

NOVAMED INC  
Form 10-Q  
May 10, 2007

**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

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**FORM 10-Q**

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

For the quarterly period ended March 31, 2007

OR

☐ 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: **0-26625**

**NOVAMED, 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**

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of May 4, 2007, there were outstanding 24,388,175 shares of the registrant's common stock, par value \$.01 per share.

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**NOVAMED, INC.**  
**FORM 10-Q FOR QUARTERLY PERIOD ENDED MARCH 31, 2007**  
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**Part I. FINANCIAL INFORMATION**

## Item 1. Interim Condensed Consolidated Financial Statements (unaudited)

**NOVAMED, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(Dollars in thousands)

|                                                                                                                                                             | March 31,<br>2007<br>(unaudited) | December 31,<br>2006 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------|----------------------|
| <b>ASSETS</b>                                                                                                                                               |                                  |                      |
| Current assets:                                                                                                                                             |                                  |                      |
| Cash and cash equivalents                                                                                                                                   | \$ 2,662                         | \$ 2,743             |
| Accounts receivable, net of allowances of \$33,538 and \$32,282, respectively                                                                               | 20,638                           | 17,278               |
| Notes and amounts due from related parties                                                                                                                  | 504                              | 505                  |
| Inventory                                                                                                                                                   | 2,460                            | 2,187                |
| Prepaid expenses and deposits                                                                                                                               | 1,160                            | 1,361                |
| Current tax assets                                                                                                                                          | 1,102                            | 569                  |
| Total current assets                                                                                                                                        | 28,526                           | 24,643               |
| Property and equipment, net                                                                                                                                 | 15,746                           | 15,066               |
| Intangible assets, net                                                                                                                                      | 127,319                          | 119,828              |
| Other assets, net                                                                                                                                           | 1,189                            | 1,010                |
| Total assets                                                                                                                                                | \$ 172,780                       | \$ 160,547           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                                                 |                                  |                      |
| Current liabilities:                                                                                                                                        |                                  |                      |
| Accounts payable                                                                                                                                            | \$ 7,374                         | \$ 6,525             |
| Accrued expenses and income taxes payable                                                                                                                   | 4,756                            | 6,505                |
| Current maturities of long-term debt                                                                                                                        | 1,063                            | 1,373                |
| Total current liabilities                                                                                                                                   | 13,193                           | 14,403               |
| Long-term debt, net of current maturities                                                                                                                   | 69,614                           | 61,227               |
| Other long-term liabilities                                                                                                                                 | 646                              | 269                  |
| Deferred income tax liabilities                                                                                                                             | 3,112                            | 2,236                |
| Minority interests                                                                                                                                          | 15,123                           | 14,296               |
| Commitments and contingencies                                                                                                                               |                                  |                      |
| Stockholders' equity:                                                                                                                                       |                                  |                      |
| Series E Junior Participating Preferred Stock, \$0.01 par value, 1,912,000 shares authorized, none outstanding at March 31, 2007 and December 31, 2006.     | —                                | —                    |
| Common stock, \$0.01 par value, 81,761,465 shares authorized, 29,174,535 and 28,533,676 shares issued at March 31, 2007 and December 31, 2006, respectively | 290                              | 285                  |
| Additional paid-in-capital                                                                                                                                  | 91,834                           | 89,653               |
| Accumulated deficit                                                                                                                                         | (10,164)                         | (11,656)             |
| Accumulated other comprehensive loss                                                                                                                        | (286)                            | (254)                |
| Treasury stock, at cost, 4,805,613 and 4,713,417 shares at March 31, 2007 and December 31, 2006, respectively                                               | (10,582)                         | (9,912)              |
| Total stockholders' equity                                                                                                                                  | 71,092                           | 68,116               |
| Total liabilities and stockholders' equity                                                                                                                  | \$ 172,780                       | \$ 160,547           |

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

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

|                                                                | Three months ended<br>March 31, |           |
|----------------------------------------------------------------|---------------------------------|-----------|
|                                                                | 2007                            | 2006      |
| Net revenue:                                                   |                                 |           |
| Surgical facilities                                            | \$ 25,095                       | \$ 17,865 |
| Product sales and other                                        | 6,291                           | 6,051     |
| Total net revenue                                              | 31,386                          | 23,916    |
| Operating expenses:                                            |                                 |           |
| Salaries, wages and benefits                                   | 10,094                          | 8,045     |
| Cost of sales and medical supplies                             | 7,173                           | 5,892     |
| Selling, general and administrative                            | 6,004                           | 4,503     |
| Depreciation and amortization                                  | 930                             | 719       |
| Total operating expenses                                       | 24,201                          | 19,159    |
| Operating income                                               | 7,185                           | 4,757     |
| Minority interests in earnings of consolidated entities        | 3,521                           | 2,218     |
| Interest (income) expense, net                                 | 1,327                           | 376       |
| Other (income) expense, net                                    | (109)                           | (115)     |
| Income before income taxes                                     | 2,446                           | 2,278     |
| Income tax provision                                           | 954                             | 911       |
| Net income from continuing operations                          | 1,492                           | 1,367     |
| Net income from discontinued operations                        | —                               | (1)       |
| Net income                                                     | \$ 1,492                        | \$ 1,366  |
| Basic earnings per common share:                               |                                 |           |
| Income from continuing operations                              | \$ 0.06                         | \$ 0.06   |
| Income from discontinued operations                            | —                               | —         |
| Net income                                                     | \$ 0.06                         | \$ 0.06   |
| Diluted earnings per common share:                             |                                 |           |
| Income from continuing operations                              | \$ 0.06                         | \$ 0.06   |
| Income from discontinued operations                            | —                               | —         |
| Net income                                                     | \$ 0.06                         | \$ 0.06   |
| Weighted average common shares outstanding                     | 23,899                          | 22,829    |
| Dilutive effect of employee stock options and restricted stock | 1,276                           | 1,783     |
| Diluted weighted average common shares outstanding             | 25,175                          | 24,612    |

