

ALLIANCE RESOURCE PARTNERS LP

Form 10-Q

August 09, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2010

OR

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

For the transition period from _____ to _____

Commission File No.: 0-26823

ALLIANCE RESOURCE PARTNERS, L.P.

(Exact name of registrant as specified in its charter)

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Delaware **73-1564280**
(State or other jurisdiction of **(IRS Employer**
incorporation or organization) **Identification No.)**
1717 South Boulder Avenue, Suite 400, Tulsa, Oklahoma 74119
(Address of principal executive offices and zip code)
(918) 295-7600
(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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (check one)

Large Accelerated Filer Accelerated Filer

Non-Accelerated Filer (Do not check if smaller reporting company) Smaller Reporting Company

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

As of August 9, 2010, 36,716,855 common units are outstanding.

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	June 30, 2010	December 31, 2009
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 9,669	\$ 21,556
Trade receivables	121,877	91,223
Other receivables	2,692	3,159
Due from affiliates	1,803	83
Inventories	52,931	64,357
Advance royalties	3,629	3,629
Prepaid expenses and other assets	3,560	8,801
Total current assets	196,161	192,808
PROPERTY, PLANT AND EQUIPMENT:		
Property, plant and equipment, at cost	1,510,054	1,378,914
Less accumulated depreciation, depletion and amortization	(607,406)	(556,370)
Total property, plant and equipment, net	902,648	822,544
OTHER ASSETS:		
Advance royalties	27,768	26,802
Other long-term assets	26,925	9,246
Total other assets	54,693	36,048
TOTAL ASSETS	\$ 1,153,502	\$ 1,051,400

LIABILITIES AND PARTNERS CAPITAL**CURRENT LIABILITIES:**

Accounts payable	\$ 66,943	\$ 62,821
Due to affiliates	434	27
Accrued taxes other than income taxes	15,683	10,777
Accrued payroll and related expenses	27,438	22,101
Accrued interest	2,920	2,918
Workers compensation and pneumoconiosis benefits	10,043	9,886
Current capital lease obligation	310	324

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Other current liabilities	13,620	11,062
Current maturities, long-term debt	18,000	18,000
Total current liabilities	155,391	137,916
LONG-TERM LIABILITIES:		
Long-term debt, excluding current maturities	427,000	422,000
Pneumoconiosis benefits	36,224	34,344
Accrued pension benefit	19,618	19,696
Workers compensation	60,519	53,845
Asset retirement obligations	53,991	53,116
Due to affiliates	1,269	1,148
Long-term capital lease obligation	314	460
Other liabilities	8,066	7,895
Total long-term liabilities	607,001	592,504
Total liabilities	762,392	730,420
COMMITMENTS AND CONTINGENCIES		
PARTNERS CAPITAL:		
Alliance Resource Partners, L.P. (ARLP) Partners Capital:		
Limited Partners - Common Unitholders 36,716,855 and 36,661,029 units outstanding, respectively	698,159	630,165
General Partners deficit	(290,438)	(293,153)
Accumulated other comprehensive loss	(16,611)	(17,149)
Total ARLP Partners Capital	391,110	319,863
Noncontrolling interest		1,117
Total Partners Capital	391,110	320,980
TOTAL LIABILITIES AND PARTNERS CAPITAL	\$ 1,153,502	\$ 1,051,400

See notes to condensed consolidated financial statements.

Table of Contents**ALLIANCE RESOURCE PARTNERS, L.P. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

(In thousands, except unit and per unit data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
SALES AND OPERATING REVENUES:				
Coal sales	\$ 385,905	\$ 287,620	\$ 750,064	\$ 599,880
Transportation revenues	8,821	12,794	18,526	23,684
Other sales and operating revenues	5,617	3,490	12,414	9,640
Total revenues	400,343	303,904	781,004	633,204
EXPENSES:				
Operating expenses (excluding depreciation, depletion and amortization)	246,702	204,477	485,969	400,853
Transportation expenses	8,821	12,794	18,526	23,684
Outside coal purchases	4,544	432	6,386	5,192
General and administrative	11,628	9,307	22,329	19,041
Depreciation, depletion and amortization	35,677	28,272	71,973	55,622
Total operating expenses	307,372	255,282	605,183	504,392
INCOME FROM OPERATIONS	92,971	48,622	175,821	128,812
Interest expense (net of interest capitalized for the three and six months ended June 30, 2010 and 2009 of \$423, \$332, \$691, and \$547, respectively)	(7,439)	(7,808)	(15,034)	(15,789)
Interest income	48	293	99	924
Other income	304	202	154	428
INCOME BEFORE INCOME TAXES	85,884	41,309	161,040	114,375
INCOME TAX EXPENSE (BENEFIT)	423	(201)	591	225
NET INCOME	85,461	41,510	160,449	114,150
LESS: NET INCOME ATTRIBUTABLE TO NONCONTROLLING INTEREST		(50)		(179)
NET INCOME ATTRIBUTABLE TO ALLIANCE RESOURCE PARTNERS, L.P. (NET INCOME OF ARLP)	\$ 85,461	\$ 41,460	\$ 160,449	\$ 113,971
GENERAL PARTNERS INTEREST IN NET INCOME OF ARLP	\$ 17,957	\$ 14,764	\$ 34,999	\$ 29,621
LIMITED PARTNERS INTEREST IN NET INCOME OF ARLP	\$ 67,504	\$ 26,696	\$ 125,450	\$ 84,350

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BASIC NET INCOME OF ARLP PER LIMITED PARTNER UNIT (Note 7)	\$ 1.82	\$ 0.72	\$ 3.38	\$ 2.28
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DILUTED NET INCOME OF ARLP PER LIMITED PARTNER UNIT (Note 7)	\$ 1.82	\$ 0.72	\$ 3.38	\$ 2.28
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DISTRIBUTIONS PAID PER LIMITED PARTNER UNIT	\$ 0.79	\$ 0.73	\$ 1.565	\$ 1.445
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WEIGHTED AVERAGE NUMBER OF UNITS OUTSTANDING - BASIC	36,716,855	36,661,029	—	—
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Earnings available to Quest Diagnostics common stockholders basic and diluted	\$ 161,840	\$ 168,447		
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Weighted average common shares outstanding basic	180,219	189,370		
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Effect of dilutive securities:

Stock options and performance share units	2,164	1,328		
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Weighted average common shares outstanding diluted	182,383	190,698		
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Earnings per share attributable to Quest Diagnostics common stockholders - basic:

Income from continuing operations	\$ 0.90	\$ 0.89		
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Loss from discontinued operations		(0.01)		
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Net income	\$ 0.90	\$ 0.88		
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Earnings per share attributable to Quest Diagnostics common stockholders - diluted:

Income from continuing operations	\$ 0.89	\$ 0.89		
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Loss from discontinued operations		(0.01)		
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Net income	\$ 0.89	\$ 0.88		
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Stock options and performance share units of 2.7 million shares and 5.1 million shares for the three months ended March 31, 2010 and March 31, 2009, respectively, were not included due to their antidilutive effect.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(in thousands, unless otherwise indicated)
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New Accounting Standards

In June 2009, the Financial Accounting Standards Board (FASB) issued an amendment to the accounting standards related to the consolidation of variable interest entities (VIE). This standard provides a new approach for determining which entity should consolidate a VIE, how and when to reconsider the consolidation or deconsolidation of a VIE and requires disclosures about an entity's significant judgments and assumptions used in its decision to consolidate or not consolidate a VIE. Under this standard, the new consolidation model is a more qualitative assessment of power and economics that considers which entity has the power to direct the activities that most significantly impact the VIE's economic performance and has the obligation to absorb losses of, or the right to receive benefits that could be potentially significant to, the VIE. The adoption of this standard on January 1, 2010 was not material to the Company's consolidated financial statements.

In October 2009, the FASB issued an amendment to the accounting standards related to the accounting for revenue in arrangements with multiple deliverables including how the arrangement consideration is allocated among delivered and undelivered items of the arrangement. Among the amendments, this standard eliminates the use of the residual method for allocating arrangement consideration and requires an entity to allocate the overall consideration to each deliverable based on an estimated selling price of each individual deliverable in the arrangement in the absence of having vendor-specific objective evidence or other third party evidence of fair value of the undelivered items. This standard also provides further guidance on how to determine a separate unit of accounting in a multiple-deliverable revenue arrangement and expands the disclosure requirements about the judgments made in applying the estimated selling price method and how those judgments affect the timing or amount of revenue recognition. This standard, for which the Company is currently assessing the impact, will become effective for the Company on January 1, 2011.

In October 2009, the FASB issued an amendment to the accounting standards related to certain revenue arrangements that include software elements. This standard clarifies the existing accounting guidance such that tangible products that contain both software and non-software components that function together to deliver the product's essential functionality, shall be excluded from the scope of the software revenue recognition accounting standards. Accordingly, sales of these products may fall within the scope of other revenue recognition accounting standards or may now be within the scope of this standard and may require an allocation of the arrangement consideration for each element of the arrangement. This standard, for which the Company is currently assessing the impact, will become effective for the Company on January 1, 2011.

In January 2010, the FASB issued an amendment to the accounting standards related to the disclosures about an entity's use of fair value measurements. Among these amendments, entities will be required to provide enhanced disclosures about transfers into and out of the Level 1 (fair value determined based on quoted prices in active markets for identical assets and liabilities) and Level 2 (fair value determined based on significant other observable inputs) classifications, provide separate disclosures about purchases, sales, issuances and settlements relating to the tabular reconciliation of beginning and ending balances of the Level 3 (fair value determined based on significant unobservable inputs) classification and provide greater disaggregation for each class of assets and liabilities that use fair value measurements. Except for the detailed Level 3 roll-forward disclosures, the new standard is effective for the Company for interim and annual reporting periods beginning after December 31, 2009. The adoption of this accounting standards amendment did not have a material impact on the Company's consolidated financial statements. The requirement to provide detailed disclosures about the purchases, sales, issuances and settlements in the roll-forward activity for Level 3 fair value measurements is effective for the Company for interim and annual reporting periods beginning after December 31, 2010. The Company does not expect that the adoption of these new disclosure requirements will have a material impact on its consolidated financial statements.

