NOVAMED EYECARE INC
Form 10-Q
July 30, 2001

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, 2001

COMMISSION FILE NUMBER: 0-26625

NOVAMED EYECARE, INC.
(Exact name of registrant as specified in its charter)

Delaware	36-4116193
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

980 North Michigan Avenue, Suite 1620, Chicago, Illinois 60611
(Address of principal executive offices)

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 [X] No [_]

As of July 25, 2001, there were outstanding 24,803,464 shares of the registrant's common stock, par value $.01 per share.

NOVAMED EYECARE, INC.
FORM 10-Q FOR QUARTERLY PERIOD ENDED JUNE 30, 2001
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PART OR ITEM

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Part I

Item 1.

NOVAMED EYECARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share data)

ASSETS	June 30, 2001	D
Current assets:		
Cash and cash equivalents	$ --	$
Accounts receivable, net	26,107	
Due from affiliated providers, net	1,097	
Notes receivable from affiliated providers	3,016	
Inventory	3,052	
Other current assets	2,800	
Total current assets	36,072	
Property and equipment, net	21,812	
Intangible assets, net	60,908	
Other assets, net	2,684	
Total assets	$ 121,476	$
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 4,889	$
Accrued expenses	3,775	
Current maturities of long-term debt	582	
Total current liabilities	9,246	
Long-term debt, net of current maturities	25,035	
Deferred income tax liability	1,705	
Commitments and contingencies		
Stockholders' equity:		
Series E Junior Participating Preferred Stock, $0.01 par value, 1,912,000 shares authorized, none outstanding at		

June 30, 2001 and December 31, 2000, respectively	--	
Common stock, $0.01 par value, 81,761,465 shares authorized, 24,803,464 and 24,679,357 shares issued and outstanding at June 30, 2001 and December 31, 2000, respectively	248	
Additional paid-in-capital	77,570	
Retained earnings	7,672	
Total stockholders' equity	85,490	
Total liabilities and stockholders' equity	$ 121,476	$

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

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NOVAMED EYECARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in thousands, except per share data; unaudited)

	Three months ended June 30,	
	2001	2000
Net revenue:		
Surgical facilities	$ 10,742	$ 10,578
Management services	19,069	17,405
Product sales and other	7,542	6,111
Total net revenue	37,353	34,094
Operating expenses:		
Salaries, wages and benefits	14,140	12,324
Cost of sales and medical supplies	10,461	9,206
Selling, general and administrative	7,709	7,912
Depreciation and amortization	2,304	1,814
Total operating expenses	34,614	31,256
Income from operations	2,739	2,838
Other expense, net	527	301
Income before income taxes	2,212	2,537
Provision for income taxes	983	1,079
Net income	$ 1,229	$ 1,458
Basic earnings per common share	$ 0.05	$ 0.06

Diluted earnings per common share	$ 0.05	$ 0.06
Basic weighted average common shares outstanding	24,803	24,474
Diluted weighted average common shares outstanding	25,303	26,141

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

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NOVAMED EYECARE, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

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Cash flows from operating activities:	
Net income	$
Adjustments to reconcile net income to net cash provided by operating activities, net of effects of purchase transactions--	
Depreciation and amortization	
Deferred taxes	
Changes in working capital items--	
Accounts receivable and due from affiliated providers, net	
Inventory	
Other current assets	
Other noncurrent assets	
Accounts payable, accrued expenses and income taxes payable	
Net cash provided by operating activities	
Cash flows from investing activities:	
Purchases of property and equipment	
Acquisitions of and affiliations with entities, net	
Receipt (issuance) of notes receivable from/(to) affiliated providers	
Net cash used in investing activities	
Cash flows from financing activities:	
Borrowings under revolving line of credit	
Payments under revolving line of credit	(
Proceeds from the issuance of common stock	
Payments of other debt, debt issuance fees and capital lease obligations	
Net cash provided (used) by financing activities	
Net decrease in cash and cash equivalents	

Cash and cash equivalents, beginning of period	
Cash and cash equivalents, end of period	$

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

NOVAMED EYECARE, INC. AND SUBSIDIARIES
NOTES TO THE INTERIM
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2001
(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, 2000, filed by NovaMed Eyecare, Inc. (the "Company") with the Securities and Exchange Commission on Form 10-K. The unaudited interim condensed consolidated financial statements as of June 30, 2001 and for the three and six months ended June 30, 2001 and 2000, 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.

