65,098	$46,285
Less--amounts retained by Affiliated Professional Entities	(12,214)	(10,777)	(10,232)
	$ 70,759	$54,321	$36,053

For the years ended December 31, 2000, 1999 and 1998, the management services revenue of one Affiliated Professional Entity accounted for 12.8%, 15.4% and 15.4% of total net revenue, respectively. Another Affiliated Professional Entity, created during 1999 from a combination of a group of our affiliated practices, accounted for 11.5% and 8.6% of total net revenue in the years ended December 31, 2000 and 1999, respectively.

NOVAMED EYECARE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Product Sales and Other

Through 1998, product sales consisted solely of revenue from our optical products purchasing organization (the Alliance). The Alliance negotiates volume buying discounts with optical products manufacturers. Products are sold to both affiliated and non-affiliated ophthalmologists and optometrists. All sales to affiliated ophthalmologists and optometrists are eliminated in consolidation. Most of the products are shipped directly from the manufacturer to the customer. Revenue is recognized, net of an allowance for returns, based on the amount billed to the customer and is recorded upon receipt of the invoice from the manufacturer or the shipping date if shipped from the Alliance. In January 1999, the Company acquired a wholesale optical laboratory, Midwest Uncuts, Inc., which manufactures and distributes corrective lenses and eyeglasses to both affiliated and non-affiliated ophthalmologists and optometrists (see Note 5). The Company's wholesale optical laboratory recognizes revenue when product is shipped, net of an allowance for returns. In May 2000, the Company acquired a producer of sales and marketing products and services; revenue is recognized when the product is shipped or service rendered.

Cost of Sales and Medical Supplies

Cost of sales and medical supplies includes the cost of optical products such as frames, optical lenses, contact lenses and medical supplies.

Stock Compensation

In October 1995, the Financial Accounting Standards Board (FASB) issued SFAS No. 123, "Accounting for Stock-Based Compensation," which allows entities to measure compensation costs related to awards of stock based compensation using either the fair value method or the intrinsic value method. The Company has elected to account for stock-based compensation programs using the intrinsic value method. See Note 14 for the pro forma disclosures of the effect on net income (loss) and earnings (loss) per share.

Concentration of Credit Risk

For the years ended December 31, 2000, 1999 and 1998, approximately 26%, 38% and 49%, respectively, of the Company's net revenue was received from Medicare and other governmental programs, which reimburse providers based on fee schedules determined by the related governmental agency. In the ordinary course of business, providers receiving reimbursement from Medicare and other governmental programs are potentially subject to a review by regulatory agencies concerning the accuracy of billings and sufficiency of supporting documentation.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

3. UNAUDITED PRO FORMA INFORMATION

In connection with the Company's Initial Public Offering in August 1999 ("IPO"), certain noncash, nonrecurring charges were recorded in the accompanying 1999 and 1998 consolidated statements of operations.

The following unaudited pro forma summary presents the results of operations as if the events described more fully in the notes below had occurred at the beginning of the periods presented (amounts in thousands, except per share data):

	Years ended December 31,	
	1999	1998
Income (loss) available to Series A and Series B convertible preferred and common stockholders	$(1,161)	$ 967
Eliminate compensation expense related to stock options (a)	2,690	--
Eliminate discount to IPO price upon the exchange of subordinated notes for common stock (b)	2,425	--
Eliminate preferred stock accretion upon conversion to common stock (c)	2,035	739
Eliminate interest expense upon debt conversion to common stock (d)	400	800
Related income tax benefit	(1,866)	(395)
Pro forma net income	$ 4,523	$ 2,111
Pro forma earnings per diluted common share	$ 0.20	$ 0.10
Pro forma weighted average diluted shares outstanding	22,476	21,649

Notes:

(a) Represents the pro forma elimination of the compensation expense associated with the IPO-related vesting of certain stock options granted in 1999.

(b) Represents the pro forma elimination of the additional interest expense which resulted from the exchange of subordinated exchangeable promissory notes into common stock at a discount to the IPO price per share.

(c) Represents the pro forma elimination of the accretion of the Series C and Series D convertible preferred stock through the IPO to its estimated fair market value. Upon the completion of the IPO, the Series C and Series D convertible preferred stock converted into common stock.

(d) Represents the pro forma elimination of the interest expense from the subordinated exchangeable promissory notes which were converted to common stock at the time of the IPO.

