

NOVAMED INC
Form 10-Q
August 13, 2004
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED: JUNE 30, 2004

COMMISSION FILE NUMBER: 0-26625

NOVAMED, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

36-4116193
(I.R.S. Employer
Identification No.)

980 North Michigan Avenue, Suite 1620, Chicago, Illinois 60611

(Address of principal executive offices)

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of July 30, 2004, there were outstanding 21,097,022 shares of the registrant's common stock, par value \$.01 per share.

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NOVAMED, INC.

FORM 10-Q FOR QUARTERLY PERIOD ENDED JUNE 30, 2004

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Item 1.

NOVAMED, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

	June 30, 2004 <u>(unaudited)</u>	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 6,270	\$ 11,801
Accounts receivable, net of allowances of \$8,633 and \$7,611, respectively	11,267	8,219
Notes and amounts due from affiliated providers	509	1,089
Notes receivable from related parties	395	597
Inventory	1,364	1,397
Current tax assets, net	279	542
Other current assets	1,115	1,107
	<u>21,199</u>	<u>24,752</u>
Property and equipment, net	7,524	7,918
Intangible assets, net	34,851	26,749
Noncurrent deferred tax assets, net	3,008	4,130
Other assets, net	131	339
	<u>\$ 66,713</u>	<u>\$ 63,888</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 5,121	\$ 4,078
Accrued expenses	2,449	2,374
Restructuring reserves	141	260
Current maturities of long-term debt	180	80
Current liabilities of discontinued operations	672	1,068
	<u>8,563</u>	<u>7,860</u>
Long-term debt, net of current maturities	167	74
Minority interests	6,940	5,841
Commitments and contingencies		
Stockholders' equity:		

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Series E Junior Participating Preferred Stock, \$0.01 par value, 1,912,000 shares authorized, none outstanding at June 30, 2004 and December 31, 2003, respectively		
Common stock, \$0.01 par value, 81,761,465 shares authorized, 25,255,765 and 25,046,195 shares issued at June 30, 2004 and December 31, 2003, respectively	252	250
Additional paid-in-capital	78,425	77,964
Accumulated deficit	(21,471)	(23,641)
Treasury stock, at cost, 4,208,743 and 3,843,399 shares at June 30, 2004 and December 31, 2003, respectively	(6,163)	(4,460)
	<u>51,043</u>	<u>50,113</u>
Total stockholders' equity		
	<u>\$ 66,713</u>	<u>\$ 63,888</u>
Total liabilities and stockholders' equity		

The notes to the interim condensed consolidated financial statements

are an integral part of these statements.

Table of Contents**NOVAMED, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Amounts in thousands, except per share data; unaudited)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Net revenue:				
Surgical facilities	\$ 11,143	\$ 9,281	\$ 20,492	\$ 17,828
Product sales and other	4,334	4,737	9,211	9,693
Total net revenue	15,477	14,018	29,703	27,521
Operating expenses:				
Salaries, wages and benefits	5,225	4,991	10,303	10,232
Cost of sales and medical supplies	3,719	3,442	7,238	6,792
Selling, general and administrative	3,358	2,949	6,512	5,829
Depreciation and amortization	640	657	1,316	1,294
Total operating expenses	12,942	12,039	25,369	24,147
Operating income	2,535	1,979	4,334	3,374
Minority interests in earnings of consolidated entities	1,177	678	1,930	1,255
Other (income) expense, net	(22)	(15)	(222)	(133)
Income before income taxes	1,380	1,316	2,626	2,252
Income tax provision	552	526	1,050	903
Net income from continuing operations	828	790	1,576	1,349
Net income from discontinued operations			594	4
Net income	\$ 828	\$ 790	\$ 2,170	\$ 1,353
Basic earnings per common share:				
Income from continuing operations	\$ 0.04	\$ 0.04	\$ 0.07	\$ 0.06
Income from discontinued operations			0.03	
Net income	\$ 0.04	\$ 0.04	\$ 0.10	\$ 0.06
Diluted earnings per common share:				
Income from continuing operations	\$ 0.04	\$ 0.04	\$ 0.07	\$ 0.06
Income from discontinued operations			0.03	
Net income	\$ 0.04	\$ 0.04	\$ 0.10	\$ 0.06

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Weighted average common shares outstanding	21,018	21,441	21,123	21,622
Dilutive effect of employee stock options	1,815	315	1,918	297
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Diluted weighted average common shares outstanding	22,833	21,756	23,041	21,919
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

The notes to the interim condensed consolidated financial statements are an integral part of these statements.

