

Alliance HealthCare Services, Inc
Form 10-Q
May 11, 2015

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended: March 31, 2015
Commission File Number: 001-16609

ALLIANCE HEALTHCARE SERVICES, INC.
(Exact name of registrant as specified in its charter)

DELAWARE
(State or Other Jurisdiction of
Incorporation or Organization)
100 Bayview Circle
Suite 400
Newport Beach, California 92660
(Address of Principal Executive Office) (Zip Code)
(949) 242-5300
(Registrant's Telephone Number, including Area Code)

33-0239910
(IRS Employer
Identification Number)

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 No

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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 Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of May 11, 2015, there were 10,748,109 shares of common stock, par value \$.01 per share, outstanding.

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PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ALLIANCE HEALTHCARE SERVICES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS(Unaudited)
(in thousands)

	December 31, 2014	March 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$33,033	\$31,489
Accounts receivable, net of allowance for doubtful accounts	62,503	64,577
Deferred income taxes	16,834	16,834
Prepaid expenses	12,527	12,441
Other receivables	5,686	2,569
Total current assets	130,583	127,910
Equipment, at cost	827,638	844,596
Less accumulated depreciation	(678,291)	(685,734)
Equipment, net	149,347	158,862
Goodwill	63,864	86,474
Other intangible assets, net	115,930	138,495
Deferred financing costs, net	8,119	7,790
Other assets	33,042	32,109
Total assets	\$500,885	\$551,640
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	\$12,109	\$13,841
Accrued compensation and related expenses	19,808	16,890
Accrued interest payable	3,154	3,132
Other accrued liabilities	26,542	27,863
Current portion of long-term debt	15,512	19,438
Total current liabilities	77,125	81,164
Long-term debt, net of current portion	491,777	514,888
Other liabilities	6,623	6,564
Deferred income taxes	36,840	37,936
Total liabilities	612,365	640,552
Commitments and contingencies (Note 12)		
Stockholders' deficit:		
Common stock	107	107
Treasury stock	(3,138)	(3,138)
Additional paid-in capital	27,653	27,966
Accumulated comprehensive loss	(351)	(479)
Accumulated deficit	(194,091)	(192,340)
Total stockholders' deficit attributable to Alliance HealthCare Services, Inc.	(169,820)	(167,884)
Noncontrolling interest	58,340	78,972
Total stockholders' deficit	(111,480)	(88,912)
Total liabilities and stockholders' deficit	\$500,885	\$551,640

See accompanying notes.

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ALLIANCE HEALTHCARE SERVICES, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 AND COMPREHENSIVE INCOME

(Unaudited)

(in thousands, except per share amounts)

	Quarter Ended	
	March 31,	
	2014	2015
Revenues	\$105,365	\$109,429
Costs and expenses:		
Cost of revenues, excluding depreciation and amortization	56,940	61,886
Selling, general and administrative expenses	18,739	20,955
Transaction costs	2	419
Severance and related costs	133	259
Impairment charges	—	76
Depreciation expense	15,795	11,633
Amortization expense	1,952	2,035
Interest expense and other, net	6,238	6,018
Other expense (income), net	77	(359)
Total costs and expenses	99,876	102,922
Income before income taxes, earnings from unconsolidated investees, and noncontrolling interest	5,489	6,507
Income tax expense	1,507	1,572
Earnings from unconsolidated investees	(998)	(1,163)
Net income	4,980	6,098
Less: Net income attributable to noncontrolling interest	(3,049)	(4,347)
Net income attributable to Alliance HealthCare Services, Inc.	\$1,931	\$1,751
Comprehensive income, net of taxes:		
Net income attributable to Alliance HealthCare Services, Inc.	\$1,931	\$1,751
Unrealized gain (loss) on hedging transactions, net of taxes	20	(128)
Comprehensive income, net of taxes	\$1,951	\$1,623
Income per common share attributable to Alliance HealthCare Services, Inc.:		
Basic	\$0.18	\$0.16
Diluted	\$0.18	\$0.16
Weighted-average number of shares of common stock and common stock equivalents:		
Basic	10,666	10,714
Diluted	10,890	10,842
See accompanying notes.		

