SEMTECH CORP
Form SC 13G/A
February 10, 2010

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

SCHEDULE 13G

Under the Securities Exchange Act of 1934

(Amendment No. 1)*

Semtech Corporation
(Name of Issuer)

Common Stock
(Title of Class of Securities)

816850101
(CUSIP Number)

December 31, 2009
(Date of Event Which Requires Filing of this Statement)

Check the appropriate box to designate the rule pursuant to which this Schedule is filed:
[X] Rule 13d-1(b)
[ ] Rule 13d-1(c)
[ ] Rule 13d-1(d)

*The remainder of this cover page shall be filled out for a reporting person's initial filing on this form with respect to the subject class of securities, and for any subsequent amendment containing information which would alter the disclosures provided in a prior cover page.

The information required in the remainder of this cover page shall not be deemed to be "filed" for the purpose of Section 18 of the Securities Exchange Act of 1934 ("Act") or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act (however, see the Notes).

CUSIP: 816850101 Page 1 of 4

1	NAMES OF REPORTING PERSONS I.R.S. IDENTIFICATION NOS. OF ABOVE PERSONS (ENTITIES ONLY) Capital Research Global Investors **	
2	CHECK THE APPROPRIATE BOX IF A MEMBER OF A GROUP (SEE INSTRUCTIONS)	(a) (b)
3	SEC USE ONLY	
4	CITIZENSHIP OR PLACE OF ORGANIZATION Delaware	

NUMBER OF SHARES BENEFICIALLY OWNED BY EACH REPORTING PERSON WITH:	5	SOLE VOTING POWER 3,066,053
	6	SHARED VOTING POWER NONE
	7	SOLE DISPOSITIVE POWER 3,066,053
	8	SHARED DISPOSITIVE POWER NONE

9	AGGREGATE AMOUNT BENEFICIALLY OWNED BY EACH REPORTING PERSON 3,066,053 Beneficial ownership disclaimed pursuant to Rule 13d-4
10	CHECK BOX IF THE AGGREGATE AMOUNT IN ROW (9) EXCLUDES CERTAIN SHARES (SEE INSTRUCTIONS)
11	PERCENT OF CLASS REPRESENTED BY AMOUNT IN ROW 9 4.9%
12	TYPE OF REPORTING PERSON (SEE INSTRUCTIONS) IA

** A division of Capital Research and Management Company (CRMC)

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Schedule 13G
Under the Securities Exchange Act of 1934

Amendment No. 1

Item 1(a) Name of Issuer:
Semtech Corporation

Item 1(b) Address of Issuer's Principal Executive Offices:
200 Flynn Road
Camarillo, CA 93012-8790

Item 2(a) Name of Person(s) Filing:
Capital Research Global Investors

Item 2(b) Address of Principal Business Office or, if none, Residence:
333 South Hope Street
Los Angeles, CA 90071

Item 2(c) Citizenship: N/A

Item 2(d) Title of Class of Securities:
Common Stock

Item 2(e) CUSIP Number:
816850101

Item 3 If this statement is filed pursuant to sections 240.13d-1(b) or 240.13d-2(b) or (c), check whether the person filing is a:
(e) [X] An investment adviser in accordance with section 240.13d-1(b)(1)(ii)(E).

Item 4 Ownership

Provide the following information regarding the aggregate number and percentage of the class of securities of the issuer identified in Item 1.

(a) Amount beneficially owned:
(b) Percent of class:
(c) Number of shares as to which the person has:
(i) Sole power to vote or to direct the vote:
(ii) Shared power to vote or to direct the vote:
(iii) Sole power to dispose or to direct the disposition of:
(iv) Shared power to dispose or to direct the disposition of:

See page 2

Capital Research Global Investors is deemed to be the beneficial owner of 3,066,053 shares or 4.9% of the 61,660,000 shares of Common Stock believed to be outstanding as a result of CRMC acting as investment adviser to various investment companies registered under Section 8 of the Investment Company Act of 1940.

Item 5 Ownership of Five Percent or Less of a Class. If this statement is being filed to report the fact that as of the date hereof the reporting person has ceased to be the beneficial owner of more than five percent of the class of securities, check the following: [X]

Item 6 Ownership of More than Five Percent on Behalf of Another Person: One or more clients of Capital Research Global Investors have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of, the Common Stock of Semtech Corporation.

Item 7 Identification and Classification of the Subsidiary Which Acquired the Security Being Reported on By the Parent Holding Company or Control Person: N/A

Item 8 Identification and Classification of Members of the Group: N/A

Item 9 Notice of Dissolution of Group: N/A

Item 10 Certification

By signing below, I certify that, to the best of my knowledge and belief, the securities referred to above were acquired and are held in the ordinary course of business and were not acquired and are not held for the purpose of or with the effect of changing or influencing the control of the issuer of the securities and were not acquired and are not held in connection with or as a participant in any transaction having that purpose or effect.

Signature

After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

Date: February 9, 2010

Signature: Timothy D. Armour***
Name/Title: Timothy D. Armour - Senior Vice President
Capital Research Global Investors

***By /s/ James P. Ryan
James P. Ryan
Attorney-in-fact

Signed pursuant to a Power of Attorney dated December 21, 2007 included as an Exhibit to Schedule 13G filed with the Securities and Exchange Commission by Capital Research Global

Investors on January 10, 2008 with respect to Lowes
Companies, Incorporated.

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CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

	December 31, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents, including $2,906 and $2,562 of restricted cash, respectively	$ 4,521	$ 3,884
Accounts receivable, net of allowances of $13,117 and $26,421, respectively	18,333	18,673
Notes and amounts due from related parties	449	473
Inventory	2,542	2,479
Prepaid expenses and deposits	1,409	1,644
Current tax assets	2,963	2,725
Current assets of discontinued operations		522
Total current assets	30,217	30,400
Property and equipment, net	15,238	18,140
Goodwill	194,417	193,268
Other intangible assets, net	2,221	2,465
Other assets, net	760	1,397
Noncurrent assets of discontinued operations		2,297
Total assets	$ 242,853	$ 247,967
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 9,936	$ 9,488
Accrued expenses	5,384	5,110
Current maturities of long-term debt	25,108	8,217
Current liabilities of discontinued operations		439
Total current liabilities	40,428	23,254
Long-term debt, net of current maturities	4,274	42,713
Convertible subordinated debt, net of unamortized debt discount of $8,292 and $13,431, respectively	66,708	61,569
Other long-term liabilities	198	301
Deferred income tax liabilities	16,976	14,118
Commitments and contingencies		
Stockholders equity:		
NovaMed, Inc. stockholders equity:		
Common stock, $0.01 par value, 27,253,000 shares authorized, 10,367,112 and 10,111,172 shares issued at December 31, 2010 and 2009, respectively*	101	100
Additional paid-in-capital*	116,413	113,561
Retained earnings (accumulated deficit)	1,668	(3,650)
Accumulated other comprehensive loss	(6)	(40)
Treasury stock, at cost, 2,412,399 and 2,395,414 shares at December 31, 2010 and 2009, respectively*	(19,115)	(18,943)
Total NovaMed, Inc. stockholders equity	99,061	91,028
Noncontrolling interests	15,208	14,984

Total stockholders equity		114,269		106,012
Total liabilities and stockholders equity	$	242,853	$	247,967

* Adjusted for 1-for-3 reverse stock split effective June 1, 2010 (Note 3)

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

NOVAMED, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share data)

