HYSTER-YALE MATERIALS HANDLING, INC.
Form 10-Q
April 29, 2015
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q
(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2015

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 000-54799

HYSTER-YALE MATERIALS HANDLING, INC.
(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	31-1637659 (I.R.S. Employer Identification No.)
5875 LANDERBROOK DRIVE, SUITE 300, CLEVELAND, OHIO (Address of principal executive offices)	44124-4069 (Zip code)

(440) 449-9600
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES þ NO o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES þ NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES o NO þ

Number of shares of Class A Common Stock outstanding at April 24, 2015: 12,359,317
Number of shares of Class B Common Stock outstanding at April 24, 2015: 3,956,940

HYSTER-YALE MATERIALS HANDLING, INC.
TABLE OF CONTENTS

Table of Contents

Part I
FINANCIAL INFORMATION
Item 1. Financial Statements

HYSTER-YALE MATERIALS HANDLING, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	MARCH 31 2015	DECEMBER 31 2014
	(In millions, except share data)	
ASSETS		
Current Assets		
Cash and cash equivalents	$91.5	$111.4
Accounts receivable, net	315.3	357.7
Inventories, net	350.8	342.5
Deferred income taxes	23.7	20.8
Prepaid expenses and other	37.6	34.6
Total Current Assets	818.9	867.0
Property, Plant and Equipment, Net	172.4	179.8
Intangible Assets	4.0	4.1
Long-term Deferred Income Taxes	13.3	11.4
Investment in Unconsolidated Affiliates	38.0	39.6
Other Non-current Assets	15.9	18.9
Total Assets	$1,062.5	$1,120.8
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable	$327.0	$331.6
Accounts payable, affiliate	16.6	18.4
Current maturities of long-term debt	24.4	19.5
Accrued payroll	30.5	57.2
Accrued warranty obligations	31.5	32.3
Other current liabilities	103.1	94.5
Total Current Liabilities	533.1	553.5
Long-term Debt	10.7	12.0
Self-insurance Liabilities	19.3	18.6
Pension and other Postretirement Obligations	21.7	24.6
Other Long-term Liabilities	55.7	56.1
Total Liabilities	640.5	664.8
Stockholders' Equity		
Common stock:		
Class A, par value $0.01 per share, 12,353,488 shares outstanding (2014 - 12,277,148 shares outstanding)	0.1	0.1
Class B, par value $0.01 per share, convertible into Class A on a one-for-one basis, 3,958,795 shares outstanding (2014 - 3,964,082 shares outstanding)	0.1	0.1
Capital in excess of par value	319.2	324.1
Treasury stock	(43.4)	(49.1)
Retained earnings	289.8	280.4
Accumulated other comprehensive loss	(145.4)	(101.1)
Total Stockholders' Equity	420.4	454.5

Noncontrolling Interest	1.6	1.5
Total Equity	422.0	456.0
Total Liabilities and Equity	$1,062.5	$1,120.8

See notes to unaudited condensed consolidated financial statements.

Table of Contents

HYSTER-YALE MATERIALS HANDLING, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	THREE MONTHS ENDED MARCH 31	
	2015	2014
	(In millions, except per share data)	
Revenues	$622.3	$676.0
Cost of sales	519.4	564.3
Gross Profit	102.9	111.7
Operating Expenses		
Selling, general and administrative expenses	81.9	80.1
Operating Profit	21.0	31.6
Other (income) expense		
Interest expense	1.0	0.9
Income from unconsolidated affiliates	(1.1)	(1.2)
Other	1.4	0.3
	1.3	—
Income Before Income Taxes	19.7	31.6
Income tax provision	5.7	9.5
Net Income	14.0	22.1
Net income attributable to noncontrolling interest	(0.1)	—
Net Income Attributable to Stockholders	$13.9	$22.1
Basic Earnings per Share	$0.85	$1.32
Diluted Earnings per Share	$0.85	$1.31
Dividends per Share	$0.2750	$0.2500
Basic Weighted Average Shares Outstanding	16.277	16.770
Diluted Weighted Average Shares Outstanding	16.331	16.863

See notes to unaudited condensed consolidated financial statements.

Table of Contents

HYSTER-YALE MATERIALS HANDLING, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	THREE MONTHS ENDED MARCH 31	
	2015	2014
	(In millions)	
Net Income	$14.0	$22.1
Other comprehensive income (loss)		
Foreign currency translation adjustment	(40.3)	2.8
Current period cash flow hedging activity	(4.6)	(0.1)
Reclassification of hedging activities into earnings	—	0.3
Reclassification of pension into earnings	0.6	1.2
Comprehensive Income (Loss)	$(30.3)	$26.3
Other comprehensive income (loss) attributable to noncontrolling interest		
Net income attributable to noncontrolling interest	(0.1)	—
Comprehensive Income (Loss) Attributable to Stockholders	$(30.4)	$26.3

See notes to unaudited condensed consolidated financial statements.

Table of Contents

HYSTER-YALE MATERIALS HANDLING, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	THREE MONTHS ENDED MARCH 31	
	2015	2014
	(In millions)	
Operating Activities		
Net income	$14.0	$22.1
Adjustments to reconcile net income to net cash used for operating activities:		
Depreciation and amortization	7.3	7.5
Amortization of deferred financing fees	0.3	0.3
Deferred income taxes	(0.6)	0.8
Stock-based compensation	0.9	2.2
Dividends from unconsolidated affiliates	2.5	—
Other non-current liabilities	1.3	2.2
Other	(2.0)	(2.8)
Working capital changes:		
Accounts receivable	25.2	(0.1)
Inventories	(32.0)	(26.0)
Other current assets	(6.3)	(5.5)
Accounts payable	8.8	6.9
Other current liabilities	(22.8)	(24.5)
Net cash used for operating activities	(3.4)	(16.9)
Investing Activities		
Expenditures for property, plant and equipment	(9.8)	(4.9)
Proceeds from the sale of assets	0.9	—
Business acquisition, purchase price adjustment	0.9	—
Other	—	(0.6)
Net cash used for investing activities	(8.0)	(5.5)
Financing Activities		
Additions to long-term debt	12.3	5.7
Reductions of long-term debt	(8.3)	(10.3)
Net change to revolving credit agreements	—	(33.5)
Cash dividends paid	(4.5)	(4.2)
Purchase of treasury stock	(0.1)	(3.5)
Net cash used for financing activities	(0.6)	(45.8)
Effect of exchange rate changes on cash	(7.9)	(0.2)
Cash and Cash Equivalents		
Decrease for the period	(19.9)	(68.4)
Balance at the beginning of the period	111.4	175.7
Balance at the end of the period	$91.5	$107.3

See notes to unaudited condensed consolidated financial statements.

5

Table of Contents

HYSTER-YALE MATERIALS HANDLING, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

						Accumulated Other Comprehensive Income (Loss)		
	Class A Common Stock	Class B Common Stock	Treasury Stock	Capital in Excess of Par Value	Retained Earnings	Foreign Currency Translation Adjustment	Deferred Gain (Loss) on Cash Flow Hedging	Pension Adjustment
	(In millions)							
Balance, January 1, 2014	$0.1	$ 0.1	$(3.4)	$320.6	$188.4	$1.3	$(1.9)	$ (55.4)
Stock-based compensation	—	—	—	2.2	—	—	—	—
Stock issued under stock compensation plans	—	—	2.2	(2.2)	—	—	—	—
Purchase of treasury stock	—	—	(3.5)	—	—	—	—	—
Net income attributable to stockholders	—	—	—	—	22.1	—	—	—
Cash dividends on Class A and Class B common stock: $0.25 per share	—	—	—		(4.2)	—	—	—
Current period other comprehensive income (loss)	—	—	—	—	—	2.8	(0.1)	—
Reclassification adjustment to net income	—	—	—	—	—	—	0.3	1.2
Balance, March 31, 2014	$0.1	$ 0.1	$(4.7)	$320.6	$206.3	$4.1	$(1.7)	$ (54.2)
Balance, January 1, 2015	$0.1	$ 0.1	$(49.1)	$324.1	$280.4	$(40.4)	$(2.0)	$ (58.7)
Stock-based compensation	—	—	—	0.9	—	—	—	—
Stock issued under stock compensation plans	—	—	5.8	(5.8)	—	—	—	—
Purchase of treasury stock	—	—	(0.1)	—	—	—	—	—
Net income attributable to stockholders	—	—	—	—	13.9	—	—	—

