NightHawk Radiology Holdings Inc
Form 10-Q
May 12, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2008**

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number 000-51786

NightHawk Radiology Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**87-0722777**
(State or other jurisdiction of	**(IRS Employer**
incorporation or organization)	**Identification No.)**
250 Northwest Boulevard, #202, Coeur d Alene, Idaho	**83814**
(Address of principal executive offices))	**(Zip code)**

(208) 676-8321

(Registrant s telephone number, including area code)

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

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Small 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 x

As of May 2, 2008, 30,735,015 shares of the Registrant s common stock were outstanding.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART 1 FINANCIAL INFORMATION

Item 1. Financial Statements

NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

(In thousands, except share data)

	March 31, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 33,620	$ 31,956
Marketable securities	33,216	30,625
Trade accounts receivable, net	25,181	25,665
Deferred income taxes	160	655
Prepaid expenses and other current assets	5,476	2,812
Total current assets	97,653	91,713
Property and equipment, net	11,746	10,555
Goodwill	68,930	68,601
Intangible assets, net	85,250	87,133
Deferred income taxes	2,968	1,251
Other assets, net	4,072	4,213
Total	$ 270,619	$ 263,466
LIABILITIES		
Current liabilities:		
Accounts payable	$ 6,915	$ 6,071
Accrued expenses and other liabilities	11,017	12,881
Accrued payroll and related benefits	3,266	4,570
Long-term debt, due within one year	1,000	1,000
Total current liabilities	22,198	24,522
Insurance reserve	3,907	3,038
Long-term debt	98,250	98,500
Other liabilities	5,472	2,717
Total liabilities	129,827	128,777
Commitments and contingencies (Note 6)		
STOCKHOLDERS EQUITY		
Common stock 150,000,000 shares authorized; $.001 par value; 30,710,271 and 30,312,322 shares issued and outstanding at March 31, 2008 and December 31, 2007, respectively	31	30
Additional paid-in capital	256,270	249,274
Retained earnings (deficit)	(112,226)	(112,957)
Accumulated other comprehensive income (deficit)	(3,283)	(1,658)
Total stockholders equity	140,792	134,689

Total	$ 270,619	$ 263,466

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

(In thousands, except share data)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Service revenue	$ 41,688	$ 25,882
Operating costs and expenses:		
Professional services (includes non-cash compensation expense of $590 and $960)	17,867	10,373
Sales, general, and administrative (includes non-cash compensation expense of $2,356 and $838)	18,170	8,464
Depreciation and amortization	2,798	850
Total operating costs and expenses	38 ,835	19,687
Operating income	2,853	6,195
Other income (expense):		
Interest expense	(2,187)	(1)
Interest income	527	888
Other, net	28	(2)
Total other income (expense)	(1,632)	885
Income before income taxes	1,221	7,080
Income tax expense	490	2,748
Net income	$ 731	$ 4,332
Earnings per common share:		
Basic	$ 0.02	$ 0.14
Diluted	$ 0.02	$ 0.14
Weighted averages of common shares outstanding:		
Basic	30,444,195	29,960,256
Diluted	31,424,363	30,881,728

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(In thousands)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Cash flows from operating activities:		
Net income	$ 731	$ 4,332
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,798	850
Accretion of discounts on marketable securities	(52)	(135)
Amortization of debt issuance costs	162	
Other loss (income)	51	(24)
Deferred income taxes	(170)	(490)
Non-cash stock compensation expense	2,946	1,798
Excess tax benefit from exercise of stock options	(79)	(198)
Provision for doubtful accounts and sales credits	190	42
Changes in operating assets and liabilities (excluding effects of acquisitions):		
Trade accounts receivable, net	224	404
Prepaid expenses and other assets	(2,478)	(604)
Accounts payable	321	692
Accrued expenses and other liabilities	579	2,258
Accrued payroll and related benefits	580	(705)
Net cash provided by operating activities	5,803	8,220
Cash flows from investing activities:		
Purchase of marketable securities	(10,305)	(11,420)
Proceeds from maturities of marketable securities	7,765	17,878
Purchase of property and equipment	(1,634)	(1,205)
Cash and cash equivalents from acquisition, net		78
Cash paid for acquisition		(21,850)
Net cash used in investing activities	(4,174)	(16,519)
Cash flows from financing activities:		
Repayment of notes payable and debt	(250)	
Excess tax benefit from exercise of stock options	79	198
Proceeds from exercise of stock options	206	226
Net cash provided by financing activities	35	424
Net increase (decrease) in cash and cash equivalents	1,664	(7,875)
Cash and cash equivalents beginning of period	31,956	46,501
Cash and cash equivalents end of period	$ 33,620	$ 38,626

See Notes to Condensed Consolidated Financial Statements.