	Years Ended December 31, 2010	2009	2008
Net revenue:			
Surgical facilities	$ 128,509	$ 131,192	$ 116,447
Product sales and other	23,293	22,839	23,721
Total net revenue	151,802	154,031	140,168
Operating expenses:			
Salaries, wages and benefits	45,003	45,569	42,036
Cost of sales and medical supplies	36,819	35,370	32,529
Selling, general and administrative	28,060	27,409	25,534
Depreciation and amortization	5,040	5,654	4,248
Total operating expenses	114,922	114,002	104,347
Operating income	36,880	40,029	35,821
Other (income) expense:			
Interest expense	8,899	8,778	8,138
Interest income	(3)	(4)	(68)
Other (income) expense	(318)	11	13
Total other (income) expense	8,578	8,785	8,083
Income before income taxes	28,302	31,244	27,738
Income tax provision	4,428	5,276	4,430
Income from continuing operations	23,874	25,968	23,308
Loss from discontinued operations	(335)	(740)	(53)
Gain (loss) on disposal of discontinued operations	(1,554)		343
Net income	21,985	25,228	23,598
Net income attributable to noncontrolling interests	16,666	17,717	16,380
Net income attributable to NovaMed, Inc.	$ 5,319	$ 7,511	$ 7,218
Amounts attributable to NovaMed, Inc.:			
Income from continuing operations	$ 7,208	$ 8,251	$ 6,928
Income (loss) from discontinued operations	(1,889)	(740)	290
Net income attributable to NovaMed, Inc.	$ 5,319	$ 7,511	$ 7,218
Earnings per common share from continuing operations attributable to NovaMed, Inc.:*			
Basic	$ 0.94	$ 1.09	$ 0.86
Diluted	$ 0.92	$ 1.06	$ 0.83
Net earnings per common share attributable to NovaMed, Inc.:*			
Basic	$ 0.69	$ 0.99	$ 0.90
Diluted	$ 0.68	$ 0.96	$ 0.86

* Adjusted for 1-for-3 reverse stock split effective June 1, 2010 (Note 3)

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

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NOVAMED, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(Dollars and shares in thousands)

	Common Stock Shares	Common Stock Par Value	Additional Paid-In Capital	Retained Earnings (Accumulated) (Deficit)	Accumulated Other Comprehensive Loss	Treasury Stock Shares	Treasury Stock At Cost	Total NovaMed, Inc. Stockholders Equity	Noncontrolling Interests
Balance, December 31, 2007*	9,802	$ 98	$ 106,928	$ (18,380)	$ (450)	(1,615)	$ (10,691)	$ 77,505	$ 15,024
Net income				7,218				7,218	16,380
Unrealized gain (loss) on interest rate swaps					232			232	(12)
Total comprehensive income								7,450	16,368
Stock options exercised*	102	1	2,159					2,160	
Shares issued employee stock purchase plan*	11		116					116	
Restricted stock activity*						(11)	(103)	(103)	
Stock-based compensation expense			2,219					2,219	
Repurchases of common stock*						(636)	(6,871)	(6,871)	
Distributions to noncontrolling interests									(16,374)
Other noncontrolling interests activity									264
Balance, December 31, 2008*	9,915	99	111,422	(11,162)	(218)	(2,262)	(17,665)	82,476	15,282
Net income				7,511				7,511	17,717
Unrealized gain on interest rate swaps					178			178	25
Total comprehensive income								7,689	17,742
Stock options exercised*	73	1	84					85	
Shares issued employee stock purchase plan*	17		97					97	
Restricted stock activity*	106					(13)	(152)	(152)	
Stock-based compensation expense			2,067					2,067	
Repurchases of common stock*						(120)	(1,126)	(1,126)	
Distributions to noncontrolling interests									(18,531)
Other noncontrolling interests activity			(109)					(109)	491
Other				1				1	
Balance, December 31, 2009*	10,111	100	113,561	(3,650)	(40)	(2,395)	(18,943)	91,028	14,984
Net income				5,319				5,319	16,666
Unrealized gain on interest rate swaps					34			34	16
Total comprehensive income								5,353	16,682
Stock options exercised	74	1	364					365	

Shares issued employee stock purchase plan	11		91					91	
Restricted stock activity	171					(17)	(172)	(172)	
Stock-based compensation expense			1,729					1,729	
Distributions to noncontrolling interests									(16,305)
Other noncontrolling interests activity			208					208	(153)
Other			460	(1)				459	
Balance, December 31, 2010	10,367	$ 101	$ 116,413	$ 1,668	$ (6)	(2,412)	$ (19,115)	$ 99,061	$ 15,208

* Adjusted for 1-for-3 reverse stock split effective June 1, 2010 (Note 3)

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

NOVAMED, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Years Ended December 31, 2010	2009	2008
Cash flows from operating activities:			
Net income	$ 21,985	$ 25,228	$ 23,598
Adjustments to reconcile net income to net cash provided by operations			
Depreciation and amortization	5,168	5,885	4,318
Stock-based compensation expense	1,729	2,067	2,219
Amortization of subordinated debt fees	642	642	646
(Gain) loss on sale of ASC			(299)
Deferred income taxes	3,002	3,986	3,955
Non-cash subordinated debt interest	4,614	4,225	3,867
Non-cash loss on sale of business	2,285		
Goodwill and asset impairment charge			(34)
Changes in operating assets and liabilities, net of effects of purchase transactions:			
Accounts receivable	493	2,186	1,577
Inventory	(12)	(107)	267
Other current assets	199	44	(227)
Accounts payable, accrued expenses and income taxes payable	346	(461)	1,277
Other noncurrent assets	699	385	261
Net cash provided by operating activities	41,150	44,080	41,425
Cash flows from investing activities:			
Payments for acquisitions, net	(1,286)	(12)	(50,119)
Purchases of property and equipment	(1,487)	(3,698)	(4,896)
Net proceeds from noncontrolling interest transactions	690	67	34
Proceeds from sale of property and equipment	73	18	96
Proceeds from sale of ASC			376
Other		(743)	(907)
Net cash used in investing activities	(2,010)	(4,368)	(55,416)
Cash flows from financing activities:			
Borrowings under revolving credit agreement	44,400	57,200	58,300
Payments under revolving credit agreement	(63,100)	(74,100)	(25,200)
Other long term borrowings	425	130	102
ASC relocation borrowings			3,300
Distributions to noncontrolling interests	(16,305)	(18,531)	(16,374)
Proceeds from the issuance of stock, net of issuance costs	284	246	507
Repurchase of common stock		(1,126)	(6,719)
Payments of other debt, debt issuance fees and capital lease obligations	(4,207)	(4,522)	(1,432)
Net cash (used in) provided by financing activities	(38,503)	(40,703)	12,484
Net (decrease) increase in cash and cash equivalents	637	(991)	(1,507)
Cash and cash equivalents, beginning of year	3,884	4,875	6,382
Cash and cash equivalents, end of year	$ 4,521	$ 3,884	$ 4,875

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

NOVAMED, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share data)

1. GENERAL INFORMATION

Description of the Business

NovaMed, Inc. (NovaMed) along with its subsidiaries (collectively, the Company) is an owner and operator of ambulatory surgery centers (ASCs). The Company s primary focus and strategy is to acquire, develop and operate ASCs in joint ownership with physicians throughout the United States. At December 31, 2010, the Company owned and operated 37 ASCs where surgeons perform various surgical procedures. The Company owned a majority interest in 35 of its ASCs with physicians owning the remaining equity interests in these ASCs. The Company owns all of the equity interests in its other two ASCs.

The Company also owns and operates optical laboratories, an optical products purchasing organization and marketing products and services businesses.

The Company also continues to provide management services to two eye care practices pursuant to long-term service agreements. These practices are located in Illinois and Georgia. Under these service agreements, the Company provides business, information technology, administrative and financial services to its affiliated providers in exchange for a management fee.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Statement Presentation and Principles of Consolidation

The consolidated financial statements include the financial statements of NovaMed and its wholly owned and majority owned subsidiaries. The Company used the equity method of accounting for the ASC in which it owned a noncontrolling interest. The Company consolidates two physician practice management (PPM) entities under the provisions included in Accounting Standards Codification (ASC) 810, *Consolidation*. All significant intercompany balances and transactions have been eliminated in consolidation. Prior year amounts have been reclassified to conform to current year presentation.