Shares received as consideration in divestiture transactions.	□	□	□	□	□	(1,370)	(2,238)	(2,238)
Stock options exercised	101	1	171	□	□	□	□	172
Shares issued - employee stock purchase plan	40	□	40	□	□	□	□	40
Net income - restated	□	□	□	□	1,869	□	□	1,869
Balance, December 31, 2003 - restated	25,046	250	77,964	□	(25,828)	(3,843)	(4,460)	47,926
Shares received as consideration in divestiture transactions.	□	□	170	□	□	(366)	(1,703)	(1,533)
Stock options exercised	583	6	1,529	□	□	□	□	1,535
Shares issued - employee stock purchase plan	21	□	47	□	□	□	□	47

Net income - restated	—	—	—	—	2,846	—	—	2,846
Balance, December 31, 2004 - restated	25,650	256	79,710	—	(22,982)	(4,209)	(6,163)	50,821
Shares received as consideration in divestiture transactions.	—	—	—	—	—	(49)	(301)	(301)
Stock options exercised	864	9	3,423	—	—	(129)	(994)	2,438
Shares issued - employee stock purchase plan	19	—	77	—	—	—	—	77
Restricted stock grant	250	3	1,620	(1,623)	—	—	—	—
Deferred compensation recognized	—	—	—	51	—	—	—	51
Net income	—	—	—	—	5,589	—	—	5,589
Balance, December 31, 2005	26,783	$ 268	$ 84,830	$ (1,572)	$ (17,393)	(4,387)	$ (7,458)	$ 58,675

The accompanying notes are an integral part of these consolidated financial statements.

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

	Years Ended December 31,		
	2005	**2004** *(restated)*	**2003** *(restated)*
Cash flows from operating activities:			
Net income	$ 5,589	$ 2,846	$ 1,869
Adjustments to reconcile net income to net cash provided by continuing operations, net of effects of purchase transactions:			
Net income from discontinued operations	(284)	(793)	(147)
Depreciation and amortization	2,458	2,445	2,634
Gain on sale of minority interests	(110)	(99)	(892)
Earnings of non-consolidated affiliate	(106)	(23)	—
Deferred compensation	51	—	—
Deferred taxes	3,308	2,379	2,230
Minority interests	7,372	4,863	2,602
Distributions to minority partners	(7,229)	(3,743)	(2,184)
Changes in operating assets and liabilities—			
Accounts receivable	(609)	(378)	(1,142)
Inventory	(390)	92	(336)
Other current assets	(41)	(38)	3,894
Other noncurrent assets	97	88	221
Accounts payable, accrued expenses and income taxes payable	1,653	2,513	516
Net cash provided by continuing operations	11,759	10,152	9,265
Cash flows from investing activities:			
Payments for acquisitions, net	(22,172)	(26,896)	—

Purchases of property and equipment	(2,608)	(2,044)	(2,884)
Proceeds from sale of minority interests	941	1,138	2,575
Proceeds from sale of property and equipment	63	101	331
Proceeds from sale of securities	40	74	—
Net cash (used in) provided by investing activities	(23,736)	(27,627)	22
Cash flows from financing activities:			
Borrowings under revolving credit agreement	45,800	19,000	825
Payments under revolving credit agreement	(33,800)	(14,000)	(825)
Proceeds from the issuance of stock, net of issuance costs	1,055	889	171
Payments of other debt, debt issuance fees and capital lease obligations	(407)	(146)	(170)
Net cash provided by financing activities	12,648	5,743	1
Cash flows from discontinued operations:			
Operating activities	74	(124)	(2,164)
Investing activities	445	555	2,720
Financing activities	—	—	—
Net cash provided by discontinued operations	519	431	556
Net increase (decrease) in cash and cash equivalents	1,190	(11,301)	9,844
Cash and cash equivalents, beginning of year	500	11,801	1,957
Cash and cash equivalents, end of year	$ 1,690	$ 500	$ 11,801

The accompanying notes are an integral part of these consolidated financial statements.

F-8

NOVAMED, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)

1. GENERAL INFORMATION

Description of the Business

NovaMed, Inc. (NovaMed) along with its subsidiaries (collectively, the Company) is an owner and operator of ambulatory surgery centers (ASCs). The Company's primary focus and strategy is to acquire, develop and operate ASCs in joint ownership with physicians throughout the United States. At December 31, 2005, the Company owned and operated 28 ASCs where surgeons perform various surgical procedures, predominantly ophthalmic procedures. The Company owned a majority interest in 23 of its ASCs and a minority interest in two ASCs, with physicians owning the remaining equity interests in these 25 ASCs. The Company owns all of the equity interests in its other three ASCs. In the future the Company may elect to sell to physicians a minority interest in these three facilities. The Company also has laser services agreements pursuant to which it provides excimer lasers and other services to ophthalmologists for their use in performing laser vision correction (LVC) surgery.

The Company also owns and operates optical laboratories, an optical products purchasing organization and a marketing products and services business.

The Company also continues to provide management services to two eye care practices pursuant to long-term service agreements. These practices are located in Illinois and Georgia. Under these service agreements, the Company provides business, information technology, administrative and financial services to its affiliated providers in exchange for a management fee.

(Dollars in thousands, except per share data)

2. RESTATEMENT

These consolidated financial statements have been restated for the years ending December 31, 2004, 2003, and 2002 (including interim periods), and the first three fiscal quarters of 2005.

During the course of the preparation of the Company’s financial statements for the year ended December 31, 2005, errors were identified with respect to the Company’s application of generally accepted accounting principles relating to certain written options (“the ASC Options”) granted by the Company to several physicians. The terms of the ASC Options provided these physicians with the right to acquire equity interests held by the Company in specified ASCs for fixed prices at various dates in the future. Historically, the Company has not accounted for the written call options. The Company purchased these written call options from the physicians in August of 2004 and March of 2005, see Note 6, for $200 and $3,600, respectively, and incorrectly recorded the purchase price as additional goodwill. The Company has determined that the ASC Options should have been initially recorded, at grant date, as a liability in its financial statements at their fair market value. The Company has also determined that the initial liability recorded should have been adjusted during each subsequent fiscal quarter for changes in fair market value with an offsetting adjustment to earnings and that upon the purchase of the call options from the physicians, the liability should have been eliminated with the difference between the purchase price and the liability being recorded as a gain or loss.

Effects of the Restatement

The restatement also impacted or made changes to the following financial statement footnotes: Note 3, 4, 6, 8, 9, 11, 17, and 20.

The following tables set forth the effects of the restatement relating to the ASC Options on the affected line items within the Company’s previously reported Consolidated Financial Statements for the periods shown below:

	As of December 31,	
	2004	**2004**
	As previously reported	**As restated**
Consolidated Balance Sheets data:		
Intangible assets, net	$ 51,240	$ 51,040
Total Assets	76,987	76,787
Accrued expenses	3,158	6,758
Total current liabilities	8,628	12,228
Accumulated deficit	(19,182)	(22,982)
Total stockholders’ equity	54,621	50,821
Total liabilities and stockholders’ equity	76,987	76,787

	December 31,			
	2004	**2004**	**2003**	**2003**
	As previously reported	**As restated**	**As previously reported**	**As restated**
Consolidated Statement of Operations data:				
Change in fair market value of written call options on				

subsidiaries	$ —	$ 1,613	$ —	$ 1,622
Total other (income) expense	4,777	6,390	1,518	3,140
Income before income taxes	6,108	4,495	5,574	3,952
Net income from continuing operations	3,666	2,053	3,344	1,722
Net income	4,459	2,846	3,491	1,869
Net earnings per common share from continuing operations:				
Basic	$ 0.17	$ 0.10	$ 0.16	$ 0.08
Diluted	$ 0.16	$ 0.09	$ 0.15	$ 0.08
Net earnings per common share:				
Basic	$ 0.21	$ 0.13	$ 0.16	$ 0.09
Diluted	$ 0.19	$ 0.12	$ 0.16	$ 0.08

NOVAMED, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Dollars in thousands, except per share data)

	December 31,					
	2004	**2004**	**2003**	**2003**	**2002**	
	As previously reported	**As restated**	**As previously reported**	**As restated**	**As previously reported**	**As**
Consolidated Statement of Stockholders' Equity data:						
Net income	$ 4,459	$ 2,846	$ 3,491	$ 1,869	$ 210	$
Balance, December 31:						
Retained Earnings (Accumulated Deficit)	(19,182)	(22,982)	(23,641)	(25,828)	(27,132)	(
Total Stockholders' Equity	54,621	50,821	50,113	47,926	48,648	

Only certain individual line items within net cash provided by continuing operations have been restated in the statements of cash flows for 2004 and 2003. Net cash flow from continuing operations for these periods was not affected by the restatement.

