ALLIANCE IMAGING INC /DE/
Form 10-Q
May 10, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For Quarter Ended: March 31, 2006

Commission File Number: 1-16609

ALLIANCE IMAGING, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**33-0239910**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

1900 South State College Boulevard
Suite 600
Anaheim, California 92806

(Address of principal executive office)

(714) 688-7100

(Registrant s telephone number, including area code)

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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer o   Accelerated filer x   Non-accelerated filer o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of April 30, 2006:

Common Stock, $.01 par value, 49,670,981 shares

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March 31, 2006

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	December 31, 2005	March 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 13,421	$ 9,744
Accounts receivable, net of allowance for doubtful accounts	48,236	52,847
Deferred income taxes	6,186	15,118
Prepaid expenses and other current assets	3,686	2,836
Other receivables	8,983	10,986
Total current assets	80,512	91,531
Equipment, at cost	752,128	759,177
Less accumulated depreciation	(393,179)	(398,987)
Equipment, net	358,949	360,190
Goodwill	154,656	154,715
Other intangible assets, net	39,071	38,843
Deferred financing costs, net	8,236	7,977
Other assets	33,918	29,447
Total assets	$ 675,342	$ 682,703
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Accounts payable	$ 23,672	$ 13,843
Accrued compensation and related expenses	14,088	14,209
Accrued interest payable	4,561	7,557
Income taxes payable	87	238
Other accrued liabilities	29,064	29,271
Current portion of long-term debt	7,781	7,618
Total current liabilities	79,253	72,736
Long-term debt, net of current portion	418,260	412,754
Senior subordinated notes	153,541	153,541
Minority interests and other liabilities	4,400	4,320
Deferred income taxes	60,144	72,826
Total liabilities	715,598	716,177
Commitments and contingencies (Note 11)		
Stockholders deficit:		
Common stock	496	496
Additional paid-in deficit	(11,876)	(10,979)
Accumulated comprehensive income	3,217	4,034
Accumulated deficit	(32,093)	(27,025)
Total stockholders deficit	(40,256)	(33,474)
Total liabilities and stockholders deficit	$ 675,342	$ 682,703

See accompanying notes.

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ALLIANCE IMAGING, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME
(Unaudited)
(in thousands, except per share amounts)

	Quarter Ended March 31, 2005	2006
Revenues	$ 105,964	$ 115,343
Costs and expenses:		
Cost of revenues, excluding depreciation and amortization	53,936	59,867
Selling, general and administrative expenses	11,686	13,756
Employment agreement costs	274	
Severance and related costs		489
Depreciation expense	20,463	21,001
Amortization expense	881	1,244
Interest expense, net of interest income	9,061	10,216
Other (income) and expense, net	(332)	728
Total costs and expenses	95,969	107,301
Income before income taxes, minority interest expense and earnings from unconsolidated investees	9,995	8,042
Income tax expense	4,132	3,474
Minority interest expense	412	540
Earnings from unconsolidated investees	(684)	(1,040)
Net income	$ 6,135	$ 5,068
Comprehensive income, net of taxes:		
Net income	$ 6,135	$ 5,068
Unrealized gain on hedging transactions, net of taxes	2,745	817
Comprehensive income	$ 8,880	$ 5,885
Earnings per common share:		
Basic	$ 0.12	$ 0.10
Diluted	$ 0.12	$ 0.10
Weighted average number of shares of common stock and common stock equivalents:		
Basic	49,132	49,608
Diluted	50,312	49,974

See accompanying notes.

