

PROXYMED INC /FT LAUDERDALE/

Form 10-Q

December 15, 2004

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended **September 30, 2004**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: **000-22052**

**PROXYMED, INC.**

\_\_\_\_\_  
(Exact name of registrant as specified in its charter)

**Florida**

**65-0202059**

\_\_\_\_\_  
(State or other jurisdiction of incorporation or organization)

\_\_\_\_\_  
(I.R.S. Employer Identification No.)

**1854 Shackelford Court, Suite 200, Atlanta, Georgia**

**30093**

\_\_\_\_\_  
(Address of principal executive offices)

\_\_\_\_\_  
(Zip Code)

**(770) 806-9918**

\_\_\_\_\_  
(Registrant's telephone number)

\_\_\_\_\_  
(Former name, former address and former fiscal year, if changed since last report)

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 registrant is an accelerated filer (as defined by Rule 12b-2 of the Securities Exchange Act of 1934).

Yes  No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

**Common Stock, \$.001 Par Value  
12,626,182 Shares as of December 13, 2004**

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**Table of Contents****PART 1 FINANCIAL INFORMATION****ITEM 1 FINANCIAL STATEMENTS****PROXYMED, INC. AND SUBSIDIARIES****Consolidated Balance Sheets**  
**(amounts in thousands except for share and per share data)**

|  | <b>September 30,<br/>2004</b> | <b>December 31,<br/>2003</b> |
|--|-------------------------------|------------------------------|
|  | <b>(unaudited)</b>            |                              |
| Assets   |                               |                              |
| Current assets:  |                               |                              |
| Cash and cash equivalents  | \$ 12,214                     | \$ 5,333                     |
| Accounts receivable trade, net of allowance of \$3,941 and \$882, respectively | 16,371                        | 10,434                       |
| Notes and other receivables  | 257                           | 187                          |
| Inventory, net   | 1,581                         | 3,347                        |
| Other current assets   | 1,379                         | 1,908                        |
|  | <hr/>                         | <hr/>                        |
| Total current assets   | 31,802                        | 21,209                       |
| Property and equipment, net  | 4,838                         | 4,772                        |
| Goodwill   | 93,605                        | 30,775                       |
| Purchased technology, capitalized software and other intangible assets, net    | 54,202                        | 15,884                       |
| Restricted cash  | 175                           | 291                          |
| Other long-term assets   | 412                           | 199                          |
|  | <hr/>                         | <hr/>                        |
| Total assets   | <b>\$ 185,034</b>             | <b>\$ 73,130</b>             |
|  | <hr/>                         | <hr/>                        |
| Liabilities and Stockholders Equity  |                               |                              |
| Current liabilities:   |                               |                              |
| Notes payable and current portion of long-term debt                            | \$ 21,367                     | \$ 1,712                     |
| Accounts payable and accrued expenses  | 11,105                        | 8,264                        |
| Deferred revenue and other current liabilities                                 | 974                           | 721                          |
| Income taxes payable   | 420                           |                              |
|  | <hr/>                         | <hr/>                        |
| Total current liabilities  | 33,866                        | 10,697                       |
| Convertible notes  | 13,137                        | 13,137                       |
| Other long-term debt   | 636                           | 2,057                        |
| Long-term deferred revenue and other long-term liabilities                     | 907                           | 1,461                        |
|  | <hr/>                         | <hr/>                        |

|  |                   |                  |
|--|-------------------|------------------|
| Total liabilities  | <u>48,546</u>     | <u>27,352</u>    |
| Commitments and contingencies (Note 13)  |                   |                  |
| Stockholders' equity:  |                   |                  |
| Series C 7% Convertible preferred stock \$ .01 par value. Authorized 300,000 shares; issued 253,265 shares; outstanding 2,000 shares; liquidation preference \$200 |                   |                  |
| Common stock \$ .001 par value. Authorized 30,000,000 and 13,333,333 shares respectively; issued and outstanding 12,626,182 and 6,782,938 shares respectively      |                   |                  |
|  | 13                | 7                |
| Additional paid-in capital   | 239,258           | 146,230          |
| Accumulated deficit  | (102,500)         | (100,273)        |
| Unearned compensation  | (186)             |                  |
| Note receivable from stockholder   | <u>(97)</u>       | <u>(186)</u>     |
| Total stockholders' equity   | <u>136,488</u>    | <u>45,778</u>    |
| Total liabilities and stockholders' equity   | <u>\$ 185,034</u> | <u>\$ 73,130</u> |

See notes to the consolidated financial statements.

**Table of Contents****PROXYMED, INC. AND SUBSIDIARIES****Consolidated Statements of Operations****(unaudited)****(amounts in thousands except for share and per share data)**

|  | <b>Three Months Ended September 30,</b> |                                   | <b>Nine Months Ended September 30,</b> |                                   |
|--|---|-----------------------------------|--|-----------------------------------|
|  | <b>2004</b>                             | <b>2003</b>                       | <b>2004</b>                            | <b>2003</b>                       |
|  |   | <b>(as restated, See Note 14)</b> |  | <b>(as restated, See Note 14)</b> |
| Net revenues:  |   |                                   |  |                                   |
| Transaction fees, cost containment services and license fees         | \$ 20,219                               | \$ 13,134                         | \$ 55,807                              | \$ 39,002                         |
| Communication devices and other tangible goods                       | 2,292                                   | 4,928                             | 11,858                                 | 14,192                            |
|  | <u>22,511</u>                           | <u>18,062</u>                     | <u>67,665</u>                          | <u>53,194</u>                     |
| Costs and expenses:  |   |                                   |  |                                   |
| Cost of transaction fees, cost containment services and license fees | 5,863                                   | 3,808                             | 16,041                                 | 12,342                            |
| Cost of laboratory communication devices and other tangible goods    | 1,929                                   | 4,246                             | 9,856                                  | 12,096                            |
| Selling, general and administrative expenses                         | 12,585                                  | 8,351                             | 35,390                                 | 27,505                            |
| Depreciation and amortization  | 2,607                                   | 1,478                             | 7,086                                  | 4,153                             |
| (Gain) loss on disposal of assets                                    | (23)                                    | 9                                 | 48                                     | 119                               |
|  | <u>22,961</u>                           | <u>17,892</u>                     | <u>68,421</u>                          | <u>56,215</u>                     |
| Operating income (loss)  | (450)                                   | 170                               | (756)                                  | (3,021)                           |
| Interest expense, net  | 503                                     | 203                               | 1,380                                  | 572                               |
| Other income   |   |                                   | (134)                                  |                                   |
|  | <u>(953)</u>                            | <u>(33)</u>                       | <u>(2,002)</u>                         | <u>(3,593)</u>                    |
| Loss before income taxes   | (953)                                   | (33)                              | (2,002)                                | (3,593)                           |
| Provision for income taxes   | 75                                      |                                   | 225                                    |                                   |
|  | <u>(1,028)</u>                          | <u>(33)</u>                       | <u>(2,227)</u>                         | <u>(3,593)</u>                    |
| Net loss   | \$ (1,028)                              | \$ (33)                           | \$ (2,227)                             | \$ (3,593)                        |

|  |                             |                             |                             |                             |
|--|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|  | <u>                    </u> | <u>                    </u> | <u>                    </u> | <u>                    </u> |
| Basic and diluted loss per share                         | \$ (0.08)                   | \$                          | \$ (0.20)                   | \$ (0.53)                   |
|  | <u>                    </u> | <u>                    </u> | <u>                    </u> | <u>                    </u> |
| Basic and diluted weighted average<br>shares outstanding | 12,626,066                  | 6,783,095                   | 11,278,954                  | 6,782,991                   |
|  | <u>                    </u> | <u>                    </u> | <u>                    </u> | <u>                    </u> |

See notes to the consolidated financial statements.

**Table of Contents****PROXYMED, INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows****(unaudited)****(amounts in thousands except for per share data)**

|  | <b>Nine Months Ended September<br/>30,</b> |                                       |
|--|--|---------------------------------------|
|  | <b>2004</b>                                | <b>2003</b>                           |
|  |  | <b>(as restated,<br/>See Note 14)</b> |
| Cash flows from operating activities:  |  |                                       |
| Net loss   | \$ (2,227)                                 | \$ (3,593)                            |
| Adjustments to reconcile net loss to net cash provided by (used in) operations:    |  |                                       |
| Depreciation and amortization  | 7,086                                      | 4,153                                 |
| Provision for doubtful accounts  | 681  | 155                                   |
| Provision for obsolete inventory   | 41   | 29                                    |
| Loss on disposal of fixed assets   | 70   | 119                                   |
| Non-cash interest income   | (59)                                       |                                       |
| Gain on settlement of liability  | (133)                                      |                                       |
| Stock option compensation charges  | 204  |                                       |
| Changes in assets and liabilities, net of effect of acquisitions and dispositions: |  |                                       |
| Accounts and other receivables   | 1,747                                      | 23                                    |
| Inventory  | (1,083)                                    | (836)                                 |
| Other current assets   | 340  | 304                                   |
| Accounts payable and accrued expenses  | (1,886)                                    | (389)                                 |
| Accrued expenses of PlanVista paid by ProxyMed                                     | (4,011)                                    |                                       |
| Deferred revenue   | 94   | 94                                    |
| Other, net   | 868  | 420                                   |
|  | <hr/>                                      | <hr/>                                 |
| Net cash provided by (used in) operating activities                                | (4)  | 479                                   |
|  | <hr/>                                      | <hr/>                                 |
| Cash flows from investing activities:  |  |                                       |
| Net cash acquired in acquisition   | 782  |                                       |
| Capital expenditures   | (2,613)                                    | (2,115)                               |
| Capitalized software   | (971)                                      | (1,173)                               |
| Collection of notes receivable   | 180  | 304                                   |
| Proceeds from sale of fixed assets   | 4,499                                      | 107                                   |
| Decrease in restricted cash  | 115  | 422                                   |
| Payments for acquisition-related costs   | (884)                                      | (5,653)                               |
|  | <hr/>                                      | <hr/>                                 |
| Net cash provided by (used in) investing activities                                | 1,108                                      | (8,108)                               |
|  | <hr/>                                      | <hr/>                                 |



|   |                  |                 |
|---|------------------|-----------------|
| Cash flows from financing activities:                       |                  |                 |
| Net proceeds from sale of common stock                      | 24,100           |                 |
| Proceeds from exercise of stock options and warrants        | 8,766            | 8               |
| Draws on line of credit                                     | 4,900            |                 |
| Repayment of line of credit                                 | (4,900)          |                 |
| Payment of notes payable, capital leases and long-term debt | (27,089)         | (1,824)         |
|   | <u>5,777</u>     | <u>(1,816)</u>  |
| Net cash provided by (used in) financing activities         |                  |                 |
|   | <u>5,777</u>     | <u>(1,816)</u>  |
| Net increase (decrease) in cash and cash equivalents        | 6,881            | (9,445)         |
| Cash and cash equivalents at beginning of period            | 5,333            | 16,378          |
|   | <u>5,333</u>     | <u>16,378</u>   |
| Cash and cash equivalents at end of period                  | \$ 12,214        | \$ 6,933        |
|   | <u>\$ 12,214</u> | <u>\$ 6,933</u> |

See notes to the consolidated financial statements.

