

Alliance HealthCare Services, Inc  
Form 10-Q  
May 08, 2014

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 Quarter Ended: March 31, 2014  
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)  
(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 May 5, 2014:  
Common Stock, \$.01 par value, 10,669,363 shares

ALLIANCE HEALTHCARE SERVICES, INC.  
FORM 10-Q  
March 31, 2014  
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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,<br>2013 | March 31,<br>2014 |
|--|----------------------|-------------------|
| <b>ASSETS</b>  |                      |                   |
| Current assets:  |                      |                   |
| Cash and cash equivalents  | \$34,702             | \$29,127          |
| Accounts receivable, net of allowance for doubtful accounts                    | 63,713               | 61,726            |
| Deferred income taxes  | 21,849               | 21,849            |
| Prepaid expenses   | 7,553                | 5,537             |
| Other receivables  | 2,796                | 2,374             |
| Total current assets   | 130,613              | 120,613           |
| Equipment, at cost   | 824,103              | 821,994           |
| Less accumulated depreciation  | (654,350)            | (662,584)         |
| Equipment, net   | 169,753              | 159,410           |
| Goodwill   | 56,975               | 56,975            |
| Other intangible assets, net   | 101,801              | 99,841            |
| Deferred financing costs, net  | 9,873                | 9,492             |
| Other assets   | 20,832               | 18,930            |
| Total assets   | \$489,847            | \$465,261         |
| <b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>                                   |                      |                   |
| Current liabilities:   |                      |                   |
| Accounts payable   | \$11,990             | \$8,358           |
| Accrued compensation and related expenses                                      | 21,166               | 12,852            |
| Accrued interest payable   | 1,645                | 3,107             |
| Other accrued liabilities  | 22,002               | 22,735            |
| Current portion of long-term debt  | 15,066               | 14,110            |
| Total current liabilities  | 71,869               | 61,162            |
| Long-term debt, net of current portion   | 514,608              | 500,584           |
| Other liabilities  | 4,714                | 4,639             |
| Deferred income taxes  | 35,273               | 35,515            |
| Total liabilities  | 626,464              | 601,900           |
| Commitments and contingencies (Note 12)  |                      |                   |
| Stockholders' deficit:   |                      |                   |
| Common stock   | 524                  | 524               |
| Treasury stock   | (2,998)              | (3,138)           |
| Additional paid-in capital   | 23,521               | 25,610            |
| Accumulated comprehensive loss   | (82)                 | (62)              |
| Accumulated deficit  | (204,709)            | (202,778)         |
| Total stockholders' deficit attributable to Alliance HealthCare Services, Inc. | (183,744)            | (179,844)         |
| Noncontrolling interest  | 47,127               | 43,205            |
| Total stockholders' deficit  | (136,617)            | (136,639)         |
| Total liabilities and stockholders' deficit                                    | \$489,847            | \$465,261         |

See accompanying notes.

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

|  | Quarter Ended |            |
|--|---------------|------------|
|  | March 31,     |            |
|  | 2013          | 2014       |
| Revenues   | \$ 110,382    | \$ 105,365 |
| Costs and expenses:  |               |            |
| Cost of revenues, excluding depreciation and amortization  | 60,639        | 56,940     |
| Selling, general and administrative expenses   | 19,095        | 18,739     |
| Transaction costs  | 80            | 2          |
| Severance and related costs  | 348           | 133        |
| Depreciation expense   | 16,516        | 15,795     |
| Amortization expense   | 3,794         | 1,952      |
| Interest expense and other, net  | 12,272        | 6,238      |
| Other (income) and expense, net  | (902          | ) 77       |
| Total costs and expenses   | 111,842       | 99,876     |
| (Loss) income before income taxes, earnings from unconsolidated investees, and noncontrolling interest | (1,460        | ) 5,489    |
| Income tax (benefit) expense   | (138          | ) 1,507    |
| Earnings from unconsolidated investees   | (1,734        | ) (998     |
| Net income   | 412           | 4,980      |
| Less: Net income attributable to noncontrolling interest   | (2,830        | ) (3,049   |
| Net (loss) income attributable to Alliance HealthCare Services, Inc.                                   | \$(2,418      | ) \$1,931  |
| Comprehensive (loss) income, net of taxes:   |               |            |
| Net (loss) income attributable to Alliance HealthCare Services, Inc.                                   | \$(2,418      | ) \$1,931  |
| Unrealized (loss) gain on hedging transactions, net of taxes   | (80           | ) 20       |
| Comprehensive (loss) income, net of taxes  | \$(2,498      | ) \$1,951  |
| (Loss) income per common share attributable to Alliance HealthCare Services, Inc.:                     |               |            |
| Basic  | \$(0.23       | ) \$0.18   |
| Diluted  | \$(0.23       | ) \$0.18   |
| Weighted-average number of shares of common stock and common stock equivalents:                        |               |            |
| Basic  | 10,627        | 10,666     |
| Diluted  | 10,627        | 10,890     |
| See accompanying notes.  |               |            |

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

|   | Three Months Ended<br>March 31, |           |
|---|---------------------------------|-----------|
|   | 2013                            | 2014      |
| Operating activities:   |                                 |           |
| Net income  | \$412                           | \$4,980   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |           |
| Provision for doubtful accounts   | 946                             | 553       |
| Share-based payment   | 406                             | 334       |
| Depreciation and amortization   | 20,310                          | 17,747    |
| Amortization of deferred financing costs  | 1,160                           | 478       |
| Accretion of discount on long-term debt   | 420                             | 111       |
| Adjustment of derivatives to fair value   | 123                             | 31        |
| Distributions (less) more than undistributed earnings from investees              | (233                            | ) 96      |
| Deferred income taxes   | (254                            | ) 421     |
| (Gain) loss on sale of assets   | (805                            | ) 141     |
| Changes in operating assets and liabilities, net of the effects of acquisitions:  |                                 |           |
| Accounts receivable   | (1,851                          | ) 1,434   |
| Prepaid expenses  | (889                            | ) 1,919   |
| Other receivables   | 546                             | 422       |
| Other assets  | 368                             | 167       |
| Accounts payable  | (1,769                          | ) (3,604  |
| Accrued compensation and related expenses   | (8,077                          | ) (8,314  |
| Accrued interest payable  | 3,405                           | 1,463     |
| Income taxes payable  | —                               | 6         |
| Other accrued liabilities   | (3,739                          | ) 573     |
| Net cash provided by operating activities   | 10,479                          | 18,958    |
| Investing activities:   |                                 |           |
| Equipment purchases   | (5,556                          | ) (5,735  |
| Decrease in deposits on equipment   | 2,861                           | 1,507     |
| Increase in cash in escrow  | (190                            | ) —       |
| Proceeds from sale of assets  | 1,596                           | 142       |
| Net cash used in investing activities   | (1,289                          | ) (4,086  |
| Financing activities:   |                                 |           |
| Principal payments on equipment debt  | (3,826                          | ) (2,866  |
| Proceeds from equipment debt  | 4,845                           | —         |
| Principal payments on term loan facility  | (15,000                         | ) (1,225  |
| Principal payments on revolving loan facility                                     | —                               | (27,000   |
| Proceeds from revolving loan facility   | —                               | 16,000    |
| Payments of debt issuance costs   | (175                            | ) —       |
| Noncontrolling interest in subsidiaries   | (4,344                          | ) (3,771  |
| Equity purchase of noncontrolling interest  | —                               | (1,500    |
| Proceeds from shared-based payment arrangements                                   | —                               | 55        |
| Purchase of treasury stock  | —                               | (140      |
| Net cash used in financing activities   | (18,500                         | ) (20,447 |
| Net decrease in cash and cash equivalents   | (9,310                          | ) (5,575  |
| Cash and cash equivalents, beginning of period                                    | 39,977                          | 34,702    |
| Cash and cash equivalents, end of period  | \$30,667                        | \$29,127  |



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

|   | Three Months Ended<br>March 31, |         |
|---|---------------------------------|---------|
|   | 2013                            | 2014    |
| Supplemental disclosure of cash flow information:                       |                                 |         |
| Interest paid   | \$7,506                         | \$4,338 |
| Income taxes paid, net of refunds                                       | 1,764                           | 46      |
| Supplemental disclosure of non-cash investing and financing activities: |                                 |         |
| Comprehensive (loss) gain from hedging transactions, net of taxes       | (80                             | ) 20    |
| Equipment purchases in accounts payable                                 | 1,981                           | 531     |
| Adjustment to equity of noncontrolling interest                         | —                               | 1,700   |
| See accompanying notes.   |                                 |         |



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ALLIANCE HEALTHCARE SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014

(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 quarter ended March 31, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. 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, 2013.

**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**

On August 4, 2011, the Company’s board of directors approved a restructuring plan that included a significant organizational restructure and a cost savings and efficiency initiative. The Company initiated this restructuring plan in the third quarter of 2011. 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; and \$188 in Cost of revenues, excluding depreciation and amortization.

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, 2013, a total of 446,698 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, 2013, there were no options in which vesting was accelerated. During the quarter ended March 31, 2014, there were no options in which vesting was accelerated.

Prior to January 1, 2008, subsequent 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

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ALLIANCE HEALTHCARE SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

March 31, 2014

(Unaudited)

(Dollars in thousands, except per share amounts)

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.

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

|                                  | Quarter Ended |        |   |  |
|----------------------------------|---------------|--------|---|--|
|                                  | 2013          | 2014   |   |  |
| Risk free interest rate          | 0.84          | % 1.83 | % |  |
| Expected dividend yield          | —             | % —    | % |  |
| Expected stock price volatility  | 66.6          | % 66.3 | % |  |
| Average expected life (in years) | 5.50          | 6.00   |   |  |

Through March 31, 2012, the expected stock price volatility rates are based on the historical volatility of the Company's common stock and peer implied volatility. The average expected life, representing the weighted-average period of time that options or awards granted are expected to be outstanding, is calculated using the simplified method described in ASC 718, as the Company did not have sufficient historical exercise data to provide a reasonable basis upon which to estimate the expected terms and experienced a change in the types of employees that receive share grants. Beginning with the second quarter of 2012, the Company changed its calculation methodology for its stock price volatility and average expected life, which are now based on its own historical data. The risk free interest rates have been, and continue to be, 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 December 31, 2013                            | 803,617          | \$ 20.83                        |   |                           |
| Granted   | 45,783           | 28.97                           |   |                           |
| Exercised   | (7,667 )         | 6.27                            |   |                           |
| Canceled  | (24,854 )        | 23.59                           |   |                           |
| Outstanding at March 31, 2014                               | 816,879          | \$ 18.82                        | 6.85  | \$13,433                  |
| Vested and expected to vest in the future at March 31, 2014 | 797,788          | \$ 18.79                        | 6.85  | \$13,178                  |
| Exercisable at March 31, 2014                               | 476,952          | \$ 20.36                        | 5.92  | \$7,699                   |

The weighted average grant date fair value of options granted during the three months ended March 31, 2013 and 2014 was \$3.67 per share and \$17.56 per share, respectively. Total stock options exercised was 7,667 during the three months ended March 31, 2014. There were 1,333 options exercised during the three months ended March 31, 2013.

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



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ALLIANCE HEALTHCARE SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

March 31, 2014

(Unaudited)

(Dollars in thousands, except per share amounts)

|                               | Shares  | Weighted-Average<br>Grant-Date<br>Fair Value |
|-------------------------------|---------|--|
| Unvested at December 31, 2013 | 376,024 | \$ 8.10                                      |
| Granted                       | 45,783  | 17.56  |
| Vested                        | (66,367 | ) 5.42                                       |
| Canceled                      | (11,254 | ) 5.35                                       |
| Unvested at March 31, 2014    | 344,186 | \$ 9.89                                      |

At March 31, 2014, the total unrecognized fair value share-based payment related to unvested stock options granted to employees was \$2,647, which is expected to be recognized over a remaining weighted-average period of 2.63 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 share-based payment noted above does not necessarily represent the value that will ultimately be realized by the Company in the consolidated statements of operations and comprehensive income (loss). The total fair value of shares vested during the three months ended March 31, 2013 and 2014 was \$765 and \$360, respectively.

Restricted Stock Awards

The 1999 Equity Plan, as amended and restated, permits the award of restricted stock, restricted stock units, stock bonus awards and performance-based awards. During 2011, awards to certain employees of the Company either cliff vest after one year or three years provided that the employee remains continuously employed through the issuance date, or cliff vest after one year provided that the employee meets certain performance criteria and remains continuously employed through the issuance date. During 2012, awards to certain employees either cliff vested after one year, or vest annually in 33.3% increments over three years. During 2013, awards to certain employees vested immediately upon the date of grant, or cliff vest after one year provided that the employee remains continuously employed through the issuance date. The Company grants restricted stock awards to non-employee directors of the Company who are unaffiliated with Oaktree Capital Management, LLC (“Oaktree”) and MTS Health Investors, LLC (“MTS”) (“unaffiliated directors”). These awards to unaffiliated directors cliff vest after one year based on the unaffiliated directors’ continued service with the Company through that date.

For the three months ended March 31, 2013 and 2014, the Company recorded share-based payment related to restricted stock awards of \$114 and \$92, respectively. The weighted-average grant-date fair value of restricted stock awards granted during the three months ended March 31, 2013 was \$6.38 per share. No restricted stock awards were granted in the first quarter of 2014.

The following table summarizes the Company’s restricted stock activity:

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ALLIANCE HEALTHCARE SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

March 31, 2014

(Unaudited)

(Dollars in thousands, except per share amounts)

|                                   | Shares     | Weighted-Average<br>Grant-Date<br>Fair Value |
|-----------------------------------|------------|--|
| Unvested at January 1, 2012       | 273,308    |  |
| Granted to employees              | 38,075     |  |
| Granted to non-employee directors | 19,469     |  |
| Vested                            | (119,968 ) |  |
| Canceled                          | (106,340 ) |  |
| Unvested at December 31, 2012     | 104,544    |  |
| Granted to employees              | 14,100     |  |
| Granted to non-employee directors | 13,619     |  |
| Vested                            | (54,038 )  |  |
| Canceled                          | (7,334 )   |  |
| Unvested at December 31, 2013     | 70,891     | \$ 7.01                                      |
| Granted to employees              | —          | —  |
| Granted to non-employee directors | —          | —  |
| Vested                            | (15,000 )  | 39.85  |
| Canceled                          | (2,000 )   | 19.15  |
| Unvested at March 31, 2014        | 53,891     | \$ 11.70                                     |

At March 31, 2014, the total unrecognized fair value share-based payment related to restricted stock awards granted to employees was \$85, which is expected to be recognized over a remaining weighted-average period of 1.34 years. At March 31, 2014, the total unrecognized fair value share-based payment related to the restricted stock awards granted to unaffiliated directors was \$623, which is expected to be recognized over a remaining weighted-average period of 0.75 years.

Directors' Compensation Program

In 2012 and 2013, under the compensation program for non-employee directors in effect during 2012, non-employee directors earned an annual fee of \$40 for their services as directors. In addition, each Unaffiliated Director, received a restricted stock unit award on December 31 for the number of shares of our Common Stock having a value equal to \$40, using the average share price of our Common Stock over the 15-day period preceding the grant date. These restricted stock unit awards vest on the first anniversary of their respective date of grant contingent upon the Unaffiliated Director's continued service to the Company through that date. In addition, each Unaffiliated Director receives additional annual cash compensation of \$40, paid in equal quarterly installments, for serving on the Board during 2012 and 2013. Beginning October 1, 2013, the Chairman of the Board, Mr. Buckelew, is entitled to restricted stock units having a value equal to \$138 as compensation for a service period of one year, for the 24 month period following his resignation as the Company's CEO. The number of units Mr. Buckelew receives, having a value equal to \$138, divided by the closing share price of the Company's stock on December 31, rounded down to the nearest whole share. On December 31, 2012 and 2013, each Oaktree/MTS Director received additional cash compensation of \$80, for serving on the Board during 2012 and 2013, respectively. Also during 2012 and 2013, non-employee directors who served as members of our Audit Committee received an additional \$15, and the non-employee director who served as Chairman of our Audit Committee received an additional \$30. In 2012 and 2013, non-employee directors who served as members of our Nominating Committee, Compensation Committee and Strategy & Finance Committee received an additional \$5, and the non-employee director who served as Chairman of our Strategy and Finance

Committee received an additional \$25. In 2012 and 2013, non-employee directors were reimbursed for travel expenses related to their Board service.