Table of Contents**NOVAMED, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Dollars in thousands; unaudited)**

	Six months ended	
	June 30,	
	2004	2003
Cash flows from operating activities:		
Net income from continuing operations	\$ 1,576	\$ 1,349
Adjustments to reconcile net income to net cash provided by continuing operations, net of effects of purchase transactions		
Depreciation and amortization	1,316	1,294
Deferred taxes	1,050	903
Gain on sale of minority interests	(163)	(115)
Minority interests	1,930	1,255
Distributions to minority partners	(1,831)	(857)
Changes in operating assets and liabilities		
Accounts receivable	(2,544)	(2,357)
Inventory	118	(211)
Other current assets	(157)	315
Accounts payable and accrued expenses	821	(40)
Other noncurrent assets	61	(12)
	<u>2,177</u>	<u>1,524</u>
Net cash provided by operating activities	2,177	1,524
Cash flows from investing activities:		
Payments for acquisitions, net	(8,133)	
Proceeds from sale of minority interests	1,048	135
Purchases of property and equipment	(1,069)	(1,196)
Proceeds from sale of property and equipment	121	38
Proceeds from sale of securities	74	
	<u>(7,959)</u>	<u>(1,023)</u>
Net cash used in investing activities	(7,959)	(1,023)
Cash flows from financing activities:		
Borrowings under revolving line of credit		825
Payments under revolving line of credit		(825)
Proceeds from the issuance of common stock	294	29
Payments of other debt, debt issuance fees and capital lease obligations	(52)	(125)
	<u>242</u>	<u>(96)</u>
Net cash provided by (used in) financing activities	242	(96)
Cash flows from discontinued operations:		
Operating activities	(342)	(1,732)
Investing activities	351	2,002
Financing activities		(1)
	<u>9</u>	<u>269</u>
Net cash provided by discontinued operations	9	269

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Net increase (decrease) in cash and cash equivalents	(5,531)	674
Cash and cash equivalents, beginning of period	11,801	1,957
Cash and cash equivalents, end of period	\$ 6,270	\$ 2,631

The notes to the interim condensed consolidated financial statements
are an integral part of these statements.

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NOVAMED, INC. AND SUBSIDIARIES

NOTES TO THE INTERIM

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2004

(Dollars in thousands, except per share data; unaudited)

1. BASIS OF PRESENTATION

The information contained in the interim consolidated financial statements and notes is condensed from that which would appear in the annual consolidated financial statements. Accordingly, the interim condensed consolidated financial statements included herein should be read in conjunction with the consolidated financial statements as of and for the year ended December 31, 2003, filed by NovaMed, Inc. with the Securities and Exchange Commission on Form 10-K. The unaudited interim condensed consolidated financial statements as of June 30, 2004 and for the three and six months ended June 30, 2004 and 2003, include all normal recurring adjustments which management considers necessary for a fair presentation. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the entire fiscal year.

2. STATEMENT OF CASH FLOWS - SUPPLEMENTAL

	Three months ended		Six months ended	
	June 30,		June 30,	
	2004	2003	2004	2003
<i>Supplemental cash information:</i>				
Interest paid	\$ 15	\$ 36	\$ 32	\$ 68
Income taxes paid	47	1	48	35
Income tax refunds received	(3)		(18)	(217)

During the first quarter of 2004, the Company received \$237 as a cash settlement from a physician for the early termination of a laser services agreement. The laser provided under this agreement was one of eight lasers whose procedures count toward our minimum annual procedure requirement under our supply agreement with Alcon Laboratories. Because the Company continues to have obligations to Alcon for all eight lasers, the Company has established a reserve for \$237 which will be evaluated quarterly and adjusted as necessary.

Non cash investing and financing activities:

The Company received 365,344 shares of its common stock from a former affiliated physician during the first quarter of 2004 to repay a \$1,533 note receivable against which the company had established a \$958 valuation allowance. Treasury shares were recorded at \$1,703, additional

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paid-in-capital was increased by \$170 and the valuation allowance was reversed and reported as income from discontinued operations.