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**PROXYMED, INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (unaudited)**

(1) **Summary of Significant Accounting Policies**

- (a) **Basis of Presentation** The accompanying unaudited consolidated financial statements of ProxyMed, Inc. and subsidiaries ( ProxyMed or the Company ) and the notes thereto have been prepared in accordance with the instructions of Form 10-Q and Rule 10-01 of Regulation S-X of the Securities and Exchange Commission (the SEC ) and do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America. However, such information reflects all adjustments (consisting of normal recurring adjustments), which are, in the opinion of management, necessary for a fair statement of results for the interim periods.

The results of operations for the nine months ended September 30, 2004 are not necessarily indicative of the results to be expected for the full year. The unaudited consolidated financial statements included herein should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company s Annual Report on Form 10-K/A for the year ended December 31, 2003 as filed with the SEC on December 15, 2004.

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

- (b) **Revenue Recognition** Revenue is derived from the Company's Transaction Services and Laboratory Communication Solutions segments.

In its Transaction Services segment, the Company provides transaction and value-added services principally between physicians and insurance companies, and physicians and pharmacies. Such transactions and services include Electronic Data Interchange ( EDI ) claims submission and reporting, insurance eligibility verification, claims status inquiries, referral management, electronic remittance advice, patient statement processing, encounters, and cost containment transaction services including claims repricing and bill renegotiation. In the Laboratory Communication Solutions segment, the Company sells, rents and services intelligent remote reporting devices and provides lab order entry and results reporting through its software products.

Transaction Services revenues are derived from insurance payers, pharmacies and submitters (physicians and other entities including billing services, practice management software vendors, claims aggregators, etc.). Such revenues are recorded on a per transaction fee basis or a flat fee basis (per physician) and are recognized in the period the service is rendered. Agreements between the Company and payers or pharmacies are for one to three years on a non-exclusive basis. Agreements with submitters are for one year, renew automatically, and are generally terminable thereafter upon 30 to 90 days notice. Transaction fees vary according to the type of transaction and other factors, including volume level commitments primarily for payers.

Revenue from Medical Cost Containment business in the Transaction Services segment is recognized when the services are performed and are recorded net of their estimated allowances (see Note 2(c)). These revenues are primarily in the form of fees generated from the discounts the Company secures for the payers that access its provider network. The Company enters into agreements with its healthcare payer customers that require them to pay a percentage of the cost savings generated from the Company's network discounts with participating providers. These agreements are generally terminable upon 90 days notice. Revenue from a percentage of savings contract is generally recognized when the related claims processing and administrative services have been performed. The remainder of the Company's revenue from its Medical Cost Containment business is generated from customers that pay a monthly fee based on eligible employees enrolled in a benefit plan covered by the Company's health benefits payers' clients.

Also in the Transaction Services segment, certain transaction fee revenue is subject to revenue sharing pursuant to agreements with resellers, vendors or gateway partners and is recorded as gross revenues in accordance with EITF No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent. Such revenue sharing amounts are based on a per transaction amount or a percentage of revenue basis and may involve increasing amounts or percentages based on transaction or revenue volumes achieved.

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

Revenue from certain up-front fees charged primarily for the development of EDI for payers and the implementation of services for submitters in the Transaction Services segment is amortized ratably over three years, which is the expected life of the customer, in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition ( SAB No. 104 ).

Revenue from support and maintenance contracts on the Company's products in both the Transaction Services and Laboratory Communication Solutions segments is recognized ratably over the contract period, which does not exceed one year. Such amounts are billed in advance and established as deferred revenue.

In the Company's Laboratory Communication Solutions segment, revenue from sales of inventory and manufactured goods is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collectibility is probable in accordance with SAB No. 104.

Revenues from maintenance fees on laboratory communication devices are charged on an annual or quarterly basis and are recognized ratably over the service period. Service fees may also be charged on a per event basis and are recognized after the service has been performed.

Revenue from the rental of laboratory communication devices is recognized ratably over the applicable period of the rental contract. Such contracts require monthly rental payments and are for a one to three year term, then renewing for a similar period after the initial term is expired. Contracts may be cancelled upon 30 days notice. A significant amount of rental revenues are derived from contracts that are no longer under the initial non-cancelable term. At the end of the rental period, the customer may return or purchase the unit for fair market value. Upon sale of the revenue earning equipment, the gross proceeds are included in net revenues and the undepreciated cost of the equipment sold is included in cost of sales.

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

- (c) Reserve for Doubtful Accounts/Bad Debt Estimates The Company relies on estimates to determine the bad debt expense and the adequacy of the reserve for doubtful accounts receivable. These estimates are based on the Company's historical experience and the industry in which it operates. If the financial condition of its customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Additionally, in the Medical Cost Containment business, the Company evaluates the collectibility of its accounts receivable based on a combination of factors, including historical collection ratios.

In circumstances where the Company is aware of a specific customer's inability to meet its financial obligations, it records a specific reserve for bad debts against amounts due to reduce the net recognized receivable to the amount it reasonably believes will be collected. For all other customers, the Company recognizes reserves for bad debts based on past write-off history and the length of time the receivables are past due. To the extent historical credit experience is not indicative of future performance or other assumptions used by management do not prevail, loss experience could differ significantly, resulting in either higher or lower future provision for losses.

- (d) Net loss per share Basic net loss per share of common stock is computed by dividing net loss by the weighted average shares of common stock outstanding during the period. Diluted loss per share reflects the potential dilution from the exercise or conversion of securities into common stock; however, the following shares were excluded from the calculation of net loss per share because their effects would have been anti-dilutive:

|  | <b>September 30,</b> |                      |
|--|----------------------|----------------------|
|  | <b>2004</b>          | <b>2003</b>          |
|  |                      | <b>(as restated)</b> |
| Common shares excluded in the computation of net loss per share: |                      |                      |
| Convertible preferred stock                                      | 13,333               | 13,333               |
| Stock options  | 1,694,531            | 1,195,375            |
| Warrants   | 900,049              | 1,460,994            |
|  | 2,607,913            | 2,669,702            |

Additionally, 238,989 shares issuable upon conversion of \$4.4 million in convertible notes (as a result of meeting the first revenue threshold in the fourth quarter of 2003) issued in connection with the Company's acquisition of MedUnite in December 2002 are excluded from the calculation for all periods presented because their effect would also be anti-dilutive.

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

- (e) **Stock Based Compensation** ProxyMed applies Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB No. 25 ), and related interpretations in accounting for its stock-based compensation plans. The Company measures compensation expense related to the grant of stock options and stock-based awards to employees (including independent directors) in accordance with the provisions of APB No. 25. In accordance with APB No. 25, compensation expense, if any, is generally based on the difference between the exercise price of an option, or the amount paid for an award, and the market price or fair value of the underlying common stock at the date of the award or at the measurement date for variable awards. Stock-based compensation arrangements involving non-employees are accounted for under Statement of Financial Accounting Standards ( SFAS ) No. 123, Accounting for Stock-Based Compensation, ( SFAS No. 123 ) as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure ( SFAS No. 148 ), under which such arrangements are accounted for based on the fair value of the option or award.