ALLIANCE HEALTHCARE SERVICES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited) (in thousands)

	Three Months Ended March 31,	
	2014	2015
Operating activities:		
Net income	\$4,980	\$6,098
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for doubtful accounts	553	438
Share-based payment	334	389
Depreciation and amortization	17,747	13,668
Amortization of deferred financing costs	478	483
Accretion of discount on long-term debt	111	114
Adjustment of derivatives to fair value	31	72
Distributions (less) more than undistributed earnings from investees	96	254
Deferred income taxes	421	1,096
Gain on sale of assets	141	—
Impairment charges	—	76
Excess tax benefit from share-based payment arrangements	—	5
Changes in operating assets and liabilities, net of the effects of acquisitions:		
Accounts receivable	1,434	1,928
Prepaid expenses	1,919	(45)
Other receivables	422	(2)
Other assets	167	1,326
Accounts payable	(3,604)	563)
Accrued compensation and related expenses	(8,314)	(4,066)
Accrued interest payable	1,463	(22)
Income taxes payable	6	—
Other accrued liabilities	573	(1,597)
Net cash provided by operating activities	18,958	20,778
Investing activities:		
Equipment purchases	(5,735)	(7,565)
Decrease (increase) in deposits on equipment	1,507	(1,836)
Acquisitions, net of cash received	—	(23,630)
Proceeds from sale of assets	142	120
Net cash used in investing activities	(4,086)	(32,911)
Financing activities:		
Principal payments on equipment debt	(2,866)	(1,973)
Principal payments on term loan facility	(1,225)	(6,126)
Principal payments on revolving loan facility	(27,000)	—
Proceeds from revolving loan facility	16,000	23,000
Noncontrolling interest in subsidiaries	(3,771)	(4,313)
Equity purchase of noncontrolling interest	(1,500)	—
Excess tax benefit from share-based payment arrangements	—	(5)
Proceeds from shared-based payment arrangements	55	6
Purchase of treasury stock	(140)	—
Net cash (used in) provided by financing activities	(20,447)	10,589)
Net decrease in cash and cash equivalents	(5,575)	(1,544)
Cash and cash equivalents, beginning of period	34,702	33,033
Cash and cash equivalents, end of period	\$29,127	\$31,489

ALLIANCE HEALTHCARE SERVICES, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
 (Unaudited)
 (in thousands)

	Three Months Ended March 31,	
	2014	2015
Supplemental disclosure of cash flow information:		
Interest paid	\$4,338	\$5,427
Income taxes paid, net of refunds	46	40
Supplemental disclosure of non-cash investing and financing activities:		
Capital lease obligations related to the purchase of equipment	\$—	\$1,294
Comprehensive income (loss) from hedging transactions, net of taxes	20	(128)
Equipment purchases in accounts payable	531	1,225
Noncontrolling interest assumed in connection with acquisitions (Note 2)	—	20,598
Adjustment to equity of noncontrolling interest	1,700	—
Debt related to purchase of equipment	—	3,025
Debt related to purchase of deposits on equipment	—	4,069
Debt related to other assets	—	854
Extinguishment of note receivable (Note 2)	—	3,071
See accompanying notes.		

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ALLIANCE HEALTHCARE SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2015

(Unaudited)

(Dollars in thousands, except per share amounts)

1. Basis of Presentation, Principles of Consolidation, and Use of Estimates

Basis of Presentation The accompanying unaudited condensed consolidated financial statements have been prepared by Alliance HealthCare Services, Inc. (the "Company") in accordance with accounting principles generally accepted in the United States of America and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles ("GAAP") for complete financial statements. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes to the consolidated financial statements for the year ended December 31, 2014.

Principles of Consolidation The accompanying unaudited condensed consolidated financial statements of the Company include the assets, liabilities, revenues and expenses of all majority-owned subsidiaries over which the Company exercises control. Intercompany transactions have been eliminated. The Company records noncontrolling interest related to its consolidated subsidiaries which are not wholly owned. Investments in non-consolidated investees are accounted for under the equity method.

Use of Estimates The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

2. Transactions

Restructuring Plan

During the three months ended March 31, 2015, the Company recorded \$255 related to restructuring charges, of which the Company recorded \$55 in Selling, general and administrative expenses, and \$200 in Cost of revenues, excluding depreciation and amortization. The Company also recorded \$259 in Severance and related costs. During the three months ended March 31, 2014, the Company recorded \$1,025 related to restructuring charges, of which the Company recorded \$704 in Selling, general and administrative expenses; \$133 in Severance and related costs, primarily as a result of the departure of one of its executive officers during the second quarter of 2014; and \$188 in Cost of revenues, excluding depreciation and amortization.