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

	Quarter Ended March 31, 2005	2006
Operating activities:		
Net income	$ 6,135	$ 5,068
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for doubtful accounts	403	761
Non-cash share-based compensation	63	715
Depreciation and amortization	21,344	22,245
Amortization of deferred financing costs	514	396
Distributions greater than (less than) equity in undistributed income of investees	175	(489)
Deferred income taxes	3,922	3,242
(Gain) loss on sale of assets	(332)	728
Changes in operating assets and liabilities:		
Accounts receivable	633	(5,439)
Prepaid expenses and other current assets	(132)	850
Other receivables	(1,424)	(2,003)
Other assets	(913)	(306)
Accounts payable	(7,198)	(9,718)
Accrued compensation and related expenses	(1,947)	121
Accrued interest payable	5,034	2,996
Income taxes payable	(34)	151
Other accrued liabilities	920	339
Minority interests and other liabilities	(65)	(168)
Net cash provided by operating activities	27,098	19,489
Investing activities:		
Equipment purchases	(13,500)	(24,331)
(Increase) decrease in deposits on equipment	(255)	5,734
Proceeds from sale of assets	788	427
Net cash used in investing activities	(12,967)	(18,170)
Financing activities:		
Principal payments on equipment debt	(1,285)	(1,129)
Principal payments on term loan facility	(25,000)	
Principal payments on revolving loan facility		(12,500)
Proceeds from revolving loan facility		8,500
Payments of debt issuance costs	(72)	(137)
Proceeds from exercise of employee stock options	605	270
Net cash used in financing activities	(25,752)	(4,996)
Net decrease in cash and cash equivalents	(11,621)	(3,677)
Cash and cash equivalents, beginning of period	20,721	13,421
Cash and cash equivalents, end of period	$ 9,100	$ 9,744
Supplemental disclosure of cash flow information:		
Interest paid	$ 3,601	$ 6,977
Income taxes paid, net of refunds	244	128
Supplemental disclosure of non-cash investing and financing activities:		
Net book value of assets exchanged	$ 1,824	$ 4,442
Capital lease obligations assumed for the purchase of equipment debt		1,839
Equipment debt transferred to unconsolidated investee		(2,379)
Comprehensive income from hedging transactions, net of taxes	2,745	817

See accompanying notes.

ALLIANCE IMAGING, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2006
(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 Imaging, 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 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 quarter ended March 31, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. 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, 2005.

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. We record minority interest expense related to our 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. Non-Cash Share-Based Compensation

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123(R) (revised December 2004), Share-Based Payment (SFAS 123(R)), which is a revision of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123) and supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). This statement requires that the fair value at the grant date resulting from all share-based payment transactions be recognized in the financial statements. Further, SFAS 123(R) requires entities to apply a fair-value based measurement method in accounting for these transactions. This value is recorded over the vesting period. The statement is effective for the first fiscal year beginning after June 15, 2005.

The Company adopted SFAS 123(R) for the fiscal year beginning January 1, 2006, using the modified prospective application transition method and, accordingly, has not restated the consolidated financial statements for prior interim periods or fiscal years. Under SFAS 123(R), the Company now records in its consolidated statements of operations (i) compensation cost for options granted, modified, repurchased or cancelled on or after January 1, 2006 under the provisions of SFAS 123(R) and (ii) compensation cost for the unvested portion of options granted prior to January 1, 2006 over their remaining vesting periods using the amounts previously measured under SFAS 123 for pro forma disclosure purposes.

Stock Option Plans and Awards

In December 1997, the Company adopted an employee stock option plan (1997 Equity Plan) pursuant to which options with respect to a total of 4,685,450 shares of the Company s common stock were available for grant. Options were granted at their fair value at the date of grant. All options have 10-year terms. On November 2, 1999, in connection with a series of transactions contemplated by an Agreement and Plan of Merger between Viewer Acquisition Corp and the Company in November 1999 (the 1999 Recapitalization Merger), all options under the 1997 Equity Plan became fully vested.

In connection with the Company s acquisition of all of the outstanding common stock of Three Rivers Holding Corporation (Three Rivers), the parent corporation of SMT Health Services, Inc., in 1999, outstanding employee stock options under the 1997 Three Rivers Stock Option Plan were converted into options to acquire shares of the Company s common stock. The Three Rivers stock option plan allowed for options with respect to a total of 2,825,200 shares of the Company s common stock to be available for grant. Options were granted at their fair value at the date of grant. All options have 10-year terms. On November 2, 1999, in connection with the 1999 Recapitalization Merger, all options under the 1997 Three Rivers Stock Option Plan became fully vested.

