

HEALTH*T***RONICS**

*2000
Annual
Report*

Management's Letter to the Shareholders

Fellow shareholders, the final year of the Millennium was a watershed year for HealthTronics. Your Company reached many milestones in 2000, the effects of which included 39% growth in revenues and 50% growth in earnings per share. More important for the future of your Company, HealthTronics established itself as the US leader in orthopaedic extracorporeal shock wave therapy (ESWT), while the urology business continued its pattern of solid growth.

Among the most exciting developments this year were those realized in our orthopaedic division. You may recall that the results of our placebo controlled, double blinded study on heel pain (plantar fasciitis) were submitted to the Food and Drug Administration (FDA) at the end of 1999.

The FDA completed initial review of the results and filed the PMA within 30 days. On July 20, the Orthopaedic and Rehabilitation Devices Panel of the FDA met to discuss the OssaTron® PMA and recommended its approval. Less than three months later, on October 12, 2000, the FDA granted HealthTronics approval to market the OssaTron extracorporeal shock wave system for the treatment of plantar fasciitis. Our orthopaedic division has since done an outstanding job establishing physician partnerships, placing machines and training orthopaedic surgeons and podiatrists. By the end of the year, almost 100 physicians had been trained and credentialed on the use of the OssaTron, and Orthotripsy® extracorporeal shock wave treatment had commenced at some 20 sites in 12 states.

Our achievements in orthopaedics have garnered a good deal of publicity for HealthTronics. Stories about the OssaTron have appeared on newscasts on ABC, CBS, NBC and Fox networks, and, in 2001, the OssaTron will be showcased in various venues, including PBS's American Medical Revolutions and on BroadcastAmerica.com. Articles about the OssaTron also have appeared in Reader's Digest and Parade Magazine, as well as in various key health, fitness and sports periodicals.

Going forward, we are conducting ongoing studies with the OssaTron for the treatment of tennis elbow and delayed fracture healing.

Our urology division also remained very strong in 2000, consistently placing new lithotripters and other urology devices into the marketplace. We believe that HealthTronics continues to be the number one provider of new lithotripsy equipment in the United States. We currently have more than 90 LithoTron® devices operating throughout the country. As always, our strategy is to derive recurring revenue from every machine in operation, and we have accomplished this by retaining an equity interest in approximately 50% of these devices. Additional recurring revenue is generated through the sale of consumables and maintenance service and through the management of partnerships.

Another product in our urology line is the LithoTron Ultra - a state-of-the-art endourology system designed primarily for major institutions, many of which are beginning to replace their aging equipment. These facilities generally experience large patient volume and therefore, the efficacy and reliability of the LithoTron Ultra are especially appealing. Its shock wave generating system boasts one of the highest stone-free rates (86.1%) and one of the lowest retreatment rates (4.1%) of any lithotripsy device on the market. Thus far, five of the largest lithotripsy centers in North America have upgraded their facilities with the LithoTron Ultra. Most recently, we have obtained the rights to sell the CystoTron™ urodiagnostic table. This device can be used to perform various urologic procedures. We expect to sell several of these devices during 2001.

Growth was the keyword at your Company this year, not only in terms of revenues and earnings, but also in terms of office space and employees. In April, HealthTronics moved from a 6,250 square foot facility to new corporate headquarters with 25,000 square feet of office and warehouse space. We also increased our staff through the course of the year from 52 to 85 employees in order to handle the increased operations experienced in 2000.

As we enter the new millennium, we anticipate more exciting and challenging prospects for growth. We continue to have the opportunity to look at new products, hoping to expand our product line in urology and orthopaedics. We appreciate your continued support and encourage your suggestions, compliments or criticisms.



Argil J. Wheelock, MD
Chairman & CEO



Roy S. Brown
President & COO



Argil J. Wheelock, MD
Chairman and Chief Executive Officer



Roy S. Brown
President and Chief Operating Officer

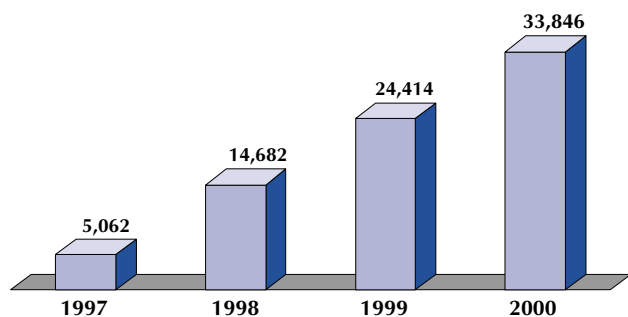
Financial Highlights

(in thousands except per share amounts)

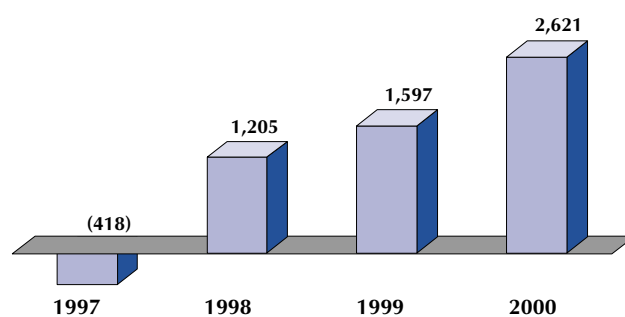
| Consolidated Statement of Operations Data | Years ended December 31 | 2000 | 1999 | 1998 | 1997 |
|---|-------------------------|------------|------------|----------|----------|
| | Revenues | | \$33,846 | \$24,414 | \$14,682 |
| Cost of goods sold, rentals and services provided | | 14,174 | 10,214 | 6,864 | 3,263 |
| Gross margin | | 19,672 | 14,200 | 7,818 | 1,799 |
| General and administrative expenses | | 9,301 | 6,493 | 3,975 | 2,187 |
| Other income (expense) | | 1,149 | 155 | 15 | (29) |
| Income (loss) before minority interest | | 11,520 | 7,863 | 3,801 | (422) |
| Minority interest | | (7,039) | (5,076) | (2,292) | (4) |
| Income (loss) before taxes | | 4,481 | 2,787 | 1,509 | (418) |
| Net income (loss) | | 2,621 | 1,597 | 1,205 | (418) |
| Net income (loss) per share | | | | | |
| Basic | | 0.24 | 0.16 | 0.13 | (0.05) |
| Diluted | | 0.24 | 0.16 | 0.13 | (0.05) |
| Weighted average common shares outstanding | | | | | |
| Basic | | 10,826,228 | 10,036,851 | | |
| Diluted | | 11,098,480 | 10,238,379 | | |

| Consolidated Balance Sheet Data | Years ended December 31 | 2000 | 1999 | 1998 | 1997 |
|------------------------------------|-------------------------|--------|----------|----------|---------|
| | Working capital | | \$15,719 | \$12,037 | \$5,413 |
| Total assets | | 30,433 | 23,535 | 14,115 | 6,947 |
| Total liabilities | | 12,249 | 9,407 | 6,490 | 3,587 |
| Stockholders' equity | | 18,184 | 14,128 | 7,625 | 3,359 |

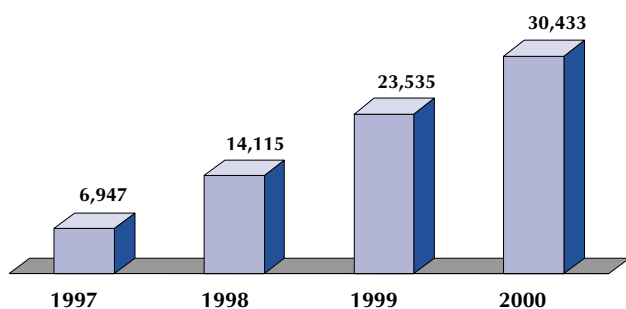
Revenues
(In Thousands)



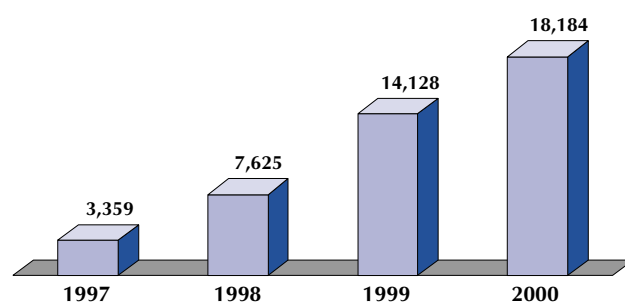
Net Income (Loss)
(In Thousands)



Total Assets
(In Thousands)



Stockholders' Equity
(In Thousands)



Urology

An estimated 600,000 patients per year are diagnosed with kidney stones in the United States. Of these, approximately 250,000 are treated with lithotripsy, a non-surgical therapy for the disintegration of kidney stones that was developed in Germany in the late 1970's and early 1980's. HealthTronics' mission is to provide state-of-the-art noninvasive treatment solutions for certain orthopaedic and urologic problems. Among these treatment solutions is kidney lithotripsy, of which HealthTronics is a provider. As such, HealthTronics supplies the device, the technologist and the consumables required to perform lithotripsy treatment. We provide this service to doctors and medical facilities.

In addition to being a service provider, HealthTronics also sells cutting edge urology devices such as the LithoTron® lithotripter, the LithoTron Ultra endourology work station with lithotripter, and the CystoTron™ urodiagnostic table. At present, there are over 100 HealthTronics urology machines in North America, operating in approximately 35 states and throughout Canada.



LithoTron®



HealthTronics' primary urology product is the LithoTron shock wave lithotripter. A lithotripter breaks kidney and ureteral stones into pieces small enough to be passed from the body through the normal flow of urine. The LithoTron accomplishes this by sending precisely focused, high energy shock waves through the body to the kidney and ureteral stones, pulverizing them into sand-like granules. The LithoTron is highly effective at breaking stones and has one of the best success rates of any lithotripter on the market.

Another benefit of the LithoTron is its portability. Because the LithoTron is small, modular and easy to move, most devices are shared by several hospitals and surgery centers, and are transported among them in small trucks. This high degree of mobility enables one LithoTron to serve multiple facilities. We estimate that 40,000 patients were treated on LithoTron lithotripters in 2000.

Sales of the LithoTron have propelled HealthTronics to its position as a leading provider of new lithotripsy equipment in North America. Since it was granted FDA approval in July 1997, we believe the LithoTron has outsold its nearest competitor by more than 2 to 1. Despite our relatively late entrance into the very mature and highly competitive field of kidney lithotripsy, HealthTronics estimates that it has captured over 15% of the market share thus far and continues to increase its stake in the market.