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid instruments with an original maturity of three months or less from the date of purchase. Pursuant to six of its limited liability company agreements, the cash held by each entity is restricted to that entity s use. The cash balance subject to such restrictions was $2,906 and $2,562, at December 31, 2010 and 2009, respectively.

Inventory

Inventory consists primarily of surgical supplies used in connection with the operation of the Company s ASCs and optical products such as eyeglass frames, optical lenses and contact lenses. Inventory is valued at the lower of cost or market, with cost determined using the first-in, first-out (FIFO) method. The Company routinely reviews its inventory for obsolete, slow moving or otherwise impaired inventory and records estimated impairments in the periods in which they occur.

As of December 31,	**2010**	**2009**
Surgical supplies	$ 1,817	$ 1,782
Optical products	672	645
Other	53	52
Total inventory	$ 2,542	$ 2,479

Property and Equipment

Property and equipment are stated at lower of cost or fair value at the date of acquisition. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the related assets, generally three to seven years for equipment, computer software, furniture and fixtures, and up to the lease term for leasehold improvements. Routine maintenance and repairs are charged to expense as incurred.

Intangible Assets

The Company s acquisitions and affiliations involve the purchase of tangible and intangible assets and the assumption of certain liabilities. As part of the purchase price allocation, the Company allocates the purchase price to the tangible assets acquired and liabilities assumed, based on estimated fair market values, with the remainder of the purchase price allocated to intangibles. Goodwill is not amortized but is subject to an annual impairment assessment in relation to its fair value.

The Company s reported goodwill represents a significant portion of its total assets. The Company tests goodwill for impairment annually (in December of each year using the carrying value of the reporting units as of October 31st) and when factors indicating impairment are present. Accounting standards require that goodwill be tested at the reporting unit level, defined as an operating segment or one level below an operating segment (referred to as a component). The fair value of the reporting unit is compared to its carrying amount, including goodwill, to determine if an impairment exists. The Company has one operating segment within its Surgical Facilities reportable segment. For impairment testing purposes, each of the Company s ASCs qualify as components of that operating segment. Because the ASCs have similar economic characteristics, the components are aggregated and deemed a single reporting unit. The Company has four other reporting units with intangible assets that are included within its Product Sales and Other reportable segments. These include its optical laboratory business, optical products purchasing organization, optometric practice/retail store and ophthalmology practice. The Company currently believes it has adequate support for the carrying value of the goodwill based on assumptions used in the impairment analysis. However, the analysis requires significant judgments and estimates to be made by management. The Company cannot predict the occurrence of certain future events that might adversely affect the reported value of goodwill. The Company will continue to perform a goodwill impairment test on an annual basis and on an interim basis if indicators of impairment exist. As additional information becomes known, the Company may change its estimates.

As of December 31, 2010 and 2009, the Company s net book value of equity exceeded its market capitalization of $91,718 and $89,814, respectively, by $7,343 and $1,214, respectively. The Company s annual test for goodwill impairment conducted in December of each year considers the relationship between market capitalization and net book value of equity but does not consider it to be the basis for the test. The Company s annual test for goodwill impairment utilizes a market multiple approach to estimate the fair value of each of its reporting units. For each reporting unit, the Company applies a range of enterprise value multiples obtained from various market sources to the respective budgeted EBITDA (earnings before interest, income taxes, depreciation and amortization) for the following year. The Company further applies a fair value percentile to each range based on its estimate of what the Company would realize if it were to sell the reporting unit as a whole in an orderly transaction between market participants. The EBITDA of the reporting units excludes certain corporate overhead expenses that, in the Company s opinion, a market participant would not incur in operating the reporting unit. When the Company s market multiple approach results in an estimated fair value less than 5% greater than its carrying value, the Company also performs a discounted cash flow projection to determine fair value. The Company believes this additional approach to estimating fair value serves two purposes. When market multiples are readily available and fall within a reasonable range and there are not significant fluctuations in EBITDA in the reporting unit over time, the discounted cash flow approach provides another reference point for fair value. In this case, the weighting of the two approaches will depend on specific circumstances such as the number of comparable transactions the Company has to derive the market multiple and the projected performance of the reporting unit as compared to its recent performance. When there are significant fluctuations in EBITDA in the reporting unit over time and/or unique issues impacting near term results, the discounted cash flow approach provides a more relevant valuation methodology as short term issues are minimized in a multi-year projection. In this case, the Company weights the discounted cash flow approach 100%. During the Company s 2010 annual goodwill assessment, its optical laboratory reporting unit had a market multiple fair value less than 5% greater than its carrying value. Both the market multiple approach fair value and the discounted cash flow approach fair value exceeded the carrying value so there was no need to weight the two approaches.

Although the Company s market capitalization has fluctuated over the last year due to a fluctuating and volatile stock price, there have not been any events that have caused the fair value of the Company s reporting units to decline significantly or materially that would be an indicator of goodwill impairment.

Impairment of Long-Lived Assets

The Company reviews the carrying value of the long-lived assets periodically to determine if facts and circumstances exist that would suggest that assets might be impaired or that the useful lives should be modified. Among the factors the Company considers in making the evaluation are changes in market position and profitability. If facts and circumstances are present which may indicate impairment is probable, the Company will prepare a projection of the undiscounted cash flows of the specific business entity and determine if the long-lived assets are recoverable based on these undiscounted cash flows. If impairment is indicated, an adjustment will be made to reduce the carrying amount of these assets to their fair value.

Income Taxes

The Company uses the liability method of accounting for income taxes. Deferred income taxes reflect the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, using enacted tax rates in effect for the year in which the differences are expected to reverse as well as tax credit carryforwards. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

Fair Value of Financial Instruments

The carrying value of financial instruments such as accounts receivable, notes and amounts due from related parties, accounts payable and accrued expenses are reasonable estimates of their fair value because of the short maturity of these items. The Company believes the current carrying amounts of its notes receivable from related parties, line of credit, and obligations under capital leases approximate fair value because the interest rates on these instruments are subject to change with, or approximate, market interest rates. The Company periodically enters into interest rate swap agreements to protect it against interest rate fluctuations of the LIBOR rate on certain of its debt. The fair value of the swaps is determined based on market interest rates for similar maturity periods and is discussed in Note 16. At December 31, 2010, the carrying value and fair value of the Company s convertible notes were $66,708 and $69,000, respectively.

Revenue Recognition

Surgical Facilities

Revenue in the Company s ASCs is based on fees charged to patients, third-party payors or others for use of the facilities and relates primarily to surgical procedures performed in the ASCs. Surgical facility revenue is net of contractual adjustments and a provision for doubtful accounts and is recognized at the time the surgical procedure is performed. The contractual allowance is the difference between the fee charged and the amount expected to be paid by the patient or the applicable third-party payor, which includes Medicare and private insurance. The Company bases its estimates for the contractual allowance on the Medicare reimbursement rates when Medicare is the payor, contracted rates with other third party payors or historical experience when there is not a specific contracted rate. The estimate for doubtful accounts is based on the aging category and historical collection experience. Although the Company does not separately track contractual adjustments and provisions for doubtful accounts, management believes that the amounts related to bad debts are immaterial for all periods presented. While the Company believes that its contractual allowances are appropriate, if its actual contractual adjustments or bad debts differ from its estimates, the Company s results of operations may be affected. During the years ended December 31, 2010, 2009 and 2008, the Company had no significant adjustments to contractual allowances related to prior periods.

Product Sales and Other

The Company s optical products purchasing organization negotiates volume buying discounts with optical products manufacturers. The buying discounts and any handling charges billed to the members of the buying group represent the revenue recognized for financial reporting purposes. Revenue is recognized as orders are shipped to members. The Company bases its estimates for sales returns and discounts on historical experience and has not experienced significant fluctuations between estimated and actual return activity and discounts given.