Under SFAS No. 123, as amended by SFAS No. 148, compensation cost for the Company's stock-based compensation plans would be determined based on the fair value at the grant dates for awards under those plans. Had the Company adopted SFAS No. 123 in accounting for its stock option plans, the Company's consolidated net loss and net loss per share for the three and nine months ended September 30, 2004 and 2003 would have been adjusted to the pro forma amounts indicated as follows:

| <b>In thousands except for per share data</b>   | <b>Three Months Ended<br/>September 30,</b> |                   | <b>Nine Months Ended<br/>September 30,</b> |                  |
|---|---|-------------------|--|------------------|
|   | <b>2004</b>                                 | <b>2003</b>       | <b>2004</b>                                | <b>2003</b>      |
| Net loss, as reported   | \$ (1,028)                                  | \$ (33)           | \$(2,227)                                  | \$(3,593)        |
| Deduct: Total stock-based employee pro forma compensation expense determined under fair value based method for all awards, net of related tax effects (1) | (307)                                       | (3,334)           | (1,613)                                    | (4,041)          |
| Addback charges already taken for intrinsic value of options  | 36  | —                 | 92   | —                |
| Pro forma net loss  | <u>\$ (1,299)</u>                           | <u>\$ (3,367)</u> | <u>\$(3,748)</u>                           | <u>\$(7,634)</u> |
| Loss per common share:  |   |                   |  |                  |
| Basic and Diluted as reported   | \$ (0.08)                                   | \$ —              | \$ (0.20)                                  | \$ (0.54)        |
| Basic and Diluted pro forma   | \$ (0.10)                                   | \$ (0.50)         | \$ (0.33)                                  | \$ (1.13)        |
| (1) The following ranges of assumptions were used in the calculation of pro forma compensation expense for the periods presented:                         |   |                   |  |                  |
| Risk-free interest rate   | 4.1% - 4.5%                                 | 3.6%              | 3.8% - 4.8%                                | 3.4% - 4.3%      |
| Expected life   | 10 years                                    | 10 years          | 10 years                                   | 10 years         |
| Expected volatility   | 75% - 76%                                   | 81%               | 75% - 77%                                  | 81%              |

|                |    |    |    |    |
|----------------|----|----|----|----|
| Dividend yield | 0% | 0% | 0% | 0% |
|----------------|----|----|----|----|

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

- (f) **New Accounting Pronouncements** In September 2004, the Financial Accounting Standards Board ( FASB ) issued EITF No. 04-8, Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share ( EITF No. 04-8 ). EITF No. 04-8 addresses when the dilutive effect of contingently convertible debt instruments should be included in diluted earnings per share and requires that contingently convertible debt instruments are to be included in the computation of diluted earnings per share regardless of whether the market price or other trigger has been met. EITF No. 04-8 also requires that prior period diluted earnings per share amounts presented for comparative purposes be restated. EITF No. 04-8 is effective for reporting periods ending after December 15, 2004. As a result of the issuance of EITF No. 04-8, shares convertible from the Company's \$13.1 million convertible notes may be required to be included in the calculation of earnings per share in periods of net income; however, the FASB has yet to reach a conclusion as to the effect of non market price triggers on earnings per share calculations in situations where the instrument contain only non-market price trigger, such as the Company's convertible notes, and therefore the impact to the Company is not determinable at this time.
- (g) **Reclassifications** Certain prior year amounts have been reclassified to conform to the current year presentation. Such reclassifications include the movement of direct labor and manufacturing overhead from selling, general and administrative expenses to cost of tangible products sold in the Laboratory Communications Solutions segment to better reflect the production of tangible products in this segment.

| In thousands  | Three Months Ended<br>September 30, 2003 |                    | Nine Months Ended<br>September 30, 2003 |                    |
|---|--|--------------------|---|--------------------|
|   | As<br>Originally<br>Reported             | As<br>Reclassified | As<br>Originally<br>Reported            | As<br>Reclassified |
| Cost of laboratory communication devices and other tangible goods | \$3,462                                  | \$4,246            | \$ 9,846                                | \$ 12,096          |
| Selling, general and administrative expenses                      | \$9,135                                  | \$8,351            | \$ 29,755                               | \$ 27,505          |



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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

(2) Acquisition of PlanVista

On March 2, 2004, the Company acquired all of the capital stock of PlanVista Corporation, a publicly-held company located in Tampa, Florida and Middletown, New York that provides medical cost containment and business process outsourcing solutions, including claims repricing services, for the medical insurance and managed care industries, as well as services for healthcare providers, including individual providers, preferred provider organizations and other provider groups, for 3,600,000 shares of ProxyMed common stock issued to PlanVista's shareholders. In addition, ProxyMed assumed debt and other liabilities of PlanVista, and incurred \$1.3 million in acquisition related expenses. The value of these shares was \$59.8 million based on the average closing price of ProxyMed's common stock for the day of and the two days before and after the announcement of the definitive agreement on December 8, 2003 in accordance with EITF No. 99-12, "Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in Purchase Business Combination". Additionally, ProxyMed raised \$24.1 million in a private placement sale of its common stock to various entities affiliated with General Atlantic Partners and Commonwealth Associates to partially fund repayment of PlanVista's debts and other obligations outstanding at the time of the acquisition (see Note 7). The acquisition enables the Company to offer a new suite of products and services, provide new end-to-end services, increase sales opportunities with payers, strengthen business ties with certain customers, expand technological capabilities, reduce operating costs and enhance its public profile.

The Company had previously entered into a joint marketing agreement with PlanVista for the sale of PlanVista's services in June 2003. As part of that agreement, PlanVista granted the Company a warrant to purchase 15% of the number of outstanding shares of PlanVista common stock on a fully-diluted basis as of the time of exercise for \$1.95 per share. The warrant was exercisable immediately and expired in December 2003. The warrant was accounted for at its cost under Accounting Principles Board Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock" since it did not meet the conditions necessary to be accounted for under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". Upon expiration of the warrant in December 2003, the Company recorded an impairment loss in the amount \$0.5 million (representing the initial value of the warrant and calculated using a Black Scholes model) which was reflected in other expense in the Company's consolidated statement of operations for the year ended December 31, 2003.

Following consummation of the acquisition, PlanVista's common stock was delisted from the Over the Counter Bulletin Board, and each share of PlanVista's outstanding common stock was cancelled and converted into the right to receive 0.08271 of a share of the Company's common stock and each holder of PlanVista series C preferred stock received 51.5292 shares of the Company's common stock in exchange for each share of PlanVista series C preferred stock, all of which represented approximately 23% of the Company's common stock on a fully converted basis. The holders of the Company's outstanding stock, options and warrants at the date of the acquisition of PlanVista retained approximately 77% of the Company after the acquisition.

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

An allocation of the purchase price is as follows. All items are considered final except for the pre-acquisition contingencies as discussed below:

| <b>In thousands</b>                       |           |
|---|-----------|
| Common stock issued                       | \$ 59,760 |
| Acquisition-related costs                 | 1,328     |
| Other adjustments                         | (642)     |
|   | 60,446    |
| Allocation of purchase price:             |           |
| Cash and cash equivalents                 | (782)     |
| Accounts receivable, net                  | (9,470)   |
| Other current assets                      | (381)     |
| Property and equipment, net               | (658)     |
| Customer relationships                    | (24,600)  |
| Provider network                          | (16,200)  |
| Technology platforms                      | (1,180)   |
| Other long-term assets                    | (360)     |
| Accounts payable and accrued expenses     | 9,612     |
| Income taxes payable                      | 633       |
| Notes payable, debt and other obligations | 44,889    |
| Other long-term liabilities               | 881       |
|   | \$ 62,830 |
| Goodwill                                  | \$ 62,830 |

As reported in the Company's Form 10-Q/A as of March 31, 2004 the excess of the consideration paid over the estimated fair value of net assets acquired in the amount of \$61.0 million was initially recorded as goodwill. Due to adjustments for settled pre-acquisition contingencies of \$0.7 million, potential exposure of other pre-acquisition contingencies of \$0.6 million, adjustments to accrued network fees of \$0.4 million and other net adjustments of \$0.1 million recorded after the initial recording of the transaction, the excess of the consideration paid over the estimated fair value of net assets acquired has increased by \$1.8 million to \$62.8 million. Of this amount, the Company has determined that \$20.7 million is tax deductible goodwill.

At the time of its acquisition by the Company, PlanVista was involved in various lawsuits and threatened litigation. As of September 30, 2004, these pre-acquisition contingencies include: (i) a lawsuit filed against a former subsidiary of PlanVista for which the Company intends to vigorously defend itself but for which the Company has determined exposure to be in a range of \$0.6 million to \$1.6 million and has accrued \$0.6 million at September 30, 2004; (ii) a disputed New York State tax liability for which the Company is still evaluating the merits of the case

and cannot yet draw a conclusion as to outcome; and (iii) two other cases for which the Company is still evaluating the merit of the case and cannot yet draw conclusions as to outcome. Management intends to either settle or determine a potential exposure for each of the aforementioned cases within 12 months, or sooner, from the acquisition date of PlanVista.

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

The weighted average useful life of the customer relationships is approximately 12.0 years, the weighted average useful life of the provider network is 10.0 years, and the weighted average useful life of the technology platforms is 4.5 years. The valuation of PlanVista's provider network and technology platforms was based on management's estimates which included consideration of a replacement cost methodology. The value of the customer relationships was calculated on a discounted cash flow model.

Additionally, the Company wrote-off against goodwill \$0.6 million of other liabilities related to the marketing agreement with PlanVista from June 2003 (shown as other adjustments in the preceding purchase price allocation table). The results of PlanVista's operations have been included in the Company's consolidated financial statements since March 2004 in its Transaction Services segment.

The issuance of the 3,600,000 shares of Company common stock to the PlanVista stockholders was registered under the Securities Act of 1933 pursuant to the Company's registration statement on Form S-4 (File No. 333-111024) (the Registration Statement) filed with the SEC and declared effective on February 2, 2004.

In connection with this transaction, on March 1, 2004, the Company's shareholders approved (1) an amendment to the Company's articles of incorporation to increase the total number of authorized shares of the Company's common stock from 13,333,333 shares to 30,000,000 shares; (2) the issuance of 1,691,227 shares of the Company's common stock at \$14.25 per share in a private equity offering valued at \$24.1 million (to retire debt of PlanVista and pay certain expenses associated with the merger); (3) the issuance of 3,600,000 shares of the Company's common stock in connection with the PlanVista merger; and (4) an amendment to the Company's 2002 Stock Option Plan to increase the total number of shares available for issuance from 600,000 to 1,350,000. Additionally, one director of PlanVista was appointed to the Company's board of directors.

All officers and employees of PlanVista, with the exception of PlanVista's chief financial officer, continued employment with the Company. In May 2004, PlanVista's Chief Executive Officer announced his resignation and effective September 1, 2004 he became a consultant to the Company. Under the terms of this agreement, he is allowed to continue to vest in the stock options he received at the time of the acquisition of PlanVista (see Note 8(b)).

