OWENS & MINOR INC/VA/
Form 10-K405
March 08, 2002
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Form 10-K Annual Report

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

[X] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the year ended December 31, 2001

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to

Commission File Number 1-9810

OWENS & MINOR, INC.
(Exact name of registrant as specified in its charter)

Virginia (State or other jurisdiction of incorporation or organization)	54-01701843 (I.R.S. Employer Identification No.)
4800 Cox Road, Glen Allen, Virginia (Address of principal executive offices)	23060 (Zip Code)

Registrant s telephone number, including area code (804) 747-9794

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

Title of each class	Name of each exchange on which registered
Common Stock, $2 par value	New York Stock Exchange
Preferred Stock Purchase Rights	New York Stock Exchange
8 1/2% Senior Subordinated Notes due 2011	Not Listed
$2.6875 Term Convertible Securities, Series A	Not Listed

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes X No _
Indicate by 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. [X]
The aggregate market value of Common Stock held by non-affiliates (based upon the closing sales price) was approximately $630,546,304 as of February 14, 2002.
The number of shares of the Company s Common Stock outstanding as of February 14, 2002 was 33,973,400 shares.

Documents Incorporated by Reference

The proxy statement for the annual meeting of security holders on April 25, 2002 is incorporated by reference for part III.

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Owens & Minor, Inc.
Statement of Differences Between Electronic Form 10-K and Printed Annual Report & Form 10-K

1. The printed Annual Report and Form 10-K document contains graphs and photographs not incorporated into the electronic Form 10-K.

2. Pages 1-15 and 17 of the printed document have not been included in the electronic document, as they do not contain items required by Form 10-K.

3. The 10-K cover sheet and index, presented on pages 57 and 58 of the printed document, have been repositioned to the front of the electronic document.

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	b.	Reports on Form 8-K:	None.
	c.	The index to exhibits has been filed as separate pages of 2001 Form 10-K and is available to shareholders on request from the Secretary of the company at the principal executive offices.	

(a) Part III will be incorporated by reference from the registrant s 2002 Proxy Statement pursuant to instructions G(1) and G(3) of the General Instructions to Form 10-K.

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 7th day of March, 2002.

OWENS & MINOR, INC.

/s/ G. Gilmer Minor, III

G. Gilmer Minor, III
Chairman and Chief Executive Officer

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 on the 7th day of March 2002 and in the capacities indicated.

Signature	Title
/s/ G. Gilmer Minor, III G. Gilmer Minor, III	Chairman and Chief Executive Officer and Director (Principal Executive Officer)
/s/ Jeffrey Kaczka Jeffrey Kaczka	Senior Vice President and Chief Financial Officer (Principal Financial Officer)
/s/ Olwen B. Cape Olwen B. Cape	Vice President and Controller (Principal Accounting Officer)
/s/ A. Marshall Acuff, Jr. A. Marshall Acuff, Jr.	Director
/s/ Henry A. Berling Henry A. Berling	Director
/s/ Josiah Bunting, III Josiah Bunting, III	Director
/s/ John T. Crotty John T. Crotty	Director
/s/ James B. Farinholt, Jr. James B. Farinholt, Jr.	Director
/s/ Vernard W. Henley Vernard W. Henley	Director
/s/ Peter S. Redding Peter S. Redding	Director
/s/ James E. Rogers James E. Rogers	Director
/s/ James E. Ukrop James E. Ukrop	Director
/s/ Anne Marie Whittemore Anne Marie Whittemore	Director

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[GRAPHICs]

Board of Directors

A. Marshall Acuff, Jr. (62) [2,4,5]
Retired Senior Vice President
& Managing Director,
Salomon Smith Barney, Inc.

Henry A. Berling (59) [1,4]
Executive Vice President,
Partnership Development,
Owens & Minor, Inc.

Josiah Bunting, III (62) [2,4,5]
Superintendent,
Virginia Military Institute

John T. Crotty (64) [2,3,4*]
Managing Partner,
CroBern Management Partnership
President, CroBern, Inc.

James B. Farinholt, Jr. (67) [1,2*,4]
Special Assistant to the President
for Economic Development,
Virginia Commonwealth University

Vernard W. Henley (72) [2,3,5]
Retired Chairman & CEO,
Consolidated Bank & Trust Company

G. Gilmer Minor, III (61) [1*,4]
Chairman & CEO,
Owens & Minor, Inc.

Peter S. Redding (63) [2,3,4]
Retired President & CEO,
Standard Register Company

James E. Rogers (56) [1,3*,4]
President, SCI Investors Inc.

James E. Ukrop (64) [3,4,5]
Chairman,
Ukrop s Super Markets, Inc.
Chairman, First Market Bank

Anne Marie Whittemore (55)[1,3,5*]
Partner,
McGuireWoods LLP

Board Committees: [1]Executive Committee, [2]Audit Committee, [3]Compensation & Benefits Committee, [4]Strategic Planning Committee, [5]Governance & Nominating Committee, [*]Denotes Chairperson

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S elected Financial Data[1]

(in thousands, except ratios and per share data)

	2001	2000	1999	1998	1997
Summary of Operations:					
Net sales	$ 3,814,994	$ 3,503,583	$ 3,194,134	$ 3,090,048	$ 3,124,062
Income before extraordinary item[2][3]	$ 30,103	$ 33,088	$ 27,979	$ 20,145	$ 24,320
Per Common Share:					
Income before extraordinary item basic	$ 0.90	$ 1.01	$ 0.86	$ 0.56	$ 0.60
Income before extraordinary item diluted	$ 0.85	$ 0.94	$ 0.82	$ 0.56	$ 0.60
Average number of shares outstanding basic	33,368	32,712	32,574	32,488	32,048
Average number of shares outstanding diluted	40,387	39,453	39,098	32,591	32,129
Cash dividends	$ 0.2725	$ 0.2475	$ 0.23	$ 0.20	$ 0.18
Stock price at year end	$ 18.50	$ 17.75	$ 8.94	$ 15.75	$ 14.50
Book value at year end	$ 6.97	$ 6.41	$ 5.58	$ 4.94	$ 4.48
Summary of Financial Position:					
Working capital	$ 311,778	$ 233,637	$ 219,448	$ 235,247	$ 233,789
Total assets	$ 953,853	$ 867,548	$ 865,000	$ 717,768	$ 712,563
Long-term debt	$ 203,449	$ 152,872	$ 174,553	$ 150,000	$ 182,550
Mandatorily redeemable preferred securities	$ 132,000	$ 132,000	$ 132,000	$ 132,000	$
Shareholders equity	$ 236,243	$ 212,772	$ 182,381	$ 161,126	$ 259,301
Selected Ratios:					
Gross margin as a percent of net sales	10.7%	10.7%	10.7%	10.8%	10.4%
Selling, general and administrative expenses as a percent of net sales	7.8%	7.7%	7.8%	8.0%	7.8%
Average receivable days sales outstanding[4]	33.1	33.3	34.9	33.5	32.4
Average inventory turnover	9.7	9.5	9.2	9.8	9.9
Return on average total equity before extraordinary item[5]	9.6%	11.2%	10.5%	8.2%	9.7%
Return on average total equity before extraordinary item[6]	13.4%	16.7%	16.3%	9.6%	9.7%
Current ratio	1.8	1.6	1.6	1.9	1.9
Capitalization ratio[4][5]	42.6%	40.4%	47.2%	43.4%	53.0%
Capitalization ratio[4][6]	63.2%	63.2%	69.4%	68.9%	53.0%

[1] *On July 30, 1999, the company acquired certain net assets of Medix, Inc. This acquisition was accounted for as a purchase.*

[2] *In 1998, the company incurred $11.2 million, or $6.6 million after taxes, of nonrecurring restructuring expenses which are included in income before extraordinary item. In 2001, 2000 and 1999, income before extraordinary item included reductions in the restructuring accrual of $1.5 million, $0.8 million and $1.0 million, or $0.8 million, $0.4 million and $0.6 million after taxes. See Note 3 to the Consolidated Financial Statements.*