Certain prior year amounts have been reclassified to conform to current year presentation.

2. NEWLY ISSUED ACCOUNTING PRONOUNCEMENT

In June 2001, the Financial Accounting Standards Board issued Statement No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). This statement establishes standards for how intangible assets should be accounted for in the financial statements. Goodwill and identifiable intangible assets with an indefinite useful life will no longer be amortized. At least annually these assets will be reviewed for impairment, and if the fair value is less than the carrying value an impairment loss will be recognized. Upon initial adoption of the statement, any impairment loss will be recorded as a change in accounting principle.

The Company has reviewed the provisions of SFAS No. 142 and based on its current intangible assets the Company expects to reduce its annual amortization expense by approximately $1.1 million. The Company is in the process of evaluating the carrying value of its goodwill under the new standard, and has not yet determined if an impairment charge will be recognized upon adoption. The statement is effective for fiscal years beginning after December 15, 2001.

3. EARNINGS PER COMMON SHARE

Diluted EPS is calculated by dividing net income by the weighted average number of common shares, including the dilutive effect of potential common shares outstanding during the period. Potential common shares consist of outstanding options whose dilutive effect is calculated using the treasury stock method.

Earnings per common share is calculated as follows (in thousands, except per share):

	Three months ended June 30,	
	2001	2000
Income available to common stockholders-basic	$ 1,229	$ 1,458
Income available to common stockholders-diluted	$ 1,229	$ 1,458

EARNINGS PER COMMON SHARE (continued)

Basic weighted average number of common shares outstanding	24,803	24,474	
Effect of dilutive securities--stock options	500	1,667	
Diluted weighted average number of shares outstanding	25,303	26,141	
Earnings per common share:			
Basic	$ 0.05	$ 0.06	$
Diluted	$ 0.05	$ 0.06	$

4. OPERATING SEGMENTS

The table below presents information about operating data and segment assets used by the chief operating decision-maker of the Company as of and for the three months and six months ended June 30, 2001 and 2000 (in thousands):

	Surgical Facilities	Management Services	Product Sales and Other	Corporat
			(in thousands)	
Three months ended June 30, 2001				

Net revenue	$ 10,742	$ 22,415	$ 7,542	$
Earnings before tax	3,772	1,653	661	(3,8
Depreciation and amortization	518	433	61	1,2
Interest income	--	(8)	(1)	(
Interest expense	--	--	--	5
Identifiable assets	15,602	24,310	5,973	75,5
Three months ended June 30, 2000				
Net revenue	$ 10,578	$ 20,862	$ 6,111	$
Earnings before tax	3,997	1,668	711	(3,8
Depreciation and amortization	365	325	50	1,0
Interest income	--	(6)	(4)	(
Interest expense	--	--	--	3
Identifiable assets	11,314	18,371	5,413	77,4
Six months ended June 30, 2001				
Net revenue	$ 21,399	$ 44,641	$ 14,403	$
Earnings before tax	7,789	3,327	1,334	(8,1
Depreciation and amortization	1,001	867	116	2,5
Interest income	--	(8)	(3)	(
Interest expense	--	--	--	1,1
Identifiable assets	15,602	24,310	5,973	75,5
Six months ended June 30, 2000				
Net revenue	$ 20,597	$ 40,605	$ 11,086	$
Earnings before tax	8,169	3,468	1,162	(7,7
Depreciation and amortization	728	666	96	2,0
Interest income	--	(10)	(6)	(
Interest expense	--	1	--	5
Identifiable assets	11,314	18,371	5,413	77,4

Item 2.

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

The discussion below contains forward-looking statements (as such term is defined in Section 21E of the Securities Exchange Act of 1934) that are based on the beliefs of our management, as well as assumptions made by, and information currently available to, our management. Our results, performance and achievements in 2001 and beyond could differ materially from those expressed in, or implied by, any such forward looking statements. See "Cautionary note regarding forward-looking statements" on page 10.