4. EARNINGS (LOSS) PER COMMON SHARE

Prior to the Company's IPO, the Company had multiple classes of convertible preferred stock outstanding. Upon the completion of the IPO, all outstanding classes of preferred stock converted into common stock of the Company. In addition, $9.7 million of subordinated exchangeable promissory notes were exchanged into 1,516,000 shares of common stock. For the computation of earnings per share, the Series A and Series B Preferred Stock was assumed to be outstanding through the IPO date of August 18, 1999.

Since the Series A and Series B Convertible Preferred Stock participated along with the common stock in the Company's earnings, the Company used the two class method for calculation of earnings per share (EPS). Under the two class method, earnings or loss is allocated to the Series A and Series B convertible preferred stock as one class, and to common stock as a second class. For each class of stock, Basic EPS is calculated by dividing allocated earnings (loss) allocable to the class by the weighted average number of shares outstanding of that class during the period. Diluted EPS is calculated by dividing net income (loss) by the weighted average number of common shares, including the dilutive effect of potential common shares outstanding during the period. Potential common shares consist of outstanding options, warrants, convertible debt and preferred stock. The dilutive effect of options and warrants are calculated using the treasury stock method. The dilutive effect of the Series A and Series B convertible preferred shares are calculated using the if converted method.

For 1999 and 1998, total earnings were allocated to each class of stock based upon the weighted average shares outstanding for each class as a percentage of total weighted average shares outstanding.

Earnings (loss) per common share is calculated as follows (amounts in thousands, except per share data):

	Years Ended December 31,		
	2000	1999	1998
Income (loss) available to Series A and B convertible preferred and common stockholders....	$ 5,344	$ (1,161)	$ 967
Income (loss) allocated to preferred stockholders.....	--	(3,130)	784
Income available to common stockholders--basic....	$ 5,344	$ 1,969	$ 183
Income (loss) available to common stockholders--diluted.....	$ 5,344	$ (1,161)	$ 967
Basic weighted average number of common shares outstanding.....	24,495	10,464	2,751
Weighted average number of common shares issuable upon the conversion of dilutive preferred			

shares	--	7,501	11,780
Effect of dilutive securities--stock options	1,544	--	1,472
Diluted weighted average number of shares outstanding	26,039	17,965	16,003
Earnings (loss) per common share:			
Basic	$ 0.22	$ 0.19	$ 0.07
Diluted	$ 0.21	$ (0.06)	$ 0.06

The following items are not included in diluted earnings per share calculation since their effects are anti-dilutive (in thousands):

	2000	1999	1998
Subordinated exchangeable promissory notes	--	1,135	4,714
Series C and Series D convertible preferred stock	--	2,713	4,130
Stock options	--	1,799	--

5. AFFILIATIONS AND ACQUISITIONS

The Company generally acquires certain net assets of Affiliated Professional Entities and LVC centers and the entire operations of the ASCs. In addition, the Company acquires the right to provide services to Affiliated Professional Entities. The following represents the significant practice affiliations occurring in 2000, 1999 and 1998:

Affiliated Professional Entity	Effective Date	Location
2000		
Richard H. Blue (2)	January 2000	Athens, GA
Atlanta Eye Surgery Group (1)	August 2000	Atlanta, GA
SureVision Surgery Center (1)	August 2000	Columbus, GA
Omni Eye Services	November 2000	Atlanta, GA and Chattanooga, TN
1999:		
Eye Healthcare Associates	November 1999	St. Louis, MO
Young Eye Clinic (1)	December 1999	St. Joseph, MO
Pomerance Eye Center (1)	December 1999	Chattanooga, TN
1998:		
Eyecare Midwest	July 1998	Kansas City, MO

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(1) Affiliation includes ASC(s)
(2) Affiliation includes LVC center(s)

The acquisitions of nonmedical operating assets and liabilities have been accounted for using the purchase method of accounting and, accordingly, the purchase price has been allocated to the tangible assets acquired and liabilities assumed based on the estimated fair values at the dates of acquisition. The following is an allocation of purchase price for the acquisitions completed during the years 2000, 1999 and 1998 (in thousands):

	2000	1999	1998
Intangible assets	$13,313	$8,856	$6,920
Total assets acquired (liabilities assumed), net	1,584	(1,993)	(15)
Total purchase	14,897	6,863	6,905
Less--			
Fair value of stock issued	(74)	(1,073)	(3,256)
Notes issued	--	(550)	--
Cash purchase price	$14,823	$5,240	$3,649

In May 2000, the Company acquired a producer of sales and marketing products and services. In January 1999, the Company acquired Midwest Uncuts, Inc., a wholesale optical laboratory with two manufacturing locations, from a related party (See Note 16). The aforementioned transactions were accounted for by the purchase method of accounting and the results of operations are included in the consolidated financial statements since the date of acquisition.