The Company s optical laboratories manufacture and distribute corrective lenses and eyeglasses to both affiliated and non-affiliated ophthalmologists and optometrists. Revenue is recognized when product is shipped, net of an allowance for discounts. The Company s marketing products and services businesses recognize revenue when the product is shipped or service rendered.

Revenue generated from affiliated ophthalmologists and optometrists with whom the Company has a management services agreement is eliminated in consolidation.

The Company owns the net operating assets and has long-term service agreements (SAs) with an ophthalmology practice and an optometric practice with a retail optical store. The Company provides services, facilities and equipment under these SAs. The SAs have 25 to 40-year terms and require the Company to provide all of the business, administrative and financial services necessary to operate the practices and the retail optical store. The Company recognizes the revenue of the SAs based on services performed and retail sales adjusted for contractual arrangements. These practices are consolidated in the Company s financial statements and all intercompany transactions are eliminated.

The Company also records an estimate for doubtful accounts based on the aging category and historical collection experience of each product sales and other business described above.

Cost of Sales and Medical Supplies

Cost of sales and medical supplies includes the cost of optical products such as eyeglass frames, optical lenses, contact lenses and surgical supplies, direct labor costs incurred in the preparation of optical lenses, and the per procedure fees paid by the Company related to operating the equipment used in laser vision correction procedures.

Stock Based Compensation

The Company accounts for stock-based compensation applying the provisions of ASC 718, *Compensation Stock Compensation*. ASC 718 applies to new awards and to awards that were outstanding as of December 31, 2005 that are subsequently vested, modified, repurchased or cancelled. Compensation expense recognized during 2010, 2009 and 2008 includes the portion vesting during the period for (1) all share-based payments granted prior to, but not yet vested as of December 31, 2005, based on the grant-date fair value estimated in accordance with the original provisions of the standard and (2) all share- based payments granted subsequent to December 31, 2005, based on the grant-date fair value estimated using the Black-Scholes option-pricing model.

Concentration of Credit Risk

For the years ended December 31, 2010, 2009 and 2008, approximately 33%, 34% and 35%, respectively, of the Company s net revenue was received from Medicare and other governmental programs, which reimburse providers based on fee schedules determined by the related governmental agency. In the ordinary course of business, providers receiving reimbursement from Medicare and other governmental programs are potentially subject to a review by regulatory agencies concerning the accuracy of billings and sufficiency of supporting documentation.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Recently Issued Accounting Pronouncements

In October 2009, the FASB issued ASU No. 2009-17, *Consolidations: Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*. It requires reporting entities to evaluate former qualifying special purpose entities for consolidation, changes the approach to determining a VIE s primary beneficiary from a quantitative assessment to a qualitative assessment designed to identify a controlling financial interest, and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a VIE. It also clarifies, but does not significantly change, the characteristics that identify a VIE. This ASU also requires additional year-end and interim disclosures and is effective for fiscal years commencing after November 15, 2009. The adoption of this standard did not impact the Company s consolidated financial statements.

In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures* (Topic 820), Improving Disclosures about Fair Value Measurements (ASU No. 2010-06). ASU No. 2010-06 requires new disclosures about significant transfers in and out of Level 1 and Level 2 fair value measurements and the reasons for such transfers and in the reconciliation for Level 3 fair value measurements disclose separately information about purchases, sales, issuances and settlements. The Company adopted the provisions of ASU No. 2010-06 on January 1, 2010, except for disclosures about purchases, sales, issuances and settlements in the reconciliation for Level 3 fair value measurements. Those disclosures will be effective for financial statements issued for fiscal years beginning after December 15, 2010. The adoption of this standard did not impact the Company s consolidated financial statements.

3. EARNINGS PER COMMON SHARE (EPS)

Basic EPS is calculated by dividing net income attributable to NovaMed, Inc. by the weighted average number of common shares outstanding during the period. Diluted EPS is calculated by dividing net income attributable to NovaMed, Inc. by the weighted average number of common shares, including the dilutive effect of potential common share equivalents outstanding during the period. The dilutive effect of potential common share equivalents, consisting of outstanding stock options and unvested restricted stock, is calculated using the treasury stock method and Convertible Notes and related warrants using the if converted method.

Earnings per common share is calculated as follows:

	Year Ended December 31, 2010	2009 (shares in thousands)	2008
Amounts attributable to NovaMed, Inc.:			
Income from continuing operations	$ 7,208	$ 8,251	$ 6,928
Income (loss) from discontinued operations	(1,889)	(740)	290
Net income attributable to NovaMed, Inc.	$ 5,319	$ 7,511	$ 7,218
Basic weighted average number of common shares outstanding	7,701	7,560	8,098
Effect of dilutive securities stock options and unvested restricted stock	169	212	200
Diluted weighted average number of shares outstanding	7,870	7,772	8,298
Basic earnings (loss) per common share:			
Continuing operations	$ 0.94	$ 1.09	$ 0.86
Discontinued operations	(0.25)	(0.10)	0.04
Basic earnings per share	$ 0.69	$ 0.99	$ 0.90
Diluted earnings (loss) per common share:			
Continuing operations	$ 0.92	$ 1.06	$ 0.83
Discontinued operations	(0.24)	(0.10)	0.03
Diluted earnings per share	$ 0.68	$ 0.96	$ 0.86

On May 19, 2010, the Company s Board of Directors and stockholders approved a 1-for-3 reverse stock split with an effective date of June 1, 2010. The Company has recast the presentation of share and per share data in the prior year financial statements to reflect the reverse stock split. The Company has also recast all share and per share data in the accompanying footnotes to the financial statements.

Stock options to purchase approximately 775,000, 809,000 and 825,000 shares of common stock as of December 31, 2010, 2009 and 2008, respectively, were outstanding but not included in the computation of diluted earnings per common share because the effect on diluted earnings per share would be anti-dilutive. The Company also excluded approximately 86,000, 32,000 and 51,000 of unvested restricted stock as of December 31, 2010, 2009 and 2008, respectively, because the effect on diluted earnings per share would be anti-dilutive. The Company also excluded the potential shares underlying its Convertible Notes of approximately 3,924,000 and related warrants of approximately 3,924,000 because the Company s stock price was lower than the conversion price (See Note 11).

4. STATEMENT OF CASH FLOWS SUPPLEMENTAL INFORMATION

	Years ended December 31,		
	2010	2009	2008
Supplemental cash flow information:			
Interest paid	$ 3,007	$ 3,837	$ 3,188
Income taxes paid	723	774	385
Income tax refunds received	82		126

Non-cash investing and financing activities:

During 2010, 2009 and 2008, the Company received 16,983, 13,021 and 11,359 shares of its common stock from certain executives to fund $172, $152 and $103 of tax withholding, respectively, due on restricted stock granted to them, which vested during the year. These were recorded as treasury shares and certain of these shares are available for future issuance under the Company s stock incentive plans.

In 2010 and 2008, the Company obtained medical equipment by entering into capital leases for $420 and $1,070, respectively. The Company did not enter into any capital leases in 2009.

5. ACQUISITIONS AND SALES OF NONCONTROLLING INTERESTS

The Company accounts for acquisitions of majority equity interests in ASCs using the purchase method of accounting. The results of operations of the acquired ASC are included in the consolidated financial statements of the Company from the date of acquisition.

