ORTHODONTIC CENTERS OF AMERICA INC /DE/
Form 10-Q
August 14, 2001

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2001, OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _________ TO ___________.

Commission File No.: 001-13457

ORTHODONTIC CENTERS OF AMERICA, INC.
(Exact name of registrant as specified in its charter)

Delaware	72-1278948
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
3850 North Causeway Boulevard, Suite 1040 Metairie, Louisiana	70002
(Address of principal executive offices)	(Zip Code)

(504) 834-4392
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

At August 9, 2001, there were 49,294,168 outstanding shares of the Registrant's Common Stock, $.01 par value per share.

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ORTHODONTIC CENTERS OF AMERICA, INC.

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FORWARD-LOOKING STATEMENTS

Certain statements contained in this Report may not be based on historical facts and are "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements may be identified by reference to a future period(s) or by the use of forward looking terminology, such as "anticipate," "estimate," "believe," "expect," "foresee," "may" or "will." These forward-looking statements include the statements regarding the Company's future growth, deferred tax asset, liquidity, capital resources, acquisition of service agreements and the proposed merger with OrthAlliance, Inc. The Company cautions you not to place undue reliance on these forward-looking statements, in that they involve certain risks and uncertainties that could cause actual results to differ materially from anticipated results. These risks and uncertainties include failure or delay in obtaining required stockholder approval or meeting other conditions to closing the proposed merger, the companies' failure to consummate the proposed merger, inability to successfully integrate the companies after the proposed merger, adverse changes in the companies' financial results and conditions, failure to consummate proposed developments or acquisitions, the ability of the Company to effectively manage an increasing number of Orthodontic Centers, changes in the general economy of the United States and the specific markets in which the Orthodontic Centers are or are proposed to be located, risks relating to the Company's foreign operations,

unexpected operating results, changes in the Company's operating or

expansion strategy, the ability of the Company to attract and retain qualified personnel and orthodontists, the ability of the Company to effectively market its services and products, existing and future regulations affecting the Company's business, the Company's dependence on existing sources of funding, and other factors generally understood to affect the financial results of orthodontic practice management companies and other factors as may be identified from time to time in the Company's Annual Report on Form 10-K for the year ended December 31, 2000 and other filings with the Securities and Exchange Commission or in other public announcements by the Company. The Company undertakes no obligation to update these forward-looking statements to reflect events or circumstances that occur after the date of this Report.

PART I. FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

Orthodontic Centers of America, Inc.
Condensed Consolidated Balance Sheets

	June 30, 2001	D
	(Unaudited)	
	(in thousan	
ASSETS:		
Current assets:		
Cash and cash equivalents	$ 7,322	$
Investments	--	
Service fee receivable, net of allowance for uncollectible amounts	44,125	
Deferred income taxes	1,439	
Current portion of advances to orthodontic entities	8,873	
Supplies inventory	7,361	
Prepaid expenses and other assets	3,508	
Total current assets	72,628	
Property, equipment and improvements, net	81,646	
Advances to orthodontic entities, less current portion	10,513	
Deferred income taxes	24,026	
Intangible assets	202,777	
Other assets	3,520	
Total assets	$ 395,110	$
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	$ 2,497	$
Accrued salaries and other current liabilities	5,428	

Deferred revenue	1,876
Income taxes payable	2,253
Amounts payable to orthodontic entities	3,294
Current portion of notes payable to affiliated orthodontists	1,549
Total current liabilities	16,897
Long-term debt, less current portion	59,798
Non-controlling interest in subsidiary	79
Stockholders' equity:	
Preferred stock	--
Common stock, $.01 par value per share, 100,000,000 shares authorized, $48,837,000 shares outstanding at June 30, 2001 and 48,600,000 shares outstanding at December 31, 2000	489
Additional paid-in capital	170,976
Retained earnings	150,232
Accumulated other comprehensive income/(expense)	(127)
Due from key employees for stock purchase program	(1,490)
Capital contribution receivable from stockholders	(1,744)
Total stockholders' equity	318,336
Total liabilities and stockholders' equity	$ 395,110

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(1) The consolidated balance sheet at December 31, 2000 has been derived from the Company's audited consolidated financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

See notes to condensed consolidated financial statements.

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Orthodontic Centers of America, Inc.

Condensed Consolidated Statements of Income (Unaudited)

	Six months ended June 30,	
	2001	200
	(in thousands, except per share d	
Net revenue	$ 159,712	$ 125
Direct expenses:		
Employee costs	45,652	36
Orthodontic supplies	12,693	9
Rent	13,888	11
Marketing and advertising	12,698	10
Total direct expenses	84,931	67
General and administrative	17,412	13
Depreciation and amortization	9,014	7

Operating profit	48,355	36
Interest income (expense), net	(2,247)	(1
Non-controlling interest in subsidiary	(80)	
Income before income taxes	46,028	34
Provision for income taxes	17,374	13
Income before cumulative effect of change in accounting principle	28,654	21
Cumulative effect of change in accounting principle, net of income tax benefit	--	(50
Net income (loss)	$ 28,654	$ (28
Net income (loss) per share:		
Basic before cumulative effect of change in accounting principle	$ 0.59	$
Cumulative effect of change in accounting principal, net of income tax benefit, per share	--	(
Basic	$ 0.59	$ (
Diluted before cumulative effect of change in accounting principle	$ 0.57	$
Cumulative effect of change in accounting principle, net of income tax benefit, per share	--	(
Diluted	$ 0.57	$ (
Average shares outstanding:		
Basic	48,813	48
Diluted	50,083	49

See notes to condensed consolidated financial statements.