The effect of the restatement on the quarterly financial statements by line item is as follows:

	As of March 31, 2005		**As of June 30, 2005**		**As of September 30,**	
	As previously reported	**As restated**	**As previously reported**	**As restated**	**As previously reported**	**As res**
Consolidated Balance Sheets data:						
Intangible assets, net	$ 58,402	$ 54,421	$ 60,605	$ 56,624	$ 60,491	$ 56
Total Assets	86,383	82,583	90,936	87,136	90,147	86
Accumulated deficit	(17,828)	(21,628)	(16,449)	(20,249)	(14,822)	(18
Total stockholders' equity	55,991	52,191	57,784	53,984	60,659	56

Total liabilities and stockholders equity	86,383	82,583	90,936	87,136	90,147	86

	As of March 31, 2004		As of June 30, 2004		As of September 30,	
	As previously reported	As restated	As previously reported	As restated	As previously reported	As res
Consolidated Balance Sheets data:						
Intangible assets, net	$ 26,562	$ 26,562	$ 34,670	$ 34,670	$ 47,398	$ 47
Total Assets	65,125	65,125	66,713	66,713	77,381	77
Accrued expenses	2,451	4,770	2,439	5,656	3,160	6
Total current liabilities	8,498	10,817	8,563	11,780	9,122	12
Accumulated deficit	(22,300)	(24,619)	(21,471)	(24,688)	(20,401)	(23
Total stockholders equity	50,146	47,827	51,043	47,826	52,884	49
Total liabilities and stockholders equity	65,125	65,125	66,713	66,713	77,381	77

NOVAMED, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, except per share data)

As a result of the restatement, previously reported statement of operations data for 2005 were not affected.

	As of March 31, 2004		As of June 30, 2004		As of September 30, 2004	
	As previously reported	As restated	As previously reported	As restated	As previously reported	As restated
Consolidated Statement of Operations data:						
Change in fair market value of written call options on subsidiaries	$	$ 132	$	$ 898	$	$ 176
Total other (income) expense	539	671	1,127	2,025	1,601	1,777
Income before income taxes	1,179	1,047	1,267	369	1,719	1,543
Net income from continuing operations	708	576	760	(138)	1,031	855
Net income	1,342	1,210	829	(69)	1,070	894
Net earnings per common share from continuing operations:						
Basic	$ 0.03	$ 0.03	$ 0.04	$ (0.01)	$ 0.05	$ 0.04
Diluted	$ 0.03	$ 0.02	$ 0.03	$ (0.01)	$ 0.05	$ 0.04
Net earnings per common share:						
Basic	$ 0.06	$ 0.06	$ 0.04	$ 0.00	$ 0.05	$ 0.04
Diluted	$ 0.06	$ 0.05	$ 0.04	$ 0.00	$ 0.05	$ 0.04

	As of March 31, 2003		As of June 30, 2003		As of September 30, 2003	
	As previously reported	As restated	As previously reported	As restated	As previously reported	As restated
Consolidated Statement of Operations data:						
Change in fair market value of written call options on subsidiaries	$ —	$ 578	$ —	$ 310	$ —	$ 266
Total other (income) expense	440	1,018	648	958	826	1,092
Income before income taxes	851	273	1,252	942	1,258	992
Net income from continuing operations	508	(70)	752	442	753	487
Net income	563	(15)	790	480	798	532
Net earnings per common share from continuing operations:						
Basic	$ 0.02	$ 0.00	$ 0.04	$ 0.02	$ 0.04	$ 0.02
Diluted	$ 0.02	$ 0.00	$ 0.03	$ 0.02	$ 0.03	$ 0.02
Net earnings per common share:						
Basic	$ 0.03	$ 0.00	$ 0.04	$ 0.02	$ 0.04	$ 0.02
Diluted	$ 0.03	$ 0.00	$ 0.04	$ 0.02	$ 0.04	$ 0.02

NOVAMED, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Dollars in thousands, except per share data)

The effect of the restatement on the Company's segments by line item is as follows:

	Surgical Facilities	
	As previously reported	As restated
2004:		
Earnings (loss) before taxes	$ 8,791	$ 7,178
Identifiable assets	59,454	59,254
2003:		
Earnings (loss) before taxes	9,151	7,529
Identifiable assets	30,163	30,163

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Statement Presentation and Principles of Consolidation

(Dollars in thousands, except per share data)

The consolidated financial statements include the financial statements of NovaMed and its wholly owned and majority owned subsidiaries. In addition, the Company consolidates the accounts of an ASC in which it does not hold a majority ownership interest because the Company maintains effective control over the ASCs assets and operations. The Company uses the equity method of accounting for the other ASC in which it owns a minority interest. The Company consolidates two physician practice management (PPM) entities under the guidance of EITF 97-2 Application of FASB Statement No. 94 and APB Opinion No. 16 to Physician Practice Management Entities and Certain Other Entities with Contractual Management Arrangements. All significant intercompany balances and transactions have been eliminated in consolidation. Prior year amounts have been reclassified to conform to current year presentation.

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid instruments with an original maturity of three months or less from the date of purchase. Pursuant to three of its limited liability company agreements, the cash held by each entity is restricted to that entitys use. The cash balance subject to such restrictions was $1,127 and $387, at December 31, 2005 and 2004, respectively. Pursuant to one of its limited liability company agreements, reserves established to fund the operating and other liabilities of that entity are to be held in that entitys bank account. The cash balance subject to such restriction was $0 at December 31, 2005 and 2004.

Inventory

Inventory consists primarily of optical products such as eyeglass frames, optical lenses and contact lenses, as well as surgical supplies used in connection with the operation of the Company's ASCs. Inventory is valued at the lower of cost or market, with cost determined using the first-in, first-out (FIFO) method. The Company routinely reviews its inventory for obsolete, slow moving or otherwise impaired inventory and records a related expense in the period such impairment is known and quantifiable.

Year ended December 31,	**2005**	**2004**
Optical products	$ 824	$ 711
Surgical supplies	967	707
Other	221	95
Total inventory	$ 2,012	$ 1,513

Property and Equipment

Property and equipment are stated at lower of cost or fair value at the date of acquisition. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the related assets, generally three to seven years for equipment, computer software, furniture and fixtures, and the lesser of the lease term or 10 years for leasehold improvements. Routine maintenance and repairs are charged to expense as incurred.

Intangible Assets

The Company's acquisitions and affiliations involve the purchase of tangible and intangible assets and the assumption of certain liabilities. As part of the purchase price allocation, the Company allocates the purchase price to the tangible assets acquired and liabilities assumed, based on estimated fair market values, with the remainder of the purchase price allocated to intangibles. The Company accounts for intangible assets in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). Goodwill is not amortized but is subject to an annual impairment assessment in relation to its fair value.

Impairment of Long-Lived Assets

The Company reviews the carrying value of the long-lived assets periodically to determine if facts and circumstances exist that would suggest that assets might be impaired or that the useful lives should be modified. Among the factors the Company considers in making the evaluation are changes in market position and profitability. If facts and circumstances are present which may indicate impairment is probable, the Company will prepare a projection of the undiscounted cash flows of the specific business entity and determine if the long-lived assets are recoverable based on these undiscounted cash flows. If impairment is indicated, an adjustment will be made to reduce the carrying amount of these assets to their fair value.

The Company accounts for impairment and disposal of its long-lived assets in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144). Although SFAS 144 supercedes SFAS 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of* and APB Opinion 30, *Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* (APB 30), the accounting treatment related to the Companys decision in September 2001 to discontinue its management services segment under APB Opinion 30 was not impacted. During 2002, the Company sold additional operations not contemplated in its 2001 divestiture plan. The sale of these businesses, as well as the sale of its interest in an ASC during 2005, were accounted for under SFAS 144.

Income Taxes

The Company uses the liability method of accounting for income taxes in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

Fair Value of Financial Instruments

The carrying value of all financial instruments such as accounts receivable, notes and amounts due from affiliated providers, accounts payable and accrued expenses are reasonable estimates of their fair value because of the short maturity of these items. The Company believes the current carrying amounts of its notes receivable from related parties, line of credit and obligations under capital leases approximate fair value because the interest rates on these instruments are subject to change with, or approximate, market interest rates.