6. PROPERTY AND EQUIPMENT

Property and equipment consist of the following as of December 31, 2000 and 1999 (in thousands):

	2000	1999
Equipment	$ 23,196	$15,780
Equipment under capital lease obligations	1,039	1,039
Computer software	2,696	2,059
Furniture and fixtures	1,988	1,070
Leasehold improvements	5,317	2,745
	34,236	22,693
Less--Accumulated depreciation and amortization	(11,700)	(6,628)
	$ 22,536	$16,065

Depreciation and amortization expense for property and equipment in 2000, 1999 and 1998 was approximately $5.1 million, $3.1 million and $1.9 million, respectively.

NOVAMED EYECARE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

7. INTANGIBLE ASSETS

Intangible assets consist of the following as of December 31, 2000 and 1999 (in thousands):

	Amortization Period	2000	1999
SAs and goodwill	5-25 Years	$ 68,964	$52,112
Less--Accumulated amortization		(6,759)	(4,260)
		$ 62,205	$47,852

Amortization expense for intangible assets in 2000, 1999 and 1998 was approximately $2.5 million, $1.8 million and $1.4 million, respectively. Effective January 1, 1998, the Company reduced the maximum useful life of the costs associated with affiliations under the SAs from 32 years to 25 years. This change was made to conform the Company's policy with that adopted by other health care services and facilities companies during 1998 and to better represent the useful lives of the SAs. The change in the estimated useful life was treated on a prospective basis and increased 1998 amortization expense by $250,000.

8. ACCRUED EXPENSES

Accrued expenses consist of the following as of December 31, 2000 and 1999 (in thousands):

	2000	1999
Accrued payroll and related benefits	$2,390	$2,113
Accrued interest	715	83
Accrued other	1,575	2,466
	$4,680	$4,662

9. INCOME TAXES

The provision for income tax expenses consists of the following for the years ended December 31, 2000, 1999 and 1998 (in thousands):

	2000	1999	1998
Current			
Federal	$2,498	$2,094	$ 366
State	382	345	61
Deferred	2,880	2,439	427
Federal	539	(542)	1,062
State	27	(89)	175
	566	(631)	1,237
	$3,446	$1,808	$1,664

The reason for the differences between the income tax expense and the amounts calculated using the U.S. statutory rate of 34% were as follows (in thousands):

	2000	1999	1998
Tax expense at U.S. statutory rate	$2,989	$ 912	$1,146
Intangible asset amortization	438	435	283
State taxes, net	413	150	235
Discount on conversion of notes	--	459	--
Other	(394)	(148)	--
Provision for income taxes	$3,446	$1,808	$1,664

Deferred tax assets (liabilities) are comprised of the following at December 31, 2000 and 1999 (in thousands):

	2000	1999
Current deferred tax assets (liabilities)		
Compensation expense	$ 341	$ 216
Receivable allowances	232	208
Prepaid expense	(587)	(568)
Other	93	(24)
	79	(168)

Long-term deferred tax assets (liabilities)		
Depreciation and amortization	(2,262)	(1,769)
Acquisitions	(113)	(705)
Compensation expense related to stock options	522	1,067
Discount on conversion of notes	363	416
Other	(11)	(122)
	(1,501)	(1,113)
	$(1,422)	$(1,281)

The Company paid $2.1 million, $2.8 million and $594,000 for income taxes in 2000, 1999 and 1998, respectively.

10. LONG-TERM DEBT

Long-term debt consists of the following as of December 31, 2000 and 1999 (in thousands):

	2000	1999
Revolving line of credit	$26,184	$ 3,200
Other	252	613
	26,436	3,813
Less--Current maturities of long-term debt	(249)	(3,617)
	$26,187	$ 196

Subordinated Exchangeable Promissory Notes

The Company issued subordinated exchangeable promissory notes (the Notes) in connection with the acquisition of certain net assets of Affiliated Professional Entities and certain ASCs, and the right to provide services to Affiliated Professional Entities. In connection with the IPO, $9.7 million of subordinated exchangeable promissory notes were exchanged for 1.5 million shares of the Company's common stock at an exchange ratio of $1.00 worth of common stock, based upon the initial public offering price, for each $0.80 of outstanding principal on the Notes. The Company recorded the difference between the value of the common stock and the Notes as a non-recurring, non-cash expense. Accordingly, the Company recorded additional interest expense of $2.4 million related to the discount on the exchange of the Notes. During 1999, the Company retired the remaining $2.2 million of the Notes.