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



**NOVAMED, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**  
(Dollars and shares in thousands, unaudited)

|                                              | Common Stock |           |                            |                     | Accumulated Other Comprehensive Loss |  | Treasury Stock |             | Total Stockholders' Equity |
|----------------------------------------------|--------------|-----------|----------------------------|---------------------|--------------------------------------|--|----------------|-------------|----------------------------|
|                                              | Shares       | Par Value | Additional Paid-In Capital | Accumulated Deficit |                                      |  | Shares         | At Cost     |                            |
| <b>Balance, December 31, 2006</b>            | 28,534       | \$ 285    | \$ 89,653                  | \$ (11,656)         | \$ (254)                             |  | (4,713)        | \$ (9,912)  | \$ 68,116                  |
| Stock options exercised                      | 550          | 5         | 1,497                      | —                   | —                                    |  | (82)           | (625)       | 877                        |
| Shares issued - employee stock purchase plan | 16           | —         | 86                         | —                   | —                                    |  | —              | —           | 86                         |
| Restricted stock grants                      | 75           | —         | —                          | —                   | —                                    |  | (11)           | (45)        | (45)                       |
| Stock compensation expense                   | —            | —         | 598                        | —                   | —                                    |  | —              | —           | 598                        |
| Unrealized loss on interest rate swaps       | —            | —         | —                          | —                   | (32)                                 |  | —              | —           | (32)                       |
| Net income                                   | —            | —         | —                          | 1,492               | —                                    |  | —              | —           | 1,492                      |
| <b>Balance, March 31, 2007</b>               | 29,175       | \$ 290    | \$ 91,834                  | \$ (10,164)         | \$ (286)                             |  | (4,806)        | \$ (10,582) | \$ 71,092                  |

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

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

|                                                                                                                             | Three months ended<br>March 31, |          |
|-----------------------------------------------------------------------------------------------------------------------------|---------------------------------|----------|
|                                                                                                                             | 2007                            | 2006     |
| Cash flows from operating activities:                                                                                       |                                 |          |
| Net income                                                                                                                  | \$ 1,492                        | \$ 1,366 |
| Adjustments to reconcile net income to net cash provided by continuing operations, net of effects of purchase transactions— |                                 |          |
| Net earnings of discontinued operations                                                                                     | —                               | 1        |
| Depreciation and amortization                                                                                               | 930                             | 719      |
| Deferred income taxes                                                                                                       | 627                             | 911      |
| Stock-based compensation                                                                                                    | 598                             | 417      |
| Loss (earnings) of non-consolidated affiliate                                                                               | 16                              | (20)     |
| Gain on sale of minority interests                                                                                          | (79)                            | (9)      |
| Minority interests                                                                                                          | 3,521                           | 2,218    |
| Distributions to minority partners                                                                                          | (3,336)                         | (1,888)  |
| Changes in operating assets and liabilities—                                                                                |                                 |          |
| Accounts receivable                                                                                                         | (2,744)                         | (1,767)  |
| Inventory                                                                                                                   | (160)                           | (17)     |
| Other current assets                                                                                                        | 200                             | 237      |
| Accounts payable and accrued expenses                                                                                       | (778)                           | 530      |
| Other noncurrent assets                                                                                                     | 50                              | 24       |
| Net cash provided by operating activities                                                                                   | 337                             | 2,722    |
| Cash flows from investing activities:                                                                                       |                                 |          |
| Payments for acquisitions, net                                                                                              | (8,084)                         | (12,617) |
| Proceeds from sale of minority interests                                                                                    | 273                             | 60       |
| Purchases of property and equipment                                                                                         | (1,013)                         | (474)    |
| Other                                                                                                                       | —                               | 18       |
| Net cash used in investing activities                                                                                       | (8,824)                         | (13,013) |
| Cash flows from financing activities:                                                                                       |                                 |          |
| Borrowings under revolving line of credit                                                                                   | 19,800                          | 21,000   |
| Payments under revolving line of credit                                                                                     | (11,500)                        | (9,000)  |
| Proceeds from the issuance of common stock                                                                                  | 694                             | 96       |
| Payments of other debt, debt issuance fees and capital lease obligations                                                    | (588)                           | (319)    |
| Net cash provided by financing activities                                                                                   | 8,406                           | 11,777   |
| Cash flows from discontinued operations:                                                                                    |                                 |          |
| Operating activities                                                                                                        | —                               | (4)      |
| Investing activities                                                                                                        | —                               | —        |
| Net cash used in discontinued operations                                                                                    | —                               | (4)      |
| Net (decrease) increase in cash and cash equivalents                                                                        | (81)                            | 1,482    |
| Cash and cash equivalents, beginning of period                                                                              | 2,743                           | 1,690    |
| Cash and cash equivalents, end of period                                                                                    | \$ 2,662                        | \$ 3,172 |

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

**NOVAMED, INC. AND SUBSIDIARIES**  
**NOTES TO THE INTERIM**  
**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**March 31, 2007**  
**(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, 2006, filed by NovaMed, Inc. with the Securities and Exchange Commission on Form 10-K. The unaudited interim condensed consolidated financial statements as of March 31, 2007 and for the three months ended March 31, 2007 and 2006, include all normal recurring adjustments which management considers necessary for a fair presentation. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the entire fiscal year.

2. STATEMENT OF CASH FLOWS - SUPPLEMENTAL

*Supplemental cash information:*

|                             | Three months ended March 31, |        |
|-----------------------------|------------------------------|--------|
|                             | 2007                         | 2006   |
| Interest paid               | \$ 1,266                     | \$ 243 |
| Income taxes paid           | —                            | —      |
| Income tax refunds received | —                            | —      |

*Non cash investing and financing activities:*

On January 25, 2007, a former senior executive exercised stock options to acquire 287,199 shares of common stock. Per the terms of the stock option agreements and the Company's stock incentive plans, the former executive tendered to the Company 82,006 shares of the Company's common stock to fund the \$625 aggregate exercise price. The Company added these tendered shares into treasury resulting in an increase in treasury stock of \$625.

On February 1, 2006, the estate of Stephen J. Winjum exercised all remaining stock options held by the estate to acquire 1,330,730 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 \$2,296 aggregate exercise price. The Company added these tendered shares into treasury. As a result of this transaction, the Company recorded additional paid-in-capital of \$5,213, which includes a deferred tax asset of \$2,930.

During the first three months of 2007 and 2006, the Company obtained medical equipment by entering into capital leases for \$38 and \$263, respectively.



**NOVAMED, INC. AND SUBSIDIARIES**  
**NOTES TO THE INTERIM**  
**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**March 31, 2007**  
**(Dollars in thousands, except per share data; unaudited)**

**3. INVENTORY**

Inventory consists primarily of surgical supplies used in connection with the operation of the Company's ambulatory surgery centers (ASCs) and optical products such as eyeglass frames, optical lenses and contact lenses. 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.

| Balances as of:   | March 31,<br>2007 | December 31,<br>2006 |
|-------------------|-------------------|----------------------|
| Surgical supplies | \$ 1,349          | \$ 1,136             |
| Optical products  | 999               | 912                  |
| Other             | 112               | 139                  |
| Total inventory   | \$ 2,460          | \$ 2,187             |

**4. INTANGIBLE ASSETS**

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

|                           | Surgical<br>Facilities | Unamortized Goodwill<br>Product<br>Sales | Other  | Total      | Other<br>Intangibles |
|---------------------------|------------------------|------------------------------------------|--------|------------|----------------------|
| Balance December 31, 2006 | \$ 113,364             | \$ 5,475                                 | \$ 941 | \$ 119,780 | \$ 48                |
| Acquisitions              | 7,445                  | —                                        | —      | 7,445      | —                    |
| Other                     | 53                     | —                                        | —      | 53         | —                    |
| Amortization              | —                      | —                                        | —      | —          | (7)                  |
| Balance March 31, 2007    | \$ 120,862             | \$ 5,475                                 | \$ 941 | \$ 127,278 | \$ 41                |

**5. ACQUISITIONS**

The Company generally acquires majority equity interests in ASCs through the purchase method of accounting. The results of operations are included in the consolidated financial statements of the Company from the date of acquisition. During the first three months of 2007, the Company made the following acquisition, which was not significant enough to require pro forma disclosure.