Orthodontic Centers of America, Inc.

Condensed Consolidated Statements of Income (Unaudited)

	Three months ended June 30,	
	2001	2000
	(in thousands, except per share data)	
Net revenue	$ 82,228	$ 65,842
Direct expenses:		
Employee costs	23,309	19,044
Orthodontic supplies	6,456	5,236
Rent	7,079	5,881

Marketing and advertising	6,457	5,306
Total direct expenses	43,301	35,467
General and administrative	9,150	6,811
Depreciation and amortization	4,624	3,667
Operating profit	25,153	19,897
Interest income (expense), net	(1,148)	(979)
Non-controlling interest in subsidiary	(190)	--
Income before income taxes	23,815	18,918
Provision for income taxes	8,989	7,089
Net income	$ 14,826	$ 11,829
Net income per share:		
Basic	$ 0.30	$ .24
Diluted	$ 0.30	$ .24
Average shares outstanding:		
Basic	48,837	48,351
Diluted	50,218	49,522

See notes to condensed consolidated financial statements.

Orthodontic Centers of America, Inc.

Condensed Consolidated Statements of Cash Flows (Unaudited)

	Six months ende June 30,
	2001
	(in thousands, except per
Operating activities:	
Net income (loss)	$ 28,654
Adjustments to reconcile net income (loss) to net cash provided by operating activities:	
Provision for bad debt expense	274
Depreciation and amortization	9,014
Deferred income taxes	543
Cumulative effect of change in accounting principle, net of income tax benefit	--
Changes in operating assets and liabilities:	
Service fee receivables	(9,049)
Supplies inventory	(55)
Prepaid expenses and other	(1,366)
Advances/amounts payable to orthodontic entities	(1,803)

Accounts payable and other current liabilities	(5,284)
Net cash provided by operating activities	20,928
Investing activities:	
Purchases of property, equipment and improvements	(9,976)
Proceeds from available-for-sale investments	999
Intangible assets acquired	(11,435)
Net cash used in investing activities	(20,412)
Financing activities:	
Proceeds from long-term debt	3,128
Repayment of long-term debt	(3,095)
Issuance of common stock	2,086
Net cash provided by financing activities	2,119
Change in cash and cash equivalents	2,635
Cash and cash equivalents at beginning of period	4,689
Cash and cash equivalents at end of period	$ 7,324
Supplemental cash flow information:	
Cash paid during period for:	
Interest	$ 2,400
Income taxes	$ 19,433
Supplemental disclosures of non-cash investing and financing activities:	
Notes payable and common stock issued to obtain service agreements	$ 796

See notes to condensed consolidated financial statements.

Orthodontic Centers of America, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited)

June 30, 2001

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

Orthodontic Centers of America, Inc. (the "Company") provides integrated business services to orthodontists throughout the United States and in Japan, Mexico, Puerto Rico and Spain.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally

accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

The Company provides business operations, financial, marketing and administrative services to orthodontic practices. These services are provided under management and consulting agreements (hereinafter referred to as "Service Agreements") with the orthodontist and their wholly-owned orthodontic entities (hereafter referred to as "Affiliated Orthodontists").

The financial statements include service fees earned under the Service Agreements and the expenses of providing the Company's services, which generally includes all expenses of the orthodontic practices except for orthodontist compensation and certain expenses directly related to the orthodontic entities, such as professional insurance coverage.

2. REVENUE RECOGNITION

Net revenue consists of service fees earned by the Company under the Service Agreements. Effective January 1, 2000, the Company changed its method of revenue recognition for service fees earned under its Service Agreements with Affiliated Orthodontists. The Company recognizes service fees based on patient contract revenues calculated on a straight-line basis over the terms of the patient contracts, net of amounts to be retained by the Affiliated Orthodontists. The amounts to be retained by orthodontists are the Company's estimates of the Affiliated Orthodontists' proportionate share of straight-line patient contract revenues, reduced by the amount of Company expenses incurred and not yet reimbursed by the Affiliated Orthodontists.

Under the terms of the Service Agreements, the Affiliated Orthodontists assign their patient receivables to the Company in payment of their service fees. Service fees receivable represents the portion of these patient receivables that the Company expects to retain and which has been recognized as net revenue. Affiliated Orthodontists retain patient revenue not paid to the Company as the service fee. The amounts ultimately retained by Affiliated Orthodontists are dependent upon the financial performance of their practices.

Orthodontic Centers of America, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited) (continued)

3. INTANGIBLE ASSETS

The Company affiliates with a practicing orthodontist by acquiring substantially all of the non-professional assets of the orthodontist's practice, either directly or indirectly through a stock purchase, and entering into a Service Agreement with the orthodontist. The terms of the Service Agreements range from 20 to 40 years, with most ranging from 20 to 25 years. The acquired assets generally consist of

equipment, furniture, fixtures and leasehold interests. The Company records these acquired tangible assets at their fair value as of the date of acquisition, and depreciates or amortizes the acquired assets using the straight-line method over their useful lives. The remainder of the purchase price is allocated to an intangible asset, which represents the costs of obtaining the Service Agreement, pursuant to which the Company obtains the exclusive right to provide business operations, financial, marketing and administrative services to the orthodontist during the term of the Service Agreement. In the event the Service Agreement is terminated, the related orthodontic entity is generally required to purchase all of the related assets, including the unamortized portion of intangible assets, at the current book value.