As disclosed in our prospectus filed with the Securities and Exchange Commission on August 18, 1999, in connection with the exchange of $9.7 million of our subordinated exchangeable promissory notes resulting

from our IPO, we agreed to lend each of these noteholders an amount equal to the Federal and state income taxes payable by the holder as a result of the exchange of the notes, but only for those shares of our common stock received in the exchange which they still owned as of April 1, 2000. In accordance with these agreements, the Company loaned $2.7 million to the holders, the majority of which was advanced in April 2000. The tax loans are noninterest bearing, nonrecourse to the debtor and secured by a number of shares of our common stock held by the debtor having a value, based on the offering price, equal to two times the loan amount. Upon the sale by a debtor after April 1, 2000 of any shares of our common stock issued in exchange for a note, the debtor will be required to repay a fraction of the debtor's initial tax loan amount equal to the number of shares sold divided by the total number of shares of our common stock previously issued in exchange for a note and owned by the debtor as of April 1, 2000. The tax loans are payable by the debtors upon our demand for payment. Currently, we intend to allow the debtors to repay these loans as they dispose of their shares of our common stock. We also have agreed to reimburse these debtors on a grossed-up basis, for any Federal or state taxes that they recognize as a result of imputed interest on the tax loans.

Revolving Credit Facility

On June 28, 2000, the Company replaced its $35 million revolving credit agreement with a new, three-year, $50 million revolving credit agreement. Interest on borrowings under the new credit agreement is payable at an annual rate equal to our lender's published base rate plus the applicable borrowing margin ranging from 0 to 0.75% or LIBOR plus a range from 1.5% to 2.25%, varying upon our ability to meet financial covenants. The weighted average interest rate on credit line borrowings was 8.6% for the twelve months ended December 31, 2000. The new credit agreement contains covenants that include limitations on indebtedness, liens, capital expenditures, acquisitions and affiliations and ratios that define borrowing availability and restrictions on the payment of dividends. As of December 31, 2000, we were in compliance with all our credit agreement covenants.

Interest Expense

The Company paid $1.2 million, $1.9 million and $1.4 million for interest and commitment fees during 2000, 1999 and 1998, respectively. Interest on funds used to finance construction of significant additions to property and equipment is capitalized and amortized over the remaining life of the asset. During the year ended December 31, 2000, $37,300 of interest was capitalized. No interest was capitalized in the years ended December 31, 1999 or 1998.

11. OPERATING LEASES

The Company has commitments under long-term, non-terminable operating leases, principally for facility and office space. Lease terms generally cover one to ten years. Certain leases contain consecutive renewal options of five-year periods. At December 31, 2000, minimum annual rental commitments under operating leases with terms in excess of one year are as follows (in thousands):

2001	$ 6,616
2002	6,072
2003	5,565
2004	4,717
2005 and thereafter	8,080

Total minimum lease payments...	$31,050

Rent expense related to operating leases amounted to approximately $8.1 million, $5.2 million and $3.6 million during 2000, 1999 and 1998, respectively.

12. COMMITMENTS AND CONTINGENCIES

Litigation

The Company is subject to various claims and legal actions that arise in the ordinary course of business. In the opinion of management, the ultimate resolution of such matters will not have a material adverse effect on the Company's financial position or results of operations.

Professional Liability Risk

The Company maintains third party professional liability insurance for its ASCs and business activities and procures insurance for its Affiliated Professional Entities through a third-party insurer. Although the Company believes that this insurance is adequate as to the amounts at risk, there can be no assurance that any claim asserted against the Company will not exceed the coverage limits of such insurance.

Insurance

The Company and the Affiliated Professional Entities are insured with respect to medical malpractice risks on a claims-made basis. Management is not aware of any claims against the Company or the Affiliated Professional Entities that might have a material impact on the Company's financial position or results of operations.

Purchase Commitments

Effective March 1, 2001, the Company entered into a new five-year medical supply agreement which amended and superseded the Company's existing agreement. As of March 15, 2001, the Company has commitments to pay up to approximately $1.4 million annually during the five-year term. The minimum commitment will increase as additional laser systems are deployed.