In connection with the 1999 Recapitalization Merger, the Company adopted an employee stock option plan (the 1999 Equity Plan) pursuant to which options with respect to a total of 6,325,000 shares of the Company s common stock became available for grant. As of March 31, 2006, a total of 1,201,625 shares are available for grant under the 1999 Equity Plan. Options are granted with exercise prices equal to fair value of the Company s common stock at the date of grant, except as noted below. All options have 10-year terms. A portion of the options vest in equal increments over five years and a portion vest after eight years (subject to acceleration if certain financial performance targets are achieved). The Company settles stock option exercises with newly issued shares of common stock.

Consistent with the valuation method for the disclosure-only provisions of SFAS 123, the Company is using the Black-Scholes option pricing model to value the compensation expense associated with stock-based awards under SFAS 123(R). The fair value of each option award is estimated on the date of grant using the Black-Scholes option pricing model that uses 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. For the quarter ended March 31, 2005, the Company recorded $63 in non-cash share-based compensation for stock options granted with exercise prices below the fair value of the Company s common stock at the date of grant and for certain stock options subject to amended performance targets under the 1999 Equity Plan, as discussed below. For the quarter ended March 31, 2006, of the total $715 in non-cash share-based compensation recorded, $553 was incremental share-based compensation as a result of the adoption of SFAS 123(R).

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

	Quarter Ended March 31,	
	2005	**2006**
Risk free interest rate	3.78 %	4.55 %
Expected dividend yield	0.00 %	0.00 %
Expected stock price volatility	52.6 %	56.7 %
Average expected life (in years)	5.45	6.69

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The expected stock price volatility rates are based on a blend of the historical volatility of the Company s common stock and peer implied volatility. The risk free interest rates are based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option or award. The average expected life represents the weighted average period of time that options or awards granted are expected to be outstanding, as calculated using the simplified method described in the Securities and Exchange Commission s Staff Accounting Bulletin No. 107.

In November 2000, the Company granted stock options to certain employees at exercise prices below the fair value of the Company s common stock, of which 35,000 options were outstanding at March 31, 2006. The exercise prices of these options and the fair value of the Company s common stock on the grant date were $5.60 and $9.52 per share, respectively. The Company recorded non-cash share-based compensation of $6 for the quarter ended March 31, 2005, with an offset to paid-in-capital deficit. As the Company adopted SFAS 123 (R) effective January 1, 2006, any non-cash share-based compensation as a result of granting these stock options is included in the Company s consolidated total of non-cash share-based compensation of $715 for the quarter ended March 31, 2006.

Under the 1999 Equity Plan, a portion of the options granted are performance options. These options vest on the eighth anniversary of the grant date if the option holder is still an employee, but the vesting accelerates if the Company meets the operating performance targets specified in the option agreements. On June 20, 2001, the Company s compensation committee authorized the Company to amend the option agreements under its 1999 Equity Plan to reduce the performance targets for 1,899,600 performance options out of the 2,284,222 performance options outstanding. On May 18, 2004, the Company s compensation committee authorized the Company to make a second amendment to the option agreements under its 1999 Equity Plan to further reduce the performance targets for all of the 1,914,500 performance options outstanding. As a result of the amendment, if the Company achieves the reduced performance targets but does not achieve the original performance targets, and an option holder terminates employment prior to the eighth anniversary of the option grant date, the Company would be required to record a non-cash share-based compensation charge equal to the amount by which the actual value of the shares subject to the performance option on the date of the amendment exceeded the option s exercise price. For the quarter ended March 31, 2005 the Company recorded $57 in non-cash share-based compensation as a result of the amendment. As the Company adopted SFAS 123 (R) effective January 1, 2006, any non-cash share-based compensation as a result of these amendments is included in the Company s consolidated total of non-cash share-based compensation of $715 for the quarter ended March 31, 2006.