Outlook

NovaMed Eyecare provides a comprehensive range of eye care services, focused primarily around its surgical facilities, including its ownership and operation of 15 ambulatory surgery centers (ASCs), and its operation of 15 laser vision correction centers. Eye care professionals perform laser vision correction, cataract and other eye-related surgical procedures in the facilities owned and/or operated by the Company. The revenue and earnings results in the second quarter and first half of 2001 were achieved despite an uncertain economic environment in the US. We expect this environment to continue for the foreseeable future.

The discussion set forth below analyzes certain factors and trends related to the financial results for each of the three and six months ended June 30, 2001 and 2000. This discussion should be read in conjunction with the condensed consolidated financial statements and notes to the condensed consolidated financial statements above.

Results of Operations

Three Months Ended June 30, 2001 Compared to the Three Months Ended June 30, 2000

Net Revenue. Net revenue for second quarter 2001 increased 9.6% to $37.4 million from $34.1 million in the prior year period. Surgical facilities net revenue increased 1.6% from $10.6 million to $10.7 million, the result of a 31% increase in cataract procedures, offset by a 16% decrease in laser vision correction procedures. Management services net revenue increased 9.6% from $17.4 million to $19.1 million. The increase in management services revenue was primarily a result of increases in cataract and other ophthalmic surgery procedures performed by our affiliated eye care professionals, despite a decrease in laser vision correction procedures, as well as new affiliations with eye care professionals. Product sales revenue increased 23.4% from $6.1 million to $7.5 million, reflecting strong product demand.

Salaries, Wages and Benefits. Salaries, wages and benefits expense increased 14.7% from $12.3 million to $14.1 million. As a percentage of revenue, salaries, wages and benefits expense increased from 36.1% to 37.9%. The absolute increase in salaries, wages and benefits expense is primarily due to new acquisitions and affiliations in the Southeast during the third and fourth quarters of 2000. The increase in salaries, wages and benefits expense as a percentage of revenue is driven by the structure of the newer acquisitions, where all physician compensation is paid as an expense under the management services agreement.

Cost of Sales and Medical Supplies. Cost of sales and medical supplies expense increased 13.6% from $9.2 million to $10.5 million. As a percentage of revenue, cost of sales and medical supplies expense increased from 27.0% to 28.0% . The absolute increase in cost of sales and medical supplies expense is primarily attributable to higher volumes at our Optical Product Sales business, along with costs incurred at new acquisitions and affiliations.

Selling, General and Administrative. Selling, general and administrative ("SG&A") expense decreased 2.6% from $7.9 million to $7.7 million. As a percentage of revenue, SG&A expense decreased from 23.2% to 20.6%. The absolute decrease in SG&A expense resulted from a 59% reduction in selling and marketing expenses from the second quarter of 2000 which more than offset a 20% increase in general and administrative expenses for the same period. The increase in general and administrative expenses was due primarily to costs incurred at new acquisitions and affiliations.

Depreciation and Amortization. Depreciation and amortization expense increased 27.0% from $1.8 million to $2.3 million. Acquisitions, affiliations and capital expenditures have increased overall depreciation and amortization expense.

Other Expense. Other expense increased from $301,000 to $527,000. The increase in other expense was primarily related to an increase in interest expense as a result of higher average outstanding indebtedness during the second quarter of 2001 as compared to the 2000 period. The higher indebtedness is directly related to the acquisitions made during the third and fourth quarters of 2000.

Provision for Income Taxes. Our effective tax rate reflects the impact of nondeductible amortization expense. Our effective tax rate increased to 44.4% from 42.5% in the second quarter of 2000.