The Company may issue shares of its common stock as consideration when it acquires the assets of and enters into Service Agreements with practicing orthodontists. The Company values the shares of stock issued in these transactions at the average closing market price during a few days prior to the date on which the particular transaction is closed.

Service Agreements are amortized over the shorter of their term or 25 years. Amortization expense for the three months ended June 30, 2001 and 2000 was $2.0 million and $1.6 million respectively. Accumulated amortization was $24,775,998 and $20,737,000 as of June 30, 2001 and December 31, 2000, respectively. Intangible assets and the related accumulated amortization are written off when fully amortized.

4. EARNINGS PER SHARE

Basic and diluted earnings per share are based on the weighted average number of shares of common stock and common equivalent shares (stock options) outstanding during the period.

5. CHANGE IN ACCOUNTING PRINCIPLE

Effective January 1, 2000, the Company adopted a change in accounting for revenue in connection with Securities and Exchange Commission Staff Accounting Bulletin No. 101 (SAB 101), "Revenue Recognition in Financial Statements." The cumulative effect of this accounting change, calculated as of January 1, 2000, was $50.6 million, net of income tax benefit of $30.6 million. The Company recognized revenue that was included in the cumulative effect adjustment of $16.9 million during the six months ended June 30, 2001 and $31.9 million during the six months ended June 30, 2000.

The Company adopted Financial Accounting Standards Board Statement FASB No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended, on January 1, 2001. As the Company had no derivatives at the date of adoption, there was no financial statement impact.

Orthodontic Centers of America, Inc.

Notes to Condensed Consolidated Financial Statements (Unaudited) (continued)

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, "Business

Combinations," and No. 142, "Goodwill and Other Intangible Assets," effective for fiscal years beginning after December 31, 2001. Under the new rules, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests in accordance with the Statements. The Company will apply the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of 2002.

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

GENERAL

The Company's business was established in 1985 by Dr. Gasper Lazzara, Jr. and Bartholomew F. Palmisano, Sr. The Company managed 611 orthodontic centers (the "Orthodontic Centers") throughout the United States and in Japan, Mexico, Puerto Rico and Spain at June 30, 2001.

The following table sets forth certain information relating to the growth in the number of Orthodontic Centers for the periods shown:

	Year ended December 31,					Six months ended June 30,
	1996	1997	1998	1999	2000	2001
Number of centers at beginning of period	145	247	360	469	537	592
Number of centers developed during period	53	58	54	36	18	17
Number of centers acquired during period	68	78	66	32	45	3
Number of centers consolidated during period	(19)	(23)	(11)	--	(8)	(1)
Number of centers at end of period	247	360	469	537	592	611

Of the 611 Orthodontic Centers at June 30, 2001, 323 were developed by the Company, 364 were existing orthodontic practices the assets of which were acquired by the Company and 76 were consolidated into another Orthodontic Center. The Company expects that future growth in the number of Orthodontic Centers will come from both developing Orthodontic Centers with existing and newly recruited orthodontists affiliated with the Company ("Affiliated Orthodontists") and acquiring the assets of, and entering into service and consulting agreements with, existing orthodontic practices.

Generally, when the Company develops a new Orthodontic Center, all patients treated at the Orthodontic Center are new patients and, in the first several months after commencing operations, the Orthodontic Center is open only for a limited number of days each month as new patients are added. The Orthodontic Centers have generally become increasingly more productive and profitable as more new patients are added and existing patients return for monthly follow-up visits. After 26 months of operations, the Orthodontic Center's growth in patient base has typically begun to stabilize as the initial patients complete treatment. At that point, an Orthodontic Center can increase the number of

patients treated by improving the efficiency of its clinical staff, increasing patient treatment intervals and by adding operating days or orthodontists.

The Orthodontic Centers may also increase revenue by implementing periodic price increases. Patient contracts are generally payable in equal monthly installments throughout the term of treatment (which averages about 26 months), except for the last month when a final payment is made. During the first quarter of 2000, approximately 30% of the Orthodontic Centers implemented a fee increase from $109 per month to $119 per month, with an increase in the final payment from $436 to $476. In the first six months of 2001, an additional 33% of the Orthodontic Centers implemented such fee increase.

The Company provides a wide range of services to its Affiliated Orthodontists under either a service agreement or a consulting agreement. The specific form of the agreement is based upon the dental regulatory provisions of the particular state in which an orthodontic center is located. The service agreement is used in the majority of states, with some minor variations from state to state. The consulting agreement, also with some variations from state to state, is used in states with particularly stringent laws relating to the practice of dentistry. The Company enters into a separate service or consulting agreement with each Affiliated Orthodontist practice owner. If an Affiliated Orthodontist operates his or her practice through a professional

corporation or association or other similar entity, that entity is a party to the agreement, as well as the Affiliated Orthodontist practice owner.