On June 15, 2000, the Company entered into an agreement to acquire two ASCs, contingent upon the resolution of certain requirements associated with the seller (the "Contingencies"). Certain of these Contingencies were satisfied in 2000 with respect to one of the ASCs, which the Company acquired in December 2000. Upon the resolution of the Contingencies affecting the other ASC and other conditions to closing, which could occur as early as May 1, 2001, the Company will be required to purchase the other ASC for approximately $9.3 million in cash consideration. The Company may elect to fund up to approximately $2.3 million of this purchase price in the form of the Company's common stock. This transaction is excluded from the acquisition limitations of the new Credit Agreement discussed above.

13. STOCKHOLDERS' EQUITY

NovaMed was incorporated in November 1996. In conjunction with a recapitalization on December 20, 1996 (the Recapitalization), NovaMed issued 11,584,000 shares of Series A convertible preferred stock, par value $.01 per share (Series A Stock), to replace previously granted 5,792 units of NovaMed LLC. In addition, the Company issued options to purchase 1,528,000 shares of Series A Stock in exchange for options to purchase 764 units of NovaMed LLC.

Contemporaneous with the Recapitalization, NovaMed issued 400,000 shares of Series B convertible preferred stock, par value $.01 per share (Series B Stock), for $2.50 per share; 2,000,000 shares of Series C convertible preferred stock, par value $.01 per share (Series C Stock), for $3.00 per share; and warrants to

purchase an aggregate of 684,932 shares of Series D convertible preferred stock, par value $.01 per share (Series D Stock), at $4.38 per share. The warrant to purchase the Series D stock was exercised in April 1998. In addition, in connection with the Company's IPO, Series A Stock, Series B Stock, Series C Stock and Series D Stock converted into common stock on a share-for-share basis. Following conversion of the outstanding preferred stock into common stock at the IPO, the Series A, B, C and D convertible preferred stock were eliminated or canceled and these shares are not available for reissuance.

On August 18, 1999, the Company sold 3,000,000 new shares of common stock in an initial public offering at a price of $8.00 per share. Net proceeds were approximately $20.2 million after deducting underwriting discounts and commissions and offering expenses. In addition, the underwriters exercised their over-allotment option on September 1, 1999, to acquire additional 600,000 shares of the Company's common stock at $8.00 per share, contributing $4.5 million of additional net proceeds.

Redemption Right

In connection with the issuance of the Series C and Series D Stock (Senior Preferred Stock), NovaMed amended its articles of incorporation (the Amendment) to provide that holders of at least two-thirds of the then outstanding Senior Preferred Stock may elect to redeem for cash up to 50% of their respective shares each year after April 2004, and April 2005, at the greater of a prescribed liquidation preference amount per share (the Carrying Value), or the fair value of such preferred stock as established by independent appraisers. The Amendment provided for a mandatory conversion of each share of convertible preferred stock to one share of common stock in the event NovaMed undertook a qualifying IPO.

Although the Company had not obtained an independent appraisal, it had estimated the potential future redemption value based upon various transactions with third parties and through comparison to comparable publicly traded companies. Based upon the estimates the Company recorded accretion of $2.0 million and $739,000 to increase the carrying value of the Senior Preferred Stock to the date of the IPO in 1999 and for the year ended December 31, 1998. In connection with the Company's IPO, the Senior Preferred Stock converted into common stock thereby eliminating the need for future accretion.

Rights Agreement

Certain shareholders possess rights to purchase fractional shares of Series E Junior Participating Preferred Stock with a par value of $.01 per share at a price of $110 per one one-thousandth of a share, subject to adjustment as defined in the Rights agreements. These rights are not exercisable until the announcement of the occurrence of certain events as defined in an agreement which also describes the various shareholders' rights.

Upon the occurrence of certain events, each right holder will be entitled to receive shares of common stock, or in specified circumstances other assets having a value of two times the purchase price of the right. Additionally, the Board of Directors may exchange the rights, in whole or in part, without additional payment, for shares of common stock at an exchange ratio defined in the agreement. At any time prior to certain events, the Board of Directors may redeem all, but not less than all, of the rights at a redemption price of $.01 per right.