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

Additionally, certain officers, directors and employees of PlanVista were granted options to purchase an aggregate of 200,000 shares of ProxyMed common stock at an exercise price of \$17.74 per share. Of these original options granted, 173,120 were to vest two-thirds on the first anniversary date of the grant and one-third on the third anniversary date of the grant. Since the exercise price was less than the market price as of the date of issuance, the Company is recording periodic non-cash compensation charges over the vesting period of the options based on the intrinsic value method. For the three and nine months ended September 30, 2004, the Company recorded non-cash compensation charges of \$35,000 and \$92,000, respectively, for these options. Subsequent to the original issuance of these options, 10,608 stock options have been cancelled due to separation of employment with the Company. In addition, 68,543 granted to the PlanVista's former Chief Executive Officer as a result of his resignation effective September 1, 2004 have been modified due to his change in employment status (see Note 8(b)). The balance of 26,880 options was granted to PlanVista's former Chief Financial Officer in connection with a consulting arrangement with him. Fifty percent of these options vested immediately upon the change of control and 25% vest on each of the three month and six month anniversaries of the change in control. The Company recorded a charge of approximately \$0.1 million in compensation expense associated with this grant in the three months ended March 31, 2004 utilizing a Black-Scholes model using the following assumptions: risk-free interest rate of 1.2%, expected life of 9 months, expected volatility of 42% and no dividend yield.

The following unaudited pro forma summary presents the consolidated results of operations of ProxyMed and PlanVista as if the acquisitions of these businesses had occurred on January 1, 2003. These pro forma results do not necessarily represent results that would have occurred if the acquisition had taken place on that date, or of results that may occur in the future.

| <b>In thousands (except for per share data)</b>      | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|--|-------------|
|  | <b>2004</b>                                | <b>2003</b> |
| Revenues   | \$ 73,333                                  | \$ 77,148   |
| Cost of sales  | \$ 27,753                                  | \$ 31,693   |
| Selling, general and administrative expenses         | \$ 37,657                                  | \$ 36,259   |
| Operating income (loss)                              | \$ (13)                                    | \$ 1,432    |
| Interest expense, net                                | \$ 1,687                                   | \$ 1,489    |
| Net loss   | \$ (1,891)                                 | \$ (626)    |
| Basic and diluted net loss per share of common stock | \$ (0.15)                                  | \$ (0.05)   |

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

**(3) Sale of Assets**

On June 30, 2004, the Company sold certain assets and liabilities of its Laboratory Communications Solutions segment that were used in its non-core contract manufacturing business to an entity formed by a former executive of the Company for \$4.5 million in cash. Under terms of the sale agreement, the Company received \$3.5 million in cash at closing and received the balance of \$1.0 million in cash in July and August 2004 upon presentation of final accounting.

The Company believes the divested manufacturing assets were not a component of an entity because the operations and cash flows could not be clearly distinguished, operationally and for financial purposes, from the rest of the entity. Accordingly, pursuant to SFAS No. 144, Accounting for the Impairment or Disposal of Long Lived Assts, failure to meet such a condition precluded these assets from being presented as discontinued operations.

As a result of the transaction, the Company recorded a loss on sales of assets of \$0.1 million in the nine months ended September 30, 2004. This loss includes the value of options to purchase 10,000 shares of the Company's common stock granted to the former executive at an exercise price of \$16.00 in July 2004 which was originally accrued at June 30, 2004.

As part of the disposition, the Company agreed to purchase certain component parts (valued at \$0.4 million at June 30, 2004) from the new owner for use in its Laboratory Communication Solutions business on a non-exclusive basis through March 31, 2005 at a fixed price deemed to be at fair market value by the Company's management. As of September 30, 2004, this remaining commitment had been reduced to less than \$0.1 million. Additionally, the Company has agreed to sublease a portion of its current facilities through April 2005 and provide certain administrative services to the new entity.

**(4) Inventory**

Inventory consists of the following at September 30, 2004 and December 31, 2003:

| <b>In thousands</b>                     | <b>September<br/>30,<br/>2004</b> | <b>December<br/>31,<br/>2003</b> |
|---|-----------------------------------|----------------------------------|
|   | <b>(unaudited)</b>                |                                  |
| Materials, supplies and component parts | \$ 664                            | \$ 2,018                         |
| Work in process                         | 24                                | 591                              |
| Finished goods                          | 933                               | 746                              |
|   | <hr/>                             | <hr/>                            |
|   | 1,621                             | 3,355                            |
| Less: obsolescence reserve              | (40)                              | (8)                              |
|   | <hr/>                             | <hr/>                            |
|   | \$ 1,581                          | \$ 3,347                         |



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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

(5) Goodwill and Other Intangible Assets

- (a) Goodwill The changes in the carrying amounts of goodwill for the nine months ended September 30, 2004 by operating segment are as follows. Changes to goodwill acquired during the period are more fully described in Note 2:

| In thousands                                    | Transaction<br>Services | Laboratory<br>Communication<br>Solutions | Total     |
|---|-------------------------|--|-----------|
| Balance as of December 31, 2003                 | \$ 28,673               | \$ 2,102                                 | \$ 30,775 |
| Goodwill acquired during the period             | 62,830                  | —  | 62,830    |
| Balance as of September 30, 2004<br>(unaudited) | \$ 91,503               | \$ 2,102                                 | \$ 93,605 |

- (b) Other Intangible Assets The carrying amounts of other intangible assets as of September 30, 2004 and December 31, 2003, by category, are as follows:

| In thousands           | September 30, 2004 (unaudited) |                             |           | December 31, 2003  |                             |           |
|------------------------|--------------------------------|-----------------------------|-----------|--------------------|-----------------------------|-----------|
|                        | Carrying<br>Amount             | Accumulated<br>Amortization | Net       | Carrying<br>Amount | Accumulated<br>Amortization | Net       |
| Capitalized software   | \$ 2,755                       | \$ (582)                    | \$ 2,173  | \$ 1,788           | \$ (183)                    | \$ 1,605  |
| Purchased technology   | 10,306                         | (4,336)                     | 5,970     | 9,126              | (3,194)                     | 5,932     |
| Customer relationships | 34,394                         | (3,590)                     | 30,804    | 9,793              | (1,446)                     | 8,347     |
| Provider network       | 16,200                         | (945)                       | 15,255    | —                  | —                           | —         |
|                        | \$ 63,655                      | \$ (9,453)                  | \$ 54,202 | \$ 20,707          | \$ (4,823)                  | \$ 15,884 |

Amortization expense of other intangible assets was \$1.8 million and \$4.6 million three and nine months ended September 30, 2004, respectively, and \$0.8 million and \$2.2 million for the three and nine months ended September 30, 2003, respectively.

As of September 30, 2004, estimated future amortization expense of other intangible assets is as follows:

**In thousands**



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|                          |                   |
|--------------------------|-------------------|
| 2004 (remaining quarter) | \$ 1,940          |
| 2005                     | 7,326             |
| 2006                     | 7,105             |
| 2007                     | 6,799             |
| 2008                     | 6,197             |
|                          | <u>          </u> |
|                          | \$29,367          |
|                          | <u>          </u> |

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

**(6) Accounts Payable and Accrued Expenses**

Accounts payable and accrued expenses consist of the following at September 30, 2004 and December 31, 2003:

| In thousands                                    | September<br>30,<br>2004 | December<br>31,<br>2003 |
|---|--------------------------|-------------------------|
|   | <b>(unaudited)</b>       |                         |
| Accounts payable                                | \$ 1,556                 | \$ 2,956                |
| Accrued payroll and related costs               | 3,131                    | 1,860                   |
| Accrued vendor rebates and network fees payable | 2,835                    | 1,198                   |
| Acquisition related costs                       |                          | 459                     |
| Other accrued expenses                          | 3,583                    | 1,791                   |
|   | \$ 11,105                | \$ 8,264                |
|   | \$ 11,105                | \$ 8,264                |

**(7) Debt Obligations**

- (a) **Senior Debt** As a result of the acquisition of PlanVista, the Company assumed and guaranteed a \$20.4 million secured obligation to PVC Funding Partners, LLC (an investment company related to Commonwealth Associates, LP). This obligation is payable in monthly installments of \$0.2 million and matures with a balloon payment of \$18.0 million on May 1, 2005 and currently bears an interest rate of 6%, payable monthly in cash, which increases to 10% on December 1, 2004. Under the covenants of the senior debt obligation, PlanVista (as a wholly-owned subsidiary) is limited in its ability to transfer cash to ProxyMed (as the parent company). Additionally, the assets of PlanVista are not eligible collateral for the Company's asset-based line of credit due to covenants of the senior debt. At September 30, 2004, the balance of this senior debt is \$19.2 million.
- (b) **Convertible Notes** On December 31, 2002, the Company issued \$13.4 million in uncollateralized convertible promissory notes at 4% to the former shareholders of MedUnite as part of the consideration paid in its acquisition of MedUnite. Interest is payable quarterly in cash in arrears. The convertible promissory notes are payable in full on December 31, 2008 unless converted earlier upon the meeting of certain aggregate revenue triggers by the former shareholders. After an offsetting claim by the Company in October 2003 in the amount of \$0.3 million, the outstanding balance of these notes is \$13.1 million. Additionally, as a result of the reduction in principal, the notes are now convertible into 716,968 shares of the Company's common stock subject to achieving the revenue triggers. The first revenue trigger was met in the fourth quarter of 2003.

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

- (c) Notes Payable In February 2003, the Company financed \$0.3 million for a certain liability insurance policy required for the MedUnite acquisition over 24 months at 5.25% to a third-party. At September 30, 2004, the note has an outstanding balance of \$28,000 and is collateralized by a letter of credit in the amount of \$0.1 million (supported with restricted cash).

In March 2003, the Company restructured \$3.4 million in accounts payable and accrued expenses acquired from MedUnite and outstanding at December 31, 2002 to one vendor by paying \$0.8 million in cash and financing the balance of \$2.6 million with an unsecured note payable over 36 months at 8% commencing in March 2003. At September 30, 2004, the balance of this note payable is \$1.3 million.