In 2014, under the revised compensation program for non-employee directors in effect during 2014, non-employee directors earn an annual fee of \$40 for their services as directors. In addition, each Unaffiliated Director, will receive a restricted stock unit award on December 31 for the number of shares of our Common Stock having a value equal to \$140, using the average share price of our Common Stock over the 15-day period preceding the grant date. These restricted stock unit awards vest on the first anniversary of their respective date of grant contingent upon the Unaffiliated Director's continued

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ALLIANCE HEALTHCARE SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

March 31, 2014

(Unaudited)

(Dollars in thousands, except per share amounts)

service to the Company through that date. In addition to the annual \$40 fee for all non-employee directors, each Affiliated Director receives additional annual cash compensation of \$140, paid in one annual installment, for serving on the Board during 2014. The Chairman of the Board and other committee chairs' and members' compensation program remains unaltered from the above discussion.

**4. Recent Accounting Pronouncements**

**Income Taxes** In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") number 2013-11, "Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists - a consensus of the FASB Emerging Issues Task Force". ASU 2013-11 generally requires, with some exceptions, an entity to present its unrecognized tax benefits as it relates to its net operating loss carryforwards, similar tax losses, or tax credit carryforwards, as a reduction of deferred tax assets when settlement in this regard is available under the tax law of the applicable taxing jurisdiction as of the balance sheet reporting date. It is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. Retrospective application is permitted. The adoption of ASU 2013-11 did not affect the Company's results of operations, cash flows, or financial position.

**Derivatives and Hedging** In July 2013, the FASB issued ASU number 2013-10, "Derivatives and Hedging (Topic 815) — Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes." ASU 2013-10 permits the use of the Fed Funds Effective Swap Rate as a U.S. benchmark interest rate for hedge accounting purposes. The ASU also removes the restriction on using different benchmark rates for similar hedges. ASU No. 2013-10 is effective for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The adoption of ASU 2013-10 did not affect the Company's results of operations, cash flows, or financial position.

**5. Fair Value of Financial Instruments**

The Company used the following methods and assumptions in estimating fair value disclosure for financial instruments:

**Cash and cash equivalents** The carrying amounts reported in the balance sheets approximate fair value due to the short-term maturity or variable rates of these instruments.

**Debt** The carrying amount of fixed and variable-rate borrowings at March 31, 2014 approximates fair value estimated based on current market rates and credit spreads for similar debt instruments.

**Derivative instruments** Fair value was determined based on the income approach and standard valuation techniques to convert future amounts to a single present amount and approximates the net gains and losses that would have been realized if the contracts had been settled at each period-end.

The estimated fair values of the Company's financial instruments are as follows:

|   | December 31, 2013 |            | March 31, 2014 |            |
|---|-------------------|------------|----------------|------------|
|   | Carrying Value    | Fair Value | Carrying Value | Fair Value |
| Cash and cash equivalents                   | \$34,702          | \$34,702   | \$29,127       | \$29,127   |
| Fixed-rate debt                             | 25,552            | 25,552     | 22,687         | 22,687     |
| Variable-rate debt                          | 504,122           | 504,112    | 492,007        | 492,007    |
| Derivative instruments - asset position     | 811               | 811        | 697            | 697        |
| Derivative instruments - liability position | 104               | 104        | 84             | 84         |

ASC 820, "Fair Value Measurement," applies to all assets and liabilities that are being measured and reported at fair value on a recurring basis. ASC 820 requires disclosure that establishes a framework for measuring fair value in



generally accepted accounting principles by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. The statement requires that assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

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(Dollars in thousands, except per share amounts)

Level 1 Quoted market prices in active markets for identical assets or liabilities.

Level 2 Observable market based inputs or unobservable inputs, including identical securities in inactive markets or similar securities in active markets, that are corroborated by market data.

Level 3 Unobservable inputs that are not corroborated by market data.

None of the Company's instruments have transferred from one level to another.

The following table summarizes the valuation of the Company's financial instruments that are reported at fair value on a recurring basis by the above ASC 820 pricing levels as of December 31, 2013:

|  | Total    | Quoted market prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|--|----------|--|---|---|
| Cash and cash equivalents                    | \$34,702 | \$ 34,702  | \$ —  | \$ —                                      |
| Interest rate contracts - asset position     | 811      | —  | 811   | —   |
| Interest rate contracts - liability position | 104      | —  | 104   | —   |

The following table summarizes the valuation of the Company's financial instruments that are reported at fair value on a recurring basis by the above ASC 820 pricing levels as of March 31, 2014:

|  | Total    | Quoted market prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|--|----------|--|---|---|
| Cash and cash equivalents                    | \$29,127 | \$ 29,127  | \$ —  | \$ —                                      |
| Interest rate contracts - asset position     | 697      | —  | 697   | —   |
| Interest rate contracts - liability position | 84       | —  | 84  | —   |

The Company's derivative instruments are primarily pay-fixed, receive-variable interest rate swaps and caps based on the LIBOR swap rate. The Company has elected to use the income approach to value these derivatives, using observable Level 2 market expectations at measurement date and standard valuation techniques to convert future amounts to a single present amount assuming that participants are motivated, but not compelled to transact. Level 2 inputs for interest rate swap and cap valuations are limited to quoted prices for similar assets or liabilities in active markets (specifically futures contracts on LIBOR for the first two years) and inputs other than quoted prices that are observable for the asset or liability (specifically LIBOR cash and swap rates at commonly quoted intervals and implied volatilities for options). ASC 820 states that the fair value measurement of an asset or liability must reflect the nonperformance risk of the entity and the counterparty. Therefore, the impact of the counterparty's creditworthiness and the Company's creditworthiness has also been factored into the fair value measurement of the derivative instruments. For additional information please see Note 9 of the Notes to the Condensed Consolidated Financial Statements.

## 6. Goodwill and Intangible Assets

Changes in the carrying amount of goodwill are as follows:



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|   |            |
|---|------------|
| Balance at January 1, 2013                | \$56,493   |
| Goodwill acquired during the period       | —          |
| Impairment charges                        | —          |
| Adjustments to goodwill during the period | 482        |
| Balance at December 31, 2013              | 56,975     |
| Goodwill acquired during the period       | —          |
| Impairment charges                        | —          |
| Adjustments to goodwill during the period | —          |
| Balance at March 31, 2014                 | \$56,975   |
| Gross goodwill                            | \$231,219  |
| Accumulated impairment charges            | (174,244 ) |
| Balance at March 31, 2014                 | \$56,975   |

Intangible assets consisted of the following:

|   | December 31, 2013     |                          |                        | March 31, 2014        |                          |                        |
|---|-----------------------|--------------------------|------------------------|-----------------------|--------------------------|------------------------|
|   | Gross Carrying Amount | Accumulated Amortization | Intangible Assets, net | Gross Carrying Amount | Accumulated Amortization | Intangible Assets, net |
| Amortizing intangible assets:                 |                       |                          |                        |                       |                          |                        |
| Customer contracts                            | \$152,629             | \$(86,584 )              | \$66,045               | \$152,629             | \$(88,327 )              | \$64,302               |
| Other   | 26,197                | (20,868 )                | 5,329                  | 26,152                | (21,040 )                | 5,112                  |
| Total amortizing intangible assets            | \$178,826             | \$(107,452 )             | \$71,374               | \$178,781             | \$(109,367 )             | \$69,414               |
| Intangible assets not subject to amortization |                       |                          | 30,427                 |                       |                          | 30,427                 |
| Total other intangible assets                 |                       |                          | \$101,801              |                       |                          | \$99,841               |

In accordance with ASC 350, "Intangibles—Goodwill and Other," the Company has elected to perform an annual impairment test in the fourth quarter for goodwill and indefinite life intangible assets based on the financial information as of September 30, or more frequently when an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The Company compares the fair value of its reporting units to its carrying amount to determine if there is potential impairment. The fair value of the reporting unit is determined by an income approach and a market capitalization approach. Significant management judgment is required in the forecasts of future operating results that are used in the income approach. The estimates that the Company has used are consistent with the plans and estimates that it uses to manage its business. The Company bases its fair value estimates on forecasted revenue and operating costs which include a number of factors including, but not limited to, securing new customers, retention of existing customers, growth in imaging and radiation oncology revenues and the impact of continued cost savings initiatives. However, it is possible that plans and estimates may change. No triggering events occurred during the first quarter of 2014 which required impairment testing based on financial information as of March 31, 2014. Although the Company concluded that no impairment was present in its intangible assets in the first quarter of 2014, the Company intends to test its Goodwill and other intangibles assets for impairment during the fourth quarter of 2014, as described above.

The Company uses the estimated useful life to amortize customer contracts, which is a weighted-average of 15 years. Other intangible assets subject to amortization are estimated to have a weighted-average useful life of six years. Amortization expense for intangible assets subject to amortization was \$3,794 and \$1,952 for the quarters ended

March 31, 2013 and 2014, respectively. The intangible assets not subject to amortization represent certificates of need and regulatory authority rights which have indefinite useful lives.

Estimated annual amortization expense for each of the fiscal years ending December 31, is presented below:

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|            |         |
|------------|---------|
| 2014       | \$5,808 |
| 2015       | 7,026   |
| 2016       | 6,020   |
| 2017       | 5,582   |
| 2018       | 5,221   |
| Thereafter | 39,757  |

## 7. Other Accrued Liabilities

Other accrued liabilities consisted of the following:

|  | December 31,<br>2013 | March 31,<br>2014 |
|--|----------------------|-------------------|
| Accrued systems rental and maintenance costs | \$1,488              | \$1,206           |
| Accrued site rental fees                     | 999                  | 816               |
| Accrued property and sales taxes payable     | 10,253               | 10,395            |
| Accrued self-insurance expense               | 1,635                | 1,903             |
| Deferred gain on sale of equipment           | 319                  | 316               |
| Other accrued expenses                       | 7,308                | 8,099             |
| Total  | \$22,002             | \$22,735          |

## 8. Long-Term Debt and Senior Subordinated Credit Facility

Long-term debt consisted of the following:

|   | December 31,<br>2013 | March 31,<br>2014 |
|---|----------------------|-------------------|
| Term loan facility                        | \$487,725            | \$486,500         |
| Discount on term loan facility            | (2,603)              | (2,493)           |
| Revolving credit facility                 | 19,000               | 8,000             |
| Equipment debt                            | 25,552               | 22,687            |
| Long-term debt, including current portion | 529,674              | 514,694           |
| Less current portion                      | 15,066               | 14,110            |
| Long-term debt                            | \$514,608            | \$500,584         |

## Senior Secured Term Loan Refinancing

On June 3, 2013, the Company replaced its existing credit facility with a new senior secured credit agreement with Credit Suisse AG, Cayman Islands Branch, as administrative agent, and the other lenders party thereto (the "Credit Agreement"). The Credit Agreement consists of (i) a \$340,000, six-year term loan facility, (ii) a \$50,000, five-year revolving loan facility, including a \$20,000 sublimit for letters of credit, (iii) uncommitted incremental loan facilities of \$100,000 of revolving or term loans, plus an additional amount if our pro forma leverage ratio is less than or equal to 3.25, subject to receipt of lender commitments and satisfaction of specified conditions, and (iv) an \$80,000 delayed draw term loan facility, which was required to be drawn within thirty days of June 3, 2013 and used for the redemption of \$80,000 in aggregate principal amount of the Company's 8% Senior Notes due 2016 (the "Notes"). On July 3, 2013 the delayed draw term loan facility was utilized together with other available funds, of which the proceeds were used to redeem \$80,000 of the Company's outstanding Notes. The delayed draw term loan facility converted into, and matched the terms of, the new \$340,000 term loan facility.



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As a result of these transactions, during 2013, the Company recognized a loss on extinguishment totaling \$17,069 for unamortized deferred financing costs and the discount related to the former credit facility. Additionally, \$1,522 and \$3,200 of expense was incurred for unamortized deferred costs and associated discount, and the related call premium, respectively, related to the redemption of the Notes.

Borrowings under the Credit Agreement bear interest through maturity at a variable rate based upon, at the Company's option, either the London interbank offered rate ("LIBOR") or the base rate (which is the highest of the administrative agent's prime rate, one-half of 1.00% in excess of the overnight federal funds rate, and 1.00% in excess of the one-month LIBOR rate), plus, in each case, an applicable margin. With respect to the term loan facilities, the applicable margin for LIBOR loans is 3.25% per annum, and with respect to the revolving loan facilities, the applicable margin for LIBOR loans ranges, based on the applicable leverage ratio, from 3.00% to 3.25% per annum, in each case, with a LIBOR floor of 1.00%. The applicable margin for base rate loans under the term loan facilities is 2.25% per annum and under the revolving loan facility ranges, based on the applicable leverage ratio, from 2.00% to 2.25% per annum. Prior to the refinancing of the term loan facilities, the applicable margin for base rate loans was 4.25% per annum and the applicable margin for revolving loans was 5.25% per annum, with a LIBOR floor of 2.00%. The Company is required to pay a commitment fee which ranges, based on the applicable leverage ratio, from 0.375% to 0.50% per annum on the undrawn portion available under the revolving loan facility and variable per annum fees with respect to outstanding letters of credit.

During the first five and three-quarter years after the closing date, and including the full amount of the delayed draw term loan facility, the Company will be required to make quarterly amortization payments of the term loans in the amount of \$1,050. The Company is also required to make mandatory prepayments of term loans under the Credit Agreement, subject to specified exceptions, from excess cash flow (as defined in the Credit Agreement), and with the proceeds of asset sales, debt issuances and specified other events.

Obligations under the Credit Agreement are guaranteed by substantially all the Company's direct and indirect domestic subsidiaries. The obligations under the Credit Agreement and the guarantees are secured by a lien on substantially all tangible and intangible property, and by a pledge of all of the shares of stock and limited liability company interests of the Company's direct and indirect domestic subsidiaries, of which the Company now owns or later acquires more than a 50% interest, subject to limited exceptions.

In addition to other covenants, the Credit Agreement places limits on the ability of the Company and its subsidiaries to declare dividends or redeem or repurchase capital stock, prepay, redeem or purchase debt, incur liens and engage in sale-leaseback transactions, make loans and investments, incur additional indebtedness, amend or otherwise alter debt and other material agreements, engage in mergers, acquisitions and asset sales, transact with affiliates and alter the business conducted by the Company and its subsidiaries.

The Credit Agreement also contains a leverage ratio covenant requiring the Company to maintain a maximum ratio of consolidated total debt to consolidated adjusted EBITDA expense that ranges from 4.95 to 1.00 to 4.30 to 1.00. For the quarter ended March 31, 2014, the Credit Agreement requires a maximum leverage ratio of not more than 4.95 to 1.00. The Credit Agreement eliminated the interest coverage ratio covenant which the Company was subject to maintain prior to the refinancing. Failure to comply with the covenants in the Credit Agreement could permit the lenders under the Credit Agreement to declare all amounts borrowed under the Credit Agreement, together with accrued interest and fees, to be immediately due and payable, and to terminate all commitments under the Credit Agreement.

In September 2013, the Company repurchased \$8,772 in principal amount of its Notes in privately negotiated transactions. The Company immediately incurred \$160 of expense related to unamortized deferred costs and associated discount, as well as \$251 for the related call premium.



