

# THE COMPLETE PICTURE OF HEALTH



DENTAL

MEDICAL

INTERNATIONAL

TECHNOLOGY

INFRASTRUCTURE

HENRY SCHEIN 2002 ANNUAL REPORT

## ABOUT HENRY SCHEIN, INC.

Henry Schein, Inc. is the largest distributor of healthcare products and services to office-based healthcare practitioners in the combined North American and European markets. Recognized for our excellent customer service, low prices, and innovative value-added solutions, we serve more than 400,000 customers worldwide, including:

- Over 75% of the estimated 120,000 U.S. office-based dental practices, nearly 5,000 Canadian dental practices, and 15,000 dental laboratories
- Over 40% of the estimated 230,000 U.S. office-based physician practices, as well as surgical centers and alternate-care settings
- Over 70% of the estimated 24,000 U.S. veterinary clinics
- Over 170,000 office-based dental, medical, and veterinary practices, primarily in Western Europe, Australia and New Zealand, and Latin America
- Government and other institutions providing healthcare services

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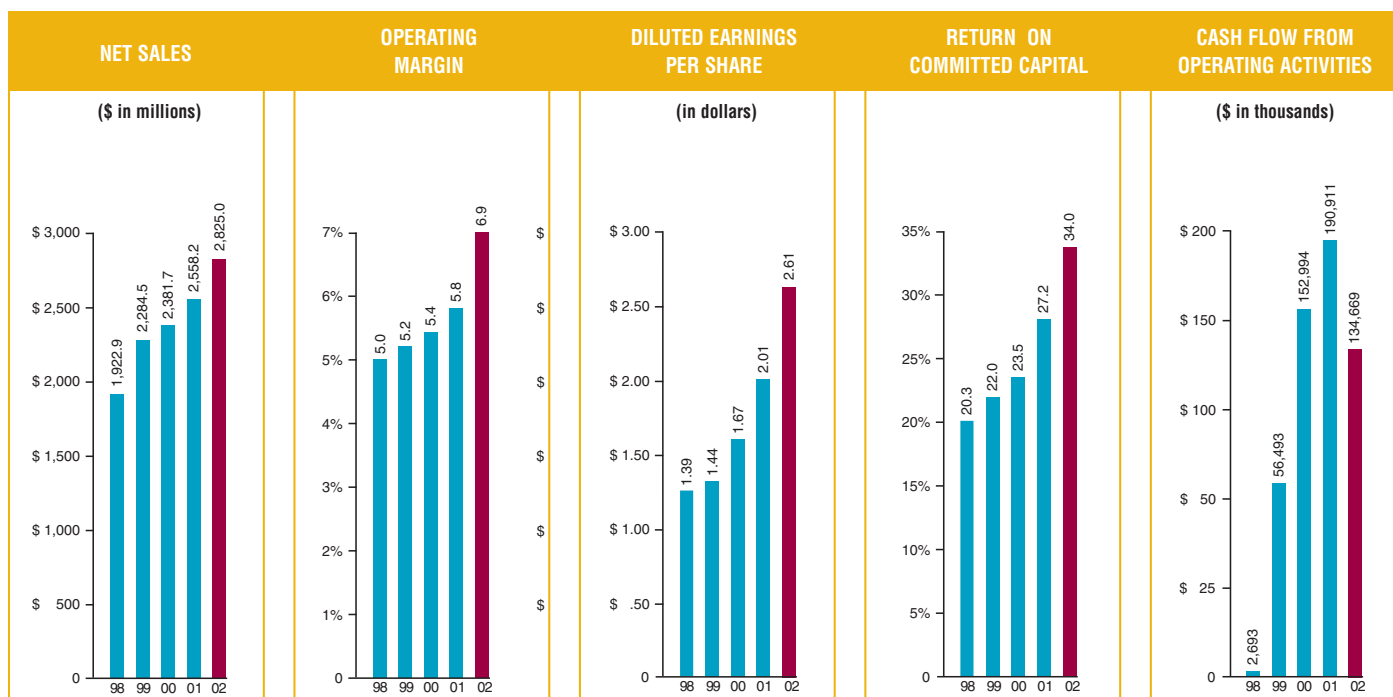
We are dedicated to helping our customers operate more efficient and profitable practices, while providing quality healthcare. Henry Schein has a sales and marketing approach that is uniquely integrated, with more than 1,350 field sales consultants (including equipment sales specialists), and 800 telesales representatives, supported by 110 equipment sales and service centers, more than 550 equipment service technicians, and a highly targeted direct marketing program. Through this program, more than 22 million catalogs, order stuffers, flyers, newsletters, e-mails, and other materials are distributed annually.

The Company operates its four business groups – Dental, Medical, International and Technology – through a centralized and automated distribution network, which provides customers in more than 125 countries with a comprehensive selection of over 90,000 national brand and Henry Schein private-brand products. Henry Schein also offers a wide range of innovative, value-added practice-management solutions – including such leading practice-management software systems as DENTRIX® and Easy Dental® for dental practices, and AVImark® for veterinary clinics, which are installed in over 48,000 practices – and ARUBA®, Henry Schein’s electronic catalog and ordering system. Headquartered in Melville, New York, Henry Schein employs over 6,900 people in 16 countries.

# THE FINANCIAL HIGHLIGHTS

For each of the past five years, Henry Schein, Inc. has shown steady growth in several key financial metrics, and 2002 was another record-breaking year. Last year, the Company posted its most impressive results ever for Net Sales, Operating Income, Operating Margin, Return on Committed Capital, Net Income, Diluted Earnings Per Share, Average Order Size, Total Assets, and Stockholders' Equity.

	<i>(In thousands, except per share and operating data)</i>				
	2002	2001	2000	1999	1998
<b>OPERATING RESULTS</b>					
Net Sales	<b>\$ 2,825,001</b>	\$ 2,558,243	\$ 2,381,721	\$ 2,284,544	\$ 1,922,851
Operating Income	<b>\$ 196,269</b>	\$ 147,750	\$ 127,613	\$ 119,232	\$ 96,196
Operating Margin	<b>6.9%</b>	5.8%	5.4%	5.2%	5.0%
Return on Committed Capital	<b>34.0%</b>	27.2%	23.5%	22.0%	20.3%
Net Income	<b>\$ 117,253</b>	\$ 87,373	\$ 70,147	\$ 59,796	\$ 57,823
Diluted Earnings Per Share	<b>\$ 2.61</b>	\$ 2.01	\$ 1.67	\$ 1.44	\$ 1.39
Diluted Average Shares Outstanding	<b>44,872</b>	43,545	42,007	41,438	41,549
<b>OPERATING DATA</b>					
Number of Orders Shipped	<b>7,861,000</b>	7,891,000	8,280,000	7,979,000	6,718,000
Average Order Size	<b>\$ 359</b>	\$ 324	\$ 288	\$ 286	\$ 286
<b>FINANCIAL POSITION AND CASH FLOW</b>					
Total Assets	<b>\$ 1,558,052</b>	\$ 1,385,428	\$ 1,231,068	\$ 1,204,102	\$ 962,040
Stockholders' Equity	<b>\$ 861,217</b>	\$ 680,457	\$ 579,060	\$ 517,867	\$ 463,034
Cash Flow from Operating Activities	<b>\$ 134,669</b>	\$ 190,911	\$ 152,994	\$ 56,493	\$ 2,693



Note: Operating Income, Operating Margin, Net Income, and Diluted Earnings Per Share are presented as originally reported, and have been adjusted to exclude certain onetime items. See "Reconciliation of Certain Operating Results" on page 18.





# SHAREHOLDERS LETTER

To Our Shareholders,

The theme of this year's report – Henry Schein: The Complete Picture of Health – truly describes the current state of our business. In 2002, we continued to see outstanding results from the sound strategies we put in place in prior years, and recorded record financial performance. We solidified our role as the largest distributor of healthcare products and services to office-based healthcare practitioners in the combined North American and European markets, and are anticipating strong growth in the coming years.

One important reason for our success is our dedicated focus on delivering excellent customer service. We are able to achieve this unparalleled level of service year after year through our world-class infrastructure, which benefits each of our business groups. We support our customers with a wide array of products and value-added services that go beyond the traditional role of a distributor, helping them anticipate and meet the challenges of their evolving practices. By enabling healthcare professionals to operate more efficient and profitable practices while providing quality healthcare, we strive to become their true business partner. The benefits of this partnership and the power of our business model can be seen in the financial health and growth of our Company.

## A YEAR OF RECORD FINANCIAL RESULTS

In 2002, we posted record net sales of \$2.8 billion, an increase of 10.4% compared with 2001, and sales growth for the year was essentially all internally generated. Net income for the year was a record \$118 million, or \$2.63 per diluted share, representing increases of 35.0% and 30.8% compared with 2001, respectively. Operating cash flow for 2002 was \$134.7 million. Since going public in November 1995, our total market capitalization has grown from \$300 million to more than \$2 billion, for a compounded annual growth rate of 37.2%. These metrics underscore that the decisions our management team is making are sound, and reinforce the fact that we have capitalized on the important business opportunities presented to us.

One of our important Company strengths is our diversity – in the array of products and services that we offer, in the markets that we serve, and in the geographic areas where we operate. In 2002, 43% of our revenue came from the Dental Group, 39% from the Medical Group, 16% from the International Group, and 2% from the Technology and Value-added Services Group. Today, we are in the right markets at the right time with an unmatched array of product and service offerings, and an infrastructure that is primed for greater capacity and efficiencies.

## OUR BUSINESS GROUPS

Our Dental Group serves an attractive market in which there is increased demand for dental services. The dentist is being asked to see an increasing number of patients, provide them with quality oral healthcare, and maintain profitable practices at the same time. There is an opportunity and a need throughout the dental profession for improvement in productivity. Dentists will need to increasingly rely on technology-driven products and services, such as practice-management software, digital X-ray, computerized charting, and other practice-enhancing tools. This challenge to improve productivity is one that we are uniquely positioned to help dentists achieve. As outlined in "The Dental Picture," we are also investing in strategic marketing initiatives, including our Privileges™ and MarketOne programs, designed to focus the organization on helping our customers succeed, and at the same time strengthening our customer relationships.

The medical market is another excellent illustration of the attractiveness of the sectors we serve. As clinical procedures continue to move from acute-care settings to physicians' offices, we believe we are the fastest-growing distributor among the major competitors in the physician and alternate-care markets, and are well-positioned to capitalize on this trend. A greater number of vaccines, injectables, and other pharmaceuticals are being used increasingly in alternate-care settings, and our Medical Group is a leading vaccine supplier to U.S. office-based medical practitioners, with reliable sources of influenza, tetanus/diphtheria toxoid, pneumococcal, and many other vaccines. The ways in which we are capitalizing on these trends are described in greater detail in "The Medical Picture." Another important component of our Medical Group is our veterinary business, which we believe to be the largest direct marketer to companion animal clinics in the United States, serving 70% of the estimated 24,000 U.S. veterinarian clinics.

Through our Technology and Value-added Services Group, we provide healthcare professionals with extraordinary software, technology, and other value-added services. Our industry-leading software products, including DENTRIX®, Easy Dental®, and AVIMark®, have made us a force in the dental and veterinary fields, and we anticipate adding a medical solution to our offerings in the near future. Perhaps the best example of

*Throughout our history, Henry Schein has earned a well-deserved reputation for innovation as we have transformed our Company and the markets we serve.*

the full potential that technology holds is the Digital Dental Office, which is described in greater detail in "The Technology and Value-added Services Picture."

Beyond North America, Henry Schein is a leading Pan-European healthcare supplier serving office-based dental, medical, and veterinary practices. As summarized in "The International Picture," we have a number of important competitive advantages that we believe will enable us to continue to grow internationally. One facilitator of this expansion is the initiative through which we are replicating our successful U.S. infrastructure in Europe. The goal of achieving greater efficiency and profitability through a common computer and warehouse platform for the entire Company is described in greater detail in "The Infrastructure/Team Schein Picture."

## GROWTH STRATEGIES AND CORE STRENGTHS

Throughout our history, Henry Schein has earned a well-deserved reputation for innovation as we have transformed our Company and the markets we serve. We have redefined and expanded the role of a distributor, and believe we will continue to do so in the future as our Company grows in four ways.

- We will seek to increase penetration of our existing customer base, and position Henry Schein as a prime vendor. Currently, we are the primary vendor to less than 15% of our customers. We intend to increase this by expanding our dental equipment sales and service penetration, by providing important value-added services, and by introducing new technologies including digital X-ray, digital imaging systems, and cameras to our existing customers.
- Gaining new customers is also a priority. In particular, we estimate that 60% of the U.S. medical practices and 45% of the Western European dental practices are not currently active customers, and we believe there also is substantial opportunity in the Western European medical and veterinary supply market. To achieve this goal, we are increasing the number of our field sales consultants and telesales representatives, and providing them with tools to increase sales productivity, as well as using our extensive customer database to focus our marketing efforts, while expanding our European equipment sales and service network.
- We also anticipate growth through an increase in our cross-selling efforts with key product lines, such as practice-management software in the dental and veterinary markets, and vaccines and injectables in the medical market.
- Lastly, we believe that our growth will be fueled by acquisitions that enhance our core strategies. There is still great potential for further consolidation in the markets we serve, and we are well-poised to capitalize on this opportunity. We have a strong cash position and significant other capital resources, and there is a focused decision-making process with dedicated teams already in place to evaluate and facilitate acquisitions. We are a cultural fit with most entrepreneurial businesses, and have a track record of success, with 20 successfully integrated acquisitions in the past five years.

I believe that our eighth decade of business will be our most successful yet because of the strengths we bring to bear.

- We are in multiple, attractive markets that diversify our risk profile and increase our opportunities.

- We have important competitive advantages. In addition to our direct sales and marketing expertise, we have a broad product offering at competitive prices and a large installed user base of dental and veterinary practice-management software upon which to build.
- We have clear growth strategies.
- We have one focus – delivering the best possible customer service to office-based practitioners.
- More than 6,900 Team Schein Members are our Company's greatest asset – each of us sharing a dedication to excellent customer service.

With growth comes added responsibility. For more than 70 years, we have remained committed to the strict sense of corporate responsibility upon which we were founded, both in terms of the governance of our Company and our role as a corporate citizen. As part of this ongoing commitment, we are pleased to welcome three new independent members to our Board of Directors: Philip A. Laskawy, the former Chairman of Ernst & Young, Norman S. Matthews, the former President of Federated Department Stores, and Louis W. Sullivan, M.D., the former U.S. Secretary of Health and Human Services and Founding Dean, Director, and President Emeritus of the Morehouse School of Medicine. As explained further in "The Corporate Responsibility Picture," we also have many programs in place to ensure that we meet or exceed our responsibility to all those we touch – Team Schein Members, our shareholders, our supplier partners, our customers, and the communities and industries in which we operate.

## THE BEST IS YET TO COME

This is an exciting time for Henry Schein. We are in the right place at the right time to take advantage of many remarkable opportunities that will ensure our continued growth. We are expanding the number of products and services we offer to our customers. We are defying the current economic trend, and are performing extremely well in a challenging business environment. We will look to continue the consolidation in the markets we serve through a healthy balance of internal growth and acquisitions.

We are a dynamic company driven by a growing number of committed people who share an entrepreneurial sense, an eagerness to serve our customers, and an excitement, continuing to build something important for the future. As a result, I remain absolutely confident in the direction that Henry Schein is heading, and firmly believe that our best years lie ahead.

Sincerely,



Stanley M. Bergman  
Chairman, Chief Executive Officer and President  
May 2003



## DENTAL SNAPSHOT

In 2002, the Dental Group recorded sales of more than \$1.2 billion, 43% of total Company revenues, which represents growth of 9.4% over 2001. This is about four percentage points ahead of the estimated market growth rate, with merchandise sales increasing 7.3% and equipment sales and service revenues increasing 18.5%.

Henry Schein's Dental Group, which includes Sullivan-Schein Dental in the United States, Henry Schein Arcona in Canada, and the Zahn Dental laboratory supply business, has 29% of the estimated \$4.2 billion U.S. and Canadian dental market. We serve over 75% of the estimated 120,000 U.S. dental practices, one-third of the estimated 15,000 Canadian dental practices, and approximately 15,000 dental laboratories. We are a major supplier to large group practices, schools, government, and other institutions, serving, for example, as a prime vendor for U.S. Army bases and clinics located throughout the U.S. and Europe.

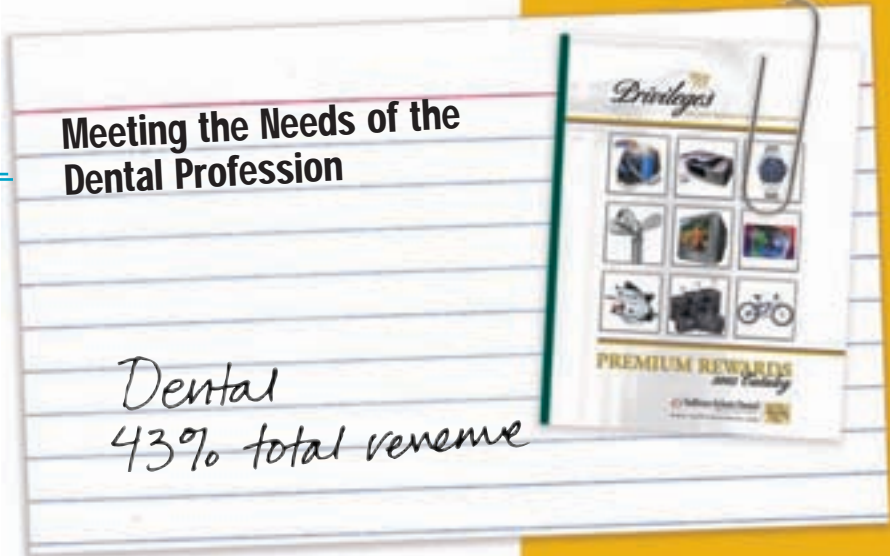
We believe that we will grow our business by more deeply penetrating our existing customer base, obtaining new customers, and cross-selling key product lines. Our approach to growth is threefold: strengthen sales leadership, develop or acquire technology for the future, and train our team members to provide the best value and quality in products and services.

Our commitment to education and training is seen in Career Development programs and Sullivan-Schein University (SSU), our online learning environment. Intensive sales training sessions, product demonstrations, and technological training on proprietary sales tools, equip our sales force with the knowledge they need to succeed. SSU contains educational development modules that enable individuals to learn at their own pace. Additionally, graduates of our Career Development programs have demonstrated impressive sales growth. They are counseling dental practices on marketing, effective scheduling, practice-management, and problem-solving.

We also provide our sales force with tools to increase their sales productivity, such as the Customer Analysis Tool (CAT) system. This electronic call-planning system displays customers' order patterns, helping to make sales calls as productive and beneficial as possible. Service technicians keep our customers' equipment optimally running with tools such as FieldCom, which contains a complete equipment and parts listing, documents and catalogs customer repair data, and facilitates ordering and billing for parts. FieldCom eliminates paperwork, generates receipts, and helps technicians quickly determine pricing and availability of parts – improving our customers' productivity and profitability by decreasing equipment downtime.



# THE DENTAL PICTURE



Tremendous challenges and opportunities face the dental profession in North America.

Today, the dentist must meet an increase in patient demand for services, maintain a high standard of clinical treatment, and keep their practices financially healthy at the same time.

They rely on Sullivan-Schein Dental in the United States and Henry Schein Arcona in Canada for products they need in clinical treatment, for technology to increase their productivity and profitability – while providing quality healthcare, and for value-added services to enhance their practices.