In 2010, the Company s Downtown Surgery Center located in Orlando, Florida acquired certain assets of a multi-specialty ASC in the market for $1,286 of which the Company allocated $1,149 to goodwill. As a result of the transaction, the operations of the acquired ASC have been merged into Downtown Surgery Center and three physician-partners and a hospital-partner of the acquired ASC have become partners in Downtown Surgery Center, representing a 5% noncontrolling interest in the ASC. The Company did not make any acquisitions during 2009. The Company acquired a majority interest in three ASCs in 2008. The Company also acquired a call center and marketing solutions business in 2008 and subsequently sold this business in 2010 (see Note 9). Total cash acquisition cost in 2008 for these ASCs and call center and marketing solutions business was $49,427 of which the Company allocated $48,017 to goodwill and $1,191 to amortizable intangible assets. The goodwill is not amortized and is expected to be fully deductible for tax purposes.

During 2010, the Company s Surgery Center of Kalamazoo, LLC sold a 5% equity interest to a local hospital. As a result of the transaction, the Company received proceeds of $746 in exchange for a 2% equity ownership; the Company now owns 61.9% of the ASC. In addition, during 2010 the Company sold noncontrolling equity interests in two of its existing ASCs and received in the aggregate approximately $113 in proceeds. The Company sold noncontrolling equity interests in two of its existing ASCs during 2009 and received in the aggregate approximately $335 in proceeds. During 2010, the Company purchased noncontrolling equity interests in four of its existing ASCs for $169. During 2009, the Company purchased noncontrolling equity interests in three of its existing ASCs for $268.

6. PROPERTY AND EQUIPMENT

Property and equipment consist of the following as of December 31, 2010 and 2009:

		2010		2009
Equipment	$	26,544	$	25,298
Information technology		3,750		3,362
Furniture and fixtures		1,444		1,430
Land and buildings		286		286
Leasehold improvements		16,036		15,987
		48,060		46,363
Less Accumulated depreciation and amortization		(32,822)		(28,223)
	$	15,238	$	18,140

Depreciation and amortization expense in 2010, 2009 and 2008 was $5,040, $5,654 and $4,248, respectively.

7. GOODWILL AND OTHER INTANGIBLE ASSETS

The Company accounts for intangible assets in accordance with ASC 350. The carrying value of these assets is assessed at least annually and an impairment charge is recorded if appropriate.

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

	Goodwill				
	Surgical Facilities	Product Sales	Other	Total	Amortized Intangibles
Balance January 1, 2008	$ 134,692	$ 10,156	$ 941	$ 145,789	$ 1,769
Acquisitions	47,329			47,329	75
Purchase price adjustments	1,650	351		2,001	
Other	(135)	(1,110)		(1,245)	1,110
Amortization					(252)
Balance December 31, 2008	183,536	9,397	941	193,874	2,702
Purchase price adjustments	(606)			(606)	
Amortization					(237)
Balance December 31, 2009	182,930	9,397	941	193,268	2,465
Acquisitions	1,149			1,149	
Other					(19)
Amortization					(225)
Balance December 31, 2010	$ 184,079	$ 9,397	$ 941	$ 194,417	$ 2,221

Estimated amortization of intangible assets for the five years and thereafter subsequent to December 31, 2010 is $207, $182, $172, $164, $155 and $1,341.

8. ACCRUED EXPENSES

Accrued expenses consist of the following as of December 31, 2010 and 2009:

	2010	2009
Accrued payroll and related benefits	$ 1,449	$ 1,331
Accrued incentive compensation	1,703	2,028
Accrued interest	229	140
Deferred revenue	89	207
Deferred rent	783	615
Accrued professional fees	762	421
Accrued business taxes	245	239
Other	124	129
	$ 5,384	$ 5,110

9. DISCONTINUED OPERATIONS

The Company reports as discontinued operations certain entities that have been disposed of or are classified as held for sale. An entity held for sale that qualifies as a discontinued operation is measured at the lower of its carrying amount or fair value less cost to sell. A loss is recognized for any initial or subsequent write-down to fair value less cost to sell and is reported within discontinued operations. The results of operations of current and prior periods of an entity disposed of or classified as held for sale is reported in discontinued operations.

During the fourth quarter of 2007, the Company recorded a net loss on the pending divestiture of the Laredo, Texas ASC of $8,092. The net loss primarily related to the write down of the carrying value of net assets to the Company s estimate of fair market value less costs to sell the ASC. In August 2008, the ASC, of which the Company owned a 96% interest, sold substantially all of it assets for $156. As a result, the Company adjusted its previously recorded loss on the sale of the ASC and recorded a pre-tax gain of $277 in 2008.

During the fourth quarter of 2007, the Company recorded a net loss on the pending divestiture of the Thibodaux, Louisiana ASC of $1,480. The net loss primarily related to the write down of the carrying value of net assets to the Company s estimate of fair market value less costs to sell the ASC. In February 2008, the Company completed the sale of its 70% interest in the ASC and received proceeds of $226. As a result, the Company adjusted its previously recorded loss on the sale of the ASC and recorded a pre-tax gain of $66 in 2008.

During 2010, one of the Company s wholly owned subsidiaries sold substantially all of the assets of its MDnetSolutions business. In the second quarter of 2010, the Company recorded an after tax loss on the sale of this business of $1,554. For purposes of the loss calculation, future potential earn-out payments to the Company from the buyers of up to $1,000 were not considered due to uncertainty of collection. All future earn-out payments received by the Company, if any, will be recorded as income from discontinued operations in the period received by the Company. The results of operations of this business during 2010, 2009 and 2008 included revenue of $1,085, $2,413 and $1,053, respectively, and pretax income (losses) of ($553), ($1,213) and $62, respectively.

In addition to recording the net loss on disposal of the businesses described above, the Company reported the results of operations of these businesses within discontinued operations for all periods presented within the Consolidated Statements of Operations and has excluded amounts related to these businesses from amounts reflected in footnotes that disclose information about continuing operations.

The operating results of all discontinued operations are summarized as follows:

	Year ended December 31,					
		2010		**2009**		**2008**
Net revenue	$	1,085	$	2,413	$	1,201
Operating expense		1,638		3,623		1,281
Interest and other expense, net				3		7
Loss from operations before income taxes		(553)		(1,213)		(87)
Income tax benefit		(218)		(473)		(34)
Net loss	$	(335)	$	(740)	$	(53)
Gain (loss) on disposal of discontinued operations	$	(2,355)	$		$	343
Income tax benefit		(801)				
Net gain (loss) on disposal of discontinued operations	$	(1,554)	$		$	343

10. INCOME TAXES

The Company and some of its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state or local income tax examinations by tax authorities for years before 2007.

In 2007, the Company recognized a liability for unrecognized tax benefits of approximately $416. No adjustment was made to the beginning retained earnings balance, as the ultimate deductibility of all these tax positions was judged to be highly certain but there is uncertainty about the timing of such deductibility. No interest or penalties have been accrued relative to these positions due to the Company having either a tax loss or having utilized a net operating loss carryforward to offset any taxable income in all subject years. Deferred tax assets have been recorded to recognize the future benefits of the positions reserved for in the liability. Because of the impact of deferred income tax accounting, the temporary differences would not affect the annual effective tax rate.