In February 2010, the FASB issued an amendment to the accounting standards related to the accounting for, and disclosure of, subsequent events in an entity's consolidated financial statements. This standard amends the authoritative guidance for subsequent events that was previously issued and among other things exempts Securities and Exchange Commission registrants from the requirement to disclose the date through which it has evaluated subsequent events for either original or restated financial statements. This standard does not apply to subsequent

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(in thousands, unless otherwise indicated)
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events or transactions that are within the scope of other applicable GAAP that provides different guidance on the accounting treatment for subsequent events or transactions. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

2. FAIR VALUE MEASUREMENTS

The Company determines fair value measurements used in its consolidated financial statements based upon the exit price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants exclusive of any transaction costs, as determined by either the principal market or the most advantageous market. The principal market is the market with the greatest level of activity and volume for the asset or liability. Absent a principal market to measure fair value, the Company has used the most advantageous market, which is the market in which the Company would receive the highest selling price for the asset or pay the lowest price to settle the liability, after considering transaction costs. However, when using the most advantageous market, transaction costs are only considered to determine which market is the most advantageous and these costs are then excluded when applying a fair value measurement.

Inputs used in the valuation techniques to derive fair values are classified based on a three-level hierarchy. The basis for fair value measurements for each level within the hierarchy is described below with Level 1 having the highest priority and Level 3 having the lowest.

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

Level 2: Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs are observable in active markets.

Level 3: Valuations derived from valuation techniques in which one or more significant inputs are unobservable.

The following table provides a summary of the recognized assets and liabilities that are measured at fair value on a recurring basis.

	Basis of Fair Value Measurements		
	Quoted Prices in Active Markets for Identical Assets / Liabilities	Significant Other Observable Inputs	Significant Unobservable Inputs
	Level 1	Level 2	Level 3
March 31, 2010			
Assets:			
Trading securities	\$ 35,016	\$ 35,016	\$
Cash surrender value of life insurance policies	18,476	18,476	\$
Stock warrants	4,003		4,003
Foreign currency forward contracts	2,153	2,153	
Total	\$ 59,648	\$ 35,016	\$ 4,003
Liabilities:			
Deferred compensation liabilities	\$ 56,358	\$ 56,358	\$
Interest rate swaps	5,994	5,994	
Foreign currency forward contracts	639	639	
Total	\$ 62,991	\$ 62,991	\$

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(in thousands, unless otherwise indicated)
(unaudited)

	Basis of Fair Value Measurements			
	Quoted Prices in Active Markets for Identical Assets / Liabilities	Significant Other Observable Inputs	Significant Unobservable Inputs	
	Level 1	Level 2	Level 3	
December 31, 2009				
Assets:				
Trading securities	\$ 33,871	\$ 33,871	\$	\$
Cash surrender value of life insurance policies	15,873		15,873	
Foreign currency forward contracts	2,357		2,357	
Total	\$ 52,101	\$ 33,871	\$ 18,230	\$
Liabilities:				
Interest rate swaps	\$ 14,398	\$	\$ 14,398	\$
Foreign currency forward contracts	311		311	
Deferred compensation liabilities	53,919		53,919	
Total	\$ 68,628	\$	\$ 68,628	\$

The Company offers certain employees the opportunity to participate in a supplemental deferred compensation plan. A participant's deferrals, together with Company matching credits, are invested in a variety of participant-directed stock and bond mutual funds that are classified as trading securities. Changes in the fair value of these securities are measured using quoted prices in active markets based on the market price per unit multiplied by the number of units held exclusive of any transaction costs. A corresponding adjustment for changes in fair value of the trading securities is also reflected in the changes in fair value of the deferred compensation obligation. The deferred compensation liabilities are classified within Level 2 because their inputs are derived principally from observable market data by correlation to the trading securities.

The Company offers certain employees the opportunity to participate in a non-qualified deferred compensation program. A participant's deferrals, together with Company matching credits, are invested at the direction of the employee in a hypothetical portfolio of investments which are tracked by an administrator. The Company purchases life insurance policies, with the Company named as beneficiary of the policies, for the purpose of funding the program's liability. Changes in the cash surrender value of the life insurance policies are based upon earnings and changes in the value of the underlying investments. Changes in the fair value of the deferred compensation obligation are derived using quoted prices in active markets based on the market price per unit multiplied by the number of units. The cash surrender value and the deferred compensation obligations are classified within Level 2 because their inputs are derived principally from observable market data by correlation to the hypothetical investments.

The fair value measurements of foreign currency forward contracts are obtained from a third-party pricing service and are based on market prices in actual transactions and other relevant information generated by market transactions involving identical or comparable assets or liabilities. The fair value measurements of the Company's interest rate swaps are model-derived valuations as of a given date in which all significant inputs are observable in active markets including certain financial information and certain assumptions regarding past, present and future market conditions. The Company does not believe that the changes in the fair values of its foreign currency forward contracts and interest rate swaps will materially differ from the amounts that could be realized upon settlement or maturity or that the changes in fair value will have a material effect on its results of operations, liquidity and capital resources.

The stock warrants are a derivative financial instrument that gives the Company the right to purchase unregistered common shares of a publicly-held company. The fair value measurements of the warrants are derived from an option pricing model that includes certain unobservable inputs and assumptions by the Company's management for an asset with limited market activity and are therefore classified within

Level 3. The tabular

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(in thousands, unless otherwise indicated)
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reconciliation of beginning and ending balances and activities of this Level 3 asset have been omitted due to its immateriality.

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable and accrued expenses approximate fair value based on the short maturities of these instruments. At March 31, 2010 and December 31, 2009, the fair value of the Company's debt was estimated at \$3.3 billion, using quoted market prices and yields for the same or similar types of borrowings, taking into account the underlying terms of the debt instruments. At March 31, 2010 and December 31, 2009, the estimated fair value exceeded the carrying value of the debt by \$144 million and \$151 million, respectively.

3. GOODWILL AND INTANGIBLE ASSETS

The changes in goodwill, net for the three months ended March 31, 2010 and for the year ended December 31, 2009 are as follows:

	<u>March 31, 2010</u>	<u>December 31, 2009</u>
Balance at beginning of period	\$ 5,083,944	\$ 5,054,926
Goodwill acquired during the year		25,973
Other purchase accounting adjustments	246	(21,195)
(Decrease) increase related to foreign currency translation	(1,937)	24,240
	<u>5,082,253</u>	<u>5,083,944</u>
Balance at end of period	<u>\$ 5,082,253</u>	<u>\$ 5,083,944</u>

Approximately 90% of the Company's goodwill as of March 31, 2010 and December 31, 2009 was associated with its clinical testing business.

For the year ended December 31, 2009, goodwill acquired during the year was associated with several immaterial acquisitions. For the three months ended March 31, 2010, other purchase accounting adjustments were primarily related to a milestone payment on an acquisition from 2008. For the year ended December 31, 2009, other purchase accounting adjustments were primarily related to a payment received from an escrow fund established at the time of an acquisition in 2007.

Intangible assets at March 31, 2010 and December 31, 2009 consisted of the following:

	Weighted Average Amortization Period	March 31, 2010			December 31, 2009		
		Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Amortizing intangible assets:							
Customer-related intangibles	19 years	\$ 600,214	\$ (137,632)	\$ 462,582	\$ 600,460	\$ (129,994)	\$ 470,466
Non-compete agreements	5 years	54,869	(50,713)	4,156	54,854	(50,252)	4,602
Other	10 years	72,604	(20,038)	52,566	68,896	(18,867)	50,029
Total	18 years	<u>727,687</u>	<u>(208,383)</u>	<u>519,304</u>	<u>724,210</u>	<u>(199,113)</u>	<u>525,097</u>
Intangible assets not subject to amortization:							
Tradenames		298,150		298,150	298,568		298,568

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	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total intangible assets	\$ 1,025,837	\$ (208,383)	\$ 817,454	\$ 1,022,778	\$ (199,113)	\$ 823,665
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Amortization expense related to intangible assets was \$9.4 million and \$9.0 million for the three months ended March 31, 2010 and 2009, respectively.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(in thousands, unless otherwise indicated)
(unaudited)

The estimated amortization expense related to intangible assets for each of the five succeeding fiscal years and thereafter as of March 31, 2010 is as follows:

Fiscal Year Ending December 31,	
Remainder of 2010	\$ 33,161
2011	40,301
2012	38,354
2013	36,778
2014	36,083
2015	33,832
Thereafter	300,795
	<hr/>
Total	\$ 519,304

4. FINANCIAL INSTRUMENTS

The Company uses derivative financial instruments to manage its exposure to market risks for changes in interest rates and foreign currency. This strategy includes the use of interest rate swap agreements, forward starting interest rate swap agreements and foreign currency forward contracts to manage its exposure to movements in interest and currency rates. The Company has established policies and procedures for risk assessment and the approval, reporting and monitoring of derivative financial instrument activities. These policies prohibit holding or issuing derivative financial instruments for speculative or trading purposes. The Company does not enter into derivative financial instruments that contain credit-risk-related contingent features or requirements to post collateral.