We support dentists by offering 60,000 SKUs, including Henry Schein exclusives, such as OralCDx®, an advance in oral cancer testing, which carries the American Dental Association's Seal of Acceptance. This computer-assisted brush biopsy test enables dentists to painlessly and easily test patients for oral cancer, which claims the lives of more than 8,000 Americans annually. Another exclusive is X-Rite's ShadeVision™, a significant technological advance in restorative tooth-shading that enables dentists to easily determine and match tooth-color data. The Debacterol® canker sore treatment is another example. A single application of Debacterol completely stops the pain of canker sores in seconds and dramatically reduces a sore's healing time.

We also provide dentists with several important technology-based value-added services, including our DENTRIX® and Easy Dental® practice-management software systems, financial services, continuing education, and dental electronic claims. In addition, we offer ProRepair®, a fast, high quality, competitively priced service for dental handpieces and small equipment repairs. With experience on all types of equipment, a full stock of parts, and precision instruments, we also provide sterilizer repair service, instrument sharpening, dental handpiece repairs, and ultrasonic inserts. All ProRepair facilities in the United States are ISO Certified, an official international recognition of our commitment to quality assurance.

To strengthen customer relationships, we have a number of strategic marketing initiatives, such as MarketOne and Privileges™. Through MarketOne, we seek to sell more DENTRIX practice-management software to Sullivan-Schein Dental customers, sell more dental consumable merchandise and equipment to DENTRIX customers, and more effectively reach dental practices that currently are not Henry Schein customers. Sullivan-Schein Dental sales consultants work closely with DENTRIX sales representatives, using new tools to expand our customer base and deepen relationships with current customers. Launched in July 2002, MarketOne is already showing promising results.

Privileges, our innovative customer loyalty program, helps us attract, reward, and retain customers for life. Privileges includes personalized, professional service, priority attention on all service calls, guaranteed emergency response time, free extended warranties, and preferred rate pricing. Through Privileges, our customers can earn gift certificates toward office-design services, in-office labor, repairs, preventive maintenance, and a host of technological offerings and service programs. By the end of 2002, more than 10,000 customers had already enrolled in the successful Privileges program, and they are increasing their business with Henry Schein at a rate far above that of our average customer.

*One of the tools that Sullivan-Schein Dental Service Technicians use to keep our customers' equipment optimally running is FieldCom, which documents and catalogs customer repair data and facilitates ordering and billing for parts. The end result is improved customer productivity and profitability through decreased equipment downtime.*

*By the end of 2002, more than 10,000 customers had already enrolled in the successful Privileges™ program, and they are increasing their business with Henry Schein at a rate far above that of our average customer.*



## MEDICAL SNAPSHOT

In 2002, the Medical Group posted record sales of \$1.1 billion, 11.3% higher than in 2001, which represents 39% of total Company revenues.

Henry Schein's Medical Group serves over 90,000 U.S. office-based physician practices – approximately 40% of the market – and has approximately 14% of the estimated \$5–\$7 billion market. We reach the physician marketplace with three brands – Henry Schein, Caligor, and General Injectables and Vaccines (GIV). More than 500 field sales and telesales representatives serve our medical customers, supported by 13 million targeted marketing pieces each year.

The Medical Group also serves acute care facilities in the northeast United States, as well as over 70% of the estimated 24,000 U.S. veterinary clinics. We are a prime vendor to VCA Antech, the largest provider of clinical petcare in the U.S.

We are also a major supplier to organizations that bundle member purchasing power such as the American Society of Plastic Surgeons, the American Academy of Dermatology, and U.S. Oncology, Inc. One of these formulary plans, the AMA PurchaseLink® Program with the American Medical Association, is now in its eighth year.

We have a number of important competitive advantages.

- Our 99% fill rate exceeds the estimated 93%–94% fill rates of our competitors.
- We offer approximately 30,000 SKUs to our medical customers—including generic and branded pharmaceuticals, vaccines, medical and surgical supplies, diagnostic kits, and major equipment; and 40,000 SKUs to our veterinary customers.
- We ship a wide range of products, and have the unique cold chain distribution expertise to ensure the integrity of the vaccines we provide to our customers.
- Our three-brand strategy enables us to reach the greatest possible number of customers, and we have expertise in pharmaceuticals, vaccines, and injectables that we believe other distributors cannot match.
- We believe that our sales consultants are the best in the industry, and we only hire experienced representatives to increase the size of the sales force.
- We have a history of direct marketing experience that we believe is unsurpassed in the industry.





# THE MEDICAL PICTURE

The medical market presents tremendous opportunities for Henry Schein. With the aging of the U.S. population, there will be a rise in U.S. healthcare services and more clinical procedures done in physicians' offices. We believe we are the fastest growing major distributor in this market, and as such, we anticipate that our growth will be driven by cross-selling our key product lines, increasing our number of customers, and using our extensive database to its best advantage.

Our three-brand strategy for serving our office-based physician customers is a unique advantage. Research indicates that the average physician's office conducts business with six to eight suppliers. Some customers prefer working with either a telesales or field sales representative, but not necessarily both. As such, we are able to reach the greatest number of potential customers by offering them three brand choices:

- Our Henry Schein Medical division has more than 140 telesales representatives offering a total portfolio of consumable, pharmaceutical, and equipment products and related services in all 50 states, supported by the distribution of 8 million marketing pieces.
- Our Caligor division has 280 full-service field sales consultants in 34 states, offering that same portfolio of consumable, pharmaceutical, and equipment products and related services, supported by over a million marketing pieces annually.
- Our General Injectables and Vaccines (GIV) division has nearly 50 telesales representatives with expertise in vaccines and injectables selling in all 50 states, supported by over 4 million marketing pieces. This division ships 25% of the U.S. doses for the Vaccine for Children (VFC) Program, and provides vaccines and injectables for other governmental institutions.

Customer overlap among our three brands is less than 15%, further supporting our approach to reaching office-based practitioners.

The use of vaccines, injectables, and other pharmaceuticals in alternate-care settings continues to build, and we expect future growth to come from vaccines, of which we are a leading U.S. distributor. Projections call for the global influenza vaccine market to double to \$2 billion in the next five years, and a five-year compounded annual growth rate of 13% is predicted in the global vaccine market, which should reach \$10 billion in 2006. As a leader in the distribution of flu vaccine to office-based practitioners in the United States, we continue to focus on the flu vaccine market.

Because we believe existing vaccines and new products will be administered primarily in physicians' offices and alternate-care settings, we are uniquely positioned to take advantage of this trend. To ensure our position as a reliable supplier to our customers, we have signed expanded commitments with our primary influenza, tetanus/diphtheria toxoid manufacturers, and continue to offer a full line of vaccines and other pharmaceuticals for a variety of disease conditions.

We have also begun an exciting new initiative to expand our pharmaceutical business – one that focuses on niche pharmaceutical products used in physicians' offices. As part of this program, we will continue to carry all of the pharmaceutical products needed by office-based physicians or veterinarians, and seek to add promising new products and related services coming to market.

*Through its three brands, Henry Schein, Caligor, and General Injectables and Vaccines (GIV), Henry Schein's Medical Group serves more than 90,000 U.S. office-based physician practices, delivering an industry leading 99% fill rate.*

## Trends and Opportunities in the Medical Segment

Medical  
39% total revenue



MEDICAL

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and using our extensive  
database to its  
best advantage. ”*

## INTERNATIONAL SNAPSHOT

For 2002, the International Group posted record sales of \$437 million; 16% of total Company revenues, which represented 9.8% growth in U.S. dollars and 4.7% growth in local currencies. European dental sales grew by 8.2% in local currencies for the year. European veterinary operations grew by more than 10% last year in local currencies.

The mission of the International Group is to provide best-in-class capabilities on a Pan-European basis, offering products and services to dental, medical, and veterinary office-based practitioners. The sales model we use to achieve this is similar to our U.S. model, and is adapted for differences present in the European marketplace. At the foundation of this model is a central infrastructure to manage our consumable business. We manage the sales, service, and marketing functions on a countrywide or regional basis.

We serve approximately 170,000 practices in 14 countries outside of North America, primarily in Western Europe, Australia, and New Zealand, offering them a selection of approximately 70,000 SKUs. We are also expanding our services into the Middle East, Africa, and Latin America through Schein Direct™, which provides rapid door-to-door air package delivery to healthcare practitioners in 125 countries around the world.

We have a 9% share of the estimated \$3.2 billion Western European dental market, and a 4% share of the estimated \$2.2 billion Western European medical and veterinary markets.





# THE INTERNATIONAL PICTURE

The opportunities for Henry Schein International are as big as the world itself.

In the countries in which we operate – Austria, Australia, Belgium, France, Germany, Iceland, Ireland, Israel, the Netherlands, New Zealand, Portugal, Spain, and the United Kingdom– we

estimate that there are more than 550,000 potential practitioner customers – 350,000 medical, 150,000 dental, and 50,000 veterinary. The total market potential in the above-mentioned countries is more than \$5.6 billion, and our combined market share for dental, medical, and veterinary customers ranges from 5% to 13% from country-to-country. The net result is that there is tremendous growth potential for Henry Schein’s international business.

In Europe, where practitioners generally have a profile similar to their North American counterparts, we believe that we have a number of important competitive advantages to enable our future growth. We can more effectively use our database market information and introduce additional products and services to our European customers. Our superior service delivers a high level of accuracy and fulfillment to our customers throughout Europe on a consistent basis. We believe we have the most comprehensive product selection, including the broadest private brand offering in the industry, enabling us to provide our customers with high quality, low cost alternatives. One additional advantage that we believe will accelerate our international expansion is our initiative to bring all of our European businesses onto our core technology platforms. We expect this to replicate our successful North American infrastructure on a Pan-European scale and enhance our efficiency throughout Europe.

Using these advantages, we are determined to grow, and see this growth coming through expansion into medical and veterinary markets where we are not currently present, such as Australia, New Zealand, and France. We anticipate this growth to come internally, as well as through acquisitions as we continue to consolidate markets. In Germany, for example, the potential for future consolidation is great, with small distributors still holding an estimated 43% of the dental category, 87% of the medical market, and 89% of the veterinary market.

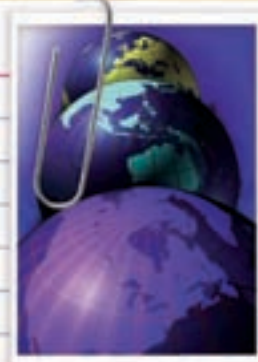
Future growth also is expected to come through the expansion of our dental consumable offering in Germany into a full-service business, which includes equipment sales and service, and by further expanding our full-service business in France. Finally, we believe that we will see growth through geographic expansion.

There is tremendous opportunity for expansion and growth for Henry Schein outside of North America. By capitalizing on our competitive advantages, continually evaluating our strategic opportunities, and making the most of them on a country-by-country basis, we are well-poised for continued revenue growth in the coming years.

*Henry Schein’s International Group offers 70,000 SKUs to 170,000 healthcare practices in countries outside of North America. Through ScheinDirect™, we provide rapid door-to-door air package delivery to healthcare practitioners in 125 countries around the world.*

## Competitive Advantages Internationally

*International  
16% total revenue*



*“ By capitalizing  
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## TECHNOLOGY AND VALUE-ADDED SERVICES SNAPSHOT

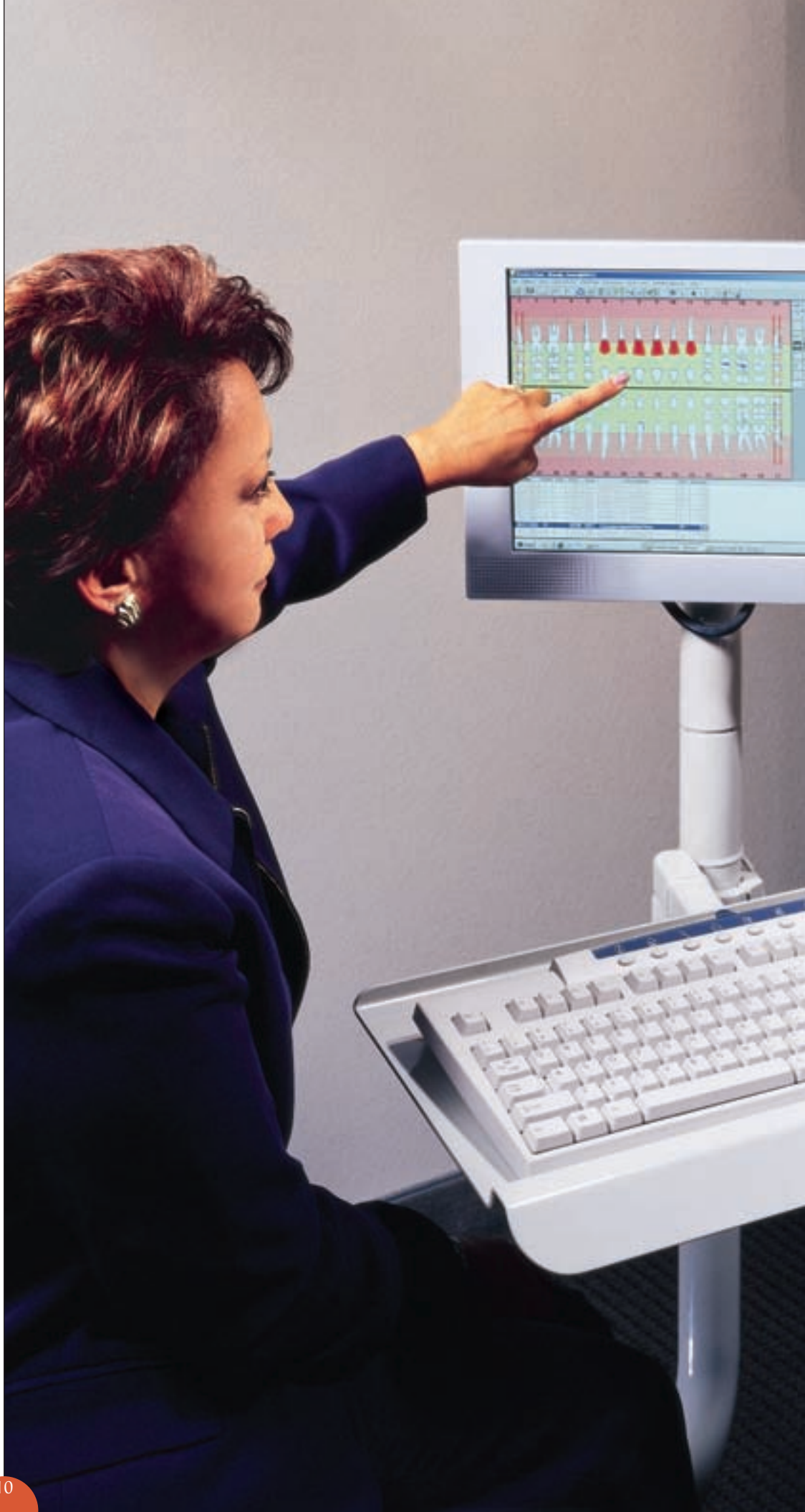
The Technology and Value-added Services Group posted a record \$66.7 million in sales in 2002, growth of 18.7% over 2001, which represented 2% of total Company revenues.

The Technology and Value-added Services Group provides extraordinary software, technology, and other value-added products and services to healthcare providers in the dental, medical, and veterinary professions. We seek to provide practitioners with the very best in products and services that will help them better manage their practice and ultimately increase their bottom line, while providing quality healthcare. In this way, we become an essential and valuable partner to our healthcare-provider customers.

More than one-third of all U.S. dental practices use our DENTRIX® or Easy Dental® practice-management software – over 42,000 practices nationwide. Our practice management software product, AVIMark®, one of the U.S. market leaders, is used in over 6,000 companion animal clinics, and represents more than 25% of the veterinary clinics around the country. We anticipate adding a medical practice-management software offering to our U.S. customers in the future.

In addition, we provide an increasing number of value-added services to help practitioners provide a high level of quality patient care while operating more efficient and profitable businesses. We believe we are one of the industry's largest processors of dental electronic claims, with approximately 23 million processed in 2002. Through Henry Schein Financial Services, we offer low rates for equipment leasing and financing, patient-financing options, electronic credit card processing, and lines of credit, as well as financial-planning services. Our services include Henry Schein's Continuing Education for Healthcare Professionals program, through which participants can access fully accredited courses on the latest healthcare technology in person, in print, or online.

Technology is changing the way in which our customers place orders, as well. In 2002, the number of electronic orders our customers placed with us through the Internet increased by nearly 70%.





# THE TECHNOLOGY AND VALUE-ADDED SERVICES PICTURE

Dental, medical, and veterinary professionals demand products and services that enhance their practice. Henry Schein's Technology and Value-added Services Group meets this demand by offering tools that help practitioners operate an efficient and profitable practice, while providing the highest level of quality care. These tools address:

- Financial management, moving more to the bottom line
- Clinical management, improving practice effectiveness
- Inventory management, improving practice efficiency
- Patient management, helping practitioners better serve more patients
- Facility and staff management, enhancing the professional image of the practice

Among the various healthcare professions, there also are unique challenges that we help to address. For example, technological tools that can enhance the efficiency of dental professionals are the best way for them to effectively treat more patients as they meet the business demands of their practices. A number of technological tools have been introduced in the dental marketplace over the past few years, including computerized clinical management; full treatment planning, including the paperless office and progress notes; intraoral imaging; aesthetic dentistry using cosmetic dentistry technology; digital X-ray processing; real-time voice dictation and charting; and others. The challenge has been to integrate these valuable tools together in a dentist's limited practice space. We have streamlined the solution through the Digital Dental Office (DDO), eliminating the need for the dentist to maintain multiple vendor relationships and support contracts.

Using three complementary products, the DDO provides dentists with true seamless integration of imaging, clinical, and financial applications. DENTRIX® ImageRAY™ delivers incredible clarity and high-resolution digital X-rays, whereas DENTRIX® ImageCAM™ enables dentists to show patients their dental problems on screen, requiring less time for explanation and more time for treatment. Images captured through these two tools can be stored with DENTRIX® practice-management software, along with front-desk scheduling, billing, ordering, and record-keeping information. With DDO, there is just one support contract for dentists, and they do not have to deal with third parties. DDO enables dentists to use most of the technology they may already have in their practice, and we also have very strong connections to our branded manufacturers, working hand-in-hand with them to deliver a level of seamless integration that we believe no other company can provide.

Through forward-looking solutions such as DDO, we have established Henry Schein as a technological leader in this market, providing for practitioners' technological needs, as well as their other practice requirements.

*Helping our customers operate more efficiently and profitably, DENTRIX and Easy Dental software systems are in use in over 42,000 U.S. dental practices.*

## Using Technology to Streamline Practice Efficiency

Technology  
2% total revenue



*Through forward-looking solutions ... we have established Henry Schein as a technological leader in this market, providing for practitioners' technological needs, as well as their other practice requirements.*

## INFRASTRUCTURE SNAPSHOT

Each year, Henry Schein processes approximately 8 million orders, and ships more than 10 million individual boxes to our customers. We have more than 1.2 million square feet of space at five U.S. distribution centers located in Denver, Pennsylvania; Indianapolis, Indiana; Jacksonville, Florida; Grapevine, Texas; and Sparks, Nevada. The strategic location of these facilities and the efficiency with which they operate enable us to provide next-day business delivery for 77% of our orders, and delivery within two days for 99% of our orders. We offer more than 90,000 SKUs at these ISO-certified facilities, which allows us to sell products in the European Union. In addition, we offer over 7,400 Henry Schein private brand SKUs in North America, which we believe is one of the most extensive offerings in the markets we serve. Our Canadian customers are serviced from distribution centers in Delta, British Columbia and Niagara-on-the-Lake, Ontario. Distribution centers beyond North America are located in the United Kingdom, France, Germany, Spain, Australia, and New Zealand.