Acquisition of The Pain Center of Arizona

On February 17, 2015, the Company purchased approximately 59% membership interest in The Pain Center of Arizona ("TPC"), a comprehensive full-time pain management medical practice with 12 locations within the state of Arizona. The acquisition took place in two stages: a purchase of a 60.0% membership interest in TPC by the Company, and a 50.0% membership interest in Medical Practice Innovations, Inc. ("MPI"), followed by a transfer of MPI assets to TPC. The MPI transaction diluted the ownership interests of TPC, with the Company retaining approximately 59% membership interest in TPC. The purchase price consisted of \$23,630 in cash, net of \$691 cash acquired, and net of extinguishment of \$3,071 of related-party notes receivable. The Company financed this acquisition using the revolving line of credit.

The following table summarizes recognized amounts of identifiable assets acquired and liabilities assumed at the acquisition date:

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ALLIANCE HEALTHCARE SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

March 31, 2015

(Unaudited)

(Dollars in thousands, except per share amounts)

Cash received	\$691	
Accounts receivable, net	4,440	
Equipment, net	3,346	
Other assets	416	
Goodwill	22,610	
Identifiable intangible assets	24,600	
Debt	(2,781)
Other liabilities	(3,531)
Noncontrolling interest	(20,598)
Cash consideration paid	\$29,193	

As a result of this acquisition, the Company recorded goodwill of \$22,610. In addition, the Company recorded intangible assets of \$24,600, of which \$13,500 was assigned to physician referral network and \$11,100 was assigned to trademarks, which are all being amortized over 20 years. The Company recorded the intangible assets at fair value at the acquisition date, which was estimated using the income approach. A portion of the recorded goodwill and intangible assets is being amortized over 15 years for tax purposes. The fair value of noncontrolling interest related to this transaction was \$20,598 as of the acquisition date. To estimate the fair value of noncontrolling interest, the Company used the implied fair value based on the Company's ownership percentage. The results for the three months ended March 31, 2015 included \$3,855 of revenue and \$271 of net income generated by TPC. The historical results of operations of the business acquired during the three months ended March 31, 2015 are not material, and accordingly, pro forma financial information is not presented.

The values assigned to the various assets and liabilities acquired in this transaction are preliminary and may be subject to adjustment as the calculation of their respective fair values could be subject to change.

The agreement includes contingent consideration arrangements, which are based on performance of the 12-month period following the transaction date. The fair value of these contingent consideration arrangements of \$1,800 was estimated using probability-adjusted performance estimates as of March 31, 2015.

3. Share-Based Payment

The Company has adopted ASC 718, "Compensation—Stock Compensation," and has elected to follow the alternative transition method as described in ASC 718 for computing its beginning additional paid-in capital pool. In addition, the Company treats the tax deductions from stock options as being realized when they reduce taxes payable in accordance with the principles and timing under the relevant tax law.

Stock Option Plans and Awards

In November 1999, the Company adopted an employee stock option plan (as amended and restated, the "1999 Equity Plan") pursuant to which options and awards with respect to a total of 2,205,000 shares have become available for grant. As of March 31, 2015, a total of 472,391 shares remained available for grant under the 1999 Equity Plan. Options are granted with exercise prices equal to the fair value of the Company's common stock at the date of grant. All options have 10-year terms. Options granted after January 1, 2008 are typically time based and vest in equal tranches over three or four years. During the year ended December 31, 2014 and the three months ended March 31, 2015 there were no options in which vesting was accelerated. Prior to January 1, 2008, stock options granted under the 1999 Equity Plan to employees were always time options which vest 5% in the first year, 20% in the second year and

25% in years three through five.

The Company uses the Black-Scholes option pricing model to value the compensation expense associated with share-based payment awards. The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model using the assumptions noted in the table below. In addition, forfeitures are estimated when recognizing compensation expense and the estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of compensation expense to be recognized in future periods.

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ALLIANCE HEALTHCARE SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

March 31, 2015

(Unaudited)

(Dollars in thousands, except per share amounts)

The following weighted average assumptions were used in the estimated grant date fair value calculations for stock option awards:

	Three months ended March 31,			
	2014	2015		
Risk free interest rate	1.83	% 1.65	%	
Expected dividend yield	—	% —	%	
Expected stock price volatility	66.3	% 65.2	%	
Average expected life (in years)	6.00	6.00		

The Company calculates its stock price volatility and average expected life based on its own historical data. The risk free interest rates are based on the United States Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option or award.

The following table summarizes the Company's stock option activity:

	Number of Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2015	633,898	\$21.39		
Granted	83,514	23.91		
Exercised	(1,000)	6.20		