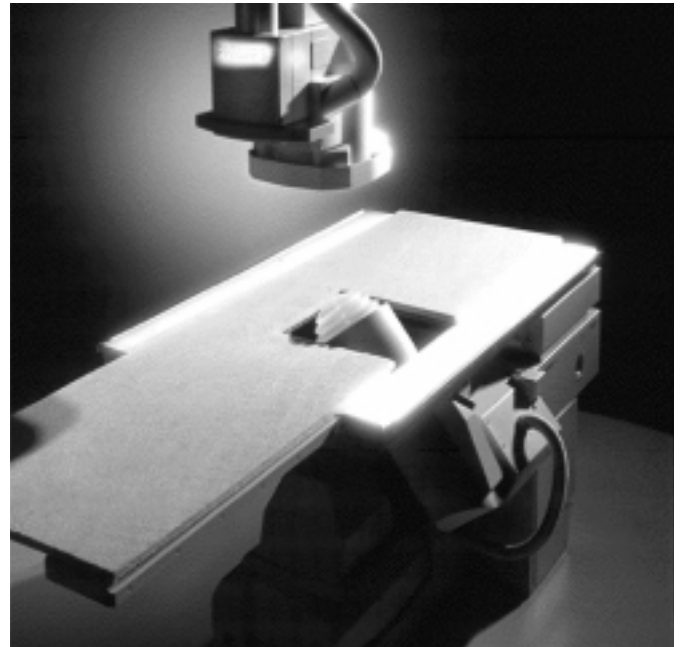


LithoTron® Ultra



The LithoTron Ultra is a high-tech medical device designed jointly by Philips Medical Systems of Germany and HMT of Switzerland. It combines a shock wave lithotripter with a complete diagnostic urology workstation. Because of its extensive range of capabilities, the LithoTron Ultra is especially appealing to major healthcare facilities and large teaching hospitals. In fact, five of the largest lithotripsy centers in North

America already have installed the LithoTron Ultra. The LithoTron Ultra has many outstanding features including a state-of-the-art x-ray system. Through a revolutionary development in x-ray technology, the Ultra is able to produce better images than conventional x-ray devices while significantly reducing radiation exposure -- in some cases, by as much as 95%. In addition, the LithoTron Ultra's lithotripsy system boasts the same excellent rate of success as the LithoTron. These benefits and many more make the LithoTron Ultra a superb adjunct to any urology program. This device has been well received in the urologic medical community, and we expect to sell many more in the future.



CystoTron™



The CystoTron is a diagnostic urology table, which was developed by Philips Medical Systems of Germany. HealthTronics has obtained the exclusive right to sell this device in the United States, Canada and Mexico. We began marketing the CystoTron in 2000.

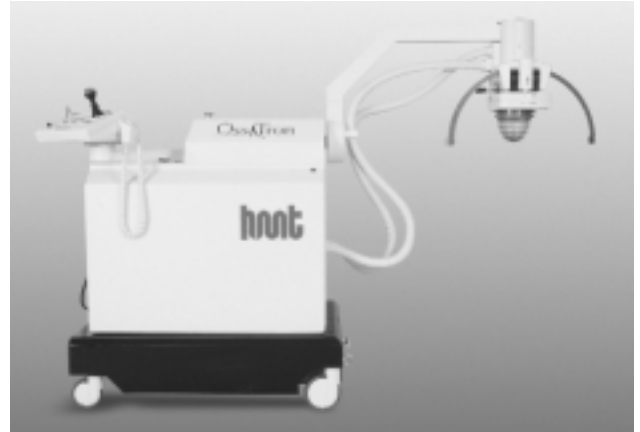
The CystoTron can be used to perform a variety of urologic examinations, procedures and treatments. It is versatile, easy to operate and has the same state of the art x-ray system as the LithoTron Ultra. This top quality urology device is well suited to meet the demanding needs of today's healthcare system.



Orthopaedics

OssaTron®

HealthTronics is the current leader in orthopaedic shock wave technology in North America. We are the first, and presently the *only* company with FDA approval to provide extracorporeal shock wave therapy (ESWT) to the commercial orthopaedic market. Our OssaTron® orthopaedic shock wave system was approved by the FDA on October 12, 2000 for the treatment of plantar fasciitis (also known as heel spurs or heel pain syndrome). This approval was highly anticipated by the orthopaedic and podiatric communities, and by the end of the year there were 20 OssaTron devices in the marketplace and almost 100 orthopaedic surgeons and podiatrists who had been trained and certified.



An estimated six and a half million new patients each year are diagnosed with plantar fasciitis. Of this number, we believe that a significant percentage could be candidates for ESWT with the OssaTron. This is good news for patients who are hoping to avoid invasive surgery since some of the benefits of ESWT over surgery include less associated pain and complications, faster recovery and lower costs.

In Europe, studies and treatments have shown shock waves to be effective in healing other soft tissue indications such as lateral epicondylitis (also known as tennis elbow, for which HealthTronics is currently conducting an FDA study), Achilles tendonitis, patellar tendonitis and shoulder tendonitis. Although there is no verifiable incidence data for these disorders, various sources estimate that between three and four million people annually in the United States may begin to suffer from each of these conditions. Based upon the widespread European applications of ESWT, HealthTronics is very optimistic about the future of ESWT in the United States.

The OssaTron has also exhibited the potential to stimulate healing of nonunion fractures and other pathologic conditions of the bone. We are currently conducting an FDA study for the treatment of delayed union fractures, and pending studies include the treatment of avascular necrosis of the head of the femur. We believe that many of the 50,000 surgeries performed each year for these disorders could be prevented by treatment with the OssaTron.



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

FORM 10-KSB

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

for the fiscal year ended December 31, 2000

or

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

COMMISSION FILE NUMBER 000-30406

HealthTronics, Inc.

(Exact name of registrant as specified in its charter)

GEORGIA **58-2210668**
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

1841 WEST OAK PARKWAY, SUITE A
MARIETTA, GEORGIA **30062**
(Address of principal executive (Zip Code)
offices)

(770) 419-0691
(Registrant's telephone number, including area code)

Securities registered under section 12(b) of the Exchange Act:

NONE

Securities registered under section 12(g) of the Exchange Act:

Common Stock, no par value

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

State issuer's revenues for the most recent fiscal year.

\$33,846,015

As of February 13, 2001 the aggregate market value of the voting and non-voting common equity held by non-affiliates was **\$126,187,027**.

State the number of shares outstanding of each of the issuer's classes of common stock.

10,972,785 Shares of No Par Value Common Stock as of February 13, 2001

Transitional Small Business Disclosure Format: YES NO

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the issuer's Proxy Statement for the Annual Meeting of Shareholders to be held on May 18, 2001 are incorporated by reference in Part III.

Cautionary Statements

Included in this report are forward-looking statements that reflect management's current outlook for future periods. As always, these expectations and projections are based on currently available competitive, financial, and economic data, along with operating plans, and are subject to future events and uncertainties, including those uncertainties identified under the caption "Risk Factors" in Item 1 of this report.

Part I

Item 1: Description of Business.

General

HealthTronics, Inc. (may be referred to as the "Company", "we", "us" or "our") is a Georgia corporation founded in 1995 for the purpose of providing state-of-the-art noninvasive treatment solutions for certain urologic and orthopaedic conditions. Our medical devices include the OssaTron(R) orthopaedic shock wave system, the LithoTron(R) kidney lithotripter and the LithoTron Ultra endourology workstation. In 2000, we also began to market the CystoTron(TM) urodiagnostic table. All of these devices have been approved by the Food and Drug Administration (FDA) and are currently marketed throughout Europe. These products are currently manufactured by HMT High Medical Technologies AG ("HMT") of Switzerland and Philips Medical Systems of Germany.

As part of its strategy, the Company also is a provider of lithotripsy and Orthotripsy(R) services to doctors, medical facilities and, increasingly, directly to patients. As a service provider, HealthTronics supplies the device, the technologist and the consumables required to perform lithotripsy or Orthotripsy treatment. Frequently we involve physician partners in these service provider entities.

The Company had 121 employees as of December 31, 2000, and management believes that relations with the employees are good.

The Orthopaedic Market

The OssaTron(R)

The OssaTron is an extracorporeal (non-invasive) medical device, which uses high energy shock waves to treat chronic musculoskeletal injuries. Orthotripsy(R), the name for this treatment, is an extension of the process used to disintegrate kidney stones.

Orthotripsy is the transmission of shock waves into the site of a chronic musculoskeletal injury. Most chronic injuries are characterized by scar and inflammatory tissue. The shock waves are applied to these tissues, creating controlled microscopic injuries within these already damaged tissues. We believe the resulting microscopic injuries stimulate the formation and growth of new blood vessels into the area. We further believe that these new blood vessels infiltrate the injury site, bringing with them bone-healing and tissue-healing cells which stimulate the healing process. The result is a physiologic repair of the musculoskeletal problem. The benefits to the patient are less associated pain and complications, faster recovery and lower costs.

HealthTronics' OssaTron device has been used successfully in Europe since 1995 to treat a variety of orthopaedic disorders such as plantar fasciitis (heel spurs), lateral epicondylitis (tennis elbow), Achilles tendonitis, patellar tendonitis, avascular necrosis, shoulder calcification and nonunion fractures. On October 12, 2000, the FDA granted a Class III pre-market approval ("PMA") for marketing of the OssaTron for the treatment of plantar fasciitis.

Market Overview

HealthTronics is the first company to market orthopaedic shock wave technology in North America. To our knowledge, the Company's OssaTron device is currently the only orthopaedic extracorporeal shock wave therapy (ESWT) system with Class III FDA approval. Our OssaTron orthopaedic shock wave device was approved by the FDA on October 12, 2000 for the treatment of plantar fasciitis (also known as heel spurs or heel pain syndrome). There is no verifiable data on the number of cases of plantar fasciitis, but we estimate that about six and a half million new patients each year present with this malady. Of these, HealthTronics believes that a significant percentage could be candidates for treatment with the OssaTron rather than having to undergo invasive surgery.

HealthTronics believes the OssaTron might be used to treat a variety of additional orthopaedic disorders. Other soft tissue indications for the OssaTron could include lateral epicondylitis (also known as tennis elbow, for which we are currently conducting an FDA study), Achilles tendonitis, patellar tendonitis and shoulder tendonitis. Although there is no verifiable incidence data for these indications, we estimate that between three and four million people annually may begin to suffer from these conditions. The OssaTron has also exhibited the potential to stimulate healing of nonunion fractures and other pathologic conditions of the bone.

Our preferred marketing strategy is to place the OssaTron devices into limited partnerships of which HT Orthotripsy Management Company, LLC, a wholly-owned subsidiary of the Company, is the general partner. The Company capitalizes each partnership with an OssaTron. We then negotiate with hospitals and surgery centers to provide Orthotripsy

services within their facilities. We pay the hospital or surgery center a fee for access to their facility. The Company then bills the third party payors for the facility fee, the technical fee and, sometimes, the professional fee. A percentage of the limited partnership interest may be sold to physicians or other partners. Our goal with this arrangement is to generate recurring revenue for the Company for as long as the device is operational.

Competition

HealthTronics knows of no company that has either received FDA approval to market a Class III orthopaedic shock wave device or submitted a PMA to the FDA for such a device. We believe that Dornier Medical Systems and Siemens GmbH are in the process of conducting clinical studies with their respective orthopaedic shock wave devices for the treatment of chronic orthopaedic injuries.

The Urology Market

LithoTron(R) Lithotripter

HealthTronics' primary urology product is the LithoTron lithotripter. The LithoTron was developed by HMT of Switzerland. Since 1996, HealthTronics has had the exclusive right to market this device in the United States, Canada, and Mexico.

A lithotripter breaks kidney and ureteral stones into pieces small enough to be passed from the body through the normal flow of urine. The LithoTron does this by sending precisely focused, high energy shock waves through the body to kidney and ureteral stones, thus pulverizing the stones into sandlike granules, which can be eliminated from the body normally.

HealthTronics received FDA approval for the LithoTron on July 21, 1997, after completion of a four-site Investigational Device Exemption (IDE) study. Since that time, we believe HealthTronics has become a leading provider of new lithotripsy equipment in North America.

One of the reasons for the overwhelming popularity of the LithoTron is its effectiveness. We believe the LithoTron has one of the highest success rates (86.1%) and one of the lowest retreatment rates (4.1%) of any lithotripter on the market. In addition, the LithoTron is very safe for patients, easy for physicians and technologists to operate, and cost effective for healthcare facilities. These factors have also helped to make the LithoTron one of the top-selling lithotripters in North America. Thus far, HealthTronics has captured over 15% of this very mature and highly competitive market.