The Company has historically granted certain physicians physically settled written call options on the equity of certain ASCs. The Companys policy is to estimate and record the fair market value of these call options on the grant date and record subsequent increases and decreases in the fair market value as expense or income, respectively, in the Companys Consolidated Statement of Operations. If the related option is subsequently exercised, the Company's policy is to reverse the cumulative effect of the previously recorded expense or income associated with changes in the fair market value of the written call options.

Revenue Recognition

Surgical Facilities

Revenue in the Companys ASCs is based on fees charged to patients, third-party payors or others for use of the facilities and relate primarily to surgical procedures performed in the ASCs. Revenue from fixed-site laser services installations is the fee charged to the doctor for use of the laser placed in that doctors facility. Surgical facility revenue is net of contractual adjustments and a provision for doubtful accounts and is recognized at the time the surgical procedure is performed. The contractual allowance is the difference between the fee charged and the amount expected to be paid by the patient or the applicable third-party payor, which includes Medicare and private insurance. The Company bases its estimates for the contractual allowance on the Medicare reimbursement rates when Medicare is the payor, contracted rates with other third party payors or historical experience when there is not a specific contracted rate. The estimate for doubtful accounts is based on the aging category and historical collection experience.

Product Sales and Other

The Companys optical products purchasing organization negotiates volume buying discounts with optical products manufacturers. The buying discounts and any handling charges billed to the members of the buying group represent the revenue recognized for financial reporting purposes. Revenue is recognized as orders are shipped to members. The Company bases its estimates for sales returns and discounts on historical experience and has not experienced significant fluctuations between estimated and actual return activity and discounts given. Revenue generated from affiliated ophthalmologists and optometrists with whom the Company has a management services agreement is eliminated in consolidation.

The Companys optical laboratories manufacture and distribute corrective lenses and eyeglasses to both affiliated and non-affiliated ophthalmologists and optometrists. Revenue is recognized when product is shipped, net of an allowance for discounts. The Companys marketing products and services company recognizes revenue when the product is shipped or service rendered.

The Company owns the net operating assets and has long-term service agreements (SAs) with an ophthalmology practice and an optometric practice with a retail optical store. The Company provides services, facilities and equipment under these SAs. The SAs have 25 to 40-year terms and require the Company to provide all of the business, administrative and financial services necessary to operate the practices and the retail optical store. The Company recognizes the revenue of the SAs based on services performed and retail sales adjusted for contractual arrangements. These practices are consolidated in the Companys financial statements and all intercompany transactions are eliminated.

The Company also records an estimate for doubtful accounts based on the aging category and historical collection experience of each product sales and other business described above.

Cost of Sales and Medical Supplies

Cost of sales and medical supplies includes the cost of optical products such as eyeglass frames, optical lenses, contact lenses and surgical supplies, direct labor costs incurred in the preparation of optical lenses, and the per procedure fees related to operating the equipment used in LVC procedures.

Stock Compensation

As discussed in Recent Accounting Pronouncements on page F-17 of this Form 10-K, the Company will adopt a new accounting standard regarding its accounting for stock-based employee compensation effective January 1, 2006. Prior to that date, the Company accounted 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 option 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. 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*. In November 2005, the Company issued 250,000 shares of restricted stock under its 2005 Restricted Stock Plan, and $51 of compensation expense was recognized in 2005. See Note 16 for additional information regarding stock plans.

	2005	2004 (restated)	2003 (restated)
Net income as reported	$ 5,589	$ 2,846	$ 1,869
Deduct: Total stock-based employee compensation expense, net of related tax effects	(640)	(879)	(1,452)
Pro forma net income	4,949	$ 1,967	$ 417
Earnings per share:			
Basic as reported	$ 0.25	$ 0.10	$ 0.09
Basic pro forma	$ 0.23	$ 0.09	$ 0.02
Diluted as reported	$ 0.23	$ 0.14	$ 0.08
Diluted pro forma	$ 0.21	$ 0.09	$ 0.02

NOVAMED, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, except per share data)

The fair value of these options was estimated using the Black-Scholes option-pricing model with the following assumptions:

	2005	2004	2003
Expected option life in years	4	4	4
Risk-free interest rate	3.93%	2.50%	2.44%
Dividend yield			
Expected volatility	.660	.708	.830

Concentration of Credit Risk

For the years ended December 31, 2005, 2004 and 2003, approximately 39%, 40% and 40%, respectively, of the Company's net revenue was received from Medicare and other governmental programs, which reimburse providers based on fee schedules determined by the related governmental agency. In the ordinary course of business, providers receiving reimbursement from Medicare and other governmental programs are potentially subject to a review by regulatory agencies concerning the accuracy of billings and sufficiency of supporting documentation.

Use of Estimates

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

Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payment*. SFAS 123R supercedes APB No. 25, FAS 123, as amended by FAS No. 148, and related interpretations. Under SFAS No. 123R, compensation cost for stock-based employee compensation is measured at the grant date based on the estimated fair value of the award and is required to be recognized as compensation expense over the vesting period. We currently plan to adopt SFAS No. 123R in the first quarter of 2006 using the modified prospective method. We expect the after-tax non-cash compensation charge for stock options and restricted stock granted through December 31, 2005, as a result of the adoption of SFAS No. 123R, to be in the range of $0.9 million to $1.0 million, or $0.04 per diluted share, for 2006.

(Dollars in thousands, except per share data)

In June 2005, the FASB ratified the conclusions of Emerging Issues Task Force No. 04-05 (EITF 04-05), *Determining Whether a General Partner or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights*. EITF 04-05 provides a framework for determining whether a general partner controls, and should consolidate, a limited partnership or similar entity. EITF 04-05 is effective for all limited partnerships beginning January 1, 2006 and we do not expect the adoption of EITF 04-05 to have a material impact on our financial condition or results of operations.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections-a replacement of APB Opinion No. 20 and FASB Statement No. 3* (SFAS 154). This statement changes the requirements for the accounting for and reporting of a change in accounting principal and applies to all voluntary changes in accounting principal. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. SFAS 154 requires retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to determine either the

period-specific effects or the cumulative effect of the change. We are required to adopt SFAS 154 during the first quarter of 2006. We do not expect the adoption of SFAS 154 to have a material impact on our financial condition or results of operations.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51* (FIN 46R). In December 2003, the FASB issued a new version of FIN 46. FIN 46, in both its original and revised versions, provides a framework for identifying variable interest entities (VIEs) and determining when a company should consolidate a VIE for financial reporting purposes. FIN 46 was initially effective for VIEs created after January 31, 2003, with the provisions of the revised FIN 46 effective for periods ending after December 15, 2003. The adoption of FIN 46 did not have an impact on our financial position or results of operations.

4. EARNINGS PER COMMON SHARE (EPS)

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. The dilutive effect of potential common shares, consisting of outstanding stock options and restricted stock, is calculated using the treasury stock method.

Earnings per common share is calculated as follows:

	Year Ended December 31,		
	2005	**2004**	**2003**
		(restated)	***(restated)***
Net income from continuing operations	$ 5,305	$ 2,053	$ 1,722
Net income from discontinued operations	284	793	147
Net income	$ 5,589	$ 2,846	$ 1,869
Basic weighted average number of common shares			

outstanding	21,742	21,181	21,470
Effect of dilutive securities			
stock options and restricted stock	2,100	1,907	644
Diluted weighted average number of shares outstanding	23,842	23,088	22,114
Basic earnings per common share:			
Continuing operations	$ 0.24	$ 0.10	$ 0.08
Discontinued operations	0.01	0.04	0.01
Basic earnings per share	$ 0.25	$ 0.14	$ 0.09
Diluted earnings per common share:			
Continuing operations	$ 0.22	$ 0.09	$ 0.08
Discontinued operations	0.01	0.03	0.01
Diluted earnings per share	$ 0.23	$ 0.12	$ 0.09

F-18

NOVAMED, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, except per share data)

5. STATEMENT OF CASH FLOWS - SUPPLEMENTAL

	Year ended December 31,		
	2005	**2004**	**2003**
Supplemental cash information:			
Interest paid	$ 615	$ 157	$ 86
Income taxes paid	430	185	158
Income tax refunds received	45	123	4,002

The tax refunds received in 2003 were primarily from the carryback of 2001 and 2002 federal net operating losses to tax years 1997 through 2000.

During 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, the Company established a reserve for $237 which is evaluated quarterly and adjusted as necessary. During 2005, the reserve was reduced by approximately $23.