Under the service agreement, the Company provides its Affiliated Orthodontists with a comprehensive range of business services in exchange for monthly service fees based on a percentage of the Affiliated Orthodontists' new patient contract balances during the first month of the term of the patient contract, plus the balance of the patient contract balance allocated equally over the remaining term of the patient contract, minus amounts retained by the Affiliated Orthodontists. The types of services the Company provides to Affiliated Orthodontists under the consulting agreements are generally similar to the services the Company provide under the service agreements; however, rather than being based on a percentage of patient contract balances, the service fees paid to the Company by Affiliated Orthodontists under the consulting agreements are a combination of, depending on the service being performed, "cost-plus" types of fees, flat monthly fees and hourly fees. Among other differences from the service agreements, some consulting agreements have shorter terms than the service agreements, some do not give the Company a right to purchase the Affiliated Orthodontist's interest in the practice assets following termination, no matter the reason, and some require more limited non-competition agreements from the Affiliated Orthodontist after termination of the consulting agreement than do most of the service agreements. In addition, the consulting agreements emphasize that the Affiliated Orthodontist has ultimate control and authority over his or her practice's business management, including such matters as advertising, hiring and termination of staff and the purchase of equipment and supplies.

Effective January 1, 2000, the Company changed its net revenue recognition pursuant to Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"). SAB 101 summarizes certain of the Securities and Exchange Commission staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. Effective January 1, 2000, the Company recognizes net revenue based on a straight-line allocation of patient contract revenue over the terms of the patient contracts (which average

about 26 months), minus the portion of that straight-line allocation retained or to be retained by Affiliated Orthodontists. Amounts retained or to be retained by an Affiliated Orthodontist are estimated using the percentage of practice operating profits that may be retained by the Affiliated Orthodontist under his or her service agreement. Amounts retained or that may be retained by an Affiliated Orthodontist equal the Affiliated Orthodontist's proportionate share of the straight-line allocation of patient contract revenue that is collected during the relevant period and the Affiliated Orthodontist's proportionate share of patient receivables representing any remaining portion of that allocation, minus any operating losses, depreciation, interest on outstanding loans, bad debt or other expenses that the Company has incurred but for which the Company has not been reimbursed by the Affiliated Orthodontist. These unreimbursed expenses reduce amounts retained by an Affiliated Orthodontist only up to the amounts that would otherwise be retained by the Affiliated Orthodontist. Any remaining unreimbursed expenses would reduce amounts retained or to be retained by the Affiliated Orthodontist in subsequent periods.

Operating expenses of the Orthodontic Centers are the Company's expenses and are recognized as incurred. Employee costs consist of wages, salaries and benefits paid to all of the Company's employees, including orthodontic assistants, business staff and management personnel. General and administrative expenses consist of provision for losses on receivables, professional service fees, maintenance and utility costs, office supply expense, telephone expense, taxes, license fees, printing expense and shipping expense.

The Company does not have a controlling financial interest in its Affiliated Orthodontists' practices. In accordance with guidance in Emerging Issues Task Force No. 97-2, the Company does not consolidate the patient revenue and other operations and accounts of its Affiliated Orthodontists within the Company's financial statements.

RECENT DEVELOPMENTS

On May 16, 2001, the Company entered into a merger agreement with OrthAlliance, Inc., whereby a wholly-owned subsidiary of the Company would merge into OrthAlliance and OrthAlliance would become a wholly-owned subsidiary of the Company. In the merger, stockholders of OrthAlliance would receive shares of the Company's common stock in exchange for their shares of OrthAlliance common stock, except for holders of OrthAlliance Class B common stock who properly exercise their appraisal rights under Delaware law. The transaction, which is subject to approval by OrthAlliance stockholders and other conditions, is currently anticipated to close in the third quarter of 2001 and to be accounted for as a purchase. OrthAlliance is a leading provider of practice management and consulting services to orthodontic and pediatric dental practices in the United States.

RESULTS OF OPERATIONS

The following table sets forth the percentages of net revenue represented by certain items in the Company's condensed consolidated statements of income.

	Six months ended June 30,	Three months ended June 30,

	2001	2000	2001	2000
Net revenue	100.0%	100.0%	100%	100%
Direct expenses:				
Employee costs	28.6	29.3	28.3	28.9
Orthodontic supplies	7.9	7.8	7.9	8.0
Rent	8.7	8.9	8.6	8.9
Marketing and advertising	8.0	8.2	7.9	8.1
Total direct expenses	53.2	54.2	52.7	53.9
General and administrative	10.9	10.7	11.1	10.3
Depreciation and amortization	5.6	5.8	5.6	5.6
Operating profit	30.3	29.3	30.6	30.2
Interest (income) expense	1.4	1.4	1.5	1.5
Non-controlling interest	0.1	--	0.2	--
Income before income taxes	28.8	27.9	28.9	28.7
Provision for income taxes	10.9	10.5	10.9	10.7
Income before cumulative effect of change in accounting principle	17.9	17.4	18.0	18.0
Cumulative effect of change in accounting principle, net of income tax benefit	--	(40.4)	--	--
Net income (loss)	17.9%	(23.0%)	18.0%	18.0%

SIX MONTHS ENDED JUNE 30, 2001 COMPARED TO SIX MONTHS ENDED JUNE 30, 2000

NET REVENUE

Net revenue increased $34.6 million, or 27.6%, to $159.7 million for the six months ended June 30, 2001 from $125.1 million for the six months ended June 30, 2000. Approximately $26.7 million of this increase was attributable to the growth of net revenue of Orthodontic Centers open throughout both periods, and approximately $7.9 million of the increase was attributable to the growth in net revenue of Orthodontic Centers opened since January 1, 2000. The number of the Affiliated Orthodontists' patient contracts increased to approximately 379,105 at June 30, 2001 from approximately 305,146 at June 30, 2000. The Company recognized revenue that was included in the cumulative effect adjustment of $16.9 million during the six months ended June 30, 2001 and $31.9 million during the six months ended June 30, 2000.