The LithoTron is small, modular and easy to move. Most LithoTrons are shared by several

hospitals and surgery centers and are transported among them in small trucks. This high degree of mobility enables a LithoTron to serve multiple facilities. We estimate that over 40,000 patients were treated on LithoTron lithotripters in 2000.

LithoTron Ultra Endourology Device

The LithoTron Ultra endourology workstation was developed jointly by HMT of Switzerland and Philips Medical Systems of Germany. HealthTronics has the exclusive right to market this product in the United States, Canada and Mexico. We received supplemental approval from the FDA to begin marketing the device in 1999.

The LithoTron Ultra was designed for fixed site installation at hospitals and large surgery centers. To date, five of the largest lithotripsy centers in North America have installed the LithoTron Ultra. This device not only has the ability to disintegrate kidney stones in the same manner as the LithoTron device but also has significant diagnostic capabilities. This multifunctional device can be used to perform a variety of urologic examinations, procedures and treatments.

Among its many features, the LithoTron Ultra has a state of the art x-ray system, which produces better images than conventional x-ray techniques. In addition to its superb imaging, the x-ray system significantly reduces the amount of radiation exposure received by patients and medical staff. In some cases, radiation exposure can be decreased by as much as 95%.

CystoTron

The CystoTron diagnostic urology table was developed by Philips Medical Systems of Germany. HealthTronics has the exclusive right to sell this device in the United States, Canada and Mexico, and began marketing this device in 2000. The CystoTron can be used to perform various urologic examinations, procedures and treatments. Like all of HealthTronics' products, the CystoTron provides maximum comfort and safety for patients and physicians. The CystoTron is versatile, easy to operate and has the same state of the art x-ray system as the LithoTron Ultra.

Market Overview

It is estimated by healthcare providers that approximately 600,000 patients per year are diagnosed with kidney stones in the United States. Of these, approximately 250,000 will be treated with lithotripsy, a non-surgical therapy for the disintegration of kidney stones that was developed in Germany in the late 1970's and early 1980's. At the end of 2000, it is estimated that there were approximately 550 active lithotripter systems in operation in the United States that were either installed in hospitals or outpatient centers, or were operating as mobile/transportable devices. The majority of these lithotripsy devices were distributed by companies other than HealthTronics.

At the end of 2000, there were approximately 100 HealthTronics urology devices operating in North America.

Marketing Strategy

The kidney lithotripsy market is extremely competitive and, therefore, we have a multifaceted marketing strategy. Our primary focus is the creation of lithotripsy partnerships with urologists. Within these partnerships we may be the manager, general partner or minority partner. These partnerships generally act as a vendor of lithotripsy services to hospitals and surgery centers on a per patient charge basis.

The Company also leases equipment to hospitals and doctors with whom we have no other affiliation. Additionally, we sell equipment directly to non-affiliates.

Competition

Our competitors in the field of kidney lithotripsy include companies such as Dornier Medical Systems, Siemens GmbH, Medstone International, Inc., Storz Medical Systems, Prime Medical Services, Inc., Integrated Health Care Services, and American Kidney Stone Management. All of these companies have been operating in the kidney lithotripsy business longer than HealthTronics, and in many cases are better financed than we are. They also enjoy a high degree of name recognition for their products and service.

Technology Services

HealthTronics formed its own Technology Services Division (HTSD) in 1999. Since that time, HTSD has been providing installation, maintenance, service and technical support for our products. The service provided includes warranty work on new equipment as well as post-warranty service. Post-warranty service is provided on either a contractual or a time and materials basis.

All service engineers meet the stringent certification prerequisites of the manufacturer HMT and HealthTronics. Their certification guarantees full compliance with all Good

Manufacturing Practice (GMP) requirements of HMT. Annual re-certification of our engineers ensures they have the most current knowledge of our products and that all service performed meets the manufacturer's conditions for GMP.

The equipment service business is very competitive, and it is entirely possible that other national or local medical device service companies will also attempt to capture a share of this business.

Risk Factors

Each of the following risk factors could adversely affect our business, financial condition and operating results, as well as the value of an investment in our common stock.

We are entirely dependent on HMT to manufacture the products we distribute. If HMT ceased operations we might not find a suitable alternative manufacturer.

Our products are manufactured by HMT, a privately held company that does not publish any financial information. If HMT experiences financial, manufacturing or development difficulties or if there are adverse developments in our relationship with HMT, we may be required to find an alternative manufacturer or to manufacture our products on our own. We may not be able to find an alternative source to develop or manufacture our products on a timely basis or on terms acceptable to us. We do not own or operate any manufacturing facilities nor do we have current plans to manufacture any of our medical devices.

If we are not able to establish or maintain relationships with physicians and hospitals, our ability to successfully commercialize our current or future products will be materially harmed.

Our success in developing and assisting in the operation of lithotripsy and Orthotripsy partnerships in which we hold an interest will depend on our ability to develop and maintain relationships with physician groups and hospitals, consistent with government regulations affecting these relationships. We cannot ensure that we will be successful in identifying and establishing relationships with physicians or hospitals, nor can we ensure that affiliated physician groups will maintain successful medical practices or that any particular key member of a physician group will continue to practice with an affiliated partnership. Furthermore, disputes may arise periodically between physicians or hospitals and us regarding the management or operation of any of the partnerships in which we have an interest. Other factors that could interfere with our relationships with physicians include dissatisfaction with our medical devices, regulatory changes, retirement of physician investors and efforts by our competitors.

Because of extensive healthcare regulation, we may not be able to enter into certain transactions with healthcare professionals or facilities to place our products in service.

Our operations and those of healthcare professionals and facilities with which we do business are subject to extensive regulation by federal and state governments. Such regulations may force us to delay, modify or avoid certain transactions that would otherwise benefit the Company.

The Medicare and Medicaid Anti-Kickback Statute (“Anti-Kickback Statute”) prohibits certain business practices and relationships under Medicare, Medicaid and other federal healthcare programs. Prohibited practices include the payment, receipt, offer or solicitation of money in connection with the referral of patients for services covered by a federal or state healthcare program. We contract with physicians under a variety of financial arrangements, and physicians have ownership interests in some entities in which we too have an interest. If we are found to have failed to comply with any of these laws, we could suffer criminal and civil penalties and/or exclusion from participating Medicare, Medicaid or other governmental healthcare programs and possible license revocation.

The Federal Self-Referral Law prohibits a physician from referring a patient to an entity with which he or she (or a family member) has a financial relationship if the referral involves a “designated health service” reimbursable under the Medicare or Medicaid programs. The term “designated health services” does not specifically include orthopaedic ESWT. However, lithotripsy procedures are currently required to be billed to Medicare as hospital services. Inpatient and outpatient hospital services are expressly included among designated health services covered under the statute. Accordingly, lithotripsy could be covered under the Federal Self-Referral Law as well. If orthopaedic ESWT procedures are performed under arrangements with hospitals, then they may be covered under the Federal Self-Referral Law as well. If orthopaedic ESWT is deemed covered under the statute because such services are required to be billed through a hospital or on some other basis and no exception is provided, referrals of Medicare and Medicaid patients by physicians with an ownership interest in, or a compensation arrangement with, a partnership, or with a hospital or ambulatory surgery center (“ASC”) with which the Partnership had leasing arrangements, may be prohibited. The final regulations do provide that a rental arrangement that otherwise satisfies a lease exception may provide for payment on a per-treatment or usage basis, even if physicians own the equipment and refer their patients for treatments using the equipment.

In addition to these federal laws, many states have adopted similar laws. Some of these laws apply even if the payment for care does not come from the government. While there is little precedent for the interpretation or enforcement of these state laws, we cannot assure you that these laws will not be enforced against us or that our attempts to structure our financial relationships with physicians and others in light of these laws will be effective.

Third-party payors could refuse to reimburse healthcare providers for use of our current or future products, which could make our revenues decline.

Third-party payors are increasingly attempting to contain healthcare costs by limiting both coverage and the level of reimbursement of new medical procedures and treatments. Consequently, significant uncertainty exists as to the reimbursement status of newly approved healthcare products. The hospitals and surgery centers to which we currently provide lithotripsy services are reimbursed for lithotripsy services under various federal and

state programs, including Medicare and Medicaid, primarily at fixed rates. These programs are subject to statutory and regulatory changes, administrative rulings, interpretations of policy and governmental funding restrictions, all of which may have the effect of decreasing program payments, increasing costs or requiring us to modify the way in which we operate our business. These changes could have a material and adverse effect on us.

With respect to the OssaTron, we cannot ensure that third-party payors will establish and maintain price levels sufficient for us to realize an appropriate return on our investment. Furthermore, physicians, hospitals and other healthcare providers may be reluctant to purchase our products if they do not receive sufficient reimbursement for the cost of the procedures using our products.

We face intense competition and rapid technological change that could result in products that are superior to the products we are commercializing or developing.

The medical device industry is subject to rapid and significant technological change. Our competitors may develop technologies and products that are more effective or less costly than any of our current or future products or that could render our products obsolete or noncompetitive. Many of these competitors have substantially greater resources and marketing capabilities than we do.

We may be subject to costly and time-consuming product liability actions that would materially harm our business.

Our business exposes us to potential product liability risks that are inherent in the testing, manufacturing, marketing and selling of medical devices, including those which may arise from misuse or malfunction of, or design flaws in, our products. We may be held liable if any of our products causes injury or is found otherwise unsuitable during product testing, manufacturing, marketing or sale. Treatment with ESWT may result in a variety of complications, in particular, post-treatment pain and neurological symptoms. We cannot ensure that we will be able to avoid product liability exposure. Product liability insurance for the medical technology industry is generally expensive, if available at all. We cannot assure that our present insurance coverage is adequate or that we can obtain adequate insurance coverage at a reasonable cost in the future.

Difficulties in managing growth could materially harm our business, financial condition and operating results.

Our recent growth has imposed significant added responsibilities on members of management, including the need to identify, recruit, maintain and integrate additional employees, including management. Future growth could strain our operations, product development and other managerial and operating resources. Our future financial

performance and ability to compete effectively will depend, in part, on our ability to manage any future growth effectively.

Our success will depend partly on our ability to operate without infringing on or utilizing the proprietary rights of others.

The medical device industry is characterized by a substantial amount of litigation over patent and other intellectual property rights. No one has claimed that any of our medical devices infringe on their intellectual property rights; however, it is possible that we may have unintentionally infringed on others' patents or other intellectual property rights. Intellectual property litigation is costly. If we do not prevail in any litigation, in addition to any damages we might have to pay, we could be required to stop the infringing activity or obtain a license. Any required license may not be available to us on acceptable terms. If we fail to obtain a required license or are unable to design around a patent, we may be unable to sell some of our products, which would reduce our revenues and net income.

If we fail to attract and retain key personnel and principal members of our management staff, our business, financial condition and operating results could be materially harmed.

Our success depends greatly on our ability to attract and retain qualified management and technical personnel, as well as to retain the principal members of our existing management staff. The loss of services of any of these persons could adversely affect the commercialization of our current products and our ability to develop and commercialize future products. There is intense competition for qualified staff, and we cannot assure that we will be able to attract and retain the necessary qualified staff to develop our business. If we fail to attract and retain key management staff, or if we lose any of our current management team, our business, financial condition and operating results could be materially harmed.

Market volatility may affect our stock price.

Our stock price has a history of volatility. This volatility has existed even in the absence of significant news or developments about us. Moreover, the stocks of medical technology companies and the stock market generally have been subject to dramatic price swings in recent years, with the stock of small capitalization companies, like ours, experiencing the greatest volatility. These price swings, both as to our stock and as to our industry and the stock market generally, are likely to continue.