[3] *In 2001, income before extraordinary item included an impairment loss of $1.1 million on an investment in marketable equity securities and a provision for disallowed income tax deductions of $7.2 million. See Notes 6 and 14 to the Consolidated Financial Statements.*

[4] *Assumes that receivables had not been sold under the company s off balance sheet receivables financing facility. See Note 9 to the Consolidated Financial Statements.*

[5] *Includes mandatorily redeemable preferred securities as equity.*

[6] *Includes mandatorily redeemable preferred securities as debt.*

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Business Description

The Company

Owens & Minor Inc. and subsidiaries (O&M or the company) is the leading distributor of national name brand medical and surgical supplies in the United States, distributing over 120,000 finished medical and surgical products produced by approximately 1,500 suppliers to approximately 4,000 customers from 44 distribution centers nationwide. The company s customers are primarily acute care hospitals and integrated healthcare networks (IHNs), which account for more than 90% of O&M s net sales. Many of these hospital customers are represented by national healthcare networks (Networks) or group purchasing organizations (GPOs) that offer discounted pricing with suppliers and contract distribution services with the company. Other customers include alternate care providers such as clinics, home healthcare organizations, nursing homes, physicians offices, rehabilitation facilities and surgery centers. The company typically provides its distribution services under contractual arrangements ranging from three to five years. Most of O&M s sales consist of consumable goods such as disposable gloves, dressings, endoscopic products, intravenous products, needles and syringes, sterile procedure trays, surgical products and gowns, urological products and wound closure products.

Founded in 1882 and incorporated in 1926 in Richmond, Virginia, as a wholesale drug company, the company refined its mission in 1992, selling the wholesale drug division to concentrate on medical and surgical distribution. O&M has significantly expanded and strengthened its national presence over the last ten years through internal growth and acquisitions, generating $3.8 billion of net sales in 2001.

The Industry

Distributors of medical and surgical supplies provide a wide variety of products and services to healthcare providers, including hospitals and hospital-based systems, IHNs and alternate care providers. The company contracts with these providers directly and through Networks and GPOs. The medical/surgical supply distribution industry has experienced growth in recent years due to the aging population and emerging medical technology resulting in new healthcare procedures and products. Over the years, healthcare providers have continued to change and model their health systems to meet the needs of the markets they serve. They have forged strategic relationships with national medical and surgical supply distributors to meet the challenges of managing the supply procurement and distribution needs of their entire network. The traditional role of distributors in warehousing and delivering medical and surgical supplies to customers is evolving into the role of assisting customers to manage the entire supply chain.

Historically, the medical/surgical supply distribution industry has been highly fragmented. During the past decade, the overall healthcare market has been characterized by the consolidation of healthcare providers into larger and more sophisticated entities seeking to lower their total costs. These providers have sought to lower total product costs through incremental value-added services from their medical and surgical supply distributors. These trends have driven a significant and ongoing consolidation within the medical/surgical supply distribution industry due to the competitive advantages enjoyed by larger distributors, which include, among other things, the ability to serve nationwide customers, buy inventory in large volume and develop technology platforms and decision support systems.

The Business

The company purchases a high volume of medical and surgical products from suppliers, inventories these items at its distribution centers and provides delivery services to its customers. O&M s 44 distribution centers are located throughout the United States and are situated close to its major customer facilities. These distribution centers generally serve hospitals and other customers within a 200-mile radius, delivering most medical and surgical supplies with a fleet of leased trucks. Almost all of O&M s delivery personnel are employees of the company, providing effective control of customer service. Contract carriers and parcel services are used to transport all other medical and surgical supplies. The company customizes its product pallets and truckloads according to the needs of its customers, thus enabling them to reduce labor on the receiving end. Furthermore, delivery times are adjusted to customers needs, allowing them to streamline receiving activities.

O&M strives to make the supply chain more efficient through the utilization of advanced warehousing, delivery and

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Business **Description** *(continued)*

purchasing techniques, enabling customers to order products using just-in-time and stockless services. A key component of this strategy is a significant investment in advanced information technology, which includes automated warehousing technology as well as electronic data interchange (EDI) and Internet-based technology for communicating with both customers and suppliers. O&M provides technology so that customers can analyze their own purchasing data to help them maintain contract compliance, create workflow efficiencies, raise employee productivity and cut costs.

Value-Added Services

The company offers its customers value-added services in the areas of supply chain management, logistics and information technology in order to help control healthcare costs, improve inventory management and increase profitability. Some of these services include:

CostTrack: This activity-based management program helps customers identify and track the cost drivers in their procurement and handling activities, giving them the information they need to drive workflow efficiencies, raise employee productivity and cut costs. With CostTrack, the pricing of services provided to customers is based on the variety of services that they choose, as compared to a traditional cost-plus pricing model. In 2001, almost 28% of the company s net sales were generated through the CostTrack program, up from 22% in 2000.

WISDOM: This Internet-accessed decision support tool connects customers, suppliers and GPOs to the company s data warehouse. WISDOM offers customers online access to a wide variety of reports, which summarize their purchase history, contract compliance, product usage and other related data. This timely information helps customers consolidate purchasing information across their healthcare systems and identify opportunities for product standardization, contract compliance and supplier consolidation. The company offers WISDOM on a subscription basis. WISDOM users represented net sales of approximately $1.5 billion for the year ended December 31, 2001.

WISDOM^2: The second generation of WISDOM, this Internet-based decision support tool provides customers access to purchasing information for all medical/surgical manufacturers and suppliers recorded in their materials management information systems. This timely information helps customers identify opportunities for product standardization, contract compliance, order optimization and efficiencies in their overall purchasing activity.

PANDAC Wound Closure Asset Management Program: This information-based program provides customers with an evaluation of their current and historical wound closure inventories and usage levels, helping them reduce their investment in high-cost wound management supplies and control their costs per operative case.

Focus On Consolidation, Utilization & Standardization (FOCUS): This supplier partnership program drives product standardization and consolidation, increasing the volume of purchases from the most efficient suppliers, which provides operational benefits and cost savings throughout the supply chain. FOCUS centers around both commodity and preference product standardization. O&M requires its FOCUS supplier partners to meet strict certification standards, such as exceeding minimum fill rates and offering a flexible returned goods policy.

Customers

The company currently provides its distribution services to approximately 4,000 healthcare providers, including hospitals, IHNs and alternative care providers, contracting with them directly and through Networks and GPOs.

Networks and GPOs

Networks and GPOs are entities that act on behalf of a group of healthcare providers to obtain pricing and other benefits that may be unavailable to individual members. Hospitals, physicians and other types of healthcare providers have joined Networks and GPOs to take advantage of improved economies of scale and to obtain services from medical and surgical supply

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distributors ranging from discounted product pricing to logistical and clinical support. Networks and GPOs negotiate directly with medical and surgical product suppliers and distributors on behalf of their members, establishing exclusive or multi-supplier relationships. Networks and GPOs cannot ensure that members will purchase their supplies from a given distributor. O&M is a distributor for Novation, an organization that manages purchasing for more than 5,000 healthcare organizations. Novation was created in 1998 to serve member organizations of VHA, which O&M has served since 1985, and University HealthSystem Consortium (UHC), an alliance of academic health centers. Sales to Novation members represented approximately 51% of the company s net sales in 2001. The company is also a distributor for Broadlane, a GPO providing national contracting for more than 300 acute care hospitals and more than 1,400 sub-acute care facilities, including Tenet Healthcare Corporation, one of the largest for profit hospital chains in the nation. Sales to Broadlane members represented approximately 11% of O&M s net sales in 2001.