On October 11, 2013, the Company entered into an amendment to the Credit Agreement with Credit Suisse AG, Cayman Islands Branch, as administrative agent, and the other lenders party thereto (the "First Amendment"). Pursuant to the First Amendment, the Company raised \$70,000 in incremental term loan commitments to repurchase the remaining Notes. On December 2, 2013, the Company borrowed \$70,000 of incremental term loans, and with such proceeds plus borrowings under its revolving line of credit and cash on hand, completed the redemption of all of its outstanding Notes on December 4, 2013. With the completion of this transaction including the redemption in full of the Notes, the Company expects to save approximately \$5,000 in cash interest on an annualized basis.

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The incremental term loan was funded at 99.0% of principal amount and will mature on the same date as the existing term loan in June 2019. The incremental term loan will be converted to match all the terms of existing term loans upon funding in December. Interest on the incremental term loan will be calculated, at the Company's option, at a base rate plus a 2.25% margin or LIBOR plus a 3.25% margin, subject to a 1.00% LIBOR floor.

As of March 31, 2014, there was \$486,500 outstanding under the new term loan facility and \$8,000 borrowings under the new revolving credit facility. As of March 31, 2014, the Company's ratio of consolidated total debt to Consolidated Adjusted EBITDA calculated pursuant to the Credit Agreement was 3.54 to 1.00.

During the first five and one half years after the closing date for the incremental term loan, the quarterly amortization payments of all term loans under the credit facility has increased to \$1,225 from the previous amount of \$1,050.

The Company's obligations under the incremental term loans are guaranteed by substantially all of the Company's direct and indirect domestic subsidiaries. The obligations under the incremental term loan and the guarantees are secured by a lien on substantially all of the Company's tangible and intangible property, and by a pledge of all of the shares of stock and limited liability company interests of the Company's direct and indirect domestic subsidiaries, of which the Company now owns or later acquires more than a 50% interest, subject to limited exceptions.

#### 9. Derivatives

The Company accounts for derivative instruments and hedging activities in accordance with the provisions of ASC 815, "Derivatives and Hedging." Management generally designates derivatives in a hedge relationship with the identified exposure on the date the Company enters into a derivative contract, as disclosed below. The Company has only executed derivative instruments that are economic hedges of exposures that can qualify in hedge relationships under ASC 815. The Company formally documents all relationships between hedging instruments and hedged items, as well as the risk-management objective and strategy for undertaking various hedge transactions. In this documentation, the Company specifically identifies the firm commitment or forecasted transaction that has been designated as a hedged item and states how the hedging instrument is expected to hedge the risks related to the hedged item. The Company formally assesses effectiveness of its hedging relationships, both at the hedge inception and on an ongoing basis, then measures and records ineffectiveness. The Company would discontinue hedge accounting prospectively (i) if it is determined that the derivative is no longer effective in offsetting change in the cash flows of a hedged item, (ii) when the derivative expires or is sold, terminated or exercised, (iii) because it is probable that the forecasted transaction will not occur, or (iv) if management determines that designation of the derivative as a hedge instrument is no longer appropriate. The Company's derivatives are recorded on the balance sheet at their fair value. For additional information please see Note 5 of the Notes to the Condensed Consolidated Financial Statements. For derivatives accounted for as cash flow hedges, any effective unrealized gains or losses on fair value are included in comprehensive income (loss), net of tax, and any ineffective gains or losses are recognized in income immediately. Amounts recorded in comprehensive income (loss) are reclassified to earnings when the hedged item impacts earnings.

#### Cash Flow Hedges

##### Interest Rate Cash Flow Hedges

The Company has entered into multiple interest rate swap and cap agreements to hedge the future cash interest payments on portions of its variable rate bank debt. For the three months ended March 31, 2013 and 2014, the Company had interest rate swap and cap agreements to hedge approximately \$163,200 and \$259,320 of its variable rate bank debt, respectively, or 29.9% and 50.4% of total debt, respectively. Over the next twelve months, the Company expects to reclassify \$36 from accumulated comprehensive loss to interest expense and other, net.

In the first quarter of 2010, the Company entered into three interest rate cap agreements, in accordance with Company policy, to avoid unplanned volatility in the income statement due to changes in the LIBOR interest rate environment. The interest rate cap agreements matured in February 2014, had a total notional amount of \$150,000, and were de-designated as cash flow hedges associated with the Company's variable rate bank debt in the fourth quarter of 2013.

In the second quarter of 2011, the Company acquired two interest rate swap agreements (the "USR Swaps") as part of the acquisition of US Radiosurgery, LLC ("USR"). One of the USR Swaps, which matures in October 2015, had a notional amount of \$1,656 as of March 31, 2014. Under the terms of this agreement, the Company receives one-month LIBOR and pays a fixed rate of 5.71%. The net effect of the hedge is to record interest expense at a fixed rate of 8.71%, as the underlying debt incurred

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interest based on one-month LIBOR plus 3.00%. The other USR Swap, which matures in April 2014, had a notional amount of \$88 as of March 31, 2014. Under the terms of this agreement, the Company receives one-month LIBOR and pays a fixed rate of 4.15%. The net effect of the hedge is to record interest expense at a fixed rate of 6.15%, as the underlying debt incurred interest based on one-month LIBOR plus 2.00%. As a result of the acquisition of USR, the USR Swaps were de-designated, hedge accounting was terminated and all further changes in the fair market value of these swaps are being recorded in interest expense and other, net.

In the fourth quarter of 2012, the Company entered into an interest rate swap agreement in connection with equipment financing. The swap, which matures in December 2017, had a notional amount of \$3,986 as of March 31, 2014. Under the terms of this agreement, the Company receives one-month LIBOR plus 2.50% and pays a fixed rate of 3.75%. The net effect of the hedge is to convert interest expense to a fixed rate of 3.75%, as the underlying debt incurred interest based on one-month LIBOR plus 2.50%.

In the first quarter of 2013, the Company entered into an interest rate swap agreement in connection with equipment financing. The swap, which matures in April 2018, had a notional amount of \$3,590 as of March 31, 2014. Under the terms of this agreement, the Company receives one-month LIBOR plus 2.00% and pays a fixed rate of 2.873%. The net effect of the hedge is to convert interest expense to a fixed rate of 2.873%, as the underlying debt incurred interest based on one-month LIBOR plus 2.00%.

In the fourth quarter of 2013, the Company entered into five interest rate cap agreements ("2013 Caps"), in accordance with Company policy, to avoid unplanned volatility in the income statement due to changes in the LIBOR interest rate environment. The 2013 Caps, which mature in December 2016, had a notional amount of \$250,000 and were designated as cash flow hedges of future cash interest payments associated with a portion of the Company's variable rate bank debt. Under these arrangements, the Company has purchased a cap on LIBOR at 2.50%. The Company paid \$815 to enter into the caps, which is being amortized through interest expense and other, net over the life of the agreements.

## The Effect of Designated Derivative Instruments on the Statement of Operations

For the Three Months Ended March 31, 2013

|  | Amount of Gain (Loss)<br>Recognized in OCI | Location of Gain<br>(Loss)<br>Reclassified from<br>Accumulated OCI<br>into<br>Income (Effective<br>Portion) | Amount of Gain (Loss)<br>Reclassified from<br>Accumulated OCI into<br>Income (Effective<br>Portion) | Location of Gain<br>(Loss) Recognized in<br>Income on Derivatives<br>(Ineffective Portion) | Amount of Gain (Loss)<br>Recognized in<br>Income<br>on Derivatives<br>(Ineffective<br>Portion) |
|--|--|---|---|--|--|
| Derivatives in Cash Flow Hedging Relationships |  |   |   |  |  |
| Interest rate contracts                        | \$ (33 )                                   | Interest expense and other, net   | \$ (190 )   | Interest expense and other, net  | \$ —   |

## The Effect of Non-Designated Derivative Instruments on the Statement of Operations

For the Three Months Ended March 31, 2013

| Derivatives in Cash Flow Hedging Relationships | Location of Gain (Loss) | Amount of Gain |
|--|-------------------------|----------------|
|--|-------------------------|----------------|

|                         | Recognized in Income on<br>Derivatives | (Loss) Recognized in<br>Income on<br>Derivatives |
|-------------------------|--|--|
| Interest rate contracts | Interest expense and other, net        | \$ (1            )                               |

The Effect of Designated Derivative Instruments on the Statement of Operations  
For the Three Months Ended March 31, 2014

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| Derivatives in Cash Flow Hedging Relationships | Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion) | Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | Amount of Gain (Loss) Recognized in Income (Effective Portion) | Location of Gain (Loss) Recognized in Income on Derivatives (Ineffective Portion) | Amount of Gain (Loss) Recognized in Income on Derivatives (Ineffective Portion) |
|--|--|---|--|---|---|
| Interest rate contracts                        | \$ (103 )  | Interest expense and other, net   | \$ (134 )  | Interest expense and other, net   | \$ (2 )   |

The Effect of Non-Designated Derivative Instruments on the Statement of Operations  
For the Three Months Ended March 31, 2014

| Derivatives in Cash Flow Hedging Relationships | Location of Gain (Loss) Recognized in Income on Derivatives | Amount of Gain (Loss) Recognized in Income on Derivatives |
|--|---|---|
| Interest rate contracts                        | Interest expense and other, net                             | \$ (1 )   |

## 10. Income Taxes

For the quarter ended March 31, 2014, the Company recorded income tax expense of \$1,507, or 43.8%, as a result of the Company's effective tax rate applied to pretax income. For the quarter ended March 31, 2013 the Company recorded income tax benefit of \$138, or (5.4)%, as a result of the Company's effective tax rate applied to pretax loss. The Company's effective tax rate for the quarter ended March 31, 2014 differed from the federal statutory rate principally as a result of state income taxes and permanent non-deductible tax items, including share-based payments, unrecognized tax benefits and other permanent differences.

As of March 31, 2014, the Company has provided a liability for \$297 of unrecognized tax benefits related to various federal and state income tax matters. The tax-effected amount that would reduce the Company's effective income tax rate if recognized is \$256.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense.

As of March 31, 2014, the Company had approximately \$19 in accrued interest and penalties related to unrecognized tax benefits.

The Company is subject to United States federal income tax as well as income tax of multiple state tax jurisdictions. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the years ended December 31, 2010 through 2013. The Company's and its subsidiaries' state income tax returns are open to audit under the applicable statutes of limitations for the years ended December 31, 2009 through 2013. The Company does not anticipate a significant change to the total amount of unrecognized tax benefits within the next 12 months.

## 11. Earnings (Loss) Per Common Share

Basic net income (loss) per share is computed utilizing the two-class method and is calculated based on the weighted-average number of common shares outstanding during the periods presented, excluding nonvested restricted stock units which do not contain nonforfeitable rights to dividend and dividend equivalents.

Diluted net income (loss) per share is computed using the weighted-average number of common and common equivalent shares outstanding during the periods utilizing the two-class method for stock options, nonvested restricted stock and nonvested restricted stock units. Potentially dilutive securities are not considered in the calculation of net loss per share as their impact would be anti-dilutive.

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The following table sets forth the computation of basic and diluted earnings (loss) per share (amounts in thousands, except per share amounts):

|   | Quarter Ended |         |
|---|---------------|---------|
|   | March 31,     |         |
|   | 2013          | 2014    |
| Numerator:  |               |         |
| Net (loss) income attributable to Alliance HealthCare Services, Inc.                              | \$(2,418 )    | \$1,931 |
| Denominator:  |               |         |
| Weighted-average shares-basic   | 10,627        | 10,666  |
| Effect of dilutive securities:  |               |         |
| Employee stock options  | —             | 224     |
| Weighted-average shares-diluted   | 10,627        | 10,890  |
| (Loss) income per common share attributable to Alliance HealthCare Services, Inc.:                |               |         |
| Basic   | \$(0.23 )     | \$0.18  |
| Diluted   | \$(0.23 )     | \$0.18  |
| Stock options excluded from the computation of diluted per share amounts:                         |               |         |
| Weighted-average shares for which the exercise price exceeds average market price of common stock | 308           | 135     |
| Average exercise price per share that exceeds average market price of common stock                | \$35.35       | \$44.29 |

## 12. Commitments and Contingencies

In the normal course of business, the Company has made certain guarantees and indemnities, under which it may be required to make payments to a guaranteed or indemnified party, in relation to certain transactions. The Company indemnifies other parties, including customers, lessors, and parties to other transactions with the Company, with respect to certain matters. The Company has agreed to hold the other party harmless against losses arising from certain events as defined within the particular contract, which may include, for example, litigation or claims arising from a breach of representations or covenants. In addition, the Company has entered into indemnification agreements with its executive officers and directors and the Company's bylaws contain similar indemnification obligations. Under these arrangements, the Company is obligated to indemnify, to the fullest extent permitted under applicable law, its current or former officers and directors for various amounts incurred with respect to actions, suits or proceedings in which they were made, or threatened to be made, a party as a result of acting as an officer or director.

It is not possible to determine the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made related to these indemnifications have been immaterial. At March 31, 2014, the Company has determined that no liability is necessary related to these guarantees and indemnities.

In connection with our acquisition of Medical Outsourcing Services, LLC ("MOS") in the third quarter of 2008, the Company subsequently identified a Medicare billing practice related to a portion of MOS's retail billing operations that raised compliance issues under Medicare reimbursement guidelines. The practice was in place before the acquisition and was discontinued when the Company became aware of it. In accordance with our corporate compliance program, the Company entered into discussions with representatives of the federal government to advise them of the issue and seek guidance on appropriate next steps.





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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

March 31, 2014

(Unaudited)

(Dollars in thousands, except per share amounts)

In June 2010, the Company commenced arbitration proceedings against the former owners of MOS related to the Medicare billing matter, in addition to certain other indemnification issues. In the arbitration, the Company asserted claims of fraud and breach of representations and warranties.

On December 29, 2011, the Company received notice of an award by the arbitration panel, which awarded the Company \$2,527 in damages for breach of contract claims, plus prejudgment interest at 9% under New York law from July 29, 2008 (which interest continues to accrue until the award is paid in full); \$255 for two other indemnification claims; \$1,453 for attorneys' fees and expenses; and \$110 for arbitration expenses. The award also provides that approximately \$1,300 of a remaining indemnification cap created in connection with the acquisition is available for future indemnification claims, including with respect to the potential government claim discussed above, and must be satisfied by the former owners of MOS. On January 25, 2012, one of the former owners of MOS paid \$665 to the Company, and on February 17, 2012, the same owner released \$592 to the Company from amounts held in an indemnification escrow related to the acquisition. On January 25, 2012, the Company filed an action in the United States District Court for the Northern District of Illinois to confirm the award as a judgment against the other former owner of MOS that has refused to satisfy its obligations under the award.

In the first quarter of 2013, the former owners of MOS paid \$1,198 which amount represented the remaining amount of the indemnification cap created in connection with the acquisition. This amount was in addition to \$5,300 the Company already recovered from the former owners of MOS in connection with the arbitration award against them. With these final payments totaling \$1,198, the former owners of MOS have now fully satisfied their obligations to the Company under the arbitration award. Following receipt of the final payments from the former owners of MOS, the Company then entered into a settlement agreement to resolve the government's investigation of the Medicare billing practices engaged in by MOS prior to the acquisition. Under the terms of the settlement agreement, the Company paid \$2,400 to the government, which amount was paid primarily from the funds recovered in the arbitration from the former owners of MOS.