Non-cash investing and financing activities:

During the third quarter of 2005, the Company received 129,180 shares of its common stock from the estate of Stephen J. Winjum to fund the $994 aggregate option exercise price of 240,000 options due to expire on August 21, 2005. These were recorded as treasury shares.

During the first quarter of 2005, the Company received 31,200 shares of its common stock from a former affiliated physician as final settlement of a lawsuit. Treasury shares were recorded at $197 and this amount was reported as income from discontinued operations. The Company also received 17,518 shares of its common stock to repay $104 of outstanding notes receivable from one of its divestiture transactions.

(Dollars in thousands, except per share data)

The Company received 365,344 shares of its common stock from a former affiliated physician during 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 paid-in-capital was increased by $170 and the valuation allowance was reversed and reported as income from discontinued operations.

In 2005, 2004 and 2003, the Company obtained medical equipment by entering into capital leases for $368, $281 and $105, respectively.

6. ACQUISITIONS AND SALES OF MINORITY INTERESTS

The Company generally accounts for acquisitions of majority equity interests in ASCs using 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 acquired a majority interest in four ASCs during 2005 and acquired a majority interest in six ASCs and a minority interest in one ASC during 2004. Total cash acquisition cost in 2005 for these ASCs was $18,464 of which the Company allocated $17,322 to goodwill. Total cash acquisition cost in 2004 was $26,079 of which the Company allocated $24,190 to goodwill. The Company made no acquisitions in 2003. The goodwill is not amortized in accordance with SFAS 142 and is expected to be fully deductible for tax purposes.

The following unaudited pro forma results of operations assume that the business acquisitions in 2005 and 2004 described above occurred as of January 1, 2004. The unaudited pro forma results from continuing operations below are based on historical results of operations and do not necessarily reflect actual results that would have occurred:

	Year ended December 31,	
Pro forma results	**2005**	**2004**
Net revenue	$ 88,327	$ 82,616
Operating income	19,257	18,235
Net income from continuing operations	6,194	4,421
Net income	6,478	5,214
Earnings per common share from continuing operations:		
Basic	0.28	0.21
Diluted	0.26	0.19
Earnings per common share:		
Basic	0.30	0.25
Diluted	0.27	0.23

Effective March 25, 2005, the Company entered into an Option Purchase Agreement with its two physician-partners in its Overland Park, KS ASC. These physician-partners had previously given notice of their intent to exercise an option to purchase all of the Companys interest in this ASC effective as of April 15, 2005. Under the terms of the Option Purchase Agreement, the Company purchased this option from these physician-partners for an aggregate sum of $3,600, with $1,800 paid to each physician-partner. As a result of this transaction, the option was terminated and the Company has retained its 51% interest in this ASC. See Note 2 for discussion of the historical accounting treatment of this written call option and its impact on these restated financial statements.

(Dollars in thousands, except per share data)

In August 2004, the Company paid the 49% physician-partner of its Merrillville, IN ASC to terminate his option to purchase the Company's 51% interest. See Note 2 for discussion of the historical accounting treatment of this written call option and its impact on these restated financial statements.

Also during 2004, the Company exercised its option to purchase the 20% minority equity interest in one of its Kansas City, MO ASCs from its physician-partners. The Company now owns 100% of this ASC. In addition, a physician-partner of the Thibodaux, LA ASC exercised his right to sell the Company a 10% interest, decreasing the physician's interest to 30%. The Company paid $816 for the above transactions.

In 2004, the Company opened a new ASC in New Albany, IN with two physician-partners who then each owned 32% of the facility. These physicians had been performing pain management procedures in the Company's other New Albany, IN ASC. In 2003, the Company built a new ASC in Kansas City, MO with a physician-partner who owns 49% of the facility. This physician had been performing procedures in one of our existing Kansas City ASCs. All of these entities are consolidated into the financial statements of the Company and the minority shareholder interests in the earnings and assets of those ASCs are reflected in the minority interest line of the consolidated financial statements.

The Company also sold minority equity interests in eight of its existing ASCs during 2005, 2004 and 2003 to various physicians. From the sale of minority interests, the Company received in the aggregate approximately $941 in cash proceeds in 2005, approximately $1,138 in cash proceeds in 2004 and approximately $1,950 in cash proceeds and 261,000 shares of its common stock in 2003.

Location	Interest % sold	Effective Date
Richmond, VA	10%	January 2003
Chicago, IL	17.5%	February 2003
Maryville, IL	10%	February 2003
Richmond, VA	10%	September 2003
Maryville, IL	10%	September 2003
Kansas City, MO	49%	October 2003
Chicago, IL	3%	December 2003
New Albany, IN	20%	December 2003
Chattanooga, TN	22.5%	February 2004
New Albany, IN	10%	March 2004
Chattanooga, TN	8%	May 2004
Chattanooga, TN	7.5%	July 2004
Columbus, GA	26%	April 2005
Richmond, VA	29%	April 2005
Columbus, GA	2.5%	July 2005
River Forest, IL	5%	August 2005

7. PROPERTY AND EQUIPMENT

Property and equipment consist of the following as of December 31, 2005 and 2004:

	2005	2004
Equipment	$ 14,713	$ 12,817
Information technology	2,050	1,970

Furniture and fixtures	873	823
Leasehold improvements	5,716	4,059
	23,352	19,669
Less--Accumulated depreciation and amortization	(13,412)	(11,624)
	$ 9,940	$ 8,045

Depreciation and amortization expense for property and equipment in 2005, 2004 and 2003 was $2,458, $2,445 and $2,634, respectively.

8. GOODWILL AND OTHER INTANGIBLE ASSETS

The Company accounts for intangible assets in accordance with SFAS 142. The carrying value of these assets is assessed at least annually and an impairment charge is recorded if appropriate.

NOVAMED, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Dollars in thousands, except per share data)

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

	Unamortized Goodwill				
	Surgical Facilities	**Product Sales**	**Other**	**Total**	**Amortized Intangibles**
Balance January 1, 2003	$ 20,159	$ 5,475	$ 941	$ 26,575	$ —
Two year non-compete agreement	—	—	—	—	43
Purchase price adjustments	(29)	—	—	(29)	—
Amortization	—	—	—	—	(21)
Balance December 31, 2003	20,130	5,475	941	26,546	22
Acquisitions - restated	24,494	—	—	24,494	—
Amortization	—	—	—	—	(22)
Balance December 31, 2004-restated	44,624	5,475	941	51,040	—
Acquisitions	17,287	—	—	17,287	108
Purchase price adjustments	(106)	—	—	(106)	—
Amortization	—	—	—	—	(30)
Balance December 31, 2005	$ 61,805	$ 5,475	$ 941	$ 68,221	$ 78

9. ACCRUED EXPENSES

Accrued expenses consist of the following as of December 31, 2005 and 2004:

	2005	**2004** ***(restated)***
Deferred revenue	$ 1,244	$ 251
Fair market value of written call options on subsidiaries	—	3,600
Accrued payroll and related benefits	1,237	979
Accrued incentive compensation	962	866
Accrued professional fees	410	313

(Dollars in thousands, except per share data)

Accrued business taxes	276	206
Alcon reserve minimum	214	237
Current deferred tax liability	126	81
Restructuring reserves	—	38
Other	428	187
	$ 4,897	$ 6,758

10. DISCONTINUED OPERATIONS

As of January 1, 2002, the Company adopted SFAS 144 under which it reports as discontinued operations certain operations that have been disposed of or are classified as held for sale**.** Under SFAS 144, projected operating results and the estimated gain or loss on sale is not accrued for when the decision to sell is made. Rather, the earnings or losses of discontinued operations continue to be reported, and any gain or loss is recognized at the time of sale.

Effective November 1, 2005, the Company sold its 80% interest in an ASC located in St. Joseph, MO to its physician-partners resulting in net gain on sale of $71. The Company sold its interest due to state licensure issues unique to this ASC as well as its limited growth potential. The operating results of this ASC are being reported as discontinued operations for all periods presented.

During the first quarter of 2005, the Company received 31,200 shares of its common stock as settlement of a dispute related to liquidating damages due the Company from a former affiliated physician. The value of these shares as of the settlement date, net of tax, of $122 is reported as income from discontinued operations.