5

Table of Contents

NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(unaudited)

	Three Months Ended March 31, 2008	2007
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 1,991	$ 1
Cash paid (received) for income taxes	374	(40)
Non-cash investing and financing activities:		
Purchases of equipment included in accounts payable	522	65
Earnout liability included in accrued expenses settled in stock	2,078	
Debt issuance costs included in accounts payable and accrued expenses		150
Acquisition costs included in accounts payable and accrued expenses		100

See Notes to Condensed Consolidated Financial Statements.

6

Table of Contents

NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Net income	$ 731	$ 4,332
Other comprehensive income:		
Change in fair value of interest rate swaps	(2,678)	
Less deferred income taxes	1,052	
Net other comprehensive income (loss)	(1,626)	
Comprehensive income (loss)	$ (895)	$ 4,332

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

NIGHTHAWK RADIOLOGY HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation The accompanying unaudited condensed consolidated financial statements include the results of operations, financial position and cash flows of the Nighthawk Radiology Holdings, Inc and its subsidiaries (the Company). All material intercompany balances have been eliminated.

In the opinion of the Company s management, the accompanying unaudited condensed consolidated financial statements include all adjustments necessary to present fairly, in all material respects, our results for the periods presented. These condensed consolidated financial statements have been prepared by us pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in Item 8 of our 2007 Annual Report on Form 10-K filed with the SEC on February 19, 2008. The results of operations for the three months ended March 31, 2008 are not necessarily indicative of results to be expected for the entire fiscal year.

Our unaudited condensed consolidated balance sheet as of December 31, 2007 has been derived from the audited consolidated balance sheet as of that date.

Use of Estimates The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company s management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Some of these estimates require difficult, subjective or complex judgments about matters that are inherently uncertain. Actual results could differ from those estimates.

On an ongoing basis, the Company evaluates its estimates, including those related to the accounts receivable allowance, fair value of acquired intangible assets and goodwill, useful lives of intangible assets and property and equipment, income taxes, the loss contingency for medical liability claims, reserves for incurred but not reported (IBNR) medical liability claims and estimates used for the purpose of determining stock-based compensation.

Trade Accounts Receivable Trade accounts receivable represent receivables for services and are recorded at the invoiced amount and are non-interest bearing. The Company has a history of minimal uncollectible receivables. Company management reviews past due accounts receivable to identify specific customers with known disputes or collectibility issues. As of March 31, 2008 and December 31, 2007, the Company had reserved $0.6 million for doubtful accounts based on its estimate of the collectibility of outstanding receivables as of those dates.

Marketable Securities The Company determines the appropriate classification of investments in marketable securities at the time of purchase and reevaluates such designation at each balance sheet date. Marketable securities have been classified and accounted for as available for sale. The Company may or may not hold securities with stated maturities greater than twelve months until maturity. In response to changes in the availability of and the yield on alternative investments as well as liquidity requirements, the Company occasionally sells these securities prior to their stated maturities. The Company expects that the majority of marketable securities will be sold within one year, regardless of maturity date. The Company primarily invests in high-credit-quality debt instruments with an active resale market and money market funds to ensure liquidity and the ability to readily convert these investments into cash to fund current operations, or satisfy other cash requirements as needed. Accordingly, all marketable securities have been classified as current assets in the accompanying balance sheets. These securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported as a component of stockholders equity, except for unrealized losses determined to be other than temporary which would be recorded as other income or expense. Any realized gains or losses on the sale of marketable securities are determined on a specific identification method, and such gains and losses are reflected as a component of other income or expense.