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

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

	2010	2009	2008
Unrecognized tax benefits beginning balance	$ 320	$ 365	$ 435
Gross increases tax positions in prior period			
Gross decreases tax positions in prior period			
Gross increases current period tax positions			
Settlements	(52)	(45)	(70)
Lapse of statute of limitations			
Unrecognized tax benefits ending balance	$ 268	$ 320	$ 365

The income tax provision from continuing operations consists of the following for the years ended December 31, 2010, 2009 and 2008:

	2010	2009	2008
Current			
Federal	$	$ (58)	$ 74
State	407	411	366
	407	353	440
Deferred			
Federal	2,347	3,567	3,626
State	273	420	209
Deferred tax provision (benefit)	2,620	3,987	3,835
Less: discontinued operations tax benefit	1,019	473	34
	3,639	4,460	3,869
Other			
Tax benefit of convertible note hedge payment and stock-based compensation recorded as additional paid-in-capital	382	463	121
	$ 4,428	$ 5,276	$ 4,430

A reconciliation of income tax expense from continuing operations and the amount calculated using the U.S. statutory rate of 34% is presented as follows:

	2010	2009	2008
Tax expense attributable to NovaMed, Inc. at U.S. statutory rate	34.0%	34.0%	34.0%
State taxes attributable to NovaMed, Inc., net	5.9	4.7	3.8
Valuation allowance	(2.0)		
Other	0.2	0.3	1.2
Provision for income taxes attributable to NovaMed, Inc.	38.1%	39.0%	39.0%

At December 31, 2010, the Company had federal net operating loss carryforwards of approximately $9,347 and $262 of federal alternative minimum tax credit carryforwards. The federal net operating loss carryforwards expire in 2026, 2027 and 2030 and the federal alternative minimum tax credits carry forward indefinitely. The Company also has capital loss carryforwards of approximately $11,592, net of a $11,007 valuation reserve, that expire starting in 2013. Due to the reporting requirements of ASC 718, $6,391 of the net operating loss carryforward is not recorded on the Company s balance sheet because the loss was created by the tax benefits of stock option exercises and under the new accounting rules cannot be recognized for book purposes until the benefit has been realized by actually reducing taxes payable.

Deferred tax assets (liabilities) are comprised of the following at December 31, 2010 and 2009:

	2010	2009
Deferred tax assets		
Discontinued operations and restructuring	$ 5,983	$ 6,039
Goodwill impairment charges	1,613	1,613
Capital loss carryforward	4,405	4,378
Net operating loss	1,159	
Loss on investment on nonconsolidated affiliate	234	396
Deferred revenue	35	197
Convertible note hedge payment	2,776	4,080
AMT credit	262	269
Discount on conversion of notes	19	83
Compensation expense related to stock options	2,808	2,454
Receivable and inventory reserves	330	387
Compensation expense	163	146
Other	392	442
	20,179	20,484
Valuation allowance	(9,874)	(10,079)
Total deferred tax assets	10,305	10,405
Deferred tax liabilities		
Depreciation and amortization	(21,042)	(16,666)
Prepaid expenses	(347)	(403)
ASC 470-20 convertible debt discount amortization	(2,929)	(4,729)
Total deferred tax liabilities	(24,318)	(21,798)
Net deferred tax assets (liabilities)	$ (14,013)	$ (11,393)

The Company recorded a valuation allowance on a portion of the losses on the sale of discontinued operations which are capital in nature, and on a portion of the stock options not expected to be exercised.

11. LONG-TERM DEBT AND CONVERTIBLE SENIOR SUBORDINATED NOTES

Long-term debt consists of the following as of December 31, 2010 and 2009:

	2010	2009
Credit facility	$ 21,500	$ 40,200
Capital lease obligations (see Note 12)	1,090	925
Notes payable	6,792	9,805
Less Current maturities	(25,108)	(8,217)
Total long-term debt	$ 4,274	$ 42,713
Convertible subordinated debt, net of discount	$ 66,708	$ 61,569

Cash payments required on debt in the five years subsequent to December 31, 2010 and thereafter are reflected in the table below:

2011	$	25,525
2012		76,987
2013		1,332
2014		731
2015		635
Thereafter		
Total cash payments	$	105,210
Less: interest on capital leases and notes payable		(828)
Less: unamortized convertible debt discount/remaining imputed interest		(8,292)
Total debt	$	96,090

Credit Facility

Effective August 31, 2009, the Company amended its credit facility, decreasing the maximum commitment available under the facility from $125,000 to $80,000, consisting of a $50,000 revolving credit facility and a $30,000 term loan facility. The expiration date of the credit facility was extended to December 15, 2011, however, if the Company has repaid or refinanced its Convertible Notes prior to this date, the expiration date will be extended to August 31, 2012. The maximum commitment available under the revolving credit facility is $50,000 or the maximum allowed under the calculated ratio limitations. The $30,000 term loan facility requires quarterly repayments of $1,000 commencing December 31, 2009, $1,250 commencing December 31, 2010 and $1,500 commencing December 31, 2011. The amended credit agreement also includes an option allowing the Company to increase the maximum commitment available under the revolving credit facility to $95,000 under certain conditions. At December 31, 2010, the Company had approximately $49,200 of potential borrowing availability under its revolving credit facility. Interest on borrowings under the facility is payable at an annual rate equal to the Company s lender s published base rate plus the applicable borrowing margin ranging from 0.75% to 3.00% or LIBOR plus a range from 2.75% to 5.00%, varying depending upon the calculated ratios and the Company s ability to meet other financial covenants. In addition, a fee ranging from 0.25% to 0.50% is charged on the unused portion of the revolver commitment. The maximum borrowing availability and applicable interest rates under the credit facility are calculated based on a ratio of total indebtedness to earnings before interest, taxes, depreciation and amortization, all as more fully defined in the Company s credit agreement. The credit agreement continues to contain customary covenants that include limitations on indebtedness, liens, capital expenditures, acquisitions, investments and share repurchases, as well as restrictions on the payment of dividends; however, many of these limitations were changed by the amendment. Under the terms of the credit agreement, the Company was subject to a maximum total leverage ratio of 5.00 times initially, which decreased to 4.75 and 4.25 times for the quarters ended December 31, 2009 and December 31, 2010, respectively, and will decrease to 4.00 times for the quarter ending December 31, 2011 and thereafter. The Company was also subject to a maximum senior leverage ratio of 2.50 times initially, which decreased to 2.25 times for the quarter ended December 31, 2010 and thereafter. The Company is required to obtain the consent of its lenders for any acquisition exceeding $25,000 individually and $40,000 for all acquisitions consummated during the term of the credit agreement. The credit facility is collateralized by certain assets of the Company.

At December 31, 2010, the Company had no borrowings outstanding under its revolving credit facility and $21,500 of borrowings under its term loan facility with a weighted average interest rate of 4.3%, and was in compliance with all of its credit agreement covenants. The weighted average interest rate on credit line borrowings during 2010 and 2009 was 4.8% and 3.7%, respectively. In addition, the Company paid a fee ranging from 0.25% to 0.50% on the unused portion of the commitment.

During 2008, the Company s Orlando (formerly Altamonte Springs), Florida ASC, of which it owns a 62% interest, entered into a $3,300 installment note which matures on December 31, 2015. Interest is payable on the outstanding principal balance at the lender s one month LIBOR rate, designated or published on the first day of each month, plus 2.5%. This note financed the cost of relocating this ASC from Altamonte Springs, Florida to Orlando, Florida, which was completed in January 2009. As of December 31, 2010, there was $2,357 outstanding under this note. The note is collateralized by certain assets of the Orlando, Florida ASC.

Effective August 1, 2006, NovaMed Eye Surgery Center of New Albany, LLC (New Albany ASC), of which the Company owns a 51% majority interest, entered into a $4,000 installment note which matures on August 1, 2013. Interest is payable at the lender s one month LIBOR rate, designated or published on the first of each month, plus 2.0%. The New Albany ASC entered into a five-year interest rate swap agreement that effectively fixes the LIBOR rate on this debt at 5.51%. The New Albany ASC has recognized the fair value of this interest rate swap as a long-term liability of approximately $9 and $59 at December 31, 2010 and 2009, respectively. As of December 31, 2010, there was $1,717 outstanding under this note. Annual principal payments of the note for the three years commencing with 2011 are $606, $653, and $458. The note is collateralized by certain assets of the New Albany ASC.

The fair value of the interest rate swaps is determined based on market interest rates for similar maturity periods. Payments or receipts of cash under the interest rate swaps are shown as a part of operating cash flow, consistent with the interest expense incurred pursuant to the credit facility and the installment note.

The remaining long-term debt consists of various capital lease and note obligations with interest rate ranges from 2.3% to 14.8%, due through 2015.