14. EMPLOYEE BENEFIT PLANS

Employee Benefits and Compensation

The Company maintains a voluntary savings plan (the Plan) for eligible employees under section 401(k) of the Internal Revenue Code whereby participants may contribute a percentage of up to 15% of their compensation. The Plan provides for the Company to match 50% of the employee's contributions on the first 3% of salary contributed by each employee. The Company's matching contributions approximated $362,000, $251,000 and $136,000 for 2000, 1999 and 1998, respectively.

Employee Stock Purchase Plan

The Company has an employee stock purchase plan for all eligible employees. Under the plan, shares of the Company's common stock may be purchased at six-month intervals at 85% of the lower of the fair market value on the first or the last day of each six-month period. Employees may purchase shares having a value not exceeding 10% of their gross compensation during an offering period; however, the amount of an employee's purchase may not exceed $20,000 in any offering period or $25,000 in any calendar year. Approximately 61,500 shares were purchased during 2000. The plan began on October 1, 1999 and, accordingly, no shares were purchased during 1999. At December 31, 2000, 338,500 shares were reserved for future issuance.

Stock Option Plans

The Company is authorized to issue up to 7,751,800 shares of its common stock, par value $.01 per share. Authorized options for common stock under the Plan are generally exercisable over a four-year period with vesting beginning six months from the date of each grant and 1/48th of the total options granted becoming exercisable each month thereafter. The option period for Common Stock options is 10 years from the date each option is granted. All current outstanding options are nonqualified stock options.

The Company grants stock options to employees and nonemployee members of the Company's Board of Directors. Pursuant to Accounting Principles Board No. 25, the Company recognizes as compensation expense the difference between the exercise price and the fair market value of its common stock on the date of grant. Stock-based compensation expense is deferred and recognized over the vesting period of the stock option. During the years ended December 31, 2000 and 1998, the Company did not recognize any stock based compensation expense. During July, 1999, the Company fully vested all options granted from February 1, 1999 through July 23, 1999, contingent on the completion of the IPO. The Company had issued options to purchase 1,050,800 shares of common stock during this time period. Accordingly, the Company recorded $1.6 million, net of tax, as compensation expense during 1999 related to those options which became fully vested on the date of the IPO.

In addition, the Company has granted stock options to physicians employed by Affiliated Professional Entities. The physicians reimburse the Company in full for the compensation recorded upon the granting of these options, which is equal to their estimated fair market value on the date of the grant as determined by the Black-Scholes option-pricing model.

The following table summarizes the activity in the stock option plan:

	Options Outstanding	Price Per Share	Weighted Average Exercise Price
Balance at December 31, 1997.....	3,143,416	$1.25-$ 4.38	$1.81
Granted.....	1,129,000	$3.50-$ 6.00	$4.53
Exercised.....	(7,388)	$1.25-$ 2.50	$1.93
Canceled.....	(122,028)	$1.25-$ 3.85	$2.05
Balance at December 31, 1998.....	4,143,000	$1.25-$ 6.00	$2.55
Granted.....	1,343,850	$4.38-$10.80	$6.69
Exercised.....	(367,562)	$1.25-$ 9.00	$2.93
Canceled.....	(111,053)	$1.25-$10.80	$4.48
Balance at December 31, 1999.....	5,008,235	$1.25-$10.80	$3.52
Granted.....	1,610,350	$1.06-$14.94	$8.26
Exercised.....	(372,231)	$1.25-$10.00	$1.91
Canceled.....	(764,912)	$1.88-$13.44	$7.37
Balance at December 31, 2000	5,481,442		$4.53

The weighted average fair value of options granted in 2000 was $6.70 per share.

The following table summarizes information about stock options outstanding

at December 31, 2000:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at 12/31/00	Average Life	Average Exercise Price	Number Exercisable at 12/31/00	Average Exercise Price
$ 1.06- 1.56	1,036,500	6.4	$ 1.24	689,000	$ 1.25
$ 1.69- 2.50	1,753,274	6.0	2.02	1,538,473	2.01
$ 3.00- 4.38	626,849	7.0	3,79	430,409	3.76
$ 5.00- 7.25	956,000	7.9	5.63	670,510	5.46
$ 7.94-10.80	403,800	8.8	9.15	214,252	9.59
$12.00-14.94	705,019	9.1	12.15	139,760	12.14
$ 1.06-14.94	5,481,442	7.1	$ 4.53	3,682,404	$ 3.53

The Company believes the exercise price of stock options granted prior to the IPO, approximated or exceeded the fair value of the applicable class of stock at the date of grant based on the pricing of transactions involving the preferred stock as discussed in Note 13, and the Company's financial condition at the date of grant. Following the IPO, options have been granted with exercise prices which are either equal to or above the market value of the stock on the date of grant.