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 (in thousands)**
Outstanding at December 31, 2005	3,571,275	$ 6.25		
Granted	861,500	4.27		
Exercised	(61,375)	4.41		
Canceled	(163,400)	8.06		
Outstanding at March 31, 2006	4,208,000	$ 5.80	7.72	$ 14,031
Vested and expected to vest in the future at March 31, 2006	4,109,000	$ 5.79	7.69	$ 13,687
Exercisable at March 31, 2006	1,498,098	$ 5.20	6.26	$ 4,607

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The weighted average grant-date fair value of options granted during the quarters ended March 31, 2005 and 2006 was $6.11 per share and $2.58 per share, respectively. The total intrinsic value of options exercised during the quarters ended March 31, 2005 and 2006 was $1,642 and $91, respectively. The total cash received from employees as a result of stock option exercises was $605 and $270 for the quarters ended March 31, 2005 and 2006, respectively.

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

	Shares	Weighted Average Grant-Date Fair Value
Unvested at December 31, 2005	2,243,851	$ 3.86
Granted	861,500	2.58
Vested	(246,349)	3.38
Canceled	(149,100)	4.43
Unvested at March 31, 2006	2,709,902	$ 3.47

At March 31, 2006, the total unrecognized fair value compensation cost related to unvested stock options granted to both employees and non-employees was $9,080, which is expected to be recognized over a remaining weighted-average period of 4.63 years. The valuation model applied in this calculation utilizes highly subjective assumptions that could potentially change over time, including the expected forfeiture rate and performance targets. Therefore the amount of unrecognized compensation expense noted above does not necessarily represent the value that will ultimately be realized by the Company in the statements of operations. The total fair value of shares vested during the quarters ended March 31, 2005 and 2006 were $502, and $857, respectively.

Employee Share-Based Compensation Expense

The table below shows the amounts recognized in the financial statements for the three months ended March 31, 2006 for awards newly subject to compensation expense under SFAS 123(R). Prior to the adoption of SFAS 123(R), the Company recorded compensation expense for stock options granted with exercise prices below the fair value of the Company s common stock at the date of grant, certain stock options subject to amended performance targets under the 1999 Equity Plan, and non-employee share-based awards granted to members of the Company s advisory committee. The table below, therefore, excludes the effect of these awards.

	Quarter Ended March 31, 2006
Selling, general, and administrative expenses	$ 553
Total cost of non-cash share-based compensation included in income, before income tax	553
Amount of income tax recognized in earnings	(225)
Amount charged against income	$ 328
Impact on net income per share:	
Basic earnings per share:	$ 0.01
Diluted earnings per share:	$ 0.01

Pro Forma Share-Based Compensation

Prior to the adoption of SFAS 123(R), the Company accounted for non-cash share-based compensation awards using the intrinsic value method prescribed under APB 25, and its related interpretations, as permitted by SFAS 123, as amended by SFAS 148, Accounting for Stock-Based Compensation Transition and Disclosure. Prior to the adoption of SFAS 123(R), the Company recognized compensation cost for only certain awards, as discussed above. All other employee share-based awards were granted with an exercise price equal to the market value of the underlying common stock on the date of grant and no compensation cost was reflected in the statement of operations for those awards. SFAS 123, as amended by SFAS 148, required presentation of pro forma information regarding net income and earnings per share determined as if the Company had accounted for its employee stock options under the fair value method of that Statement.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options expected vesting period. Had compensation cost for the Company s stock option plan been determined based on the estimated fair value at the grant dates for awards under the plan consistent with the fair value method of SFAS 123 utilizing the Black-Scholes option-pricing model, the Company s net income and basic and diluted earnings per share for the quarter ended March 31, 2005 would have approximated the pro forma amount indicated below:

	Quarter Ended March 31, 2005
Net income:	
As reported	$ 6,135
Add: Share-based compensation expense included in reported net income, net of related tax effects	38
Deduct: Share-based compensation expense determined under fair value based method, net of related tax effects	(371)
Pro forma net income	$ 5,802
Basic earnings per share:	
As reported	$ 0.12
Pro forma	0.12
Diluted earnings per share:	
As reported	$ 0.12
Pro forma	0.12

3. Recent Accounting Pronouncements

Accounting Changes and Error Corrections In May 2005, the FASB issued SFAS 154, Accounting for Changes and Error Corrections (SFAS 154), which is a replacement of APB Opinion No. 20, Accounting Changes, and SFAS 3, Reporting Accounting Changes in Interim Financial Statements. This statement changes the requirements for the accounting for and reporting of all voluntary changes in accounting principle and in the instance that a pronouncement does not include specific transition provisions. This statement requires retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS 154 did not have a material impact on the Company s consolidated financial position or results of operations.