IHNs

IHNs are typically networks of different types of healthcare providers that seek to offer a broad spectrum of healthcare services and comprehensive geographic coverage to a particular local market. IHNs have become increasingly important because of their expanding role in healthcare delivery and cost containment and their reliance upon the hospital as a key component of their organizations. Individual healthcare providers within a multiple-entity IHN may be able to contract individually for distribution services; however, the providers shared economic interests create strong incentives for participation in distribution contracts established at the system level. Because IHNs frequently rely on cost containment as a competitive advantage, IHNs have become an important source of demand for O&M s enhanced inventory management and other value-added services.

Individual Providers

In addition to contracting with healthcare providers at the IHN level, and through Networks and GPOs, O&M contracts directly with individual healthcare providers. In 2001, not-for-profit hospitals represented a majority of these facilities.

Sales and Marketing

O&M s sales and marketing function is organized to support its decentralized field sales teams of approximately 220 people. Based from the company s distribution centers nationwide, the company s local sales teams are positioned to respond to customer needs quickly and efficiently. National account directors work closely with Networks and GPOs to meet their needs and coordinate activities with their individual member facilities. In addition, O&M has a national field organization, the Medical Specialties Group, which is focused on assisting customers in the clinical environment. The company s integrated sales and marketing strategy offers customers value-added services in logistics, information management, asset management and product mix management. O&M provides special training and support tools to its sales team to help promote these programs and services.

Contracts and Pricing

Industry practice is for healthcare providers or their GPOs to negotiate product pricing directly with suppliers and then negotiate distribution pricing terms with distributors. Distribution contracts in the medical/surgical supply industry establish the price at which products will be distributed and, in many cases, specify a minimum volume of product to be purchased and are terminable by the customer upon short notice.

The majority of O&M s arrangements compensate the company on a cost-plus percentage basis under which a negotiated percentage distributor fee is added to the product cost agreed to by the customer and the supplier. This negotiated distributor fee is calculated either on a fixed cost-plus percentage basis or a variable cost-plus percentage basis that varies according to the services rendered and the dollar volume of purchases. Under this variable pricing method, as the company s sales to an institution grow, the cost-plus percentage charged to the customer generally decreases. Additionally, O&M has arrangements that charge incremental fees for additional distribution and enhanced inventory management services, such as more frequent deliveries and distribution of products in small units of measure. Although the company s marketing and sales personnel based in the distribution centers can negotiate local arrangements and pricing levels with customers, corporate management has established minimum pricing levels and a contract review process.

Business Description *(continued)*

Pricing under O&M s CostTrack model differs from pricing under a traditional cost-plus model. With CostTrack, the pricing of services provided to customers is based on the variety of services that they choose, as compared to a traditional cost-plus pricing model. As a result, this pricing model more accurately aligns the distribution fees charged to the customer with the costs of the individual services provided.

Suppliers

O&M believes that its size, strength and long-standing relationships enable it to obtain attractive terms from suppliers, including discounts for prompt payment and volume incentives. The company has well-established relationships with virtually all major suppliers of medical and surgical supplies, and uses cross-functional teams to work with its largest suppliers to create operating efficiencies in the supply chain.

Approximately 16% of O&M s net sales in 2001 were sales of Johnson & Johnson Hospital Services, Inc. products. Approximately 15% of O&M s 2001 net sales were sales of products of the subsidiaries of Tyco International, which include Kendall Healthcare Products, United States Surgical Corporation and Mallinckrodt.

Information Technology

To support its strategic efforts, the company has developed information systems to manage all aspects of its operations, including warehouse and inventory management, asset management and electronic commerce. O&M believes that its investment in and use of technology in the management of its operations provides the company with a significant competitive advantage. In 2001, the company ranked number one on the *InformationWeek* 500 listing of the most innovative users of technology in the nation.

In 1998, O&M signed a 10-year agreement with Perot Systems Corporation to outsource its information technology (IT) operations and to procure strategic application development services. This partnership has allowed the company to provide resources to major IT initiatives, which support internal operations and enhance services to customers and suppliers. The company has focused its technology expenditures on electronic commerce, data warehouse and decision support, supply chain management and warehousing systems, sales and marketing programs and services and infrastructure enhancements. In 2001, O&M s capital expenditures included approximately $9.8 million for computer hardware and software.

Owens & Minor is an industry leader in the use of electronic commerce to conduct business transactions with customers and suppliers, using OM Direct, an Internet-based product catalog and direct ordering system, to supplement existing EDI technologies.

The company also provides distribution services for several Internet-based medical and surgical supply companies. O&M is committed to an ongoing investment in an open, Internet-based electronic commerce platform to support the company s supply chain management initiatives and to enable expansion into new market segments for medical and surgical products.

Asset Management

O&M aims to provide the highest quality of service in the medical/surgical supply distribution industry by focusing on providing suppliers and customers with local sales and service support and the most responsive, efficient and cost-effective distribution of medical and surgical products. The company draws on technology to provide a broad range of value-added services to control inventory and accounts receivable.

Inventory

Due to O&M s significant investment in inventory to meet the rapid delivery requirements of customers, efficient asset management is essential to the company s profitability. The significant and ongoing emphasis on cost control in the healthcare industry puts pressure on suppliers, distributors and healthcare providers to create more efficient inventory management systems. O&M has responded to these ongoing challenges by developing inventory forecasting capabilities, a client/server warehouse management system, a product standardization and consolidation initiative, and a vendor-managed inventory process. This vendor-managed inventory process allows some of the company s major suppliers to monitor daily sales, inventory levels and product forecasts electronically so they can automatically and accurately replenish O&M s inventory.

Accounts Receivable

The company s credit practices are consistent with those of other medical and surgical supply distributors. O&M actively manages its accounts receivable to minimize credit risk and does not believe that the risk of loss associated with accounts receivable poses a significant risk to its results of operations.

Competition

The medical/surgical supply distribution industry in the United States is highly competitive and consists of three major nationwide distributors: O&M; Allegiance Corp., a subsidiary of Cardinal Health, Inc.; and McKesson General Medical Corp., a subsidiary of McKesson HBOC, Inc. The industry also includes smaller national distributors of medical and surgical supplies and a number of regional and local distributors.

Competitive factors within the medical/surgical supply distribution industry include total delivered product cost, product availability, the ability to fill and invoice orders accurately, delivery time, services provided, inventory management, information technology, electronic commerce capabilities and the ability to meet special customer requirements. O&M believes its emphasis on technology, combined with its customer-focused approach to distribution and value-added services, enables it to compete effectively with both larger and smaller distributors by being located near the customer and offering a high level of customer service.

Other Matters

Regulation

The medical/surgical supply distribution industry is subject to regulation by federal, state and local government agencies. Each of O&M s distribution centers is licensed to distribute medical and surgical supplies as well as certain pharmaceutical and related products. The company must comply with regulations, including operating and security standards for each of its distribution centers, of the Food and Drug Administration, the Occupational Safety and Health Administration, state boards of pharmacy and, in certain areas, state boards of health. O&M believes it is in material compliance with all statutes and regulations applicable to distributors of medical and surgical supply products and pharmaceutical and related products, as well as other general employee health and safety laws and regulations.

Employees

At the end of 2001, the company had 2,937 full-time and part-time employees. O&M believes that ongoing employee training is critical to performance, so the company emphasizes quality and technology in training programs to increase employee efficiency by sharpening overall customer service skills and by focusing on functional best practices. Management believes that relations with employees are good.

Properties

O&M s corporate headquarters are located in western Henrico County, in a suburb of Richmond, Virginia, in facilities leased from unaffiliated third parties. The company owns two undeveloped parcels of land adjacent to its corporate headquarters. In March 2001, the company purchased an undeveloped parcel of land in nearby Hanover County to be used for its future corporate headquarters. The company leases offices and warehouses for 42 of its distribution centers across the United States from unaffiliated third parties. In addition, the company has a distribution center located at a customer facility in Columbia, South Carolina, and has a warehousing arrangement in Honolulu, Hawaii. In the normal course of business, the company regularly assesses its business needs and makes changes to the capacity and location of its distribution centers. The company believes that its facilities are adequate to carry on its business as currently conducted. A number of leases are scheduled to terminate within the next several years. The company believes that, if necessary, it could find facilities to replace these leased premises without suffering a material adverse effect on its business.