Item 2: Description of Property.

In January 2000, we negotiated a seven-year lease on a 28,000 square foot facility located in Marietta, Georgia. We took occupancy of the new facility in April 2000. The monthly rental is calculated on a graduating scale beginning at \$8,500 per month for the first year and ending with \$18,600 per month for the last year. The straight-line expense is \$17,800 per month for the life of the lease. The property is in good condition and is sufficient to meet our current operating needs.

Item 3: Legal Proceedings.

The Company is periodically involved as a plaintiff or defendant in various legal actions, in the ordinary course of its business. Management believes that those claims are without merit or that the ultimate liability, if any, resulting from them will not materially affect the Company's financial condition.

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

No matters were submitted to a vote of shareholders of the Company during the fourth quarter of the Company's fiscal year ended December 31, 2000.

Part II

Item 5: Market for Common Equity and Related Shareholder Matters.

We began trading on the NASDAQ Stock Market on November 16, 1999 under the symbol HTRN. The following table sets forth the high and low sales price for our Common Stock for the quarters indicated as reported.

| <u>Fiscal Year ended December 31, 1999</u> | <u>High</u> | <u>Low</u> |
|--|-------------|------------|
| Fourth Quarter | \$9.00 | \$6.25 |
| <u>Fiscal Year ended December 31, 2000</u> | <u>High</u> | <u>Low</u> |
| First Quarter | \$20.94 | \$ 8.31 |
| Second Quarter | \$19.81 | \$11.38 |
| Third Quarter | \$21.00 | \$12.25 |
| Fourth Quarter | \$15.25 | \$ 5.00 |

The stock markets have experienced extreme price and volume fluctuations during certain periods. These broad market fluctuations and other factors may adversely affect the market price of our common stock. Any shortfall in revenue or earnings from levels expected by securities analysts could have an immediate and significant adverse effect on the trading price of our common stock in

any given period. Additionally, we may not learn of such shortfalls until late in the fiscal quarter, which could result in an even more immediate and adverse effect on the trading price of our common stock. Finally, we participate in a highly dynamic industry, which often results in significant volatility of the common stock price.

At March 21, 2001, there were approximately 282 shareholders of record.

We have not paid dividends on common stock since our inception in December 1995. Our Board of Directors does not anticipate that any cash dividends will be paid in the foreseeable future.

Item 6: Management's Discussion and Analysis or Plan of Operation.

HealthTronics was organized in December of 1995 to address market opportunities in the fields of urology and orthopaedics. We commenced operations in May 1996.

During 1998 and part of 1999, sales of LithoTron devices, consumables and service, as well as revenues from lithotripsy partnerships and our service provider entities produced revenues which exceeded the necessary funding for our OssaTron FDA studies. In 1999, we also received supplemental FDA approval to market the LithoTron Ultra, and sales of this product provided additional profits.

On October 12, 2000, HealthTronics was granted FDA approval to market the OssaTron orthopaedic extracorporeal shock wave device. The response within the orthopaedic and podiatric communities was overwhelming. As a result, there were 20 OssaTron devices in the market and approximately 100 orthopaedic surgeons and podiatrists certified on the device by the end of 2000. The Company realized revenues of \$24.4 and \$33.8 million in 1999 and 2000, respectively. Profits for the years 1999 and 2000 were \$1.6 and \$2.6 million, respectively.

Results of Consolidated Operations

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

Net Revenue: Net revenue increased from \$24,414,179 for the year ended December 31, 1999 to \$33,846,015 for the year ended December 31, 2000, an increase of 39%. This increase is primarily attributable to the increase in lithotripsy treatment revenues and the increase in device service revenues. The FDA approval of the OssaTron on October 12, 2000 had a minimal impact (6%) on the revenues for the year.

Cost of Goods Sold, Rentals and Services Provided: Cost of goods sold, rentals and services provided increased from \$10,213,821 for the year ended December 31, 1999 to \$14,174,272 for the year ended December 31, 2000, an increase of 39%. This increase is attributable to the direct personnel and device costs associated with the increases in lithotripsy treatment revenues and device service revenues.

Salaries, Wages and Benefits: Salaries, wages and benefits increased from \$2,367,836 for the year ended December 31, 1999 to \$3,113,784 for the year ended December 31, 2000, an increase of 32%. The increase in salaries, wages and benefits is directly attributable to the additional marketing and administrative employees hired to handle the increase in treatment and service revenues and to prepare for new market opportunities as a result of the October 12, 2000 FDA approval of the OssaTron.

General and Administrative Expenses: General and administrative expenses increased from \$4,125,073 for the year ended December 31, 1999 to \$6,187,463 for the year ended December 31, 2000, an increase of 50%. This increase is attributable to the increase in travel, marketing materials, and general and administrative expenses associated with the addition of personnel and the new OssaTron market opportunities. The Company also experienced an increase in legal, accounting, filing and administrative costs associated with being publicly traded.

Equity in Earnings of Unconsolidated Partnerships: Equity in earnings of unconsolidated partnerships increased from \$117,711 for the year ended December 31, 1999 to \$164,516 for the year ended December 31, 2000, a increase of 40%. This increase is attributable to the increase in the earnings of two equity-based US Lithotripsy partnerships in which we invested during 1999.

Partnership Distributions: Partnership distributions increased from \$147,252 for the year ended December 31, 1999 to \$387,997 for the year ended December 31, 2000, an increase of 163%. This increase is due to an increase in the earnings of the four cost-based partnership investments added in 1999.

Gain on Sale of Investment Interest: Gain on sale of investment interest increased from \$151,637 for the year ended December 31, 1999 to \$739,851 for the year ended December 31, 2000, an increase of 388%. This increase is attributable to the sale of a portion of the Company's partnership investments in excess of its cost basis.

Interest Expense: Interest expense increased from \$315,694 for the year ended December 31, 1999 to \$378,523 for the year ended December 31, 2000, an increase of 20%. This increase is attributable to the increase in the consolidated debt used to finance medical device purchases by subsidiary partnerships.

Interest Income: Interest income increased from \$54,546 for the year ended December 31, 1999 to \$235,355 for the year ended December 31, 2000, an increase of 331%. This increase is primarily due to larger average cash equivalents and short-term investments after the Company's public offering in the fourth quarter of 1999.

Minority Interest: Minority interest increased from \$5,076,045 for the year ended December 31, 1999 to \$7,038,613 for the year ended December 31, 2000, an increase of 39%. This increase is attributable to the addition of new lithotripsy subsidiary partnerships as well as the growth in the earnings of the new and existing partnerships.

Provision for Income Taxes: Provision for income taxes increased from \$1,189,638 for the year ended December 31, 1999 to \$1,860,221 for the year ended December 31, 2000, an increase of 56%. The increase is primarily attributable to the increase in income before income taxes.

Liquidity and Capital Resources

Prior to our initial public offering (“IPO”) we satisfied our working capital and capital spending needs through private placements and the sales of medical devices. Subsequent to our IPO, these needs have been met by issuance of common stock on option exercise, the use of short-term borrowings and long-term debt and the sales of medical devices. The subsidiary partnership equipment financing has been provided by term bank debt secured by the related device and guarantees from the various partners, including HealthTronics. The Company maintains a line of credit of \$5,000,000 at December 31, 2000. The line of credit matures April 30, 2001. As of December 31, 2000, we have \$596,114 outstanding under the line of credit.

Cautionary Statements

Included in this report are forward-looking statements that reflect management's current outlook for future periods. As always, these expectations and projections are based on currently available competitive, financial, and economic data, along with operating plans, and are subject to future events and uncertainties, including those uncertainties identified under the caption “Risk Factors” in Item 1 of this report.

Item 7: Financial Statements.

HealthTronics, Inc. and Subsidiaries

Consolidated Financial Statements *Years ended December 31, 2000 and 1999 with Report of Independent Auditors*

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Report of Independent Auditors

The Board of Directors and Shareholders
HealthTronics, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of HealthTronics, Inc. and Subsidiaries as of December 31, 2000 and 1999, and the related consolidated statements of income, shareholders' equity, and cash flows for the years then ended. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

/s/

ERNST & YOUNG LLP

Atlanta, Georgia
February 3, 2001

HealthTronics, Inc. and Subsidiaries

Consolidated Balance Sheets

| | December 31, | |
|--|--------------|--------------|
| | 2000 | 1999 |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 5,822,626 | \$ 5,024,890 |
| Trade accounts receivable, less allowance for doubtful accounts of \$701,134 and \$129,237 at December 31, 2000 and 1999, respectively | 5,158,775 | 4,426,973 |
| Income taxes receivable | 894,763 | — |
| Inventory | 2,702,392 | 1,195,743 |
| Due from affiliated equity partnerships | 210,157 | 162,523 |
| Vendor deposits | 337,151 | 802,009 |
| Prepaid expenses | 314,563 | 48,778 |
| Deferred income taxes | 278,967 | 375,751 |
| Total current assets | 15,719,394 | 12,036,667 |
| Property and equipment, at cost: | | |
| Medical devices placed in service | 13,123,439 | 9,085,000 |
| Office equipment, furniture and fixtures | 539,735 | 129,942 |
| Vehicles and accessories | 1,723,679 | 1,340,420 |
| | 15,386,853 | 10,555,362 |
| Less accumulated depreciation | (4,742,163) | (2,376,510) |
| Net property and equipment | 10,644,690 | 8,178,852 |
| Partnership investments | 473,757 | 318,150 |
| Goodwill (net of accumulated amortization of \$586,793 and \$340,700 at December 31, 2000 and 1999, respectively) | 3,422,490 | 2,905,540 |
| Patent license (net of accumulated amortization of \$54,990 and \$44,993 at December 31, 2000 and 1999, respectively) | 45,010 | 55,007 |
| Other assets | 127,477 | 40,465 |
| Total assets | \$30,432,818 | \$23,534,681 |

| | December 31, | |
|---|--------------|--------------|
| | 2000 | 1999 |
| Liabilities and shareholders' equity | | |
| Current liabilities: | | |
| Trade accounts payable | \$ 1,235,435 | \$ 1,131,142 |
| Customer deposits | 760,779 | 903,352 |
| Income taxes payable | — | 141,652 |
| Warranty accrual | 287,716 | 513,305 |
| Other accrued expenses | 841,025 | 1,099,751 |
| Deferred profit on service contracts | 25,417 | 90,155 |
| Short-term borrowings | 596,114 | — |
| Current portion of long-term debt | 1,521,164 | 1,287,054 |
| Total current liabilities | 5,267,650 | 5,166,411 |
| Deferred income taxes | 664,193 | 12,977 |
| Deferred profit on medical device sales to related parties | 251,867 | 244,194 |
| Long-term debt, less current portion | 1,967,859 | 1,759,126 |
| Minority interest | 3,945,355 | 2,224,087 |
| Other liabilities | 151,627 | — |
| Total liabilities | 12,248,551 | 9,406,795 |
| Shareholders' equity: | | |
| Common stock — no par value, voting: | | |
| Authorized — 30,000,000 shares at December 31, 2000 and 1999; Issued and outstanding — 10,971,585 and 10,716,271 shares at December 31, 2000 and 1999, respectively | 13,744,704 | 12,309,181 |
| Retained earnings | 4,439,563 | 1,818,705 |
| | 18,184,267 | 14,127,886 |
| Total liabilities and shareholders' equity | \$30,432,818 | \$23,534,681 |

See accompanying notes.