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EMPLOYEE COSTS

Employee costs increased $9.0 million, or 24.7%, to $45.7 million for the six months ended June 30, 2001 from $36.6 million for the six months ended June 30, 2000. As a percentage of net revenue, however, employee costs decreased to 28.6% for the six months ended June 30, 2001 from 29.3% for the six months ended June 30, 2000, primarily due to efficiencies achieved through a general change to longer patient treatment intervals by the Affiliated Orthodontists, which resulted in fewer treatments per patient contract and lower employee costs per

patient. As a result of developments in orthodontic technology, a patient may be seen every six to eight weeks, rather than the traditional four weeks, without compromising quality of care. Consistent with industry trends, the Affiliated Orthodontists have begun increasing the intervals between patient treatments. Patients who received orthodontic treatment in the Orthodontic Centers during the six months ended June 30, 2001 averaged 45.64 days between office visits, compared to an average of 43.4 days for patients who received treatment during the six months ended June 30, 2000. This increase in patient treatment interval reduces the number of office visits during the term of a patient's treatment, which continues to average about 26 months, and results in lower employee costs per patient. The increased interval does not, however, reduce the amount of treatment fees per patient. Therefore, the increased interval reduces the employee costs incurred with respect to an individual patient relative to the patient's treatment fee.

ORTHODONTIC SUPPLIES

Orthodontic supplies expense increased $2.9 million, or 29.8%, to $12.7 million for the six months ended June 30, 2001 from $9.8 million for the six months ended June 30, 2000. As a percentage of net revenue, orthodontic supplies expense increased to 7.9% for the six months ended June 30, 2001 from 7.8% for the six months ended June 30, 2000. Cost improvements attained through bulk purchasing were offset by increased expense associated with an increased percentage of new patient treatment days, which require greater orthodontic supplies per patient.

RENT

Rent expense increased $2.7 million, or 24.1%, to $13.9 million for the six months ended June 30, 2001 from $11.2 million for the six months ended June 30, 2000, primarily due to Orthodontic Centers affiliated, opened or relocated after June 30, 2000. As a percentage of net revenue, however, rent expense decreased to 8.7% for the six months ended June 30, 2001 from 8.9% for the six months ended June 30, 2000.

MARKETING AND ADVERTISING

Marketing and advertising expense increased $2.5 million, or 24.8%, to $12.7 million for the six months ended June 30, 2001 from $10.2 million for the six months ended June 30, 2000, primarily due to increases in marketing and advertising related to growth in net revenue for existing Orthodontic Centers and marketing and advertising for Orthodontic Centers added after June 30, 2000. As a percentage of net revenue, however, marketing and advertising expense decreased to 8.0% for the six months ended June 30, 2001 from 8.2% for the six months ended June 30, 2000.

GENERAL AND ADMINISTRATIVE

General and administrative expense increased $4.0 million, or 29.6%, to $17.4 million for the six months ended June 30, 2001 from $13.4 million for the six months ended June 30, 2000, primarily due to the

addition of Orthodontic Centers and increases in the Affiliated Orthodontists' patient base after June 30, 2000. As a percentage of net revenue, general and administrative expense increased to 10.9% for the six months ended June 30, 2001 from 10.7% for the six months ended June 30, 2000, primarily due to several nonrecurring accounting and legal expenses in the second quarter of 2001.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization expense increased $1.8 million, or 25.0%, to $9.0 million for the six months ended June 30, 2001 from $7.2 million for the six months ended June 30, 2000, due to fixed assets acquired and service agreements entered into for Orthodontic Centers developed, acquired or relocated after June 30, 2000. As a percentage of net revenue, however, depreciation and amortization expense decreased to 5.6% for the six months ended June 30, 2001 from 5.8% for the six months ended June 30, 2000.

OPERATING PROFIT

Operating profit increased $11.6 million, or 31.7%, to $48.4 million for the six months ended June 30, 2001 from $36.7 million for the six months ended June 30, 2000. As a percentage of net revenue, operating profit increased to 30.3% for the six months ended June 30, 2001 from 29.3% for the six months ended June 30, 2000, as a result of the factors discussed above.

INTEREST

Net interest expense increased $482,000, or 27.3%, to $2.2 million for the six months ended June 30, 2001 from $1.8 million for the six months ended June 30, 2000, due to an increase since June 30, 2000 in the average balance of borrowings under the Company's $100.0 million revolving line of credit associated with expansion in new and existing markets in the United States and foreign countries. As a percentage of net revenue, net interest expense remained 1.4% for the six months ended June 30, 2001 and 2000.

NON-CONTROLLING INTEREST

In the first quarter of 2001, the Company finalized an arrangement with its Affiliated Orthodontists in Japan pursuant to which these Affiliated Orthodontists acquired a 16% ownership interest in the Company's Japanese subsidiary.