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Management Discussion & Analysis *(continued)*

2001 Financial Results

In 2001, O&M earned net income of $23.0 million, or $0.68 per diluted common share, compared with $33.1 million, or $0.94 per diluted common share in 2000, and $28.0 million, or $0.82 per diluted common share in 1999. Results from 2001 included a $1.1 million impairment loss on an investment, a $7.2 million additional tax provision related principally to disallowed interest deductions for corporate-owned life insurance for the years 1995 through 1998, and a $7.1 million after-tax extraordinary loss on the early retirement of debt. Net income in 2001, 2000 and 1999 included reductions in a restructuring reserve, originally established in 1998, of $0.8 million, $0.4 million, and $0.6 million, net of tax. Excluding these unusual items, net income for 2001 increased to $37.5 million, or $1.03 per diluted common share, from $32.7 million, or $0.93 per diluted common share, for 2000 and $27.4 million, or $0.80 per diluted common share for 1999. The increase from 2000 to 2001 was primarily due to the increase in sales, a reduction of financing costs, and a lower effective tax rate for ongoing operations. The increase from 1999 to 2000 resulted from higher sales and success in controlling operating expenses through productivity improvements.

The following tables reconcile net income as reported under generally accepted accounting principles to income excluding unusual items for the years ended December 31, 2001, 2000 and 1999:

(in thousands, except per share data)

	Year ended December 31, 2001		
	As reported	Unusual items	Excluding unusual items
Income before income taxes and extraordinary item	$ 64,577	$ 405	$ 64,172
Income tax provision	34,474	7,817	26,657
Income before extraordinary item	30,103	(7,412)	37,515
Extraordinary loss on early retirement of debt	(7,068)	(7,068)	
Net income	$ 23,035	$ (14,480)	$ 37,515
Per common share diluted:			
Income before extraordinary item	$ 0.85	$ (0.18)	$ 1.03
Extraordinary loss on early retirement of debt	(0.17)	(0.17)	
Net income	$ 0.68	$ (0.35)	$ 1.03

	Year ended December 31, 2000		
	As reported	Unusual items	Excluding unusual items
	$ 60,160	$ 750	$ 59,410

Income before income taxes			
Income tax provision	27,072	338	26,734
Net income	$ 33,088	$ 412	$ 32,676
Net income per diluted common share	$ 0.94	$ 0.01	$ 0.93

	Year ended December 31, 1999		
	As reported	Unusual items	Excluding unusual items
Income before income taxes	$ 50,058	$ 1,000	$ 49,058
Income tax provision	22,079	441	21,638
Net income	$ 27,979	$ 559	$ 27,420
Net income per diluted common share	$ 0.82	$ 0.02	$ 0.80

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Results of Operations

The following table presents the company s consolidated statements of income on a percentage of net sales basis:

Year ended December 31,	2001	2000	1999
Net sales	100.0%	100.0%	100.0%
Cost of goods sold	89.3	89.3	89.3
Gross margin	10.7	10.7	10.7
Selling, general and administrative expenses	7.8	7.7	7.8
Depreciation and amortization	0.6	0.6	0.6
Interest expense, net	0.3	0.3	0.4
Discount on accounts receivable securitization	0.1	0.2	0.1
Impairment loss on investment	0.0		
Distributions on mandatorily redeemable preferred securities	0.2	0.2	0.2
Restructuring credit	(0.0)	(0.0)	(0.0)
Total expenses	9.0	9.0	9.1
Income before income taxes and extraordinary item	1.7	1.7	1.6
Income tax provision	0.9	0.8	0.7
Income before extraordinary item	0.8	0.9	0.9
Extraordinary loss on early retirement of debt	(0.2)		
Net income	0.6%	0.9%	0.9%

Acquisition. On July 30, 1999, the company acquired certain net assets of Medix, Inc. (Medix), a distributor of medical/surgical supplies, for approximately $83 million. The company paid cash of approximately $68 million and assumed debt of approximately $15 million, which was paid off as part of the closing transaction. The excess of the purchase price over the fair value of the identifiable net assets acquired of approximately $58 million was recorded as goodwill and has been amortized on a straight-line basis over 40 years. As the acquisition was accounted for as a purchase, the operating results of Medix have been included in the company s consolidated financial statements since July 30, 1999.

In connection with the acquisition, management adopted a plan for integration of the businesses that included closure of some Medix facilities and consolidation of certain administrative functions. An accrual of $2.7 million, included in the allocation of the purchase price, was established to provide for certain costs related to this plan. In 2001, 2000, and 1999 amounts of $0.3 million, $1.0 million, and $0.1 million were charged against the accrual, principally for lease payments on closed facilities and employee separations. The integration of the Medix business was completed in 2001, and the integration accrual was re-evaluated, resulting in a reduction in the accrual of $0.6 million. This adjustment was recorded as a reduction in goodwill. The remaining accrual consists primarily of losses on lease commitments for vacated warehouse space on leases through 2003. Management subleases the vacant space when practicable to reduce these losses.

Net sales. Net sales increased by 9% to $3.81 billion for 2001, from $3.50 billion for 2000. This increase resulted from further penetration of existing accounts, as well as new business, including the addition of several large customers. In April 2001, the company signed a new distribution agreement with Novation, the supply company of VHA, Inc. and University HealthSystem Consortium, continuing its long-standing

relationship with these organizations. Under the new three-year agreement, the company is one of two national medical and surgical supply distributors authorized to serve members in all areas of the country. Sales to Novation members represented approximately 51% of the company s net sales in 2001.

Net sales increased by 10% to $3.50 billion for 2000, from $3.19 billion in 1999. Excluding the sales generated by customers acquired through the Medix acquisition, net sales increased 6%. Most of this increase resulted from increased penetration of existing accounts, most significantly Broadlane, whose distribution contract began in February 1999.

The company anticipates sales growth for 2002 to be in the 6 to 8 percent range.

[Graphic]

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Management Discussion & Analysis *(continued)*

Gross margin. Gross margin as a percentage of net sales for 2001 remained unchanged from 2000 and 1999 at 10.7%. From 1999 to 2000 and from 2000 to 2001, customer margins decreased slightly due to competitive pressures and changes in the company s customer mix. These decreases, however, were offset by increased margins from supplier incentives and inventory buying opportunities.

For 2002, management anticipates continued competitive pressure, as well as potential lessening of supplier incentives. The company will continue to pursue opportunities for margin improvement, including an emphasis on providing value-added services to customers and converting more business to CostTrack, which better aligns the fees charged to customers with the services provided. The company will also continue to actively pursue buying opportunities in order to reduce the cost of goods sold. As a result, management anticipates that, in 2002, gross margin as a percentage of net sales will remain consistent with 2001.

[GRAPHIC]

Selling, general and administrative expenses. Selling, general and administrative (SG&A) expenses as a percentage of net sales were 7.8% in 2001 compared with 7.7% in 2000 and 7.8% in 1999. The increase from 2000 to 2001 was primarily the result of higher personnel, warehouse and employee benefits costs driven by customer and business transitions, including:

- higher than normal activity levels related to customer sign-ups as a result of the Novation contract renewal,
- the addition of several large new customer accounts, and
- changes in the levels of service provided to certain customers, such as low unit-of-measure delivery.

The decreases from 1999 to 2000 as a percentage of net sales were attributable to economies of scale achieved as a result of a higher sales base without a significant increase in fixed costs, operating efficiencies driven by improved warehouse technology, and continued management of administrative costs, including consolidation of certain administrative functions.

Management anticipates that in 2002, SG&A expenses as a percentage of net sales will improve by a minimum of 10 basis points as compared to 2001, as the volume of customer transitions is expected to be lower and the company is focusing on further standardization of processes. Increased demand for low unit-of-measure delivery and other increases in levels of service as a result of customer needs could affect the company s ability to decrease SG&A expenses as a percentage of net sales, but increased fees for these services should enable the company to preserve or enhance operating margins.