In June 2012, Pacific Coast Cardiology ("PCC") d/b/a Pacific Coast Imaging, Emanuel Shaoulian, MD, Inc., and Michael M. Radin, MD, Inc. filed a lawsuit in California state court against the Company and other defendants. The complaint asserts a number of claims related to the Company's decision not to purchase PCC in 2010, and also separately seeks a determination regarding an amount the Company contends is owed to it by PCC pursuant to a previous contractual arrangement. Plaintiffs are seeking monetary and punitive damages. The Company intends to vigorously defend against the claims asserted in this lawsuit. The Company has not recorded an expense related to any potential damages in connection with this matter because any potential loss is not probable or reasonably estimable at this time.

On November 9, 2012, USR, a subsidiary of the Company, received a grand jury subpoena issued by the United States Attorney's Office for the Middle District of Tennessee seeking documents related to USR and its financial relationships with physicians and other healthcare providers. The Company and USR are cooperating fully with the inquiry. The Company is currently unable to predict the timing or outcome of this matter, however, it is not unusual for such matters to continue for a considerable period of time. Responding to this matter will require management's attention and likely result in significant legal expense. To management's knowledge, the federal government has not initiated any proceedings against the Company at this time.

On March 27, 2013, the Company was served with a lawsuit filed in U.S. District Court for the Northern District of Mississippi by Superior MRI Services, Inc. The plaintiff is an alleged successor in interest to a former local competitor, P&L Contracting, Inc.

Plaintiff alleges the Company disregarded Mississippi Certificate of Need ("CON") rules and regulations by operating without obtaining the appropriate authority, and is seeking in excess of \$1,000 in damages as well as requesting

injunctive relief. In January of 2014, the District Court dismissed Plaintiff's Complaint on a number of procedural and substantive grounds. The plaintiff has appealed the District Court's ruling and the Company will respond accordingly. The Company has not recorded an expense related to any potential damages in connection with this matter because any potential loss is not probable or reasonably estimable at this time.

On June 14, 2013, Alliance Oncology, LLC, a subsidiary of the Company, filed a complaint against Harvard Vanguard Medical Associates, Inc. ("HVMA") in the United States District Court for the District of Massachusetts, including several claims seeking damages resulting from HVMA's early termination of a long-term services agreement between the two companies. HVMA filed an answer to Alliance Oncology's complaint on August 27, 2013. Without specifying its alleged damages, HVMA also asserted several counterclaims in its answer. The Company filed its answer to HVMA's counterclaims on

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October 4, 2013, and intends to vigorously defend against the claims asserted. The Company has not recorded an expense related to any potential damages in connection with this matter because any potential loss is not probable or reasonably estimable at this time.

The Company from time to time is involved in routine litigation and regulatory matters incidental to the conduct of its business. The Company believes that resolution of such matters will not have a material adverse effect on its consolidated results of operations or financial position.

**13. Related-Party Transactions**

On April 16, 2007, Oaktree and MTS purchased 4,900,301 shares of the Company's common stock. Upon completion of the transaction, Oaktree and MTS owned in the aggregate approximately 49.7% of the outstanding shares of common stock of the Company. At March 31, 2014, Oaktree and MTS owned in the aggregate approximately 51.0% of the outstanding shares of common stock of the Company. The Company does not pay management fees to Oaktree and MTS for their financial advisory services to the Company.

Revenues from management agreements with unconsolidated equity investees were \$2,244 and \$2,321 during the quarters ended March 31, 2013 and 2014, respectively. The Company provides services as part of its ongoing operations for and on behalf of the unconsolidated equity investees, which are included in the management agreement revenue, who reimburse the Company for the actual amount of the expenses incurred. The Company records the expenses as cost of revenues and the reimbursement as revenues in its condensed consolidated statements of operations and comprehensive income (loss). For the quarters ended March 31, 2013 and 2014, the amounts of the revenues and expenses were \$1,809 and \$1,904, respectively.

On June 3, 2013, the Company replaced its existing credit facility with a new senior secured credit agreement with Credit Suisse AG, Cayman Islands Branch, as administrative agent, and the other lenders party thereto (the "Credit Agreement"). Of the other lenders, Oaktree funded approximately \$40,476 of the \$340,000 six-year term loan facility. In addition, as of July 3, 2013, Oaktree funded approximately \$9,524 of the \$80,000 delayed draw.

On October 11, 2013, the Company obtained commitments from its current lenders with respect to a \$70,000 incremental term loan under its Credit Agreement. On December 2, 2013 The Company borrowed \$70,000 of the incremental term loans, and with such proceeds plus borrowings under its revolving line of credit and cash on hand, completed the redemption of all its outstanding Notes on December 4, 2013. Oaktree funded \$10,000 of the \$70,000 incremental term loan.

**14. Investments in Unconsolidated Investees**

The Company has direct ownership in four unconsolidated investees at March 31, 2014. The Company owns between 15% and 50% of these investees, and provides management services under agreements with three of these investees, expiring at various dates through 2025. All of these investees are accounted for under the equity method since the Company does not exercise control over the operations of these investees.

Set forth below are certain financial data for Alliance-HNI, LLC and Subsidiaries, one of the Company's unconsolidated investees:

|                        | December 31,<br>2013 | March 31,<br>2014 |
|------------------------|----------------------|-------------------|
| Balance Sheet Data:    |                      |                   |
| Current assets         | \$ 4,650             | \$4,814           |
| Noncurrent assets      | 9,732                | 10,923            |
| Current liabilities    | 2,810                | 3,381             |
| Noncurrent liabilities | 2,757                | 3,836             |



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(Unaudited)

(Dollars in thousands, except per share amounts)

|   | Quarter Ended March<br>31, |                   |
|---|----------------------------|-------------------|
|   | 2013                       | 2014              |
| Operating Results:  |                            |                   |
| Revenues  | \$4,498                    | \$4,106           |
| Expenses  | 1,977                      | 2,555             |
| Net income  | 2,521                      | 1,551             |
| Earnings from unconsolidated investee   | 1,276                      | 776               |
| Set forth below are certain financial data for the aggregate of the Company's unconsolidated investees, including Alliance-HNI, LLC and Subsidiaries: |                            |                   |
|   | December 31,<br>2013       | March 31,<br>2014 |
| Balance Sheet Data:   |                            |                   |
| Current assets  | \$ 7,188                   | \$7,693           |
| Noncurrent assets   | 11,058                     | 12,090            |
| Current liabilities   | 3,569                      | 4,200             |
| Noncurrent liabilities  | 3,382                      | 4,337             |
|   |                            |                   |
|   | Quarter Ended March<br>31, |                   |
|   | 2013                       | 2014              |
| Combined Operating Results:   |                            |                   |
| Revenues  | \$6,737                    | \$6,431           |
| Expenses  | 3,591                      | 3,535             |
| Net income  | 3,146                      | 2,896             |
| Earnings from unconsolidated investees  | 1,542                      | 998               |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

March 31, 2014

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(Dollars in thousands, except per share amounts)

## 15. Stockholders' Deficit

The following table summarizes consolidated stockholders' deficit, including noncontrolling interest.

|  | Common Stock |        | Treasury Stock |           | Additional | Accumulated   | Stockholders' Equity |                     | Total           |             |
|--|--------------|--------|----------------|-----------|------------|---------------|----------------------|---------------------|-----------------|-------------|
|  | Shares       | Amount | Shares         | Amount    | Paid-In    | Comprehensive | Accumulated          | (Deficit)           | Attributable to |             |
|  |              |        |                |           | Capital    | Income        | Deficit              | Alliance HealthCare | Noncontrolling  |             |
|  |              |        |                |           |            | (Loss)        |                      | Services, Inc       | Stockholders'   |             |
|  |              |        |                |           |            |               |                      | Interest            | Deficit         |             |
| Balance at   |              |        |                |           |            |               |                      |                     |                 |             |
| January 1, 2014                                    | 10,667,136   | \$524  | (144,921)      | \$(2,998) | \$23,521   | \$(82)        | \$(204,709)          | \$(183,744)         | \$47,127        | \$(136,617) |
| Exercise of stock options                          | 7,667        | —      | —              | —         | 55         | —             | —                    | 55                  | —               | 55          |
| Issuance of restricted stock                       | —            | —      | (5,323)        | (140)     | —          | —             | —                    | (140)               | —               | (140)       |
| Share-based payment                                | —            | —      | —              | —         | 334        | —             | —                    | 334                 | —               | 334         |
| Unrealized gain on hedging transaction, net of tax | —            | —      | —              | —         | —          | 20            | —                    | 20                  | —               | 20          |
| Net investment in subsidiary                       | —            | —      | —              | —         | 1,700      | —             | —                    | 1,700               | (6,971)         | (5,271)     |
| Net income   | —            | —      | —              | —         | —          | —             | 1,931                | 1,931               | 3,049           | 4,980       |
| Balance at March 31, 2013                          | 10,674,803   | \$524  | (150,244)      | \$(3,138) | \$25,610   | \$(62)        | \$(202,778)          | \$(179,844)         | \$43,205        | \$(136,639) |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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(Dollars in thousands, except per share amounts)

## 16. Segment Information

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker (“CODM”) in deciding how to allocate resources and in assessing performance. In accordance with ASC 280, “Segment Reporting,” and based on the nature of the financial information that is received by the CODM, the Company operates in two operating segments, which are also its two reportable segments, Imaging and Radiation Oncology, based on similar economic and other characteristics.

The Imaging segment is comprised of diagnostic imaging services including MRI, PET/CT and other imaging services. The Radiation Oncology segment is comprised of radiation oncology services. All intercompany revenues, expenses, payables and receivables are eliminated in consolidation and are not reviewed when evaluating segment performance. Each segment’s performance is evaluated based on Revenue, Segment Income and Net Income. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in Note 1 of the Notes to the Consolidated Financial Statements on Form 10-K for the year ended December 31, 2013. Additionally, the Company does not consider its wholesale revenue and retail revenue sources to constitute separate operating segments as discrete financial information does not exist and is not provided to the CODM.

The following table summarizes the Company’s revenue by segment:

|                    | Quarter Ended March 31, |           |
|--------------------|-------------------------|-----------|
|                    | 2013                    | 2014      |
| Revenue            |                         |           |
| Imaging            | \$91,974                | \$84,638  |
| Radiation Oncology | 18,408                  | 20,727    |
| Total              | \$110,382               | \$105,365 |

The following are components of revenue:

|                                    | Quarter Ended March 31, |           |
|------------------------------------|-------------------------|-----------|
|                                    | 2013                    | 2014      |
| Revenue                            |                         |           |
| MRI revenue                        | \$46,081                | \$44,185  |
| PET/CT revenue                     | 36,750                  | 33,369    |
| Radiation Oncology revenue         | 18,408                  | 20,727    |
| Other modalities and other revenue | 9,143                   | 7,084     |
| Total                              | \$110,382               | \$105,365 |

Segment income represents net income (loss) before income taxes; interest expense and other, net; amortization expense; depreciation expense; share-based payment; severance and related costs; noncontrolling interest in subsidiaries; restructuring charges; transaction costs; impairment charges, loss on extinguishment of debt, other non recurring charges, and non-cash charges. Segment income is the most frequently used measure of each segment’s performance by the CODM and is commonly used in setting performance goals. The following table summarizes the Company’s segment income:



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|                    | Quarter Ended March 31, |          |
|--------------------|-------------------------|----------|
|                    | 2013                    | 2014     |
| Segment income     |                         |          |
| Imaging            | \$35,163                | \$31,010 |
| Radiation Oncology | 7,685                   | 9,322    |
| Corporate / Other  | (7,687                  | ) (7,380 |
| Total              | \$35,161                | \$32,952 |

The reconciliation of Net loss to total segment income is shown below:

|  | Quarter Ended March 31, |           |
|--|-------------------------|-----------|
|  | 2013                    | 2014      |
| Net (loss) income attributable to Alliance HealthCare Services, Inc.                   | \$(2,418                | ) \$1,931 |
| Income tax (benefit) expense   | (138                    | ) 1,507   |
| Interest expense and other, net  | 12,272                  | 6,238     |
| Amortization expense   | 3,794                   | 1,952     |
| Depreciation expense   | 16,516                  | 15,795    |
| Share-based payment (included in selling, general and administrative expenses)         | 406                     | 334       |
| Noncontrolling interest in subsidiaries  | 2,830                   | 3,049     |
| Restructuring charges (Note 2)   | 1,473                   | 1,025     |
| Transaction costs  | 80                      | 2         |
| Other non-recurring charges (included in selling, general and administrative expenses) | 317                     | 799       |
| Other non-cash charges (included in other income and expense, net)                     | 29                      | 320       |
| Total segment income   | \$35,161                | \$32,952  |

Net income for the Imaging and Radiation Oncology segments does not include charges for interest expense, net of interest income, income taxes or certain selling, general and administrative expenses. These costs are charged against the Corporate / Other segment. The following table summarizes the Company's net income (loss) by segment:

|                    | Quarter Ended March 31, |           |
|--------------------|-------------------------|-----------|
|                    | 2013                    | 2014      |
| Net (loss) income  |                         |           |
| Imaging            | \$19,652                | \$17,194  |
| Radiation Oncology | 1,249                   | 3,426     |
| Corporate / Other  | (23,319                 | ) (18,689 |
| Total              | \$(2,418                | ) \$1,931 |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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(Dollars in thousands, except per share amounts)

The following table summarizes the Company's identifiable assets by segment:

|                     | As of December 31,<br>2013 | As of March 31,<br>2014 |
|---------------------|----------------------------|-------------------------|
| Identifiable assets |                            |                         |
| Imaging             | \$ 240,317                 | \$ 208,949              |
| Radiation Oncology  | 158,216                    | 153,676                 |
| Corporate / Other   | 91,314                     | 102,636                 |
| Total               | \$ 489,847                 | \$ 465,261              |

The following table summarizes the Company's goodwill by segment:

|   | Imaging    | Radiation<br>Oncology | Corporate<br>/ Other | Total      |
|---|------------|-----------------------|----------------------|------------|
| Balance at January 1, 2013                | \$41,684   | \$ 14,809             | \$—                  | \$56,493   |
| Goodwill acquired during the period       | —          | —                     | —                    | —          |
| Impairment charges                        | —          | —                     | —                    | —          |
| Adjustments to goodwill during the period | 482        | —                     | —                    | 482        |
| Balance at December 31, 2013              | \$42,166   | \$ 14,809             | \$—                  | \$56,975   |
| Goodwill acquired during the period       | —          | —                     | —                    | —          |
| Impairment charges                        | —          | —                     | —                    | —          |
| Adjustments to goodwill during the period | —          | —                     | —                    | —          |
| Balance at March 31, 2014                 | \$42,166   | \$ 14,809             | \$—                  | \$56,975   |
| Gross goodwill                            | \$196,508  | \$34,711              | \$—                  | \$231,219  |
| Accumulated impairment charges            | (154,342 ) | (19,902 )             | —                    | (174,244 ) |
| Balance at March 31, 2014                 | \$42,166   | \$ 14,809             | \$—                  | \$56,975   |

Cash used for capital expenditures for the Imaging, Radiation Oncology and Corporate segments were \$2,067, \$0, and \$3,668, respectively, for the quarter ended March 31, 2014. Capital expenditures in the Imaging, Radiation Oncology and Corporate segments were \$2,013, \$413 and \$3,130, respectively, for the quarter ended March 31, 2013.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Overview

We are a leading national provider of advanced outpatient diagnostic imaging and radiation therapy services, based upon annual revenue and number of imaging systems deployed and radiation oncology centers operated. Our principal sources of revenue are derived from providing magnetic resonance imaging ("MRI"), positron emission tomography/computed tomography ("PET/CT") through our Imaging Division and radiation oncology services through our Radiation Oncology Division. Unless the context otherwise requires, the words "we," "us," "our," "Company" or "Alliance" as used in this Quarterly Report on Form 10-Q refer to Alliance HealthCare Services, Inc. and our direct and indirect subsidiaries. We provide imaging and therapeutic services primarily to hospitals and other healthcare providers on a shared-service and full-time service basis. We also provide services through fixed-site imaging centers, primarily to hospitals or health systems. Our imaging services normally include the use of our imaging systems, technologists to operate the systems, equipment maintenance and upgrades and management of day-to-day shared-service and fixed-site diagnostic imaging operations. We also provide non scan-based services, which include only the use of our imaging systems under a short-term contract. We have leveraged our leadership in MRI, PET/CT and radiology services to expand into radiation oncology, including stereotactic radiosurgery. We operate our radiation oncology business through our wholly owned subsidiary, Alliance Oncology, LLC, which we sometimes refer to as our Radiation Oncology Division. This division includes a wide range of services for cancer patients covering initial consultation, preparation for treatment, simulation of treatment, actual radiation oncology delivery, therapy management and follow-up care. Our services include the use of our linear accelerators or stereotactic radiosurgery systems, therapists to operate those systems, administrative staff, equipment maintenance and upgrades, and management of day-to-day operations.