HealthTronics, Inc. and Subsidiaries
Consolidated Statements of Income

| | Year ended December 31, | |
|---|-------------------------|--------------|
| | 2000 | 1999 |
| Net revenue | \$33,846,015 | \$24,414,179 |
| Cost of goods sold, rentals and services provided | 14,174,272 | 10,213,821 |
| | 19,671,743 | 14,200,358 |
| Salaries, wages and benefits | 3,113,784 | 2,367,836 |
| General and administrative expenses | 6,187,463 | 4,125,073 |
| | 10,370,496 | 7,707,449 |
| Equity in earnings of unconsolidated partnerships | 164,516 | 117,711 |
| Partnership distributions | 387,997 | 147,252 |
| Gain on sale of investment interest | 739,851 | 151,637 |
| Interest expense | (378,523) | (315,694) |
| Interest income | 235,355 | 54,546 |
| Income before minority interest and income taxes | 11,519,692 | 7,862,901 |
| Minority interest | (7,038,613) | (5,076,045) |
| Income before income taxes | 4,481,079 | 2,786,856 |
| Provision for income taxes | 1,860,221 | 1,189,638 |
| Net income | \$ 2,620,858 | \$ 1,597,218 |
| Basic and diluted income per common share: | | |
| Basic | \$ 0.24 | \$ 0.16 |
| Diluted | \$ 0.24 | \$ 0.16 |
| Weighted average common shares outstanding: | | |
| Basic | 10,826,228 | 10,036,851 |
| Diluted | 11,098,480 | 10,238,379 |

See accompanying notes.

HealthTronics, Inc. and Subsidiaries

Consolidated Statements of Shareholders' Equity

| | Common Stock | | Retained Earnings | Total Shareholders' Equity |
|---|------------------|--------------|-------------------|----------------------------|
| | Number of Shares | Amount | | |
| Balance at January 1, 1999 | 9,665,342 | \$7,403,226 | \$ 221,487 | \$7,624,713 |
| Common stock issued via initial public offering, net of issuance costs of \$1,211,611 | 1,000,000 | 4,788,389 | - | 4,788,389 |
| Common stock issued on exercise of stock options | 50,000 | 115,671 | - | 115,671 |
| Common stock issued to consultants | 929 | 1,895 | - | 1,895 |
| Net income | - | - | 1,597,218 | 1,597,218 |
| Balance at December 31, 1999 | 10,716,271 | 12,309,181 | 1,818,705 | 14,127,886 |
| Common stock issued on exercise of stock options | 252,634 | 1,396,625 | - | 1,396,625 |
| Common stock issued to consultants | 2,680 | 38,898 | - | 38,898 |
| Net income | - | - | 2,620,858 | 2,620,858 |
| Balance at December 31, 2000 | 10,971,585 | \$13,744,704 | \$4,439,563 | \$18,184,267 |

See accompanying notes.

HealthTronics, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

| | Year ended December 31, | |
|---|-------------------------|-------------|
| | 2000 | 1999 |
| Operating activities | | |
| Net income | \$2,620,858 | \$1,597,218 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization | 2,621,743 | 1,783,166 |
| Provision for doubtful accounts | 571,897 | 108,846 |
| Deferred income taxes | 748,000 | 188,198 |
| Deferred profit on medical device sales to related parties | 7,673 | 244,194 |
| Deferred profit on service contracts | (64,738) | 74,155 |
| Equity in earnings of unconsolidated partnerships, net of dividends | (46,805) | (117,711) |
| Minority interest in subsidiaries, net of distributions to minority interests | 1,721,268 | 754,409 |
| Changes in operating assets and liabilities, net of businesses acquired: | | |
| Trade accounts receivable | (1,303,699) | (1,739,468) |
| Income tax receivable | (894,763) | — |
| Inventory | (1,506,649) | (16,445) |
| Due from affiliated equity partnerships | (47,634) | (36,421) |
| Vendor deposits | 464,858 | (802,009) |
| Prepaid expenses | (265,785) | 207,575 |
| Trade accounts payable | 104,293 | 475,302 |
| Customer deposits | (142,573) | 903,352 |
| Income taxes payable | (141,652) | 141,652 |
| Warranty accrual | (225,589) | 217,476 |
| Other accrued expenses | (258,726) | 681,362 |
| Other liabilities | 151,627 | — |
| Net cash provided by operating activities | 4,113,604 | 4,664,851 |

HealthTronics, Inc. and Subsidiaries

Consolidated Statements of Cash Flows (continued)

| | Year ended December 31, | |
|--|-------------------------|--------------|
| | 2000 | 1999 |
| Investing activities | | |
| Purchases of property and equipment, net of businesses acquired | (4,744,534) | (4,800,988) |
| Acquisition of partnership interest | (167,622) | (34,500) |
| Partnership distributions | 58,820 | 75,909 |
| Acquisition of businesses, net of cash acquired | (850,000) | - |
| Other assets | (87,012) | 338 |
| Net cash used in investing activities | (5,790,348) | (4,759,241) |
| Financing activities | | |
| Proceeds from issuance of common stock | 1,435,523 | 4,905,955 |
| Proceeds from issuance of long-term debt | 2,138,751 | 1,292,165 |
| Principal payments on long-term debt | (1,695,908) | (1,831,809) |
| Proceeds from short-term borrowings | 8,106,128 | 4,828,401 |
| Principal payments on short-term borrowings | (7,510,014) | (4,876,995) |
| Net cash provided by financing activities | 2,474,480 | 4,317,717 |
| Net increase in cash and cash equivalents | 797,736 | 4,223,327 |
| Cash and cash equivalents at beginning of year | 5,024,890 | 801,563 |
| Cash and cash equivalents at end of year | \$ 5,822,626 | \$ 5,024,890 |
| Supplemental disclosures of cash flow information | | |
| Cash paid for interest | \$ 378,523 | \$ 315,545 |
| Cash paid for income taxes | \$ 1,116,750 | \$ 887,455 |

See accompanying notes.

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2000

1. Description of the Business and Basis of Presentation

HealthTronics, Inc. (the “Company”) was incorporated in the State of Georgia in 1995. The Company was founded for the purpose of obtaining approval (Pre-Market Approval - “PMA”) from the Food & Drug Administration (“FDA”) for certain products manufactured by HMT High Medical Technologies AG (“HMT”), a Swiss corporation, in particular, certain medical devices utilizing shock wave therapies, known as the LithoTron and the OssaTron. Both products are being used outside the United States and Canada. During 1997, the Company received FDA approval to market the LithoTron. On October 12, 2000, the Company received FDA approval to begin marketing the OssaTron for treatment of plantar fasciitis. The Company is currently establishing additional test sites for OssaTron FDA clinical trials for additional applications.

In 1996, HMT granted to the Company the right to purchase the manufacturing rights to the LithoTron and OssaTron medical devices. The Company also operates under the terms of a distribution agreement with HMT that grants the Company the exclusive right to make, use, sell and lease the LithoTron and OssaTron and related parts in the United States, Canada and Mexico.

With each FDA approval, it is the Company’s intent to generate revenues from three sources: 1) sales of medical devices including related accessories; 2) recurring revenues from leasing, licensing fees, sales of consumable products and maintenance of equipment; and 3) investment income generated from partnerships and joint ventures with physicians, dealerships and hospitals that purchase equipment from the Company, as well as management fees from such entities.

Effective April 1, 1997, the Company entered into an Entity Interest Agreement with U.S. Lithotripsy, LP (“USL”), a Texas limited partnership, and with Litho Management, Inc. (“LMI”). The Entity Interest Agreement granted the Company a 40% ownership interest (0.4% general partnership ownership interest and 39.6% limited partnership ownership interest) in USL in return for the issuance of 200,000 shares of the Company’s common stock. The Entity Interest Agreement also granted LMI a 0.6% general partnership ownership interest in USL (the remaining 59.4% limited partnership interest in USL is owned by independent shareholders).

The April 1, 1997 Entity Interest Agreement constituted the formation of USL as a limited partnership entity. Subsequent to April 1, 1997, USL made a number of investments as the sole general partner in several separate partnerships with equity interests ranging from 10%

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Description of the Business and Basis of Presentation (continued)

to 99% (the “second tier partnerships”), formed for the purpose of purchasing, owning and operating certain medical devices utilizing shock wave therapies. As the sole general partner, USL consolidates the second tier partnerships. Prior to May 1, 1998, the Company used the equity method of accounting for their investment in USL, as the Company was not the majority general partner.

On May 1, 1998, the Company purchased 100% of the outstanding stock of LMI in exchange for 700,000 shares of the Company’s common stock.

The accompanying consolidated financial statements include the accounts of each of the Company’s subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. See Note 5 for discussion of minority interests.

2. Summary of Significant Accounting Policies

Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Reclassifications

Certain prior year balances have been reclassified to conform to the 2000 presentation.

Revenue Recognition and Allowance for Doubtful Accounts

For sales of medical devices to unaffiliated entities, revenue is recognized upon arrival at the destination; for miscellaneous sales of consumables, revenue is recognized at the time of shipment by the Company.

During 1999 and 2000, the Company sold medical devices to certain limited partnerships and limited liability corporations in which the Company has a minority interest and has guaranteed a portion of the long-term obligations related to the purchase of the medical devices. The Company has accounted for these minority interests using the equity or cost

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

basis methods of accounting (depending upon the Company's ability to exercise significant influence over the operating and financial policies of the investment partnership) and deferred a pro-rata portion of the profit, \$7,673 and \$244,194 on sales of the medical devices to these entities for the years ended December 31, 2000 and 1999, respectively.

The Company recognizes a gain or loss on the sale of previously unissued partnership interests when the sale is to investors outside the consolidated group.

Net revenue also includes rental fees for the LithoTron and other medical devices in the clinical setting. Revenue is generated primarily from rental contracts with various medical facilities; the Company does not contract directly with any third party payors including governmental programs or health maintenance organizations. Net revenue under these facility agreements is recorded at established billing rates reduced by an allowance for contractual adjustments. Contractual adjustments arise due to the terms of certain facility agreements which reduce revenue from established billing rates to amounts estimated to be reimbursable under the individual facility agreement. Such adjustments are recognized in the period the services are rendered. Differences in estimates recorded and final settlements are reported during the period final settlements are made.

An allowance for doubtful accounts is established for revenue estimated to be uncollectible and is adjusted periodically based upon management's evaluation of current economic conditions, historical collection experience, and other relevant factors which, in the opinion of management, deserve recognition in estimating such allowance.

Inventory

Inventory is carried at the lower of cost (first-in, first-out) or market and consists of medical devices and consumables.

Partnership Investments

During 2000 and 1999, the Company made a number of investments in various general and limited partnerships. The majority of these investments are consolidated (see Note 5) based upon the Company's ability to exercise control. The remaining investments totaling \$473,757 and \$318,150 at December 31, 2000 and 1999, respectively, were recorded using the cost or equity method of accounting, depending upon the Company's ability to exercise significant influence over the

operating and financial policies of the investment partnership.

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Patent License

The original cost of the patent license is being amortized on a straight-line basis over a period of ten years, which approximates the life of the patent.

Property and Equipment

Property and equipment is stated at cost. Depreciation is computed based on the straight-line method over the three to five-year estimated useful lives of the related equipment.

Warranty Accrual

The Company accrues service and parts warranty expense on the sale of each medical device sold with a warranty.

Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*. Under this method, deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that are expected to be in effect when the differences are expected to be recovered or settled.