In April 2003, the Company financed a net total of \$2.0 million (\$2.8 million in accounts payable and accrued expenses offset by \$0.8 million in accounts receivable) existing at December 31, 2002 from MedUnite to NDCHealth by issuing an unsecured note payable over 24 months at 6%. At September 30, 2004, the balance of this note payable is \$1.0 million.

In January 2004, the Company financed \$0.3 million of a liability insurance policy premium with an unsecured note, payable over 9 months at 4.9% to a third-party. As of September 30, 2004, the balance of this note has been paid in full.

As a result of the acquisition of PlanVista, the Company also assumed notes payable to two former board members of PlanVista. The combined balance of these notes is \$0.5 million at September 30, 2004. One of these board members has been appointed as director of ProxyMed as a result of the acquisition. These notes bear interest at prime plus 4% and \$0.1 million in interest is accrued at September 30, 2004. Both principal and interest were due on December 1, 2004; however, repayment of principal and accrued interest are expressly subordinated to prior payment of the Senior Debt which has not yet been paid and is due on May 1, 2005.

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

The Company also assumed an unsecured note payable that financed a certain liability policy of PlanVista that was required as part of the acquisition. This note bears interest at 8.5% and is payable to a third-party. As of September 30, 2004, the balance of this note had been paid in full.

- (d) Revolving Credit Facility In February 2004, the Company drew down \$4.4 million on its revolving credit facility to provide bridge funding in its acquisition of PlanVista. This amount was repaid in March 2004. At March 31, 2004, there was \$0.5 million drawn on this line of credit which was subsequently repaid in April 2004.

Debt as of September 30, 2004 and December 31, 2003 are as follows:

| <u>In thousands</u>      | <u>September 30,<br/>2004</u> | <u>December 31,<br/>2003</u> |
|--------------------------|-------------------------------|------------------------------|
|                          | (unaudited)                   |                              |
| Senior debt              | \$19,195                      | \$                           |
| Convertible notes        | 13,137                        | 13,137                       |
| Notes payable            | 2,809                         | 3,769                        |
|                          | <u>35,141</u>                 | <u>16,906</u>                |
| Less: current maturities | 21,367                        | 1,712                        |
|                          | <u>\$13,774</u>               | <u>\$15,194</u>              |

As of September 30, 2004, debt payments over the next several years are as follows. The amounts assume no conversion of the convertible debt:

|                          |                 |
|--------------------------|-----------------|
| 2004 (remaining quarter) | \$ 1,726        |
| 2005                     | 20,073          |
| 2006                     | 205             |
| 2007                     |                 |
| 2008                     | 13,137          |
|                          | <u>\$35,141</u> |

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

(8) Equity Transactions

- (a) Sale of Common Stock On March 2, 2004, the Company sold an aggregate of 1,691,227 shares of unregistered common stock at \$14.25 per share in a private placement to General Atlantic Partners 77, L.P., GAP Coinvestments III, LLC, GAP Coinvestments IV, LLC, Gapstar, LLC, GAPCO GmbH & Co. KG., PVC Funding Partners, LLC, ComVest Venture Partners, L.P., Shea Ventures, LLC, and Robert Priddy (the Purchasers ) resulting in net proceeds of \$24.1 million. No placement agent was used in this transaction. The Company has agreed to grant the Purchasers certain demand and piggy back registration rights. The proceeds from this transaction were used with other available funds to retire certain debts of PlanVista and to fund certain costs associated with the Company's acquisition of PlanVista.
- (b) Stock Options During the three and nine months ended September 30, 2004, the Company granted 43,500 and 290,373 stock options, respectively, at exercise prices between \$10.10 and \$20.05 per share to officers and employees. Such options are for a ten-year term and generally vest equally over the three years following the date of the grant. However, of these options, 173,120 options granted to employees of PlanVista upon its acquisition by ProxyMed will vest two-thirds on the first anniversary date of the grant and one-third on the third anniversary date of the grant. As described in Note 2, since these options were granted at an exercise price of \$17.74, which was below the \$19.00 market price at the time of issuance, the Company records periodic non-cash compensation charges over the vesting period of the options based on the intrinsic value method. For the three and nine months ended September 30, 2004, the Company recorded charges of \$35,000 and \$92,000, respectively, for these options.

In March 2004, 26,880 options at an exercise price of \$17.74 per share were granted to PlanVista's former Chief Financial Officer in connection with a consulting arrangement with him. Fifty percent of these options vested immediately upon the change of control and 25% will vest on each of the three month and six month anniversaries of the change in control. The Company recorded \$0.1 million in compensation expense associated with this grant in the three months ended March 31, 2004 based on the Black-Scholes method of valuation.

Additionally, in March 2004, 15,000 stock options at an exercise price of \$17.50 per share were granted to a new director upon appointment to the Company's board of directors as result of the acquisition of PlanVista. Such options are for a ten-year term and vest equally over the three years following the date of the grant.

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

In June 2004, the Company's outside directors were granted a total of 35,000 and 15,000 options at an exercise price of \$20.00 to compensate the directors upon re-election to the board and for participation on a committee, respectively, pursuant to guidelines adopted by the Company's Board of Directors in May 2002. Option grants for the re-election to the board are for a ten-year term and vest immediately. Options for participation in committees are for a ten-year term and vest in full after three years but a portion may be accelerated to vest after each committee meeting attended.

As noted in Note 3, stock options to purchase 10,000 shares of the Company's common stock at an exercise price of \$16.00 were granted to a former executive of the Company who purchased the Company's contract manufacturing assets on June 30, 2004. Such options were valued at \$0.1 million and included in the loss on disposal of assets for the nine months ended September 30, 2004. These options are for a three-year term and 5,000 options vest the end of each of next two years.

As a result of PlanVista's former Chief Executive Officer's change in status and modification to the original stock option award as described in Note 2, the Company is amortizing the \$0.1 million value of these options as a non-cash compensation charge in its statement of operations over the 30-month period of the agreement in proportion to the vesting schedule of the stock options. The value of these options was computed utilizing a Black-Scholes model using the following assumptions: risk-free interest rate of 2.8%, expected life of 2.5 years, expected volatility of 65% and no dividend yield. Additionally, each reporting period the Company must measure the value of these options and record any increase in value as a period charge. As of September 30, 2004, the value of these options had increased by \$3,400 and the Company recorded a charge in its statement of operations for the three and nine months ended September 30, 2004.

- (c) Exercise of Warrants On March 25, 2004, General Atlantic Partners exercised 549,279 warrants it received in April 2002 with an exercise price of \$15.93 for \$8.75 million in cash.

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

(9) Segment Information

ProxyMed operates in two reportable segments that are separately managed: Transaction Services (formerly known as Electronic healthcare transaction processing) and Laboratory Communication Solutions. Transaction Services includes transaction, cost containment and value-added services principally between physicians and insurance companies (Payer Services and Medical Cost Containment Services) and physicians and pharmacies (Prescription Services); and Laboratory Communication Solutions includes the sale, lease and service of communication devices principally to laboratories and through June 30, 2004, the contract manufacturing of printed circuit boards (Laboratory Services). As a result of a re-alignment of its Corporate overhead functions (i.e., executives, finance, legal, human resources, facilities, insurance, etc.) in the second quarter of 2004, the Company is now reporting these expenses and assets as part of its Transaction Services segment. International sales were attributable to the manufacturing assets of the Laboratory Communication Solutions segment that were sold on June 30, 2004.

|   | <b>Three Months Ended<br/>September 30,</b> |                 | <b>Nine Months Ended<br/>September 30,</b> |                   |
|---|---|-----------------|--|-------------------|
|   | <b>2004</b>                                 | <b>2003</b>     | <b>2004</b>                                | <b>2003</b>       |
| <b>In thousands</b>                           |   |                 |  |                   |
| Net revenues by operating segment:            |   |                 |  |                   |
| Transaction Services                          | \$18,999                                    | \$11,829        | \$52,117                                   | \$35,102          |
| Laboratory Communication Solutions            | 3,512                                       | 6,233           | 15,548                                     | 18,092            |
|   | <u>\$22,511</u>                             | <u>\$18,062</u> | <u>\$67,665</u>                            | <u>\$53,194</u>   |
| Net revenues by geographic location:          |   |                 |  |                   |
| Domestic                                      | \$22,511                                    | \$17,720        | \$67,559                                   | \$52,046          |
| International (1)                             | <u>          </u>                           | 342             | 106  | 1,148             |
|   | <u>\$22,511</u>                             | <u>\$18,062</u> | <u>\$67,665</u>                            | <u>\$53,194</u>   |
| Operating income (loss) by operating segment: |   |                 |  |                   |
| Transaction Services                          | \$ (959)                                    | \$ 784          | \$ (1,123)                                 | \$ (1,382)        |
| Laboratory Communication Solutions            | 509   | 366             | 1,464                                      | 1,168             |
| Corporate                                     | <u>          </u>                           | (980)           | (1,097)                                    | (2,807)           |
|   | <u>\$ (450)</u>                             | <u>\$ 170</u>   | <u>\$ (756)</u>                            | <u>\$ (3,021)</u> |

|                                    | <b>September 30,<br/>2004</b> | <b>December 31,<br/>2003</b> |
|------------------------------------|-------------------------------|------------------------------|
|                                    | <u>                    </u>   | <u>                    </u>  |
| Total assets by operating segment: |                               |                              |
| Transaction Services               | \$ 177,761                    | \$ 54,052                    |
| Laboratory Communication Solutions | 7,273                         | 12,053                       |
| Corporate                          |                               | 7,025                        |
|                                    | <u>                    </u>   | <u>                    </u>  |
|                                    | <b>\$ 185,034</b>             | <b>\$ 73,130</b>             |
|                                    | <u>                    </u>   | <u>                    </u>  |

(1) All amounts are transacted in US Dollars



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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

**(10) Income Taxes**

As of September 30, 2004, the Company had a net deferred tax asset of approximately \$68.0 million, which was fully offset by a valuation allowance. Realization of the net deferred tax asset is dependent upon the Company generating sufficient taxable income prior to the expiration of the federal net operating loss carryforwards. The Company will adjust this valuation reserve if, during future periods, management believes the Company will generate sufficient taxable income to realize the net deferred tax asset. The provision for income taxes reported in the statement of operations for the three and nine months ended September 30, 2004 reflects approximately \$0.1 million and \$0.2 million, respectively, primarily for state income taxes.