During the first quarter of 2004, a former affiliated physician repaid a note secured by shares of the Company’s stock by tendering such shares to the Company. (For additional information regarding the note please refer to Note 18 “Related Party Transactions.”) When the Company implemented its Plan of Discontinued Operations and Restructuring in 2001, 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 reported it as income from discontinued operations. At the end of 2004, the Company reviewed its remaining lease commitments, expiring through May 2005, and other costs to complete its exit from the Physician Practice Management (“PPM”) business. As a result of this review, approximately $325 of excess reserve was reversed and reported as income from discontinued operations.

On December 19, 2003, the Company completed all of its planned divestiture transactions. From the sale of the PPM business, two ASCs and five optical dispensaries, all of which have been treated as discontinued operations, the Company has received proceeds of $19,384, consisting of $19,319 in cash and $65 in promissory notes with multi-year terms. The Company also received as consideration 2.7 million shares of its common stock.

The operating results of all discontinued operations are summarized as follows:

	Year ended December 31,		
	2005	**2004**	**2003**
Net revenue	$ 726	$ 927	$ 2,644
Operating expenses	542	(691)	4,634
Interest and other expense, net	(165)	62	51

Income (loss) from operations before income taxes	349	1,556	(2,041)
Income tax provision (benefit)	136	763	(817)
Net income (loss) from operations	213	793	(1,224)
Net loss charged to reserves	—	—	(1,371)
Net income per statement of operations	$ 213	$ 793	$ 147
Gain on disposal	$ 118	$ —	$ —
Income tax expense	47	—	—
Net gain on disposal of discontinued operations	$ 71	$ —	$ —

NOVAMED, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Dollars in thousands, except per share data)

The balance sheet components of discontinued operations are summarized as follows (in thousands):

	2005	**2004**
Accounts and notes receivable	$ —	$ 54
Inventory	—	5
Other current assets	—	17
Current assets of discontinued operations	$ —	$ 76
Net property and equipment	$ —	$ 65
Intangible assets	—	181
Noncurrent assets of discontinued operations	$ —	$ 246
Accounts payable	$ —	$ 39
Accrued expenses	—	9
Minority interests	—	92
Discontinued operations reserves	89	246
Current liabilities of discontinued operations	$ 89	$ 386

11. INCOME TAXES

The income tax provision from continuing operations consists of the following for the years ended December 31, 2005, 2004 and 2003:

	2005	**2004**	**2003**
Current			
Federal	$ —	$ —	$ —
State	228	63	—
	228	63	—
Deferred			
Federal	2,932	2,022	1,889
State	376	357	341
	3,308	2,379	2,230
	$ 3,536	$ 2,442	$ 2,230

(Dollars in thousands, except per share data)

A reconciliation of income tax expense for financial reporting purposes and the amount calculated using the U.S. statutory rate of 34% is presented as follows:

	2005	2004	2003
Tax expense at U.S. statutory rate	34.0%	34.0%	34.0%
State taxes, net	4.9	4.8	4.8
Valuation Allowance		14.3	16.4
Other	1.1	1.2	1.2
Provision for income taxes	40.0%	54.3%	56.4%

At December 31, 2005, the Company had federal net operating loss carryforwards of $1,045 and $262 of federal alternative minimum tax credits. The federal net operating loss carryforwards expire in 2022 and 2023 and the federal alternative minimum tax credits carryforward indefinitely. The Company also has capital loss carryforwards of $557 which expire starting in 2007 through 2010.

Deferred tax assets (liabilities) are comprised of the following at December 31, 2005 and 2004:

	2005	2004
Deferred tax assets		
Discontinued operations and restructuring	$ 2,934	$ 3,082
Goodwill impairment charges	1,613	1,613
Change in fair market value of written call options	1,520	1,520
Capital loss carryforward	1,298	1,489
Deferred revenue	473	95
Net operating loss carryforward / carryback	398	1,440
AMT credit	262	208
Discount on conversion of notes	203	235
Compensation expense related to stock options	159	282
Receivable and inventory reserves	86	83
Compensation expense	77	61
Other	183	
	9,206	10,108
Valuation allowance	(4,617)	(4,760)
Total deferred tax assets	4,589	5,348
Deferred tax liabilities		
Depreciation and amortization	(3,878)	(2,804)
Prepaid expense	(324)	(361)
Other	(43)	(16)
Total deferred tax liabilities	(4,245)	(3,181)
	$ 344	$ 2,167

The Company recorded a valuation allowance on a portion of the losses on the sale of discontinued operations which are capital in nature, and on a portion of the stock options not expected to be exercised. Additionally, a valuation allowance has been recorded with respect to the book expense for the written call options, which are capital in nature for tax purposes.

12. LONG-TERM DEBT

Long-term debt consists of the following as of December 31, 2005 and 2004:

	2005	2004
Revolving credit facility expires June 30, 2008	$ 17,000	$ 5,000
Capital lease obligations (see Note 13)	591	358
Notes payable due 2006	115	230
Less Current maturities	(302)	(274)
	$ 17,404	$ 5,314

NOVAMED, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, except per share data)

Revolving Credit Facility

At December 31, 2005, the Company had $17,000 of borrowings outstanding under its revolving credit facility and was in compliance with all of its credit agreement covenants. The maximum commitment available under the facility is the lesser of $50,000 or the maximum allowed under the calculated ratio limitations and expires June 30, 2008. Maximum borrowing availability and applicable interest rates under the facility are calculated based on a ratio of total indebtedness to earnings before interest, taxes, depreciation and amortization. Interest on borrowings under the facility is payable at an annual rate equal to the Companys lenders published base rate plus the applicable borrowing margin ranging from 0% to .5% or LIBOR plus a range from 1.25% to 2.0%, varying depending upon the Companys ratios and ability to meet other financial covenants. The credit agreement contains covenants that include limitations on indebtedness, liens, capital expenditures, acquisitions, investments and share repurchases, as well as restrictions on the payment of dividends. The weighted average interest rate on credit line borrowings during 2005 was 4.9%. In addition, the Company paid a fee of .175% on the unused portion of the commitment. The weighted average interest rate on credit line borrowings at December 31, 2005 was 5.6%.

At December 31, 2005 the Company had outstanding letters of credit issued to two of its optical products buying group vendors in the amounts of $175 and $110 that expire on March 31, 2006 and December 31, 2006, respectively. The outstanding letters of credit reduce the amount available under the credit facility.

13. OPERATING AND CAPITAL LEASES

The Company has commitments under long-term, non-terminable operating leases, principally for facility and office space. Lease terms generally cover one to ten years. Certain leases contain consecutive renewal options and escalation clauses.

The Company entered into four new capital leases for medical equipment during 2005 and assumed five capital leases with its 2005 acquisitions. In addition, the Company has three capital leases for medical equipment that existed as of December 31, 2004. The annual interest rates on capital leases range from 4.0% to 8.5% .

At December 31, 2005, minimum annual rental commitments are as follows:

	Operating	Capital

	Leases	Leases
2006	$ 3,810	$ 276
2007	3,384	155
2008	3,038	132
2009	2,675	63
2010	1,756	29
thereafter	4,209	—
Minimum lease payments	18,872	655
Less: sublease receipts	(801)	—
Total minimum lease payments	$ 18,071	655
Less: amount representing interest		(64)
Total obligation under capital leases		$ 591

Included in the table above are operating lease annual rent commitments with related parties for the five years commencing with 2006 of approximately $1,494, $1,169, $1,033, $968, $897 and $1,892 thereafter. Rent expense of continuing operations related to operating leases amounted to $4,432, $3,726 and $3,287, during 2005, 2004 and 2003, respectively.

NOVAMED, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Dollars in thousands, except per share data)

14. COMMITMENTS AND CONTINGENCIES

Litigation

The Company is subject to various claims and legal actions that arise in the ordinary course of business. In the opinion of management, the ultimate resolution of such matters will not have a material adverse effect on the Company's financial position or results of operations.

Professional Liability Risk

The Company maintains third party professional liability insurance for its ASCs and business activities. Although the Company believes that this insurance is adequate as to the amounts at risk, there can be no assurance that any claim asserted against the Company will not exceed the coverage limits of such insurance.

Insurance

The Company is insured with respect to professional liability risks on a claims-made basis. Management is not aware of any claims against the Company that might have a material impact on the Company's financial position or results of operations.

Purchase Commitments

The Company has a nonexclusive supply agreement with Alcon Laboratories, Inc. pursuant to which it can procure and utilize excimer lasers and other equipment manufactured by Alcon. Through the termination date of December 31, 2006, the Company will pay Alcon monthly based on the number of procedures performed on each of its LADARVision Systems. The Company is required to pay for a minimum number of annual procedures on each LADARVision System during the remaining term, whether or not these procedures are performed. Assuming the Company does not procure additional LADARVision Systems under the agreement, the annual minimum commitment for 2006 is approximately $804.