PROVISION FOR INCOME TAXES

Provision for income taxes increased $4.2 million, or 32.2%, to $17.4 million for the six months ended June 30, 2001 from $13.1 million for the six months ended June 30, 2000. The Company's effective income tax rate was 37.8% for the six months ended June 30, 2001 and 2000. The Company's change in accounting principle pursuant to SAB 101 effective January 1, 2000 resulted in deferred tax assets of $25.5 million as of June 30, 2001, because the Company has not received approval from taxing authorities to change its tax accounting method of recognizing revenue. The Company cannot assure you that it will receive any such approval. Failure to obtain this approval could have an adverse effect on the Company's cash flow from operating activities. The Company has provided no valuation allowance for deferred tax assets. The Company believes that the deferred tax assets at June 30, 2001 are realizable through carrybacks and future reversals of existing taxable temporary differences.

CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE

Effective January 1, 2000, the Company recorded a cumulative effect of a change in accounting principle of $50.6 million, net of an income tax benefit of $30.6 million, with respect to the Company's change in revenue recognition effective as of January 1, 2000 pursuant to SAB 101.

NET INCOME (LOSS)

Net income increased $57.4 million, or 199.6%, to $28.7 million for the six months ended June 30, 2001 from a net loss of $28.8 million for the six months ended June 30, 2000. As a percentage of net revenue, net income after the cumulative effect of change in accounting principle increased to 17.9% for the six months ended June 30, 2001 from (23.0)% for the six months ended June 30, 2000, as a result of the factors discussed above.

THREE MONTHS ENDED JUNE 30, 2001 COMPARED TO THREE MONTHS ENDED JUNE 30, 2000

NET REVENUE

Net revenue increased $16.4 million, or 24.9%, to $82.2 million for the three months ended June 30, 2001 from $65.8 million for the three months ended June 30, 2000. Approximately $13.6 million of this increase was attributable to the growth of net revenue of Orthodontic Centers open throughout both periods, and approximately $2.8 million of the increase was attributable to the growth in net revenue of Orthodontic Centers opened since June 30, 2000. The Company recognized revenue that was included in the cumulative effect adjustment of $7.4 million during the three months ended June 30, 2001 and $15.2 million during the three months ended June 30, 2000.

EMPLOYEE COSTS

Employee costs increased $4.3 million, or 22.4%, to $23.3 million for the three months ended June 30, 2001 from $19.0 million for the three months ended June 30, 2000. As a percentage of net revenue, however, employee costs decreased to 28.3% for the three months ended June 30, 2001 from 28.9% for the three months ended June 30, 2000, primarily due to efficiencies achieved through a general change to longer patient treatment intervals by the Affiliated Orthodontists, which resulted in fewer treatments per patient contract and lower employee costs per patient. As a result of developments in orthodontic technology, a patient may be seen every six to eight weeks, rather than the traditional four weeks, without compromising quality of care. Consistent with industry trends, the Affiliated Orthodontists have begun increasing the intervals between patient treatments. This increase in patient treatment interval reduces the number of office visits during the term of a patient's treatment, which continues to average about 26 months, and results in lower employee costs per patient. The increased interval does not, however, reduce the amount of treatment fees per patient. Therefore, the increased interval reduces the employee costs incurred with respect to an individual patient relative to the patient's treatment fee.

ORTHODONTIC SUPPLIES

Orthodontic supplies expense increased $1.2 million, or 23.3%, to $6.5 million for the three months ended June 30, 2001 from $5.2 million for the three months ended June 30, 2000. As a percentage of net revenue, orthodontic supplies expense decreased to 7.9% for the three months ended June 30, 2001 from 8.0% for the three months ended June 30, 2000.

RENT

Rent expense increased $1.2 million, or 20.4%, to $7.1 million for the three months ended June 30, 2001 from $5.9 million for the three months ended June 30, 2000, primarily due to Orthodontic Centers affiliated,

opened or relocated after June 30, 2000. As a percentage of net revenue, however, rent expense decreased to 8.6% for the three months ended June 30, 2001 from 8.9% for the three months ended June 30, 2000.

MARKETING AND ADVERTISING

Marketing and advertising expense increased $1.2 million, or 21.7%, to $6.5 million for the three months ended June 30, 2001 from $5.3 million for the three months ended June 30, 2000, primarily due to increases in marketing and advertising related to growth in net revenue for existing Orthodontic Centers and marketing and advertising for Orthodontic Centers added after June 30, 2000. As a percentage of net revenue, however, marketing and advertising expense decreased to 7.9% for the three months ended June 30, 2001 from 8.1% for the three months ended June 30, 2000.

GENERAL AND ADMINISTRATIVE

General and administrative expense increased $2.4 million, or 34.3%, to $9.2 million for the three months ended June 30, 2001 from $6.8 million for the three months ended June 30, 2000, primarily due to the addition of Orthodontic Centers and increases in the Affiliated Orthodontists' patient base after June 30, 2000. As a percentage of net revenue, general and administrative expense increased to 11.1% for the three months ended June 30, 2001 from 10.3% for the three months ended June 30, 2000, primarily due to several nonrecurring accounting and legal expenses in the second quarter of 2001.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization expense increased $957,000, or 26.1%, to $4.6 million for the three months ended June 30, 2001 from $3.7 million for the three months ended June 30, 2000, due to fixed assets acquired and service agreements entered into for Orthodontic Centers developed, acquired or relocated after June 30, 2000. As a percentage of net revenue, depreciation and amortization expense remained 5.6% for the three months ended June 30, 2001 and 2000.