A summary of the fair values of derivative instruments in the consolidated balance sheets is stated in the table below (in thousands):

	March 31, 2010		December 31, 2009	
	Balance Sheet Classification	Fair Value	Balance Sheet Classification	Fair Value
Derivatives Designated as Hedging Instruments				
Liability Derivatives:				
Interest rate swaps	Other liabilities	\$ 5,994	Other liabilities	\$ 14,398
Total		5,994		14,398
Derivatives Not Designated as Hedging Instruments				
Asset Derivatives:				
Foreign currency forward contracts	Other current assets	2,153	Other current assets	2,357
Stock warrants	Other assets	4,003		
Total		6,156		2,357
Liability Derivatives:				
	Other current		Other current	

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Foreign currency forward contracts	liabilities	639	liabilities	311
		<u> </u>		<u> </u>
Total		<u>639</u>		<u>311</u>
		<u> </u>		<u> </u>
Total Net Derivatives Liability		\$ 477		\$ 12,352
		<u> </u>		<u> </u>

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(in thousands, unless otherwise indicated)
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Interest Rate Risk

The Company is exposed to interest rate risk on its cash and cash equivalents and its debt obligations. Interest income earned on cash and cash equivalents may fluctuate as interest rates change, however, due to their relatively short maturities, the Company does not hedge these assets and the impact of interest rate risk is not material. The Company's debt obligations consist of fixed-rate and variable-rate debt instruments. The Company's objective is to mitigate the variability in cash outflows that result from changes in interest rates by maintaining a balanced mix of fixed-rate and variable-rate debt obligations. In order to achieve these objectives, the Company has entered into interest rate swaps. Interest rate swaps involve the periodic exchange of payments without the exchange of underlying principal or notional amounts. Net payments are recognized as an adjustment to interest expense.

The Company formally documents its hedge relationships, including identifying the hedging instruments and the hedged items, as well as its risk management objectives and strategies for undertaking the hedge transaction. On the date the derivative is entered into, the Company designates the type of derivative as a fair value hedge or cash flow hedge, and accounts for the derivative in accordance with its designation as prescribed by the FASB standards on accounting for derivative instruments and hedging activities. At inception and at least quarterly thereafter, the Company formally assesses whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in the fair value or cash flows of the hedged item. All components of each derivative financial instrument's gain or loss are included in the assessment of hedge effectiveness.

In November 2009, the Company entered into various fixed-to-variable interest rate swap agreements (the Fixed-to-Variable Interest Rate Swap Agreements) which have a notional amount totaling \$350 million and a variable interest rate based on one-month LIBOR plus 1.33%. These derivative financial instruments are accounted for as fair value hedges of a portion of our Senior Notes due 2020 and effectively convert that portion of the debt into variable interest rate debt. Accordingly, the Company recognizes the changes in the fair value of both the Fixed-to-Variable Interest Rate Swap Agreements and the underlying debt obligation in other income (expense), net as equal and offsetting gains and losses. The fair value of the Fixed-to-Variable Interest Rate Swap Agreements was a liability of \$6.0 million and \$14.4 million, respectively, at March 31, 2010 and December 31, 2009. Since inception, the fair value hedges were effective; therefore, there is no impact on earnings for the three months ended March 31, 2010 as a result of hedge ineffectiveness.

In previous years, the Company entered into various forward starting interest rate swap agreements and treasury-lock agreements that were accounted for as cash flow hedges. The effective portions of the changes in fair value of these derivatives represent deferred gains or losses that are recorded in accumulated other comprehensive loss. These deferred gains or losses are reclassified from accumulated other comprehensive loss to the statement of operations in the same period or periods during which the hedged transaction affects earnings, which is when the Company recognizes interest expense on the hedged cash flows. The total loss, net of tax benefit, recognized in accumulated other comprehensive loss on these cash flow hedges as of March 31, 2010 and December 31, 2009 was \$7.2 million and \$7.3 million, respectively. The net amount of deferred gains and losses on cash flow hedges that is expected to be reclassified from accumulated other comprehensive loss into earnings within the next 12 months is \$1.1 million.

Foreign Currency Risk

The Company is exposed to market risk for changes in foreign exchange rates primarily under certain intercompany receivables and payables. Foreign exchange forward contracts are used to mitigate the exposure of the eventual net cash inflows or outflows resulting from these intercompany transactions. The objective is to hedge a portion of the forecasted foreign currency risk over a rolling 12-month time horizon to mitigate the eventual impacts of changes in foreign exchange rates on the cash flows of the intercompany transactions. As of March 31, 2010, the total notional amount of foreign currency forward contracts in U.S. dollars was \$76.6 million and principally consists of contracts in Swedish krona and British pounds. Notional amounts represent the face amount of contractual arrangements and the basis on which currencies are exchanged and are not a measure of market or credit risk exposure. The Company does not designate these derivative instruments as hedges under current

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
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accounting standards unless the benefits of doing so are material. The Company's foreign exchange exposure is not material to the Company's consolidated financial condition or results of operations. The Company does not hedge its net investment in non-U.S. subsidiaries because it views those investments as long-term in nature.

Stock Warrants

The stock warrants are a derivative financial instrument that gives the Company the right to purchase unregistered common shares of a publicly-held company and the value is derived from an option pricing model.

5. STOCKHOLDERS' EQUITY

Changes in stockholders' equity for the three months ended March 31, 2010 were as follows:

	Quest Diagnostics Stockholders' Equity								
	Shares of Common Stock Outstand- -ing	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Compre- -hensive Loss	Treasury Stock, at Cost	Compre- -hensive Income	Non- -controlling Interests	Total Stock- -holders Equity
Balance, December 31, 2009	183,293	\$ 2,141	\$ 2,302,368	\$ 3,216,639	\$ (20,961)	\$ (1,510,548)		\$ 21,825	\$ 4,011,464
Net income				162,448			\$ 162,448	8,705	171,153
Currency translation					(1,854)		(1,854)		(1,854)
Deferred loss, less reclassifications					181		181		181
Comprehensive income							\$ 160,775		
Dividends declared				(18,058)					(18,058)
Distributions to noncontrolling interests								(5,489)	(5,489)
Issuance of common stock under benefit plans	747	2	(25,090)			29,773			4,685
Stock-based compensation expense			10,296			831			11,127
Exercise of stock options	553		(7,863)			27,602			19,739
Shares to cover employee payroll tax withholdings on stock issued under benefit plans	(267)	(1)	(5,280)			(9,615)			(14,896)
Tax benefits associated with stock-based compensation plans			1,875						1,875
Purchases of treasury stock	(4,460)					(250,712)			(250,712)
Balance, March 31, 2010	179,866	\$ 2,142	\$ 2,276,306	\$ 3,361,029	\$ (22,634)	\$ (1,712,669)		\$ 25,041	\$ 3,929,215

The deferred loss primarily represents deferred losses on the Company's interest rate swap and forward starting interest rate swap agreements, net of amounts reclassified to interest expense. Foreign currency translation adjustments are not adjusted for income taxes since they relate to indefinite investments in non-U.S. subsidiaries.

Dividend Program

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During each of the quarters of 2010 and 2009, the Company's Board of Directors has declared a quarterly cash dividend of \$0.10 per common share.

Share Repurchase Plan

In January 2010, the Company's Board of Directors authorized the Company to repurchase an additional \$750 million of the Company's common stock. The share repurchase authorization has no set expiration or termination date.

In January 2010, the Company executed an accelerated share repurchase transaction with a bank to repurchase 4.5 million shares of the Company's outstanding common stock for an initial purchase price of \$56.05

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
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per share. The purchase price of these shares was subject to an adjustment based on the volume weighted average price of the Company's common stock during a period following execution of the agreement. The total cost of the initial purchase was \$250 million. The purchase price adjustment was settled in the first quarter of 2010 and resulted in an additional cash payment of \$0.7 million, for a final purchase price of \$250.7 million, or \$56.21 per share. For the three months ended March 31, 2010, the Company reissued 1.0 million shares for employee benefit plans. At March 31, 2010, \$499 million of share repurchase authorization remained available.

Changes in stockholders' equity for the three months ended March 31, 2009 were as follows:

	Quest Diagnostics Stockholders' Equity								
	Shares of Common Stock Outstand- -ing	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Compre- -hensive Loss	Treasury Stock, at Cost	Compre- -hensive Income	Non- -controlling Interests	Total Stock- -holders Equity
Balance, December 31, 2008	190,374	\$ 2,141	\$ 2,262,065	\$ 2,561,679	\$ (68,068)	\$ (1,152,921)		\$ 20,238	\$ 3,625,134
Net income				167,102			\$ 167,102	8,554	175,656
Currency translation					(20,094)		(20,094)		(20,094)
Market valuation, net of tax expense of \$(190)					290		290		290
Deferred loss, less reclassifications					330		330		330
Comprehensive income							\$ 147,628		
Dividends declared				(18,611)					(18,611)
Distributions to noncontrolling interests								(5,007)	(5,007)
Issuance of common stock under benefit plans	373		25			4,425			4,450
Stock-based compensation expense			2,739			11,352			14,091
Exercise of stock options	327		(5,840)			15,856			10,016
Shares to cover employee payroll tax withholdings on stock issued under benefit plans	(119)		(1,298)			(3,996)			(5,294)
Tax benefits associated with stock-based compensation plans			1,370						1,370
Purchase of treasury stock	(5,620)					(250,000)			(250,000)
Balance, March 31, 2009	185,335	\$ 2,141	\$ 2,259,061	\$ 2,710,170	\$ (87,542)	\$ (1,375,284)		\$ 23,785	\$ 3,532,331

The market valuation adjustment represents the reversal of prior period unrealized holding losses for investments, net of taxes, where the decline in fair value was deemed to be other than temporary and the resulting loss was recognized in the consolidated statement of operations. The deferred loss primarily represents deferred losses on the Company's interest rate swap agreements, net of amounts reclassified to interest expense. Foreign currency translation adjustments are not adjusted for income taxes since they relate to indefinite investments in non-U.S. subsidiaries.

For the three months ended March 31, 2009, the Company repurchased approximately 5.6 million shares of its common stock at an average price of \$44.48 per share for \$250 million, including 4.5 million shares repurchased from SB Holdings Capital Inc., a wholly-owned subsidiary of GlaxoSmithKline plc., at an average price of \$44.33 per share, for \$200 million. For the three months ended March 31, 2009, the Company reissued 0.6 million shares for employee benefit plans.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
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6. SUPPLEMENTAL CASH FLOW & OTHER DATA

	Three Months Ended March 31,	
	2010	2009
Depreciation expense	\$ 53,974	\$ 55,855
Interest expense	(36,530)	(39,844)
Interest income	575	436
	(35,955)	(39,408)
Interest paid	35,312	47,137
Income taxes paid	6,829	31,347

7. COMMITMENTS AND CONTINGENCIES

The Company has a line of credit with a financial institution totaling \$85 million for the issuance of letters of credit (the Letter of Credit Line). The Letter of Credit Line, which is renewed annually, matures on November 19, 2010 and is guaranteed by certain of the Company's domestic, wholly-owned subsidiaries (the Subsidiary Guarantors).