Six months Ended June 30, 2001 Compared to the Six months Ended June 30, 2000

Net Revenue. Net revenue for the first six months of 2001 increased 13.0% to $74.2 million from $65.7 million in the prior year period. Surgical facilities net revenue increased 3.9% from $20.6 million to $21.4 million, primarily as a result of a 20% increase in cataract procedures and a 6% increase in laser vision correction procedures, compared to the first six months of 2000. The increase in cataract procedures mainly resulted from an overall increase in demand as well as new affiliations and agreements with eye care professionals. The increase in laser vision correction procedures mainly resulted from our fixed-site laser service agreements. Management services net revenue increased 12.9% from $34.0 million to $38.4 million. The increase in management services revenue was primarily a result of overall increases in cataract and other ophthalmic surgery procedures performed by our affiliated eye care professionals as well as new affiliations with eye care professionals. Product sales revenue increased 29.9% from $11.1 million to $14.4 million, primarily as a result of strong product demand and, to a lesser extent, revenue contributed by our eye care marketing products and services operations, which we acquired in May, 2000.

Salaries, Wages and Benefits. Salaries, wages and benefits expense increased 16.8% from $24.1 million to $28.2 million. As a percentage of revenue, salaries, wages and benefits expense increased from 36.7% to 37.9%. The absolute increase in salaries, wages and benefits expense is primarily due to new acquisitions and affiliations in the Southeast during the third and fourth quarters of 2000. The increase in salaries, wages and benefits expense as a percentage of revenue is driven by the structure of the newer acquisitions, where all physician compensation is paid as an expense under the management services agreement.

Cost of Sales and Medical Supplies. Cost of sales and medical supplies expense increased 16.6% from $17.4 million to $20.3 million. As a percentage of revenue, cost of sales and medical supplies expense increased from 26.5% to 27.3% . The absolute increase in cost of sales and medical supplies expense is primarily attributable to higher volumes at our Optical Product Sales business, along with costs incurred at new acquisitions and affiliations. Supply costs associated with the increase in laser vision correction and cataract procedures also contributed to the absolute increase during the period.

Selling, General and Administrative. Selling, general and administrative expense increased 4.1% from $15.1 million to $15.7 million. As a percentage of revenue, SG&A expense decreased from 23.0% to 21.2%. The absolute increase in SG&A expense related primarily to costs incurred at new acquisitions and affiliations. This increase was offset by a 40% reduction in selling and marketing expense during the same period, which accounted for the percentage decrease of expense to revenue.

Depreciation and Amortization. Depreciation and amortization expense increased 29.3% from $3.5 million to $4.5 million. Acquisitions, affiliations and capital expenditures have increased overall depreciation and amortization expense.

Other Expense. Other expense increased from $0.5 million to $1.2 million. The increase in other expense was primarily related to an increase in interest expense as a result of higher average outstanding indebtedness during the first half of 2001 as compared to the 2000 period. The higher indebtedness is directly related to the acquisitions made during the third and fourth quarters of 2000.

Provision for Income Taxes. Our effective tax rate reflects the impact of nondeductible amortization expense. Our effective tax rate in 2001 increased to 43.5% from 42.4% in 2000.

Liquidity and Capital Resources

Net cash provided by operating activities for both the six months ended June 30, 2001 and 2000 was $2.5 million. The Company used $2.1 million of cash for investing activities during the first six months of 2001, primarily for the purchase of equipment. During the first six months of 2001, the Company's net borrowings under its revolving credit line decreased $1.2 million from the December 31, 2000 level. At June 30, 2001, the Company had working capital of $26.8 million.

On June 28, 2000, the Company entered into a three-year, $50 million revolving credit agreement, replacing its previously existing agreement. Interest on borrowings under the credit agreement is payable at an annual rate equal to our lender's published base rate plus the applicable borrowing margin ranging from 0 to 0.75% or LIBOR plus a range from 1.5% to 2.25%, varying upon our ability to meet financial covenants. The weighted average interest rate on credit line borrowings for the three months and six months ended June 30, 2001 was approximately 6.8% and 7.4%, respectively. 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, 2001, we were in compliance with all of our credit agreement covenants. We had $25.0 million available on our line of credit as of June 30, 2001.

We expect that our funds from operations, our cash and our access to bank credit lines will be sufficient to fund our operations and capital expenditures for at least the next 12 months. Our future capital requirements and the adequacy of available funds will depend on many factors, including the timing of our acquisition activities, new affiliations with eye care professionals, capital requirements associated with our surgical facilities and the future cost of surgical equipment.