Depreciation and amortization. Depreciation and amortization increased by 4% in 2001 to $22.5 million, compared with $21.5 million in 2000 and $19.4 million in 1999. Excluding goodwill amortization of $6.0 million in 2001 and 2000 and $5.1 million in 1999, depreciation and amortization increased by 6% from 2000 to 2001 and by 9% from 1999 to 2000 as a result of continued capital spending associated with information technology initiatives. O&M anticipates similar increases in depreciation in 2002 as the company continues to invest in information technology. In 2002, the company will adopt Statement of Financial Accounting Standards No. (SFAS) 142, *Goodwill and Other Intangible Assets,* and as a result, the company will no longer amortize goodwill.

Net interest expense and discount on accounts receivable securitization (financing costs). Net financing costs totaled $17.7 million in 2001, compared with $19.4 million in 2000 and $17.1 million in 1999. Net financing costs included collections of customer finance charges of $4.5 million in 2001, compared with $5.3 million in 2000 and $4.6 million in 1999. Excluding the collection of customer finance charges, financing costs decreased to $22.2 million in 2001 from $24.8 million in 2000, and increased

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[Graphic]
from $21.7 million in 1999. The decrease in financing costs from 2000 to 2001 was primarily driven by lower effective interest rates resulting from both the refinancing of the company s long-term debt and from decreases in short-term interest rates. The increase in financing costs from 1999 to 2000 was due to a combination of higher interest rates due to external market forces and an increase in outstanding financing resulting from the Medix acquisition. O&M expects to continue to manage its financing costs by managing working capital levels. Future financing costs will be affected primarily by changes in short-term interest rates, as well as working capital requirements.

Impairment loss on investment. The company owns equity securities of a provider of business-to-business e-commerce services in the healthcare industry. The market value of these securities fell significantly below the company s original cost basis and, as management believed that recovery in the near term was unlikely, the company recorded an impairment charge of $1.1 million in the third quarter of 2001.

Restructuring credits. As a result of the cancellation of a significant customer contract in 1998, the company recorded a nonrecurring restructuring charge of $6.6 million, after taxes, to downsize operations. The company periodically re-evaluates its restructuring reserve, and since the actions under this plan have resulted in lower projected total costs than originally anticipated, the company has recorded reductions in the reserve in 2001, 2000 and 1999 of $1.5 million, $0.8 million and $1.0 million. These reductions in the reserve have increased net income for 2001, 2000 and 1999 by $0.8 million, $0.4 million and $0.6 million. In 2001, 2000 and 1999, amounts of $0.3 million, $1.8 million and $2.1 million were charged against this liability. The remaining accrual consists primarily of losses on lease commitments for vacated office space on leases through 2006, as well as anticipated asset write-offs. Management subleases the vacant space when practicable to reduce the cost of the restructuring plan.

Income taxes. The provision for income taxes was $34.5 million in 2001, including a $7.2 million provision for estimated tax liabilities related principally to interest deductions for corporate-owned life insurance claimed on the company s tax returns for the years 1995 through 1998. Excluding this charge, the impairment loss on investment, and the reduction of the restructuring reserve, O&M s effective tax rate was 41.5% in 2001, compared with 45.0% in 2000 and 44.1% in 1999. The reduction in rate from 2000 to 2001 resulted primarily from lower effective state income tax rates and decreases in the effect of certain nondeductible items. The increase in the effective tax rate from 1999 to 2000 resulted primarily from increases in certain nondeductible expenses. The effective tax rate is expected to decrease in 2002 as a result of the elimination of goodwill amortization expense, of which only a small part was deductible for income tax purposes.

Financial Condition, Liquidity and Capital Resources

Liquidity. Combined outstanding debt and off balance sheet accounts receivable securitization increased by $39.9 million from December 31, 2000 to $273.4 million at December 31, 2001. This increase in financing levels was primarily a result of an increased investment in inventory to support growing sales volume and to ensure high service levels during customer transitions. Excluding sales of accounts receivable, and their subsequent collections, under the company s off balance sheet receivables financing facility (Receivables Financing Facility), $11.6 million of cash was provided by operating activities in 2001, compared with $68.8 million in 2000 and $61.7 million in 1999. This decrease in operating cash flow resulted largely from increased purchases of inventory.

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Management's Discussion & Analysis *(continued)*

In July 1999, the company acquired certain net assets of Medix for approximately $83 million. This acquisition was funded by cash flow from operations and an increase in outstanding financing under the Receivables Financing Facility.

During 2000, the company replaced its revolving credit facility and Receivables Financing Facility with new facilities expiring in April 2003 and July 2001. The new revolving credit facility allows the company to borrow up to $225 million, unchanged from the prior facility. Under the new Receivables Financing Facility, the company can sell up to $225 million of accounts receivable, an increase of $75 million from the prior facility. In July 2001, the company extended the expiration of its Receivables Financing Facility to July 11, 2002. The company expects to renew or replace both its Receivables Financing Facility and its revolving credit facility in 2002.

On July 2, 2001, the company issued $200 million of 8 1/2% Senior Subordinated Notes which will mature in July 2011. The proceeds from these notes were used to retire the company's $150 million of 10 7/8% Senior Subordinated Notes and to reduce the amount of outstanding financing under the Receivables Financing Facility. The retirement of the 10 7/8% Notes resulted in an extraordinary loss on the early retirement of debt of $7.1 million, net of income tax benefit. In conjunction with the new notes, the company entered into interest rate swap agreements through 2011 under which the company pays counterparties a variable rate based on London Interbank Offered Rate (LIBOR) and the counterparties pay the company a fixed interest rate of 8 1/2% on a notional amount of $100 million.

The company expects that its available financing will be sufficient to fund its working capital needs and long-term strategic growth, although this cannot be assured. At December 31, 2001, O&M had $213.6 million of unused credit under its revolving credit facility and the ability to sell an additional $155.0 million of accounts receivable under the Receivables Financing Facility.

The following is a summary of the company's significant contractual obligations:

(in millions)

	Payments due by period				
Contractual obligations	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Long-term debt	$ 200.0	$	$	$	$ 200.0
Mandatorily redeemable preferred securities	132.0				132.0
Leases and other commitments	76.9	23.2	35.2	15.2	3.3
Total contractual obligations	$ 408.9	$ 23.2	$ 35.2	$ 15.2	$ 335.3

In addition, the company has two commitments to outsource information technology operations that are cancelable upon payment of termination fees. These commitments are more fully described in Note 18 to the Consolidated Financial Statements.

Working Capital Management. The company's working capital increased by $78.1 million from December 31, 2000, to $311.8 million at December 31, 2001, as a result of increased levels of inventory. Inventory turnover improved to 9.7 times for the year ended December 31, 2001, from 9.5 times for the year ended December 31, 2000, as a result of increased sales. Accounts receivable, assuming they had not been sold under the company's Receivables Financing Facility, decreased by $7.7 million to $334.2 million at December 31, 2001.

Capital Expenditures. Capital expenditures were approximately $16.8 million in 2001, including $3.3 million for the purchase of land to be used for the company's future headquarters. The company spent $9.8 million to purchase computer hardware and software. The company expects to continue supporting strategic initiatives and improving operational efficiency through investments in technology, including system upgrades.

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Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) issued the following new accounting pronouncements: SFAS 141, *Business Combinations,* SFAS 142, *Goodwill and Other Intangible Assets,* and SFAS 143, *Accounting for Asset Retirement Obligations.*

The provisions of SFAS 141 require that all business combinations initiated after June 30, 2001 be accounted for using the purchase method and also specify criteria that intangible assets acquired in a business combination must meet to be recognized and reported apart from goodwill. The adoption of this standard will affect the company s accounting for future acquisitions.