The following summarizes the pro forma effect on net income (loss) if the fair values of stock based compensation had been recognized in the year presented as compensation expense on a straight-line basis over the vesting period of the grant (in thousands, except per share data):

	2000	1999	1998
Net income (loss) available to common stockholders	$3,648	$(3,507)	$578
Earnings (loss) per common share:			
Basic	$ .15	$ .04	$.04
Diluted	$ .14	$ (.20)	$.04

The fair value of these options was estimated using the Black-Scholes option-pricing model for 2000 and 1999 and the minimum value method in 1998 with the following assumptions:

	2000	1999	1998
Expected option life in years	4	4.92	10
Risk-free interest rate	5.93%	5.22%	6.06%
Dividend yield	--	--	--
Expected volatility	.950	.850	N/A

15. OPERATING SEGMENTS

During 1998, the Company adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." The Company manages its business segments by types of service provided. The Company's reportable segments are as follows:

Surgical facilities. Surgical facilities include the results of operations from owning, managing and operating ASCs, LVC centers, and fixed site laser services agreements.

Management services. Management services include medical services provided to patients, the sale of optical products and research.

Product sales. Product sales include the Alliance, the Company's optical products purchasing organization, Midwest Uncuts, Inc., a wholesale optical laboratory, and beginning in May 2000, a producer of marketing products and services.

The accounting policies of the various segments are the same as those described in the "Summary of Significant Accounting Policies" in Note 2, except for the management services segment. Management services revenue is reported to management using the net revenue of the Affiliated Professional Entities as the total revenue. The revenue for the management services segment on the accompanying Consolidated Statements of Operations is the net revenue of the Affiliated Professional Entities reduced by amounts retained by the Affiliated Professional Entities (See Note 2). Under either approach, the earnings before income taxes (EBT) are identical.

The Company evaluates the performance of its segments based on EBT and cash flow (EBITDA). Segment EBT includes all revenue and expenses directly attributable to the segment except amortization of intangible assets and excludes certain expenses that are managed outside the reportable segment. Items excluded from the segment EBT primarily consist of corporate expenses for salaries, wages and benefits, general and administrative, interest on debt, and amortization of intangible assets. Segment EBITDA includes earnings before interest, taxes, depreciation and amortization.

The Company excludes intercompany transfers for management reporting purposes, as they have no effect on the EBT of the individual segments. Segment identifiable assets include accounts receivable, inventory, other current assets and long-lived assets of the segment. Corporate identifiable assets represent all other assets of the Company including cash and cash equivalents, corporate other current assets, and corporate long-lived assets, which include property and equipment, notes receivable, intangible assets, and other long-term assets. Capital expenditures for long-lived assets are not reported to management by segment and are excluded, as presenting such information is not practical.

	Surgical Facilities	Management Services	Product Sales	Corporate	Eliminations	Total

			(In thousands)			
2000--						
Net revenue.....	$41,720	$82,973	$23,159	$ --	$(12,214)	$135,638
Earnings before taxes.....	17,107	6,519	2,551	(17,387)	--	8,790
Depreciation and amortization.....	1,575	1,448	207	4,352	--	7,582
Interest (income).....	--	(18)	(13)	(106)	--	(137)
Interest expense.....	2	9	--	1,904	--	1,915
Identifiable assets...	14,157	22,526	5,157	79,073	--	120,913
1999--						
Net revenue.....	$31,223	$65,098	$15,599	$ --	$(10,777)	$101,143
Earnings before taxes.....	12,588	6,185	1,483	(17,574)	--	2,682
Depreciation and amortization.....	920	1,142	142	2,708	--	4,912
Interest (income).....	--	(18)	(31)	(165)	--	(214)
Interest expense.....	2	3	1	1,507	--	1,513
Identifiable assets...	10,273	15,601	3,329	59,049	--	88,252
1998--						
Net revenue.....	$20,131	$46,285	$ 7,545	$ --	$(10,232)	$ 63,729
Earnings before taxes.....	7,181	5,707	546	(10,064)	--	3,370
Depreciation and amortization.....	563	874	5	1,891	--	3,333
Interest (income).....	--	(14)	(11)	(248)	--	(273)
Interest expense.....	1	17	1	1,527	--	1,546
Identifiable assets...	7,236	12,120	1,301	42,022	--	62,679

The Company has no revenues attributed to customers outside of the United States and no assets located in foreign countries.