On January 1, 2007, the Company acquired a 54% interest in the St. Peters Ambulatory Surgery Center, a multi-specialty ASC located in St. Peters, Missouri, for \$8,000, of which the Company allocated \$7,445 to goodwill. The acquisition was funded from the Company's credit facility.

During the first three months of 2006, the Company acquired a majority interest in one ASC for \$12,450, of which the Company allocated \$10,859 to goodwill.

**NOVAMED, INC. AND SUBSIDIARIES**  
**NOTES TO THE INTERIM**  
**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**March 31, 2007**  
**(Dollars in thousands, except per share data; unaudited)**

**6. UNCERTAIN TAX POSITIONS**

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state or local income tax examinations by tax authorities for years before 2003.

The Company adopted the provisions of FASB Interpretation No. 48 *Accounting for Uncertainty in Income Taxes* on January 1, 2007 ("FIN 48"). As a result of the implementation of FIN 48, the Company recognized a liability for unrecognized tax benefits of approximately \$416. No adjustment was made to the beginning retained earnings balance, as the ultimate deductibility of all these tax positions is highly certain but there is uncertainty about the timing of such deductibility. No interest or penalties have been accrued relative to these positions due to the Company having either a tax loss or having utilized a net operating loss carryforward to offset any taxable income in all subject years. Deferred tax assets have been recorded to recognize the future benefits of the positions reserved for in the FIN 48 liability. Because of the impact of deferred income tax accounting, the temporary differences would not affect the annual effective tax rate.

Should the Company need to accrue interest or penalties on unrecognized tax positions, it would recognize the interest in interest expense and penalties in operating expenses.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

|                                                 |    |      |
|-------------------------------------------------|----|------|
| Unrecognized Tax Benefits — January 1, 2007     | \$ | 416  |
| Gross increases - tax positions in prior period |    | —    |
| Gross decreases - tax positions in prior period |    | —    |
| Gross increases - current period tax positions  |    | —    |
| Settlements                                     |    | (72) |
| Lapse of statute of limitations                 |    | —    |
| Unrecognized Tax Benefits — March 31, 2007      | \$ | 344  |

**7. OTHER (INCOME) EXPENSE**

|                                               |      | Three months ended<br>March 31, |          |
|-----------------------------------------------|------|---------------------------------|----------|
|                                               | 2007 |                                 | 2006     |
| Loss (earnings) of non-consolidated affiliate | \$   | 16                              | \$ (20)  |
| Gain on sale of minority interests            |      | (79)                            | (9)      |
| Other, net                                    |      | (46)                            | (86)     |
| Other (income) expense, net                   | \$   | (109)                           | \$ (115) |

During the first quarter of 2007, the Company sold a 10% minority interest in its Chicago, Illinois ASC to two physicians, increasing minority ownership in this ASC to 30.5% and sold a 5% minority interest in its Chattanooga,

Tennessee ASC to one of its existing partners, increasing minority interest ownership in this ASC to 43%. These transactions resulted in a net gain on the sale of minority interests of \$79 in the first quarter of 2007.

**NOVAMED, INC. AND SUBSIDIARIES**  
**NOTES TO THE INTERIM**  
**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**March 31, 2007**  
**(Dollars in thousands, except per share data; unaudited)**

During the first quarter of 2006, the Company sold a 3% minority interest in its Maryville, Illinois ASC to a physician, increasing minority ownership in this ASC to 23%. This transaction resulted in a net gain on the sale of minority interest of \$9 in the first quarter of 2006.

**8. REVOLVING CREDIT FACILITY**

Effective February 7, 2007, the Company amended its credit facility, increasing the maximum commitment available under the facility from \$80,000 to \$125,000 and extending the expiration date to February 5, 2010. The maximum commitment available under the facility is the lesser of \$125,000 or the maximum allowed under the calculated ratio limitations. The amended credit agreement also includes an option allowing the Company to increase the maximum commitment available to \$150,000 under certain conditions. Maximum borrowing availability and applicable interest rates under the facility are based on a ratio of total indebtedness to earnings before interest, taxes, depreciation and amortization as defined in the credit agreement. The amended credit agreement provides for temporary increases in this ratio through September 30, 2008 for purposes of calculating the maximum borrowing availability. Interest on borrowings under the facility is payable at an annual rate equal to the Company's lender's published base rate plus the applicable borrowing margin ranging from 0% to .5% or LIBOR plus a range from 1.00% to 2.25%, varying depending upon the calculated ratios and the Company's ability to meet other financial covenants. The credit agreement continues to contain covenants that include limitations on indebtedness, liens, capital expenditures, acquisitions, investments and share repurchases, as well as restrictions on the payment of dividends; however, many of these limitations were changed by these amendments. At March 31, 2007, the Company had \$66,000 of borrowings outstanding under its revolving credit facility with a weighted average interest rate of 7.38% and was in compliance with all of its credit agreement covenants. The weighted average interest rate on credit line borrowings during the three months ended March 31, 2007 was 7.28%. In addition, the Company paid a fee ranging from .175% to .250% on the unused portion of the commitment.

During the second quarter of 2006, the Company entered into two interest rate swap agreements. The interest rate swaps protect the Company against certain interest rate fluctuations of the LIBOR rate on \$24,000 of the Company's variable rate debt under the credit facility. The date of the first interest rate swap was April 12, 2006, and it expires on April 19, 2009. This interest rate swap effectively fixes the Company's LIBOR rate on \$12,000 of variable rate debt at a rate of 5.34%. The date of the second interest rate swap was June 28, 2006 and it expires on September 30, 2008. This interest rate swap effectively fixes the Company's LIBOR rate on \$12,000 of variable rate debt at a rate of 5.75%. The Company has recognized the fair value of these interest rate swaps as a long-term liability of approximately \$252 at March 31, 2007.