Stock Based Compensation

The Company has elected to follow Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations in accounting for employee stock options and adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock Based Compensation* ("FAS 123") for option grants to employees. The Company generally grants stock options for a fixed number of shares to employees with an exercise price equal to the fair value of the shares at the date of grant, and, accordingly, recognizes no compensation expense for the employee stock option grants.

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 amounts

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Concentrations of Credit Risk

The Company sells its products primarily in the United States, Canada and Mexico. Credit is extended based on an evaluation of the customer's financial condition and collateral is generally not required.

Fair Value of Financial Instruments

The Company's financial instruments are comprised principally of cash and cash equivalents, trade accounts receivable, vendor deposits, amounts due from affiliated partnerships, trade accounts payable, customer deposits, short-term borrowings and long-term debt. The carrying amounts of these financial instruments approximate their fair values.

Long-Lived Assets

Goodwill represents the excess of cost over the market value of net tangible assets and identifiable intangible assets acquired and is amortized using the straight-line method over fifteen years. The Company periodically evaluates the recoverability of non-current tangible and intangible assets.

Basic and Diluted Income Per Common Share

The Company's per share amounts for all periods have been presented in accordance with the provisions of Statement of Financial Accounting Standards No. 128, *Earnings per Share* ("SFAS No. 128"). Basic and diluted income per share is computed based on the weighted average number of common shares outstanding. Common share equivalents (which may consist of options, warrants and convertible debentures) are excluded from the computation of diluted income per share if the effect would be antidilutive.

Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (“SFAS 133”). SFAS 133 establishes a new model for accounting for derivatives and hedging activities and supersedes several existing standards. SFAS 133, as amended by

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Summary of Significant Accounting Policies (continued)

Statement of Financial Accounting Standards No. 137, *Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of SFAS 133*, and Statement of Financial Accounting Standards No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities an Amendment of SFAS 133*, is effective for all fiscal quarters of fiscal years beginning after June 15, 2000. The adoption of SFAS 133 effective January 1, 2001 did not have a material impact on the Company’s financial statements.

In December 1999, the SEC staff issued Staff Accounting Bulletin SAB 101, *Revenue Recognition in Financial Statements* (“SAB 101”). SAB 101 explains how the SEC staff applies by analogy the existing rules on revenue recognition to other transactions not specifically covered by such rules. In March 2000, the SEC issued SAB 101A that delayed the original effective date of SAB 101 until the second quarter of 2000 for calendar year companies. In June 2000, the SEC issued SAB 101B that further delayed the effective date of SAB 101 until no later than the fourth fiscal quarter of fiscal years beginning after December 15, 1999. The adoption of SAB 101 did not have a material impact on the Company’s financial statements.

3. Inventory

Inventory consists of the following at December 31:

| | 2000 | 1999 |
|-----------------|-------------|-------------|
| Medical devices | \$2,466,191 | \$1,110,163 |
| Consumables | 236,201 | 85,580 |
| | \$2,702,392 | \$1,195,743 |

4. Business Acquisition and Disposition

On January 24, 2000, the Company completed the acquisition of the assets of Health Horizons (E.S.W.L.), L.P. for \$850,000 in cash and the assumption of certain liabilities, including a lease, accounts payable and obligations under regulatory permits. The assets purchased included a lithotripter and related medical equipment, other furniture, equipment, patient records and other

related assets used in New Jersey Kidney Stone Treatment Center. The Company pre-negotiated to sell its interest in the assets purchased to a limited liability company, which will be managed by the Company and of which the Company owns 15%.

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

4. Business Acquisition and Disposition (continued)

The sale of the assets from Health Horizons (E.S.W.L.), L.P. to the newly established limited liability company was consummated on June 1, 2000. The remaining members will be independent of the Company. The Company is the sole general partner and has the ability to exercise control over the operating and financial policies of the new limited liability company and therefore, the Company has consolidated the financial position and results of operations of the new limited liability company.

HealthTronics, Inc. and Subsidiaries
Pro Forma Combined Condensed Statements of Income
FOR THE YEAR ENDED DECEMBER 31, 2000
(UNAUDITED)

| | HISTORICAL | | | |
|------------------------------------|------------------------|--|--------------------------|-----------------------|
| | HEALTHTRONICS, INC. | HEALTH HORIZONS (E.S.W.L.), L.P. | PRO FORMA ADJUSTMENTS | PRO FORMA COMBINED |
| Net revenues | \$ 33,846,015 | \$ 235,272 | \$ 0 | \$ 34,081,287 |
| Net income before income taxes | 4,481,079 | 78,318 | (4,185) | 4,555,212 |
| Net income | <u>2,620,858</u> | <u>78,318</u> | <u>(36,436)</u> | <u>2,662,740</u> |
| Basic income per common share | 0.24 | | | 0.25 |
| Diluted income per common share | 0.24 | | | 0.24 |

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Partnership Investments

As discussed in Note 1, as a result of the Company's May 1, 1998 acquisition of LMI, the Company maintains a 40.6% interest in USL (1.0% general partnership ownership interest and a 39.6% limited partnership ownership interest) and is the sole general partner of USL. USL also maintains the sole general partnership interest in several second tier partnerships. Based upon the Company's ability to exercise control over the operating and financial policies of USL and the second tier partnerships through its acquisition of LMI, the Company has consolidated the financial position and results of operations of the individual partnerships for the years ended December 31, 2000 and 1999.

The Company maintains investments in certain other limited partnerships and limited liability corporations in which the Company has a minority interest as a limited partner. The Company has accounted for these minority interests using the equity or cost basis method of accounting depending upon the Company's ability to exercise significant influence over the operating and financial policies of the investment partnership.

During 2000 and 1999, the Company sold a portion of the partnership interests of certain limited liability corporations and recognized gains of \$739,851 and \$151,637, respectively, representing the excess of the sales price over the Company's investment basis in the partnerships.

6. Related Party Transactions

During the years ended December 31, 2000 and 1999, the Company recorded sales of medical devices to certain partnerships accounted for on the cost or equity basis of accounting. The partnerships obtained third party financing, payable generally over five years or less, to satisfy their obligations to the Company under these sales. The Company, as a minority partner, has guaranteed its proportionate interest in the related partnership debt based upon the Company's ownership percentage in the partnership. As a result, the Company has deferred approximately \$251,867 and \$244,194 of gross profit related to these sales for the years ended December 31, 2000 and 1999, respectively.

Several of the Company's major shareholders are also the officers of the Company's supplier, HMT. Other shareholders of the Company are also limited partners in USL and the second tier partnerships.

Several of the Company's shareholders are employees of a company that contracted with the Company to provide installation and warranty service, through September 30, 1999. Payments to

this company were \$843,000 for 1999.

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

6. Related Party Transactions (continued)

Trade accounts payable due to the Company's supplier, HMT, totaled \$220,000 and \$617,500 as of December 31, 2000 and 1999, respectively. During 2000 and 1999, the Company made payments totaling \$9,762,153 and \$8,509,000, respectively, to HMT for medical devices, related parts and consumables purchases.

7. Short-Term Borrowings

The Company maintains a line of credit with availability of \$4,403,886 at December 31, 2000. This line of credit matures April 30, 2001. The Company had an outstanding balance of \$596,114 under this line as of December 31, 2000.

The line of credit with a Tennessee bank contains various financial and non-financial covenants that must be met by the Company (excluding USL and the second tier partnerships). The Company was in compliance with such covenants at December 31, 2000 and 1999.

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt

Long-term debt consists of the following at December 31:

| | 2000 | 1999 |
|---|------------------|-------------------|
| Equipment note payable, variable interest rate (9.0% at December 31, 2000), principal and interest due in monthly installments of \$16,000 through March 2001, secured by the equipment under loan, and through guarantees from the general partner and personal guarantees from certain limited partners | \$ 39,669 | \$ 215,669 |
| Equipment note payable, variable interest rate (8.25% at December 31, 2000), principal and interest due in monthly installments of \$9,287 through November 1999; renewed in September 1999, principal and interest due in monthly installments of \$9,286 through March 2002, secured by the equipment under loan, and through guarantees from the general partner and personal guarantees from certain limited partners | 122,188 | 217,390 |
| Equipment note payable, variable interest rate (9.5% at December 31, 2000), principal and interest due in monthly installments of \$16,250 through May 2001, secured by the equipment under loan, and through guarantees from the general partner and personal guarantees from certain limited partners and the Company | 71,166 | 266,166 |
| Equipment note payable, interest at 12%, principal and interest due in monthly installments of \$14,200 through March, 2004, secured by the equipment under loan, and through guarantees from the general partner and personal guarantees from certain limited partners | 426,296 | 544,407 |
| Equipment note payable, variable interest rate (8.25% at December 31, 2000), principal due in monthly installments of \$13,215 through October 2002, secured by the equipment under loan, and through guarantees from the general partner and personal guarantees from certain limited partners and the Company | 316,696 | 429,357 |

| | | |
|--|--------------------|--------------------|
| Equipment note payable, variable interest rate (9.0% at December 31, 2000), principal and interest due in monthly installments of \$13,524 through July 2002, secured by the equipment under loan, and through guarantees from the general partner and personal guarantees from certain limited partners and the Company | 283,984 | 446,273 |
| Note payable to bank, interest at 8.25%, principal and interest due in monthly installments of \$14,025 through November, 2002, secured by the equipment under loan | 310,332 | 446,891 |
| Equipment note payable, interest at 9.5%, principal and interest due in monthly installments of \$15,409 through November 2003, secured by the equipment under loan | 468,574 | — |
| Equipment note payable, variable interest rate (10.0% at December 31, 2000), principal due in monthly installments of \$13,125 through October 2002, secured by the equipment under loan | 280,876 | — |
| Equipment note payable, interest at 8.75%, principal and interest due in monthly installments of \$12,502 through April 2004, secured by the equipment under loan | 431,673 | — |
| Equipment note payable, interest at 8.5%, principal and interest due in monthly installments of \$12,685 through March 2004, secured by the equipment under loan | 419,067 | — |
| Term loan, interest at 8.35%, principal and interest payments of \$15,975 due monthly through September, 2001, secured by personal guarantees of certain minority shareholders; term loan was retired early | — | 309,617 |
| Other | 318,502 | 170,410 |
| | 3,489,023 | 3,046,180 |
| Less current portion | 1,521,164 | 1,287,054 |
| | \$1,967,859 | \$1,759,126 |

Future maturities of long-term debt at December 31, 2000 are as follows:

| | |
|-------------|---------------------|
| Fiscal Year | |
| 2001 | \$ 1,521,164 |
| 2002 | 1,200,081 |
| 2003 | 653,109 |
| 2004 | 95,158 |
| 2005 | 19,511 |
| | \$ 3,489,023 |

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Income Taxes

A reconciliation of the provision for income taxes to the federal statutory rate of 34% for 2000 and 1999 is:

| | 2000 | 1999 |
|--|--------------------|---------------------|
| Statutory federal income tax expense | \$3,910,301 | \$2,673,386 |
| State income taxes, net of federal benefit | 455,435 | 311,371 |
| Other | 159,203 | 131,747 |
| Minority interest | <u>(2,664,718)</u> | <u>(1,926,866)</u> |
| | \$1,860,221 | \$ 1,189,638 |

Income tax expense consists of the following:

| | 2000 | 1999 |
|-------------------|------------------|------------------|
| Current federal | \$ 945,388 | \$ 824,899 |
| Current state | <u>166,833</u> | <u>176,541</u> |
| Total current | 1,112,221 | 1,001,440 |
| Deferred federal | 635,800 | 155,021 |
| Deferred state | <u>112,200</u> | <u>33,177</u> |
| Total deferred | 748,000 | 188,198 |
| Total tax expense | 1,860,221 | 1,189,638 |

Significant components of the Company's deferred tax assets and liabilities as of December 31 are as follows:

| | 2000 | 1999 |
|------------------------------------|--------------------|------------------|
| Deferred tax assets: | | |
| Deferred revenue | \$262,254 | \$360,411 |
| Accrued liabilities and other | 177,771 | 229,326 |
| Warranty reserve | <u>109,217</u> | <u>153,218</u> |
| | 549,242 | 742,955 |
| Deferred tax liabilities: | | |
| Property and equipment | (511,573) | (324,547) |
| Net partnership income | (418,796) | (52,005) |
| Other | <u>(4,099)</u> | <u>(3,629)</u> |
| | (934,468) | (380,181) |
| Net deferred tax asset (liability) | \$(385,226) | \$362,774 |

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Employee Benefit Plan

The Company sponsors a defined contribution 401(k) plan for all eligible employees. The plan provides for a deferral of up to 15% of the employee's qualifying compensation under Section 401(k) of the Internal Revenue Code. The Company provides a discretionary match up to a maximum of 6% of employee compensation. The Company recognized \$150,089 and \$69,185 in expense related to the 401(k) plan in 2000 and 1999, respectively.