Through strategic investments in physical infrastructure; in technology, such as radio frequency, guide-by-wire, and fiber optic systems; and in special capabilities, such as cold chain distribution expertise and a drug order monitoring system, we maintain a level of customer service that we believe is unsurpassed in the industry.

## TEAM SCHEIN SNAPSHOT

Henry Schein's greatest asset is Team Schein – more than 6,900 individuals who recognize that the way we serve our customers sets us apart, as it has for more than 70 years. Fostering this Team Schein culture is an entrepreneurial environment that thrives in an atmosphere of mutual respect based on the Team Schein Wheel of Success – each Team Schein Member is a spoke in the wheel, and each member is as important as the next in achieving ultimate success.

We support this shared belief with programs that recognize and reward those who demonstrate excellence, including:

- Competitive compensation
- A performance incentive plan
- Stock option programs
- A 401(k) plan, and
- An exceptional benefits program

We believe that these programs contribute to a highly motivated Team Schein.





# THE INFRASTRUCTURE AND TEAM SCHEIN PICTURE

Henry Schein's North American infrastructure enables us to deliver a superior level of customer service including:

- 99% of all our U.S. and Canadian orders shipped complete.
- 99% of these orders shipped on the same day they are received.
- 99% of these orders delivered within two days of placement.
- 99% of these orders shipped accurately.

Our North American infrastructure operates effectively for a number of reasons. We are uniquely devoted to the office-based practitioner, and we focus on shipping small packages with an average of six to seven items in a box, including pharmaceuticals, medical and surgical supplies, dental supplies, and other products. Our current infrastructure is poised to handle increasing volume efficiently and with improved profitability as we expand sales across our broad customer base.

We are currently in the process of replicating this state-of-the-art North American infrastructure on a Pan-European scale. This project will bring our European businesses onto our core technology platform, which we anticipate will facilitate growth and enhance efficiency in the European markets. This will allow Henry Schein Europe to use the same North American information technology development for field force automation through our Customer Analysis Tool (CAT) system, e-commerce solutions through ARUBA®, henryschein.com, database marketing, and financial management. The move to a single European system also will provide a means to consolidate our purchasing volume and better manage margins on that continent. It will enable us to implement an integrated Pan-European distribution network, which we believe will result in improved customer service, superior inventory management, improved use of working capital, expanded product offerings for all markets, and lower operating expenses as a percentage of sales.

The strategic investments we have made in our North American infrastructure are already paying off. We are seeing this in our distribution efficiency and accuracy as we deliver a superior level of customer service within the markets we serve. We also are seeing this in our potential to expand operating margins as we increase utilization in the future. Through the strategic investments we are making, we believe that these dividends will soon extend across the Atlantic.

*Henry Schein processes approximately 8 million orders annually. Through strategic investments in infrastructure and technology, our more than 6,900 Team Schein Members maintain a level of customer service that is unsurpassed in the industry.*

**One Company,  
One System**

*6,900 Team Schein  
Members and  
growing!*



*“ Our current infrastructure is poised to handle increasing volume efficiently and with improved profitability as we expand sales across our broad customer base. ”*

## CORPORATE CHARTER

### To Our Customers

We provide the best quality and value in products and services, helping them, as business partners, to:

- Deliver quality healthcare to their patients;
- Efficiently operate and grow their practices; and
- Increase their financial return and financial security.

### To Our Shareholders and Venture Partners

We are responsible for achieving continued growth and profitability, resulting in an excellent return on investment.

### To Team Schein

We will continue to foster an entrepreneurial environment, while offering exciting opportunities for personal and professional growth, and treating each individual with respect and dignity.

### To Our Suppliers

Together, we will strive to create an environment that enables us to grow our respective businesses in the spirit of partnership, each making a fair profit.

*Photos one and five below:  
Courtesy ADA News  
© 2003 American Dental Association*

# THE CORPORATE PICTURE

Henry Schein's business practices are based on the firm belief that we must fulfill our responsibility as a corporate citizen. We have always recognized that we must adhere to ethical business practices and give back to the communities in which we operate. As a result, Team Schein has always had a culture of ethics and integrity.

Henry Schein has a long history as a socially responsible organization that has sponsored community-based programs throughout the world. Acting with enlightened self-interest, we believe that we can do well by doing good.

The cornerstone of our multifaceted and coordinated social responsibility and corporate citizenship program is Henry Schein Cares. The mission of Henry Schein Cares is to assist in narrowing the disparity in the delivery of healthcare services and information in underserved communities, both in the United States and abroad, by providing resources to support the programs of community-based healthcare professionals and their organizations. To achieve this mission, we provide our products to medical and dental public, private, and not-for-profit organizations that demonstrate they will use these products effectively at the grass roots level. For example, we donate supplies to office-based practitioners who volunteer their services in underserved communities around the globe.

The activities of the Henry Schein Cares program are wide-ranging. We have contributed to organizations including the American Dental Association (ADA), ADA Foundation, Oral Health America, Academy of General Dentistry Foundation, National Dental Association, Hispanic Dental Association, American Dental Education Association, American Dental Hygienists' Association, American Dental Assistance Association, Alpha Omega, Bureau of Primary Health Care clinics, Indian Health Service clinics, and Medical Education for South African Blacks (MESAB).

Henry Schein works closely with most U.S. dental schools and many international schools on a variety of programs, including oral cancer screening community outreach initiatives, and we have helped raise in-kind donations to open new facilities at New York University, the University of Pennsylvania, Nova University, Hebrew University, and other institutions.

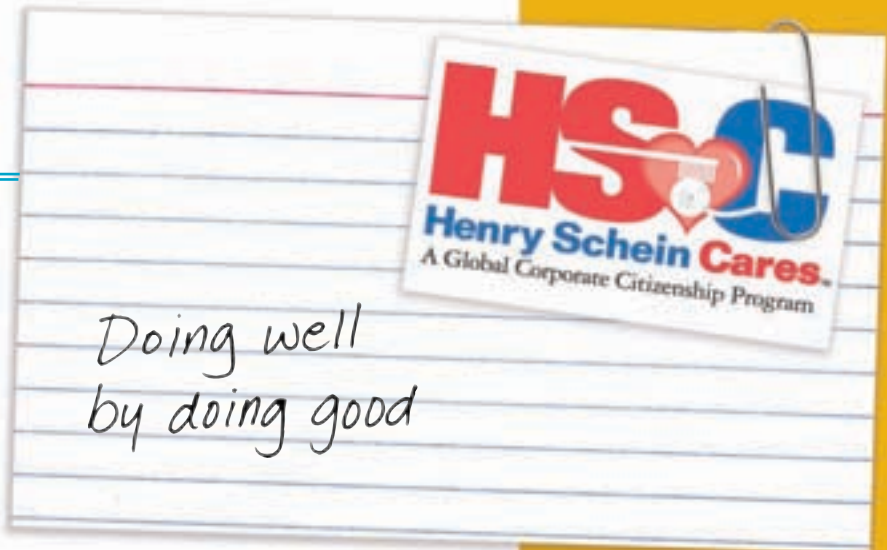
As the exclusive distributor of professional products, we were a driving force behind the ADA's Give Kids A Smile<sup>SM</sup> program, through which 10,000 dentists provided oral health services, including screening and treatment, to nearly one million underserved children, free of charge. We also are working closely with the ADA to sponsor the creation of a diversity leadership institute for the dental profession.





Finally, many of the more than 6,900 Team Schein Members have the opportunity to participate in a variety of Henry Schein sponsored community-based programs in our hometowns, such as our annual Back-to-School program, through which clothing and school supplies are donated to children heading back to class in September. We are committed to enhancing the quality of life for Team Schein Members through a variety of wellness programs, including medical screenings, crisis counseling, and other services.

Henry Schein Cares is an investment that we are pleased to make as our commitment to social responsibility and corporate citizenship continues into our eighth decade.



**Henry Schein Cares Mission Statement**

To assist in narrowing the disparity in the delivery of the healthcare services and information in underserved communities, both in the United States and abroad, by providing resources to support the programs of community-based health professionals and their organizations.

**Working together with the dental industry...**

**Sullivan-Schein Dental**<sup>®</sup>

A HENRY SCHEIN<sup>®</sup> COMPANY



## DIRECTORS AND OFFICERS

### BOARD OF DIRECTORS

**Stanley M. Bergman**

*Chairman, Chief Executive Officer and President*

**Barry J. Alperin (1) (2) (3)**

*Retired Vice Chairman, Hasbro, Inc.*

**Gerald A. Benjamin**

*Executive Vice President and Chief Administrative Officer*

**James P. Breslawski**

*Executive Vice President and President, Sullivan-Schein Dental*

**Leonard A. David**

*Vice President, Human Resources and Special Counsel*

**Pamela Joseph**

*Director, MaNose Studios*

**Donald J. Kabat (1) (2)**

*Retired Partner, Accenture*

**Philip A. Laskawy (1) (3)**

*Retired Chairman, Ernst & Young*

**Norman S. Matthews (2)**

*Former President, Federated Department Stores*

**Mark E. Mlotek**

*Senior Vice President, Corporate Business Development*

**Steven Paladino**

*Executive Vice President and Chief Financial Officer*

**Marvin H. Schein**

*Founder, Schein Dental Equipment Corp.*

**Irving Shafran, Esq.**

*Attorney at Law*

**Louis W. Sullivan, M.D. (3)**

*Former U.S. Secretary of Health and Human Services, and Founding Dean, Director and President Emeritus of the Morehouse School of Medicine*

### EXECUTIVE OFFICERS

**Stanley M. Bergman**

*Chairman, Chief Executive Officer and President*

**Gerald A. Benjamin**

*Executive Vice President and Chief Administrative Officer*

**James P. Breslawski**

*Executive Vice President and President, Sullivan-Schein Dental*

**Leonard A. David**

*Vice President, Human Resources and Special Counsel*

**Larry Gibson**

*Executive Vice President and Chief Technology Officer*

**Mark E. Mlotek**

*Senior Vice President, Corporate Business Development*

**Steven Paladino**

*Executive Vice President and Chief Financial Officer*

**Michael Racioppi**

*President, Medical Group*

**Michael Zack**

*Senior Vice President, International Group*

*(1) Member Audit Committee*

*(2) Member Compensation Committee*

*(3) Member Nominating and Governance Committee*



**First row, from left to right:**

Larry Gibson, James P. Breslawski,  
Stanley M. Bergman, Michael Zack

**Second row, from left to right:**

Mark E. Mlotek, Steven Paladino,  
Leonard A. David, Michael Racioppi,  
Gerald A. Benjamin

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## MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The following table sets forth, for the periods indicated, the high and low reported sales prices of our Common Stock as reported on the NASDAQ National Market System for each quarterly period in fiscal 2001 and 2002 and for the first quarter of fiscal 2003 through March 18, 2003.

	High	Low
Fiscal 2001:		
1st Quarter	\$37.44	\$27.19
2nd Quarter	\$40.57	\$29.84
3rd Quarter	\$40.00	\$31.61
4th Quarter	\$41.50	\$31.90
Fiscal 2002:		
1st Quarter	\$46.11	\$35.34
2nd Quarter	\$50.59	\$43.10
3rd Quarter	\$54.98	\$39.00
4th Quarter	\$57.73	\$40.30
Fiscal 2003:		
1st Quarter (Through March 18, 2003)	\$46.60	\$34.17

Our Common Stock is quoted through the NASDAQ National Market tier of the NASDAQ Stock Market under the symbol "HSIC". On March 18, 2003, there were approximately 662 holders of record of the Common Stock. On March 18, 2003, the last reported sales price was \$43.41.

## DIVIDEND POLICY

We currently do not anticipate paying any cash dividends on our Common Stock. We intend to retain earnings to finance the expansion of our business and for general corporate purposes, including our stock repurchase program. Any payment of dividends will be at the discretion of our Board of Directors and will depend upon the earnings, financial condition, capital requirements, level of indebtedness, contractual restrictions with respect to payment of dividends and other factors. Our revolving credit agreement, as well as the agreements governing our Senior Notes, limit the distribution of dividends without the prior written consent of the lenders.

## RECONCILIATION OF CERTAIN OPERATING RESULTS

The following table sets forth, for the periods indicated, a reconciliation of Operating income and Net income, as originally reported to Adjusted operating income and Adjusted net income.

	Years ended				
	December 28, 2002	December 29, 2001	December 30, 2000	December 25, 1999	December 26, 1998
(In thousands, except per share data)					
Operating income, as originally reported	\$197,003	\$147,750	\$112,589	\$105,765	\$39,530
Adjust for:					
Merger and integration costs	(1,163)	—	585	13,467	56,666
Restructuring costs	429	—	14,439	—	—
Adjusted operating income	\$196,269	\$147,750	\$127,613	\$119,232	\$96,196
Net income, as originally reported	\$117,987	\$ 87,373	\$ 56,749	\$ 50,312	\$16,327
Adjust for:					
Merger and integration costs	(1,163)	—	585	13,467	56,666
Tax effect on merger and integration costs	—	—	—	(3,983)	(12,591)
Restructuring costs	429	—	14,439	—	—
Tax effect on restructuring costs	—	—	(5,169)	—	—
Loss on sale of Novocol	—	—	1,925	—	—
Loss on sale of UK Technology Business	—	—	1,616	—	—
Pro forma tax adjustment-Meer acquisition	—	—	—	—	(2,579)
Adjusted net income	\$117,253	\$ 87,373	\$ 70,147	\$ 59,796	\$57,823
Diluted earnings per share:					
As originally reported	\$ 2.63	\$ 2.01	\$ 1.35	\$ 1.21	\$ 0.39
Adjusted	\$ 2.61	\$ 2.01	\$ 1.67	\$ 1.44	\$ 1.39
Diluted average shares outstanding	44,872	43,545	42,007	41,438	41,549



## SELECTED FINANCIAL DATA

The following selected financial data, with respect to our financial position and results of operations for each of the five years in the period ended December 28, 2002, set forth below, has been derived from our consolidated financial statements. The selected financial data presented below should be read in conjunction with the Consolidated Financial Statements and related notes thereto herein and "Management's Discussion and Analysis of Financial Condition and Results of Operations" herein. The Selected Operating Data and Net Sales By Market Data presented below have not been audited.

	Years ended				
	December 28, 2002	December 29, 2001	December 30, 2000	December 25, 1999	December 26, 1998
(In thousands, except per share and selected operating data)					
<b>Statements of Operations Data:</b>					
Net sales	\$2,825,001	\$2,558,243	\$2,381,721	\$2,284,544	\$1,922,851
Gross profit	794,904	699,324	647,901	608,596	523,831
Selling, general and administrative expenses	598,635	551,574	520,288	489,364	427,635
Merger and integration (credits) costs (1)	(1,163)	-	585	13,467	56,666
Restructuring costs (2)	429	-	14,439	-	-
Operating income	197,003	147,750	112,589	105,765	39,530
Interest income	10,446	10,078	6,279	7,777	6,964
Interest expense	(17,960)	(17,324)	(20,409)	(23,593)	(12,050)
Other - net	940	(153)	(1,925)	(166)	1,570
Other income (expense) - net	(6,574)	(7,399)	(16,055)	(15,982)	(3,516)
Income before taxes on income, minority interest and equity in earnings (losses) of affiliates	190,429	140,351	96,534	89,783	36,014
Taxes on income	70,510	51,930	36,150	35,589	20,325
Minority interest in net income of subsidiaries	2,591	1,462	1,757	1,690	145
Equity in earnings (losses) of affiliates	659	414	(1,878)	(2,192)	783
Net income	117,987	87,373	56,749	50,312	16,327
Net income per common share:					
Basic	\$ 2.71	\$ 2.06	\$ 1.38	\$ 1.24	\$ 0.42
Diluted	\$ 2.63	\$ 2.01	\$ 1.35	\$ 1.21	\$ 0.39
Weighted average common shares outstanding:					
Basic	43,489	42,366	41,244	40,585	39,305
Diluted	44,872	43,545	42,007	41,438	41,549

	Years ended				
	December 28, 2002	December 29, 2001	December 30, 2000	December 25, 1999	December 26, 1998
(In thousands, except per share and selected operating data)					
<b>Selected Operating Data:</b>					
Number of orders shipped	7,861,000	7,891,000	8,280,000	7,979,000	6,718,000
Average order size	\$ 359	\$ 324	\$ 288	\$ 286	\$ 286
<b>Net Sales by Market Data: (3)</b>					
Healthcare Distribution:					
Dental (4)	\$1,227,273	\$1,121,394	\$1,087,073	\$1,056,406	\$1,088,182
Medical (5)	1,093,956	982,569	851,301	767,258	563,768
International (6)	437,046	398,071	389,946	403,140	230,792
Total Healthcare Distribution	2,758,275	2,502,034	2,328,320	2,226,804	1,882,742
Technology (7)	66,726	56,209	53,401	57,740	40,109
	\$2,825,001	\$2,558,243	\$2,381,721	\$2,284,544	\$1,922,851
<b>Balance Sheet data:</b>					
Working capital	\$ 604,199	\$ 489,909	\$ 423,547	\$ 428,429	\$ 403,592
Total assets	1,558,052	1,385,428	1,231,068	1,204,102	962,040
Total debt	250,013	261,417	276,693	363,624	209,451
Minority interest	6,748	6,786	7,996	7,855	5,904
Stockholders' equity	861,217	680,457	579,060	517,867	463,034

- (1) In 2002, we revised our original estimates of our anticipated merger and integration expenses. This change in estimates is attributable to facts and circumstances that arose subsequent to the original charges. As a result, we reversed certain of our previously recorded expenses. In 1998, the merger and integration costs consisted primarily of investment banking, legal, accounting and advisory fees, compensation, write-off of duplicate management information systems, and other assets and the impairment of goodwill arising from acquired businesses integrated into our medical and dental businesses, as well as certain other integration costs incurred primarily in connection with the 1998 acquisition of H. Meer Dental Supply Co., Inc. ("Meer") and the 1997 acquisitions of Sullivan Dental Products, Inc. and Micro Bio-Medics, Inc., which were accounted for under the pooling of interests method of accounting. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Acquisition Strategy" herein and the Consolidated Financial Statements and related notes thereto herein.
- (2) In 2002, we revised our original estimates of our anticipated restructuring expenses. This change in estimates is attributable to facts and circumstances that arose subsequent to the original charges. As a result, we recorded additional expenses. These restructuring costs consist primarily of employee severance costs, including severance pay and benefits for 2002 and 2000 of approximately \$0.1 million and \$7.2 million, respectively, facility closing costs, primarily lease termination and asset write-off costs of approximately \$0.3 million and \$4.4 million, respectively, and professional and consulting fees directly related to the restructuring plan of approximately \$0.0 million and \$2.8 million, respectively. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Plan of Restructuring" herein and the Consolidated Financial Statements and related notes thereto herein.
- (3) Reclassified to conform to current period presentation.
- (4) Dental consists of our dental business in the United States and Canada.
- (5) Medical consists of our medical and veterinary businesses in the United States.
- (6) International consists of our business (primarily dental) outside the United States and Canada, primarily in Europe.
- (7) Technology consists of our practice management software business and certain other value-added products and services, which are distributed primarily to healthcare professionals in the United States and Canada.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Cautionary Note Regarding Forward-Looking Statements

Except for historical information contained herein, the statements in this report (including without limitation, statements indicating that we “expect,” “estimate,” “anticipate,” or “believe” and all other statements concerning future financial results, product or service offerings or other events that have not yet occurred) are forward-looking statements that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. Forward-looking statements involve known and unknown factors, risks and uncertainties which may cause our actual results in future periods to differ materially from those expressed in any forward-looking statements. Those factors, risks and uncertainties include, but are not limited to, the factors described under “Risk Factors” below.