At December 31, 2010, the Company had outstanding letters of credit issued to two of its optical products buying group vendors in the amounts of $630 and $203 that expire on March 31, 2011 and September 30, 2011, respectively. The outstanding letters of credit reduce the amount available under the credit facility.

Convertible Senior Subordinated Notes

In June 2007, the Company issued $75,000 aggregate principal amount of 1.0% convertible senior subordinated notes due June 15, 2012 (the Convertible Notes). Proceeds from the Convertible Notes were used to pay down $62,375 of outstanding indebtedness on the Company s revolving credit facility and to fund the $10,000 net cost of the convertible note hedge and warrant transactions described below. Interest on the Convertible Notes is payable semi-annually in arrears on June 15 and December 15 of each year, commencing December 15, 2007. The Convertible Notes rank subordinate to the Company s senior debt and rank pari passu or senior to all of the Company s other subordinated indebtedness. The Convertible Notes are convertible into shares of the Company s common stock at an initial conversion price of $19.113 per share, or approximately 52.3204 shares per $1,000 principal amount of Convertible Notes. At December 31, 2010, the Company had $66,708 in convertible subordinated debt outstanding, net of debt discount. As of December 31, 2010, the fair value of the $75,000 Convertible Notes was approximately $69,000, based on the level 2 valuation hierarchy under ASC 820 (formerly SFAS No. 157). The Convertible Notes include a net-share settlement feature that requires the Company to settle conversion of the notes in cash up to the notes principal amount and settle any excess of the Convertible Notes conversion value above their principal amount by delivering shares of the Company s stock, cash, or a combination of cash and common stock, at the Company s option. The conversion value of the Convertible Notes is equal to the market price of the Company s common stock times the conversion rate of approximately 52.3204 shares per $1,000 principal amount of Convertible Notes. A market price that exceeds the conversion price of $19.113 at the time of settlement results in excess conversion value above the original principal amount of $1,000. As a result of the net-share settlement feature, the Company will be able to substantially reduce the number of shares of common stock issuable in the event of the conversion of the Convertible Notes by repaying principal in cash instead of issuing shares of common stock for that amount. Additionally, the Company is not required to include the underlying shares of common stock in the calculation of the Company s diluted weighted average shares outstanding for earnings per share until the Company s common stock price exceeds $19.113. Effective January 1, 2009, the Company adopted a new accounting standard included in ASC 470-20 (formerly FSP APB 14-1). ASC 470-20 applies to convertible debt instruments that may be settled in cash upon conversion, including partial cash settlement, when the conversion option does not need to be bifurcated and accounted for separately as a derivative instrument in accordance with ASC 815 (formerly FAS 133). ASC 470-20 requires that issuers of convertible debt instruments that, upon conversion, may be settled fully or partially in cash, must separately account for the liability and equity components in a manner that will reflect the entity s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. Additionally, debt issuance costs are required to be allocated in proportion to the allocation of the liability and equity components and accounted for as debt issuance costs and equity issuance costs, respectively. In accordance with the provisions of ASC 470-20, the Company determined based on the level 2 valuation hierarchy that the fair value of its Convertible Notes at issuance in 2007 was approximately $52,131, and the Company designated the residual value of approximately $22,869 as the equity component. Additionally, the Company allocated approximately $1,825 of the $2,625 original Convertible Notes issuance cost as debt issuance cost, which is being amortized using the effective interest rate method over the term of the Convertible Notes, and the remaining $800 as equity issuance cost. The adoption of ASC 470-20 added approximately $4,614, $4,225 and $3,867 of non-cash interest expense to its 2010, 2009 and 2008 results of operations, respectively. This resulted in a reduction to net income of approximately $2,791 ($0.35 per diluted share), $2,577 ($0.33 per diluted share) and $2,359 ($0.28 per diluted share) in 2010, 2009 and 2008, respectively. The adoption of ASC 470-20 will add approximately $5,055 of non-cash interest expense to the Company s 2011 results of operations and will reduce net income by approximately $3,058. The adoption of ASC 470-20 does not have an impact on the Company s cash flows.

The balances of the liability and equity components as of each period presented are as follows:

	December 31, 2010	December 31, 2009
Convertible subordinated debt	$ 75,000	$ 75,000
Unamortized debt discount	(7,748)	(12,522)
Unamortized debt issuance costs	(544)	(909)
Liability component net carrying amount	$ 66,708	$ 61,569

Equity component, net of tax	$	13,462	$	13,462

The components of interest expense for 2010, 2009 and 2008 related to the Convertible Notes was recognized as follows:

	2010	2009	2008
Interest expense coupon rate	$ 750	$ 750	$ 750
Pre-ASC 470-20 debt issuance cost amortization	525	525	525
Imputed interest expense per ASC 470-20	4,774	4,385	4,027
Debt issuance cost allocated to equity per ASC 470-20	(160)	(160)	(160)
Total interest expense on Convertible Notes	$ 5,889	$ 5,500	$ 5,142

The Convertible Notes also contain a restricted convertibility feature that does not affect the conversion price of the Convertible Notes but, instead, places restrictions on a holder s ability to convert their Convertible Notes into shares of the Company s common stock. A holder may convert the Convertible Notes prior to December 15, 2011 only if one or more of the following conditions are satisfied:

- during any calendar quarter commencing after the date of original issuance of the Convertible Notes, if the closing sale price of the Company s common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the calendar quarter preceding the quarter in which the conversion occurs is more than 120% of the conversion price of the Convertible Notes in effect on the last trading day;

- during the ten consecutive trading-day period following any five consecutive trading-day period in which the trading price for the Convertible Notes for each such trading day was less than 97% of the closing sale price of the Company s common stock on such date multiplied by the then current conversion rate;

- the Company makes certain significant distributions to holders of the Company s common stock;

- the Company enters into specified corporate transactions; or

- the Company s common stock ceases to be approved for listing on the NASDAQ Global Select Market and is not listed for trading on another U.S. national securities exchange.

Holders may also surrender their Convertible Notes for conversion after December 15, 2011 at any time prior to the close of business on the business day immediately prior to the stated maturity date regardless of whether any of the foregoing conditions have been satisfied. Upon the satisfaction of any of the foregoing conditions as of the last day of a reporting period, or during the twelve months prior to the stated maturity date, the Company would write off to expense all remaining unamortized debt issuance costs and discount in that period.

If the Convertible Notes are converted in connection with certain fundamental changes that occur prior to December 15, 2011, the Company may be obligated to issue additional shares upon conversion as a make-whole premium with respect to the Convertible Notes. The terms of the

Convertible Notes require the Company to purchase the Convertible Notes for cash in the event of a fundamental change, such as a change in control of the Company.

Concurrent with the sale of the Convertible Notes, the Company entered into a convertible note hedge transaction with respect to the Company s common stock (the purchased call option) with Deutsche Bank AG London (the counterparty), an affiliate of the underwriter. The purchased call options cover an aggregate of approximately 3,924,000 shares of the Company s common stock at a strike price of $19.113 per share. The cost of the call options totaled $24,000. The Company also sold warrants to the counterparty to purchase from the Company an aggregate of approximately 3,924,000 shares of the Company s common stock at an exercise price of $24.93 per share. The Company received proceeds from the sale of these warrants of $14,000. Taken together, the call option and warrant agreements have the effect of increasing the effective conversion price of the Convertible Notes to $24.93 per share. The call options and warrants must be settled in net shares, except in connection with certain termination events, in which case they would be settled in cash based on the fair market value of the instruments. On the date of settlement, if the market price per share of the Company s common stock is above $24.93 per share, the Company will be required to deliver shares of its common stock representing the value of the warrants in excess of $24.93 per share.

The warrants have a strike price of $24.93 and are generally exercisable at anytime. The Company issued and sold the warrants in a transaction exempt from the registration requirements of the Securities Act of 1933, as amended, because the offer and sale did not involve a public offering. There were no underwriting commissions or discounts in connection with the sale of the warrants.