OPERATING PROFIT

Operating profit increased $5.3 million, or 26.4%, to $25.2 million for the three months ended June 30, 2001 from $19.9 million for the three months ended June 30, 2000. As a percentage of net revenue, operating profit increased to 30.6% for the three months ended June 30, 2001 from 30.2% for the three months ended June 30, 2000, as a result of the factors discussed above.

INTEREST

Net interest expense increased $169,000, or 17.3%, to $1.2 million for the three months ended June 30, 2001 from $980,000 for the three months ended June 30, 2000, due to an increase since June 30, 2000 in the average balance of borrowings under the Company's $100.0 million revolving line of credit associated with expansion in new and existing markets in the United States and foreign countries. As a percentage of net revenue, net interest expense remained 1.5% for the three months ended June 30, 2001 and 2000.

NON-CONTROLLING INTEREST

In the first quarter of 2001, the Company finalized an arrangement with its Affiliated Orthodontists in Japan pursuant to which these Affiliated Orthodontists acquired a 16% ownership interest in the Company's Japanese

subsidiary.

PROVISION FOR INCOME TAXES

Provision for income taxes increased $1.9 million, or 26.8%, to $9.0 million for the three months ended June 30, 2001 from $7.1 million for the three months ended June 30, 2000. The Company's effective income tax rate was 37.8% for the three months ended June 30, 2001 and 2000. The Company's change in accounting principle pursuant to SAB 101 effective January 1, 2000 resulted in deferred tax assets of $25.5 million as of June 30, 2001, because the Company has not received approval from taxing authorities to change our tax accounting method of recognizing revenue. The Company cannot assure you that it will receive any such approval. Failure to obtain this approval could have an adverse effect on the Company's cash flow from operating activities. The Company has provided no valuation allowance for deferred tax assets. The Company believes that the deferred tax assets at June 30, 2001 are realizable through carrybacks and future reversals of existing taxable temporary differences.

NET INCOME

Net income increased $3.0 million, or 25.3%, to $14.8 million for the three months ended June 30, 2001 from $11.8 million for the three months ended June 30, 2000. As a percentage of net revenue, net income remained constant at 18% for the three months ended June 30, 2001 and 2000.

LIQUIDITY AND CAPITAL RESOURCES

The Company's net cash provided by operations was $20.9 million for the six months ended June 30, 2001, an increase of $3.6 million, or 20.8%, from $17.3 million for the six months ended June 31, 2000. The Company's working capital at June 30, 2001 was $55.7 million, an increase of $19.1 million, or 48.2%, from $39.6 million at December 31, 2000, including cash and cash equivalents of $7.3 million at June 30, 2001, compared to $4.7 million at December 31, 2000, primarily due to the timing of the Company's estimated income tax payments. The Company's net cash used in investing activities for the six months ended June 30, 2001 was $20.4 million, an increase of $4.6 million, or 28.7%, from $15.9 million for the six months ended June 30, 2000.

The Company's capital expenditures consist primarily of the costs associated with the development of additional Orthodontic Centers. The average cost of developing a new Orthodontic Center in the United States is about $255,000, including the cost of equipment, leasehold improvements, working capital and start-up losses associated with the initial operations of the Orthodontic Center. These costs are shared by the Company and the particular Affiliated Orthodontist. The Company assists Affiliated Orthodontists in obtaining financing for their share of these costs by providing a guaranty of loans from the Company's primary lender. In some cases, the Company bears an Affiliated Orthodontist's share of these costs until it is reimbursed by the Affiliated Orthodontist. At June 30, 2001, the outstanding balance of these amounts guaranteed by the Company was $2.5 million, compared to about $2.9 million at December 31, 2000. The Company also intends to continue to make advances of about $40,000 to newly-affiliated Affiliated Orthodontists during the first year of an Orthodontic Center's operations, which advances bear no interest and typically are repaid during the second year of the Orthodontic Center's operations. The Company intends to fund these advances and any continued financing through a combination of bank borrowings and cash from operations.

In October 1998, the Company entered into a $100.0 million revolving line of credit with a lending group that currently consists of First Union National Bank, Bank of America FSB, Bank One, N.A., Hibernia National Bank and Wachovia Bank, N.A. The line of credit provides an aggregate of $100.0 million for general working capital needs and expansion of the number of orthodontic centers, and bears interest at varying rates above the lender's prime rate or LIBOR. Amounts borrowed under the line of credit are secured by a security interest in all of the Company's assets, including its accounts receivable and equipment. At June 30, 2001,

$60.0 million of indebtedness was outstanding under the line of credit, compared to $57.4 million at December 31, 2000. During the six months ended June 30, 2001, amounts borrowed under the Company's line of credit were used to finance the Company's foreign operations.

The Company expects to require cash in the future primarily for developing additional Orthodontic Centers, acquiring assets from and affiliating with additional orthodontists, capital expenditures, repayment of long-term debt, payment of income taxes and general corporate purposes. In addition, in the merger agreement with OrthAlliance, Inc., the Company agreed that, at the effective time of the proposed merger with OrthAlliance, the Company would pay in full all borrowings and accrued interest owing under OrthAlliance's revolving line of credit. The Company anticipates that it would enter into a new credit facility to finance the repayment of amounts owing under OrthAlliance's revolving line of credit, concurrent with completion of the proposed merger.