### Key Aspects of Our Business

MRI, PET/CT and radiation oncology services generated 42%, 32% and 20% of our revenue, respectively, for the three months ended March 31, 2014 and 42%, 34% and 17% of our revenue, respectively, for the three months ended March 31, 2013. Our remaining revenue was comprised of other modality diagnostic imaging services revenue, primarily computed tomography ("CT") and management contract revenue. Other revenue in the first quarter of 2013 included professional radiology services, which was sold in December 2013. We operated 497 diagnostic imaging and radiation oncology systems, including 262 MRI systems (of which 19 are operating leases) and 121 PET/CT systems (of which 9 are operating leases) and served over 1,000 clients in 43 states at March 31, 2014. We operated 123 fixed-site imaging centers (one in an unconsolidated joint venture), which constitute systems installed in hospitals or other medical buildings on or near hospital campuses, including modular buildings, systems installed inside medical groups' offices, parked mobile systems, and free-standing fixed-site imaging centers, which include systems installed in medical office buildings, ambulatory surgical centers, or other retail space at March 31, 2014. Of the 123 fixed-site imaging centers (including one unconsolidated joint venture), 94 were MRI fixed-site imaging centers, 18 were PET/CT fixed-site imaging centers, eleven were other modality fixed-site imaging centers. We also operated 30 radiation oncology centers and stereotactic radiosurgery facilities (including one radiation oncology center as an unconsolidated joint venture) at March 31, 2014.

Revenues from fixed-site imaging centers and radiation oncology centers can be structured as either "wholesale" or "retail" revenues. We generated approximately 80% and 82% of our revenues for the three months ended March 31, 2014 and 2013, respectively, by providing services to hospitals and other healthcare providers, which we refer to as "wholesale" revenues. We typically generate our wholesale revenues from contracts that require our clients to pay us based on the number of scans we perform on patients on our clients' behalf, although some pay us a flat fee for a period of time regardless of the number of scans we perform. Wholesale payments are due to us independent of our clients' receipt of retail reimbursement from third-party payors, although receipt of reimbursement from third-party payors may affect demand for our services. We typically deliver our services for a set number of days per week through exclusive, long-term contracts with hospitals and other healthcare providers. The initial terms of these contracts average approximately three years in length for mobile services and approximately five to 10 years in length for fixed-site arrangements. Our contracts for radiation oncology services average approximately 10 to 20 years in

length. These contracts often contain automatic renewal provisions and certain contracts have cancellation clauses if the hospital or other healthcare provider purchases its own system. We price our contracts based on the type of system used, the scan volume, and the number of ancillary services provided. Competitive pressures also affect our pricing. We generated approximately 20% and 18% of our revenues for the three months ended March 31, 2014 and 2013, respectively, by providing services directly to patients from our sites located at or near hospitals or other healthcare provider facilities, which we refer to as "retail" revenues. We generate our revenue from these sites from direct billings to patients or their third-party payors, including Medicare, and we record this revenue net of contractual discounts and other arrangements for

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providing services at discounted prices. We typically receive a higher price per scan or treatment under retail billing than we do under wholesale billing.

#### Factors Affecting our Results of Operations

Our revenues, whether for wholesale or retail arrangements, are dependent directly or indirectly on third-party payor reimbursement policies, including Medicare. Please see Item 1, Business-Reimbursement in our 2013 Annual Report on Form 10-K for a more detailed explanation of how we bill and receive payment for our services.

The principal components of our cost of revenues include compensation paid to technologists, therapists, drivers and other clinical staff; system maintenance costs; insurance; medical supplies; system transportation; technologists' travel costs; and professional costs related to the delivery of radiation therapy and professional radiology interpretation services. Because a majority of these expenses are fixed, increased revenues as a result of higher scan and treatment volumes per system significantly improves our margins while lower scan and treatment volumes result in lower margins.

The principal components of selling, general and administrative expenses are sales and marketing costs, corporate overhead costs, provision for doubtful accounts, and share-based payment.

We record noncontrolling interest and earnings from unconsolidated investees related to our consolidated and unconsolidated subsidiaries, respectively. These subsidiaries primarily provide shared-service and fixed-site diagnostic imaging and radiation therapy services.

With respect to our retail business, for services for which we bill Medicare directly, we are paid under the Medicare Physician Fee Schedule, which is updated on an annual basis. Under the Medicare statutory formula, payments under the Physician Fee Schedule would have decreased for the past several years if Congress had failed to intervene. In the past, when the application of the statutory formula resulted in lower payment, Congress has passed interim legislation to prevent the reductions. For 2013, the Centers for Medicare & Medicaid Services ("CMS") projected an aggregate rate reduction of 26.5% from 2012 payment rates if Congress failed to intervene. This reduction was delayed by the enactment of the ATRA on January 2, 2013, which allowed for the continuation of 2012 physician payment rates by adopting a 0% update through December 31, 2013.

For 2014, CMS estimated that the statutory formula would result in a 20.1% reduction in physician payment rates if Congress failed to intervene. On December 26, 2013, President Obama signed into law the Bipartisan Budget Act of 2013 ("2013 Budget Act"), which replaced the payment reduction scheduled to take effect on January 1, 2014, with a 0.5% increase in physician payment rates for the period beginning January 1, 2014, and ending on March 31, 2014. On April 1, 2014, the physician payment rates enacted under the 2013 Budget Act were extended through March 31, 2015, when President Obama signed into law the Protecting Access to Medicare Act of 2014 ("PAMA"). There also have been a number of legislative initiatives to develop a permanent revision to the statutory formula. If Congress fails to extend the existing rates beyond the current March 31, 2015, deadline or otherwise fails to revise the statutory formula for future years to prevent substantial reductions to physician payment levels, the resulting decrease in payment will adversely affect our revenues and results of operations.

Also with respect to our retail business, for services furnished on or after July 1, 2010, CMS began implementing a 50% reduction in reimbursement for multiple images on contiguous body parts, as mandated by the PPACA.

Beginning January 1, 2011, CMS applied the same reduction to certain CT and CT angiography, MRI and MR angiography, and ultrasound services furnished to the same patient in the same session, regardless of the imaging modality, and not limited to contiguous body areas. CMS projected that this expanded policy would reduce payment for 20% more services than the prior multiple procedure payment reduction policy, and would primarily reduce payments for radiology services and to freestanding diagnostic imaging centers, such as our retail business. For 2012, CMS extended this policy to the physician reviews of these imaging services by implementing a 25% multiple procedure reduction to the professional payments to the specialties of radiology and interventional radiology. In addition, beginning in 2013, CMS expanded the 25% multiple-procedure reduction policy to certain other nuclear medicine and cardiovascular diagnostic procedures. At this time, we do not believe that these multiple procedure payment reductions will have a material effect on our future retail revenues.

Other recent legislative and regulatory updates to the Physician Fee Schedule included reduced payment rates for certain diagnostic services using equipment costing more than \$1 million through revisions to usage assumptions from the previous 50% usage rate to a 90% usage rate. This change began in 2010 with a planned four-year phase-in period

for MRI and CT scans, but not for radiation therapy and other therapeutic equipment. The PPACA superseded CMS's assumed usage rate for such equipment and, beginning on January 1, 2011, CMS instituted a 75% usage rate. Also in 2011, CMS expanded the list of services to which the higher equipment usage rate assumption applies to include certain diagnostic CTA and MRA procedures using similar CT and MRI scanners that cost more than \$1 million. Through enactment of the ATRA, Congress increased the

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usage rate assumption from 75% to 90% for fee schedules to be developed for 2014 and subsequent years. We currently estimate that the new usage assumptions for MRI and CT scans under the ATRA will not have a material adverse effect on our future retail revenues.

Effective January 1, 2011, CMS made further adjustments to the Physician Fee Schedule so that specialties that have a higher proportion of the payment rate attributable to operating expenses such as equipment and supplies, which include radiation oncology, will experience an increase in aggregate payments. In addition, as a result of adjustments to codes identified to be misvalued, radiation oncology specialties and suppliers providing the technical component of diagnostic tests are among the entities that will experience decreases in aggregate payment. Some of these changes are being transitioned over time; for 2013, CMS estimated aggregate payment reductions of 7% in radiation oncology, 3% in radiology, 3% in nuclear medicine, 7% for suppliers providing the technical component of diagnostic tests and 9% for radiation therapy centers. A portion of the payment reduction to radiation oncology and radiation therapy centers stems from revisions to the operating expenses and procedure time allotted to perform Intensity Modulated Radiation Therapy ("IMRT") and Stereotactic Body Radiotherapy ("SBRT"). CMS is also undertaking a review of procedure times allotted to other radiation oncology treatments. At this time, we do not believe that these regulatory changes will have a material effect on our future retail revenues.

In the Physician Fee Schedule for 2014, CMS made additional revisions to the formula it uses to account for physician time and practice expenses when calculating updates to the Physician Fee Schedule. CMS's revisions include changes to the Medicare Economic Index formula, which have the effect of redistributing some practice expense payment to the physician time component. This policy change, combined with the 90% usage rate assumption described above and various other adjustments for the 2014 Physician Fee Schedule, are projected to result in an aggregate payment increase of 1% in radiation oncology, no change to payments for nuclear medicine, and aggregate payment reductions of 2% in radiology, 11% for suppliers providing the technical component of diagnostic tests, and 1% for radiation therapy centers. At this time, we do not believe that these regulatory changes will have a material effect on our retail revenues.

In addition to annual updates to the Physician Fee Schedule, as indicated above, CMS also publishes regulatory changes to the hospital outpatient prospective payment system ("HOPPS") on an annual basis. These payments are bundled amounts received by our hospital clients for hospital outpatient services related to PET scans, PET/CT scans and SRS treatments. Recent adjustments to the HOPPS payments for these procedures have not had a material adverse effect on our revenue and earnings in 2011, 2012, 2013, or the first three months of 2014.

Beginning on April 1, 2013, the ATRA required CMS to equalize the HOPPS payment associated with Cobalt 60-based SRS treatments to the payment amount for the less-expensive, linac-based SRS treatment. In the final HOPPS rule for 2014, CMS equalized payments for the treatments by establishing a single new payment level derived from CMS claims data for both treatments, which results in a payment increase for linac-based treatments and a payment decrease for Cobalt 60-based treatments beginning January 1, 2014. In addition, beginning in 2014, CMS will utilize newly-available data to revise its estimate of hospitals' costs of providing CT and MRI services, which are used to calculate Medicare payments to hospitals for these services. The use of such data could result in payment reductions for CT and MRI procedures performed in the outpatient departments of our hospital clients. At this time, we do not believe that these changes will have a material adverse effect on our future revenues; however, we cannot predict the effect of future rate reductions on our future revenues or business.

Over the past few years, the growth rate of MRI industry wide scan volumes has slowed in part due to weak hospital volumes as reported by several investor-owned hospital companies, additional patient-related cost-sharing programs and an increasing trend of third-party payors intensifying their utilization management efforts, for example, through benefit managers who require prior authorizations to control the growth rate of imaging services generally. We expect that these trends will continue. One recent initiative to potentially reduce utilization of certain imaging services is the Medicare Imaging Demonstration, which is a two-year demonstration project designed to collect data regarding physician use of advanced diagnostic imaging services. This information would be used to determine the appropriateness of services by developing medical specialty guidelines for advanced imaging procedures within three designated modalities (MRI, CT and nuclear medicine). On February 2, 2011, CMS announced that it selected five participants for the demonstration project. The data collection portion of the demonstration concluded on April 1, 2012, and the 18-month intervention portion of the demonstration then went into effect, during which time the

appropriateness of a physician's order for diagnostic imaging services was considered at the time the order was entered into the decision support systems being tested. The demonstration concluded on September 30, 2013, and a report to Congress summarizing the results of the demonstration is expected by October 1, 2014. In addition, the PAMA requires CMS, in conjunction with medical specialty societies, to adopt appropriate use criteria (“AUC”) for certain advanced diagnostic imaging services by November 2015. Beginning in 2017, CMS must establish a program that promotes the use of AUC by requiring physicians who order and furnish advanced diagnostic imaging services to consult and report compliance with the AUC. Advanced imaging services ordered by certain physicians who do not adhere to the AUC will be subject to prior authorization for applicable imaging services provided to Medicare beneficiaries beginning in 2020.



We cannot predict the full impact of the PPACA and other recent and future legislative enactments on our business. The reform law substantially changed the way health care is financed by both governmental and private insurers. Although certain provisions may negatively affect payment rates for certain imaging services, the PPACA also extended coverage to an estimated 26 million previously uninsured people, which may result in an increase in the demand for our services. Other legislative changes have been proposed and adopted since the PPACA was enacted, which also may impact our business. On August 2, 2011, the President signed into law the Budget Control Act of 2011 (“BCA”), which, among other things, created the Joint Select Committee on Deficit Reduction to recommend proposals in spending reductions to Congress. The Joint Select Committee did not achieve its targeted deficit reduction of at least \$1.2 trillion for the years 2013 through 2021, triggering the legislation's automatic reduction to several government programs. These reductions include aggregate reductions to Medicare payments to providers of up to 2% per fiscal year, which were scheduled to go into effect on January 2, 2013. The enactment of the ATRA delayed the imposition of the automatic cuts until March 1, 2013. On March 1, 2013, the President signed an executive order implementing the automatic budget reductions. Pursuant to that order, payments to Medicare providers for services furnished on or after April 1, 2013 were reduced by 2%. The impact to our revenue related to this 2% reduction was approximately \$0.3 million in 2013 and is anticipated to be \$0.4 million in 2014. The 2013 Budget Act extended the 2% reduction in payments to Medicare providers by another two years (through 2023), and subsequent legislation extended the cuts through 2024. Unless Congress acts to repeal or revise the automatic budget cuts enacted by the BCA, this payment reduction will continue. The PAMA also included a new quality incentive payment policy that, beginning January 1, 2016, will reduce Medicare payments for certain CT services paid under the Physician Fee Schedule or HOPPS that are furnished using equipment that does not meet certain dose optimization and management standards. The full effect of the PPACA, BCA, ATRA, and PAMA on our business is uncertain, and it is not clear whether other legislative changes will be adopted or how those changes would affect the demand for our services. Payments to us by third-party payors depend substantially upon each payor's coverage and reimbursement policies. Third-party payors may impose limits on coverage or reimbursement for diagnostic imaging services, including denying reimbursement for tests that do not follow recommended diagnostic procedures. Coverage policies also may be expanded to reflect emerging technologies. Because unfavorable coverage and reimbursement policies have and may continue to constrict the profit margins of the hospitals and clinics we bill directly, we have and may continue to need to lower our fees to retain existing clients and attract new ones. If coverage is limited or reimbursement rates are inadequate, a healthcare provider might find it financially unattractive to own diagnostic imaging or radiation oncology systems, yet beneficial to purchase our services. It is possible that third-party coverage and reimbursement policies will affect the need or prices for our services in the future, which could significantly affect our financial performance and our ability to conduct our business.