On June 15, 2000, we entered into an agreement to acquire two ASCs, contingent upon the resolution of certain requirements associated with the seller (the "Contingencies"). Certain of these Contingencies were satisfied in 2000 with respect to one of the ambulatory surgery centers, which we acquired in December 2000. Upon the resolution of the Contingencies affecting the other ambulatory surgery center and other conditions to closing, we will be required to purchase the other ambulatory surgery center for approximately $9.3 million in cash consideration. We may elect to fund up to approximately $2.3 million of this purchase price in the form of common stock. This transaction is excluded from the acquisition limitations of the Credit Agreement discussed above.

One of our affiliated eye care professionals has the option, exercisable through November 1, 2002, to acquire up to a 25% interest in one of our ASCs.

Effective March 1, 2001, we entered into a new five-year supply agreement with Alcon Laboratories, Inc. setting forth the terms upon which we can procure and utilize excimer lasers manufactured by Alcon. This agreement amended and superseded our previous agreement originally entered into with Summit Technology, Inc., which was acquired by Alcon in 2000. During the five-year term, we will pay Alcon monthly based on the number of procedures performed on each of our APEX/Infinity lasers and LADARVision Systems. We are required to pay for a minimum number of annual procedures on each LADARVision System during the five-year term, whether or not these procedures are performed. As of June 30, 2001, we have entered into commitments to pay Alcon up to approximately $1.4 million annually during the five-year term. The minimum commitment will increase if we deploy additional laser systems.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS. This Form 10-Q contains certain forward-looking statements that reflect our current expectations about our future results of operations, performance and achievements. When used in the Form 10-Q, the words "anticipates," "believes," "estimates," "plans," "intends," and similar expressions, as they relate to us or our management, are intended to identify such forward-looking statements. These forward-looking statements reflect our current beliefs and are based on information currently available to us. Accordingly, these statements are subject to certain risks, and uncertainties which could cause our actual results,

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performance or achievements in 2001 and beyond to differ materially from those expressed in, or implied by, such statements. These risks and uncertainties include: our ability to acquire, develop and manage a sufficient number of profitable surgical facilities; the acceptance of laser vision correction and other refractive surgical procedures by eye care professionals and the general public; our ability to establish and maintain profitable affiliations with eye care professionals; the adoption of competing new technologies for eye surgical procedures, including vision correction surgery; reduced prices and reimbursement rates for surgical procedures, including prices for laser vision correction procedures; the application of existing or proposed government regulations; and our failure to grow or manage our growth. See "Management's Discussion and Analysis of Financial Conditions and Results of Operations - Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2000 for further discussion. We undertake no obligation to update or revise any such forward-looking statements that may be made to reflect events or circumstances after the date of this Form 10-Q or to reflect the occurrence of unanticipated events.

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PART II. OTHER INFORMATION

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

We held our 2001 Annual Meeting of Stockholders on May 17, 2001, at which the following item was submitted to and voted upon by the stockholders:

The stockholders voted to re-elect two Class II directors for a term of three years expiring at our 2004 Annual Meeting of Stockholders. Results of the voting were as follows:

Authority

Directors	For	Withheld	Abstentions
John D. Hunkeler, M.D.	18,326,120	53,136	--
C.A. Lance Piccolo	18,326,220	53,036	--

R. Judd Jessup, Scott H. Kirk, M.D., Steven V. Napolitano and Stephen J. Winjum continued their terms of office as directors of the Company after the 2001 Annual Meeting of Stockholders.

Item 6. Exhibits and Reports on Form 8-K

A. Exhibits
None.

B. Reports on Form 8-K
We did not file any reports on Form 8-K during the second quarter of 2001.

SIGNATURE

Pursuant to the requirement of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NOVAMED EYECARE, INC.

/s/ Ronald G. Eidell	July 30, 2001
Ronald G. Eidell	Date

Executive Vice President,
Chief Financial Officer and Secretary
(on behalf of Registrant and as principal financial officer)

/s/ Robert L. Hiatt	July 30, 2001
Robert L. Hiatt	Date

Vice President Finance
(principal accounting officer)