Effective August 1, 2006, NovaMed Eye Surgery Center of New Albany, LLC, of which the Company owns a 67.5% majority interest, entered into a five-year, \$4,000 installment note to fund an acquisition. Interest is payable at the lender's one month LIBOR rate, designated or published on the first of each month, plus 2.0%. The ASC entered into a five-year interest rate swap agreement that effectively fixes the LIBOR rate on this debt at 5.51%. The ASC has recognized the fair value of this interest rate swap as a long-term liability of approximately \$50 at March 31, 2007.

The Company has two outstanding letters of credit issued to two of its optical products buying group vendors in the amounts of \$238 and \$130 that expire on March 31, 2008 and December 31, 2007, respectively. The outstanding

letters of credit reduce the amount available under the credit facility.

**NOVAMED, INC. AND SUBSIDIARIES**  
**NOTES TO THE INTERIM**  
**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**March 31, 2007**  
**(Dollars in thousands, except per share data; unaudited)**

**9. OTHER COMPREHENSIVE INCOME**

The Company reports other comprehensive income as a measure of changes in stockholders' equity that resulted from recognized transactions and other economic events of the period from non-owner sources. Other comprehensive income of the Company results from adjustments due to the fluctuation of the value of the Company's interest rate swaps accounted for under Statement of Financial Accounting Standard No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended. The Company entered into two interest rate swaps during the second quarter of 2006 and one of its 67.5% owned subsidiaries entered into an interest rate swap during the third quarter of 2006. The Company's share of the negative value of the interest rate swaps was \$286 at March 31, 2007 and is recorded as accumulated other comprehensive loss in the accompanying unaudited consolidated balance sheet. See Note 8 for further discussion of the interest rate swaps. The total comprehensive income for the first three months of 2007 and 2006 was \$1,206 and \$1,366, respectively.

**10. STOCK BASED COMPENSATION**

The Company accounts for stock based compensation applying Statement of Financial Accounting Standards No. 123 (revised 2004), "Share Based Payment" ("SFAS 123(R)"). SFAS 123(R) applies to new awards and to awards that were outstanding as of December 31, 2005 that are subsequently vested, modified, repurchased or cancelled. Compensation expense recognized during the first three months of 2007 and 2006 includes the portion vesting during the period for (1) all share-based payments granted prior to, but not yet vested as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") and (2) all share-based payments granted subsequent to December 31, 2005, based on the grant-date fair value estimated using the Black-Scholes option-pricing model. During the first three months of 2007, the Company granted its directors and employees options to purchase 574,500 shares with an exercise price of \$7.35 per share and options to purchase 75,000 shares with an exercise price of \$6.24 per share. Stock compensation expense of \$446 and \$303 was recognized on existing stock options during the three months ended March 31, 2007 and 2006, respectively.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for stock options granted during the three months ended March 31, 2007. No stock options were granted during the first quarter of 2006.

|                               | Three months ended March<br>31, |      |
|-------------------------------|---------------------------------|------|
|                               | 2007                            | 2006 |
| Expected option life in years | 6                               | —    |
| Risk-free interest rate       | 4.77%                           | —    |
| Dividend yield                | —                               | —    |
| Expected volatility           | 48.1%                           | —    |
|                               | \$ 3.77                         | —    |

Per share fair  
value

The expected option life used for 2007 grants is the average of the vesting term assuming options are exercised as vested and the original contractual term of the option. The risk free interest rate is based on the yield curve for U.S. Treasury zero-coupon issues with an equivalent remaining term. The dividend yield is based on the Company's current dividend yield as the best estimate of projected dividend yield for periods within the expected life of the options. The expected volatility in 2007 is based on the historical volatility of the Company's stock price for the period beginning January 1, 2003 through the option grant date.

A summary of stock based compensation activity within the Company's stock-based compensation plans for the three months ended March 31, 2007 is as follows:

|                                  | Number of<br>Shares | Weighted<br>Average<br>Exercise Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (Years) | Aggregate<br>Intrinsic Value |
|----------------------------------|---------------------|---------------------------------------|-----------------------------------------------------------------|------------------------------|
| Outstanding at December 31, 2006 | 4,604,068           | \$ 4.15                               |                                                                 |                              |
| Granted                          | 649,500             | \$ 7.22                               |                                                                 |                              |
| Exercised                        | (550,084)           | \$ 2.33                               |                                                                 |                              |
| Canceled                         | (46,271)            | \$ 11.31                              |                                                                 |                              |
| Outstanding at March 31, 2007    | 4,657,213           | \$ 4.71                               | 6.6                                                             | \$ 10,912                    |
| Exercisable at March 31, 2007    | 2,933,247           | \$ 3.58                               | 5.2                                                             | \$ 10,187                    |

**NOVAMED, INC. AND SUBSIDIARIES**  
**NOTES TO THE INTERIM**  
**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**March 31, 2007**  
**(Dollars in thousands, except per share data; unaudited)**

The aggregate intrinsic value for stock options outstanding and exercisable is defined as the difference between the market value of the Company's stock as of the end of the period and the exercise price of the stock options. The total intrinsic value of stock options exercised during the first three months of 2007 was \$2,285. As a result of the stock options exercised, the Company recorded common stock and additional paid-in-capital of \$1,502, which includes \$224 of tax benefits recognized. During the first three months of 2007, cash received from stock options exercised was \$653.

On January 25, 2007, a former senior executive exercised stock options to acquire 287,199 shares of common stock. Per the terms of the stock option agreements and the Company's stock incentive plans, the former executive tendered to the Company 82,006 shares of the Company's common stock to fund the \$625 aggregate exercise price. The Company added these tendered shares into treasury resulting in an increase in treasury stock of \$625.

The following is a summary of nonvested stock option activity:

|                                | Number of Shares | Weighted<br>Average<br>Grant-Date Fair<br>Value |
|--------------------------------|------------------|-------------------------------------------------|
| Nonvested at December 31, 2006 | 1,207,655        | \$ 3.22                                         |
| Granted                        | 649,500          | \$ 3.77                                         |
| Vested                         | (126,917)        | \$ 3.51                                         |
| Canceled                       | (6,271)          | \$ 3.42                                         |
| Nonvested at March 31, 2007    | 1,723,967        | \$ 3.40                                         |

At March 31, 2007, there was \$5,868 of total unrecognized compensation cost related to nonvested stock options. This cost will be recognized over 4 years.

The Company also grants restricted stock awards to certain employees. Restricted stock awards are valued at the closing market value of the Company's common stock on the day prior to the grant, and the total value of the award is recognized as expense ratably over the vesting period of the employees receiving the grants. The Company granted 75,000 restricted stock awards during the first quarter of 2007. As of March 31, 2007, the total amount of unrecognized compensation expense related to nonvested restricted stock awards was approximately \$1,882, which is expected to be recognized over a weighted-average period of approximately 3.1 years. The Company recognized compensation expense of \$138 and \$101 on existing restricted stock awards during the three months ended March 31, 2007 and 2006, respectively.