In accordance with the provisions of ASC 480*, Distinguishing Liabilities from Equity,* the Company recorded the call options as a reduction and the warrants as an increase in additional paid in capital, and will not recognize subsequent changes in fair value of the call options and warrants in its consolidated financial statements. For income tax purposes, the Company has elected to apply the Integration Regulations under Treas. Reg. 1.275-6 to treat the Convertible Notes and the associated call options as synthetic debt instruments and is accordingly deducting the option premium paid for the call options as original issue discount over the five-year term. A deferred tax asset of $8,160 was initially recorded to reflect the future cash benefit of the deduction over the term of the Convertible Notes. Also, pursuant to Internal Revenue Code Section 1032, the Company will not recognize any gain or loss for tax purposes with respect to the exercise or lapse of the warrants.

12. OPERATING AND CAPITAL LEASES

The Company has commitments under long-term, non-terminable operating leases, principally for facility and office space. Lease terms generally cover one to ten years. Certain leases contain consecutive renewal options and escalation clauses.

The Company entered into four new capital leases for medical equipment during 2010. The Company had nine and seven capital leases for medical equipment that existed as of December 31, 2010 and 2009, respectively. The net book value of assets under capital leases was $1,090 and $925 at December 31, 2010 and 2009, respectively. The annual interest rates on capital leases range from 5.0% to 14.8%.

At December 31, 2010, minimum annual rental commitments are as follows:

	Operating Leases	Capital Leases
2011	$ 6,362	$ 491
2012	5,770	318
2013	5,256	180
2014	4,539	116
2015	3,569	98
2016 and thereafter	4,248	
Minimum lease payments	29,744	1,203
Less: sublease receipts	(70)	
Total minimum lease payments	$ 29,674	1,203
Less: amount representing interest		(113)
Total obligation under capital leases		$ 1,090

Included in the table above are operating lease annual rent commitments with related parties for the five years commencing with 2011 of approximately $3,103, $2,801, $2,653, $2,353, $4,926 and $344 thereafter. Rent expense of continuing operations related to operating leases amounted to $8,393, $8,819 and $7,560 during 2010, 2009 and 2008, respectively.

13. COMMITMENTS AND CONTINGENCIES

Litigation

The Company is subject to various claims and legal actions that arise in the ordinary course of business. In the opinion of management, the ultimate resolution of such matters will not have a material adverse effect on the Company s financial position or results of operations.

Professional Liability Risk

The Company maintains third party professional liability insurance for its ASCs and business activities. Although the Company believes that this insurance is adequate as to the amounts at risk, there can be no assurance that any claim asserted against the Company will not exceed the coverage limits of such insurance.

Insurance

The Company is insured with respect to professional liability risks on a claims-made basis. Management is not aware of any claims against the Company that might have a material impact on the Company s financial position or results of operations.

Purchase Commitments

Pursuant to the sale of a 29% interest in its Richmond, VA ASC to two physicians, the Company granted the physicians an option to sell back their interests to the Company for the original price paid at any time which is $319. In October 2010, the Company received notices from both physicians of their intent to exercise this option. The Company repurchased these interests effective February 25, 2011.

Employment Agreements

The Company has employment agreements with certain of its executives that specify that if the executive is terminated by the Company for other than cause following a change in control of the Company, the executive shall receive severance pay ranging from twelve to twenty-four months salary plus bonus and certain other benefits.

14. STOCKHOLDERS EQUITY

Common Stock

On July 23, 2008, the Company s Board of Directors adopted a program to repurchase from time to time at management s discretion up to $8,000 of the Company s common stock at prevailing market prices in the open market or in private transactions during the 12-month period ended July 31, 2009. During the six months ended December 31, 2008, the Company purchased 636,320 shares of the Company s common stock for $6,871 at an average price of $10.80 per share. During the first quarter of 2009, the Company purchased 120,433 shares of the Company s common stock for $1,126 at an average price of $9.36 per share which completed the repurchase program.

Other Comprehensive Income

The Company reports other comprehensive income as a measure of changes in stockholders equity that resulted from recognized transactions and other economic events of the period from non-owner sources. Other comprehensive income of the Company results from adjustments due to the fluctuation of the value of the Company s interest rate swaps accounted for under the provisions of ASC 815. The New Albany ASC entered into an interest rate swap during the third quarter of 2006. The Company s share of the negative value of the interest rate swap was $6 at December 31, 2010 and is recorded as accumulated other comprehensive loss in the accompanying consolidated balance sheet. The total comprehensive income attributable to NovaMed, Inc. for the years ended December 31, 2010, 2009 and 2008 was $5,353, $7,689 and $7,450, respectively. See Note 11 for further discussion of the interest rate swaps.

15. EMPLOYEE BENEFIT PLANS

Employee Benefits and Compensation

The Company maintains a voluntary savings plan (the Savings Plan) for eligible employees under section 401(k) of the Internal Revenue Code whereby participants may contribute a percentage (up to 100%) of their compensation not to exceed IRS limits. During 2010, the Savings Plan provided for the Company to match 50% of the employee s contributions on the first 4% of salary contributed by each employee. The Company s matching contributions approximated $348, $369 and $298 for 2010, 2009 and 2008, respectively.

Employee Stock Purchase Plan

The Company has an employee stock purchase plan for all eligible employees. Under the plan, shares of the Company s common stock may be purchased at six-month intervals at 85% of the lower of the fair market value on the first or the last day of each six-month period. Employees may purchase shares having a value not exceeding 10% of their gross compensation during an offering period; however, the amount of an employee s purchase may not exceed $20 in any offering period or $25 in any calendar year. Under this plan 10,980 shares, 16,964 shares and 11,857 shares were purchased during 2010, 2009 and 2008, respectively. Under the provisions of ASC 718, the Company recognized compensation expense of $22, $27 and $30 during 2010, 2009 and 2008, respectively. At December 31, 2010, 44,177 shares were reserved for future issuance.

Stock Plans

The Company is authorized to issue up to 3,700,600 shares of its common stock, par value $.01 per share, under various stock plans. Of this amount, 289,111 shares remain available for issuance as of December 31, 2010. Under these plans, the Company has granted restricted stock and non-qualified options to purchase shares of common stock to employees and outside directors. Options are granted at market value on the date of the grant. Options become exercisable over a four-year period with 1/8th of the total options granted becoming exercisable six months from the date of each grant and 1/48th of the total options granted becoming exercisable each month thereafter. Options generally have a term of ten years from the date of the grant.

The Company accounts for stock-based compensation applying the provisions of ASC 718, *Compensation Stock Compensation*. ASC 718 applies to new awards and to awards that were outstanding as of December 31, 2005 that are subsequently vested, modified, repurchased or cancelled. Compensation expense recognized during 2010, 2009 and 2008 includes the portion vesting during the period for (1) all share-based payments granted prior to, but not yet vested as of December 31, 2005, based on the grant-date fair value estimated in accordance with the original provisions of the standard and (2) all share- based payments granted subsequent to December 31, 2005, based on the grant-date fair value estimated using the Black-Scholes option-pricing model. The Company calculated its available APIC pool of net excess benefits using the transition method as defined in ASC 718. During 2010, the Company did not grant any options. Stock compensation expense of $932, $1,338 and $1,601 was recognized on existing stock options during the years ended December 31, 2010, 2009 and 2008, respectively.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for stock options granted during 2010, 2009 and 2008.

	2010	2009	2008
Weighted average fair value of options at the date of grant	$	$ 3.87	$ 4.80
Expected option life in years		6	6
Risk-free interest rate		3.53%	3.06%
Dividend yield			
Expected volatility		43.26%	44.44%

The expected option life used for 2009 and 2008 grants was the weighted average of the vesting term assuming options are exercised as vested and the original contractual term of the option. The risk free interest rate is based on the yield curve