In support of its risk management program, to ensure the Company's performance or payment to third parties, \$72 million in letters of credit were outstanding at March 31, 2010. The letters of credit primarily represent collateral for current and future automobile liability and workers' compensation loss payments. In addition, \$6.4 million of bank guarantees were outstanding at March 31, 2010 in support of certain foreign operations.

Contingent Lease Obligations

The Company is subject to contingent obligations under certain leases and other instruments incurred in connection with real estate activities and other operations associated with LabOne, Inc., which the Company acquired in 2005, and certain of its predecessor companies. No liability has been recorded for any of these potential contingent obligations. See Note 15 to the Consolidated Financial Statements contained in the Company's 2009 Annual Report on Form 10-K for further details.

Legal Matters

The Company is involved in various legal proceedings. Some of the proceedings against the Company involve claims that are substantial in amount.

In 2005, the Company received a subpoena from the U. S. Attorney's Office for the District of New Jersey. The subpoena seeks the production of business and financial records regarding capitation and risk sharing arrangements with government and private payers for the years 1993 through 1999. The Company cooperated with the U. S. Attorney's Office.

In 2005, the Company received a subpoena from the U. S. Department of Health and Human Services, Office of the Inspector General, seeking business records including records regarding the Company's relationship with health maintenance organizations, independent physician associations, group purchasing organizations, and preferred provider organizations relating back to 1995. The Company has cooperated with the investigation. Subsequently, in November 2009, the U.S. District Court for the Southern District of New York partially unsealed a civil complaint, U. S. ex rel. Fair Laboratory Practices Associates v. Quest Diagnostics Incorporated, filed against the Company under the whistleblower provisions of the federal False Claims Act. The complaint alleges, among other things, violations of the federal Anti-Kickback Statute and the federal False Claims Act in connection with the

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
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Company's pricing of laboratory services. The complaint seeks damages for alleged false claims associated with laboratory tests reimbursed by government payors, treble damages and civil penalties.

In 2006 and 2008, the Company and several of its subsidiaries received subpoenas from the California Attorney General's Office seeking documents relating to the Company's billings to MediCal, the California Medicaid program. The Company has cooperated with the government's requests. Subsequently, the State of California intervened as plaintiff in a civil lawsuit, California ex rel. Hunter Laboratories, LLC v. Quest Diagnostics Incorporated., et al., filed in California Superior Court against a number of clinical laboratories, including the Company and several of its subsidiaries. The complaint alleges, among other things, overcharging of MediCal for testing services. The complaint was originally filed by a competitor laboratory in California under the whistleblower provisions of the California False Claims Act. The complaint was unsealed on March 20, 2009.

In June 2009, a shareholder plaintiff filed a purported derivative action in the Superior Court of New Jersey, Morris County, on behalf of the Company against certain present and former directors and officers of the Company based on, among other things, their alleged breaches of fiduciary duties in connection with the manufacture, marketing, sale and billing related to certain test kits manufactured by NID. The complaint includes claims for, among other things, breach of fiduciary duty and waste of corporate assets and seeks, among other things, damages and remission of compensation received by the individual defendants.

In April 2010, a putative class action was filed against the Company and NID in the U.S. District Court for the Eastern District of New York on behalf of entities that allegedly purchased or paid for certain of NID's test kits. The complaint alleges that certain of NID's test kits were defective and that defendants, among other things, violated RICO and state consumer protection laws. The complaint alleges an unspecified amount of damages.

The Company and certain of its subsidiaries have received subpoenas from state agencies in four states which seek documents relating to the Company's Medicaid billing practices in those states. The Company is cooperating with the requests.

The federal or state governments may bring claims based on new theories as to the Company's practices which management believes to be in compliance with law. In addition, certain federal and state statutes, including the qui tam provisions of the federal False Claims Act, allow private individuals to bring lawsuits against healthcare companies on behalf of government or private payers. The Company is aware of certain pending individual or class action lawsuits, and has received several subpoenas, related to billing practices filed under the qui tam provisions of the Civil False Claims Act and/or other federal and state statutes, regulations or other laws. The Company understands that there may be other pending qui tam claims brought by former employees or other whistleblowers as to which the Company cannot determine the extent of any potential liability.

Several of these matters are in their early stages of development and involve responding to and cooperating with various government investigations and related subpoenas. While the Company believes that at least a reasonable possibility exists that losses may have been incurred, based on the nature and status of the investigations, the losses are either currently not probable or cannot be reasonably estimated.

Management has established reserves in accordance with generally accepted accounting principles for the matters discussed above. Such reserves totaled approximately \$10 million as of March 31, 2010. Although management cannot predict the outcome of such matters, management does not anticipate that the ultimate outcome of such matters will have a material adverse effect on the Company's financial condition but may be material to the Company's results of operations or cash flows in the period in which the impact of such matters is determined or paid.

As a general matter, providers of clinical testing services may be subject to lawsuits alleging negligence or other similar legal claims. These suits could involve claims for substantial damages. Any professional liability litigation could also have an adverse impact on the Company's client base and reputation. The Company maintains various liability insurance coverages for, among other things, claims that could result from providing, or failing to provide, clinical testing services, including inaccurate testing results, and other exposures. The Company's

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
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insurance coverage limits its maximum exposure on individual claims; however, the Company is essentially self-insured for a significant portion of these claims. Reserves for such matters are established by considering actuarially determined losses based upon the Company's historical and projected loss experience. Management believes that present insurance coverage and reserves are sufficient to cover currently estimated exposures. Although management cannot predict the outcome of any claims made against the Company, management does not anticipate that the ultimate outcome of any such proceedings or claims will have a material adverse effect on the Company's financial condition but may be material to the Company's results of operations or cash flows in the period in which the impact of such claims is determined or paid.

8. DISCONTINUED OPERATIONS

During the fourth quarter of 2005, NID instituted its second voluntary product hold within a six-month period due to quality issues, which adversely impacted the operating performance of NID. As a result, the Company evaluated a number of strategic options for NID. On April 19, 2006, the Company decided to discontinue NID's operations. During the third quarter of 2006, the Company completed its wind down of NID and classified the operations of NID as discontinued operations. Results of operations for NID have been reported as discontinued operations in the accompanying consolidated statements of operations and related disclosures for all periods presented.

During the third quarter of 2007, the government and the Company began settlement discussions with respect to the government's investigation involving NID and the Company. Based on the status of settlement discussions, during 2007 the Company established a reserve, in accordance with generally accepted accounting principles, reflected in discontinued operations, of \$241 million in connection with these claims.

During the third quarter of 2008, the Company and NID reached an agreement in principle with the United States Attorney's Office to settle the federal government investigation involving NID and the Company regarding NID test kits and tests performed using those test kits. As a result of the agreement in principle in 2008, the Company recorded charges of \$75 million in discontinued operations to increase its reserve for the settlement and related matters.

On April 15, 2009, the Company finalized the resolution of the federal government investigation related to NID and entered into a final settlement agreement with the federal government. In the second quarter of 2009, the Company paid \$268 million to settle the civil allegations. The Company also entered into a five-year corporate integrity agreement with the Office of Inspector General for the United States Department of Health and Human Services. In addition, NID pled guilty to a single count of felony misbranding and paid a \$40 million fine. These second quarter payments totaling \$308 million, which had been previously reserved, were funded out of cash on-hand and available credit facilities. During the third quarter of 2009, the Company finalized separate settlement agreements with certain states and paid approximately \$6 million, which had been previously reserved for.

Summarized financial information for the discontinued operations of NID is set forth below:

	Three Months Ended March 31,	
	2010	2009
Net revenues	\$	\$
Income (loss) from discontinued operations before income taxes	15	(2,820)
Income tax (expense) benefit	(67)	1,149
Loss from discontinued operations, net of taxes	\$ (52)	\$ (1,671)

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
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The balance sheet information related to NID was not material at March 31, 2010 and December 31, 2009.

9. BUSINESS SEGMENT INFORMATION

Clinical testing is an essential element in the delivery of healthcare services. Physicians use clinical tests to assist in the detection, diagnosis, evaluation, monitoring and treatment of diseases and other medical conditions. Clinical testing is generally categorized as clinical laboratory testing and anatomic pathology services. Clinical laboratory testing is performed on whole blood, serum, plasma and other body fluids, such as urine, and specimens such as microbiology samples. Anatomic pathology services are principally for the detection of cancer and are performed on tissues, such as biopsies, and other samples, such as human cells. Customers of the clinical testing business include patients, physicians, hospitals, employers, governmental institutions and other commercial clinical laboratories. The clinical testing business accounted for greater than 90% of net revenues from continuing operations in 2010 and 2009.

All other operating segments include the Company's non-clinical testing businesses and consist of its risk assessment services, clinical trials testing, healthcare information technology and diagnostics products businesses. The Company's risk assessment business provides underwriting support services to the life insurance industry including teleunderwriting, paramedical examinations, laboratory testing and medical record retrieval. The Company's clinical trials testing business provides clinical testing performed in connection with clinical research trials on new drugs and vaccines. The Company's healthcare information technology business is a developer and integrator of clinical connectivity and data management solutions for healthcare organizations, physicians and clinicians. The Company's diagnostics products business manufactures and markets diagnostic test kits.

On April 19, 2006, the Company decided to discontinue NID's operations and results of operations for NID have been classified as discontinued operations for all periods presented (see Note 8).

At March 31, 2010, substantially all of the Company's services are provided within the United States, and substantially all of the Company's assets are located within the United States.