**(11) Settlement of Liability**

In May 2004, the Company settled a long-term liability assumed in the acquisition of MedUnite for \$0.8 million. The liability was being carried at its present value of \$0.9 million. The resulting gain of \$0.1 million is reflected as other income in the statement of operations for the three and nine months ended September 30, 2004.

**(12) Supplemental Cash Flow Information**

| <b>In thousands</b>    | <b>Nine months Ended<br/>September 30,</b> |              |
|------------------------|--|--------------|
|                        | <b>2004</b>                                | <b>2003</b>  |
| Cash paid for interest | \$ 1,259                                   | \$ 601       |
|                        | <b>_____</b>                               | <b>_____</b> |

In January 2004, the Company financed \$0.3 million of a liability insurance policy premium with an unsecured note, payable over 9 months at 4.9% to a third-party.

In March 2004, the Company issued 3,600,000 shares of common stock in connection with its acquisition of PlanVista valued at \$59.8 million (see Notes 2 and 8).

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**PROXYMED, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (unaudited), Continued**

**(13) Commitments and Contingencies**

- (a) **Leases** In September 2004, the Company entered into a new five year facilities lease for its California operations. As a result, it moved its previously existing Santa Ana and San Diego facilities into a one new facility in Santa Ana.
- (b) **Commitments** As part of the its disposition of certain assets and liabilities of its Laboratory Communications Solutions segment that were used in its non-core contract manufacturing business on June 30, 2004 (see Note 3), the Company agreed to purchase certain component parts (valued at \$0.4 million at June 30, 2004) from the new owner for use in its Laboratory Communication Solutions business on a non-exclusive basis through March 31, 2005 at a fixed price deemed to be at fair market value by the Company's management. As of September 30, 2004, this remaining commitment had been reduced to less than \$0.1 million. Additionally, the Company has agreed to sublease a portion of its current facilities through April 2005 and provide certain administrative services to the new entity.
- (c) **Contingencies** - At the time of its acquisition by the Company, PlanVista was involved in various lawsuits and threatened litigation. These pre-acquisition contingencies include: (i) a lawsuit filed against a former subsidiary of PlanVista for which the Company intends to vigorously defend itself but for which the Company has determined exposure to be in a range of \$0.6 million to \$1.6 million and has accrued \$0.6 million at June 30, 2004; (ii) a disputed New York State tax liability for which the Company is still evaluating the merits of the case and cannot yet draw a conclusion as to outcome; and (iii) two other cases that preceded the acquisition of PlanVista for which the Company is still evaluating the merits of the case and cannot yet draw conclusions as to outcome. In the ordinary course of business, the Company is subject to various pending and threatened litigation, none that management is able to determine will have a material impact on the Company's consolidated financial statements.
- (14) **Restatement** - The Company determined that the mark-to-market increases in the warrant value the Company received from PlanVista previously recorded to other income in the 2003 periods were not appropriate and should be eliminated.

The impact of the restatement for item described above is as follows for the periods noted:

| In thousands                      | Three Months Ended<br>September 30, 2003<br>(unaudited) |                | Nine Months Ended<br>September 30, 2003<br>(unaudited) |                |
|-----------------------------------|---|----------------|--|----------------|
|                                   | As<br>Previously<br>Reported                            | As<br>Restated | As<br>Previously<br>Reported                           | As<br>Restated |
| Other income                      | \$ 4,041  | \$             | \$ 4,793   | \$             |
| Net income (loss)                 | \$ 4,008  | \$ (33)        | \$ 1,200   | \$ (3,593)     |
| Basic earnings (loss) per share   | \$ 0.59   | \$             | \$ 0.18  | \$ (0.53)      |
| Diluted earnings (loss) per share | \$ 0.58   | \$             | \$ 0.18  | \$ (0.53)      |
|                                   | 25  |                |  |                |

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

**Overview**

Management's discussion and analysis of financial condition and results of operations ( MD&A ) is provided as a supplement to our consolidated financial statements on this Form 10-Q and notes thereto and those included in Part IV starting on Page F-7 of our Form 10-K/A for the year ended December 31, 2003 and to provide an understanding of our results of operations, financial condition, and changes in financial condition. Our MD&A is organized as follows:

*Introduction* - This section provides a general description of our business, summarizes the significant acquisitions/dispositions we completed in the last two years, and provides a brief overview of our operating segments.

*Restatement of Financial Statements* - This section briefly describes restatements of our previously filed consolidated financial statements.

*Results of Operations* - This section provides our analysis and outlook for the line items on our consolidated statement of operations on both a company-wide and segment basis.

*Liquidity and Capital Resources* - This section provides an analysis of our liquidity and cash flows, as well as our discussion of our debts and other commitments.

*Critical Accounting Policies and Estimates* - This section discusses those accounting policies that are considered to be both important to our financial condition and results of operations, and require us to exercise subjective or complex judgments in their application. In addition, all of our significant accounting policies, including our critical accounting policies, are summarized in Note 1 to our consolidated financial statements in this Form 10-Q and starting on Page F-7 in our Form 10-K/A for the year ended December 31, 2003.

*New Accounting Pronouncements* - This section includes a discussion of recently published accounting authoritative literature that may have an impact on our historical or prospective results of operations or financial condition.

**Introduction**

We believe we are the nation's second largest independent provider-based electronic healthcare transaction services company. We provide connectivity services and related value-added products to physicians, payers, pharmacies, medical laboratories, and other healthcare providers and suppliers. Our services support a broad range of financial, clinical and administrative transactions, and are HIPAA-certified through Claredi, an independent certification and testing services company specializing in HIPAA compliance. To facilitate these services, we operate *Phoenix*<sup>TM</sup>, our secure national electronic information platform, which

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provides physicians and other healthcare providers with direct connectivity to one of the industry's largest list of payers, the industry's largest list of chain and independent pharmacies and the largest list of clinical laboratories. Our corporate headquarters is located in Atlanta, Georgia and our products and services are provided from various operational facilities located throughout the United States. We also operate our clinical computer network and portions of our financial and real-time production computer networks from a secure, third-party co-location site located in Atlanta, Georgia. All of our revenues are generated domestically.

Our primary strategy is focused on leveraging our leading position as an independent back-end connectivity provider to small physician offices. Through strategic relationships and partnerships with front-end solution providers, our goal is to drive more healthcare transactions through *Phoenix<sup>TM</sup>* while remaining neutral in the battle for the physician's desktop. Additionally, we expect that there will be opportunities to increase revenues by cross-selling our existing products and services to our current customer base of physicians and other healthcare providers, as well as revenue opportunities from the development of new services from our development efforts, including Internet-based transaction services. We remain committed to developing additional capabilities and value-added products and services, and to expanding our back-end connectivity network. In conjunction with this philosophy, we have recently introduced *PCAT* and *ProxyEnroll*, our new web-based service tools for support and enrollment. We have also added new services offerings for our payer customers through our acquisition of PlanVista Corporation ( *PlanVista* ) on March 2, 2004 for claims re-pricing services..

## **Restatement of Financial Statements**

As discussed in Note 14 to the consolidated financial statements, our financial statements for the 2003 periods have been restated. The accompanying MD&A gives effect to that restatement.

## **Acquisitions**

On December 31, 2002, we acquired all of the outstanding stock of MedUnite, Inc. ( *MedUnite* ) for \$10 million in cash and an aggregate of \$13.4 million principal amount of 4% convertible promissory notes. In addition, we paid approximately \$6.7 million in transaction and exit related costs (which were originally estimated at \$8.3 million). Interest on the convertible notes is payable in cash on a quarterly basis. The convertible promissory notes (now currently payable at a maturity value of \$13.1 million after a claim setoff against the escrow in December 2003) are payable in full on December 31, 2008, and are convertible into an aggregate

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of 716,968 shares (originally 731,322 shares before the claim setoff) of our common stock if the former shareholders of MedUnite achieve certain revenue-based triggers over the next three and one-half year period. The shares of our common stock issuable upon conversion of the convertible notes were to be registered by us promptly after a conversion trigger event is met. The first threshold trigger was reached during the fourth quarter of 2003 and the convertible notes were reduced to \$13.1 million at December 31, 2003 as a result of a claim against the escrow. We have filed a registration statement for these shares on Form S-3 with the SEC, which has not yet gone effective as of the date of this report. The operations of MedUnite are reflected with our operations for the twelve months ended December 31, 2003. Additionally, we spent much of the 2003 year integrating the operations of MedUnite into our existing operations, and currently the organizations are run and managed as one operating unit. As a result, meaningful separate results and statistics for MedUnite are no longer available.

On March 2, 2004, we acquired PlanVista Corporation ( PlanVista ), a company that provides medical cost containment and business process outsourcing solutions for the medical insurance and managed care industries, as well as services for health care providers, including individual providers, preferred provider organizations and other provider groups for 3,600,000 shares of our common stock issued to PlanVista shareholders valued at \$59.8 million (based on the average closing price of our common stock for the day of and the two days before and after December 8, 2003, the date of the announcement of the definitive agreement). We also assumed debt and other liabilities of PlanVista, and incurred \$1.3 million in acquisition-related costs. Additionally, we raised \$24.1 million in a private placement sale of our common stock to General Atlantic Partners, Commonwealth Associates and other parties to partially fund repayment of certain of PlanVista's debts and other obligations outstanding at the time of the acquisition. The merger enables us to offer a new suite of products and services, provide new end-to-end services, increase sales opportunities with payers, strengthen business ties with certain customers, expand technological capabilities, reduce operating costs and enhance our public profile.