#### Seasonality

We experience seasonality in the revenues and margins generated for our services. First and fourth quarter revenues are typically lower than those from the second and third quarters. First quarter revenue is affected primarily by fewer calendar days and inclement weather, typically resulting in fewer patients being scanned or treated during the period. Fourth quarter revenues are affected by holiday and client and patient vacation schedules, resulting in fewer scans or treatments during the period. The variability in margins is higher than the variability in revenues due to the fixed nature of our costs. We also experience fluctuations in our revenues and margins due to acquisition activity and general economic conditions, including recession or economic slowdown.

## Results of Operations

The following table shows our consolidated statements of operations as a percentage of revenues for each of the quarters ended March 31:

|   | Quarter Ended<br>March 31, |         |  |   |
|---|----------------------------|---------|--|---|
|   | 2013                       | 2014    |  |   |
| Revenues  | 100.0                      | % 100.0 |  | % |
| Costs and expenses:   |                            |         |  |   |
| Cost of revenues, excluding depreciation and amortization   | 54.9                       | 54.0    |  |   |
| Selling, general and administrative expenses  | 17.3                       | 17.8    |  |   |
| Transaction costs   | 0.1                        | —       |  |   |
| Severance and related costs   | 0.3                        | 0.1     |  |   |
| Depreciation expense  | 15.0                       | 15.0    |  |   |
| Amortization expense  | 3.4                        | 1.9     |  |   |
| Interest expense and other, net   | 11.1                       | 5.9     |  |   |
| Other (income) and expense, net   | (0.8)                      | ) 0.1   |  |   |
| Total costs and expenses  | 101.3                      | 94.8    |  |   |
| (Loss) income before income taxes, earnings from unconsolidated investees and noncontrolling interest | (1.3)                      | ) 5.2   |  |   |
| Income tax (benefit) expense  | (0.1)                      | ) 1.4   |  |   |
| Earnings from unconsolidated investees  | (1.6)                      | ) (0.9) |  | ) |
| Net income  | 0.4                        | 4.7     |  |   |
| Less: Net income attributable to noncontrolling interest, net of tax                                  | (2.6)                      | ) (2.9) |  | ) |
| Net (loss) income attributable to Alliance HealthCare Services, Inc.                                  | (2.2)                      | )% 1.8  |  | % |

The table below provides MRI statistical information for the quarters ended March 31:

|   | Quarter Ended<br>March 31, |          |
|---|----------------------------|----------|
|   | 2013                       | 2014     |
| MRI statistics                                |                            |          |
| Average number of total systems               | 257.7                      | 252.4    |
| Average number of scan-based systems          | 215.7                      | 209.4    |
| Scans per system per day (scan-based systems) | 8.18                       | 8.14     |
| Total number of scan-based MRI scans          | 114,991                    | 111,187  |
| Price per scan                                | \$360.42                   | \$353.32 |

The table below provides PET/CT statistical information for each of the quarters ended March 31:

|                                      | Quarter Ended<br>March 31, |        |
|--------------------------------------|----------------------------|--------|
|                                      | 2013                       | 2014   |
| PET/CT statistics                    |                            |        |
| Average number of systems            | 111.3                      | 110.8  |
| Scans per system per day             | 5.64                       | 5.36   |
| Total number of PET and PET/CT scans | 37,301                     | 33,757 |
| Price per scan                       | \$963                      | \$959  |

The table below provides Radiation oncology statistical information for each of the quarters ended March 31:

|                                       | Quarter Ended<br>March 31, |        |
|---------------------------------------|----------------------------|--------|
|                                       | 2013                       | 2014   |
| Radiation oncology statistics         |                            |        |
| Number of radiation oncology centers* | 28                         | 30     |
| Linac treatments                      | 14,675                     | 18,004 |
| Stereotactic radiosurgery patients    | 635                        | 681    |

\*Number of radiation oncology centers operated as of March 31, 2013 and 2014 included one unconsolidated joint venture.

Following are the components of revenue (in millions) for each of the quarters ended March 31:

|                                    | Quarter Ended<br>March 31, |         |
|------------------------------------|----------------------------|---------|
|                                    | 2013                       | 2014    |
| Total MRI revenue                  | \$46.1                     | \$44.2  |
| PET/CT revenue                     | 36.8                       | 33.4    |
| Radiation oncology revenue         | 18.4                       | 20.7    |
| Other modalities and other revenue | 9.1                        | 7.1     |
| Total                              | \$110.4                    | \$105.4 |

|   | Quarter Ended<br>March 31, |        |
|---|----------------------------|--------|
|   | 2013                       | 2014   |
| Total fixed-site imaging center revenue (in millions) | \$29.9                     | \$26.3 |

#### Quarter Ended March 31, 2014 Compared to Quarter Ended March 31, 2013

Revenue decreased \$5.0 million, or 4.5%, to \$105.4 million in the first quarter of 2014 compared to \$110.4 million in the first quarter of 2013 mostly due to decreases in MRI and PET/CT revenues of \$5.3 million, and a decrease of \$2.1 million in other revenues, mostly attributed to the sale of our professional services business in December 2013. These decreases were partially offset by an increase in radiation oncology revenue of \$2.3 million, due to an increase in patient volume and number of treatments performed.

MRI revenue decreased \$1.9 million in the first quarter of 2014, or 4.1%, compared to the first quarter of 2013. Scan-based MRI revenue decreased \$2.2 million in the first quarter of 2014, or 5.2%, compared to the first quarter of 2013, to \$39.3 million in the first quarter of 2014 from \$41.4 million in the first quarter of 2013. The decrease in scan-based MRI revenue was primarily due to year-over-year decreases in the average price per MRI scan and average number of scan-based systems in service. The average price per MRI scan decreased to \$353.32 per scan in the first quarter of 2014 from \$360.42 per scan in the first quarter of 2013. The average number of scan-based systems in service decreased to 209.4 systems in the first quarter of 2014 from 215.7 systems in the first quarter of 2013. Average scans per system per day decreased 0.5% to 8.14 in the first quarter of 2014 from 8.18 in the first quarter of 2013. Scan-based MRI scan volume decreased 3.3% to 111,187 scans in the first quarter of 2014 from 114,991 scans in the first quarter of 2013, primarily due to severe weather conditions during the first quarter of 2014, which historically has resulted in fewer patients being scanned or treated during the period. Non scan-based MRI revenue increased \$0.3 million in the first quarter of 2014 over the same period in 2013. Included in the revenue totals above are fixed-site imaging center revenues, which decreased \$3.6 million to \$26.3 million in the first quarter of 2014 from \$29.9 million in the first quarter of 2013.

PET/CT revenue in the first quarter of 2014 decreased \$3.4 million, or 9.2%, compared to the first quarter of 2013 primarily due to a decrease in the average price per PET/CT scan, which averaged \$959 per scan in the first quarter of 2014 compared to \$963 per scan in the first quarter of 2013. The average number of PET/CT systems in service

decreased to 110.8 systems in the first quarter of 2014 from 111.3 systems in the first quarter of 2013. Total PET/CT scan volumes decreased from

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37,301 scans in the first quarter of 2013 to 33,757 scans in the first quarter of 2014. Scans per system per day decreased to 5.4 in the first quarter of 2014 from 5.6 in the first quarter of 2013.

Radiation oncology revenue increased \$2.3 million, or 12.6%, to \$20.7 million in the first quarter of 2014 compared to \$18.4 million in the first quarter of 2013, primarily due to a 22.7% increase in the number of Linac treatments performed in the first quarter of 2014, compared to the first quarter of 2013 and a 7.2% increase in the number of SRS patients we treated. Also, during the first quarter of 2014, Alliance Oncology commenced the strategic affiliation with the Medical University of South Carolina, for which results are included in the revenue increase.

Other modalities and other revenue decreased \$2.1 million, or 22.5%, to \$7.1 million in the first quarter of 2014 compared to \$9.1 million in the first quarter of 2013, mostly attributed to the sale of our professional services business in December 2013.

At March 31, 2014 we operated 262 MRI systems and 121 PET/CT systems, including 19 MRI systems and nine PET/CT systems on operating leases as a result of our sale and lease transaction that occurred in the fourth quarter of 2012. We had 265 MRI systems and 119 PET/CT systems at March 31, 2013, including 19 MRI systems and nine PET/CT systems on operating leases as a result of our sale and lease transaction. We operated 123 fixed-site imaging centers (including one in an unconsolidated investee) at March 31, 2014, compared to 129 fixed-site imaging centers (including one in an unconsolidated joint venture) at March 31, 2013. We operated 30 radiation oncology centers (including one in an unconsolidated joint venture) at March 31, 2014, compared to 28 radiation oncology centers (including one unconsolidated investee) at March 31, 2013.

Cost of revenues, excluding depreciation and amortization, decreased \$3.7 million, or 6.1%, to \$56.9 million in the first quarter of 2014 compared to \$60.6 million in the first quarter of 2013. The decrease in cost of revenues is primarily due to a \$2.5 million, or 53.1%, decrease in outside medical services expense due to lower radiology fees related to the sale of our professional services business. Maintenance and related costs decreased \$0.6 million, or 4.7%, due to negotiating lower service contract costs and a smaller asset base. Renegotiating with service contract providers and medical supply vendors is one of our cost reduction initiatives. Costs related to medical supplies decreased \$0.3 million, or 6.9%, due to lower PET/CT scan volumes. Compensation and related employee expenses increased \$0.1 million, or 0.3%. All other cost of revenues, excluding depreciation and amortization, decreased \$0.2 million, or 3.0%. Cost of revenues, as a percentage of revenue, decreased to 54.0% in the first quarter of 2014, compared to 54.9% in the first quarter of 2013.

Selling, general and administrative expenses decreased \$0.4 million, or 1.9%, to \$18.7 million in the first quarter of 2014 compared to \$19.1 million in the first quarter of 2013. Decreases to selling, general and administrative expenses include a \$0.1 million decrease in compensation and related employee expenses and a decrease to the provision for doubtful accounts increased \$0.2 million, or 16.3%. The provision for doubtful accounts as a percentage of revenue was 0.8% in the first quarter of 2014 compared to 0.9% in the first quarter of 2013. Stock-based compensation expense decreased \$0.1 million in the first quarter of 2014 compared to the first quarter of 2013. All other selling, general and administrative expenses decreased \$0.1 million, or 2.2%. Selling, general and administrative expenses as a percentage of revenue was 17.8% in the first quarter of 2014 compared to 17.3% in the first quarter of 2013. Severance and related costs decreased \$0.2 million, or 61.8%, to \$0.1 million in the first quarter of 2014 compared to \$0.3 million in the first quarter of 2013, due to strategic restructuring activities in 2013 related to our cost savings and efficiency initiatives.

Depreciation expense decreased \$0.7 million, or 4.4%, to \$15.8 million in the first quarter of 2014 compared to \$16.5 million in the first quarter of 2013 due to the decision to upgrade units we currently own as an alternative to purchasing new equipment, and a decrease in the total number of units we own and centers we operate.

Amortization expense decreased \$1.8 million, or 48.6%, to \$2.0 million in the first quarter of 2014 compared to \$3.8 million in the first quarter of 2013. This decrease is primarily due to lower amortization charges related intangible assets that were impaired or written off in the latter half of 2013.

Interest expense and other, net decreased \$6.0 million, or 49.2%, to \$6.2 million in the first quarter of 2014 compared to \$12.3 million in the first quarter of 2013, primarily due to the \$15.0 million debt repayment made in the first quarter of 2013 and the refinancing of our term loan in June 2013, whereby our interest rate decreased to LIBOR plus 3.25%, compared to LIBOR plus 5.25%, and lowered our LIBOR floor from 2% to 1%. In addition, we redeemed all \$190.0 million of our 8% Notes with funds borrowed under our new credit agreement and cash on-hand. The interest

rate pertaining to the amount borrowed under the incremental term loan to redeem the Notes conforms to the rates previously discussed above.

Income tax expense was \$1.5 million in the first quarter of 2014 compared to \$0.1 million tax benefit in the first quarter of 2013. Our effective tax rates differed from the federal statutory rate principally as a result of state income taxes and

permanent non-deductible tax items, including share-based compensation, unrecognized tax benefits and other permanent differences.

Earnings from unconsolidated investees decreased \$0.7 million, or 42.4%, to \$1.0 million in the first quarter of 2014 compared to \$1.7 million in the first quarter of 2013.

Net income attributable to noncontrolling interest increased \$0.2 million, or 7.7%, to \$3.0 million in the first quarter of 2014 compared to \$2.8 million in the first quarter of 2013.

Net income attributable to Alliance HealthCare Services, Inc. was \$1.9 million, or \$0.18 per share on a diluted basis, in the first quarter of 2014 compared to a net loss of \$2.4 million, or \$(0.23) per share on a diluted basis, in the first quarter of 2013.

#### Liquidity and Capital Resources

Our primary source of liquidity is cash provided by operating activities. We generated \$19.0 million and \$10.5 million of cash flow from operating activities in the first three months of 2014 and 2013, respectively. Our ability to generate cash flow is affected by numerous factors, including demand for MRI, PET/CT, other diagnostic imaging and radiation oncology services. Our ability to generate cash flow from operating activities is also dependent upon the collections of our accounts receivable. The provision for doubtful accounts decreased by \$0.2 million in the first three months of 2014 compared to the first three months of 2013. Our number of days of revenue outstanding for our accounts receivable increased to 51 days as of March 31, 2014, compared to 50 days as of March 31, 2013. We believe this number is comparable, or better than, other diagnostic imaging and radiation oncology providers. As of March 31 2014, we had \$45.9 million of available borrowings under our revolving line of credit, net of outstanding letters of credit.

We used cash of \$4.1 million and \$1.3 million for investing activities in the three months ended March 31, 2014 and 2013, respectively. Investing activities during the first three months of 2014 included \$0.1 million of proceeds from sales of assets and \$1.5 million in cash provided by deposits for equipment.

While we had no acquisition activity in the first quarter of 2014, we may use cash for acquisitions in the future. Other than acquisitions, our primary use of capital resources is to fund capital expenditures. We spend capital:

- to purchase new systems;
- to replace less advanced systems with new systems;
- to upgrade MRI, PET/CT and radiation oncology systems; and
- to upgrade our corporate infrastructure, primarily in information technology.

Capital expenditures totaled \$5.7 million and \$5.6 million during the three months ended March 31, 2014 and 2013, respectively. We purchased one MRI system and other imaging equipment, upgraded various imaging equipment, and traded-in or sold a total of four systems during the three months ended March 31, 2014. We expect to purchase additional systems in 2014 and finance substantially all of these purchases with our available cash, cash from operating activities and equipment leases. Based upon the client demand described above, which dictates the amount and type of equipment we purchase and upgrade, we expect capital expenditures to total approximately \$52 million to \$62 million in 2014.

At March 31, 2014, we had cash and cash equivalents of \$29.1 million. This available cash and cash equivalents are held in accounts managed by third-party financial institutions and consist of invested cash and cash in our operating accounts. The invested cash is invested in interest-bearing funds managed by third-party financial institutions. These funds invest in high-quality money market instruments, primarily direct obligations of the government of the United States. To date, we have experienced no loss or lack of access to our invested cash or cash equivalents; however, we cannot assure you that access to our invested cash and cash equivalents will not be affected by adverse conditions in the financial markets.

At March 31, 2014, we had \$22.9 million in our accounts with third-party financial institutions that exceed the Federal Deposit Insurance Corporation ("FDIC") insurance limits. While we monitor daily the cash balances in our operating accounts and adjust the cash balances as appropriate, these cash balances could be adversely affected if the underlying financial institutions fail or could be subject to other adverse conditions in the financial markets. To date, we have experienced no loss or lack of access to cash in our operating accounts.