The following table is a summary of segment information for the three months ended March 31, 2010 and 2009. Segment asset information is not presented since it is not used by the chief operating decision maker at the operating segment level. Operating earnings (loss) of each segment represents net revenues less directly identifiable expenses to arrive at operating income for the segment. General management and administrative corporate expenses, including amortization of intangible assets, are included in general corporate expenses below. The accounting policies of the segments are the same as those of the Company as set forth in Note 2 to the Consolidated Financial Statements contained in the Company's 2009 Annual Report on Form 10-K and Note 1 to the interim consolidated financial statements.

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	Three Months Ended March 31,	
	2010	2009
Net revenues:		
Clinical laboratory testing business	\$ 1,657,067	\$ 1,663,633
All other operating segments	148,436	144,373
	\$ 1,805,503	\$ 1,808,006
Operating earnings (loss):		
Clinical laboratory testing business	\$ 340,884	\$ 343,411
All other operating segments	2,400	12,863
General corporate expenses	(44,722)	(35,211)
	298,562	321,063
Non-operating expenses, net	(21,979)	(33,547)
	276,583	287,516
Income from continuing operations before income taxes		
Income tax expense	105,378	110,189
	171,205	177,327
Loss from discontinued operations, net of taxes	(52)	(1,671)
	171,153	175,656
Net income	171,153	175,656
Less: Net income attributable to noncontrolling interests	8,705	8,554
	\$ 162,448	\$ 167,102

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
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10. SUMMARIZED FINANCIAL INFORMATION

The Company's Senior Notes due 2010, Senior Notes due 2011, Senior Notes due 2015, Senior Notes due 2017, Senior Notes due 2020, Senior Notes due 2037 and Senior Notes due 2040 are fully and unconditionally guaranteed, jointly and severally, by the Subsidiary Guarantors. With the exception of Quest Diagnostics Receivables Incorporated (QDRI) (see paragraph below), the non-guarantor subsidiaries are primarily foreign subsidiaries and less than wholly-owned subsidiaries.

In conjunction with the Company's secured receivables credit facility, the Company maintains a wholly-owned non-guarantor subsidiary, QDRI. The Company and certain of its Subsidiary Guarantors transfer certain domestic receivables to QDRI. QDRI utilizes the transferred receivables to collateralize borrowings under the Company's secured receivables credit facility. The Company and the Subsidiary Guarantors provide collection services to QDRI. QDRI uses cash collections principally to purchase new receivables from the Company and the Subsidiary Guarantors.

The following condensed consolidating financial data illustrates the composition of the combined guarantors. Investments in subsidiaries are accounted for by the parent using the equity method for purposes of the supplemental consolidating presentation. Earnings (losses) of subsidiaries are therefore reflected in the parent's investment accounts and earnings. The principal elimination entries relate to investments in subsidiaries and intercompany balances and transactions.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
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Condensed Consolidating Statement of Operations
Three Months Ended March 31, 2010

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Net revenues	\$ 211,221	\$ 1,482,590	\$ 192,336	\$ (80,644)	\$ 1,805,503
Operating costs and expenses:					
Cost of services	122,587	879,787	63,999		1,066,373
Selling, general and administrative	23,078	314,118	100,868	(7,331)	430,733
Amortization of intangible assets	17	7,631	1,711		9,359
Royalty (income) expense	(101,492)	101,492			
Other operating expense (income), net	1,025	233	(782)		476
Total operating costs and expenses	45,215	1,303,261	165,796	(7,331)	1,506,941
Operating income	166,006	179,329	26,540	(73,313)	298,562
Non-operating (expense) income, net	(30,559)	(66,445)	1,712	73,313	(21,979)
Income from continuing operations before taxes	135,447	112,884	28,252		276,583
Income tax expense	51,485	45,747	8,146		105,378
Income from continuing operations	83,962	67,137	20,106		171,205
Loss from discontinued operations, net of taxes		(52)			(52)
Equity earnings from subsidiaries	78,486			(78,486)	
Net income	162,448	67,085	20,106	(78,486)	171,153
Less: Net income attributable to noncontrolling interests			8,705		8,705
Net income attributable to Quest Diagnostics	\$ 162,448	\$ 67,085	\$ 11,401	\$ (78,486)	\$ 162,448

Condensed Consolidating Statement of Operations
Three Months Ended March 31, 2009

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Net revenues	\$ 210,052	\$ 1,495,917	\$ 171,559	\$ (69,522)	\$ 1,808,006
Operating costs and expenses:					
Cost of services	126,963	868,087	58,439		1,053,489
Selling, general and administrative	32,672	306,970	91,977	(7,318)	424,301
Amortization of intangible assets	26	7,848	1,131		9,005
Royalty (income) expense	(96,340)	96,340			
Other operating (income) expense, net	(979)	211	916		148

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Total operating costs and expenses	62,342	1,279,456	152,463	(7,318)	1,486,943
Operating income	147,710	216,461	19,096	(62,204)	321,063
Non-operating (expense) income, net	(41,806)	(56,464)	2,519	62,204	(33,547)
Income from continuing operations before taxes	105,904	159,997	21,615		287,516
Income tax expense	41,290	63,794	5,105		110,189
Income from continuing operations	64,614	96,203	16,510		177,327
Loss from discontinued operations, net of taxes		(1,671)			(1,671)
Equity earnings from subsidiaries	102,488			(102,488)	
Net income	167,102	94,532	16,510	(102,488)	175,656
Less: Net income attributable to noncontrolling interests			8,554		8,554
Net income attributable to Quest Diagnostics	\$ 167,102	\$ 94,532	\$ 7,956	\$ (102,488)	\$ 167,102

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
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Condensed Consolidating Balance Sheet
March 31, 2010

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Assets					
Current assets:					
Cash and cash equivalents	\$ 374,387	\$ 22,033	\$ 66,819	\$	\$ 463,239
Accounts receivable, net	27,203	129,830	708,127		865,160
Other current assets	72,789	163,458	99,029	(18,427)	316,849
	<u>474,379</u>	<u>315,321</u>	<u>873,975</u>	<u>(18,427)</u>	<u>1,645,248</u>
Total current assets	474,379	315,321	873,975	(18,427)	1,645,248
Property, plant and equipment, net	177,625	599,289	34,961		811,875
Goodwill and intangible assets, net	156,143	5,302,152	441,412		5,899,707
Intercompany receivable (payable)	465,450	(89,347)	(376,103)		
Investment in subsidiaries	5,860,723			(5,860,723)	
Other assets	166,122	10,918	55,969	(73,630)	159,379
	<u>7,300,442</u>	<u>6,138,333</u>	<u>1,030,214</u>	<u>(5,952,780)</u>	<u>8,516,209</u>
Total assets	\$ 7,300,442	\$ 6,138,333	\$ 1,030,214	\$ (5,952,780)	\$ 8,516,209
Liabilities and Stockholders' Equity					
Current liabilities:					
Accounts payable and accrued expenses	\$ 675,619	\$ 201,460	\$ 47,442	\$ (18,427)	\$ 906,094
Current portion of long-term debt	165,772	2,376	2,256		170,404
	<u>841,391</u>	<u>203,836</u>	<u>49,698</u>	<u>(18,427)</u>	<u>1,076,498</u>
Total current liabilities	841,391	203,836	49,698	(18,427)	1,076,498
Long-term debt	2,457,487	145,700	341,602		2,944,789
Other liabilities	97,390	490,731	51,216	(73,630)	565,707
Stockholders' equity:					
Quest Diagnostics stockholders' equity	3,904,174	5,298,066	562,657	(5,860,723)	3,904,174
Noncontrolling interests			25,041		25,041
	<u>3,904,174</u>	<u>5,298,066</u>	<u>587,698</u>	<u>(5,860,723)</u>	<u>3,929,215</u>
Total stockholders' equity	3,904,174	5,298,066	587,698	(5,860,723)	3,929,215
Total liabilities and stockholders' equity	\$ 7,300,442	\$ 6,138,333	\$ 1,030,214	\$ (5,952,780)	\$ 8,516,209

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
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Condensed Consolidating Balance Sheet
December 31, 2009

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Assets					
Current assets:					
Cash and cash equivalents	\$ 464,958	\$ 17,457	\$ 51,841	\$	\$ 534,256
Accounts receivable, net	3,461	156,102	667,780		827,343
Other current assets	64,354	169,233	99,109	(14,870)	317,826
	<u>532,773</u>	<u>342,792</u>	<u>818,730</u>	<u>(14,870)</u>	<u>1,679,425</u>
Total current assets	532,773	342,792	818,730	(14,870)	1,679,425
Property, plant and equipment, net	181,790	607,951	36,205		825,946
Goodwill and intangible assets, net	153,145	5,308,433	446,031		5,907,609
Intercompany receivable (payable)	471,421	(137,227)	(334,194)		
Investment in subsidiaries	5,790,333			(5,790,333)	
Other assets	194,990	11,428	49,970	(105,725)	150,663
	<u>7,324,452</u>	<u>6,133,377</u>	<u>1,016,742</u>	<u>(5,910,928)</u>	<u>8,563,643</u>
Total assets	\$ 7,324,452	\$ 6,133,377	\$ 1,016,742	\$ (5,910,928)	\$ 8,563,643
Liabilities and Stockholders' Equity					
Current liabilities:					
Accounts payable and accrued expenses	\$ 641,964	\$ 239,417	\$ 22,194	\$ (14,870)	\$ 888,705
Current portion of long-term debt	165,661	2,436	2,410		170,507
	<u>807,625</u>	<u>241,853</u>	<u>24,604</u>	<u>(14,870)</u>	<u>1,059,212</u>
Total current liabilities	807,625	241,853	24,604	(14,870)	1,059,212
Long-term debt	2,430,806	146,556	359,430		2,936,792
Other liabilities	96,382	513,987	51,531	(105,725)	556,175
Stockholders' equity:					
Quest Diagnostics stockholders' equity	3,989,639	5,230,981	559,352	(5,790,333)	3,989,639
Noncontrolling interests			21,825		21,825
	<u>3,989,639</u>	<u>5,230,981</u>	<u>581,177</u>	<u>(5,790,333)</u>	<u>4,011,464</u>
Total stockholders' equity	3,989,639	5,230,981	581,177	(5,790,333)	4,011,464
	<u>7,324,452</u>	<u>6,133,377</u>	<u>1,016,742</u>	<u>(5,910,928)</u>	<u>8,563,643</u>
Total liabilities and stockholders' equity	\$ 7,324,452	\$ 6,133,377	\$ 1,016,742	\$ (5,910,928)	\$ 8,563,643