The Company has an employee stock purchase plan ("ESPP") for all eligible employees. Under the plan, shares of the Company's 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. Approximately 15,800 and 9,000 shares were purchased under this plan during the three months ended March 31, 2007 and 2006, respectively. Under the provisions of SFAS 123(R), the

Company recognized compensation expense of \$14 and \$13 during the first three months of 2007 and 2006, respectively. At March 31, 2007, 72,900 shares were reserved for future issuance under the ESPP.

**NOVAMED, INC. AND SUBSIDIARIES**  
**NOTES TO THE INTERIM**  
**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)**  
**March 31, 2007**  
**(Dollars in thousands, except per share data; unaudited)**

**11. OPERATING SEGMENTS**

The table below presents information about operating data and segment assets as of the three months ended March 31, 2007 and 2006:

|                                          | Surgical<br>Facilities | Product<br>Sales | Other    | Corporate | Total     |
|------------------------------------------|------------------------|------------------|----------|-----------|-----------|
| <b>Three months ended March 31, 2007</b> |                        |                  |          |           |           |
| Net revenue                              | \$ 25,095              | \$ 4,380         | \$ 1,902 | \$ 9      | \$ 31,386 |
| Earnings (loss) before taxes             | 3,739                  | 1,422            | 157      | (2,872)   | 2,446     |
| Depreciation and amortization            | 782                    | 59               | 38       | 51        | 930       |
| Interest income                          | 33                     | —                | —        | 3         | 36        |
| Interest expense                         | 86                     | —                | —        | 1,277     | 1,363     |
| Capital expenditures                     | 626                    | 51               | 86       | 250       | 1,013     |
| Accounts receivable                      | 13,989                 | 5,906            | 691      | 52        | 20,638    |
| Identifiable assets                      | 151,151                | 13,084           | 2,502    | 6,043     | 172,780   |
| <b>Three months ended March 31, 2006</b> |                        |                  |          |           |           |
| Net revenue                              | \$ 17,865              | \$ 3,985         | \$ 2,045 | \$ 21     | \$ 23,916 |
| Earnings (loss) before taxes             | 2,875                  | 984              | 283      | (1,864)   | 2,278     |
| Depreciation and amortization            | 582                    | 54               | 21       | 62        | 719       |
| Interest income                          | 12                     | —                | —        | 5         | 17        |
| Interest expense                         | 13                     | —                | —        | 380       | 393       |
| Capital expenditures                     | 294                    | 91               | 19       | 70        | 474       |
| Accounts receivable                      | 7,568                  | 5,808            | 700      | 76        | 14,152    |
| Identifiable assets                      | 94,185                 | 12,962           | 1,901    | 7,227     | 116,275   |

**12. RECENT ACCOUNTING PRONOUNCEMENTS**

The Company adopted the provisions of FASB Interpretation No. 48 *Accounting for Uncertainty in Income Taxes* on January 1, 2007 (“FIN 48”). As a result of the implementation of FIN 48, the Company recognized a liability for unrecognized tax benefits of approximately \$416. No adjustment was made to the beginning retained earnings balance, as the ultimate deductibility of all these tax positions is highly certain but there is uncertainty about the timing of such deductibility. No interest or penalties have been accrued relative to these positions since the Company does not have either a tax loss or have utilized a net operating loss carryforward to offset any taxable income in all subject years. Deferred tax assets have been recorded to recognize the future benefits of the positions reserved for in the FIN 48 liability. Because of the impact of deferred income tax accounting, the temporary differences would not affect the annual effective tax rate.

In September 2006, the FASB issued SFAS No. 157, “*Fair Value Measurements*.” SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS

No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and will become effective for the Company beginning with the first quarter of 2008. The Company has not yet determined the impact of the adoption of SFAS No. 157 on its financial statements and note disclosures.

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities.*" SFAS No. 159 allows entities the option to measure eligible financial instruments at fair value as of specified dates. Such election, which may be applied on an instrument by instrument basis, is typically irrevocable once elected. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and will become effective for the Company beginning with the first quarter of 2008. The Company has not yet determined the impact of the adoption of SFAS No. 159 on its financial statements and note disclosures.

**ITEM 2.**

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

The following discussion and analysis presents our consolidated financial condition at March 31, 2007 and the results of operations for the three months ended March 31, 2007 and 2006. You should read the following discussion together with our consolidated financial statements and the related notes contained elsewhere in this quarterly report. In addition to the historical information provided below, we have made certain estimates and forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated or implied by these estimates and forward-looking statements as a result of certain factors, including those discussed in the CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS on page 20 of this quarterly report.

**Overview**

We consider our core business to be the ownership and operation of ambulatory surgery centers (ASCs). As of March 31, 2007, we owned and operated 37 ASCs, of which 35 were jointly owned with physician-partners. We also own other businesses including an optical laboratory, an optical products purchasing organization, and a marketing products and services company. In addition, we provide management services to two eye care practices.

**First Quarter Financial Highlights:**

- Consolidated net revenue increased 31.2% to \$31.4 million. Surgical facilities net revenue increased 40.5% to \$25.1 million (same-facility surgical net revenue increased 9.9% to \$18.2 million).
- Operating income increased 51.0% to \$7.2 million.
- Increased the available commitment under our credit facility to \$125 million.

**Results of Operations**

The following table summarizes our operating results as a percentage of net revenue:

|                                                         | <b>Three months ended<br/>March 31,</b> |             |
|---------------------------------------------------------|-----------------------------------------|-------------|
|                                                         | <b>2007</b>                             | <b>2006</b> |
| Net Revenue:                                            |                                         |             |
| Surgical facilities                                     | 80.0%                                   | 74.7%       |
| Product sales and other                                 | 20.0                                    | 25.3        |
| Total net revenue                                       | 100.0                                   | 100.0       |
| Operating expenses:                                     |                                         |             |
| Salaries, wages and benefits                            | 32.2                                    | 33.6        |
| Cost of sales and medical supplies                      | 22.8                                    | 24.6        |
| Selling, general and administrative                     | 19.1                                    | 18.8        |
| Depreciation and amortization                           | 3.0                                     | 3.0         |
| Total operating expenses                                | 77.1                                    | 80.0        |
| Operating income                                        | 22.9                                    | 20.0        |
| Minority interests in earnings of consolidated entities | 11.2                                    | 9.3         |
| Other (income) expense                                  | 3.9                                     | 1.1         |
| Income before income taxes                              | 7.8                                     | 9.6         |

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|                                         |      |      |
|-----------------------------------------|------|------|
| Income tax provision                    | 3.0  | 3.8  |
| Net income from continuing operations   | 4.8  | 5.8  |
| Net income from discontinued operations | -    | -    |
| Net income                              | 4.8% | 5.8% |

*Three Months Ended March 31, 2007 Compared to the Three Months Ended March 31, 2006***Net Revenue**

**Consolidated.** Total net revenue increased 31.2% from \$23.9 million to \$31.4 million. Net revenue by segment is discussed below.