Limited Partnerships In June 2005, the FASB issued Emerging Issues Task Force Issue No. 04-05, Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights (EITF 04-05). EITF 04-05 clarifies how general partners in a limited partnership should determine whether they control a limited partnership. A general partner of a limited partnership is presumed to control the limited partnership unless the limited partners have substantive kick-out rights or participating rights. For general partners of all new limited partnerships formed and for existing limited partnerships for which the partnership agreements are modified, EITF 04-05 is effective after June 29, 2005. For general partners in all other limited partnerships, EITF 04-05 is effective for the first period in fiscal years beginning after December 15, 2005. The adoption of EITF 04-05 did not have a material impact on the Company s consolidated financial position or results of operations.

4. Transactions

Effective September 1, 2005, the Company acquired certain assets associated with nine multi-modality fixed-site diagnostic imaging centers. The multi-modality fixed-site diagnostic imaging centers include one MRI system, six CT systems, and 29 other modality systems. The purchase price consisted of $7,650 in cash and $826 in assumed liabilities and transaction costs. The acquisition was financed using the Company s internally generated funds. As a result of this acquisition, the Company recorded goodwill and intangible assets of $2,246 and $2,400, respectively. The intangible assets were recorded at fair value at the acquisition date. All recorded goodwill is deductible for tax purposes and will be amortized over 15 years for tax purposes. The acquisition also includes $246 of contingent payment due to the shareholders of the centers if certain performance targets are met over a three year period. When the contingency is resolved and consideration is distributable, the Company will record the fair value of the additional consideration as an adjustment to goodwill. Adjustments to goodwill may occur in future periods as a result of changes in the original valuation of assets and liabilities acquired. During the quarter ended March 31, 2006, the company increased goodwill by $26 as a result of changes in the original valuation of assets and liabilities acquired. The Company has not included pro forma information as this acquisition did not have a material impact on the Company s consolidated financial position or results of operations.

Effective October 1, 2005, the Company acquired 100% of the outstanding stock of PET Scans of America Corp. (PSA), a mobile provider of PET and PET/CT services primarily to hospitals in 13 states. The purchase price consisted of $36,596 in cash and $3,692 in assumed liabilities and transaction costs. The acquisition was financed using the Company s revolving line of credit, internally generated funds, and capital leases. As a result of this acquisition the Company acquired intangible assets of $11,400, of which $9,100 was assigned to PSA customer contracts, which will be amortized over 10 years, and $2,100 was assigned to certificates of need held by PSA, which have indefinite useful lives and are not subject to amortization. These assets were recorded at fair value at the acquisition date. The Company recorded total goodwill of $22,472, which includes $3,007 of goodwill related to income tax timing differences as a result of the acquisition. None of the goodwill recorded is deductible for tax purposes. Adjustments to goodwill may occur in future periods as a result of changes in the original valuation of assets and liabilities acquired. During the quarter ended March 31, 2006, the company decreased goodwill by $23 as a result of changes in the original valuation of assets and liabilities acquired. The Company has not included pro forma information as this acquisition did not have a material impact on the Company s consolidated financial position or results of operations.

In late December 2005, the Company purchased an additional equity interest in a joint venture the Company formed in 2004 with the University of Pittsburgh Medical Center. The joint venture, Alliance Oncology (AO), is designed to partner with hospitals to build and operate radiation oncology centers, with an emphasis on intensity modulated radiation therapy and image guided radiation therapy. The purchase price for the additional equity interest was $8,000, which was financed through the Company s revolving line of credit. The Company now owns 80% of AO. As a result of this acquisition the Company recorded goodwill of $6,946, which is deductible for tax purposes and will be amortized over 15 years for tax purposes. Adjustments to goodwill may occur in future periods as a result of changes in the original valuation of assets and liabilities acquired. D