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(in thousands, unless otherwise indicated)
(unaudited)

Condensed Consolidating Statement of Cash Flows
Three Months Ended March 31, 2010

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Cash flows from operating activities:					
Net income	\$ 162,448	\$ 67,085	\$ 20,106	\$ (78,486)	\$ 171,153
Adjustments to reconcile net income to net cash provided by (used in) operating activities:					
Depreciation and amortization	12,348	46,853	4,132		63,333
Provision for doubtful accounts	1,471	12,107	62,701		76,279
Other, net	(22,721)	(22,860)	(9,034)	78,486	23,871
Changes in operating assets and liabilities	67,891	(106,426)	(56,886)		(95,421)
Net cash provided by (used in) operating activities	221,437	(3,241)	21,019		239,215
Net cash used in investing activities	(50,483)	(29,595)	(1,189)	38,673	(42,594)
Net cash (used in) provided by financing activities	(261,525)	37,412	(4,852)	(38,673)	(267,638)
Net change in cash and cash equivalents	(90,571)	4,576	14,978		(71,017)
Cash and cash equivalents, beginning of period	464,958	17,457	51,841		534,256
Cash and cash equivalents, end of period	\$ 374,387	\$ 22,033	\$ 66,819	\$	\$ 463,239

Condensed Consolidating Statement of Cash Flows
Three Months Ended March 31, 2009

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Cash flows from operating activities:					
Net income	\$ 167,102	\$ 94,532	\$ 16,510	\$ (102,488)	\$ 175,656
Adjustments to reconcile net income to net cash provided by (used in) operating activities:					
Depreciation and amortization	14,226	47,237	3,397		64,860
Provision for doubtful accounts	1,430	16,715	63,283		81,428
Other, net	(58,962)	(13,545)	(6,295)	102,488	23,686
Changes in operating assets and liabilities	98,711	(92,541)	(79,037)		(72,867)
Net cash provided by (used in) operating activities	222,507	52,398	(2,142)		272,763
Net cash used in investing activities	(14,705)	(30,290)	(564)	4,194	(41,365)
Net cash (used in) provided by financing activities	(275,555)	(17,319)	15,945	(4,194)	(281,123)
Net change in cash and cash equivalents	(67,753)	4,789	13,239		(49,725)
Cash and cash equivalents, beginning of period	218,565	6,715	28,666		253,946

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Cash and cash equivalents, end of period	\$ 150,812	\$ 11,504	\$ 41,905	\$ 204,221
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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Healthcare Reform

In March 2010, U.S. federal legislation was enacted which is likely to have a significant impact on, among other things, access to and the cost of healthcare in the United States. The legislation provides for extensive health insurance reforms and expands coverage to approximately 32 million Americans which will result in expanded access to healthcare. In addition, the legislation eliminates patient cost-sharing for certain prevention and wellness benefits. We believe these changes will benefit our industry by leading to increased utilization of our services.

These benefits are expected to be partially offset by provisions of the legislation aimed at reducing the overall cost of healthcare. Impacting laboratories specifically, the legislation provides for annual reductions in the Medicare clinical laboratory fee schedule of 1.75% for five years beginning in 2011 and includes a productivity adjustment which reduces the CPI market basket update beginning in 2011. Approximately 12% of our consolidated revenues are reimbursed by Medicare under the clinical laboratory fee schedule. The legislation also imposes an excise tax on the seller for the sale of certain medical devices in the United States, including those purchased and used by laboratories, beginning in 2013.

In addition, the legislation is focused on reducing the growth of healthcare costs. The legislation establishes the Independent Payment Advisory Board, which will be responsible, beginning in 2014, annually to submit proposals aimed at reducing Medicare cost growth while preserving quality. These proposals automatically will be implemented unless Congress enacts alternative proposals that achieve the same savings targets. Further, the legislation calls for a Center for Medicare and Medicaid Innovation that will examine alternative payment methodologies and conduct demonstration programs.

We believe that the legislation will be a net positive for our industry over the long term due to expanded coverage and the elimination of patient cost-sharing for certain prevention and wellness benefits, and that we are well positioned to respond to the evolving healthcare environment and related market forces.

In addition to the healthcare reform legislation, in April 2010, Congress passed an extension to delay until May 31, 2010 a potential 21.2% decrease in the Medicare fee schedule for pathology and other physician services performed for patients and billed under Part B of the Medicare program. It is currently not clear if legislation will be passed to permanently eliminate this potential fee decrease. In 2009, approximately 3% of our consolidated revenues were reimbursed based on this fee schedule.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions and select accounting policies that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

While many operational aspects of our business are subject to complex federal, state and local regulations, the accounting for our business is generally straightforward, with net revenues primarily recognized upon completion of the testing process. Our revenues are primarily comprised of a high volume of relatively low dollar transactions, and about one-half of total operating costs and expenses consist of employee compensation and benefits. Due to the nature of our business, several of our accounting policies involve significant estimates and judgments. These accounting policies have been described in our Annual Report on Form 10-K for the year ended December 31, 2009.

Results of Operations

Our clinical testing business currently represents our one reportable business segment. In both 2010 and 2009, our clinical testing business accounted for greater than 90% of our net revenues. Our other operating segments consist of our risk assessment services, clinical trials testing, healthcare information technology and

diagnostic products businesses. Our business segment information is disclosed in Note 9 to the interim consolidated financial statements.

Three Months Ended March 31, 2010 Compared with Three Months Ended March 31, 2009

Continuing Operations

Income from continuing operations for the three months ended March 31, 2010 was \$163 million, or \$0.89 per diluted share, compared to \$169 million, or \$0.89 per diluted share, in 2009. The decrease in income from continuing operations for the three month period was primarily due to severe weather and charges principally associated with workforce reductions.

Results for the three months ended March 31, 2010 include \$17.3 million of pre-tax charges, or \$0.06 per diluted share, principally associated with workforce reductions. Of these costs, \$4.5 million and \$12.8 million, respectively, were included in cost of services and selling, general and administrative expenses. We also estimate that the impact of severe weather adversely affected the comparison of operating income for the three months ended March 31, 2010 to the prior year period by \$14.3 million, or \$0.05 per diluted share. Additionally, other income (expense), net for the three months ended March 31, 2010 includes a pre-tax gain on an investment of \$4.0 million.

Net Revenues

Net revenues for both the three months ended March 31, 2010 and 2009 were \$1.8 billion. Revenue growth for 2010 was reduced by an estimated 1% due to the impact of severe weather. For the first quarter of 2010, revenues for our clinical testing business, which accounts for over 90% of our net revenues, decreased by 0.4%, compared to the prior year. Clinical testing volume, measured by the number of requisitions, decreased 2.6% for the quarter ended March 31, 2010. We estimate that the impact of severe weather adversely affected the growth in our clinical testing revenues and volume by 1%. In addition to the impact of severe weather, we believe that clinical testing volume was adversely affected by a general slowdown in physician office visits. Revenue per requisition increased 2.3% for the three months ended March 31, 2010, with the increase primarily driven by a positive test mix, partially offset by the 1.9% Medicare fee schedule decrease, which went into effect on January 1, 2010 and served to reduce revenue per requisition by about half of one percent.

Our businesses other than clinical laboratory testing accounted for approximately 8% of our net revenues. These businesses include our risk assessment services, clinical trials testing, healthcare information technology, and diagnostic products businesses. These businesses contain most of our international operations and, in the aggregate, reported revenues for the quarter ended March 31, 2010 were 3% above the prior year, with the increase principally driven by the favorable impact of foreign exchange rates.

Operating Costs and Expenses

Total operating costs and expenses for the three months ended March 31, 2010 increased \$20 million compared to the first quarter of 2009, and increased as a percentage of net revenues to 83.5%, compared to 82.2% in 2009. Lower testing volume related to severe weather and charges associated with actions we have taken to adjust our cost structure in response to lower testing volume served to increase total operating costs as a percentage of net revenues for the three months ended March 31, 2010. During the first quarter of 2010, we recorded \$17.3 million of pre-tax charges, principally associated with workforce reductions, of which \$4.5 million was recorded in cost of services and \$12.8 million was recorded in selling, general and administrative expenses.

Cost of services, which includes the costs of obtaining, transporting and testing specimens, was 59.1% of net revenues for the three months ended March 31, 2010, compared to 58.3% of net revenues in the prior year period. The increase in cost of services as a percentage of net revenues for the three months ended March 31,

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2010 primarily reflects the impact of lower testing volume related to severe weather and charges associated with actions we have taken to adjust our cost structure, partially offset by the improvement in revenue per requisition.

Selling, general and administrative expenses, which include the costs of the sales force, billing operations, bad debt expense, and general management and administrative support, were 23.9% of net revenues for the three months ended March 31, 2010, compared to 23.5% in the prior year period. This increase in selling, general, and administrative expenses as a percentage of net revenues primarily reflects the impact lower testing volume related to severe weather and charges associated with actions we have taken to adjust our cost structure, partially offset by the improvement in revenue per requisition.

For the three months ended March 31, 2010 and 2009, bad debt expense was 4.2% and 4.5% of net revenues, respectively. Continued progress in our billing and collection processes has resulted in improvements in bad debt, days sales outstanding and the cost of our billing operation. With our disciplined approach, we expect to see continued strong performance in our billing and collection metrics, despite a slow economy.

Operating Income

Operating income for the three months ended March 31, 2010 was \$299 million, or 16.5% of net revenues, compared to \$321 million, or 17.8% of net revenues, in the prior year period. The estimated impact of severe weather combined with charges associated with actions we have taken to adjust our cost structure adversely impacted the year-over-year change in operating income as a percentage of net revenues for the first quarter by 1.6%, compared to the prior year period.