**Surgical Facilities.** The table below summarizes surgical facilities net revenue and procedures performed for the first quarter of 2007 and 2006. Revenues generated from surgical facilities are derived from the fees charged for the procedures performed in our ASCs and through our laser services agreements. Our procedure volume is directly impacted by the number of ASCs we operate, the number of excimer lasers in service, and their respective utilization rates. Net surgical facilities revenue increased 40.5% from \$17.9 million to \$25.1 million. This increase was primarily the result of \$6.2 million of net revenue from ASCs acquired or developed after January 1, 2006 (“new ASCs”) and a \$1.6 million increase from ASCs that we owned for the entire comparable reporting periods (“same-facility”). The increase in same-facility revenue was primarily the result of a 7.1% increase in the number of same-facility procedures performed and a 2.6% increase in the net revenue per procedure due to a change in procedure mix.

The success of our business depends on our relationship with, and the success and efforts of, the physicians who perform surgical procedures at our ASCs. Our revenue and profitability would decline if our relationship with key physicians deteriorated or those physicians reduced or eliminated their use of our ASCs. One of our ASCs acquired in 2006 has experienced a significant decline in the number of procedures performed. This ASC was dilutive to our earnings during the first quarter of 2007 when considering the interest expense on the purchase price paid for the ASC.

|                                                   | Three Months Ended<br>March 31, |           | Increase<br>(Decrease) |
|---------------------------------------------------|---------------------------------|-----------|------------------------|
| <i>Dollars in thousands</i>                       | 2007                            | 2006      |                        |
| <b>Surgical Facilities:</b>                       |                                 |           |                        |
| Same-facility:                                    |                                 |           |                        |
| Net revenue                                       | \$ 18,163                       | \$ 16,530 | \$ 1,633               |
| # of procedures                                   | 21,838                          | 20,392    | 1,446                  |
|                                                   |                                 |           |                        |
| New ASCs:                                         |                                 |           |                        |
| Net revenue                                       | \$ 6,906                        | \$ 685    | \$ 6,221               |
| # of procedures                                   | 9,407                           | 665       | 8,742                  |
|                                                   |                                 |           |                        |
| Expired laser services agreement and ASC closures |                                 |           |                        |
| Net revenue                                       | \$ 26                           | \$ 650    | \$ (624)               |
| # of procedures                                   | —                               | 1,318     | (1,318)                |

**Product Sales and Other.** The table below summarizes net product sales and other revenue by significant business component. Product sales and other revenue for the first quarter increased 4.0% from \$6.1 million to \$6.3 million.

| <i>Dollars in thousands</i>                      | <b>Three Months Ended March 31,</b> |                 | <b>Increase</b>   |
|--------------------------------------------------|-------------------------------------|-----------------|-------------------|
|                                                  | <b>2007</b>                         | <b>2006</b>     | <b>(Decrease)</b> |
| <b>Product Sales:</b>                            |                                     |                 |                   |
| Optical laboratories                             | \$ 1,639                            | \$ 1,593        | \$ 46             |
| Optical products purchasing organization         | 802                                 | 686             | 116               |
| Marketing products and services                  | 1,461                               | 1,260           | 201               |
| Optometric practice/retail store                 | 478                                 | 446             | 32                |
|                                                  | 4,380                               | 3,985           | 395               |
| <b>Other:</b>                                    |                                     |                 |                   |
| Ophthalmology practice                           | 1,902                               | 1,973           | (71)              |
| Other                                            | 9                                   | 93              | (84)              |
|                                                  | 1,911                               | 2,066           | (155)             |
| <b>Total Net Product Sales and Other Revenue</b> | <b>\$ 6,291</b>                     | <b>\$ 6,051</b> | <b>\$ 240</b>     |

### *Salaries, Wages and Benefits*

**Consolidated.** Salaries, wages and benefits expense increased 25.5% from \$8.0 million to \$10.1 million. As a percentage of net revenue, salaries, wages and benefits expense decreased from 33.6% to 32.2% primarily due to minimal increases in product sales staffing to service increased revenue. Salaries, wages and benefits expense by segment is discussed below.

**Surgical Facilities.** Salaries, wages and benefits expense in our surgical facilities segment increased 38.5% from \$4.1 million to \$5.6 million. The increase was the result of staff costs associated with new ASCs and staffing required at same-facility ASCs due to increased procedure volume.

**Product Sales and Other.** Salaries, wages and benefits expense in our product sales and other segments remained flat at \$2.1 million.

**Corporate.** Salaries, wages and benefits expense increased 27.9% from \$1.8 million to \$2.4 million. The increase was primarily due to higher stock-based compensation expense of \$0.2 million, additional employees required to service the new ASCs, annual salary increases and increased corporate infrastructure expenses.

### *Cost of Sales and Medical Supplies*

**Consolidated.** Cost of sales and medical supplies expense increased 21.7% from \$5.9 million to \$7.2 million. As a percentage of net revenue, cost of sales and medical supplies expense decreased from 24.6% to 22.8%. Cost of sales and medical supplies expense by segment is discussed below.

**Surgical Facilities.** Cost of sales and medical supplies expense in our surgical facilities segment increased 30.8% from \$4.2 million to \$5.5 million. The expense increase was primarily the result of costs associated with our new ASCs and increased procedure volumes at some of our same-facility ASCs.

**Product Sales and Other.** Cost of sales and medical supplies expense in our product sales and other segments decreased \$24,000 to \$1.6 million. As a percentage of net revenue, cost of sales and medical supplies expense

decreased from 27.5% to 26.1% primarily due an increase in higher margin revenue within our marketing products and services business.

### ***Selling, General and Administrative***

**Consolidated.** Selling, general and administrative expense increased 33.3% from \$4.5 million to \$6.0 million. As a percentage of net revenue, selling, general and administrative expense increased from 18.8% to 19.1%. Selling, general and administrative expense by segment is discussed below.

**Surgical Facilities.** Selling, general and administrative expense in our surgical facilities segment increased 42.4% from \$3.6 million to \$5.1 million. The increase is due to costs associated with our new ASCs and an increase of \$0.3 million in professional fees which include management and billing/collections fees charged to the ASCs for services rendered by our corporate personnel.