11. Earnings Per Share

HealthTronics' per share amounts for all periods have been presented in accordance with the provisions of SFAS No. 128. Basic and diluted income per share are computed based on the weighted average number of common shares outstanding. Common share equivalents (which consist of options) are excluded from the computation of diluted income per share if the effect would be dilutive.

The following table sets forth the computation of earnings per share:

| | Year Ended December 31, | |
|--|-------------------------|---------------------|
| | 2000 | 1999 |
| Numerator: Net income | <u>\$ 2,620,858</u> | <u>\$ 1,597,218</u> |
| Effect of dilutive securities: | | |
| Weighted average shares | | |
| Outstanding | 10,826,228 | 10,036,851 |
| Stock options | 272,252 | 201,528 |
| Denominator for diluted earnings per share | <u>11,098,480</u> | <u>10,238,379</u> |
| Basic earnings per share | 0.24 | 0.16 |
| Diluted earnings per share | 0.24 | 0.16 |

12. Shareholders' Equity

On August 30, 1999, the Company completed an initial public offering and issued 1,000,000 shares with proceeds totaling \$4,788,389, net of issuance costs of \$1,211,611.

During the years ended December 31, 2000 and 1999, the Company issued 2,680 and 929 shares, respectively, to consultants for services rendered. The per share prices at time of issuance ranged from \$5.00 per share to \$21.00 per share in 2000 and from \$7.25 per share to \$8.31 in 1999.

The Company recognized expenses of \$38,898 and \$1,895 on issuance of shares for consulting services during the years ended December 31, 2000 and 1999,

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Shareholders' Equity (continued)

respectively.

13. Stock Options

Under the HealthTronics, Inc. Stock Option Plan, 1,800,000 and 800,000 options to purchase the Company's common stock have been approved as of December 31, 2000 and 1999, respectively.

Stock warrants for 100,000 shares of common stock with an exercise price of \$9.90 per share of common stock were issued to the placement agent for services rendered during the Company's initial public offering. The warrants are exercisable as of May 2000 and have an estimated life of five years.

A summary of stock option activity under the HealthTronics, Inc. Stock Option Plan follows:

| | <u>Shares</u> | <u>Price Range</u> | <u>Weighted Average Price</u> |
|----------------------------------|-----------------------|--------------------|-----------------------------------|
| Outstanding at January 1, 1999 | 451,500 | \$1.00 – 6.00 | \$ 1.76 |
| Granted | 205,506 | 6.00 – 8.50 | 5.07 |
| Exercised | <u>50,000</u> | 1.00 | 1.00 |
| Outstanding at December 31, 1999 | 607,006 | \$ 1.00 – 8.50 | \$ 4.52 |
| Granted | 380,250 | 6.50 – 15.44 | 11.84 |
| Exercised | (252,134) | 1.00 – 6.00 | 1.46 |
| Canceled | <u>(51,500)</u> | 6.00 – 14.875 | 9.74 |
| Outstanding at December 31, 2000 | <u><u>683,622</u></u> | \$ 1.00 – 15.44 | \$ 8.69 |

The following table summarizes information concerning outstanding and exercisable options under the HealthTronics, Inc. Stock Option Plan.

| <u>Exercise Price</u> | <u>Number Outstanding</u> | <u>Weighted Average Remaining Contractual Life</u> | <u>Weighted Average Exercise Price</u> | <u>Number Exercisable</u> | <u>Weighted Average Exercise Price</u> |
|-----------------------|-------------------------------|--|--|-------------------------------|--|
| 1.00 – 3.00 | 119,700 | 3.99 | 2.74 | 119,700 | 2.74 |
| 6.00 – 6.50 | 51,172 | 8.47 | 6.02 | 32,002 | 6.07 |
| 7.25 – 10.50 | 285,500 | 7.34 | 9.81 | 260,000 | 9.77 |

| | | | | | |
|---------------|----------------|------|-------|----------------|-------|
| 11.50 – 15.44 | <u>227,250</u> | 9.45 | 12.16 | <u>10,250</u> | 12.06 |
| | <u>683,622</u> | | | <u>421,952</u> | |

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

13. Stock Options (continued)

For the Company, pro forma information regarding net income is required by FAS 123 and has been determined as if the Company had accounted for its employee stock options granted under the fair value method of that Statement. The fair value for these options was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions for 2000 and 1999: risk-free interest rate of 6.06% and 6.69%, expected life of the option of three to ten years, and no dividend yield. The weighted-average fair value of options granted under the HealthTronics, Inc. Stock Option Plan was \$9.01 and \$5.11 for 2000 and 1999.

Had the employee option grants been accounted for under the fair value method of FAS 123, net income would be \$1,472,946 and \$1,567,175 for the years ended December 31, 2000 and 1999, respectively.

The pro forma disclosures above are not likely to be representative of the effects on net income in future years.

14. Operating Leases

The Company leases office/warehouse space at a monthly rental of \$17,800 (straight-line) that expires in March 2007. The rental payments began at \$8,500 in April 2000 and graduate over the life of the lease. Rental expense for 2000 and 1999 was \$140,575 and \$80,716, respectively.

Aggregate future minimum lease payments under operating lease agreements for terms greater than one year as of December 31, 2000 are as follows:

| | |
|---------------------|---------------------------|
| Fiscal Year | |
| 2001 | \$ 209,727 |
| 2002 | 227,142 |
| 2003 | 229,685 |
| 2004 | 231,048 |
| 2005 and thereafter | 528,393 |
| | <u>\$1,425,995</u> |

15. Commitments and Contingencies

In connection with the original distributorship agreements between the Company and HMT, the Company committed to purchase ten OssaTron orthopaedic shock wave and twelve LithoTron lithotripter units per year over the life of the agreement. Aggregate funding

HealthTronics, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

15. Commitments and Contingencies (continued)

needed for this commitment is approximately \$7,000,000 per year based upon current market prices.

Physicians and technicians who use the Company's products are subject to the risk of liability and malpractice claims. Those claims could also name the Company, based on a theory of malpractice or claim liability. Although the Company has not experienced any malpractice or product liability claims, an award for such damages could exceed the limits of its applicable insurance coverage. Successful liability claims asserted against the Company, to the extent not covered by insurance, could affect the Company's ability to operate profitably. While management believes the Company's current level of insurance is adequate, there can be no assurance of this.

16. Subsequent Events

The Company has tentatively settled a lawsuit which would require the Company to pay attorney's fees related to the suit and would cause a reduction of revenue of either \$450 or \$300 per treatment for the first 1,200 treatments at certain facilities. No amounts have been accrued in the accompanying financial statements for this settlement as the actual number of treatments that will be performed and timing of such treatments are not determinable at this time.

Item 8: Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

Not applicable.

Part III

Item 9: Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act.

Information about the directors of the Company is in "Election of Directors - Information Concerning the Nominees and the Incumbent Directors" of the Company's 2001 Proxy Statement and is incorporated into this report by reference. Information about the executive officers of the Company is in "Executive Officers of the Company" of the Company's 2001 Proxy Statement and is incorporated into this report by reference. Information about compliance with Section 16(a) of the Exchange Act of 1934, as amended, by the Company's executive officers and directors, persons owning more than 10% of the Company's common stock, and their affiliates who are required to comply with such reporting requirements, is in "Election of Directors - Section 16(a) Beneficial Ownership Reporting Compliance" of the Company's 2001 Proxy Statement, and is incorporated into this report by reference.

Item 10: Executive Compensation:

Information about director compensation is in "Election of Directors - Compensation of Directors" of the Company's 2001 Proxy Statement, and information about executive compensation is in "Executive Compensation" in the Company's 2001 Proxy Statement, all of which is incorporated into this report by reference.

Item 11: Security Ownership of Certain Beneficial Owners and Management.

Information about ownership of the Company's common stock by certain persons is in "General Information about Voting - Principal Shareholders" and "Election of Directors - Security Ownership of Directors and Officers" of the Company's 2001 Proxy Statement, all of which is incorporated into this report by reference.

Item 12: Certain Relationships and Related Transactions.

Information about certain transactions is in "Certain Relationships and Related Transactions" of the Company's 2001 Proxy Statement, all of which is incorporated into this report by reference.

Item 13: Exhibits, List and Reports on Form 8-K.

(a) Exhibits

| EXHIBIT NO. ----- | DESCRIPTION ----- |
|----------------------|---|
| 3.1 | Amended Articles of Incorporation of HealthTronics, Inc., incorporated by reference to Exhibit 3.6 to the Company's Registration Statement on Form SB-2 (Reg. No. 333-66977) |
| 3.2 | Restated Bylaws of HealthTronics, Inc., incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form SB-2 (Reg. No. 333-66977) |
| 9.1 | HMT Group Stock Voting Agreement, incorporated by reference to Exhibit 9.2 to the Company's Registration Statement on Form SB-2 (Reg. No. 333-66977) |
| 10.1 | Entity Interest Agreement between HealthTronics, Inc. and USL, incorporated by reference to Exhibit 10.2 to the Company's Registration Statement on Form SB-2 (Reg. No. 333-66977) |
| 10.2 | Distributorship Agreement between HealthTronics, Inc. and USL and amendments thereto, incorporated by reference to Exhibit 10.3 to the Company's Registration Statement on Form SB-2 (Reg. No. 333-66977) |
| 10.3 | Patent License Agreement dated June 3, 1995 between OssaTronics, Inc. and HMT High Medical Technologies GmbH along with amendments thereto, incorporated by reference to Exhibit 10.4 to the Company's Registration Statement on Form SB-2 (Reg. No. 333-66977) |
| 10.3 (a) | Patent Purchase Agreement between VISSH Voennomedicinsky Institute and HMT, incorporated by reference to Exhibit 10.4 (a) to the Company's Registration Statement on Form SB-2 (Reg. No. 333-66977) |
| 10.3 (b) | U.S. Patent Number 4,979,501 for a method and an apparatus for medical treatment of the pathological state of bones, incorporated by reference to Exhibit 10.4 (b) to the Company's Registration Statement on Form SB-2 (Reg. No. 333-66977) |