3. INTANGIBLE ASSETS

Goodwill balances by reportable segment are summarized in the table below:

	Unamortized Goodwill			Amortized Intangibles	
	Surgical Facilities	Product Sales	Other		Total
	<u> </u>	<u> </u>	<u> </u>		<u> </u>
Balance December 31, 2003	\$ 20,311	\$ 5,475	\$ 941	\$ 26,727	\$ 22
Acquisition of ASCs	8,113			8,113	
Amortization					(11)
Balance June 30, 2004	\$ 28,424	\$ 5,475	\$ 941	\$ 34,840	\$ 11

Table of Contents**NOVAMED, INC. AND SUBSIDIARIES****NOTES TO THE INTERIM****CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)****June 30, 2004****(Dollars in thousands, except per share data; unaudited)****4. ACQUISITIONS**

The Company generally acquires majority equity interests in ASCs through the purchase method of accounting. The results of operations are included in the consolidated financial statements of the Company from the date of acquisition.

The Company made the following acquisitions during the second quarter of 2004:

Acquisition	Location	Effective Date	Purchase Price
ASC (51%)	Bedford, NH	April 2004	\$1.4 million
ASC (51%)	Nashua, NH	April 2004	\$1.5 million
ASC (70%)	Altamonte Springs, FL	June 2004	\$5.2 million

5. DISCONTINUED OPERATIONS

During the first quarter of 2004 a former affiliated physician repaid a note secured by shares of the Company's stock by the tendering of such shares. (For additional information regarding the note please refer to Note 2 above and the Company's 2003 Annual Report on Form 10K Note 17 Related Party Transactions.) When the Company adopted its Plan of Discontinued Operations and Restructuring the market value of the shares with which the loan was secured was significantly below the value of the note. Included in the initial discontinued operations charge was the establishment of a valuation allowance against the note to adjust it to its secured value based on the then current market value of the collateral shares. When shares were tendered in repayment of the note, the market value of the shares exceeded the original secured value. The Company reversed the valuation allowance established on the note and has reported it as income from discontinued operations.

The discontinued operations reserve balance was \$672 and \$1,068 at June 30, 2004 and December 31, 2003, respectively. The reserve is for remaining severance payments payable through December 2004, lease commitments expiring July 2005 and other costs from exiting the PPM business. The operating results of discontinued operations are summarized below.

Three months ended Six months ended

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	June 30,		June 30,	
	2004	2003	2004	2003
Net revenue	\$	\$ 273	\$	\$ 1,421
Operating expenses		1,083		3,010
Reverse valuation allowance			958	
Income (loss) before income taxes		(810)	958	(1,589)
Income tax provision (benefit)		(323)	364	(635)
Net income (loss) from operations		(487)	594	(954)
Net income (loss) charged to reserves		(487)		(958)
Net income per statement of operations	\$	\$	\$ 594	\$ 4

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NOVAMED, INC. AND SUBSIDIARIES

NOTES TO THE INTERIM

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

June 30, 2004

(Dollars in thousands, except per share data; unaudited)

6. RESTRUCTURING RESERVES

Commitments under restructuring reserves expire through May 2005. The following represents activity during the first six months of 2004:

	Reserve at December 31, 2003	Charges Utilized	Reserve at June 30, 2004
Lease Commitments	\$ 143	\$ (56)	\$ 87
Asset Impairments	94	(61)	33
Other	23	(2)	21
Total reserve balance	<u>\$ 260</u>	<u>\$ (119)</u>	<u>\$ 141</u>

7. OTHER (INCOME) EXPENSE

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
Interest expense	\$ 27	\$ 40	\$ 56	\$ 77
Interest income	(21)	(38)	(54)	(80)
(Gain) loss on sale of minority interests	27		(163)	(115)
Other, net	(55)	(17)	(61)	(15)
Other (income) expense, net	<u>\$ (22)</u>	<u>\$ (15)</u>	<u>\$ (222)</u>	<u>\$ (133)</u>

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During the first quarter of 2004 the Company sold a 22.5% minority interest in its Chattanooga, TN ASC to four physicians and sold an additional 10% interest in its New Albany, IN ASC to an affiliate of its existing minority partners, thereby increasing minority ownership in this ASC to 30%. During the second quarter of 2004, the Company sold an additional 8% minority interest in its Chattanooga, TN ASC to a fifth physician increasing minority ownership in this ASC to 30.5%.