The Company's cash needs could significantly change depending upon its ability to recruit orthodontists, find appropriate sites, enter into long-term service or consulting agreements and acquire the assets of existing orthodontic practices. The Company believes that the combination of funds available under its revolving line of credit (or a replacement credit facility) and cash flow from operations will be sufficient to meet its anticipated funding requirements during the remainder of 2001.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

During the six months ended June 30, 2001, there were no material changes to the quantitative and qualitative disclosures about market risks presented in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On April 9, 2001, Joanne Bay filed an action in the United States District Court for the Eastern District of Louisiana against the Company and Bartholomew F. Palmisano, Sr., the Company's Chairman of the Board, President and Chief Executive Officer, Bartholomew F. Palmisano, Jr., the Company's Chief Financial Officer, and Dr. Gasper Lazzara, Jr., the Company's former Chairman of the Board. In addition, three similar actions were filed in the United States District Court for the Eastern District of Louisiana against the Company and the other defendants on May 17, 2001, May 17, 2001 and June 13, 2001 by Daowei

Ma, Delmer Nimz and Warren Walton, respectively. Each of these actions purports to be filed as a class action on behalf of the plaintiff and other purchasers of shares of the Company's common stock from April 27, 2000 through March 15, 2001. In each of these complaints, the plaintiff alleged that the Company and the other defendants violated Section 10(b) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 thereunder, by allegedly recognizing revenue in violation of generally accepted accounting principles and SEC disclosure requirements and by allegedly making false and misleading statements about the Company's financial results and accounting. In each of these actions, the plaintiff is seeking unspecified compensatory damages, interest and attorneys' fees. On June 27, 2001, the court entered an order consolidating these actions and established a preliminary pretrial schedule for appointment of lead plaintiffs and counsel, filing of a consolidated amended complaint and filing and briefing of a motion to dismiss. A motion to appoint lead plaintiffs is currently under submission. The Company believes that these actions lack merit, and denies the plaintiffs' allegations. The Company intends to defend these actions vigorously. These lawsuits are at a very early stage, and at this time the Company cannot predict whether it will prevail in these actions or estimate the amount of damages that it might incur. The Company is also currently unable to estimate any reimbursement that it may receive from insurance policies in the event it incurs any damages or costs in connection with these actions. Regardless of the outcome, these lawsuits could be costly, time-consuming and could divert the time and attention of the Company's senior management.

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

The annual meeting of stockholders of the Company was held on June 12, 2001. At this meeting, the following matters were voted upon by the Company's stockholders:

(a) Election of Class I Directors

Dr. John J. Sheridan and A Gordon Tunstall were elected to serve as Class I directors of the Company until the annual meeting of stockholders in 2004 or until their successors are elected and qualified. The vote was as follows:

Name	Votes Cast In Favor	Votes Cast Against or Withheld	Abstentions/ Non Votes
Dr. John J. Sheridan	39,238,075	1,415,238	8,805,226
A Gordon Tunstall	36,668,076	3,985,237	8,505,226

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The terms of the following directors continued following the meeting:

Name	Term Expires
Michael C. Johnsen	2002

Ashton J. Ryan, Jr.	2002
Edward J. Walters, Jr.	2002
Bartholomew F. Palmisano, Sr.	2003
Dr. Gasper Lazzara, Jr.*	2003

* Dr. Gasper Lazzara, Jr. resigned as a director of the Company effective as of June 18, 2001.

(b) Selection of Independent Auditors

The stockholders of the Company ratified the appointment of Ernst & Young LLP as the Company's independent auditors for the fiscal year ending December 31, 2001 by the following vote:

Votes Cast In Favor	Votes Cast Against or Withheld	Abstentions/ Non Votes
39,179,359	1,473,954	8,805,226

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS

Exhibit number	Description
3.1	Bylaws of the Registrant (incorporated by reference to exhibits filed with the Registrant's Registration Statement on Form S-1, Registration Statement No. 33-85326)
3.2	Restated Certificate of Incorporation of the Registrant (incorporated by reference to exhibits filed with the Registrant's Registration Statement on Form S-1, Registration Statement No. 33-85326)
4	Specimen Stock Certificate (incorporated by reference to exhibits filed with the Registrant's Registration Statement on Form S-1, Registration Statement No. 33-85326)
10.1	Agreement and Plan of Merger, dated as of May 16, 2001, among the Registrant, OCA Acquisition Corporation and OrthAlliance, Inc. (incorporated by reference to exhibits filed with the Registrant's Current Report on Form 8-K filed on May 18, 2001)
10.2	Lease Agreement, dated October 7, 1999, between the Registrant and Ponte Vedra Management Group, Ltd.

(b) REPORTS ON FORM 8-K

During the three months ended June 30, 2001, the Company filed the following current reports on Form 8-K:

(i) On April 20, 2001, the Company filed a current report on Form 8-K reporting information under "Item 9. Regulation FD Disclosure."

(ii) On May 18, 2001, the Company filed a current report on Form 8-K reporting information under "Item 5. Other Events" and "Item 7. Financial Statements and Exhibits."

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.

Orthodontic Centers of America, Inc.

(Registrant)

Date: August 14, 2001

/s/ Bartholomew F. Palmisano, Sr.

Bartholomew F. Palmisano, Sr.
Chairman of the Board, President
and Chief Executive Officer

/s/ Bartholomew F. Palmisano, Jr.

Bartholomew F. Palmisano, Jr.
Chief Financial Officer

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