**Product Sales and Other.** Selling, general and administrative expense in our product sales and other segments remained flat at \$0.9 million.

**Corporate.** Corporate selling, general and administrative expense increased from \$9,000 to \$14,000. This increase consists of two components. Corporate selling, general and administrative expenses decreased by \$0.3 million due to an increase of \$0.3 million in management and billing/collections fees charged to the operating segments for services rendered by certain corporate personnel. Corporate selling, general and administrative expenses increased by \$0.3 million due to higher professional fees, information technology/consulting expenses and travel costs.

**Depreciation and Amortization.** Depreciation and amortization expense increased 29.2% from \$0.7 million to \$0.9 million due to increases in depreciation associated with our new ASCs and capital expenditures in our surgical facilities segment.

**Minority Interests and Other (Income) Expense.** Minority interests in the earnings of our ASCs were \$3.5 million in 2007 as compared to \$2.2 million in 2006. Of this increase, 68.2% is attributable to new ASCs.

**Interest (Income) Expense, net.** Interest expense increased from \$0.4 million to \$1.3 million due to our increased borrowings to fund our ASC acquisitions and higher borrowing costs primarily related to an increase in interest rates over the past year.

**Provision for Income Taxes.** Our effective tax rate in the first quarter of 2007 was 39.0%. Our effective tax rate is affected by expenses that are deducted from operations in arriving at pre-tax income that are not allowed as a deduction on our federal income tax return.

### **Liquidity and Capital Resources**

Operating activities during the first three months of 2007 generated \$0.3 million in cash flow from continuing operations compared to \$2.7 million in the comparable 2006 period. Before considering changes in working capital, operating cash flow from continuing operations was flat compared to the first three months of 2006. During the first quarter of 2007 and 2006, working capital consumed \$3.5 million and \$1.5 million in cash, respectively. The increased cash consumption in the first quarter of 2007 is primarily due to recent acquisitions and the delay in receiving new insurance provider numbers which delays the billing and collection process, an increase in annual cash incentive payments compared to the first quarter of 2006, and the timing of vendor payments.

Investing activities during the first three months of 2007 resulted in negative cash flow of \$8.8 million. Investing activities during the first three months of 2007 included the acquisition of one ASC for \$8.0 million, the purchase of property and equipment for \$1.0 million and proceeds of \$0.3 million relating to the sale of minority interests.

Investing activities during the first three months of 2006 resulted in negative cash flow of \$13.0 million which included the acquisition of one ASC for \$12.6 million, the purchase of property and equipment for \$0.5 million and proceeds of \$0.1 million relating to the sale of minority interests.

Cash flows from financing activities during the first three months of 2007 included \$8.3 million of net borrowings under our credit facility and \$0.7 million from the exercise of stock options and issuance of stock to employees as part of our employee stock purchase plan. These financing activities were partially offset by \$0.6 million of capital lease and other debt obligation payments. Cash flows from financing activities during the first three months of 2006 included \$12.0 million of net borrowings under our credit facility and \$0.1 million from the exercise of stock options and issuance of stock to employees as part of our employee stock purchase plan, offset by \$0.3 million of capital lease obligation payments.

At March 31, 2007, we had \$66.0 million of borrowings outstanding under our revolving credit facility and were in compliance with all of our credit agreement covenants. Effective February 7, 2007, we amended our credit facility, increasing the maximum commitment available under the facility from \$80 million to \$125 million and extending the expiration date to February 5, 2010. The maximum commitment available under the facility is the lesser of \$125 million or the maximum allowed under the calculated ratio limitations. The amended credit agreement also includes an option allowing us to increase the maximum commitment available to \$150 million under certain conditions. Maximum borrowing availability and applicable interest rates under the facility are based on a ratio of our total indebtedness to our earnings before interest, taxes, depreciation and amortization as defined in the credit agreement. The amended credit agreement provides for temporary increases in this ratio through September 30, 2008 for purposes of calculating our maximum borrowing availability. Interest on borrowings under the facility is payable at an annual rate equal to our lender's published base rate plus the applicable borrowing margin ranging from 0% to 0.5% or LIBOR plus a range from 1.00% to 2.25%, varying depending upon our ratios and ability to meet other financial covenants. In addition, a fee ranging from .175% to .250% is charged on the unused portion of the commitment. The credit agreement contains covenants that include limitations on indebtedness, liens, capital expenditures, acquisitions, investments and share repurchases, as well as restrictions on the payment of dividends; however, many of these limitations were changed by these amendments. The weighted average interest rate on credit line borrowings at March 31, 2007 was 7.38%.

During 2006, we entered into two interest rate swap agreements. The interest rate swaps protect us against certain interest rate fluctuations of the LIBOR rate on \$24 million of our variable rate debt under our credit facility. The date of the first interest rate swap was April 12, 2006, and it expires on April 19, 2009. This interest rate swap effectively fixes our LIBOR rate on \$12 million of variable rate debt at a rate of 5.34%. The date of the second interest rate swap was June 28, 2006 and it expires on September 30, 2008. This interest rate swap effectively fixes our LIBOR rate on \$12 million of variable rate debt at a rate of 5.75%. Effective August 1, 2006, NovaMed Eye Surgery Center of New Albany, LLC ("New Albany ASC"), of which we own a 67.5% majority interest, entered into a \$4 million installment note which matures on August 1, 2013. Interest is payable at the lender's one month LIBOR rate, designated or published on the first of each month, plus 2.0%. The New Albany ASC entered into a five-year interest rate swap agreement that effectively fixes the LIBOR rate on this debt at 5.51%.

As of March 31, 2007, we had cash and cash equivalents of \$2.7 million of which \$2.4 million was restricted pursuant to agreements with six of our ASCs. As of March 31, 2007, we had working capital of \$15.3 million.

We expect our cash flow from operations and funds available under our existing credit facility to be sufficient to fund our operations for at least 12 months. Our future capital requirements and the adequacy of our available funds will depend on many factors, including the timing of our acquisition and expansion activities, capital requirements associated with our surgical facilities, and the future cost of surgical equipment.

We have an option to purchase an additional 26% equity interest from our physician-partner in our Ft. Lauderdale, Florida ASC to enable us to increase our interest in the ASC to a majority equity interest. The purchase price of this 26% interest is based on a multiple of the ASC's twelve-month trailing EBITDA. If we do not to exercise this option by July 2007, we have the option to sell our minority interest to our physician-partner for the original purchase price paid. If neither of the aforementioned options are exercised by us by September 2007, our physician-partner has the option to purchase our minority interest at the original purchase price paid.

Two partners in our Richmond, Virginia ASC who each own a 14.5% equity interest have the option to sell us back their interest at the same price they paid to acquire their interest.