We believe that, based on current levels of operations, our cash flow from operating activities, together with other available sources of liquidity, including borrowings available under our revolving line of credit, will be sufficient over the next one to two years to fund anticipated capital expenditures and potential acquisitions and make required payments of principal

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and interest on our debt and other contracts. As of March 31, 2014, we were in compliance with all covenants contained in our long-term debt agreements and expect that we will be in compliance with these covenants for the remainder of 2014.

If our remaining ability to borrow under our revolving and incremental term loan credit facility is insufficient for our capital requirements, we will be required to seek additional sources of financing, including issuing equity, which may be dilutive to our current stockholders, or incurring additional debt. Our ability to incur additional debt is subject to the restrictions in our existing credit facility. We cannot assure you that the restrictions contained in the existing credit facility will permit us to borrow the funds that we need to finance our operations, or that additional debt will be available to us on commercially reasonable terms or at all. If we are unable to obtain funds sufficient to finance our capital requirements, we may have to forego opportunities to expand our business.

In October 2012, we raised \$30.0 million from the sale of certain imaging assets, which we then leased from the purchasers under competitive terms. The \$30.0 million in proceeds from the sale and lease transactions was used in its entirety to permanently reduce borrowings outstanding under the then-existing term loan facility. As a result, we incur \$8.0 million of annual rent expense in connection with the sale and lease transaction.

On June 3, 2013, we replaced our existing credit facility with a new senior secured credit agreement with Credit Suisse AG, Cayman Islands Branch, as administrative agent, and the other lenders party thereto (the "Credit Agreement"). The Credit Agreement consists of (i) a \$340.0 million, six-year term loan facility, (ii) a \$50.0 million, five-year revolving loan facility, including a \$20.0 million sublimit for letters of credit, (iii) uncommitted incremental loan facilities of \$100.0 million of revolving or term loans, plus an additional amount if our pro forma leverage ratio is less than or equal to 3.25, subject to receipt of lender commitments and satisfaction of specified conditions, and (iv) an \$80.0 million delayed draw term loan facility, which was required to be drawn within thirty days of June 3, 2013 and was used for the redemption of our 8% Senior Notes due 2016 (the "Notes") in the original aggregate principal amount of \$190.0 million.

On July 3, 2013 the delayed draw term loan facility was utilized together with other available funds, of which the proceeds were used to redeem \$80.0 million in aggregate principal amount of our outstanding Notes. The delayed draw term loan facility converted into, and matched the terms of, the new \$340.0 million term loan facility.

As a result of these transactions, we recognized a loss on extinguishment totaling \$17.1 million for unamortized deferred financing costs and the discount related to the former credit facility. Additionally, \$1.5 million and \$3.2 million of expense was incurred for unamortized deferred costs and associated discount, and the related call premium, respectively, related to the redemption of the Notes.

Borrowings under the Credit Agreement bear interest through maturity at a variable rate based upon, at our option, either the London interbank offered rate ("LIBOR") or the base rate (which is the highest of the administrative agent's prime rate, one-half of 1.00% in excess of the overnight federal funds rate, and 1.00% in excess of the one-month LIBOR rate), plus, in each case, an applicable margin. With respect to the term loan facilities, the applicable margin for LIBOR loans is 3.25% per annum, and with respect to the revolving loan facilities, the applicable margin for LIBOR loans ranges, based on the applicable leverage ratio, from 3.00% to 3.25% per annum, in each case, with a LIBOR floor of 1.00%. The applicable margin for base rate loans under the term loan facilities is 2.25% per annum and under the revolving loan facility ranges, based on the applicable leverage ratio, from 2.00% to 2.25% per annum. Prior to the refinancing of the term loan facilities, the applicable margin for base rate loans was 4.25% per annum and the applicable margin for revolving loans was 5.25% per annum, with a LIBOR floor of 2.00%. We are required to pay a commitment fee which ranges, based on the applicable leverage ratio, from 0.375% to 0.50% per annum on the undrawn portion available under the revolving loan facility and variable per annum fees with respect to outstanding letters of credit.

During the first five and three-quarter years after the closing date, and including the full amount of the delayed draw term loan facility, we are required to make quarterly amortization payments of the term loans in the amount of \$1.05 million. We are also required to make mandatory prepayments of term loans under the Credit Agreement, subject to specified exceptions, from excess cash flow (as defined in the Credit Agreement), and with the proceeds of asset sales, debt issuances and specified other events.

Obligations under the Credit Agreement are guaranteed by substantially all our direct and indirect domestic subsidiaries. The obligations under the Credit Agreement and the guarantees are secured by a lien on substantially all

tangible and intangible property, and by a pledge of all of the shares of stock and limited liability company interests of our direct and indirect domestic subsidiaries, of which we now own or later acquire more than a 50% interest, subject to limited exceptions.

In addition to other covenants, the Credit Agreement places limits on our ability, including our subsidiaries, to declare dividends or redeem or repurchase capital stock, prepay, redeem or purchase debt, incur liens and engage in sale-leaseback transactions, make loans and investments, incur additional indebtedness, amend or otherwise alter debt and other material agreements, engage in mergers, acquisitions and asset sales, transact with affiliates and alter the business we and our subsidiaries conduct.

The Credit Agreement also contains a leverage ratio covenant requiring us to maintain a maximum ratio of consolidated total debt to consolidated adjusted EBITDA that ranges from 4.95 to 1.00 to 4.30 to 1.00. At March 31 2014, the Credit Agreement requires a maximum leverage ratio of not more than 4.95 to 1.00. The Credit Agreement eliminated the interest coverage ratio covenant which we were subject to maintain prior to the refinancing. Failure to comply with the covenants in the Credit Agreement could permit the lenders under the Credit Agreement to declare all amounts borrowed under the Credit Agreement, together with accrued interest and fees, to be immediately due and payable, and to terminate all commitments under the Credit Agreement.

In September 2013, we repurchased \$8.8 million in principal amount of our Notes in privately negotiated transactions. We immediately incurred \$0.2 million of expense related to unamortized deferred costs and associated discount, as well as \$0.3 million for the related call premium.

On October 11, 2013, the Company entered into an amendment to the Credit Agreement with Credit Suisse AG, Cayman Islands Branch, as administrative agent, and the other lenders party thereto (the "First Amendment"). Pursuant to the First Amendment, the Company raised \$70 million in incremental term loan commitments to repurchase the remaining outstanding Notes. On December 2, 2013, the Company borrowed \$70 million of incremental term loans, and with such proceeds plus borrowings under its revolving line of credit and cash on hand, completed the redemption of its outstanding Notes on December 4, 2013. With the completion of this transaction including the redemption in full of the Notes, the Company expects to save approximately \$5 million in cash interest on an annualized basis. As a result of this transaction, we recognized a loss on extinguishment totaling \$3.8 million including \$1.7 million of expense related to unamortized deferred costs and associated discount, as well as \$2.0 million for the related call premium.

The incremental term loans were funded at 99.0% of principal amount and will mature on the same date as the existing term loan facility under the Company's credit facility on June 3, 2019. Upon funding, the incremental term loans were converted to match all the terms of existing term loans. Interest on the incremental term loan is calculated, at the Company's option, at a base rate plus a 2.25% margin or LIBOR plus a 3.25% margin, subject to a 1.00% LIBOR floor.

As of March 31, 2014, there was \$486.5 million outstanding under the new term loan facility and \$8.0 million in borrowings under the new revolving credit facility. As of March 31, 2014, our ratio of consolidated total debt to Consolidated Adjusted EBITDA calculated pursuant to the Credit Agreement was 3.54 to 1.00.

During the first five and one half years after the closing date for the incremental term loan, the quarterly amortization payments of all term loans under the credit facility has increased to \$1.23 million from the previous amount of \$1.05 million.

Our obligations under the incremental term loans are guaranteed by substantially all our direct and indirect domestic subsidiaries. The obligations under the incremental term loan and the guarantees are secured by a lien on substantially all of the our tangible and intangible property, and by a pledge of all of the shares of stock and limited liability company interests of the our direct and indirect domestic subsidiaries, of which we own or later acquire more than a 50% interest, subject to limited exceptions.

#### Recent Accounting Pronouncements

For a discussion of recent accounting pronouncements, please refer to Note 4 of the Notes to Condensed Consolidated Financial Statements.

#### Cautionary Statement Pursuant to the Private Securities Litigation Reform Act of 1995

Certain statements contained in Management's Discussion and Analysis of Financial Condition and Results of Operations, particularly in the sections entitled "Overview," "Results of Operations" and "Liquidity and Capital Resources," and elsewhere in this Quarterly Report on Form 10-Q, are "forward-looking statements," within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

In some cases you can identify these statements by forward-looking words, such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "seek," "intend" and "continue" or similar words. Forward-looking statements may use different phrases. Forward-looking statements address, among other things, our future expectations, projections of our future results of operations or of our financial condition and other forward-looking information and include statements related to the Company's cost-savings and long-term growth, including its efforts to stabilize and grow the Imaging Division, grow the Radiation Oncology Division, divest our professional radiology services business, and

increase organizational efficiency.

Statements regarding the following subjects, among others, are forward-looking by their nature:

(a) future legislation and other healthcare regulatory reform actions, and the effect of that legislation and other regulatory actions on our business,

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- (b) our expectations with respect to future MRI, PET/CT and radiation oncology volumes and revenues,
- (c) the effect of seasonality on our business,
- (d) our expectations with respect to the sufficiency of our liquidity over the next one to two years,
- (e) our expectations with respect to capital expenditures in 2014, and
- (f) the effect of recent accounting pronouncements on our results of operations and cash flows or financial position.

We believe it is important to communicate our expectations to our investors. There may be events in the future, however, that we are unable to predict accurately or that we do not fully control that cause actual results to differ materially from those expressed or implied by our forward-looking statements, including:

- our high degree of leverage and our ability to service our debt;
  - factors affecting our leverage, including interest rates;
  - the risk that the counterparties to our interest rate swap agreements fail to satisfy their obligations under those agreements;
  - our ability to obtain financing;
  - the effect of operating and financial restrictions in our debt instruments;
  - the accuracy of our estimates regarding our capital requirements;
  - intense levels of competition in our industry;
  - changes in the rates or methods of third-party reimbursements for diagnostic imaging and radiation oncology services;
  - fluctuations or unpredictability of our revenues, including as a result of seasonality;
  - changes in the healthcare regulatory environment;
  - our ability to keep pace with technological developments within our industry;
  - the growth or decline in the market for MRI and other services;
  - the disruptive effect of hurricanes and other natural disasters;
  - adverse changes in general domestic and worldwide economic conditions and instability and disruption of credit and equity markets;
  - our ability to successfully integrate acquisitions; and
- other factors discussed under Risk Factors in our Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, for the fiscal year ended December 31, 2013 and that are otherwise described or updated from time to time in our SEC reports by us.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We provide our services exclusively in the United States and receive payment for our services exclusively in United States dollars. As a result, our financial results are unlikely to be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets.

Our interest expense is sensitive to changes in the general level of interest rates in the United States, particularly because the majority of our indebtedness has interest rates which are variable. The recorded carrying amount of our long-term debt under our Credit Agreement approximates fair value as these borrowings have variable rates that reflect currently available terms and conditions for similar debt. To decrease the risk associated with interest rate increases, we have entered into multiple interest rate swap and cap agreements for a portion of our variable rate debt. These swaps and cap are designated as cash flow hedges of variable future cash flows associated with our long-term debt.

In the first quarter of 2010, we entered into three interest rate cap agreements (the "2010 Caps") to avoid unplanned volatility in the income statement due to changes in the London Interbank Offering Rate ("LIBOR") interest rate environment. The interest rate cap agreements matured in February 2014, had a total notional amount of \$150 million and were de-designated as cash flow hedges associated with the Company's variable rate bank debt in the fourth quarter of 2013.

In the second quarter of 2011, we acquired two interest rate swap agreements (the "USR Swaps") as part of the acquisition of USR. One of the USR Swaps, which matures in October 2015, had a notional amount of \$1.7 million as of March 31, 2014. Under the terms of this agreement, we receive one-month LIBOR and pay a fixed rate of 5.71%. The net effect of the hedge is to record interest expense at a fixed rate of 8.71%, as the underlying debt incurred interest based on one-month LIBOR plus 3.00%. The other USR Swap, which matures in April 2014, had a notional amount of \$0.1 million as of March 31, 2014. Under the terms of this agreement, we receive one-month LIBOR and pay a fixed rate of 4.15%. The net effect of the hedge is to record interest expense at a fixed rate of 6.15%, as the underlying debt incurred interest based on one-month LIBOR plus 2.00%. As a result of the acquisition of USR, the USR Swaps were de-designated, hedge accounting was terminated and all further changes in the fair market value of these swaps are being recorded in interest expense and other, net. Settlement amounts under these swap agreements were not material for the three months ended March 31, 2014.

In the fourth quarter of 2012, we entered into an interest rate swap agreement in connection with equipment financing. The swap, which matures in December 2017, had a notional amount of \$4.0 million as of March 31, 2014. Under the terms of this agreement, we receive one-month LIBOR plus 2.50% and pay a fixed rate of 3.75%. The net effect of the hedge is to convert interest expense to a fixed rate of 3.75%, as the underlying debt incurred interest based on one-month LIBOR plus 2.50%.

In the first quarter of 2013, we entered into an interest rate swap agreement in connection with equipment financing. The swap, which matures in April 2018, had a notional amount of \$3.6 million as of March 31, 2014. Under the terms of this agreement, we receive one-month LIBOR plus 2.00% and pay a fixed rate of 2.87%. The net effect of the hedge is to convert interest expense to a fixed rate of 2.87%, as the underlying debt incurred interest based on one-month LIBOR plus 2.00%.

In the fourth quarter of 2013, we entered into five interest rate cap agreements ("2013 Caps") to avoid unplanned volatility in the income statement due to changes in the LIBOR interest rate environment. The 2013 Caps, which mature in December 2016, had a notional amount of \$250.0 million and were designated as cash flow hedges of future cash interest payments associated with a portion of our variable rate bank debt. Under these arrangements, we purchased a cap on LIBOR at 2.50%. We paid \$0.8 million to enter into the 2013 Caps, which is being amortized through interest expense and other, net over the life of the agreements. Upon purchase of the 2013 Caps, the 2010 Cap agreements were de-designated as cash flow hedges.

Our interest income is sensitive to changes in the general level of interest rates in the United States, particularly because the majority of our investments are in cash equivalents. We maintain our cash equivalents in financial instruments with original maturities of 90 days or less. Cash and cash equivalents are invested in interest bearing funds managed by third-party financial institutions. These funds invest in high-quality money market instruments, primarily direct obligations of the government of the United States. At March 31, 2014, we had cash and cash equivalents of \$29.1 million, of which \$22.9 million was held in accounts that are with third-party financial

institutions which exceed the FDIC insurance limits. At March 31, 2013, we had cash and cash equivalents of \$30.7 million, of which \$23.7 million was held in accounts that are with third-party financial institutions which exceed the FDIC insurance limits.

#### ITEM 4. CONTROLS AND PROCEDURES

##### Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports 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 Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, 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 management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Also, we have investments in certain unconsolidated entities. As we do not control or manage these entities, our disclosure controls and procedures with respect to such entities are more limited than those we maintain with respect to our consolidated subsidiaries. These unconsolidated entities are not considered material to our consolidated financial position or results of operations.

As required by SEC Rule 13a-15(b), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief 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 the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

##### Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



## PART II—OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

From time to time, we are involved in routine litigation incidental to the conduct of our business. We believe that none of this litigation pending against us will have a material adverse effect on our business.