16. RELATED-PARTY TRANSACTIONS

Facility Rent

The Company leases facility space from various related parties, which include affiliated providers. Rent expense on related-party operating leases amounted to approximately $2.1 million, $1.6 million and $1.5 million during 2000, 1999 and 1998, respectively.

Notes Receivable

The Company holds notes receivable of $3.2 million from physicians affiliated with the Company. This includes $2.7 million of noninterest bearing tax loans issued in connection with the IPO (See Note 10). The remainder of the loans bear interest rates between 9.0-9.5%, are secured against future

services, and are either payable upon demand of the Company or within a prescribed term.

Acquisition of Midwest Uncuts, Inc.

Effective January 1, 1999, the Company acquired all of the issued and outstanding shares of Midwest Uncuts, Inc. in exchange for $4.6 million in net cash and 250,000 shares of Series A convertible preferred stock. The stockholders were Mr. and Mrs. John P. Winjum, the parents of the Company's Chairman of the Board, President and Chief Executive Officer. Prior to this acquisition, the Company had retained Midwest Uncuts, Inc., to finish and surface lenses on a purchase order basis on market terms. The Company made payments of approximately $982,000 during 1998, to Midwest Uncuts for services provided under the purchase order.

Other

The Company receives professional services from a firm that employs a director of the Company. Total payments for services received during 2000, 1999 and 1998 were approximately $617,000, $1.8 million, and $422,000, respectively.

17. QUARTERLY FINANCIAL DATA (Unaudited)

Summarized quarterly financial data for 2000 and 1999 is as follows (in thousands except per share data):

	Quarter			
	First	Second	Third	Fourth
2000				
Net revenue	$31,616	$34,094	$35,079	$34,849
Income from operations	2,736	2,838	2,713	2,281
Net income	1,478	1,458	1,157	1,251
Basic earnings per share	.06	.06	.05	.05
Diluted earnings per share	.06	.06	.05	.05
1999--Actual				
Net revenue	$21,026	$23,836	$26,474	$29,807
Income from operations	975	2,006	273	3,113
Net income (loss)	258	814	(1,917)	1,719
Basic earnings per share	(.02)	(.15)	.05	.07
Diluted earnings per share	(.02)	(.15)	(.09)	.07
1999--Proforma (1)				
Income from operations	1,032	2,167	2,745	3,113
Net income	400	1,049	1,355	1,719
Diluted earnings per share	.02	.04	.06	.07

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(1) In connection with the Company's IPO, certain noncash, nonrecurring charges were recorded in 1999. The proforma data presented excludes the effect of

these items. See Note 3.

SCHEDULE I

NOVAMED EYECARE, INC.

RULE 12-09 VALUATION RESERVES

(in 000's)

Allowance for contractual adjustments and bad debt	Balance at beginning of period	Charged to costs and expenses	Deductions	Balance at end of period
1998	$ 6,994	$40,647	$(37,294)	$10,347
1999	$10,347	$56,536	$(54,169)	$12,714
2000	$12,714	$76,760	$(72,451)	$17,023

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, on the 30th day of March, 2001.

NovaMed Eyecare, Inc.

By: /s/ Stephen J. Winjum
Stephen J. Winjum
President, Chief Executive Officer
and
Chairman of the Board of Directors

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on the 30th day of March, 2001.

Signature	Title
/s/ Stephen J. Winjum Stephen J. Winjum	President, Chief Executive Officer (Principal Executive Officer), Chairman of the Board of Directors, and a Director
/s/ Ronald G. Eidell	Executive Vice President, Chief Financial Officer and Secretary

Ronald G. Eidell	(Principal Financial Officer)
/s/ Robert L. Hiatt Robert L. Hiatt	Vice President Finance (Principal Accounting Officer)
/s/ John D. Hunkeler, M.D. John D. Hunkeler, M.D.	National Medical Director and Director
/s/ R. Judd Jessup R. Judd Jessup	Director
/s/ Scott H. Kirk, M.D. Scott H. Kirk, M.D.	Director
/s/ Steven V. Napolitano Steven V. Napolitano	Director
/s/ C.A. Lance Piccolo C.A. Lance Piccolo	Director
/s/ Douglas P. Williams, M.D. Douglas P. Williams, M.D.	Director