- 10.3 (c) Provisional Patent Application for the use of acoustic shock waves in the treatment of medical, dental and veterinary conditions, incorporated by reference to Exhibit 10.4 (c) to the Company's Registration Statement on Form SB-2 (Reg. No. 333-66977)
- 10.3 (d) U.S. Patent Number 5,595,178 for a system and an apparatus for treatment of degenerative bone, incorporated by reference to Exhibit 10.4 (d) to the Company's Registration Statement on Form SB-2 (Reg. No. 333-66977)
- 10.3 (e) Second Amendment to Patent License Agreement, incorporated by reference to Exhibit 10.4 (e) to the Company's Registration Statement on Form SB-2 (Reg. No. 333-66977)
- 10.4 Distributorship and Manufacturing Agreements between HealthTronics and HMT for both the OssaTron(R) (11/22/94) and the LithoTron(R) (1/24/96) and amendments to both agreements dated March 1, 1996 and August 7, 1996, incorporated by reference to Exhibit 10.5 to the Company's Registration Statement on Form SB-2 (Reg. No. 333-66977)
- 10.5 HealthTronics' 401(k) plan, incorporated by reference to Exhibit 10.6 to the Company's Registration Statement on Form SB-2 (Reg. No. 333-66977)
- 10.6 Agreement dated February 15, 1995 between OssaTronics, Inc., John Warlick, Argil Wheelock, MD, Karl-Heinz Restle and Scott A. Cochran, incorporated by reference to Exhibit 10.7 to the Company's Registration Statement on Form SB-2 (Reg. No. 333-66977)
- 10.7 Manufacturing Agreement dated June 20, 1996 between HealthTronics and HMT, incorporated by reference to Exhibit 10.8 of Form SB-2 (Reg. No. 333-66977)
- 10.8 Employment Agreement with Ms. Beck, incorporated by reference to Exhibit 10.11 of Form SB-2 (Reg. No. 333-66977)
- 10.9 Employment Agreement with Ms. Marlow, incorporated by reference to Exhibit 10.13 of Form SB-2 (Reg. No. 333-66977)
- 21.1 Subsidiaries
- 23.1 Consent of Independent Auditors

- 99.1 Letter from FDA dated 7/21/97 approving the PMA for the LithoTron(R) Lithotripsy System, subject to certain conditions, incorporated by reference to Exhibit 99.1 of Form SB-2 (Reg. No. 333-66977)

- 99.2 Letter from FDA dated 10/12/00 approving the PMA for the OssaTron(R) Orthopaedic Extracorporeal Shock Wave System, subject to certain conditions

(b) Reports on Form 8-K.

There were no reports on Form 8-K filed with the Commission during the quarter ended December 31, 2000.

Signatures

Pursuant to the requirements of Section 13 or 15(d) of Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

HEALTHTRONICS, INC.

By: /s/ Argil J. Wheelock

Argil J. Wheelock
Chief Executive Officer

Dated: March 26, 2001

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on March 26, 2001.

| <u>SIGNATURE</u> | <u>TITLE</u> |
|---|--|
| /s/ Argil J. Wheelock ----- Argil J. Wheelock | Chairman of the Board, Chief Executive Officer and Director (Principal Executive Officer) |
| /s/ Roy S. Brown ----- Roy S. Brown | President, Chief Operating Officer and Director |
| /s/ Victoria W. Beck ----- Victoria W. Beck | Chief Financial Officer (Principal Financial and Accounting Officer) |
| /s/ Scott Cochran ----- Scott Cochran | Secretary/Treasurer and Director |
| /s/ James R. Andrews ----- James R. Andrews | Director |
| /s/ Jon Burke ----- Jon Burke | Director |
| /s/ Russ Maddox ----- Russ Maddox | Director |
| John House ----- John House | Director |

EXHIBIT 21.1

HEALTHTRONICS, INC.
 SCHEDULE OF SUBSIDIARIES
 (as of January 31, 2001)

| | | |
|--|----|-------------------------------|
| Tenn-Ga Prostate Therapies, LLC | TN | Limited Liability Corporation |
| Prostate Therapies of East Texas, LLC | TX | Limited Liability Corporation |
| Litho Management, Inc. | TX | Corporation |
| HLE Corporation | TX | Corporation |
| U.S. Lithotripsy, L.P. | TX | Limited Partnership |
| Metro I Stone Management, Ltd. | TX | Limited Partnership |
| Mississippi Valley I Stone Management, L.P. | MO | Limited Partnership |
| East Texas I Stone Management, Ltd. | TX | Limited Partnership |
| Dallas Stone Management, L.P. | TX | Limited Partnership |
| S.C. Missouri Stone Management, L.P. | MO | Limited Partnership |
| Tulsa Stone Management, L.P. | OK | Limited Partnership |
| SE Colorado Lithotripsy, L.P. | CO | Limited Partnership |
| Mississippi Valley II Stone Management, L.P. | MO | Limited Partnership |
| Missouri Valley Lithotripsy, L.P. | MO | Limited Partnership |
| North Central Texas Lithotripsy, L.P. | TX | Limited Partnership |
| White River Lithotripsy, LP | CO | Limited Partnership |
| Central Texas Lithotripsy, LP | TX | Limited Partnership |
| Central Dallas Lithotripsy, LP | TX | Limited Partnership |

| | | |
|---|----|-------------------------------|
| Western Colorado Lithotripsy, LP | CO | Limited Partnership |
| Oklahoma Lithotripsy, LP | OK | Limited Partnership |
| Lithotripsy of East Texas, LP | TX | Limited Partnership |
| N.C. Missouri Lithotripsy, LP | MO | Limited Partnership |
| Rio Grande Lithotripsy, LP | TX | Limited Partnership |
| Florida Lithology, Inc. | FL | Corporation |
| Florida Lithology, Ltd. | FL | Limited Partnership |
| Wave Forms Lithotripsy, LLC | WA | Limited Liability Corporation |
| Big Country Lithotripsy, LP | TX | Limited Partnership |
| Rolla Lithotripsy, LP | MO | Limited Partnership |
| Metro II Stone Management, LP | TX | Limited Partnership |
| Ozarks Lithotripsy, LP | AR | Limited Partnership |
| OssaTronics of Houston | TX | Limited Liability Corporation |
| New Jersey Kidney Stone, LLC | NJ | Limited Liability Corporation |
| Tyler Stone Services, LP | TX | Limited Partnership |
| HT Lithotripsy Management Company, LLC | GA | Limited Liability Corporation |
| HT Orthotripsy Management Company, LLC | GA | Limited Liability Corporation |
| Orthotripsy Services of Anchorage, LP | AK | Limited Partnership |
| Orthotripsy Services of Atlanta, LP | GA | Limited Partnership |
| Orthotripsy Services of Austin, LP | TX | Limited Partnership |
| Orthotripsy Services of Bakersfield, LP | CA | Limited Partnership |
| Orthotripsy Services of Baltimore, LP | MD | Limited Partnership |

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| Orthotripsy Services of Chattanooga, LP | TN | Limited Partnership |
| Orthotripsy Services of Chicago, LP | IL | Limited Partnership |
| Orthotripsy Services of Cincinnati, LP | OH | Limited Partnership |
| Orthotripsy Services of Eastern Tennessee, LP | TN | Limited Partnership |
| Orthotripsy Services of Memphis, LP | TN | Limited Partnership |
| Orthotripsy Services of Houston, LP | TX | Limited Partnership |
| Orthotripsy Services of Illinois, LP | IL | Limited Partnership |
| Orthotripsy Services of Fayetteville, LP | NC | Limited Partnership |
| Orthotripsy Services of Metroplex, LP | TX | Limited Partnership |
| Orthotripsy Services of New Mexico, LP | NM | Limited Partnership |
| Orthotripsy Services of New Orleans, LP | LA | Limited Partnership |
| Orthotripsy Services of Ohio, LP | OH | Limited Partnership |
| Orthotripsy Services of Oklahoma City, LP | OK | Limited Partnership |
| Orthotripsy Services of Philadelphia, LP | PA | Limited Partnership |
| Orthotripsy Services of Rochester, LP | NY | Limited Partnership |
| Orthotripsy Services of San Antonio, LP | TX | Limited Partnership |
| Orthotripsy Services of San Francisco, LP | CA | Limited Partnership |
| Orthotripsy Services of Seattle, LP | WA | Limited Partnership |
| Orthotripsy Services of South Central Michigan, LP | MI | Limited Partnership |
| Orthotripsy Services of Southeast Tennessee, L.P. | TN | Limited Partnership |
| Orthotripsy Services of Southern Idaho, LP | ID | Limited Partnership |
| OssaTron Services of Sioux Falls, LP | ID | Limited Partnership |

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| OssaTron Services of Tampa Bay, LP | FL | Limited Partnership |
| OssaTron Services of the Ozarks, LP | AR | Limited Partnership |
| OssaTron Services of Colorado, LP | CO | Limited Partnership |
| OssaTron Services of the Southeast I, LP | GA | Limited Partnership |
| OssaTronics of Los Angeles, LLC | CA | Limited Liability Corporation |

EXHIBIT 23.1

CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in Registration Statements Form S-8 (No. 333-31820) and Form S-8 (No. 333-43412), pertaining to the HealthTronics, Inc. Stock Option Plan of our report dated February 3, 2001, with respect to the consolidated financial statements of HealthTronics, Inc. and Subsidiaries included in this Annual Report (Form 10-KSB) for the year ended December 31, 2000.

Atlanta, Georgia

March 23, 2001

/s/ Ernst & Young LLP

Corporate Information

Board of Directors:

Argil J. Wheelock, MD

Chairman of the Board
Chief Executive Officer
HealthTronics, Incorporated

Roy S. Brown

President and Chief Operating Officer
HealthTronics, Incorporated

James R. Andrews, MD

Orthopaedic Surgeon

Jon Burke

Managing Member,
Capital Appreciation Management LLC

Scott Cochran, Esq.

Partner,
Cochran, Camp & Snipes

John House, MD

Urologist

Russ Maddox

Former Executive Vice President,
HealthSouth Corporation

Officers:

Argil J. Wheelock, MD

Chief Executive Officer

Roy S. Brown

President and Chief Operating Officer

Victoria W. Beck

Executive Vice President and
Chief Financial Officer

Bradley G. Devine

Senior Vice President,
Technical Operations

Devonne D. Pavlak

Vice President, Reimbursement Issues

Corporate Data

Auditors

Ernst & Young LLP - Atlanta, Georgia

Transfer Agent

SunTrust Bank - Atlanta, Georgia
(404) 588-7831

Legal Counsel

Miller & Martin LLP - Chattanooga, Tennessee
and Atlanta, Georgia

Corporate Headquarters

1841 West Oak Parkway, Suite A
Marietta, Georgia 30062
Phone: 770-419-0691 • 1-800-464-3795
Fax: 770-419-9490
www.healthtronics.com

Shareholder Inquiries

Inquiries regarding stock transfers, lost certificates or address changes should be directed to the transfer agent. A copy of HealthTronics' annual report to the Securities and Exchange Commission (Form 10-KSB) will be furnished without charge to any shareholder upon written request to our Investor Relations Department at the corporate headquarters.

Common Stock

HealthTronics, Inc. common stock is traded on The NASDAQ Stock Market's National Market under the symbol HTRN. The following table shows the quarterly high and low sales prices of the common stock during the year 2000.

| | High | Low |
|----------------|---------|---------|
| First Quarter | \$20.94 | \$ 8.31 |
| Second Quarter | \$19.81 | \$11.38 |
| Third Quarter | \$21.00 | \$12.25 |
| Fourth Quarter | \$15.25 | \$ 5.00 |

Annual Meeting

The Annual Meeting of Shareholders will be held on May 18, 2001 at 1:00 p.m. (local time) at the Wyndam Garden Hotel, 1775 Parkway Place, NW, Marietta, Georgia 30067.



1841 West Oak Parkway, Suite A
Marietta, Georgia 30062
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