The Company has entered into various Product Usage and Volume Lease Purchase agreements with some of its surgical suppliers, under which the Company is required to purchase a minimum quantity of products at a predetermined price. At December 31, 2005, the Company had remaining product purchase commitments of $2,471.

Pursuant to the sale of a 29% interest in its Richmond, VA ASC to two physicians, the Company granted the physicians an option to sell back their interests to the Company for the original price paid at any time. The Company has recorded a liability on its balance sheet within Minority interests in the event this option is exercised.

Employment Agreements

The Company has employment agreements with certain of its executives that specify that if the executive is terminated by the Company for other than cause following a change in control of the Company, the executive shall receive severance pay ranging from twelve to twenty-four months salary plus bonus and certain other benefits.

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15. STOCKHOLDERS' EQUITY

Rights Agreement

Certain shareholders possess rights to purchase fractional shares of Series E Junior Participating Preferred Stock with a par value of $.01 per share at a price of $110 per one one-thousandth of a share, subject to adjustment as defined in the Rights agreements. These rights are not exercisable until the announcement of the occurrence of certain events as defined in the agreement (none of which are currently expected) which also describes the various shareholders rights.

Upon the occurrence of certain events, each right holder will be entitled to receive shares of common stock, or in specified circumstances other assets having a value of two times the purchase price of the right. Additionally, the Board of Directors may exchange the rights, in whole or in part, without additional payment, for shares of common stock at an exchange ratio defined in the agreement. At any time prior to certain events, the Board of Directors may redeem all, but not less than all, of the rights at a redemption price of $.01 per right.

16. EMPLOYEE BENEFIT PLANS

Employee Benefits and Compensation

The Company maintains a voluntary savings plan (the Savings Plan) for eligible employees under section 401(k) of the Internal Revenue Code whereby participants may contribute a percentage (up to 100%) of their compensation not to exceed IRS limits. The Savings Plan provides for the Company to match 50% of the employee's contributions on the first 3% of salary contributed by each employee. The Company's matching contributions approximated $145, $127 and $132 for 2005, 2004 and 2003, respectively.

Employee Stock Purchase Plan

The Company has an employee stock purchase plan for all eligible employees. Under the plan, shares of the Companys common stock may be purchased at six-month intervals at 85% of the lower of the fair market value on the first or the last day of each six-month period. Employees may purchase shares having a value not exceeding 10% of their gross compensation during an offering period; however, the amount of an employees purchase may not exceed $20,000 in any offering period or $25,000 in any calendar year. Approximately 19,000 shares, 21,000 shares and 40,100 shares were purchased under this plan during 2005, 2004 and 2003, respectively. At

(Dollars in thousands, except per share data)

December 31, 2005, 110,500 shares were reserved for future issuance. Upon the adoption of FAS 123R, the Company will begin to recognize compensation expense when these shares are issued.

Stock Plans

The Company is authorized to issue up to 10,101,800 shares of its common stock, par value $.01 per share under various stock plans. Of this amount, 1,021,345 shares remain available for issuance. Authorized options for common stock under the various plans are generally exercisable over a four-year period with 1/8th of the total options granted becoming exercisable six months from the date of each grant and 1/48th of the total options granted becoming exercisable each month thereafter. The option period for common stock options is generally 10 years from the date each option is granted. All current outstanding options are nonqualified stock options.

The Company grants stock options to employees and nonemployee members of the Company's Board of Directors. Pursuant to Accounting Principles Board No. 25, the Company would recognize as compensation expense the difference between the exercise price and the fair market value of its common stock on the date of grant. Stock-

based compensation expense is deferred and recognized over the vesting period of the stock option. During the three years ended December 31, 2005, the Company did not recognize any stock based compensation expense for stock options as none were issued with an exercise price less than fair market value. Upon the adoption of FAS 123R, the Company will begin to recognize compensation expense when these shares are issued.

The following table summarizes the activity in the stock option plans:

	Options Outstanding	Price Per Share	Weighted Average Exercise Price
Balance at January 1, 2003	6,317,955	$ 0.74-$ 12.61	$ 2.90
Granted	523,000	$ 1.27-$ 2.15	$ 1.37
Exercised	(100,550)	$ 0.78-$ 1.75	$ 1.30
Canceled	(605,926)	$ 0.78-$ 12.00	$ 5.56
Balance at December 31, 2003	6,134,479	$ 0.74-$ 12.61	$ 2.53
Granted	690,000	$ 3.60-$ 4.45	$ 4.40
Exercised	(582,744)	$ 0.78-$ 4.45	$ 1.54
Canceled	(57,985)	$ 0.78-$ 12.00	$ 4.22
Balance at December 31, 2004	6,183,750	$ 0.74-$ 12.61	$ 2.80
Granted	919,500	$ 5.15-$ 6.96	$ 6.05
Exercised	(868,138)	$ 0.78-$ 6.00	$ 2.14
Canceled	(302,316)	$ 0.78-$ 12.00	$ 2.78
Balance at December 31, 2005	5,932,796	$ 0.74-$ 12.61	$ 3.40

The weighted average fair value of options granted in 2005, 2004 and 2003 was $3.20, $2.47 and $0.83 per share, respectively.

The following table summarizes information about stock options outstanding at December 31, 2005:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at 12/31/05	Average Life	Average Exercise Price	Number Exercisable at 12/31/05	Average Exercise Price
\$ 0.74- 0.83	825,645	5.0	\$ 0.79	762,383	\$ 0.79
\$ 1.15- 1.70	830,664	5.6	\$ 1.39	745,862	\$ 1.40
\$ 1.75- 2.50	2,033,729	2.1	\$ 1.87	2,007,479	\$ 1.87
\$ 2.84- 4.14	192,042	3.8	\$ 3.58	154,124	\$ 3.52
\$ 4.38- 6.49	1,508,316	8.3	\$ 5.45	473,119	\$ 4.98
\$ 6.58- 9.00	201,000	5.2	\$ 7.99	163,624	\$ 8.30
\$ 10.00- 12.61	341,400	2.8	\$ 11.95	341,400	\$ 11.95
\$ 0.74- 12.61	5,932,796	4.8	\$ 3.40	4,647,991	\$ 2.95

NOVAMED, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Dollars in thousands, except per share data)

The Company granted 250,000 restricted shares at a market value of \$6.49 per share from its 2005 Restricted Stock Plan to its Chief Executive Officer on November 14, 2005. The shares vest over the same period as the stock options discussed above. The market value of the restricted shares on the date of grant is initially recorded as deferred compensation and charged to stock compensation expense over the vesting period. The Company recognized \$51 of stock based compensation expense during 2005.

17. OPERATING SEGMENTS

The Company manages its business segments by types of service provided. The Company's reportable segments are as follows:

Surgical facilities. Surgical facilities reportable segment aggregates the results of operations from owning and/or operating ASCs and fixed site laser services agreements. Earnings before taxes in 2005, 2004 and 2003 include \$110, \$99 and \$892, respectively, of gains from the sale of minority interests in the Companys ASCs.

Product sales. Product sales segment aggregates the Companys optical products purchasing organization, optical laboratories, marketing products and services company and an optometric practice with a retail optical store.

Other. Other segment aggregates management services provided to a physician practice with multiple locations in Atlanta, GA and an administrative services agreement.

Corporate. Corporate consists of corporate expenses for salaries, wages and benefits, general and administrative costs not allocated to the operating segments and interest on debt.

The accounting policies of the various segments are the same as those described in the "Summary of Significant Accounting Policies" in Note 3. The Company evaluates the performance of its segments based on earnings before taxes (EBT). Segment EBT includes all revenue and expenses directly attributable to the segment, certain corporate expenses for salaries, wages and benefits directly attributable to the management of the reportable segment and allocated management, billing and collection fees.

Segment identifiable assets include accounts receivable, inventory, other current assets and long-lived assets, including goodwill, of the segment. Corporate identifiable assets represent all other assets of the Company including cash and cash equivalents, corporate other current assets, and corporate long-lived assets, which include property and equipment, notes receivable and other long-term assets and assets of discontinued operations. The Company has no revenues attributed to customers outside of the United States and no assets located in foreign countries.