## Recent Accounting Pronouncements

We adopted the provisions of FASB Interpretation No. 48 *Accounting for Uncertainty in Income Taxes* on January 1, 2007 ("FIN 48"). As a result of the implementation of FIN 48, we recognized a liability for unrecognized tax benefits of approximately \$0.4 million. No adjustment was made to the beginning retained earnings balance, as the ultimate deductibility of all these tax positions is highly certain but there is uncertainty about the timing of such deductibility. No interest or penalties have been accrued relative to these positions since we have either a tax loss or have utilized a net operating loss carryforward to offset any taxable income in all subject years. Deferred tax assets have been recorded to recognize the future benefits of the positions reserved for in the FIN 48 liability. Because of the impact of deferred income tax accounting, the temporary differences would not affect the annual effective tax rate.

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*." SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and will become effective for us beginning with the first quarter of 2008. We have not yet determined the impact of the adoption of SFAS No. 157 on our financial statements and note disclosures.

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities*." SFAS No. 159 allows entities the option to measure eligible financial instruments at fair value as of specified dates. Such election, which may be applied on an instrument by instrument basis, is typically irrevocable once elected. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and will become effective for us beginning with the first quarter of 2008. We have not yet determined the impact of the adoption of SFAS No. 159 on our financial statements and note disclosures.

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS.** This Form 10-Q contains certain "forward-looking statements" that reflect our current expectations regarding our future results of operations, performance and achievements. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We have tried, wherever possible, to identify these forward-looking statements by using words such as "anticipates," "believes," "estimates," "expects," "plans," "intends" and similar expressions. These statements reflect our current beliefs and are based on information currently available to us. Accordingly, these statements are subject to certain risks, uncertainties and contingencies that could cause our actual results, performance or achievements to differ materially from those expressed in, or implied by, such statements. These risks and uncertainties relate to our business, our industry and our common stock and include: reduced prices and reimbursement rates for surgical procedures; our ability to acquire, develop or manage a sufficient number of profitable surgical facilities, including facilities that are not exclusively dedicated to eye-related procedures; our ability to manage our increasing borrowing costs as we incur additional indebtedness to fund the acquisition and development of surgical facilities; our ability to access capital on a cost-effective basis to continue to successfully implement our growth strategy; our ability to maintain successful relationships with the physicians who use our surgical facilities; our operating margins and profitability could suffer if we are unable to grow and manage effectively our increasing number of surgical facilities; competition from other companies in the acquisition, development and operation of surgical facilities; and the application of existing or proposed government regulations, or the adoption of new laws and regulations, that could limit our business operations, require us to incur significant expenditures or limit our ability to relocate our facilities if necessary.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We have exposure to interest rate risk related to our financing, investing and cash management activities. We have not held or issued derivative financial instruments other than the use of variable-to-fixed interest rate swaps for portions of our borrowings. We do not use derivative instruments for speculative purposes. Our borrowings are primarily indexed to the prime rate or LIBOR and have a mix of maturities. We entered into two swap agreements in 2006 as follows: \$12.0 million in principal amount outstanding under our credit facility with a fixed rate of 5.34% from April 19, 2006 to April 19, 2009 and \$12.0 million in principal amount outstanding under our credit facility with a fixed rate of 5.75% from September 30, 2006 to September 30, 2008. In addition, NovaMed Eye Surgery Center of New Albany, LLC, of which we own a 67.5% equity interest, entered into a swap agreement in 2006 as follows: \$4.0 million in principal amount outstanding under a note with National City Bank with a fixed rate of 5.51% from August 4, 2006 to August 1, 2011.

At March 31, 2007, \$66.0 million of our long-term debt was subject to variable rates of interest. Excluding the impact of our previously disclosed swap agreements, a hypothetical 100 basis point increase in market interest rates would

result in additional annual interest expense of \$0.7 million. The fair value of our long-term debt approximated its carrying value at March 31, 2007.

#### **Item 4. Controls and Procedures**

##### ***Evaluation of Disclosure Controls and Procedures***

We maintain a system of disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”), that are designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chairman and Chief Executive Officer and Executive Vice President and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

We have carried out an evaluation under the supervision and with the participation of the Company’s management, including the Company’s Chairman and Chief Executive Officer and Executive Vice President and Chief Financial Officer (its principal executive officer and principal financial officer), of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on their evaluation, the Chairman and Chief Executive Officer and Executive Vice President and Chief Financial Officer concluded that such disclosure controls and procedures were effective as of the end of the period covered by this report to ensure that required information will be disclosed on a timely basis in our reports filed under the Exchange Act.

In designing and evaluating the disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily was required to apply their judgment in evaluating the cost-benefit relationship of possible controls and procedures. We believe our disclosure controls and procedures provide such reasonable assurance.

##### ***Changes in Internal Control Over Financial Reporting***

There were no changes in the Company’s internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) that occurred during the quarterly period ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

## PART II. OTHER INFORMATION

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds****C. Issuer Repurchases of Equity Securities**

The following table contains information regarding repurchases by the Company of shares of its outstanding equity securities during the quarter ended March 31, 2007:

| Period                | Total<br>Number of<br>Shares<br>Purchased (1) | Average<br>Price Paid<br>per Share | Total Number of<br>Shares<br>Purchased as<br>Part of Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Number of<br>Shares that May<br>Yet Be<br>Purchased<br>Under the Plan<br>or Programs |
|-----------------------|-----------------------------------------------|------------------------------------|----------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------|
| 1/01/2007 - 1/31/2007 | 84,019                                        | \$ 7.62                            | None                                                                                               | None                                                                                            |
| 2/01/2007 - 2/28/2007 | 2,013                                         | \$ 7.40                            | None                                                                                               | None                                                                                            |
| 3/01/2007 - 3/31/2007 | 2,518                                         | \$ 6.37                            | None                                                                                               | None                                                                                            |

(1) Represents 6,544 shares of restricted stock delivered by employees to the Company, upon vesting, to satisfy tax withholding requirements and 82,006 shares of common stock tendered by a former senior executive to exercise stock options.

**Item 6. Exhibits**

|      |                                                                                                                                    |
|------|------------------------------------------------------------------------------------------------------------------------------------|
| 21   | Subsidiaries of the Registrant                                                                                                     |
| 31.1 | Certification by the CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                 |
| 31.2 | Certification by the CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                 |
| 32   | Certification of Principal Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

**SIGNATURES**

Pursuant to the requirements 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.**

/s/ Scott T. Macomber

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May 10, 2007

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Scott T. Macomber  
Executive Vice President and Chief Financial  
Officer  
(on behalf of Registrant and as principal  
financial officer)

Date

/s/ John P. Hart

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May 10, 2007

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John P. Hart  
Vice President, Corporate Controller  
(as principal accounting officer)

Date