The following discussion and analysis of our consolidated financial condition and consolidated results of operations should be read in conjunction with our Consolidated Financial Statements and related notes thereto herein.

### Overview

We are the largest distributor of healthcare products and services to office-based healthcare practitioners in the combined North American and European markets with operations in the United States, Canada, the United Kingdom, the Netherlands, Belgium, Germany, France, Austria, Spain, Ireland, Portugal, Australia and New Zealand. We sell products and services to over 400,000 customers, primarily dental practices and dental laboratories, as well as physician practices, veterinary clinics and institutions. Through our comprehensive catalogs and other direct sales and marketing programs, we offer customers a broad product selection of both branded and private brand products.

We conduct our business through two segments: healthcare distribution and technology. These operations offer different products and services to the same customer base. The healthcare distribution segment consists of our dental, medical (including veterinary), and international groups. The international group is comprised of our healthcare distribution business units located primarily in Europe, and offers products and services to dental and medical (including veterinary) customers located in their respective geographic regions. The technology segment consists primarily of our practice management software business and certain other value-added products and services which are distributed primarily to healthcare professionals in the United States and Canada.

### Critical Accounting Policies and Estimates

Securities Exchange Commission Financial Reporting Release No. 60 requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements.

We believe that the following critical accounting policies affect the significant judgments and estimates used in the preparation of our financial statements:

#### *Management's Estimates*

The preparation of consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate estimates, including those related to sales allowance provisions, as described below, volume purchase rebates, income taxes, inventory and bad debts reserves, and contingencies. We base our estimates on historical data, when available, experience, industry and market trends, and on various other assumptions that are believed to be reasonable under the circumstances, the combined results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

#### *Revenue Recognition*

Sales are recorded when products are shipped or services are rendered to customers, as we generally have no significant post delivery obligations, the product price is fixed and determinable, collection of the resulting receivable is probable and product returns are reasonably estimable. Revenues derived from post contract customer support for practice management software are deferred and recognized ratably over the period in which the support is to be provided, generally one year. Revenues from freight charged to customers are recognized when products are shipped. Provisions for discounts, rebates to customers, customer returns and other adjustments are provided for in the period the related sales are recorded based upon historical data.



### *Accounts Receivable and Credit Policies*

The carrying amount of accounts receivable is reduced by a valuation allowance that reflects our best estimate of the amounts that will not be collected. In addition to reviewing delinquent accounts receivable, we consider many factors in estimating our general allowance, including historical data, experience, customer types, credit worthiness, and economic trends. From time to time, we may adjust our assumptions for anticipated changes in any of those or other factors expected to affect collectability.

Allowances for accounts receivable, comprised primarily of the allowance for doubtful accounts and the allowance for sales returns, were \$36.2 million and \$31.9 million at December 28, 2002 and December 29, 2001, respectively.

### *Long-Lived Assets*

Long-lived assets, other than goodwill, are evaluated for impairment when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable through the estimated undiscounted future cash flows from the use of these assets. When any such impairment exists, the related assets are written down to fair value.

Other intangible assets are amortized over their estimated useful lives. We have reassessed the estimated useful lives of our intangible assets, which primarily consist of non-compete agreements, and no changes were deemed necessary.

### *Goodwill*

At December 28, 2002, we had recorded approximately \$310.3 million in goodwill and other intangible assets, net of accumulated amortization, primarily related to acquisitions made in 2002 and prior years. In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, "Business Combinations", ("FAS 141"), and No. 142, "Goodwill and Other Intangible Assets", ("FAS 142"), effective for fiscal years beginning after December 15, 2001. Under the new standards, goodwill and intangible assets deemed to have indefinite lives are no longer amortized but are subject to annual impairment tests in accordance with FAS 142. We estimated the fair value of our reporting units in accordance with the new standard and compared these valuations with the respective book values for each of the reporting units to determine whether any goodwill impairment existed. The goodwill is substantially related to our healthcare distribution segment. In determining the fair value, we consider past, present and future expectations of performance. As required by FAS 142, we will complete subsequent goodwill impairment tests at least annually. During the fourth quarter of 2002, we completed the annual test using a methodology similar to the transitional test and determined that there was no impairment of goodwill as of the first day of the fourth quarter. Changes in market conditions, among other factors, could have a material impact on these estimates.

### *Stock-Based Compensation*

We account for stock option awards to employees under the intrinsic value-based method of accounting prescribed by Accounting Principles Board Opinion No 25, "Accounting for Stock Issued to Employees". Under this method, no compensation expense is recorded so long as the quoted market price of the stock at the date of grant is equal to the exercise price. We make pro forma disclosures of net income and earnings per share as if the fair value-based method of accounting (the alternative method of accounting for stock-based compensation) had been applied as required by Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation", ("FAS 123"). Had we elected to use FAS 123 to account for stock-based compensation under the fair value method, we would have been required to record compensation expense, and as a result, diluted earnings per common share for the fiscal years ended December 2002, 2001, and 2000 would have been lower by \$0.21, \$0.16, and \$0.19, respectively.

## **Plan of Restructuring**

On August 1, 2000, we announced a comprehensive restructuring plan designed to improve customer service and increase profitability by maximizing the efficiency of our infrastructure. In addition to closing or downsizing certain facilities, this worldwide initiative included the elimination of approximately 300 positions, including open positions, or approximately 5% of the total workforce, throughout all levels within the organization. The restructuring plan was substantially completed at December 30, 2000.

For the years ended December 28, 2002 and December 30, 2000, we incurred one-time restructuring costs of approximately \$0.4 million (\$0.4 million after taxes) and \$14.4 million, (\$9.3 million after taxes), or approximately \$0.01 and \$0.22 per diluted share, respectively, consisting primarily of: employee severance costs, including severance pay and benefits of approximately \$0.1 million and \$7.2 million, respectively, facility closing costs, primarily lease termination and asset write-off costs of approximately \$0.3 million and \$4.4 million, respectively, and outside professional and consulting fees directly related to the restructuring plan of approximately \$0.0 million and \$2.8 million, respectively.

## Acquisition Strategy

Our results of operations in recent years have been significantly impacted by strategies and transactions we undertook to expand our business, both domestically and internationally, in part, to address significant changes in the healthcare industry, including potential healthcare reform, trends toward managed care, cuts in Medicare, consolidation of healthcare distribution companies and collective purchasing arrangements.

In connection with certain acquisitions completed during the year ended December 30, 2000, we incurred certain merger and integration costs of approximately \$0.6 million. Net of taxes, merger and integration costs were approximately \$0.01 per share, on a diluted basis. Merger and integration costs for the healthcare distribution and technology segments were \$0.0 million and \$0.6 million for 2000. Merger and integration costs consist primarily of investment banking, legal, accounting and advisory fees, severance, and impairment of goodwill arising from acquired businesses integrated into our medical and dental businesses, as well as certain other integration costs associated with these mergers. During 2002, we revised our original estimates of our merger and integration costs from prior years. The change in estimates was attributable to facts and circumstances that arose subsequent to the original charges. As a result, in the fourth quarter of 2002, we reversed \$1.2 million of our previously recorded expenses. Net of taxes, merger and integration credits were approximately \$0.03 per share, on a diluted basis.

## Results of Operations

The following table sets forth, for the periods indicated, Net Sales, Gross Profit and Adjusted Operating Profit, excluding merger and integration, and restructuring (credits) costs (in thousands), by business segment for the years ended 2002, 2001, and 2000. Percentages are calculated on related net sales.

	2002		2001 (1)		2000 (1)	
<b>Net Sales by Segment Data:</b>						
Healthcare distribution:						
Dental (2)	\$1,227,273	43.4%	\$1,121,394	43.8%	\$1,087,073	45.7%
Medical (3)	1,093,956	38.7%	982,569	38.4%	851,301	35.7%
International (4)	437,046	15.5%	398,071	15.6%	389,946	16.4%
Total healthcare distribution	2,758,275	97.6%	2,502,034	97.8%	2,328,320	97.8%
Technology (5)	66,726	2.4%	56,209	2.2%	53,401	2.2%
Total	\$2,825,001	100.0%	\$2,558,243	100.0%	\$2,381,721	100.0%
<b>Gross Profit by Segment Data:</b>						
Healthcare distribution	\$ 743,880	27.0%	\$ 659,092	26.3%	\$ 610,082	26.2%
Technology	51,024	76.5%	40,232	71.6%	37,819	70.8%
Total	\$ 794,904	28.1%	\$ 699,324	27.3%	\$ 647,901	27.2%
<b>Adjusted Operating Income (excluding merger and integration, and restructuring (credits) costs) by Segment Data:</b>						
Healthcare distribution (6)	\$ 170,253	6.2%	\$ 128,337	5.1%	\$ 106,944	4.6%
Technology (7)	26,016	39.0%	19,413	34.5%	20,669	38.7%
Total	\$ 196,269	6.9%	\$ 147,750	5.8%	\$ 127,613	5.4%

(1) Reclassified to conform to current period presentation.

(2) Dental consists of our dental business in the United States and Canada.

(3) Medical consists of our medical and veterinary businesses in the United States.

(4) International consists of our business (primarily dental) outside the United States and Canada, primarily in Europe.

(5) Technology consists of our practice management software business and certain other value-added products and services, which are distributed primarily to healthcare professionals in the United States and Canada.

(6) Excludes merger and integration, and restructuring (credits) costs of \$(0.7) million, \$0.0 million, and \$14.0 million in 2002, 2001 and 2000, respectively.

(7) Excludes merger and integration, and restructuring costs of \$1.0 million in 2000.

## *2002 Compared to 2001*

For the year ended December 28, 2002, our net sales increased \$266.8 million, or 10.4%, to \$2,825.0 million in 2002, from \$2,558.2 million in 2001. Of the \$266.8 million increase, approximately \$256.3 million, or 96.1%, represented a 10.2% increase in our healthcare distribution business. As part of this increase, approximately \$111.4 million represented an 11.3% increase in our medical business, \$105.9 million represented a 9.4% increase in our dental business, and \$39.0 million represented a 9.8% increase in our international business. The increase in medical net sales was primarily attributable to increased sales to core physicians' offices and alternate care markets. In the dental market, the increase in net sales was primarily due to increased dental equipment sales and services and increased penetration to existing customers primarily driven by our Privileges loyalty program. Net sales of dental consumable merchandise increased by 7.3%, while net sales of dental equipment increased by 18.5%. In the international market, the increase in net sales was primarily due to increased account penetration in France, the United Kingdom, and Australia and by favorable exchange rates to the U.S. dollar. Had net sales for the international market been translated at the same exchange rates in 2001, net sales would have increased by 4.7%. The remaining increase in 2002 net sales was due to the technology business, which increased \$10.5 million, or 18.7%, to \$66.7 million for 2002, from \$56.2 million for 2001. The increase in technology and value-added product net sales was primarily due to increased sales of software products and related services. As part of a new marketing initiative, MarketOne, certain technology and equipment products were sold directly to end-user customers beginning with the third quarter of 2002, rather than through resellers, which resulted in a higher growth rate for the technology business. Without this change, the technology business net sales would have increased 13.9%.

Gross profit increased by \$95.6 million, or 13.7%, to \$794.9 million in 2002, from \$699.3 million in 2001. Gross profit margin increased by 0.8% to 28.1%, from 27.3% in the prior year. Healthcare distribution gross profit increased by \$84.8 million, or 12.9%, to \$743.9 million in 2002, from \$659.1 million in 2001. Healthcare distribution gross profit margin increased by 0.7%, to 27.0%, from 26.3% in the prior year primarily due to changes in sales mix. Technology gross profit increased by \$10.8 million, or 26.8%, to \$51.0 million in 2002, from \$40.2 million in 2001. Technology gross profit margin increased by 4.9%, of which 1.0% was attributable to the MarketOne initiative referred to above, to 76.5%, from 71.6% in the prior year primarily due to changes in sales mix.

Selling, general and administrative expenses increased by \$47.0 million, or 8.5%, to \$598.6 million in 2002, from \$551.6 million in 2001. Selling and shipping expenses increased by \$36.0 million, or 10.8%, to \$370.1 million in 2002, from \$334.1 million in 2001. As a percentage of net sales, selling and shipping expenses remained constant at 13.1% in 2002 compared to 2001. General and administrative expenses increased \$11.0 million, or 5.1%, to \$228.5 million in 2002, from \$217.5 million in 2001. As a percentage of net sales, general and administrative expenses decreased 0.4% to 8.1% in 2002, from 8.5% in 2001. The decrease in general and administrative expenses was primarily due to the elimination of goodwill amortization expense in accordance with FAS 142.

Other income (expense) - net decreased by \$0.8 million, to \$(6.6) million in 2002, from \$(7.4) million for 2001, due primarily to the favorable settlement of a real estate transaction.

Equity in earnings of affiliates increased \$0.3 million to \$0.7 million in 2002, from \$0.4 million in 2001.

For 2002, our effective tax rate was 37.2%. For 2001, our effective tax rate was 37.0%. The difference between our effective tax rates and the Federal statutory rates relates primarily to state income taxes.

## *2001 Compared to 2000*

We report financial results on a 52-53 week basis and, as such, the 2000 fiscal year included an additional week. For the year ended December 29, 2001, net sales increased \$176.5 million, or 7.4%, to \$2,558.2 million in 2001, from \$2,381.7 million in 2000. On a comparable basis (excluding the additional week in 2000), net sales growth was approximately 8.7%. Of the \$176.5 million increase, approximately \$173.7 million, or 98.4%, represented a 7.5% (8.7% on a comparable basis) increase in our healthcare distribution business. As part of this increase, approximately \$131.3 million represented a 15.4% (17.0% on a comparable basis) increase in our medical business, \$34.3 million represented a 3.2% (4.1% on a comparable basis) increase in our dental business, and \$8.1 million represented a 2.1% (3.5% on a comparable basis) increase in our international business. The increase in medical net sales was primarily attributable to increased sales to core physicians' offices and alternate care markets. In the dental market, the increase in net sales was primarily due to increased account penetration. In the international market, the increase in net sales was primarily due to increased account penetration in Germany, France, and the United Kingdom, somewhat offset by unfavorable exchange rates to the U.S. dollar. Had net sales for the international market been translated at the same exchange rates in 2000, net sales would have increased by 5.8%. The remaining increase in 2001 net sales was due to the technology business, which increased \$2.8 million, or 5.3% (6.1% on a comparable basis), to \$56.2 million for 2001, from \$53.4 million for 2000. The increase in technology and value-added product net sales was primarily due to increased sales of technology products and related services.

Gross profit increased by \$51.4 million, or 7.9%, to \$699.3 million in 2001, from \$647.9 million in 2000. Gross profit margin increased by 0.1% to 27.3%, from 27.2% in the prior year. Healthcare distribution gross profit increased by \$49.0 million, or 8.0%, to \$659.1 million in 2001, from \$610.1 million in 2000. Healthcare distribution gross profit margin increased by 0.1%, to 26.3%, from 26.2% in the prior year primarily due to changes in sales mix. Technology gross profit increased by \$2.4 million, or 6.4%, to \$40.2 million in 2001, from \$37.8 million in 2000. Technology gross profit margin increased by 0.8%, to 71.6%, from 70.8% in the prior year primarily due to changes in sales mix.



Selling, general and administrative expenses increased by \$31.3 million, or 6.0%, to \$551.6 million in 2001, from \$520.3 million in 2000. Selling and shipping expenses increased by \$23.5 million, or 7.6%, to \$334.1 million in 2001, from \$310.6 million in 2000. As a percentage of net sales, selling and shipping expenses increased 0.1% to 13.1% in 2001, from 13.0% in 2000. General and administrative expenses increased \$7.8 million, or 3.7%, to \$217.5 million in 2001, from \$209.7 million in 2000. As a percentage of net sales, general and administrative expenses decreased 0.3% to 8.5% in 2001, from 8.8% in 2000. The decrease in general and administrative expenses was primarily due to reductions in expenses associated with our restructuring program.

Other income (expense) - net decreased by \$(8.7) million, to \$(7.4) million in 2001, from \$(16.1) million for 2000, due primarily to higher interest income on long-term loans receivable and short-term investments, higher finance charge income on trade accounts receivable, lower interest expense due to reductions in long-term debt and bank credit line balances and lower interest rates, and in 2000, the non-recurring loss of \$1.6 million after tax on the sale of our software development unit in the United Kingdom.

Equity in earnings (losses) of affiliates increased \$2.3 million to \$0.4 million in 2001, from \$(1.9) million in 2000. The increase is primarily due to a non-recurring net loss of \$1.9 million during the fourth quarter of 2000 from the sale of our interest in HS Pharmaceutical, Inc.

For 2001, our effective tax rate was 37.0%. The difference between our effective tax rate and the Federal statutory rate relates primarily to state income taxes.

For 2000, our effective tax rate was 37.4%. Excluding merger and integration costs, the majority of which are not deductible for income tax purposes, our effective tax rate would have been 37.3%. The difference between our effective tax rate and the Federal statutory rate relates primarily to state income taxes.

### *Seasonality*

Our business is subject to seasonal and other quarterly influences. Net sales and operating profits are generally higher in the fourth quarter due to timing of sales of software and equipment, year end promotions and purchasing patterns of office-based healthcare practitioners and are generally lower in the first quarter due primarily to the increased purchases in the prior quarter. Quarterly results also may be materially affected by a variety of other factors, including the timing of acquisitions and related costs, timing of purchases and/or sales, special promotional campaigns, seasonal products, fluctuations in exchange rates associated with international operations and adverse weather conditions.

### *E-Commerce*

Traditional healthcare supply and distribution relationships are being impacted by electronic on-line commerce solutions. Our distribution business is characterized by rapid technological developments and is highly competitive. The rapid evolution of on-line commerce will require us to provide continuous improvement in performance, features and reliability of Internet content and technology, particularly in response to competitive offerings. Through our proprietary technologically-based suite of products, we offer customers a variety of competitive alternatives. We believe that our tradition of reliable service coupled with our name recognition and large customer base built on solid customer relationships makes us well situated to participate in this growing aspect of the distribution business. We are exploring ways and means of improving and expanding our Internet presence and will continue to do so.

### *Inflation*

Management does not believe inflation had a material effect on the financial statements for the periods presented.

### *Effect of Recently Issued Accounting Standards*

In June 2002, the Financial Accounting Standards Board ("FASB") issued Statements of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", ("FAS 146"). This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force, ("EITF"), Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)", ("EITF 94-3"). The principal difference between this Statement and EITF 94-3 relates to the Statement's requirements for recognition of a liability for a cost associated with an exit or disposal activity. This Statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF 94-3, a liability was recognized at the date of an entity's commitment to an exit plan. This Statement is effective for exit or disposal activities that are initiated after December 31, 2002. We do not expect the adoption of FAS 146 to have a material impact on our financial position or results of operations.

In September 2002, the EITF reached a consensus on Issue 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables", ("EITF 00-21"). EITF 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. Those arrangements could involve the delivery or performance of multiple products, services, or rights to use assets, and the performance could occur at different points in time or over different periods of time. The Issue addresses when and, if so, how a company should divide an arrangement involving multiple deliverables into separate units of accounting. EITF 00-21 is effective for revenue arrangements entered into in fiscal years beginning after December 15, 2002. We do not expect the adoption of EITF 00-21 to have a material impact on our financial position or results of operations.