Upon completion of the acquisition, each share of PlanVista's outstanding common stock was cancelled and converted into the right to receive 0.08271 shares of our common stock and each holder of PlanVista series C preferred stock received 51.5292 shares of our common stock in exchange for each share of PlanVista series C preferred stock, representing approximately 23% of our common stock on a fully converted basis, and the holders of our outstanding stock, options and warrants retained approximately 77% of ProxyMed following the transaction. PlanVista's operations are included in our Transaction Services segment commencing March 2004.

In connection with this acquisition, our shareholders approved (1) an amendment to our articles of incorporation to increase the total number of authorized shares of the Company's common stock from 13,333,333-1/3 shares to 30,000,000 shares, (2) the issuance of 1,691,229 shares of our common stock at \$14.25 per share in a private equity offering valued at \$24.1 million (to retire a portion of debt of PlanVista and pay certain expenses associated with the merger), (3) the issuance of 3,600,000 shares of our common stock in connection with the merger, and (4) an amendment to our 2002 Stock Option Plan to increase the total number of shares available for issuance from 600,000 to 1,350,000.

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**Sale of Assets**

On June 30, 2004, we sold certain assets and liabilities of our Laboratory Communications Solutions segment that were used in our non-core contract manufacturing business to a new entity owned by a former executive of ProxyMed for \$4.5 million in cash. Under terms of the sale agreement, we received \$3.5 million in cash at closing and received the balance of \$1.0 million in cash in July and August 2004 following the presentation of the final accounting. As part of the disposition, we agreed to purchase certain component parts from the new owner for use in our Laboratory Communication Solutions business on a non-exclusive basis at a fixed price deemed to be at fair market value by management. These parts were valued at \$0.4 million at June 30, 2004. As of September 30, 2004, this remaining commitment had been reduced to less than \$0.1 million. Additionally, we agreed to sublease a portion of our current facilities through April 2005 and provide certain administrative services to the new entity.

As a result of the transaction, we recorded a loss on sale of assets of \$0.1 million in the three months ended June 30, 2004. This loss includes the value of options to purchase 10,000 shares of the Company's common stock granted to the former executive at an exercise price of \$16.00 in July 2004 which was accrued at June 30, 2004.

**Operating Segments**

We operate in two reportable segments that are separately managed: Transaction Services (formerly known as Electronic healthcare transaction processing) and Laboratory Communication Solutions. Transaction Services includes transaction, cost containment and other value-added services principally between physicians and insurance companies (Payer Services) and physicians and pharmacies (Prescription Services); and Laboratory Communication Solutions includes the sale, lease and service of communication devices principally to laboratories and, through June 30, 2004, the contract manufacturing of printed circuit boards (Laboratory Services). Commencing in March 2004, the operations of PlanVista are included in our Transaction Services segment (Medical Cost Containment Services). As a result of a re-alignment of our Corporate overhead functions (i.e., executives, finance, legal, human resources, facilities, insurance, etc.) in the second quarter of 2004, we now report these expenses as part of our Transaction Services segment. Accordingly, our Corporate segment in the comparable periods has been combined with our Transaction Services segment to facilitate a better comparison between periods.

**Table of Contents****Results of Operations****Three Months Ended September 30, 2004 Compared to Three Months Ended September 30, 2003.**

*Net Revenues.* Consolidated net revenues for the three months ended September 30, 2004 increased by \$4.4 million, or 25%, to \$22.5 million from consolidated net revenues of \$18.1 million for the three months ended September 30, 2003. Net revenues classified by our reportable segments are as follows:

| <u>In thousands</u>                | <u>Three Months Ended<br/>September 30,</u> |                  |
|------------------------------------|---|------------------|
|                                    | <u>2004</u>                                 | <u>2003</u>      |
| Transaction Services               | \$ 18,999                                   | \$ 11,829        |
| Laboratory Communication Solutions | 3,512                                       | 6,233            |
|                                    | <u>\$ 22,511</u>                            | <u>\$ 18,062</u> |

Net revenues in our Transaction Services segment increased by \$7.2 million, or 61%, over the 2003 period. This increase is primarily due to the acquisition of PlanVista (increase of \$8.0 million in net revenues) offset by declines in volumes of electronic claims, statements and real-time transactions processed (decrease of \$0.9 million). While core transaction growth is up 4% compared to the 2003 period (see below), revenue dollars have grown significantly due to the higher per transaction revenue attributable to our cost containment transactions compared to our traditional core transactions.

For the 2004 period, approximately 84% of our revenues came from our Transaction Services segment compared to 65% from this segment for the 2003 period. For the remainder of 2004 and beyond, it is anticipated that our greatest growth will come from this segment.

Laboratory Communication Solutions segment net revenues decreased by \$2.7 million, or 44%, over the 2003 period. We did see a decrease in revenue from sales of our laboratory communication devices and related services compared to the 2003 period (decrease of \$0.2 million), but as expected, our overall revenues in this segment declined because of the sale of certain assets and liabilities in this segment for our contract manufacturing business on June 30, 2004 (decrease of \$2.5 million).

A summary of the number of transactions we processed for the periods presented is as follows:

| <u>In thousands</u>   | <u>Three Months Ended<br/>September 30,</u> |             |
|-----------------------|---|-------------|
|                       | <u>2004</u>                                 | <u>2003</u> |
| Core transactions (1) | 46,323                                      | 48,495      |

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|                              |               |               |
|------------------------------|---------------|---------------|
| Additional core transactions | 17,354        | 12,661        |
| Encounters                   | <u>6,561</u>  | <u>6,510</u>  |
| Total transactions           | <u>70,238</u> | <u>67,666</u> |

(1) Includes 1.3 million cost containment transactions in the 2004 period from ProxyMed's acquisition of PlanVista

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Core transactions represent all transactions except for encounters. As a result of a continued review of our business, we have made changes to our transaction counting process to insure that our transactions are counted on the same methodology for all purposes, whether internal or external. Previously, we had excluded certain transactions primarily associated with an outsourcing contract due to the nature of the business model for those transactions. These transactions are included above as additional core transactions .

Cost Containment transactions represent the number of claims sent by our payer clients to be re-priced through our provider network, and are included in the core transaction count.

Encounters are an administrative reporting transaction for payers but do not generate revenue for the provider who must submit them. Accordingly, rather than submitting on a routine basis, most providers choose to periodically catch up on their submissions, creating monthly and quarterly swings in both the number of encounters we process and what percentage of our transaction mix they represent. Since encounters are at a significantly lower price than claims, these swings make it difficult to easily analyze our quarter-over-quarter growth in our core business. In addition, we do not expect our encounter volume to grow on an annual basis, as payers are not expanding the capitated service model that is the foundation of encounters. Therefore, we believe that breaking out encounters shows more clearly our growth in core transactions.

*Cost of Sales.* Consolidated cost of sales decreased as a percentage of net revenues to 35% for the three months ended September 30, 2004 from 45% for the three months ended September 30, 2003. Cost of sales classified by our reportable segments is as follows:

| <b>In thousands</b>                | <b>Three Months Ended<br/>September 30,</b> |                 |
|------------------------------------|---|-----------------|
|                                    | <b>2004</b>                                 | <b>2003</b>     |
| Transaction Services               | \$ 5,856                                    | \$ 3,804        |
| Laboratory Communication Solutions | 1,936                                       | 4,250           |
|                                    | <b>\$ 7,792</b>                             | <b>\$ 8,054</b> |

Cost of sales in our Transaction Services segment consists of transaction fees, provider network outsourcing fees, services and license fees, third-party electronic transaction processing costs, certain telecommunication and co-location center costs, revenue sharing arrangements with our business partners, third-party database licenses, and certain travel expenses. Cost of sales in the 2004 period increased \$2.1 million, or 54%, from the 2003 period. As a percentage of revenues, cost of sales in this segment decreased to 31% in the 2004 period compared to 32% in the same period last year primarily due to a change in the mix of transaction types from higher cost patient statements to lower cost claim transactions (decrease of \$0.4 million), the loss of business from a low margin gateway partner (i.e. another clearinghouse that routes transactions through our network because they do not have a contract with one or more specific payers) during the latter half of the 2003 year (decrease of \$0.1 million), offset by the addition of higher margin medical Cost Containment services from our acquisition of PlanVista (increase of \$2.7 million).

With the filing of our financial statements for the 2003 fiscal year, we reclassified direct labor and

manufacturing overhead from selling, general and administrative expenses to cost of tangible products sold to better reflect the production of tangible products. All prior periods

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have a similar reclassification. As a result, cost of sales in the Laboratory Communication Solutions segment includes hardware, third party software, consumable materials, direct manufacturing labor and indirect manufacturing overhead. Cost of sales in the 2004 period decreased \$2.3 million, or 54%, from the 2003 period. As a percentage of revenues, cost of sales in this segment decreased to 55% for the three months ended September 30, 2004 from 68% for three months ended September 30, 2003. These decreases are primarily due to the sale of our contract manufacturing assets (decrease of \$2.5 million) offset by increased sales of *Report Tracker™*, one of our lab results reporting products (increase of \$0.1 million).

*Selling, General and Administrative Expenses.* Consolidated SG&A increased for the three months ended September 30, 2004 by \$4.2 million, or 50%, to \$12.6 million from consolidated SG&A of \$8.4 million for the three months ended September 30, 2003. Consolidated SG&A expenses as a percentage of consolidated revenues increased to 56% for the 2004 period compared to 46% in the same period last year. SG&A expenses classified by our reportable segments are as follows:

| <b>In thousands</b>                | <b>Three Months Ended<br/>September 30,</b> |                 |
|------------------------------------|---|-----------------|
|                                    | <b>2004</b>                                 | <b>2003</b>     |
| Transaction Services               | \$ 11,653                                   | \$ 6,986        |
| Laboratory Communication Solutions | 932   | 1,365           |
|                                    | <b>\$ 12,585</b>                            | <b>\$ 8,351</b> |

Transaction Services segment SG&A expenses for the three months ending September 30, 2004 increased \$4.7 million, or 67%, over the same period last year primarily due to the addition of SG&A expenses from PlanVista for a full quarter in the 2004 period (increase of \$3.0 million). Additionally, while we achieved significant reductions in expenses from our MedUnite acquisition over the course of 2003, these savings have been offset by increased expenditures related to our ongoing efforts to comply with the Sarbanes-Oxley Act of 2002 in the 2004 period (increase of \$0.4 million) and finance system conversion and consolidation costs (increase of \$0.1 million). As a result, segment SG&A expenses as a percentage of segment net revenues increased to 61% for the 2004 period compared to 59% for the same period last year.