Other Income (Expense)

Interest expense, net for the three months ended March 31, 2010 decreased \$3.5 million compared to the prior year period. The decrease was primarily due to lower interest rates on our variable-rate debt.

Other income (expense), net represents miscellaneous income and expense items related to non-operating activities such as gains and losses associated with investments and other non-operating assets. For the three months ended March 31, 2010, other income (expense), net includes a gain on an investment of \$4.0 million.

Discontinued Operations

Loss from discontinued operations, net of taxes, for the three months ended March 31, 2010 was \$0.1 million, with no impact on diluted earnings per share, compared to a loss of \$1.7 million, or \$0.01 per diluted share, in 2009. See Note 8 to the interim consolidated financial statements for further details.

Quantitative and Qualitative Disclosures About Market Risk

We address our exposure to market risks, principally the market risk of changes in interest rates, through a controlled program of risk management that includes the use of derivative financial instruments. We do not hold or issue derivative financial instruments for trading purposes. We believe that our exposures to foreign exchange impacts and changes in commodities prices are not material to our consolidated financial condition or results of operations. See Note 4 to the interim consolidated financial statements for additional discussion of our financial instruments and hedging activities.

At March 31, 2010 and December 31, 2009, the fair value of our debt was estimated at approximately \$3.3 billion, using quoted market prices and yields for the same or similar types of borrowings, taking into account the underlying terms of the debt instruments. At March 31, 2010 and December 31, 2009, the estimated fair value exceeded the carrying value of the debt by \$144 million and \$151 million, respectively. A hypothetical 10% increase in interest rates (representing 46 basis points at both March 31, 2010 and December 31, 2009) would potentially reduce the estimated fair value of our debt by \$94 million and \$96 million at March 31, 2010 and December 31, 2009, respectively.

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Borrowings under our senior unsecured revolving credit facility, our secured receivables credit facility and our term loan due May 2012 are subject to variable interest rates. Interest on our secured receivables credit facility is based on rates that are intended to approximate commercial paper rates for highly-rated issuers. Interest rates on our senior unsecured revolving credit facility and term loan due May 2012 are subject to a pricing schedule that can fluctuate based on changes in our credit ratings. As such, our borrowing costs under these credit arrangements will be subject to both fluctuations in interest rates and changes in our credit ratings. As of March 31, 2010, the borrowing rates under these credit facilities were: for our secured receivables credit facility, 1.38%; for our senior unsecured credit facility, LIBOR plus 0.40%; and for our term loan due May 2012, LIBOR plus 0.40%. At March 31, 2010, the weighted average LIBOR rate was 0.24 %. At March 31, 2010, there was \$742 million outstanding under our term loan due May 2012, and no borrowings outstanding under our \$750 million senior unsecured revolving credit facility or our \$525 million secured receivables credit facility.

Our objective is to mitigate the variability in cash outflows that result from changes in interest rates by maintaining a balanced mix of fixed-rate and variable-rate debt obligations. In order to achieve these objectives, we have entered into interest rate swaps. Interest rate swaps involve the periodic exchange of payments without the exchange of underlying principal or notional amounts. Net payments are recognized as an adjustment to interest expense.

In November 2009, we entered into various fixed-to-variable interest rate swap agreements that effectively convert a portion of our 4.75% Senior Notes due 2020 to variable-interest rate debt based on LIBOR plus 1.33%. At March 31, 2010, the interest rate swap agreements which expire in January 2020 have a notional amount totaling \$350 million. The fixed-to-variable interest rate swap agreements are accounted for as fair value hedges of a portion of our outstanding 4.75% Senior Notes due 2020. Based on our net exposure to interest rate changes, a hypothetical 10% change in interest rates on our variable rate indebtedness (representing 3 basis points) would impact annual interest expense by \$0.3 million, assuming no changes to the debt outstanding at March 31, 2010.

The fair value of the fixed-to-variable interest rate swap agreements at March 31, 2010 was a liability of \$6.0 million. A hypothetical 10% change in interest rates (representing 37 basis points) would potentially change the fair value of the liability of these instruments by approximately \$11 million.

For details regarding our outstanding debt, see Note 10 to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2009. For details regarding our financial instruments, see Note 4 to the interim consolidated financial statements.

Risk Associated with Investment Portfolio

Our investment portfolio includes equity investments in publicly held companies that are classified as available-for-sale securities and other strategic equity holdings in privately held companies. These securities are exposed to price fluctuations and are generally concentrated in the life sciences industry. The carrying values of our available-for-sale equity securities and privately held securities were \$12 million at March 31, 2010.

We regularly evaluate the fair value measurements of our equity investments to determine if losses in value are other than temporary and if an impairment loss has been incurred. The evaluation considers if the security has the ability to recover and, if so, the estimated recovery period. Other factors that are considered in this evaluation include the amount of the other-than-temporary decline and its duration, the issuer's financial condition and short-term prospects and whether the market decline was caused by overall economic conditions or conditions specific to the individual security.

We do not hedge our equity price risk. The impact of an adverse movement in equity prices on our holdings in privately held companies cannot be easily quantified, as our ability to realize returns on investments depends on, among other things, the enterprises' ability to raise additional capital or derive cash inflows from continuing operations or through liquidity events such as initial public offerings, mergers or private sales.

Liquidity and Capital Resources

Cash and Cash Equivalents

Cash and cash equivalents at March 31, 2010 totaled \$463 million compared to \$534 million at December 31, 2009. Cash and cash equivalents consist of highly liquid short-term investments, including time deposits with highly-rated banks, and various insured money market funds, including those that invest in U.S. Treasury securities. For the three months ended March 31, 2010, cash flows from operating activities of \$239 million, together with cash on-hand, were used to fund investing and financing activities of \$43 million and \$268 million, respectively. Cash and cash equivalents at March 31, 2009 totaled \$204 million compared to \$254 million at December 31, 2008. Cash flows from operating activities in 2009 of \$273 million, together with cash on-hand, were used to fund investing and financing activities of \$41 million and \$281 million, respectively.

Cash Flows from Operating Activities

Net cash provided by operating activities for the three months ended March 31, 2010 was \$239 million compared to \$273 million in the prior year period. This decrease was primarily due to a change in the timing of variable compensation payments. Days sales outstanding, a measure of billing and collection efficiency, were 41 days at March 31, 2010 compared to 43 days at both March 31, 2009 and December 31, 2009.

Cash Flows from Investing Activities

Net cash used in investing activities for the three months ended March 31, 2010 and 2009 was \$43 million and \$41 million, respectively, and consisted principally of capital expenditures.

Cash Flows from Financing Activities

Net cash used in financing activities for the three months ended March 31, 2010 was \$268 million, consisting primarily of purchases of treasury stock totaling \$251 million, dividend payments of \$18 million and a decrease in book overdrafts of \$12 million, partially offset by \$19 million in proceeds from the exercise of stock options, including related tax benefits. The \$251 million of treasury stock purchases represents 4.5 million shares of our common stock purchased at an average price of \$56.21 per share under an accelerated stock purchase agreement with a bank.

Net cash used in financing activities for the three months ended March 31, 2009 was \$281 million, consisting primarily of purchases of treasury stock totaling \$250 million, dividend payments of \$19 million and a decrease in book overdrafts of \$17 million. The \$250 million of treasury stock purchases represents 5.6 million shares of our common stock purchased at an average price of \$44.48 per share. Cash flows from financing activities also included \$11 million in proceeds from the exercise of stock options, including related tax benefits. In addition, \$50 million of borrowings under our secured receivables credit facility which were used to fund certain of the share repurchases were repaid in the quarter.

Dividend Program

During each of the quarters of 2010 and 2009, our Board of Directors declared a quarterly cash dividend of \$0.10 per common share. On February 11, 2010, our Board of Directors declared a quarterly cash dividend per common share of \$0.10, paid on April 6, 2010. We expect to fund future dividend payments with cash flows from operations, and do not expect the dividend to have a material impact on our ability to finance future growth.

Share Repurchase Plan

In January 2010, our Board of Directors authorized \$750 million of additional share repurchases. The share repurchase authorization has no set expiration or termination date. For the three months ended March 31, 2010, we repurchased 4.5 million shares of our common stock at an average price of \$56.21 per share for \$251 million under an accelerated stock purchase agreement with a bank. For the three months ended March 31, 2010, we reissued 1.0 million shares for employee benefit plans. Since its inception in May 2003, we have repurchased

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approximately 64 million shares of our common stock at an average price of \$46.87 for \$3.0 billion under our share repurchase program. At March 31, 2010, \$499 million of share repurchase authorization remained available.

Contractual Obligations and Commitments

The following table summarizes certain of our contractual obligations as of March 31, 2010:

Contractual Obligations	Payments due by period				
	Total	Remainder of 2010	(in thousands)		
			1-3 years	3 5 years	After 5 years
Outstanding debt	\$ 3,116,802	\$ 165,534	\$ 901,268	\$ 5,682	\$ 2,050,000
Capital lease obligations	24,272	3,658	7,827	5,682	7,105
Interest payments on outstanding debt	1,722,264	99,400	228,742	321,112	1,073,010
Operating leases	667,513	148,583	246,594	118,237	154,099
Purchase obligations	111,350	38,512	57,498	11,892	3,448
Total contractual obligations	\$ 5,642,201	\$ 455,687	\$ 1,441,929	\$ 456,923	\$ 3,287,662

Interest payments on our outstanding debt have been calculated after giving effect to our interest rate swap agreements, using the interest rates as of March 31, 2010 applied to the March 31, 2010 balances, which are assumed to remain outstanding through their maturity dates.

A full description of the terms of our indebtedness and related debt service requirements and our future payments under certain of our contractual obligations is contained in Note 10 to the Consolidated Financial Statements in our 2009 Annual Report on Form 10-K. A full discussion and analysis regarding our minimum rental commitments under noncancelable operating leases and noncancelable commitments to purchase products or services at December 31, 2009 is contained in Note 15 to the Consolidated Financial Statements in our 2009 Annual Report on Form 10-K.