On December 31, 2002, the FASB amended the transition and disclosure requirements of FASB Statement No. 123, "Accounting for Stock-Based Compensation", ("FAS 123"), through the issuance of FASB Statement No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure", ("FAS 148"). FAS 148 amends the existing disclosures that a company should make in its annual financial statements and requires, for the first time, disclosures in interim financial reports. Those disclosures are required regardless of the method being used to account for stock-based employee compensation. The amended and new disclosure requirements are effective for our fiscal year ending December 27, 2003. The adoption of the disclosure requirements of FAS 148 will not have a material effect on our financial statements. As permitted under FAS 123, we apply Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", ("APB 25") and related interpretations in accounting for its employee stock options. Under APB 25, because the exercise price of our employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others", ("FIN 45"). FIN 45 addresses the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. The disclosure requirements in this Interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002. We do not expect this Interpretation to have an effect on the consolidated financial statements.

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities", ("FIN 46"). FIN 46 clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is applicable immediately for variable interest entities created after January 31, 2003. For variable interest entities created prior to January 31, 2003, the provisions of FIN 46 are applicable no later than July 1, 2003. We do not expect this Interpretation to have an effect on our consolidated financial statements.

## **Risk Management**

We have operations in the United States, Canada, the United Kingdom, the Netherlands, Belgium, Germany, France, Austria, Spain, Ireland, Portugal, Australia and New Zealand. We endeavor to protect substantially all of our operations' financial results by using foreign currency forward contracts to hedge intercompany debt and the foreign currency payments to foreign vendors. The total U.S. dollar equivalent of all foreign currency forward contracts hedging intercompany debt and the purchase of merchandise from foreign vendors was \$73.6 million and \$4.4 million, respectively, as of the end of fiscal 2002. As of December 28, 2002, the fair value of these contracts, which expire through January 2004, is determined by quoted market prices and was not material. For the year ended December 28, 2002, we recognized an immaterial loss relating to our foreign currency forward contracts.

We consider our investment in foreign operations to be both long-term and strategic. As a result, we do not hedge the long-term translation exposure to our balance sheet. We have experienced positive and negative translation adjustments of approximately \$19.0 million and \$(5.7) million in 2002 and 2001, respectively, which were reflected in the balance sheet as a component of stockholders' equity. The cumulative translation adjustment at the end of 2002 showed a net negative translation adjustment of \$(4.8) million.

## **Liquidity and Capital Resources**

Our principal capital requirements have been to fund (a) capital expenditures, (b) acquisitions, and (c) working capital needs resulting from increased sales and special inventory forward buy-in opportunities. Since sales tend to be strongest during the fourth quarter and special inventory forward buy-in opportunities are most prevalent just before the end of the year, our working capital requirements have been generally higher from the end of the third quarter to the end of the first quarter of the following year. We have financed our business primarily through our operations, our revolving credit facilities, private placement loans and stock issuances.

Net cash provided by operating activities for the year ended December 28, 2002 of \$134.7 million resulted primarily from net income of \$118.0 million and non-cash charges of approximately \$36.2 million, offset by a net increase in operating items of working capital of approximately \$19.5 million. The increase in working capital items was primarily due to an increase in inventories of \$23.1 million, a \$18.4 million increase in other current assets, and a \$2.0 million increase in accounts receivable, offset by a \$24.0 million increase in accounts payable and accruals. Our accounts receivable days sales outstanding ratio improved to 48.2 days for the period ending December 28, 2002, from 53.5 days for the period ending December 29, 2001, primarily due to greater focus in this area. Our inventory turns were 6.6 inventory turns for the period ending December 28, 2002 compared to 6.9 inventory turns for the period ending December 29, 2001, primarily due to an increase in forward buy-ins and inventory stocking for warehouses opened in 2002. We anticipate future increases in working capital requirements as a result of our continued sales growth, extended payment terms and special inventory forward buy-in opportunities.

Net cash used in investing activities for the year ended December 28, 2002 of \$142.8 million resulted primarily from cash used for the purchases of United States government and government agency bonds, municipal bonds, and corporate bonds rated AAA by Moody's (or an equivalent rating) and commercial paper rated P-1 by Moody's (or an equivalent rating) with maturities of more than three months, for which fair values are determined by quoted market prices, of \$55.2 million, capital expenditures of \$47.5 million, of which approximately \$11.6 million was for the purchase of a building used for our corporate headquarters, and business acquisitions of \$36.2 million, of which \$27.4 million represented contingent earnout payments associated with acquisitions made in prior years. During the past three years, we have invested \$123.4 million in the development of new computer systems, and for new and existing operating facilities. In the coming year, we expect to invest in excess of \$35.0 million in capital projects to modernize and expand our facilities and infrastructure computer systems, and integrate operations.

Net cash provided by financing activities for the year ended December 28, 2002 of \$18.7 million resulted primarily from proceeds from the issuance of stock upon exercise of stock options of \$34.1 million, offset primarily by net payments on long-term debt of \$14.9 million.

Certain holders of minority interests in entities we have acquired have the right at certain times to require us to acquire their interest at a price that approximates fair value pursuant to a formula price based on earnings of the entity.

Our cash and cash equivalents as of December 28, 2002 of \$200.7 million consist of bank balances and investments in money market funds. These investments have staggered maturity dates, none of which exceed three months, and have a high degree of liquidity since the securities are actively traded in public markets.

On May 2, 2002, we renewed and increased our revolving credit facility to \$200.0 million from \$150.0 million. The new facility is a four year committed line scheduled to terminate on May 2, 2006. There were no borrowings under the credit facility at December 28, 2002. We also have one uncommitted bank line of \$15.0 million, of which no amounts have been borrowed against at December 28, 2002.

On June 30, 1999 and September 25, 1998, we completed private placement transactions under which we issued \$130.0 million and \$100.0 million, respectively, in Senior Notes. The \$130.0 million notes come due on June 30, 2009 and bear interest at a rate of 6.94% per annum. Principal payments totaling \$20.0 million are due annually starting September 25, 2006 on the \$100.0 million notes and bear interest at a rate of 6.66% per annum. Interest on both notes is payable semi-annually. Certain of our subsidiaries have credit facilities that totaled \$28.2 million at December 28, 2002, under which \$4.8 million had been borrowed.

The following table shows our contractual obligations related to fixed and variable rate long-term debt, as well as lease obligations (See Notes 10 and 15 to the Consolidated Financial Statements):

	Payments due by period (in thousands)				
	Total	< 1 year	1 - 3 years	4 - 5 years	> 5 years
Contractual obligations:					
Long-term debt	\$243,176	\$ 2,088	\$ 1,810	\$40,981	\$198,297
Capital lease obligations	2,047	574	720	292	461
Operating lease obligations	112,037	23,065	36,232	23,069	29,671
<b>Total</b>	<b>\$357,260</b>	<b>\$25,727</b>	<b>\$38,762</b>	<b>\$64,342</b>	<b>\$228,429</b>

On March 12, 2003, we announced that our Board of Directors had authorized the repurchase of up to two million shares of our Common Stock, which represented approximately 4.5% of shares outstanding on the announcement date. We expect purchases to be made from time to time in the open market or through negotiated transactions.

We believe that our cash and cash equivalents of \$200.7 million and our investment in short-term marketable securities of \$31.2 million as of December 28, 2002, our ability to access public and private debt and equity markets, and the availability of funds under our existing credit agreements will provide us with sufficient liquidity to meet our currently foreseeable short-term and long-term capital needs.



## Market Risks

We are exposed to market risks, which include changes in U.S. and international interest rates, as well as changes in foreign currency exchange rates as measured against the U.S. dollar and each other. We attempt to reduce these risks by utilizing financial instruments that are consistent with our internal policies.

### *Forward Foreign Currency Contracts*

The value of certain foreign currencies as compared to the U.S. dollar may affect our financial results. Changes in exchange rates may positively or negatively affect our revenues (as expressed in U.S. dollars), gross margins, operating expenses, and retained earnings. Where we deem it prudent, we engage in hedging programs aimed at limiting, in part, the impact of currency fluctuations. Using primarily forward exchange contracts, we hedge those transactions that, when remeasured according to accounting principles generally accepted in the United States, may impact our statement of income. From time to time, we purchase short-term forward exchange contracts to protect against currency exchange risks associated with of intercompany loans, of a long-term investment nature, due from our international subsidiaries and the payment of merchandise purchases to foreign vendors. As of December 28, 2002, we had outstanding foreign currency forward contracts aggregating \$78.0 million, of which \$73.6 million related to intercompany debt and \$4.4 million related to the purchase of merchandise from foreign vendors. The contracts hedge against currency fluctuations of British Pounds (\$38.1 million), Euros (\$34.9 million), Australian Dollars (\$3.9 million), Swiss Francs (\$0.8 million), Japanese Yen (\$0.2 million), and New Zealand Dollars (\$0.1 million). As of December 28, 2002, the fair value of these contracts, which are determined by quoted market prices and expire through January 2004, was not material. For the year ended December 28, 2002, we recognized an immaterial loss relating to our foreign currency forward contracts.

These hedging activities provide only limited protection against currency exchange risks. Factors that could impact the effectiveness of our programs include volatility of the currency markets and availability of hedging instruments. All currency contracts that we enter into are components of hedging programs and are entered into for the sole purpose of hedging an existing or anticipated currency exposure, not for speculation. Although we maintain these programs to reduce the impact of changes in currency exchange rates, when the U.S. dollar sustains a strengthening position against currencies in which we sell products and services, or a weakening exchange rate against currencies in which we incur costs, our revenues or costs are adversely affected.

### *Interest Rates*

We are exposed to risk from changes in interest rates from borrowings under certain variable bank credit lines and loan agreements. We have fixed rate debt of \$130.0 million at 6.94% and \$100.0 million at 6.66%. If the remaining outstanding debt at December 28, 2002 of \$20.0 million was the average balance for the following twelve month period and we experienced a 1% increase in average interest rates, the interest expense for that period would have increased by \$0.2 million. Based upon current economic conditions, we do not believe interest rates will increase substantially in the near future. As a result, we do not believe that it is currently necessary to hedge our exposure against potential future interest rate increases.

## *Risk Factors*

Stockholders and investors should carefully consider the risks described below and other information in this annual report. Our business, financial condition and operating results, and the trading price of our common stock could be adversely affected if any of these risks materialize.

- The healthcare products distribution industry is highly competitive, and we compete with numerous companies, including major manufacturers and distributors that have greater financial and other resources than us. Competitors could obtain exclusive rights to market particular products or manufacturers could increase their efforts to sell directly to end-users, thereby bypassing distributors like us. Consolidation among healthcare products distributors could result in existing competitors increasing their market position. In addition, unavailability of products, whether due to our inability to gain access to products or interruptions in supply of products from manufacturers, could adversely affect our operating results.
- In recent years, the healthcare industry has undergone significant change driven by various efforts to reduce costs, including the reduction of spending budgets by government and private insurance programs, such as Medicare, Medicaid and corporate health insurance plans; trends toward managed care; consolidation of healthcare distribution companies; electronic commerce; and collective purchasing arrangements among office-based healthcare practitioners. If we are unable to react effectively to these and other changes in the healthcare industry, our operating results could be adversely affected.
- Our technology segment, which primarily sells practice management software and other value-added products, depends upon continued product development, technical support and marketing. Failures in these and related areas could adversely affect our results of operations.
- Our business is subject to requirements under various local, state, Federal and foreign governmental laws and regulations applicable to the manufacture and distribution of pharmaceuticals and medical devices, including the Federal Food, Drug, and Cosmetic Act, the Prescription Drug Marketing Act of 1987 and the Controlled Substances Act. There is no assurance that current or future government regulations will not adversely affect our business.
- Our business involves a risk of product liability and other claims in the ordinary course of business, and from time to time we are named as a defendant in cases as a result of our distribution of pharmaceutical and other healthcare products. We have insurance policies, including product liability insurance, and in many cases we have indemnification rights from manufacturers with respect to the products we distribute. There is no assurance that insurance coverage or manufacturers' indemnity will be available in all of the pending or any future cases brought against us, or that an unfavorable result in any such case will not adversely affect our financial condition or results of operations.
- Our business is dependent upon our ability to hire and retain qualified sales representatives, service specialists and other sales agents. Due to the relationships developed between our field sales representatives and their customers, upon the departure of a sales representative we face the risk of losing the representative's customers, especially if the representative becomes an employee of one of our competitors.
- Our business has been subject to seasonal and other quarterly fluctuations. Net sales and operating profits generally have been higher in the fourth quarter due to purchasing patterns of office-based healthcare practitioners and year end promotions. Net sales and operating profits generally have been lower in the first quarter, primarily due to increased purchases in the prior quarter.
- Our international operations are subject to inherent risks, which could adversely affect our operating results. These risks include difficulties in opening and managing foreign offices and distribution centers; difficulties in establishing channels of distribution; fluctuations in the value of foreign currencies; longer payment cycles of foreign customers and difficulty of collecting receivables in foreign jurisdictions; import/export duties and quotas; and unexpected regulatory, economic and political changes in foreign markets.
- Our expansion through acquisitions and/or joint ventures could result in a loss of customers, diversion of management attention and increased demands on our operations, information systems and financial resources.
- We rely on third parties to ship products to our customers. Increases in shipping rates or interruptions of service could adversely affect our operating results.
- Changes in e-commerce could affect our business relationships and could require significant resources. The evolution of on-line commerce, including business-to-business exchanges, will require us to continuously improve the performance, security, features and reliability of Internet content and technology.

## REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

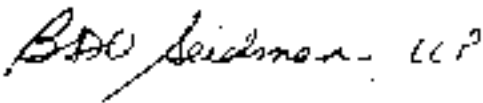
Board of Directors and Stockholders  
Henry Schein, Inc.  
Melville, New York

We have audited the accompanying consolidated balance sheets of Henry Schein, Inc. and Subsidiaries as of December 28, 2002 and December 29, 2001, and the related consolidated statements of income and comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended December 28, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Henry Schein, Inc. and Subsidiaries at December 28, 2002 and December 29, 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 28, 2002 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 5, the Company changed its policy of accounting for goodwill in 2002 as required by Financial Accounting Standards Board Statement No. 142, "Goodwill and Other Intangible Assets".



BDO SEIDMAN, LLP



New York, New York  
February 27, 2003

## HENRY SCHEIN, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	December 28, 2002	December 29, 2001
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 200,651	\$ 193,367
Marketable securities	31,209	—
Accounts receivable, less reserves of \$36,200 and \$31,929, respectively	368,263	363,700
Inventories	323,080	291,231
Deferred income taxes	29,919	25,751
Prepaid expenses and other	74,407	52,922
Total current assets	1,027,529	926,971
Property and equipment, net	142,532	117,980
Goodwill	302,687	279,981
Other intangibles, net of accumulated amortization of \$4,151 and \$3,348, respectively	7,661	8,023
Investments and other	77,643	52,473
	\$1,558,052	\$1,385,428
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 243,166	\$ 263,190
Bank credit lines	4,790	4,025
Accruals:		
Salaries and related expenses	53,954	41,602
Merger, integration, and restructuring costs	3,044	5,867
Acquisition earnout payments	1,460	26,800
Taxes and other expenses	114,254	80,355
Current maturities of long-term debt	2,662	15,223
Total current liabilities	423,330	437,062
Long-term debt	242,561	242,169
Other liabilities	24,196	18,954
Total liabilities	690,087	698,185
Minority interest	6,748	6,786
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.01 par value, authorized 1,000,000, issued and outstanding 0 and 0, respectively	—	—
Common stock, \$.01 par value, authorized 120,000,000, issued: 44,041,591 and 42,745,204, respectively	440	427
Additional paid-in capital	436,554	393,047
Retained earnings	430,389	312,402
Treasury stock, at cost, 62,479 shares	(1,156)	(1,156)
Accumulated comprehensive loss	(4,794)	(23,922)
Deferred compensation	(216)	(341)
Total stockholders' equity	861,217	680,457
	\$1,558,052	\$1,385,428

See accompanying notes to consolidated financial statements.



**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**

(In thousands, except share data)

	Years ended		
	December 28, 2002	December 29, 2001	December 30, 2000
Net sales	\$2,825,001	\$2,558,243	\$2,381,721
Cost of sales	2,030,097	1,858,919	1,733,820
Gross profit	794,904	699,324	647,901
Operating expenses:			
Selling, general and administrative	598,635	551,574	520,288
Merger, integration and restructuring costs (credits)	(734)	—	15,024
Operating income	197,003	147,750	112,589
Other income (expense):			
Interest income	10,446	10,078	6,279
Interest expense	(17,960)	(17,324)	(20,409)
Other - net	940	(153)	(1,925)
Income before taxes on income, minority interest and equity in earnings (losses) of affiliates	190,429	140,351	96,534
Taxes on income	70,510	51,930	36,150
Minority interest in net income of subsidiaries	2,591	1,462	1,757
Equity in earnings (losses) of affiliates	659	414	(1,878)
Net income	\$ 117,987	\$ 87,373	\$ 56,749
Comprehensive income:			
Net income	\$ 117,987	\$ 87,373	\$ 56,749
Foreign currency translation adjustment	18,989	(5,743)	(7,820)
Other	139	—	—
Comprehensive income	\$ 137,115	\$ 81,630	\$ 48,929
Net income per common share:			
Basic	\$ 2.71	\$ 2.06	\$ 1.38
Diluted	\$ 2.63	\$ 2.01	\$ 1.35
Weighted average common shares outstanding:			
Basic	43,489	42,366	41,244
Diluted	44,872	43,545	42,007

See accompanying notes to consolidated financial statements.

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

(In thousands, except share data)

	Common Stock \$.01 Par Value		Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Comprehensive Loss	Deferred Compen- sation	Total Stock- holders' Equity
	Shares	Amount						
Balance, December 25, 1999	40,768,306	\$407	\$361,757	\$ 167,809	\$(1,156)	\$(10,359)	\$(591)	\$517,867
Retained earnings of one company acquired under the pooling of interests method, not deemed material	—	—	—	471	—	—	—	471
Net income	—	—	—	56,749	—	—	—	56,749
Shares issued for acquisitions	465,480	5	423	—	—	—	—	428
Shares issued to ESOP trust	121,253	1	2,192	—	—	—	—	2,193
Amortization of restricted stock	—	—	—	—	—	—	125	125
Foreign currency translation loss	—	—	—	—	—	(7,820)	—	(7,820)
Shares issued upon exercise of stock options by employees, including tax benefit of \$2,758	591,245	6	9,041	—	—	—	—	9,047
Balance, December 30, 2000	41,946,284	419	373,413	225,029	(1,156)	(18,179)	(466)	579,060
Net income	—	—	—	87,373	—	—	—	87,373
Shares issued to ESOP trust	61,997	1	2,224	—	—	—	—	2,225
Amortization of restricted stock	—	—	—	—	—	—	125	125
Foreign currency translation loss	—	—	—	—	—	(5,743)	—	(5,743)
Shares issued upon exercise of stock options by employees, including tax benefit of \$3,262	736,923	7	17,410	—	—	—	—	17,417
Balance, December 29, 2001	42,745,204	427	393,047	312,402	(1,156)	(23,922)	(341)	680,457
Net income	—	—	—	117,987	—	—	—	117,987
Shares issued to ESOP trust	24,859	—	1,340	—	—	—	—	1,340
Amortization of restricted stock	—	—	—	—	—	—	125	125
Accumulated comprehensive income:								
Foreign currency translation gain	—	—	—	—	—	18,989	—	18,989
Net unrealized investment gain	—	—	—	—	—	139	—	139
Shares issued upon exercise of stock options by employees, including tax benefit of \$8,058	1,271,528	13	42,167	—	—	—	—	42,180
Balance, December 28, 2002	44,041,591	\$440	\$436,554	\$ 430,389	\$(1,156)	\$( 4,794)	\$(216)	\$861,217

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands, except share data)

	Years ended		
	December 28, 2002	December 29, 2001	December 30, 2000
Cash flows from operating activities:			
Net income	\$117,987	\$ 87,373	\$56,749
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	28,272	35,642	33,762
Provision for losses and allowances on trade and other receivables	4,271	7,988	7,165
Stock issued to ESOP trust	1,340	2,225	2,193
Provision (benefit) for deferred income taxes	226	292	(1,335)
Undistributed (earnings) losses of affiliates	(659)	(414)	1,878
Minority interest in net income of subsidiaries	2,591	1,462	1,757
Write-off of equipment, intangibles and other	145	7,067	701
Changes in operating assets and liabilities (net of purchase acquisitions):			
(Increase) decrease in accounts receivable	(2,023)	3,194	5,186
(Increase) decrease in inventories	(23,075)	(17,850)	4,630
(Increase) decrease in other current assets	(18,445)	8,808	(4,628)
Increase in accounts payable and accruals	24,039	55,124	44,936
Net cash provided by operating activities	134,669	190,911	152,994
Cash flows from investing activities:			
Capital expenditures	(47,543)	(46,127)	(29,743)
Business acquisitions, net of cash acquired of \$0, \$228, and \$0	(36,224)	(8,588)	(6,838)
Purchase of marketable securities with maturities of more than three months	(55,211)	—	—
Other	(3,780)	(355)	(9,645)
Net cash used in investing activities	(142,758)	(55,070)	(46,226)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt	—	10,166	—
Principal payments on long-term debt	(14,941)	(13,042)	(5,147)
Proceeds from issuance of stock upon exercise of stock options by employees	34,122	14,155	6,283
Proceeds from borrowing from banks	3,061	1,988	9,714
Payments on borrowings from banks	(2,667)	(12,740)	(89,047)
Other	(892)	(156)	346
Net cash provided by (used in) financing activities	18,683	371	(77,851)
Net increase in cash and cash equivalents	10,594	136,212	28,917
Effect of exchange rate changes on cash and cash equivalents	(3,310)	(1,207)	3,426
Cash and cash equivalents, beginning of year	193,367	58,362	26,019
Cash and cash equivalents, end of year	\$200,651	\$193,367	\$58,362

See accompanying notes to consolidated financial statements.