The provisions of SFAS 142 state that goodwill should not be amortized but should be tested for impairment upon adoption of the standard, and at least annually, at the reporting unit level. The company is required to adopt the provisions of this standard beginning on January 1, 2002. As a result, the company will no longer record goodwill amortization expense. Amortization expense related to goodwill for 2001, 2000 and 1999 was $6.0 million, $6.0 million and $5.1 million. Had SFAS 142 been in effect in 2001, 2000 and 1999, net income would have been increased by $5.3 million, $5.3 million and $4.8 million, or $0.13, $0.13 and $0.12 per diluted common share. Management expects that implementation of SFAS 142 will increase net income by approximately $5.3 million, or $0.13 per diluted common share, in 2002.

The provisions of SFAS 142 require the company to perform an assessment of whether there is an indication that goodwill is impaired as of the date of adoption. Any such transitional impairment loss would be recognized as the cumulative effect of a change in accounting principle in the company s consolidated statement of income. Management does not expect to incur a transitional impairment loss upon adoption of this standard.

The provisions of SFAS 142 also require the company to evaluate its existing intangible assets and goodwill that were acquired in purchase business combinations, and to make any necessary reclassifications in order to conform with the new classification criteria in SFAS 141 for recognition separate from goodwill. At December 31, 2001, the company had no separately identifiable intangible assets from purchase business combinations that were recorded either separately or within goodwill.

The provisions of SFAS 143 address financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The company will be required to adopt the provisions of this standard beginning on January 1, 2003. Management believes that adoption of this standard will not have a material effect on the company s financial condition or results of operations.

In August 2001, the FASB issued SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* The provisions of SFAS 144 will modify the accounting treatment for impairments of long-lived assets and discontinued operations. The company will be required to adopt the provisions of this standard beginning on January 1, 2002. Management believes that adoption of this standard will not have a material effect on the company s financial condition or results of operations.

Customer Risk

The company is subject to risks associated with changes in the medical industry, including continued efforts to control costs, which place pressure on operating margin, and changes in the way medical and surgical services are delivered to patients. The loss of one of the company s larger customers could have a significant effect on its business. However, management believes that the company s competitive position in the marketplace and its ability to control costs would enable it to continue profitable operations and attract new customers in the event of such a loss.

Market Risk

O&M provides credit, in the normal course of business, to its customers. The company performs ongoing credit evaluations of its customers and maintains reserves for credit losses.

The company is exposed to market risk relating to changes in interest rates. To manage this risk, O&M uses interest rate swaps to modify the company s exposure to interest rate movements and reduce borrowing costs. The company is exposed to

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Management Discussion & Analysis *(continued)*

certain losses in the event of nonperformance by the counterparties to these swap agreements. However, O&M s exposure is not significant and, since the counterparties are investment grade financial institutions, nonperformance is not anticipated.

The company is exposed to market risk from both changes in interest rates related to its interest rate swaps and changes in discount rates related to its Receivables Financing Facility. Interest expense and discount on accounts receivable securitization are subject to change as a result of movements in interest rates. As of December 31, 2001, O&M had $100 million of interest rate swaps on which the company pays a variable rate based on LIBOR and receives a fixed rate, as well as $70 million of receivables sold under the Receivables Financing Facility. Assuming similar levels of financing under the Receivables Financing Facility, a hypothetical increase in interest rates of 100 basis points would result in a potential reduction in future pre-tax earnings of approximately $1.7 million per year in connection with the swaps and the accounts receivable securitization.

Forward-Looking Statements

Certain statements in this discussion constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Although O&M believes its expectations with respect to the forward-looking statements are based upon reasonable assumptions within the bounds of its knowledge of its business and operations, all forward-looking statements involve risks and uncertainties and, as a result, actual results could differ materially from those projected, anticipated or implied by these statements. Such forward-looking statements involve known and unknown risks, including, but not limited to, general economic and business conditions; dependence on sales to certain customers; dependence on suppliers; competition; changing trends in customer profiles; the ability of the company to meet customer demand for additional value added services; the ability to convert customers to CostTrack; the availability of supplier incentives; the ability to capitalize on buying opportunities; the ability to manage operating expenses; the ability of the company to manage financing costs and interest rate risk; the risk that a decline in business volume or profitability could result in an impairment of goodwill; the ability to timely or adequately respond to technological advances in the medical supply industry; the ability to successfully identify, manage or integrate possible future acquisitions; the outcome of outstanding litigation; and changes in government regulations. The company undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future results, or otherwise.

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Consolidated Statements of Income

(in thousands, except per share data)

Year ended December 31,	2001	2000	1999
Net sales	$ 3,814,994	$ 3,503,583	$ 3,194,134
Cost of goods sold	3,406,758	3,127,911	2,851,556
Gross margin	408,236	375,672	342,578
Selling, general and administrative expenses	296,807	268,205	249,960
Depreciation and amortization	22,469	21,515	19,365
Interest expense, net	13,363	12,566	11,860
Discount on accounts receivable securitization	4,330	6,881	5,240
Impairment loss on investment	1,071		
Distributions on mandatorily redeemable preferred securities	7,095	7,095	7,095
Restructuring credit	(1,476)	(750)	(1,000)
Total expenses	343,659	315,512	292,520
Income before income taxes and extraordinary item	64,577	60,160	50,058
Income tax provision	34,474	27,072	22,079
Income before extraordinary item	30,103	33,088	27,979
Extraordinary loss on early retirement of debt, net of tax benefit	(7,068)		
Net income	$ 23,035	$ 33,088	$ 27,979
Per common share basic:			
Income before extraordinary item	$ 0.90	$ 1.01	$ 0.86
Extraordinary loss, net of tax benefit	(0.21)		
Net income	$ 0.69	$ 1.01	$ 0.86
Per common share diluted:			
Income before extraordinary item	$ 0.85	$ 0.94	$ 0.82
Extraordinary loss, net of tax benefit	(0.17)		
Net income	$ 0.68	$ 0.94	$ 0.82
Cash dividends per common share	$ 0.2725	$ 0.2475	$ 0.23

See accompanying notes to consolidated financial statements.

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Consolidated Balance Sheets

(in thousands, except per share data)

December 31,	2001	2000
Assets		
Current assets		
Cash and cash equivalents	$ 953	$ 626
Accounts and notes receivable, net	264,235	261,905
Merchandise inventories	389,504	315,570
Other current assets	24,760	16,190
Total current assets	679,452	594,291
Property and equipment, net	25,257	24,239
Goodwill, net	198,324	204,849
Other assets, net	50,820	44,169
Total assets	$ 953,853	$ 867,548
Liabilities and shareholders equity		
Current liabilities		
Accounts payable	$ 286,656	$ 291,507
Accrued payroll and related liabilities	12,669	9,940
Deferred income taxes	27,154	16,502
Other accrued liabilities	41,195	42,705
Total current liabilities	367,674	360,654
Long-term debt	203,449	152,872
Accrued pension and retirement plans	14,123	8,879
Deferred income taxes	364	371
Total liabilities	585,610	522,776
Company-obligated mandatorily redeemable preferred securities of subsidiary trust, holding solely convertible debentures of Owens & Minor, Inc.	132,000	132,000
Shareholders equity		
Preferred stock, par value $100 per share; authorized 10,000 shares Series A; Participating Cumulative Preferred Stock; none issued		
Common stock, par value $2 per share; authorized 200,000 shares; issued and outstanding 33,885 shares and 33,180 shares	67,770	66,360
Paid-in capital	27,181	18,039
Retained earnings	142,854	129,001
Accumulated other comprehensive loss	(1,562)	(628)
Total shareholders equity	236,243	212,772
Commitments and contingencies		
Total liabilities and shareholders equity	$ 953,853	$ 867,548

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows

(in thousands)