As of March 31, 2010, our total liabilities for unrecognized tax benefits were approximately \$134 million, which were excluded from the table above. We believe it is reasonably possible that our liabilities for unrecognized tax benefits may decrease by \$26 million within the next twelve months, primarily as a result of the expiration of statutes of limitations, settlements and/or the conclusion of tax examinations on certain tax positions. For the remainder, we cannot make reasonably reliable estimates of the timing of the future payments of these liabilities. See Note 5 to the Consolidated Financial Statements in our 2009 Annual Report on Form 10-K for information regarding our contingent tax liability reserves.

Our credit agreements and our term loan due May 2012 contain various covenants and conditions, including the maintenance of certain financial ratios, that could impact our ability to, among other things, incur additional indebtedness. As of March 31, 2010, we were in compliance with the various financial covenants included in our credit agreements and we do not expect these covenants to adversely impact our ability to execute our growth strategy or conduct normal business operations.

Unconsolidated Joint Ventures

We have investments in unconsolidated joint ventures in Phoenix, Arizona; Indianapolis, Indiana; and Dayton, Ohio, which are accounted for under the equity method of accounting. We believe that our transactions with our joint ventures are conducted in all material respects at arm's length, reflecting current market conditions and pricing. Total net revenues of our unconsolidated joint ventures equal less than 6% of our consolidated net revenues. Total assets associated with our unconsolidated joint ventures are less than 2% of our consolidated total assets. We have no material unconditional obligations or guarantees to, or in support of, our unconsolidated joint ventures and their operations.

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Requirements and Capital Resources

We estimate that we will invest approximately \$200 million during 2010 for capital expenditures to support and expand our existing operations, principally related to investments in information technology, equipment, and facility upgrades.

As of March 31, 2010, \$1.3 billion of borrowing capacity was available under our existing credit facilities, consisting of \$525 million available under our secured receivables credit facility and \$750 million available under our senior unsecured revolving credit facility.

We believe the banks participating in our various credit facilities are predominantly highly-rated banks, and that the amounts under the credit facilities are currently available to us. Should one or several banks no longer participate in either of our credit facilities, we would not expect it to impact our ability to fund operations.

We believe that cash and cash equivalents on-hand and cash from operations, together with our borrowing capacity under our credit facilities, will provide sufficient financial flexibility to meet seasonal working capital requirements and to fund capital expenditures, debt service requirements, cash dividends on common shares, share repurchases and additional growth opportunities for the foreseeable future. We believe that our credit profile should provide us with access to additional financing, if necessary, to fund growth opportunities that cannot be funded from existing sources.

New Accounting Standards

In October 2009, the Financial Accounting Standards Board (FASB) issued an amendment to the accounting standards related to the accounting for revenue in arrangements with multiple deliverables, and an amendment to the accounting standards related to certain revenue arrangements that include software elements. In January 2010, the FASB issued an amendment to the accounting standards related to the disclosures about an entity's use of fair value measurements. In February 2010, the FASB issued an amendment to the accounting standards related to the accounting for, and disclosure of, subsequent events in an entity's consolidated financial statements. The impact of these accounting standards is discussed in Note 1 to the interim consolidated financial statements.

Forward-Looking Statements

Some statements and disclosures in this document are forward-looking statements. Forward-looking statements include all statements that do not relate solely to historical or current facts and can be identified by the use of words such as may, believe, will, expect, project, estimate, anticipate, plan or continue. These forward-looking statements are based on our current plans and expectations and are subject to a number of risks and uncertainties that could significantly cause our plans and expectations, including actual results, to differ materially from the forward-looking statements. Risks and uncertainties that may affect our future results include, but are not limited to, adverse results from pending or future government investigations, lawsuits or private actions, the competitive environment, changes in government regulations, changing relationships with customers, payers, suppliers and strategic partners and other factors discussed in Business in Part I, Item 1, Risk Factors and Cautionary Factors That May Affect Future Results in Item I, Part 1A, Legal Proceedings in Part I, Item 3, Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7 and Quantitative and Qualitative Disclosures About Market Risk in Part II, Item 7A in our 2009 Annual Report on Form 10-K and Management's Discussion and Analysis of Financial Condition and Results of Operations in Part I, Item 2, Quantitative and Qualitative Disclosures About Market Risk in Part I, Item 3 and Risk Factors in Part II, Item 1A in our 2010 Quarterly Reports on Form 10-Q and other items throughout the 2009 Form 10-K and our 2010 Quarterly Reports on Form 10-Q and Current Reports on Form 8-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended). Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

During the first quarter of 2010, there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended) that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

See Note 7 to the interim consolidated financial statements for information regarding the status of legal proceedings involving the Company.

Item 1A. Risk Factors

In addition to the risk factors set forth in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2009, investors should consider the following risk factor before deciding to invest in any securities issued by the Company.

U.S. healthcare reform legislation may result in significant change, and our business could be adversely impacted if we fail to adapt.

Government oversight of and attention to the healthcare industry in the United States is significant and increasing. In March 2010, U.S. federal legislation was enacted to reform healthcare. The legislation provides for reductions in the Medicare clinical laboratory fee schedule of 1.75% for five years beginning in 2011 and also includes a productivity adjustment which reduces the CPI market basket update beginning in 2011. Approximately 12% of our consolidated revenues are reimbursed by Medicare under the clinical laboratory fee schedule. The legislation imposes an excise tax on the seller for the sale of certain medical devices in the United States, including those purchased and used by laboratories, beginning in 2013. The legislation establishes the Independent Payment Advisory Board, which will be responsible, beginning in 2014, annually to submit proposals aimed at reducing Medicare cost growth while preserving quality. These proposals automatically will be implemented unless Congress enacts alternative proposals that achieve the same savings targets. Further, the legislation calls for a Center for Medicare and Medicaid Innovation that will examine alternative payment methodologies and conduct demonstration programs. The legislation provides for extensive health insurance reforms, including the elimination of pre-existing condition exclusions and other limitations on coverage, fixed percentages on medical loss ratios, expansion in Medicaid and other programs, employer mandates, individual mandates, creation of state and regional health insurance exchanges, and tax subsidies for individuals to help cover the cost of individual insurance coverage. The legislation also permits the establishment of accountable care organizations, a new healthcare delivery model. While the ultimate impact of the legislation on the healthcare industry is unknown, it is likely to be extensive and may result in significant change. Our failure to adapt to these changes could have a material adverse effect on our business.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The table below sets forth the information with respect to purchases made by or on behalf of the Company of its common stock during the first quarter of 2010.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (in thousands)
January 1, 2010 – January 31, 2010				
Share Repurchase Program (A)	4,460,304	\$ 56.21	4,460,304	\$ 499,338
Employee Transactions (B)	39	\$ 61.21	N/A	N/A
February 1, 2010 – February 28, 2010				
Share Repurchase Program (A)		\$		\$ 499,338
Employee Transactions (B)	45,563	\$ 55.89	N/A	N/A
March 1, 2010 – March 31, 2010				
Share Repurchase Program (A)		\$		\$ 499,338
Employee Transactions (B)	225,798	\$ 55.78	N/A	N/A
Total				
Share Repurchase Program (A)	4,460,304	\$ 56.21	4,460,304	\$ 499,338
Employee Transactions (B)	271,400	\$ 55.80	N/A	N/A

- (A) In January 2010, our Board of Directors authorized the Company to repurchase an additional \$750 million of the Company's common stock. Since the share repurchase program's inception in May 2003, our Board of Directors has authorized \$3.5 billion of share repurchases of our common stock through March 31, 2010. The share repurchase authorization has no set expiration or termination date.
- (B) Includes: (1) shares delivered or attested to in satisfaction of the exercise price and/or tax withholding obligations by holders of stock options (granted under the Company's Amended and Restated Employee Long-Term Incentive Plan and its Amended and Restated Non-Employee Director Long-Term Incentive Plan, collectively the "Stock Compensation Plans") who exercised options; (2) restricted common shares withheld (under the terms of grants under the Stock Compensation Plans) to offset tax withholding obligations that occur upon vesting and release of the restricted common shares; and (3) shares withheld (under the terms of grants under the Stock Compensation Plans) to offset tax withholding obligations that occur upon the delivery of common shares underlying restricted stock units and performance share units.

Item 6. Exhibits

Exhibits:

- 10.1* Fourth Amended and Restated Credit and Security Agreement dated as of June 11, 2008, among Quest Diagnostics Receivables Inc., as Borrower, the Company, as Servicer, each of the lenders party thereto and The Bank of Tokyo-Mitsubishi UFJ, Ltd., New York Branch, as Administrative Agent
- 10.2* Credit Agreement dated as of May 31, 2007, among the Company, certain subsidiary guarantors of the Company, the lenders party thereto, Bank of America, N.A., as Administrative Agent, Morgan Stanley Senior Funding, Inc., as Syndication Agent, Barclays Bank Plc, JPMorgan Chase Bank, N.A., Merrill Lynch Bank, USA and Wachovia Bank, National Association, as co-Documentation Agents, and Morgan Stanley Senior Funding, Inc. and Banc of America Securities LLC, as Joint Lead Arrangers and Joint Book Runners
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101.INS dgx-20100331.xml
- 101.SCH dgx-20100331.xsd
- 101.CAL dgx-20100331_cal.xml
- 101.DEF dgx-20100331_def.xml
- 101.LAB dgx-20100331_lab.xml
- 101.PRE dgx-20100331_pre.xml
- 101.REF dgx-20100331_ref.xml

* Portions of this Exhibit have been omitted pursuant to a request for confidential treatment and filed separately with the Securities and Exchange Commission.

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

April 26, 2010

Quest Diagnostics Incorporated

By /s/ Surya N. Mohapatra

Surya N. Mohapatra, Ph.D.
Chairman of the Board, President and
Chief Executive Officer

By /s/ Robert A. Hagemann

Robert A. Hagemann
Senior Vice President and
Chief Financial Officer