8. REVOLVING CREDIT FACILITY

At June 30, 2004, the Company had no outstanding borrowings under its revolving credit facility. The maximum commitment available under the Company's credit facility is \$30 million. The credit agreement expires on June 30, 2006.

Under the facility, interest on borrowings under the credit agreement is payable at an annual rate equal to the Company's lender's published base rate plus the applicable borrowing margin ranging from 0% to .50% or LIBOR plus a range from 1.25% to 2.0%, varying upon the Company's ability to meet financial covenants. In addition, a fee ranging from .175% to .250% is charged on the unused portion of the commitment. The credit agreement contains covenants that include limitations on indebtedness, liens, capital expenditures, acquisitions and affiliations and ratios that define borrowing availability and restrictions on the payment of dividends. As of June 30, 2004, the Company was in compliance with all its credit agreement covenants.

At June 30, 2004 the Company had an outstanding letter of credit issued to one of its optical products buying group vendors in the amount of \$200 that expires on March 31, 2005.

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NOVAMED, INC. AND SUBSIDIARIES

NOTES TO THE INTERIM

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

June 30, 2004

(Dollars in thousands, except per share data; unaudited)

9. STOCK BASED COMPENSATION

The Company accounts for its stock-based employee compensation plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to or above the market value of the underlying common stock at the date of grant. During the first quarter of 2004, the Company granted its employees options to purchase 525,000 shares with an exercise price of \$4.45 per share and granted four of its outside directors options to purchase 100,000 shares with an exercise price of \$4.45 per share. During the second quarter of 2004, the Company granted an additional outside director options to purchase 25,000 shares with an exercise price of \$4.07 per share. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation.

	Three months ended		Six months ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Net income as reported	\$ 828	\$ 790	\$ 2,170	\$ 1,353
Deduct: Total stock based compensation expense, net of related tax effects	(181)	(382)	(563)	(754)
Pro forma net income	\$ 647	\$ 408	\$ 1,607	\$ 599
Earnings per share:				
Basic as reported	\$ 0.04	\$ 0.04	\$ 0.10	\$ 0.06
Basic pro forma	\$ 0.03	\$ 0.02	\$ 0.08	\$ 0.03
Diluted as reported	\$ 0.04	\$ 0.04	\$ 0.10	\$ 0.06
Diluted pro forma	\$ 0.03	\$ 0.02	\$ 0.07	\$ 0.03

10. SUBSEQUENT EVENTS

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Effective July 1, 2004, the Company sold a 5% and a 2.5% minority interest in its Chattanooga, TN ASC to two of its existing partners, increasing their minority interest ownership to 10% and 5%, respectively and increasing total minority ownership interest in this ASC to 38%. This will result in a \$67 pretax loss on the sale of minority interests in the third quarter of 2004.

Effective July 1, 2004, the Company repurchased the 20% minority interest of one of its Kansas City, MO ASCs from two physician partners who each held a 10% interest and performed the majority of the surgical procedures at this ASC. The Company is currently working to attract new physicians to this ASC.

Effective July 27, 2004, the Company acquired a 51% majority interest in an ASC located in Oak Lawn, IL and effective July 31, 2004, the Company acquired a 60% majority interest in an ASC located in Lake Worth, FL. The aggregate purchase price of these two ASCs was \$13.2 million which was funded from the Company's existing cash and credit facility.

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NOVAMED, INC. AND SUBSIDIARIES

NOTES TO THE INTERIM

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

June 30, 2004

(Dollars in thousands, except per share data; unaudited)

11. OPERATING SEGMENTS

The table below presents information about operating data and segment assets as of and for the three and six months ended June 30, 2004 and 2003:

	Surgical Facilities	Product Sales	Other	Corporate	Total
Three months ended June 30, 2004					
Net revenue	\$ 11,143	\$ 2,653	\$ 1,681	\$	\$ 15,477
Income before income taxes	2,274	501	83	(1,478)	1,380
Depreciation and amortization	461	46	28	105	640
Interest income	1			20	21
Interest expense	1			26	27
Capital expenditures	510	26		37	573
Identifiable assets	40,752	11,647	2,355	11,959	66,713
Three months ended June 30, 2003					
Net revenue	\$ 9,281	\$ 2,704	\$ 2,033	\$	\$ 14,018
Income before income taxes	2,282	545	(46)	(1,465)	1,316