Year ended December 31,	2001	2000	1999
Operating activities			
Income before extraordinary item	$ 30,103	$ 33,088	$ 27,979
Adjustments to reconcile income before extraordinary item to cash provided by operating activities:			
Depreciation and amortization	22,469	21,515	19,365
Restructuring credit	(1,476)	(750)	(1,000)
Impairment loss on investment	1,071		
Deferred income taxes	11,268	(1,293)	8,236
Provision for LIFO reserve	4,264	2,973	1,741
Provision for losses on accounts and notes receivable	782	227	559
Sales of (collections of sold) accounts receivable, net	(10,000)	(25,612)	30,612
Changes in operating assets and liabilities:			
Accounts and notes receivable	6,888	(9,593)	(30,131)
Merchandise inventories	(78,198)	23,935	(42,397)
Accounts payable	10,049	(14,783)	86,871
Net change in other current assets and current liabilities	48	8,926	(11,232)
Other, net	4,373	4,522	1,686
Cash provided by operating activities	1,641	43,155	92,289
Investing activities			
Net cash paid for acquisition of business			(82,699)
Additions to property and equipment	(10,147)	(8,005)	(8,933)
Additions to computer software	(6,686)	(11,622)	(13,172)
Other, net	(858)	(152)	(2,359)
Cash used for investing activities	(17,691)	(19,779)	(107,163)
Financing activities			
Net proceeds from issuance of long-term debt	194,331		
Payments to retire long-term debt	(158,594)		
Additions (reductions) to other debt, net	(3,533)	(21,645)	25,178
Cash dividends paid	(9,182)	(8,156)	(7,520)
Proceeds from exercise of stock options	8,255	4,837	80
Other, net	(14,900)	1,545	(2,741)
Cash provided by (used for) financing activities	16,377	(23,419)	14,997
Net increase (decrease) in cash and cash equivalents	327	(43)	123
Cash and cash equivalents at beginning of year	626	669	546
Cash and cash equivalents at end of year	$ 953	$ 626	$ 669

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Changes in Shareholders Equity

(in thousands, except per share data)

	Common Shares Outstanding	Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders Equity
Balance December 31, 1998	32,618	$ 65,236	$ 12,280	$ 83,610	$	$ 161,126
Net income				27,979		27,979
Comprehensive income						27,979
Issuance of restricted stock, net of forfeitures	74	148	893			1,041
Unearned compensation			(454)			(454)
Cash dividends				(7,520)		(7,520)
Exercise of stock options	6	12	71			83
Other	13	26	100			126
Balance December 31, 1999	32,711	65,422	12,890	104,069		182,381
Net income				33,088		33,088
Other comprehensive income, net of tax:						
Unrealized loss on investment					(628)	(628)
Comprehensive income						32,460
Issuance of restricted stock, net of forfeitures	102	204	622			826
Unearned compensation			(139)			(139)
Cash dividends				(8,156)		(8,156)
Exercise of stock options	355	710	4,541			5,251
Other	12	24	125			149
Balance December 31, 2000	33,180	66,360	18,039	129,001	(628)	212,772
Net income				23,035		23,035
Other comprehensive income, net of tax:						
Unrealized gain on investment					272	272
Reclassification of unrealized loss to net income					642	642
Minimum pension liability adjustment					(1,848)	(1,848)
Comprehensive income						22,101
Issuance of restricted stock, net of forfeitures	55	110	813			923

Unearned compensation			(173)			(173)
Cash dividends				(9,182)		(9,182)
Exercise of stock options	696	1,392	9,237			10,629
Other	(46)	(92)	(735)			(827)
Balance December 31, 2001	33,885	$ 67,770	$ 27,181	$ 142,854	$ (1,562)	$ 236,243

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

Note 1 Summary of Significant Accounting Policies

Basis of Presentation. Owens & Minor, Inc. is the leading distributor of national name brand medical and surgical supplies in the United States. The consolidated financial statements include the accounts of Owens & Minor, Inc. and its wholly owned subsidiaries (the company). All significant intercompany accounts and transactions have been eliminated.

Use of Estimates. The preparation of the consolidated financial statements in accordance with generally accepted accounting principles requires management to make assumptions and estimates that affect amounts reported. Estimates are used for, but not limited to, the accounting for the allowance for doubtful accounts, inventory valuation allowances, collectibility of rebates receivable, depreciation and amortization, tax liabilities, and other contingencies. Actual results may differ from these estimates.

Cash and Cash Equivalents. Cash and cash equivalents include cash and marketable securities with an original maturity or maturity at acquisition of three months or less. Cash and cash equivalents are stated at cost, which approximates market value.

Accounts Receivable. The company maintains an allowance for doubtful accounts based upon the expected collectibility of accounts receivable. Allowances for doubtful accounts of $5.3 million and $6.4 million have been applied as reductions of accounts receivable at December 31, 2001 and 2000.

Merchandise Inventories. The company s merchandise inventories are valued on a last-in, first-out (LIFO) basis.

Property and Equipment. Property and equipment are stated at cost or, if acquired under capital leases, at the lower of the present value of minimum lease payments or fair market value at the inception of the lease. Normal maintenance and repairs are expensed as incurred, and renovations and betterments are capitalized. Depreciation and amortization are provided for financial reporting purposes using the straight-line method over the estimated useful lives of the assets or, for capital leases and leasehold improvements, over the terms of the lease, if shorter. In general, the estimated useful lives for computing depreciation and amortization are four to eight years for warehouse equipment and three to eight years for computer, office and other equipment. Straight-line and accelerated methods of depreciation are used for income tax purposes.

Goodwill. Goodwill is amortized on a straight-line basis over 40 years from the dates of acquisition. As of December 31, 2001 and 2000, goodwill was $238.3 and $238.8 million and the related accumulated amortization was $40.0 million and $34.0 million. Based upon management s assessment of undiscounted future cash flows, the carrying value of goodwill at December 31, 2001 has not been impaired in accordance with the provisions of Statement of Financial Accounting Standards No. (SFAS) 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of.*

Amortization expense related to goodwill for 2001, 2000 and 1999 was $6.0 million, $6.0 million and $5.1 million. Effective January 1, 2002, the company will be required to adopt the provisions of SFAS 142, *Goodwill and Other Intangible Assets*.

The provisions of SFAS 142 state that goodwill should not be amortized but should be tested for impairment upon adoption of the standard, and at least annually, at the reporting unit level. As a result, the company will no longer record goodwill amortization expense. The company will be required to perform an assessment of whether there is an indication that goodwill is impaired as of the date of adoption. Any such transitional impairment loss would be recognized as the cumulative effect of a change in accounting principle in the company s consolidated statement of income.

The provisions of SFAS 142 also require the company to evaluate its existing intangible assets and goodwill that were acquired in purchase business combinations, and to make any necessary reclassifications in order to conform with the new classification criteria in SFAS No. 141 for recognition separate from goodwill. At December 31, 2001, the company had no separately identifiable intangible assets from purchase business combinations that are recorded either separately or within goodwill.

Computer Software. The company develops and purchases software for internal use. Software development costs incurred during the application development stage are capitalized. Once the software has been installed and tested and is ready for use, additional costs incurred in connection with the software are expensed as incurred. Capitalized computer software

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costs are amortized over the estimated useful life of the software, usually between 3 and 5 years. Computer software costs are included in other assets, net in the consolidated balance sheets. Unamortized software at December 31, 2001 and 2000 was $22.8 million and $23.7 million. Depreciation and amortization expense includes $7.6 million, $6.1 million and $4.9 million of software amortization for the years ended December 31, 2001, 2000 and 1999.

Investment. The company owns equity securities that are classified as available-for-sale, in accordance with SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*, and are included in other assets, net in the consolidated balance sheets at fair value, with unrealized gains and losses, net of tax, reported as accumulated other comprehensive income or loss. Other than temporary declines in market value from original cost are reclassified to net income.

Revenue Recognition. The company recognizes product revenue when product has been shipped, fees are determinable, and collectibility is probable. Service revenue is recognized ratably over the period during which services are provided. In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) 101, *Revenue Recognition in Financial Statements*, which clarifies the application of generally accepted accounting principles to revenue recognition in financial statements. The company adopted the provisions of SAB 101 in the fourth quarter 2000.