Property and Equipment Property and equipment are stated at cost. Depreciation is provided using the straight-line method over the estimated useful lives of each asset, which ranges as follows:

Table of Contents

Computers, diagnostic workstations and telecommunications systems	3 5 years
Office furniture and equipment	7 10 years
Software	3 7 years
Leasehold improvements	Term of lease or asset life, whichever is shorter

Expenditures for maintenance and repairs are charged to operating expense as incurred and expenditures for renewals and betterments are capitalized. Upon sale or retirement of depreciable assets, the related cost and accumulated depreciation are removed from the records and any gain or loss is reflected in operating expenses.

Cost of computer software used for internal use is capitalized and accounted for in accordance with Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Capitalized costs are amortized based on the Company s expected utilization of existing internally developed software.

Depreciation expense for the three months ended March 31, 2008 and 2007 was $0.9 million and $0.5 million, respectively.

Medical Liability Insurance The Company is exposed to various risks of loss related to litigation that may arise related to malpractice and maintains insurance for medical liabilities in amounts considered adequate by Company management. The Company s claims-made policy provides coverage up to the policy limits for claims filed within the period of the policy term, subject to deductible requirements. Coverage for affiliated radiologists is initiated when they begin providing services on behalf of the Company.

The Company records reserves for both reported and IBNR amounts. Reported amounts are reserved based upon the Company s best estimate of future probable costs. IBNR amounts are estimated using historical claims information and industry indices. This reserve is intended to cover potential medical claims that might arise related to past interpretations performed by the Company s affiliated radiologists.

Concentration of Credit Risk Financial instruments that potentially expose the Company to concentration of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company maintains its cash and cash equivalents with high quality credit institutions. At times, such amounts may be in excess of insured amounts. As of March 31, 2008 and December 31, 2007, a total of $16.2 million and $12.0 million, respectively, of cash and cash equivalents exceeded insured amounts.

Recent Accounting Standards In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value according to accounting principles generally accepted in the United States of America, and expands disclosure requirements regarding fair value measurements. This statement emphasizes that fair value should be determined based on assumptions market participants would use to price the asset or liability. The provisions of SFAS No. 157 were effective for fiscal years beginning after November 15, 2007. The Company adopted this new accounting pronouncement as of January 1, 2008 and the impact of adoption was not significant. See Note 11 for disclosures regarding fair value measurements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159) which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 was effective for the Company on January 1, 2008. The Company has assessed this option and decided against electing the fair value option for any items eligible at January 1, 2008.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS 141(R)) which establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumes, and any controlling interest; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effect of the business combination. SFAS 141(R) is to be applied prospectively to business combinations for which the acquisition date is on or after an entity s fiscal year that begins after December 15, 2008. SFAS 141(R) will be effective for the Company on January 1, 2009. The Company is currently evaluating the impact of adopting SFAS 141(R) on its financial position and results of operations.

Table of Contents

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* (SFAS 160). SFAS 160 requires that all entities in which its parent has a controlling financial interest be consolidated into the parent at 100 percent of fair value and the parent s consolidated net income include amounts attributable to both the parent and noncontrolling interest. SFAS 160 clarifies that non-controlling interests in subsidiaries be presented as equity and any changes to the ownership interest are considered equity transactions providing the parent maintains its controlling financial interest in the subsidiary. SFAS 160 will be effective for the Company on January 1, 2009. The Company is currently evaluating the impact of adopting SFAS 160 on its financial position and results of operations.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161) which amends and expands the disclosure requirements of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. The Company is currently evaluating the impact of adopting SFAS 161 on its financial statements and footnotes.

2. ACQUISITIONS

MIDWEST PHYSICIANS SERVICES, LLC AND EMERGENCY RADIOLOGY SERVICES, LLC.

On July 16, 2007, the Company entered into a Membership Interest Purchase Agreement (the Purchase Agreement) with SPR Holdings II, LLC, (SPR Holdings) a privately held company located in St. Paul, Minnesota, Midwest Physicians Services, LLC (MPS), and Emergency Radiology Services, LLC (ERS), pursuant to which the Company acquired all of the outstanding equity interests of MPS and ERS from SPR Holdings. MPS was formed by St. Paul Radiology, P.A. (St. Paul Radiology or SPR) to provide a suite of