## HENRY SCHEIN, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share data)

### Note 1—Significant Accounting Policies

#### *Principles of Consolidation*

The consolidated financial statements include the accounts of Henry Schein, Inc. and all of its wholly- owned and majority-owned subsidiaries (collectively the "Company"). Investments in unconsolidated affiliates, which are greater than or equal to 20% and less than or equal to 50% owned, are accounted for under the equity method. All intercompany accounts and transactions are eliminated in consolidation.

#### *Use of Estimates*

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

#### *Fiscal Year*

The Company reports its operations and cash flows on a 52-53 week basis ending on the last Saturday of December. The fiscal years ended December 28, 2002 and December 29, 2001 consisted of 52 weeks. The fiscal year ended December 30, 2000 consisted of 53 weeks.

#### *Revenue Recognition*

Sales are recorded when products are shipped or services are rendered to customers, as the Company generally has no significant post delivery obligations, the product price is fixed and determinable, collection of the resulting receivable is probable and product returns are reasonably estimable. Revenues derived from post contract customer support for practice management software are deferred and recognized ratably over the period in which the support is to be provided, generally one year. Revenues from freight charged to customers are recognized when products are shipped. Provisions for discounts, rebates to customers, customer returns and other adjustments are provided for in the period the related sales are recorded based on historical data.

#### *Marketable Securities*

Marketable securities held by the Company are classified as available-for-sale and are recorded at fair value. The fair value of substantially all securities is determined by quoted market prices. Unrealized gains and losses, net of related taxes, are included as a separate component of stockholders' equity.

#### *Accounts Receivable and Credit Policies*

The carrying amount of accounts receivable is reduced by a valuation allowance that reflects management's best estimate of the amounts that will not be collected. In addition to reviewing delinquent accounts receivable, management considers many factors in estimating its general allowance, including historical data, experience, customer types, credit worthiness, and economic trends. From time to time, management may adjust its assumptions for anticipated changes in any of those or other factors expected to affect collectability.



**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 1—Significant Accounting Policies (Continued)**

Allowances for accounts receivable, comprised primarily of the allowance for doubtful accounts and the allowance for sales returns, were \$36,200 and \$31,929 at December 28, 2002 and December 29, 2001, respectively.

*Direct Shipping and Handling Costs*

Freight and other direct shipping costs are included in "Cost of sales". Direct handling costs, which represent primarily direct compensation costs of employees who pick, pack and otherwise prepare, if necessary, merchandise for shipment to the Company's customers are reflected in "Selling, general and administrative" expenses. These costs were approximately \$23,200, \$21,200, and \$17,700 for the years ended 2002, 2001, and 2000, respectively.

*Advertising*

The Company generally expenses advertising and promotional costs as incurred. Total advertising and promotional expenses were approximately \$13,900, \$14,300, and \$13,900 for fiscal years ended 2002, 2001, and 2000, respectively.

*Inventories*

Inventories consist substantially of finished goods and are valued at the lower of cost or market. Cost is determined primarily by the first-in, first-out ("FIFO") method.

*Property and Equipment and Depreciation and Amortization*

Property and equipment are stated at cost. Depreciation is computed primarily under the straight-line method over the following estimated useful lives:

	Years
Buildings and improvements	40
Machinery and warehouse equipment	5-10
Furniture, fixtures and other	3-10
Computer equipment and software	3-8

Amortization of leasehold improvements is computed using the straight-line method over the lesser of the useful life of the assets or the lease term.

Capitalized software costs consist of costs to purchase and develop software. Costs incurred during the application development stage for software bought and further customized by outside vendors for the Company's use and software developed by a vendor for the Company's proprietary use have been capitalized. Costs incurred for the Company's own personnel who are directly associated with software development are also capitalized.

*Taxes on Income*

The Company accounts for income taxes under an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. In estimating future tax consequences, the Company generally considers all expected future events other than enactments of changes in tax laws or rates. The effect on deferred tax assets and liabilities of a change in tax rates will be recognized as income or expense in the period that includes the enactment date. The Company files a consolidated United States Federal income tax return with its 80% or greater owned United States subsidiaries.

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 1—Significant Accounting Policies (Continued)**

*Statement of Cash Flows*

For purposes of the statement of cash flows, the Company considers all highly liquid debt instruments and other short-term investments with an initial maturity of three months or less to be cash equivalents.

*Foreign Currency Translation and Transactions*

The financial position and results of operations of the Company's foreign subsidiaries are determined using local currency as the functional currency. Assets and liabilities of these subsidiaries are translated at the exchange rate in effect at each year end. Income statement accounts are translated at the average rate of exchange prevailing during the year. Translation adjustments arising from the use of differing exchange rates from period to period are included in the accumulated comprehensive loss account in stockholders' equity. Gains and losses resulting from foreign currency transactions are included in earnings.

*Derivative Financial Instruments*

On December 31, 2000, the Company adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities", ("FAS 133"), as amended and interpreted, which requires that all derivative instruments be recorded on the balance sheet at their fair value. The impact of adopting FAS 133 on the Company's Statement of Income and Balance Sheet was not material.

The Company uses derivatives to reduce its exposure to fluctuations in foreign currencies. Derivative products, specifically foreign currency forward contracts, are used to hedge the foreign currency exposures underlying certain intercompany investments, debt and interest, and certain forecasted transactions with foreign vendors. The Company does not enter such contracts for speculative purposes.

Most derivative instruments are designated as hedging instruments based on exposure being hedged. Increases or decreases in the value of hedges (primarily related to intercompany debt of a long-term investment nature) are included in accumulated comprehensive income or loss. Derivatives that are not hedges are adjusted to fair value through earnings.

The fair value of derivative contracts at December 28, 2002 and December 29, 2001 was immaterial. The amount of net gains and losses during 2002 and 2001 was immaterial.

*Acquisitions*

The net assets of businesses purchased are recorded at their fair value at the acquisition date and the consolidated financial statements include their operations from that date. Any excess of acquisition costs over the fair value of identifiable net assets acquired is included in goodwill. Certain acquisitions provide for contingent consideration, primarily cash, to be paid in the event certain financial performance targets are satisfied over future periods. The Company's policy is to record a liability and adjust goodwill for such amounts when the targets are met.

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 1—Significant Accounting Policies (Continued)**

*Goodwill*

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, "Business Combinations", ("FAS 141"), and No. 142, "Goodwill and Other Intangible Assets", ("FAS 142"), effective for fiscal years beginning after December 15, 2001. Under the new standards, goodwill and intangible assets deemed to have indefinite lives are no longer amortized but are subject to annual impairment tests in accordance with FAS 142. The Company estimates fair value of its reporting units in accordance with the new standard and compares these valuations with the respective book values for each of the reporting units to determine whether any goodwill impairment exists. The goodwill is substantially related to the Company's healthcare distribution segment. In determining fair value, the Company considers past, present and future expectations of performance. As required by FAS 142, the Company will complete subsequent goodwill impairment tests at least annually. During the fourth quarter of 2002, the Company completed the annual test using a methodology similar to the transitional test and determined that there was no impairment of goodwill as of the first day of the fourth quarter.

*Long-Lived Assets*

Long-lived assets, other than goodwill, are evaluated for impairment when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable through the estimated undiscounted future cash flows from the use of these assets. When any such impairment exists, the related assets are written down to fair value.

Other intangible assets continue to be amortized over their estimated useful lives. The Company has reassessed the estimated useful lives of its intangible assets, which primarily consist of non-compete agreements, and no changes have been deemed necessary.

*Stock-Based Compensation*

The Company applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", ("APB 25"), and related interpretations in accounting for its employee stock options. Under APB 25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Pro forma information regarding net income and earnings per share has been determined as if the Company and its acquired subsidiaries had accounted for its employee stock options under the fair value method of Financial Accounting Standards Board Statement No. 123 "Accounting for Stock-Based Compensation", ("FAS 123"). The weighted average fair value of options granted during 2002, 2001, and 2000 was \$25.13, \$17.05, and \$8.85, respectively. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for 2002, 2001, and 2000: risk-free interest rates of 4.8% for 2002, 5.0% for 2001, and 6.3% for 2000; volatility factor of the expected market price of the Company's Common Stock of 49.6% for 2002, 48.0% for 2001, and 45.1% for 2000, assumed dividend yield of 0% for all years and a weighted-average expected life of the option of 10 years.

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 1—Significant Accounting Policies (Continued)**

Under the accounting provisions of FAS 123, the Company's net income and net income per common share would have been adjusted to the pro forma amounts indicated below:

	Years ended		
	December 28, 2002	December 29, 2001	December 30, 2000
Net income as reported	\$117,987	\$87,373	\$56,749
Deduct: Total stock-based employee compensation expense determined under fair value method	(9,340)	(6,645)	(8,119)
Pro forma net income	\$108,647	\$80,728	\$48,630
Net income per common share - as reported:			
Basic	\$ 2.71	\$ 2.06	\$ 1.38
Diluted	\$ 2.63	\$ 2.01	\$ 1.35
Net income per common share - pro forma:			
Basic	\$ 2.50	\$ 1.91	\$ 1.18
Diluted	\$ 2.42	\$ 1.85	\$ 1.16

*Earnings Per Share*

Basic earnings per share includes no dilution and is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted earnings per common share reflect, in periods in which they have a dilutive effect, the effect of common shares issuable upon exercise of stock options.

*Comprehensive Income*

Comprehensive income includes certain gains and losses that, under generally accepted accounting principles, are excluded from net income as these amounts are recorded directly as an adjustment to stockholders' equity. The Company's comprehensive income is comprised of net income, unrealized gains (losses) on marketable securities and foreign currency translation adjustments.

*Fair Value of Financial Instruments*

The carrying amounts of cash, accounts receivable, and accounts payable approximate fair value because of the immediate or short-term maturity of these financial instruments. The carrying amount reported for long-term debt approximates fair value because certain of the underlying instruments are at variable rates, which are repriced frequently. The remaining portion of long-term debt approximates fair value because the interest approximates current market rates for financial instruments with similar maturities and terms.

*New Accounting Pronouncements*

In June 2002, the Financial Accounting Standards Board ("FASB") issued Statements of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", ("FAS 146"). This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)", ("EITF 94-3"). The principal difference between this Statement and EITF 94-3 relates to the Statement's requirements for recognition of a liability for a cost associated with an exit or disposal activity. This Statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF 94-3, a liability was recognized at the date of an entity's commitment to an exit plan. This Statement is effective for exit or disposal activities that are initiated after December 31, 2002. The Company does not expect the adoption of FAS 146 to have a material impact on its financial position or results of operations.



**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 1—Significant Accounting Policies (Continued)**

*New Accounting Pronouncements (Continued)*

In September 2002, the EITF reached a consensus on Issue 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables", ("EITF 00-21"). EITF 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue generating activities. Those arrangements could involve the delivery or performance of multiple products, services, or rights to use assets, and the performance could occur at different points in time or over different periods of time. The Issue addresses when and, if so, how a company should divide an arrangement involving multiple deliverables into separate units of accounting. EITF 00-21 is effective for revenue arrangements entered into in fiscal years beginning after December 15, 2002. The Company does not expect the adoption of EITF 00-21 to have a material impact on its financial position or results of operations.

On December 31, 2002, the FASB amended the transition and disclosure requirements of FASB Statement No. 123, "Accounting for Stock-Based Compensation", ("FAS 123"), through the issuance of FASB Statement No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure", ("FAS 148"). FAS 148 amends the existing disclosures that a company should make in its annual financial statements and requires, for the first time, disclosures in interim financial reports. Those disclosures are required regardless of the method being used to account for stock-based employee compensation. The amended and new disclosure requirements are effective for the Company for the fiscal year ending December 27, 2003. The adoption of the disclosure requirements of FAS 148 will not have a material affect on the Company's financial statements. As permitted under FAS 123, management applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", ("APB 25"), and related interpretations in accounting for its employee stock options. Under APB 25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

In November 2002, the FASB issued FASB Interpretation No. 45, ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others". FIN 45 addresses the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. The disclosure requirements in this Interpretation are effective for financial statements of interim or annual periods ending after December 15, 2002. The Company does not expect this Interpretation to have an effect on the consolidated financial statements.

In January 2003, the FASB issued FASB Interpretation No. 46, ("FIN 46"), "Consolidation of Variable Interest Entities". FIN 46 clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is applicable immediately for variable interest entities created after January 31, 2003. For variable interest entities created prior to January 31, 2003, the provisions of FIN 46 are applicable no later than July 1, 2003. The Company does not expect this Interpretation to have an effect on the consolidated financial statements.

**Note 2—Earnings Per Share**

A reconciliation of shares used in calculating basic and diluted earnings per common share follows:

	Years ended		
	December 28, 2002	December 29, 2001	December 30, 2000
Basic	43,489,229	42,366,048	41,243,600
Effect of assumed conversion of employee stock options	1,382,965	1,179,061	763,409
Diluted	44,872,194	43,545,109	42,007,009

Options to purchase approximately 30,000, 1,114,000, and 3,011,000, shares of common stock at prices ranging from \$46.80 to \$54.00, \$35.50 to \$46.00, and \$19.73 to \$46.00 per share that were outstanding during 2002, 2001, and 2000, respectively, were excluded from the computation of diluted earnings per common share for each of the respective years because the options' exercise prices exceeded the fair market value of the Company's common stock.

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 3—Investments in Marketable Securities**

Investments in available-for-sale securities at December 28, 2002 were as follows:

	Amortized Cost	Gross Unrealized Gain	Fair Market Value
<b>Debt Securities recorded at market, maturing within one year</b>			
U.S. government and agency securities	\$ 7,517	\$ 68	\$ 7,585
Municipal securities	14,512	4	14,516
Corporate notes and bonds	9,106	2	9,108
Total short-term	31,135	74	31,209
<b>Debt Securities recorded at market, maturing between one and two years (1)</b>			
U.S. government and agency securities	15,911	64	15,975
Municipal securities	1,000	—	1,000
Corporate notes and bonds	7,000	1	7,001
Total long-term	23,911	65	23,976
Total investments in marketable securities	\$55,046	\$139	\$55,185

(1) Investments maturing between one and two years are recorded in investments and other.

The Company determines cost on the specific identification basis. Proceeds from sales of available-for-sale securities were immaterial in 2002 and 2001. There were no material gains or losses on the sales of securities in 2002. The securities held on December 28, 2002 had contractual maturities of up to two years. Expected maturities of debt securities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalty.

**Note 4—Property and Equipment, Net**

Major classes of property and equipment consist of the following:

	December 28, 2002	December 29, 2001
Land	\$ 7,061	\$ 3,540
Buildings and leasehold improvements	62,724	52,257
Machinery and warehouse equipment	27,165	24,016
Furniture, fixtures and other	25,737	27,096
Computer equipment and software	121,364	101,894
	244,051	208,803
Less accumulated depreciation and amortization	101,519	90,823
Net property and equipment	\$142,532	\$117,980

The net book value of equipment held under capital leases amounted to approximately \$930 and \$1,081 as of December 28, 2002 and December 29, 2001, respectively (See Note 15(b)).

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 5—Goodwill and Other Intangibles, Net**

The Company completed the transitional goodwill impairment test required by FASB Statement No. 142, "Goodwill and Other Intangible Assets", ("FAS 142"), in the second quarter of 2002. The Company estimated fair value of its reporting units in accordance with the new standard and compared these valuations with the respective book values for each of the reporting units to determine whether any goodwill impairment existed. In determining fair value, the Company considered past, present and future expectations of performance and determined that there was no goodwill impairment in any of the Company's reporting units as of the adoption date, December 30, 2001.

As required by FAS 142, the Company will complete subsequent goodwill impairment tests at least annually. During the fourth quarter of 2002, the Company completed the annual test using a methodology similar to the transitional test and determined that there was no impairment of goodwill as of the first day of the fourth quarter.

The changes in the carrying amount of goodwill for the year ended December 28, 2002 are as follows:

	Healthcare Distribution	Technology	Total
Balance as of December 29, 2001	\$279,666	\$315	\$279,981
Adjustments to goodwill:			
Acquisition costs incurred during the year ended December 28, 2002	10,486	20	10,506
Foreign currency translation	12,442	—	12,442
Other	(242)	—	(242)
Balance as of December 28, 2002	\$302,352	\$335	\$302,687

The acquisition costs incurred during the year ended December 28, 2002 related to contingent earnout payments relating to acquisitions made in prior years, increased ownership interest in consolidated subsidiaries, and the acquisition of a dental consumable supply business. The acquisition of the dental consumable supply business was not material.

With the adoption of FAS 142, the Company ceased amortization of goodwill as of December 30, 2001. The following table presents the results of the Company for all periods presented on a comparable basis:

	Years ended		
	December 28, 2002	December 29, 2001	December 30, 2000
Net income	\$117,987	\$87,373	\$56,749
Add back goodwill amortization, net of income tax provision	—	7,296	6,993
Adjusted net income	\$117,987	\$94,669	\$63,742
Diluted net income per common share:			
Net income	\$ 2.63	\$ 2.01	\$ 1.35
Add back goodwill amortization, net of income tax provision	—	0.17	0.17
Adjusted diluted net income per common share	\$ 2.63	\$ 2.18	\$ 1.52

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 5—Goodwill and Other Intangibles, Net (Continued)**

Other intangible assets as of December 28, 2002 and December 29, 2001 are as follows:

	December 28, 2002		December 29, 2001	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Other intangible assets:				
Non-compete agreements	\$10,826	\$ (3,549)	\$10,426	\$(2,850)
Other	986	(602)	945	(498)
<b>Total</b>	<b>\$11,812</b>	<b>\$ (4,151)</b>	<b>\$11,371</b>	<b>\$(3,348)</b>

Amortization of other intangible assets for the years ended December 28, 2002 and December 29, 2001 was approximately \$1,085 and \$1,300, respectively. The annual amortization expense expected for the years 2003 through 2007 is \$763, \$626, \$485, \$285, and \$268, respectively.