F-30

NOVAMED, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Dollars in thousands, except per share data)

	Surgical Facilities	Product Sales	Other	Corporate	Total
2005					
Net revenue	$ 60,169	$ 13,479	$ 7,524	$ 54	$ 81,226
Earnings (loss) before taxes	10,638	2,892	696	(5,385)	8,841
Depreciation and amortization	1,852	207	104	295	2,458
Interest income	25	—	—	17	42
Interest expense	30	—	—	733	763
Capital expenditures	2,189	249	80	90	2,608
Accounts receivable	7,306	3,962	524	141	11,933
Identifiable assets	80,408	11,066	1,739	3,949	97,162
2004 — restated					
Net revenue	$ 45,704	$ 10,641	$ 7,303	$ —	$ 63,648
Earnings (loss) before taxes -restated.	7,178	1,907	614	(5,204)	4,495
Depreciation and amortization	1,747	192	114	392	2,445
Interest income	4	—	—	80	84
Interest expense	7	—	—	219	226
Capital expenditures	1,802	117	33	92	2,044
Accounts receivable	5,658	3,526	748	251	10,183
Identifiable assets -restated	59,254	10,278	1,960	5,295	76,787
2003 — restated					
Net revenue	$ 35,428	$ 10,871	$ 8,225	$ —	$ 54,524
Earnings (loss) before taxes -restated.	7,529	2,150	(164)	(5,563)	3,952
Depreciation and amortization	1,735	287	131	481	2,634
Interest income	1	1	—	128	130
Interest expense	2	—	1	116	119
Capital expenditures	2,515	143	87	139	2,884
Accounts receivable	3,505	3,511	1,034	97	8,147
Identifiable assets -restated	30,163	10,720	2,521	20,484	63,888

F-31

NOVAMED, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Dollars in thousands, except per share data)

18. RELATED-PARTY TRANSACTIONS

Facility Rent

The Company leases facility space from various related parties, which include partners, at rates the Company believes approximate fair market value. Amounts paid to related parties for rent, taxes and other facility costs amounted to approximately $1,578, $1,076 and $686 during 2005, 2004 and 2003, respectively. The Companys minimum annual rental commitments include total commitments of $7,452 that relate to facilities leased from related parties. Annual rent commitments for the five years commencing with 2006 are approximately $1,494, $1,169, $1,033, $968, $897 and $1,892 thereafter. (See Note 13).

Notes Receivable

The Company holds notes receivable of $1,335, less reserves of $832, from physicians affiliated with the Company. This balance includes a $1,190 non-interest bearing tax loan issued in connection with the IPO (see below) and a $145 note, bearing a 7% interest rate, due October 2008 which was issued in one of the Companys divestiture transactions.

As disclosed in a prospectus filed with the Securities and Exchange Commission on August 18, 1999, in connection with the exchange of $9,700 of the Companys subordinated exchangeable promissory notes resulting from its IPO, the Company agreed to lend each of these noteholders an amount equal to the Federal and state income taxes payable by the holder as a result of the exchange of the notes, but only for those shares of the Companys common stock received in the exchange which they still owned as of April 1, 2000. In accordance with these agreements, the Company loaned $2,723 to the holders, the majority of which was advanced in April 2000. The tax loans are noninterest bearing, nonrecourse to the debtor and secured by a number of shares of the Companys common stock held by the debtor having a value, based on the offering price, equal to two times the loan amount. Upon the sale by a debtor after April 1, 2000 of any shares of the Companys common stock issued in exchange for a note, the debtor will be required to repay a fraction of the debtors initial tax loan amount equal to the number of shares sold divided by the total number of shares of the Companys common stock previously issued in exchange for a note and owned by the debtor as of April 1, 2000. During 2004, one of the note holders repaid his note with shares of the Companys common stock. The remaining tax loan is payable by the debtor upon the Companys demand for payment. Currently, the Company intends to allow the debtor to repay this loan as he disposes of his shares of the Companys common stock. The Company also has agreed to reimburse this debtor on a grossed-up basis, for any Federal or state taxes that he recognizes as a result of imputed interest on the tax loan.

Other

The Company received professional services from firms that employed a director of the Company. Total payments for services received during 2005, 2004 and 2003 were approximately $158, $184 and $346, respectively.

19. SUBSEQUENT EVENTS

Effective January 31, 2006, the Company acquired an additional 15% interest in its Pain Management Center located in New Albany, Indiana. The Company purchased 7.5% from each of its exiting partners, increasing the Companys ownership in this ASC to 51%.

Effective January 31, 2006, the Companys ASC located in Berkley, Michigan redeemed its retiring partners entire interest in this ASC, issuing a promissory note payable in eight quarterly installments through November 1, 2007 . This physicians 24% interest was allocated proportionately among the remaining partners. This increased the Companys interest in this ASC to 67% from its previous 51% ownership interest.

On February 1, 2006, the estate of Stephen J. Winjum exercised all remaining stock options held by the estate to acquire 1,330,750 shares of common stock. Per the terms of the stock option agreements and the Company's stock incentive plans, the estate tendered to the Company 305,254 shares of the Company's common stock that the estate owned to fund the $2,295 aggregate exercise price. The Company will retire these shares into treasury.

On February 22, 2006, the Company acquired a 65% interest in the Preston Plaza Surgery Center, a multi-specialty ASC located in Dallas, Texas for $12,450, which was funded from the Company's credit facility.

Also on February 22, 2006, the Company announced it had entered into a definitive agreement to acquire a 51% interest in a multi-specialty surgery center currently under development in Gainesville, Florida. The Company expects to complete the acquisition in the second quarter of 2006.

Effective March 1, 2006, the Company sold a 3% interest in its Maryville, Illinois ASC to a new physician-partner, decreasing the Company's ownership in this ASC to 77%.

Effective April 13, 2006, the Company acquired a 55% interest in an ASC located in San Antonio, Texas, which was funded from the Company's credit facility.

20. QUARTERLY FINANCIAL DATA (Unaudited**)**

Summarized quarterly financial data for 2005 and 2004 (restated) is as follows:

	Quarter			
2005	**First**	**Second**	**Third**	**Fourth**
Net revenue	$ 18,286	$ 20,411	$ 20,929	$ 21,600
Operating income	3,455	4,145	4,653	4,104
Net income from:				
Continuing operations	1,205	1,341	1,602	1,157
Discontinued operations	149	38	25	72
Net income	1,354	1,379	1,627	1,229
Basic earnings per share	0.06	0.06	0.07	0.06
Diluted earnings per share	0.06	0.06	0.07	0.05

	Quarter			
2004 - restated	**First**	**Second**	**Third**	**Fourth**
Net revenue	$ 14,008	$ 15,189	$ 17,182	$ 17,269
Operating income	1,718	2,394	3,320	3,453
Net income from:				
Continuing operations - restated	576	(138)	855	760
Discontinued operations	634	69	39	51
Net income - restated	1,210	(69)	894	811
Basic earnings per share - restated	0.06	0.00	0.04	0.04
Diluted earnings per share - restated	0.05	0.00	0.04	0.03

NOVAMED, INC. AND SUBSIDIARIES **Schedule II**

RULE 12-09 VALUATION RESERVES

(Dollars in thousands)

Allowance for contractual adjustments and bad debt	Balance at beginning of period	Charged to costs and expenses	Deductions	Balance at end of period
2003	$ 5,858	51,259	(49,705)	$ 7,412
2004	$ 7,412	66,494	(63,908)	$ 9,998
2005	$ 9,998	91,732	(87,789)	$ 13,941

SIGNATURES

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

NOVAMED, INC.

By: /S/ THOMAS S. HALL
Thomas S. Hall
President and Chief Executive Officer
Date: April 28, 2006

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.

Signature	Title	Date
/S/ THOMAS S. HALL Thomas S. Hall	President and Chief Executive Officer (Principal Executive Officer), and a Director	April 28, 2006
/S/ SCOTT T. MACOMBER Scott T. Macomber	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	April 28, 2006
/S/ JOHN P. HART John P. Hart	Vice President, Corporate Controller (Principal Accounting Officer)	April 28, 2006
/S/ ROBERT J. KELLY Robert J. Kelly	Chairman of the Board and a Director	April 28, 2006
/S/ R. JUDD JESSUP R. Judd Jessup	Director	April 28, 2006
/S/ SCOTT H. KIRK Scott H. Kirk, M.D.	Director	April 28, 2006
/S/ STEVEN V. NAPOLITANO		

Steven V. Napolitano	Director	April 28, 2006
/S/ C.A. LANCE PICCOLO C.A. Lance Piccolo	Director	April 28, 2006