Stock-based Compensation. The company uses the intrinsic value method as defined by Accounting Principles Board Opinion No. 25 to account for stock-based compensation. This method requires compensation expense to be recognized for the excess of the quoted market price of the stock at the grant date or the measurement date over the amount an employee must pay to acquire the stock. The disclosures required by SFAS 123 are included in Note 12 to the Consolidated Financial Statements.

Derivative Financial Instruments. On January 1, 2001, the company adopted the provisions of SFAS 133*, Accounting for Derivative Instruments and Hedging Activities,* as amended. SFAS 133 requires that an entity recognize all derivatives as either assets or liabilities measured at fair value. The accounting treatment for changes in the fair value of a derivative depends upon the intended use of the derivative and the resulting designation. The adoption of this Standard did not have a material impact on the company s results of operations or financial position.

The company enters into interest rate swaps as part of its interest rate risk management strategy. The purpose of these swaps is to maintain the company s desired mix of fixed to floating rate financing in order to manage interest rate risk. These swaps are recognized on the balance sheet at their fair value, based on estimates of the prices obtained from a dealer. All of the company s interest rate swaps since the implementation of SFAS 133 have been designated as hedges of the fair value of a portion of the company s long-term debt and, accordingly, the changes in the fair value of the swaps and the changes in the fair value of the hedged item attributable to the hedged risk are recognized as a charge or credit to interest expense. The company assesses, both at the hedge s inception and on an ongoing basis, whether the swaps are highly effective in offsetting changes in the fair values of the hedged items. If it is determined that an interest rate swap has ceased to be a highly effective hedge, the company discontinues hedge accounting prospectively.

Prior to the adoption of the provisions of SFAS 133, the company entered into interest rate swaps as part of its interest rate risk management strategy. The instruments were designated as hedges of interest-bearing liabilities and anticipated cash flows associated with off balance sheet financing. Net payments or receipts were accrued as interest payable or receivable and as interest expense or income. Fees related to these instruments were amortized over the life of the instrument. If the outstanding balance of the underlying liability were to drop below the notional amount of the swap, the excess portion of the swap was marked to market, and the resulting gain or loss included in net income.

Operating Segments. As defined in SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*, the company has eight operating segments, representing various geographic areas within the United States. As each of these segments is substantially identical to the others in each of the five aggregation characteristics identified in the statement, they

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are considered one operating segment for purposes of financial statement disclosure.

Note 2 Acquisition

On July 30, 1999, the company acquired certain net assets of Medix, Inc. (Medix), a distributor of medical and surgical supplies, for approximately $83 million. Medix customers, located primarily in the Midwest, included acute care hospitals, long-term care facilities and clinics. The acquisition has been accounted for by the purchase method and, accordingly, the operating results of Medix have been included in the company s consolidated financial statements since the date of acquisition. Assuming the acquisition had been made at the beginning of 1999, consolidated net sales on a pro forma basis would have been approximately $3.31 billion for the year ended December 31, 1999. Consolidated net income and net income per share on a pro forma basis would not have been materially different from the results reported.

The company paid cash of approximately $68 million and assumed debt of approximately $15 million, which was paid off as part of the closing transaction. The excess of the purchase price over the fair value of the identifiable net assets acquired of approximately $58 million was recorded as goodwill and is being amortized on a straight-line basis over 40 years.

In connection with the acquisition, management adopted a plan for integration of the businesses that included closure of some Medix facilities and consolidation of certain administrative functions. An accrual was established to provide for certain costs of this plan. The integration accrual was re-evaluated in the fourth quarter of 2001, resulting in a reduction in the accrual of $0.6 million. The accrual adjustment was recorded as a reduction in goodwill, as it reduced the purchase price of the Medix acquisition. The following table sets forth the major components of the accrual and activity through December 31, 2001:

(in thousands)

	Exit Plan Provision	Charges	Adjustments	Balance at December 31, 2001
Losses under lease commitments	$ 1,643	$ 610	$ (296)	$ 737
Employee separations	395	350	(45)	
Other	685	410	(210)	65
Total	$ 2,723	$ 1,370	$ (551)	$ 802

The employee separations relate to severance costs for employees in operations and activities that were exited. Approximately 40 employees were terminated. While the integration of the Medix business has been completed, the company continues to make payments under lease commitments and other obligations.

Note 3 Restructuring

In 1998, the company recorded a nonrecurring restructuring charge of $11.2 million as a result of the cancellation of a significant medical/surgical distribution contract. The restructuring plan included reductions in warehouse space and in the number of employees in those facilities that had the highest volume of business under that contract. The company periodically re-evaluates its estimate of the remaining costs to be incurred and, as a result, has reduced the accrual by $1.5 million in 2001, $0.8 million in 2000 and $1.0 million in 1999. Approximately 130 employees were terminated in connection with the restructuring plan.

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The following table sets forth the activity in the restructuring accrual through December 31, 2001:

(in thousands)

	Restructuring Provision	Charges	Adjustments	Balance at December 31, 2001
Losses under lease commitments	$ 4,194	$ 3,351	$ 78	$ 921
Asset write-offs	3,968	1,466	(1,653)	849
Employee separations	2,497	1,288	(1,209)	
Other	541	99	(442)	
Total	$ 11,200	$ 6,204	$ (3,226)	$ 1,770

Note 4 Merchandise Inventories

The company s merchandise inventories are valued on a LIFO basis. If LIFO inventories had been valued on a current cost or first-in, first-out (FIFO) basis, they would have been greater by $35.8 million and $31.6 million as of December 31, 2001 and 2000.

Note 5 Property And Equipment

The company s investment in property and equipment consists of the following:

(in thousands)

December 31,	2001	2000
Warehouse equipment	$ 24,906	$ 24,012
Computer equipment	36,449	34,137
Office equipment and other	12,991	12,683
Leasehold improvements	11,440	10,540
Land and improvements	5,065	1,743
	90,851	83,115
Accumulated depreciation and amortization	(65,594)	(58,876)
Property and equipment, net	$ 25,257	$ 24,239

Depreciation and amortization expense for property and equipment in 2001, 2000 and 1999 was $8.9 million, $9.4 million and $9.3 million.

Note 6 Investment

The company owns equity securities of a provider of business-to-business e-commerce services in the healthcare industry. Net income for the year ended December 31, 2001 included an impairment charge of $1.1 million, as the market value of these securities fell significantly below the company s original cost basis and management believed that recovery in the near term was unlikely. The following table summarizes the fair value (based on the quoted market price), gross unrealized gains and losses, and adjusted cost basis of the investment as of December 31, 2001 and 2000:

(in thousands)

December 31,	2001	2000

Fair value	$ 627	$ 175
Gross unrealized gain (loss)	476	(1,047)
Adjusted cost basis	151	1,222

Note 7 Accounts Payable

Accounts payable balances were $286.7 million and $291.5 million as of December 31, 2001 and 2000, of which $259.7 million and $249.6 million were trade accounts payable and $27.0 million and $41.9 million, were drafts payable. Drafts payable are checks written in excess of bank balances to be funded upon clearing the bank.

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Note 8 Debt

The company s long-term debt consists of the following:

(in thousands)

December 31,	2001		2000	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
8.5% Senior Subordinated Notes, $200 million par value, mature July 2011	$ 203,449	$ 210,000	$	$
10.875% Senior Subordinated Notes, $150 million par value, retired in 2001			150,000	156,375
Revolving Credit Facility with interest based on London Interbank Offered Rate (LIBOR) or Prime Rate, expires April 2003, credit limit of $225,000			2,200	2,200
Obligation under software financing agreement			1,333	1,333
Total debt	203,449	210,000	153,533	159,908
Less current maturities			(661)	(661)
Long-term debt	$ 203,449	$ 210,000	$ 152,872	$ 159,247