**Note 6—Investments and Other**

Investments and other consist of the following:

	December 28, 2001	December 29, 2002
Long-term notes receivables (1)	\$39,566	\$41,214
Investments in long-term marketable securities	23,976	—
Investment in unconsolidated affiliates (2)	4,728	4,201
Other	9,373	7,058
	<b>\$77,643</b>	<b>\$52,473</b>

(1) Long-term notes receivable carry interest rates ranging from 2.8% to 12.0% and are due in varying installments through 2020. Long-term notes receivables include various notes due arising from the sale of certain businesses of approximately \$22,532 in 2002 and \$22,251 in 2001.

(2) The Company's investment as of December 28, 2002 and December 29, 2001, is a 50% interest in an unconsolidated affiliate, which is involved in the healthcare distribution business.

**Note 7—Business Acquisitions**

During the year ended December 28, 2002, the Company completed the acquisition of one healthcare distribution business and purchased additional interest in three consolidated subsidiaries in Europe. These purchases were not considered material either individually or in the aggregate.

During the year ended December 29, 2001, the Company completed the acquisition of two healthcare distribution businesses, which included the purchase of the remaining 50% interest of an affiliate. Neither of these purchases was considered material either individually or in the aggregate. The two transactions were accounted for under the purchase method of accounting and have been included in the consolidated financial statements from their respective acquisition dates.

In 2000, the Company completed the acquisition of two healthcare distribution businesses and one technology business, none of which were considered material either individually or in the aggregate. Of the three completed acquisitions, two were accounted for under the purchase method of accounting and the remaining acquisition was accounted for under the pooling of interests method of accounting. The Company issued 465,480 shares of its Common Stock, with an aggregate value of approximately \$7,900 in connection with the pooling transaction. The transactions completed under the purchase method of accounting have been included in the consolidated financial statements from their respective acquisition dates. The pooling transaction was not material and accordingly, prior period financial statements have not been restated. Results of the acquired company have been included in the consolidated financial statements from the beginning of the second quarter of 2000.



**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 7—Business Acquisitions (Continued)**

Summarized unaudited pro forma results of operations for the acquisitions completed during fiscal 2002, 2001 and 2000, which were accounted for under the purchase method of accounting, are not presented as the impact of reflecting the Company's results of operations, which assumed the acquisitions occurred as of the beginning of the fiscal period, is not material.

During the fourth quarter of 2002, the Company revised some of its estimates of the merger and integration expenses from prior years. These changes in estimates were attributable to facts and circumstances that arose subsequent to the original charges.

Merger and integration (credits) and costs were as follows:

	Years ended		
	December 28, 2002	December 29, 2001	December 30, 2000
Direct transaction / merger (credits) costs (1)	\$(1,469)	\$ —	\$585
Integration costs (credits):			
Severance and other direct costs	65	—	—
Costs associated with the closure of distribution centers (2)	257	—	—
Long-lived asset write-off and impairment	(16)	—	—
Total integration costs	306	—	—
Total merger and integration (credits) costs	\$(1,163)	\$ —	\$585

(1) Primarily investment banking and professional fees (primarily legal fees resulting from the acquisition).

(2) Primarily rent and consulting fees.

The following table shows the activity in the merger and integration accruals:

	Balance at Beginning of Year	Provision	Payments	Adjustments to Reflect Actual Cost	Balance at End of Year
<b>Year ended December 30, 2000:</b>					
Severance and other direct costs	\$ 1,694	\$ —	\$ (947)	\$ —	\$ 747
Direct transaction and other integration costs	8,399	585	(4,844)	—	4,140
	\$10,093	\$585	\$ (5,791)	\$ —	\$4,887
<b>Year ended December 29, 2001:</b>					
Severance and other direct costs	\$ 747	\$ —	\$ (382)	\$ —	\$ 365
Direct transaction and other integration costs	4,140	—	(1,957)	—	2,183
	\$ 4,887	\$ —	\$ (2,339)	\$ —	\$2,548
<b>Year ended December 28, 2002:</b>					
Severance and other direct costs	\$ 365	\$ —	\$ (164)	\$ 65	\$ 266
Direct transaction and other integration costs	2,183	—	(667)	(1,228)	288
	\$ 2,548	\$ —	\$ (831)	\$ (1,163)	\$ 554

As a result of the acquisitions and integration of certain businesses into the Company's infrastructure, 870 employees were terminated through December 25, 1999. Of the terminated employees, 206 received severance during 1999, 37 received severance during 2000, 11 received severance during 2001, one received severance during 2002, and one was owed severance at December 28, 2002.

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 8—Plan of Restructuring**

On August 1, 2000, the Company announced a comprehensive restructuring plan designed to improve customer service and increase profitability by maximizing the efficiency of the Company's infrastructure. In addition to closing or downsizing certain facilities, this worldwide initiative included the elimination of approximately 300 positions, including open positions, or about 5% of the total workforce, throughout all levels within the organization.

For the year ended December 30, 2000, the Company incurred one-time restructuring costs of approximately \$14,439 (\$9,270 after taxes), consisting of employee severance pay and benefits, facility closing costs, representing primarily lease termination and asset write-off costs, and outside professional and consulting fees directly related to the restructuring plan.

During the fourth quarter of 2002, the Company revised some of the original estimates of its anticipated restructuring expenses. These changes in estimates are attributable to facts and circumstances that arose subsequent to the original charges. As a result, the Company recorded additional expenses.

The following table shows amounts expensed and paid in 2002 for restructuring costs that were initially incurred and accrued in 2000:

	Balance at December 29, 2001	Payments	Adjustments to Reflect Actual Cost	Balance at December 28, 2002
Severance costs (1)	\$ 633	\$ (446)	\$105	\$ 292
Facility closing costs (2)	2,645	(812)	317	2,150
Other professional and consulting costs	41	-	7	48
	<b>\$3,319</b>	<b>\$(1,258)</b>	<b>\$429</b>	<b>\$2,490</b>

(1) Represents salaries and related benefits for employees separated from the Company.

(2) Represents costs associated with the closing of certain equipment branches (primarily lease termination costs) and property and equipment write-offs.

For the year ended December 30, 2000, 284 employees separated from the Company and received severance payments in 2000. These employees were from nearly all functional areas of the Company's operations.

The Company paid severance to 104 of these employees during 2001, and to six of these employees during 2002. At December 28, 2002, one employee was owed severance pay and benefits related to the restructuring plan.

**Note 9—Bank Credit Lines**

At December 28, 2002, certain subsidiaries of the Company had available various short-term bank credit lines totaling approximately \$28,209, expiring through January 2004. Borrowings of \$4,790 under these credit lines, bear interest rates ranging from 3.65% to 6.50%, and were collateralized by accounts receivable, inventory and property and equipment with an aggregate net book value of \$88,504 at December 28, 2002.

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 10—Long-Term Debt**

Long-term debt consists of:

	Years ended	
	December 28, 2002	December 29, 2001
Private Placement Loans (a)	\$ 230,000	\$ 230,000
Borrowings under Revolving Credit Agreement (b)	—	—
Notes payable to banks, interest at 4.15% to 6.94%, payable in quarterly installments ranging from \$43 to \$74 through 2019, semi-annual installments of \$452 paid through 2002 and a lump sum payment of \$5,423 which was repaid on January 1, 2002	11,667	21,091
Various loans payable with interest, in varying installments through 2004, uncollateralized	1,509	2,517
Note payable, interest payable quarterly at 5.28% plus a margin; repaid on January 1, 2002 .	—	1,644
Capital lease obligations in various installments through fiscal 2010; interest at 6.4% to 11.2% or varies with prime rate (see Note 15 (b))	2,047	2,140
Total	245,223	257,392
Less current maturities	2,662	15,223
Total long-term debt	\$ 242,561	\$ 242,169

As of December 28, 2002, the aggregate amounts of long-term debt maturing in each of the next five years are as follows: 2003 - \$2,662; 2004 - \$1,672; 2005 - \$859; 2006 - \$20,753; 2007 - \$20,520.

*(a) Private Placement Loans*

On June 30, 1999 and September 25, 1998, the Company completed private placement transactions under which it issued \$130,000 and \$100,000, respectively, in Senior Notes. The \$130,000 notes come due on June 30, 2009 and bear interest at a rate of 6.94% per annum. Principal payments on the \$100,000 notes totaling \$20,000 are due annually starting September 25, 2006 and bear interest at a rate of 6.66% per annum. Interest on both notes is payable semi-annually.

The agreements governing our Senior Notes provide, among other things, that the Company will maintain, on a consolidated basis, leverage and priority debt ratios and a minimum net worth. The agreements also contain restrictions relating to transactions with affiliates, annual dividends, mergers and acquisitions, and liens.

*(b) Revolving Credit Agreement*

On May 2, 2002, the Company renewed and increased its revolving credit facility to \$200,000 from \$150,000, extending the term to 2006. The interest rate on any borrowings under the agreement is based on LIBOR, or prime, as defined in the agreement, which were 1.48%, and 4.25%, respectively, at December 28, 2002. There were no borrowings outstanding at December 28, 2002. The agreement provides, among other things, that the Company will maintain, on a consolidated basis, as defined, interest coverage ratios, a maximum leverage ratio, and contains restrictions relating to annual dividends in excess of \$25,000, guarantees of subsidiary debt, investments in subsidiaries, mergers and acquisitions, liens, certain changes in ownership and employee and shareholder loans.

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 11—Taxes on Income**

Taxes on income are based on income before taxes on income, minority interest and equity in earnings (losses) of affiliates as follows:

	Years ended		
	December 28, 2002	December 29, 2001	December 30, 2000
Domestic	\$186,134	\$140,675	\$102,777
Foreign	4,295	(324)	(6,243)
Total	\$190,429	\$140,351	\$ 96,534

The provision (benefit) for taxes on income was as follows:

	Years ended		
	December 28, 2002	December 29, 2001	December 30, 2000
Current tax expense:			
U.S. Federal	\$ 59,254	\$ 46,225	\$ 33,989
State and local	9,223	3,806	2,882
Foreign	1,807	1,607	614
Total current	70,284	51,638	37,485
Deferred tax expense (benefit):			
U.S. Federal	(1,196)	(162)	(1,046)
State and local	(151)	234	90
Foreign	1,573	220	(379)
Total deferred	226	292	(1,335)
Total provision	\$ 70,510	\$ 51,930	\$ 36,150

The tax effects of temporary differences that give rise to the Company's deferred tax asset (liability) are as follows:

	Years ended	
	December 28, 2002	December 29, 2001
Current deferred tax assets:		
Inventory, premium coupon redemptions and accounts receivable valuation allowances	\$18,991	\$14,433
Uniform capitalization adjustments to inventories	3,473	3,578
Other accrued liabilities	7,455	7,740
Total current deferred tax asset	29,919	25,751
Non-current deferred tax asset (liability):		
Property and equipment	(14,590)	(12,402)
Provision for other long-term liabilities	(17,723)	(5,198)
Net operating loss carryforward	1,318	150
Net operating losses of foreign subsidiaries	11,221	2,697
Total non-current deferred tax liability	(19,774)	(14,753)
Valuation allowance for non-current deferred tax assets (1)	(1,842)	(1,850)
Net non-current deferred tax liability	(21,616)	(16,603)
Net deferred tax asset	\$ 8,303	\$ 9,148

(1) Primarily relates to operating losses of foreign subsidiaries.

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 11—Taxes on Income (Continued)**

The net deferred tax asset is realizable as the Company has sufficient taxable income in prior years to realize the tax benefit for deductible temporary differences. The non-current deferred tax liability is included in "Other liabilities" on the Consolidated Balance Sheets.

At December 28, 2002, the Company has domestic unconsolidated net operating loss carryforwards of \$3,340, which are available to offset future Federal taxable income through 2022. Foreign net operating losses totaled \$32,915 at December 28, 2002. Such losses can be utilized against future foreign income. Of these foreign net operating losses, \$545 expire in 2006, whereas the remaining have an indefinite life.

The tax provisions differ from the amount computed using the Federal statutory income tax rate as follows:

	Years ended		
	December 28, 2001	December 29, 2000	December 30, 2002
Provision at Federal statutory rate	\$66,652	\$49,122	\$33,785
State income taxes, net of Federal income tax effect	5,897	2,626	1,874
Other	(2,039)	182	491
Income tax provision	\$70,510	\$51,930	\$36,150

Provision has not been made for U.S. or additional foreign taxes on undistributed earnings of foreign subsidiaries, which have been and will continue to be reinvested. These earnings could become subject to additional tax if they were remitted as dividends, if foreign earnings were loaned to the Company or a U.S. affiliate, or if the Company should sell its stock in the foreign subsidiaries. It is not practicable to determine the amount of additional tax, if any, that might be payable on the foreign earnings; however, the Company believes that foreign tax credits would substantially offset any U.S. tax. At December 28, 2002, the cumulative amount of reinvested earnings was approximately \$9,510.

**Note 12—Financial Instruments and Credit Risk Concentrations**

*(a) Financial Instruments*

To reduce its exposure to fluctuations in foreign currencies, the Company is party to foreign currency forward contracts with major financial institutions, which are used to hedge the foreign currency market exposures underlying certain intercompany debt and certain forecasted transactions with foreign vendors.

As of December 28, 2002, the Company had outstanding foreign currency forward contracts aggregating \$78,012, of which, \$73,633 related to intercompany debt and \$4,379 related to the purchase and sale of merchandise from foreign vendors. The contracts hedge against currency fluctuations of British Pounds (\$38,132), Euros (\$34,916), Australian Dollars (\$3,854), Swiss Francs (\$794), Japanese Yen (\$234), and New Zealand Dollars (\$82). As of December 28, 2002, the fair value of these contracts, which are determined by quoted market prices and expire through January 2004, was not material. For the year ended December 28, 2002, the Company recognized an immaterial loss relating to its foreign currency forward contracts.

While the Company is exposed to credit loss in the event of non-performance by the counter parties of these contracts, the Company does not anticipate non-performance by the counter parties. The Company does not require collateral or other security to support these financial instruments.

*(b) Concentrations of Credit Risk*

Certain financial instruments potentially subject the Company to concentrations of credit risk. These financial instruments consist primarily of trade receivables and short-term cash investments. The Company places its short-term cash investments with high credit quality financial institutions and, by policy, limits the amount of credit exposure to any one financial institution. Concentrations of credit risk with respect to trade receivables are limited due to a large customer base and its dispersion across different types of healthcare professionals and geographic areas. The Company maintains an allowance for doubtful accounts based on the expected collectability of all accounts receivable.



**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 13—Segment and Geographic Data**

The Company has two reportable segments: healthcare distribution and technology. The healthcare distribution segment, which is comprised of the Company's dental, medical, and international business groups, distributes healthcare products (primarily consumable) and services to office-based healthcare practitioners and professionals in the combined United States, Canada, and international markets. Products, which are similar for each business group, are maintained and distributed from strategically located distribution centers. The technology segment consists primarily of the Company's practice management software business and certain other value-added products and services that are distributed primarily to healthcare professionals in the United States and Canada.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates segment performance based primarily on operating income.

The Company's reportable operations are strategic business units that offer different products and services to the same customer base. Most of the technology business was acquired as a unit, and the management at the time of acquisition was retained. The following table presents information about the Company's business segments:

	Years ended		
	December 28, 2002	December 29, 2001 (1)	December 30, 2000 (1)
Net Sales:			
Healthcare distribution (2):			
Dental	\$1,227,273	\$1,121,394	\$1,087,073
Medical	1,093,956	982,569	851,301
International (3)	437,046	398,071	389,946
Total healthcare distribution	2,758,275	2,502,034	2,328,320
Technology (4)	66,726	56,209	53,401
Total	\$2,825,001	\$2,558,243	\$2,381,721

(1) Reclassified to conform to current period presentation.

(2) Consists of consumable products, small equipment, laboratory products, large dental equipment, branded and generic pharmaceuticals, surgical products, diagnostic tests, infection control and vitamins.

(3) Consists of products sold in Dental, Medical and Veterinary markets, primarily in Europe.

(4) Consists of practice management software and other value-added products and services, which are distributed primarily to healthcare professionals in the United States and Canada.

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 13—Segment and Geographic Data (Continued)**

	Years ended		
	December 28, 2002	December 29, 2001 (1)	December 30, 2000 (1)
<b>Operating Income:</b>			
Healthcare distribution (includes merger and integration and restructuring (credits) costs of \$(734), \$0, and \$14,666, respectively)	\$170,987	\$128,337	\$ 92,278
Technology (includes merger and integration and restructuring costs of \$0, \$0, and \$358, respectively)	26,016	19,413	20,311
<b>Total</b>	<b>\$197,003</b>	<b>\$147,750</b>	<b>\$112,589</b>
<b>Interest Income:</b>			
Healthcare distribution	\$ 10,354	\$ 9,565	\$ 5,345
Technology	4,022	2,494	4,199
<b>Total</b>	<b>\$ 14,376</b>	<b>\$ 12,059</b>	<b>\$ 9,544</b>
<b>Interest Expense:</b>			
Healthcare distribution	\$ 18,012	\$ 18,814	\$ 22,939
Technology	3,878	491	735
<b>Total</b>	<b>\$ 21,890</b>	<b>\$ 19,305</b>	<b>\$ 23,674</b>
<b>Depreciation and Amortization:</b>			
Healthcare distribution	\$ 25,978	\$ 34,412	\$ 32,756
Technology	2,294	1,230	1,006
<b>Total</b>	<b>\$ 28,272</b>	<b>\$ 35,642</b>	<b>\$ 33,762</b>
<b>Capital Expenditures:</b>			
Healthcare distribution	\$ 46,641	\$ 45,428	\$ 28,358
Technology	902	699	1,385
<b>Total</b>	<b>\$ 47,543</b>	<b>\$ 46,127</b>	<b>\$ 29,743</b>
<b>Total Assets:</b>			
Healthcare distribution	\$1,533,529	\$1,369,241	\$1,202,331
Technology	106,319	75,030	82,825
<b>Total</b>	<b>\$1,639,848</b>	<b>\$1,444,271</b>	<b>\$1,285,156</b>

(1) Reclassified to conform to current period presentation.

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 13—Segment and Geographic Data (Continued)**

The following table reconciles segment totals to consolidated totals as of, and for the years ended December 28, 2002, December 29, 2001, and December 30, 2000:

	2002	2001 (1)	2000 (1)
<b>Total Assets:</b>			
Total assets for reportable segments	\$1,639,848	\$1,444,271	\$1,285,156
Receivables due from healthcare distribution segment	(80,855)	(57,685)	(46,494)
Receivables due from technology segment	(941)	(1,158)	(7,594)
Consolidated total assets	\$1,558,052	\$1,385,428	\$1,231,068
<b>Interest Income:</b>			
Total interest income for reportable segments	\$ 14,376	\$ 12,059	\$ 9,544
Interest on receivables due from healthcare distribution segment	(3,878)	(1,737)	(2,887)
Interest on receivables due from technology segment	(52)	(244)	(378)
Total consolidated interest income	\$ 10,446	\$ 10,078	\$ 6,279
<b>Interest Expense:</b>			
Total interest expense for reportable segments	\$ 21,890	\$ 19,305	\$ 23,674
Interest on payables due to healthcare distribution segment	(52)	(244)	(378)
Interest on payables due to technology segment	(3,878)	(1,737)	(2,887)
Total consolidated interest expense	\$ 17,960	\$ 17,324	\$ 20,409

(1) Reclassified to conform to current period presentation.