In connection with our acquisition of Medical Outsourcing Services, LLC (“MOS”) in the third quarter of 2008, we subsequently identified a Medicare billing practice related to a portion of MOS’s retail billing operations that raised compliance issues under Medicare reimbursement guidelines. The practice was in place before the acquisition and was discontinued when we became aware of it. In accordance with our corporate compliance program, we have entered into discussions with representatives of the federal government to advise them of the issue and seek guidance on appropriate next steps. The discussions are ongoing and no resolution has yet been reached.

In June 2010, we commenced arbitration proceedings against the former owners of MOS related to the Medicare billing matter, in addition to certain other indemnification issues. In the arbitration, we asserted claims of fraud and breach of representations and warranties.

On December 29, 2011, we received notice of an award by the arbitration panel, which awarded us \$2.5 million in damages for breach of contract claims, plus prejudgment interest at 9% under New York law from July 29, 2008 (which interest continues to accrue until the award is paid in full); \$0.3 million for two other indemnification claims; \$1.5 million for attorneys’ fees and expenses; and \$0.1 million for arbitration expenses. The award also provides that approximately \$1.3 million of a remaining indemnification cap created in connection with the acquisition is available for future indemnification claims, including with respect to the potential government claim discussed above, and must be satisfied by the former owners of MOS. On January 25, 2012, one of the former owners of MOS paid \$0.7 million to us, and on February 17, 2012, the same owner released \$0.6 million to us from amounts held in an indemnification escrow related to the acquisition. On January 25, 2012, we filed an action in the United States District Court for the Northern District of Illinois to confirm the award as a judgment against the other former owner of MOS that has refused to satisfy its obligations under the award.

In the first quarter of 2013, the former owners of MOS paid \$1.2 million which amount represented the remaining amount of the indemnification cap created in connection with the acquisition. This amount was in addition to \$5.3 million we already recovered from the former owners of MOS in connection with the arbitration award against them. With this final payment, the former owners of MOS have now fully satisfied their obligations to us under the arbitration award. Following receipt of the final payments from the former owners of MOS, we then entered into a settlement agreement to resolve the government’s investigation of the Medicare billing practices engaged in by MOS prior to our acquisition. Under the terms of the settlement agreement, we paid \$2.4 million to the government, which amount was paid primarily from the funds recovered in the arbitration from the former owners of MOS.

In June 2012, Pacific Coast Cardiology (“PCC”) d/b/a Pacific Coast Imaging, Emanuel Shaoulian, MD, Inc., and Michael M. Radin, MD, Inc. filed a lawsuit in California state court against us and other defendants. The complaint asserts a number of claims related to our decision not to purchase PCC in 2010, and also separately seeks a determination regarding an amount we contend is owed to us by PCC pursuant to a previous contractual arrangement. Plaintiffs are seeking monetary and punitive damages. We intend to vigorously defend against the claims asserted in this lawsuit. We have not recorded an expense related to any potential damages in connection with this matter because any potential loss is not probable or reasonably estimable at this time.

On November 9, 2012, U.S. Radiosurgery, LLC (“USR”) our subsidiary, received a grand jury subpoena issued by the United States Attorney’s Office for the Middle District of Tennessee seeking documents related to USR and its financial relationships with physicians and other healthcare providers. We are cooperating fully with the inquiry. We are currently unable to predict the timing or outcome of this matter, however, it is not unusual for such matters to continue for a considerable period of time. Responding to this matter will require management’s attention and likely result in significant legal expense. To our knowledge, the federal government has not initiated any proceedings against us at this time.

On March 27, 2013, we have served with a lawsuit filed in U.S. District Court for the Northern District of Mississippi by Superior MRI Services, Inc. The plaintiff is an alleged successor in interest to a former local competitor, P&L Contracting, Inc.

Plaintiff alleges our disregard for Mississippi Certificate of Need ("CON") rules and regulations by operating without obtaining the appropriate authority, and is seeking in excess of \$1.0 million in damages as well as requesting injunctive relief. In January of 2014, the District Court dismissed Plaintiff's Complaint on a number of procedural and substantive grounds. The plaintiff has appealed the District Court's ruling and the Company will respond accordingly. We have not recorded an expense

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ALLIANCE HEALTHCARE SERVICES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014

(Unaudited)

(Dollars in thousands, except per share amounts)

related to any potential damages in connection with this matter because any potential loss is not probable or reasonably estimable at this time.

On June 14, 2013, Alliance Oncology, LLC, our subsidiary, filed a complaint against Harvard Vanguard Medical Associates, Inc. (“HVMA”) in the United States District Court for the District of Massachusetts, including several claims seeking damages resulting from HVMA’s early termination of a long-term services agreement between the two companies. HVMA filed an answer to Alliance Oncology’s complaint on August 27, 2013. Without specifying its alleged damages, HVMA also asserted several counterclaims in its answer. We filed our answer to HVMA’s counterclaims on October 4, 2013, and we intend to vigorously defend against the claims asserted. We have not recorded an expense related to any potential damages in connection with this matter because any potential loss is not probable or reasonably estimable at this time.

ITEM 1A. RISK FACTORS

The Company has included in Part I, Item 1A of its Annual Report on Form 10-K for the year ended December 31, 2013, a description of risks and uncertainties that could affect the Company’s business, future performance or financial condition (the “Risk Factors”). The Risk Factors are hereby incorporated in Part II, Item 1A of this quarterly report on Form 10-Q. There have been no material changes in the Company’s risk factors from those disclosed in the Risk Factors. Investors should consider the Risk Factors prior to making an investment decision with respect to the Company’s stock.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS  
(a) Exhibits

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| Exhibit No. | Description   |
|-------------|---|
| 3.1         | Amended and Restated Certificate of Incorporation of Alliance. (Filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q (File No. 001-16609) with the SEC on August 14, 2001)   |
| 3.1.1       | Certificate of Amendment to Amended and Restated Certificate of Incorporation of Alliance. (Filed as Exhibit 3.1 to the Company's Current Report on Form 8-K (File No. 001-16609) with the SEC on February 17, 2009)  |
| 3.1.2       | Certificate of Amendment to the Amended and Restated Certificate of Incorporation of Alliance HealthCare Services, Inc. (Filed as Exhibit 3.1 to the Company's Current Report on Form 8-K (File No. 001-16609) with the SEC on December 12, 2012)   |
| 3.2         | Amended and Restated By-laws of Alliance. (Filed as Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q (File No. 001-16609) with the SEC on August 14, 2001)  |
| 3.2.1       | Certain Amended and Restated Provisions of the By-laws of Alliance. (Filed as Exhibit 3.1 to the Company's Current Report on Form 10-Q (File No. 001-16609) with the SEC on December 20, 2007)  |
| 4.1         | Specimen certificate for shares of common stock, \$.01 par value, of Alliance. (Filed as Exhibit 4.3 to the Company's Quarterly Report on Form 10-Q (File No. 001-16609) with the SEC on August 14, 2001)   |
| 4.2         | Indenture, including the form of Note, dated as of December 1, 2009, with respect to the 8% Senior Notes due 2016, between Alliance HealthCare Services, Inc., as issuer, and The Bank of New York Mellon Trust Company, N.A., as trustee. (Filed as Exhibit 4.3 to the Company's Current Report on Form 8-K (File No. 001-16609) with the SEC on December 4, 2009) |
| 10.1*       | The 1999 Equity Plan for Employees of Alliance and Subsidiaries, as amended and restated. (Filed as Appendix A to the Company's Proxy Statement on Form DEF 14A (File No. 001-16609) with the SEC on April 17, 2009)  |
| 10.2*       | Form of non-qualified stock option agreement under the 1999 Equity Plan for Employees of Alliance and Subsidiaries, as amended and restated. (Filed as Exhibit 10.25 to Amendment No. 1 to the Company's Registration Statement on Form S-4/A (File No. 333-60682) with the SEC on June 14, 2001)   |
| 10.3*       | Alliance Directors' Deferred Compensation Plan, as amended and restated. (Filed as Exhibit 10.3 to the Company's Current Report on Form 8-K (File No. 001-16609) with the SEC on December 20, 2007)   |
| 10.4        | Form of Stockholder's Agreement. (Filed as Exhibit 10.21 to the Company's Registration Statement on Form S-4 (File No. 333-60682) with the SEC on May 10, 2001)   |
| 10.5*       | Form of Indemnification Agreement. (Filed as Exhibit 10.27 to the Company's Registration Statement on Form S-1 (File No. 333-64322) with the SEC on July 2, 2001)   |
| 10.6*       | Employment Agreement dated as of December 1, 2005 between Alliance and Howard K. Aihara. (Filed as Exhibit 10.34 to the Company's Annual Report on Form 10-K (File No. 001-16609) with the SEC on March 16, 2006)   |
| 10.7*       |   |

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Agreement Not to Compete dated as of December 1, 2005 between Alliance and Howard K. Aihara. (Filed as Exhibit 10.35 to the Company's Annual Report on Form 10-K (File No. 001-16609) with the SEC on March 16, 2006)

10.8\* Form of Restricted Stock Award Agreement under the 1999 Equity Plan for Employees of Alliance and Subsidiaries, as amended and restated. (Filed as Exhibit 10.22 to the Company's Annual Report on Form 10-K (File No. 001-16609) with the SEC on March 16, 2007)

10.9\* Form of Restricted Stock Unit Award Grant Notice and Restricted Stock Unit Award Agreement (Directors) under the 1999 Equity Plan for Employees of Alliance and Subsidiaries, as amended and restated. (Filed as Exhibit 10.2 to the Company's Current Report on Form 8-K (File No. 001-16609) with the SEC on December 20, 2007)

10.10\* Form of Stock Bonus Award Agreement under the 1999 Equity Plan for Employees of Alliance and Subsidiaries, as amended and restated. (Filed as Exhibit 10.23 to the Company's Annual Report on Form 10-K (File No. 001-16609) with the SEC on March 16, 2007)

10.11 Governance and Standstill Agreement, dated as of March 16, 2007, among Alliance Imaging, Inc., OCM Principal Opportunities Fund IV, LP., and MTS Health Investors II, L.P. (Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 001-16609) with the SEC on March 22, 2007)

10.12\* Form of Executive Severance Agreement. (1)

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| Exhibit No. | Description   |
|-------------|---|
| 10.13*      | Amendment of Employment Agreement, dated as of April 16, 2007, between Howard K. Aihara and Alliance Imaging, Inc. (Filed as Exhibit 10.4 to the Company's Current Report on Form 8-K (File No. 001-16609) with the SEC on April 20, 2007)  |
| 10.14*      | New form of non-qualified stock option agreement under the 1999 Equity Plan for Employees of Alliance and Subsidiaries, as amended and restated. (Filed as Exhibit 10.35 to the Company's Annual Report on Form 10-K (File No. 001-16609) with the SEC on March 12, 2008)   |
| 10.15*      | Form of Restricted Stock Award Agreement under the 1999 Equity Plan for Employees of Alliance and Subsidiaries, as amended and restated (For Director Awards Only). (Filed as Exhibit 10.34 to the Company's Annual Report on Form 10-K (File No. 001-16609) with the SEC on March 10, 2009)  |
| 10.16*      | Amendment to the Alliance Imaging, Inc. Directors' Deferred Compensation Plan, as amended and restated. (Filed as Exhibit 10.35 to the Company's Annual Report on Form 10-K (File No. 001-16609) with the SEC on March 10, 2009)  |
| 10.17*      | Second Amendment of Employment Agreement, dated as of December 9, 2008, between Howard K. Aihara and Alliance Imaging, Inc. (Filed as Exhibit 10.37 to the Company's Annual Report on Form 10-K (File No. 001-16609) with the SEC on March 10, 2009)  |
| 10.18*      | Form of Amendment of Executive Severance Agreement. (Filed as Exhibit 10.38 to the Company's Annual Report on Form 10-K (File No. 001-16609) with the SEC on March 10, 2009)  |
| 10.19       | Credit Agreement, dated as of June 3, 2013, among Alliance HealthCare Services, Inc., Credit Suisse AG, Cayman Islands Branch, as administrative agent and the lenders party thereto. (Filed as Exhibit 10.22 to the Company's Quarterly Report on Form 10-Q (File No. 001-16609) with the SEC on August 7, 2013)   |
| 10.20       | Amendment No. 1 to Credit Agreement, dated as of October 11, 2013, among Alliance HealthCare Services, Inc., Credit Suisse AG, Cayman Islands Branch, as administrative agent and the lenders party thereto. (Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 001-16609) with the SEC on October 16, 2013)  |
| 10.21       | Incremental Term Loan Commitment Agreement, dated October 11, 2013, by and among the Company, Credit Suisse AG, Cayman Islands Branch, as administrative agent and other lenders party thereto. (Incorporated by reference to exhibits filed in response to Item 9.01(d), "Exhibits" of the Company's Current Report on Form 8-K, dated October 16, 2013 (File No. 001-16609) |
| 10.22*      | Form of Letter Agreement Evidencing Retention Bonus Arrangements with Executive Officers, dated as of January 31, 2012, with schedule of individual bonus amounts. (Filed as Exhibit 10.27 to the Company's Annual Report on Form 10-K (File No. 001-16609) with the SEC on March 15, 2012)   |
| 10.23*      | Schedule of Executive Officer Compensation.(1)  |
| 10.24*      | Schedule of Non-Employee Director Compensation.(1)  |
| 10.25*      |   |

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Offer Letter, dated as of May 31, 2012, between Larry C. Buckelew and Alliance HealthCare Services Inc. (Filed as Exhibit 10.30 to the Company's Quarterly Report on Form 10-Q (File No. 001-16609) with the SEC on August 7, 2012)

10.26\* Offer Letter, dated as of May 31, 2012, between Michael J. Shea and Alliance HealthCare Services Inc. (Filed as Exhibit 10.31 to the Company's Quarterly Report on Form 10-Q (File No. 001-16609) with the SEC on August 7, 2012)

10.27\* Offer Letter, dated as of July 29, 2013, between Percy C. Tomlinson and Alliance HealthCare Services Inc. (Filed as Exhibit 99.1 to the Company's Current Report on Form 8-K (File No. 001-16609) with the SEC on August 2, 2013)

10.28\* Executive Severance Agreement, dated October 1, 2013, between Percy C. Tomlinson and Alliance HealthCare Services, Inc. (Filed as Exhibit 99.2 to the Company's Current Report on Form 8-K (File No. 001-16609) with the SEC on August 2, 2013)

10.29\* Form of Restricted Stock Unit Award Agreement under the 1999 Equity Plan for Employees of Alliance and Subsidiaries (1)



| Exhibit No. | Description  |
|-------------|--|
| 21.1        | Subsidiaries of the Registrant.(Incorporated by reference to the exhibit filed in response to Item 15(a)(3), "Exhibits" of the Company's Annual Report on Form 10-K for the year ended December 31, 2006 (File No. 001-16609).   |
| 31          | Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.(1)  |
| 32          | Certifications of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.(1)  |
| 101         | The following materials from Alliance's Annual Report on Form 10-Q for the quarter ended March 31, 2014, formatted in eXtensible Business Reporting Language (XBRL): (a) Consolidated Balance Sheets at March 31, 2014 and March 31, 2013; (b) Consolidated Statements of Operations and Comprehensive Loss for the quarters ended March 31, 2014 and 2013; (c) Consolidated Statements of Cash Flows for the quarters ended March 31, 2014 and 2013; (d) Consolidated Statements of Changes in Shareholders' Equity (Deficit); and (e) Notes to Consolidated Financial Statements.(1) |

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\* Management contract or compensatory plan or arrangement.

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.

ALLIANCE HEALTHCARE SERVICES, INC.

May 7, 2014

By: /s/ PERCY C. TOMLINSON  
Percy C. Tomlinson  
Chief Executive Officer  
(Principal Executive Officer)

May 7, 2014

By: /s/ HOWARD K. AIHARA  
Howard K. Aihara  
Executive Vice President and  
Chief Financial Officer  
(Principal Financial Officer and Principal Accounting Officer)