The following table presents information about the Company by geographic area as of, and for the years ended December 28, 2002, December 29, 2001, and December 30, 2000. Revenues by geographic area are based on the respective locations of the Company's subsidiaries. No individual country, except for the United States, generated net sales greater than 10% of consolidated net sales. There were no material amounts of sales or transfers among geographic areas and there were no material amounts of United States export sales.

	2002		2001		2000	
	Net Sales	Long-Lived Assets	Net Sales	Long-Lived Assets	Net Sales	Long-Lived Assets
United States and Canada	\$2,403,734	\$322,315	\$2,179,645	\$296,858	\$2,010,398	\$271,188
Europe and other	421,267	130,565	378,598	109,126	371,323	115,493
Consolidated Total	\$2,825,001	\$452,880	\$2,558,243	\$405,984	\$2,381,721	\$386,681

The Company's subsidiary located in Germany had long-lived assets of \$85,230, \$71,825, and \$77,995 at December 28, 2002, December 29, 2001, and December 30, 2000, respectively

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 14—Stockholders' Equity**

*(a) Common Stock Purchase Rights*

On November 30, 1998, the Company's Board of Directors adopted a Stockholder Rights Plan (the "Rights Plan"), and declared a dividend under the Rights Plan of one Common Stock purchase right (a "Right") on each outstanding share of the Company's Common Stock. Until the occurrence of certain events, each share of Common Stock that is issued will also have a Right attached to it. The Rights provide, in substance, that should any person or group acquire 15% or more of the outstanding Common Stock of the Company after the date of adoption of the Rights Plan, each Right, other than Rights held by the acquiring person or group, would entitle its holder to purchase a certain number of shares of Common Stock for 50% of the then-current market value of the Common Stock. Unless a 15% acquisition has occurred, the Company may redeem the Rights at any time prior to the termination date of the Rights Plan. This Right to purchase the Common Stock at a discount will not be triggered by a person's or group's acquisition of 15% or more of the Common Stock pursuant to a tender or exchange offer which is for all outstanding shares at a price and on terms that the Board of Directors determines (prior to acquisition) to be adequate and in the stockholders' best interests. In addition, the Right will not be triggered by the positions of existing shareholders.

Certain business combinations with an acquiring person or its affiliates will trigger an additional feature of the Rights. Each Right, other than Rights held by the acquiring person or group, will entitle its holder to purchase a certain number of shares of the Common Stock of the acquiring person at a price equal to 50% of the market value of such shares at the time of exercise. Initially, the Rights will be attached to, and trade with, the certificates representing the Company's outstanding shares of Common Stock and no separate certificates representing the Rights will be distributed. The Rights will become exercisable only if a person or group acquires, or commences a tender or exchange offer for, 15% or more of the Company's Common Stock.

The Board of Directors may, at its option, redeem all but not less than all of the then outstanding Rights at a redemption price of \$0.01 per Right at any time prior to the earlier of (a) any person or group acquiring 15% or more of the Company's Common Stock or (b) the final expiration date of November 30, 2008.

*(b) Stock Options*

The Company established the 1994 Stock Option Plan (the "Plan") for the benefit of certain employees. As amended in June 2001, pursuant to this plan the Company may issue up to approximately 4,445,000 shares of its Common Stock. The Plan provides for two classes of options: Class A options and Class B options. A maximum of 237,897 shares of Common Stock may be covered by Class A options. Both incentive and non-qualified stock options may be issued under the Plan.

In 1995, Class A options to acquire 237,897 common shares were issued to certain executive management at an exercise price of \$4.21 per share, substantially all of which became exercisable upon the closing of the Company's initial public offering which was on November 3, 1995. The exercise price of all Class B options issued has been equal to the market price on the date of grant, and accordingly, no compensation cost has been recognized. Substantially all Class B options become exercisable up to the tenth anniversary of the date of issuance, subject to acceleration upon termination of employment.

On May 8, 1996, the Company's stockholders approved the 1996 Non-Employee Director Stock Option Plan. As amended in June 2002, pursuant to this plan the Company may grant options to each director who is not also an officer or employee of the Company, for up to 100,000 shares of the Company's Common Stock. The exercise price and term, not to exceed 10 years, of each option is determined by the plan committee at the time of the grant. During 2002, 2001, and 2000, 40,000, 12,000, and 0, options, respectively, were granted to certain non-employee directors at exercise prices, which were equal to the market price on the date of grant.

Additionally, in 1997 as a result of the Company's acquisition of Sullivan Dental Products, Inc. and Micro Bio-Medics, Inc., the Company assumed their respective stock option plans (the "Assumed Plans"). Options granted under the Assumed Plans of 1,218,000 and 1,117,000, respectively, are exercisable for up to ten years from the date of grant at prices not less than the fair market value of the respective acquirees' common stock at the date of grant, on a converted basis.

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 14—Stockholders' Equity (Continued)**

*(b) Stock Options (Continued)*

A summary of the status of the Company's two fixed stock option plans and the Assumed Plans, and the related transactions is presented below:

	Years ended					
	December 28, 2001		December 29, 2000		December 30,	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
2002						
Outstanding at beginning of year	4,646,271	\$26.04	4,650,722	\$24.59	5,439,340	\$23.53
Granted	1,017,850	41.37	883,600	28.73	93,500	14.77
Exercised	(1,271,528)	26.69	(736,923)	19.21	(591,245)	11.00
Forfeited	(111,168)	37.56	(151,128)	30.26	(290,873)	29.39
Outstanding at end of year	4,281,425	\$29.20	4,646,271	\$26.04	4,650,722	\$24.59
Options exercisable at year end	3,183,593	\$26.44	3,722,164	\$26.53	3,708,213	\$25.98

The following table summarizes information about stock options outstanding at December 28, 2002:

	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
Range of Exercise Prices					
\$4.21 to \$20.16	1,048,688	5.9	\$13.14	1,033,731	\$13.11
\$21.50 to \$28.63	1,306,176	7.2	\$26.68	974,294	\$26.01
\$29.00 to \$40.63	921,209	5.4	\$37.73	910,563	\$37.76
\$40.82 to \$54.00	1,005,352	9.2	\$41.40	265,005	\$41.16
	4,281,425	7.0	\$29.20	3,183,593	\$26.44



**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 14—Stockholders' Equity (Continued)**

*(c) Employee Benefit Plans*

*Employee Stock Ownership Plan (ESOP)*

In 1994, the Company established an ESOP and a related trust as a benefit for substantially all of its domestic employees. This plan supplements the Company's Profit Sharing Plan, whereby a percentage, as defined, of the profit sharing allocation granted to eligible employees is provided in shares of the Company's Common Stock. Charges to operations related to this plan were \$2,656, \$2,378, and \$2,537 for 2002, 2001, and 2000, respectively, based on the prevailing market price of the Company's Common Stock on the date of issuance. Under this plan, the Company issued 24,859, 61,997, and 121,253 shares of the Company's Common Stock to the trust in 2002, 2001, and 2000, to satisfy the 2001, 2000, and 1999 contribution, respectively. The Company expects to fund the 2002 accrued contribution in 2003 with shares of the Company's Common Stock. As of April 1, 1998, the Company's ESOP was merged into its 401(k) plan. Shares of the Company's Common Stock are held in trust by the 401(k) plan.

*Profit Sharing Plan*

Prior to April 1, 1998, the Company had qualified contributory and non-contributory 401(k) and profit sharing plans, respectively, for eligible employees. As of April 1, 1998, the Company's profit sharing plan was merged into its 401(k) plan. Assets of the profit sharing plan are now held in self-directed accounts within the 401(k) plan. Contributions to the plans were determined by the Board of Directors and charged to operations during 2002, 2001, and 2000 amounted to \$5,341, \$4,099, and \$7,305, respectively.

The Company provides a matching 401(k) contribution of up to 100% of the participants' contributions for up to the first 7% of the employees' base compensation. Forfeitures attributable to participants who leave the Company before becoming fully vested are used by the Company to reduce the matching contribution.

*Supplemental Executive Retirement Plan*

In 1994, the Company instituted an unfunded non-qualified supplemental executive retirement plan for eligible employees. The increases in plan value that were charged to operations, were \$707, \$426, and \$360 for 2002, 2001, and 2000, respectively.

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 15—Commitments and Contingencies**

*(a) Operating Leases*

The Company leases facilities and equipment under non-cancelable operating leases expiring through 2016. Management expects that in the normal course of business, leases will be renewed or replaced by other leases.

Future minimum annual rental payments under the non-cancelable leases at December 28, 2002 are as follows:

2003	\$ 23,065
2004	19,995
2005	16,237
2006	12,415
2007	10,654
Thereafter	29,671
Total minimum lease payments	\$112,037

Total rental expense for 2002, 2001, and 2000 was \$25,837, \$26,085, and \$29,730, respectively.

*(b) Capital Leases*

The Company leases certain equipment under capital leases. The following is a schedule of approximate future minimum annual lease payments under the capitalized leases together with the present value of the net minimum lease payments at December 28, 2002:

2003	\$ 639
2004	563
2005	260
2006	202
2007	179
Thereafter	510
Total minimum lease payments	2,353
Less: Amount representing interest at 6.4% to 11.2%	(306)
	\$2,047

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 15—Commitments and Contingencies (Continued)**

(c) Litigation

The Company's business involves a risk of product liability claims and other claims in the ordinary course of business, and from time to time the Company is named as a defendant in cases as a result of its distribution of pharmaceutical and other healthcare products. As of December 28, 2002, the Company was named a defendant in approximately 57 product liability cases. Of these claims, 47 involve claims made by healthcare workers who claim allergic reaction relating to exposure to latex gloves. In each of these cases, the Company acted as a distributor of both brand name and Henry Schein® private brand latex gloves, which were manufactured by third parties. To date, discovery in these cases has generally been limited to product identification issues. The manufacturers in these cases have withheld indemnification of the Company pending product identification; however, the Company is taking steps to implead those manufacturers into each case in which the Company is a defendant.

On January 27, 1998, in District Court in Travis County, Texas, the Company and one of its subsidiaries were named as defendants in a matter entitled "Shelly E. Stromboe and Jeanne Taylor, on Behalf of Themselves and all others Similarly Situated vs. Henry Schein, Inc., Easy Dental Systems, Inc. and Dentisoft, Inc.", Case No. 98-00886. The Petition alleges, among other things, negligence, breach of contract, fraud, and violations of certain Texas commercial statutes involving the sale of certain practice management software products sold prior to 1998 under the Easy Dental® name. In October 1999, the trial court, on motion, certified both a Windows® sub-class and a DOS sub-class to proceed as a class action pursuant to Tex. R. Civ. P. 42. It is estimated that 5,000 Windows® customers and 10,000 DOS customers were covered by the class action that was certified by the trial court. In November of 1999, the Company filed an interlocutory appeal of the trial court's determination to the Texas Court of Appeals on the issue of whether this case was properly certified as a class action. On September 14, 2000, the Court of Appeals affirmed the trial court's certification order. On January 5, 2001, the Company filed a Petition for Review in the Texas Supreme Court asking the Court to find that it had "conflicts jurisdiction" to permit review of the trial court's certification order. The Texas Supreme Court heard oral argument on February 6, 2002. On October 31, 2002, the Texas Supreme Court issued an opinion in the case holding that it had conflicts jurisdiction to review the decision of the Court of Appeals and finding that the trial court's certification of the case as a class action was improper. The Supreme Court further held that the judgment of the court of appeals which affirmed the class certification order must be reversed in its entirety. Upon reversal of the class certification order, the Supreme Court remanded the case to the trial court for further proceedings consistent with its opinion. On January 31, 2003, counsel for the class filed a Motion for Rehearing with the Texas Supreme Court seeking a reversal for the Supreme Court's earlier opinion reversing the class certification order. The Motion for Rehearing has not yet been ruled upon and remains pending before the Texas Supreme Court. Because the Texas Supreme Court has not yet ruled upon the Motion for Rehearing and because this matter has not yet come before the trial court for consideration consistent with the Texas Supreme Court's opinion reversing the trial court's certification order, it is not possible to determine what the trial court will do if the plaintiffs file another motion for class certification. Further, because of the decertification of the class by the Texas Supreme Court, the pending Motion for Rehearing before the Texas Supreme Court and other factors, it is not possible to determine whether the trial court will certify a different class upon motion, if any, and other factors, it is not possible to determine the possible range of damages or other relief sought by the plaintiffs in the trial court.

In February 2002, the Company was served with a summons and complaint in an action commenced in the Superior Court of New Jersey, Law Division, Morris County, entitled "West Morris Pediatrics, P.A. vs. Henry Schein, Inc., doing business as Caligor", Case No. MRSL-421-02. The complaint by West Morris Pediatrics purports to be on behalf of a nationwide class, but there has been no court determination that the case may proceed as a class action. Plaintiff seeks to represent a class of all physicians, hospitals and other healthcare providers throughout New Jersey and across the United States. This complaint, as amended in August 2002, alleges, among other things, breach of oral contract, breach of implied covenant of good faith and fair dealing, violation of the New Jersey Consumer Fraud Act, unjust enrichment, conversion, and promissory estoppel relating to sales of a vaccine product in the year 2001. The Company filed an answer in October 2002. Because damages have not been specified by the plaintiffs, it is not possible to determine the range of damages or other relief sought by the plaintiffs. The Company intends to vigorously defend itself against this claim, as well as all other claims, suits and complaints.

The Company has various insurance policies, including product liability insurance, covering risks and in amounts it considers adequate. In many cases in which the Company has been sued in connection with products manufactured by others, the Company is provided indemnification by the manufacturer. There can be no assurance that the coverage maintained by the Company is sufficient or will be available in adequate amounts or at a reasonable cost, or that indemnification agreements will provide adequate protection for the Company. In the opinion of the Company, all pending matters are covered by insurance or will not otherwise seriously harm the Company's financial condition.

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 15—Commitments and Contingencies (Continued)**

*(d) Employment, Consulting and Non-compete Agreements*

The Company has employment, consulting and non-compete agreements expiring through 2007 (except for a lifetime consulting agreement with a principal stockholder, which provides for current compensation of \$308 per year, increasing \$25 every fifth year with the next increase in 2007). The agreements provide for varying base aggregate annual payments of approximately \$3,988 per year, which decrease periodically to approximately \$1,441 per year. In addition, some agreements have provisions for incentive and additional compensation.

**Note 16—Supplemental Cash Flow Information**

Cash paid for interest expense and income taxes amounted to the following:

	Years ended		
	December 28, 2002	December 29, 2001	December 30, 2000
Interest expense	\$17,217	\$17,541	\$19,810
Income taxes	\$63,196	\$37,222	\$28,219

The fair value of assets acquired through business acquisitions is indicated in the following table:

	Years ended		
	December 28, 2002	December 29, 2001	December 30, 2000
Fair value of assets acquired, excluding cash	\$36,224	\$10,074	\$6,838
Less: Liabilities assumed and created upon acquisition	—	(1,486)	—
Net cash paid	\$36,224	\$ 8,588	\$6,838

**HENRY SCHEIN, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)**

(In thousands, except share data)

**Note 17—Quarterly Information (Unaudited)**

The following presents certain unaudited quarterly financial data:

	Quarters ended			
	March 30, 2002	June 29, 2002	September 28, 2002	December 28, 2002
Net Sales	\$647,093	\$671,432	\$759,073	\$747,403
Gross profit	178,390	192,396	216,472	207,646
Operating income	35,198	46,989	64,285	50,531
Net income	19,730	28,066	39,228	30,963
Net income per common share:				
Basic	\$ 0.46	\$ 0.65	\$ 0.90	\$ 0.70
Diluted	\$ 0.45	\$ 0.63	\$ 0.87	\$ 0.69

	Quarters ended			
	March 31, 2001	June 30, 2001	September 29, 2001	December 29, 2001
Net Sales	\$593,895	\$606,285	\$659,774	\$698,289
Gross profit	159,357	166,892	178,856	194,219
Operating income	27,583	35,272	41,875	43,020
Net income	14,132	20,910	25,195	27,136
Net income per common share:				
Basic	\$ 0.34	\$ 0.49	\$ 0.59	\$ 0.64
Diluted	\$ 0.33	\$ 0.48	\$ 0.58	\$ 0.62

The Company's business is subject to seasonal and other quarterly influences. Net sales and operating profits are generally higher in the fourth quarter due to the timing of sales of software and equipment, year end promotions and purchasing patterns of office-based healthcare practitioners, and are generally lower in the first quarter due primarily to the increased purchases in the prior quarter. Quarterly results also may be materially affected by a variety of other factors, including the timing of acquisitions and related costs, timing of purchases, special promotional campaigns, fluctuations in exchange rates associated with international operations and adverse weather conditions.

In 2002, influenza vaccine sales occurred earlier than they did in 2001. The timing shift, from the fourth quarter to the third quarter, equated to approximately \$44,000 of third quarter 2002 sales, which net of related costs and expenses, accounted for approximately \$0.11 of the third quarter diluted earnings per common share.

Diluted earnings per share calculations for each quarter include the effect of stock options, when dilutive to the quarter's weighted average number of common shares outstanding for each period, and therefore the sum of the quarters may not necessarily be equal to the full year earnings per share amount.



## CORPORATE INFORMATION

Corporate Headquarters  
Henry Schein, Inc.  
135 Duryea Road  
Melville, New York 11747  
U.S.A.  
(631) 843-5500  
henryschein.com

### Common Stock

Henry Schein Common Stock trades on the NASDAQ Stock Market® under the symbol "HSIC".

### Annual Shareholders Meeting

Our Annual Meeting of Shareholders will be held on June 18, 2003 at 10:00 a.m. at the Melville Marriott Long Island Hotel in Melville, New York.

### Henry Schein on the Internet

For more information about Henry Schein and its products and services, go to [henryschein.com](http://henryschein.com). Other Company Web sites include: [sullivanschein.com](http://sullivanschein.com); [caligor.com](http://caligor.com); [giv.com](http://giv.com); [dentrrix.com](http://dentrrix.com); [easydental.com](http://easydental.com); [labnet.net](http://labnet.net); [ident.com](http://ident.com); [digitaldentaloffice.com](http://digitaldentaloffice.com); [zahndental.com](http://zahndental.com); [studentdentist.com](http://studentdentist.com); and [avimark.com](http://avimark.com).

### Shareholder Reports and Investor Inquiries

For shareholder inquiries, including requests for quarterly and annual reports, contact our Investor Relations department at (631) 843-5611/5562, or e-mail your request to [investor@henryschein.com](mailto:investor@henryschein.com). Printed materials can also be requested through the Company's Web site.

### Form 10-K

A copy of the Company's annual report on Form 10-K for the fiscal year ended December 28, 2002, is available without charge to shareholders upon request to the Company's Investor Relations department. The report is also available on the Company's Web site.

### Independent Auditors

BDO Seidman, LLP  
330 Madison Avenue  
New York, N.Y. 10017

### Legal Counsel

Proskauer Rose, LLP  
1585 Broadway  
New York, N.Y. 10036

### Stock Transfer Agent

For address changes, account consolidation, registration changes, and lost stock certificates, please contact: Continental Stock Transfer & Trust Company  
17 Battery Place  
New York, N.Y. 10004  
(212) 509-4000

This Annual Report contains forward-looking statements under "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere. The Company's results may differ materially from those expressed in or indicated by such forward-looking statements. The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements.

## CORPORATE MISSION

To be the worldwide leader  
in providing the best quality and value  
in products and services for our  
healthcare customers.



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