Laboratory Communication Solutions segment SG&A expenses for the three months ended September 30, 2004 decreased by \$0.4 million, or 32%, over the same period last year and segment SG&A expenses as a percentage of segment net revenues increased to 27% for the 2004 period compared to 22% for the same period last year. As expected, these decreases are primarily due to the reduction in SG&A expenses related to the sale of our contract manufacturing assets on June 30, 2004.

*Depreciation and Amortization.* Consolidated depreciation and amortization increased by \$1.1 million to \$2.6 million for the three months ended September 30, 2004 from \$1.5 million for the same period last year. This increase was due to approximately \$1.1 million for the amortization of intangible assets acquired in the PlanVista acquisition. Depreciation and amortization classified by our reportable segments is as follows:



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| <u>In thousands</u>                | <b>Three Months Ended<br/>September 30,</b> |                 |
|------------------------------------|---|-----------------|
|                                    | <b>2004</b>                                 | <b>2003</b>     |
| Transaction Services               | \$ 2,450                                    | \$ 1,227        |
| Laboratory Communication Solutions | 157   | 251             |
|                                    | <b>\$ 2,607</b>                             | <b>\$ 1,478</b> |

*(Gain) Loss on Disposal of Assets.* In the three months ended September 30, 2004, we recorded a gain of \$23,000 primarily related to the disposition of delivery vehicles and other equipment in our Laboratory Communication Solutions segment.

*Operating Income (Loss).* As a result of the foregoing, the consolidated operating loss for the three months ended September 30, 2004 was \$0.4 million compared to operating income of \$0.2 million for the same period last year. Operating loss classified by our reportable segments is as follows:

| <u>In thousands</u>                | <b>Three Months Ended<br/>September 30,</b> |               |
|------------------------------------|---|---------------|
|                                    | <b>2004</b>                                 | <b>2003</b>   |
| Transaction Services               | \$ (959)                                    | \$ (196)      |
| Laboratory Communication Solutions | 509   | 366           |
|                                    | <b>\$ (450)</b>                             | <b>\$ 170</b> |

*Interest Expense, net.* Consolidated net interest expense for the three months ended September 30, 2004 was \$0.5 million compared to \$0.2 million for the same period last year. This increase in expense is primarily due to the assumption of debt in conjunction with the PlanVista acquisition (increase of \$0.3 million). Interest expense for the 2004 year is expected to be at levels above those in the prior year due to the senior debt acquired from PlanVista.

*Net Loss.* As a result of the foregoing, consolidated net loss for the three months ended September 30, 2004 was \$1.0 million compared to a net loss of \$33,000 for the same period last year.

**Nine Months Ended September 30, 2004 Compared to Nine Months Ended September 30, 2003.**

*Net Revenues.* Consolidated net revenues for the nine months ended September 30, 2004 increased by \$14.5 million, or 27%, to \$67.7 million from consolidated net revenues of \$53.2 million for the nine months ended September 30, 2003. Net revenues classified by our reportable segments are as follows:

| <b>In thousands</b>                | <b>Nine Months Ended<br/>September 30,</b> |                  |
|------------------------------------|--|------------------|
|                                    | <b>2004</b>                                | <b>2003</b>      |
| Transaction Services               | \$ 52,117                                  | \$ 35,102        |
| Laboratory Communication Solutions | 15,548                                     | 18,092           |
|                                    | <u>\$ 67,665</u>                           | <u>\$ 53,194</u> |

Net revenues in our Transaction Services segment for the nine months ended September 30, 2004 increased by \$17.0 million, or 48%, over the comparable period in 2003. This increase is primarily due to the acquisition of PlanVista (increase of \$19.1 million), offset

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by declines in volumes of electronic claims, statements and other real-time transactions processed (decrease \$1.5 million) and additional revenue reserves required due to a degradation in the aging of outstanding traditional accounts (increase of \$0.8 million). While core transaction transactions growth was up 3% compared to the 2003 period (see below), revenue dollars have grown significantly due to the higher per transaction revenue attributable to our cost containment transactions compared to our traditional core transactions.

For the nine months ended September 30, 2004 period, approximately 77% of our revenues came from our Transaction Services segment compared to 66% from this segment for the same period in 2003. For the remainder of 2004 and beyond, it is anticipated that our greatest growth will come from this segment.

Laboratory Communication Solutions segment net revenues for the nine months ended September 30, 2004 decreased by \$2.5 million, or 14%, from the comparable 2003 period primarily as a result of the asset sale discussed earlier in this report (decrease of \$million).

A summary of the number of transactions we processed for the periods presented is as follows:

| <b>In thousands</b>          | <b>Nine Months Ended<br/>September 30,</b> |                |
|------------------------------|--|----------------|
|                              | <b>2004</b>                                | <b>2003</b>    |
| Core transactions (1)        | 144,336                                    | 147,152        |
| Additional core transactions | 45,924                                     | 37,021         |
| Encounters                   | 22,614                                     | 18,494         |
| <br>                         |  |                |
| Total transactions           | <u>212,874</u>                             | <u>202,667</u> |

(1) Includes 3.1 million cost containment transactions in the 2004 period from ProxyMed's acquisition of PlanVista

Core transactions represent all transactions except for encounters. Additionally, as a result of a continued review of our business, we have made changes to our transaction counts to insure that our transactions are counted on the same methodology for all purposes, whether internal or external. Previously, we had excluded certain transactions primarily associated with an outsourcing contract due to the nature of the business model for those transactions. These transactions are included above as additional core transactions.

Cost Containment transactions represent the number of claims sent by our payer clients to be re-priced through our provider network.

Encounters are an administrative reporting transaction for payers but do not generate revenue for the provider who must submit them. Accordingly, rather than submitting on a routine basis, most providers choose to periodically catch up on their submissions, creating monthly and quarterly swings in both the number of encounters we process and what percentage of our transaction mix they represent. Since encounters are at a significantly lower price point than claims, these swings make it difficult to easily analyze our quarter-over-quarter growth in our core business. In addition, we do not expect our encounter volume to grow on an annual basis, as payers are not expanding the capitated

service model that is the foundation of encounters. Therefore, we believe that breaking out encounters shows more clearly our growth in core transactions.



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*Cost of Sales.* Consolidated cost of sales decreased as a percentage of net revenues to 38% for the nine months ended September 30, 2004 from 46% for the nine months ended September 30, 2003. Cost of sales classified by our reportable segments is as follows:

| <b>In thousands</b>                | <b>Nine Months Ended<br/>September 30,</b> |                  |
|------------------------------------|--|------------------|
|                                    | <b>2004</b>                                | <b>2003</b>      |
| Transaction Services               | \$ 16,015                                  | \$ 12,327        |
| Laboratory Communication Solutions | 9,882                                      | 12,111           |
|                                    | <b>\$ 25,897</b>                           | <b>\$ 24,438</b> |

Cost of sales in our Transaction Services segment consists of transaction fees, provider network outsourcing fees, services and license fees, third-party electronic transaction processing costs, certain telecommunication and co-location center costs, revenue sharing arrangements with our business partners, third-party database licenses, and certain travel expenses. Cost of sales in this segment increased by \$3.7 million, or 30%, in the 2004 period compared to the 2003 period. As a percentage of revenues, cost of sales decreased to 31% in the 2004 period compared to 35% in the same period last year primarily due to a change in the mix of transaction types from higher cost patient statements to lower cost claim transactions (decrease of \$0.6 million), the loss of business from a low margin gateway partner during the latter half of the 2003 year (decrease of \$0.8 million), offset by the addition of higher margin medical cost containment services from our acquisition of PlanVista (increase of \$6.0 million).

Cost of sales in our Laboratory Communication Solutions segment includes hardware, third party software, consumable materials, direct manufacturing labor and indirect manufacturing overhead. Cost of sales for this segment in the 2004 period decreased \$2.2 million, or 18%, from the 2003 period. Cost of sales as a percentage of revenues in this segment was 64% for the 2004 period compared to 67% for the 2003 period. These decreases are primarily due to the sale of our contract manufacturing assets.

*Selling, General and Administrative Expenses.* Consolidated SG&A increased for the nine months ended September 30, 2004 by \$7.9 million, or 29%, to \$35.4 million from consolidated SG&A of \$27.5 million for the nine months ended September 30, 2003. Consolidated SG&A expenses as a percentage of consolidated revenues remained constant at 52% for both periods presented. SG&A expenses classified by our reportable segments are as follows:

| <b>In thousands</b>                | <b>Nine Months Ended<br/>September 30,</b> |             |
|------------------------------------|--|-------------|
|                                    | <b>2004</b>                                | <b>2003</b> |
| Transaction Services               | \$ 31,826                                  | \$ 23,416   |
| Laboratory Communication Solutions | 3,564                                      | 4,089       |

|           |           |
|-----------|-----------|
| _____     | _____     |
| \$ 35,390 | \$ 27,505 |
| _____     | _____     |

Transaction Services segment SG&A expenses for the nine months ended September 30, 2004 increased by \$8.4 million, or 36% over the same period last year primarily due to the addition of SG&A expenses from PlanVista for seven months in the 2004 period (increase of \$7.8 million). Additionally, while we achieved significant reductions in expenses

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from our MedUnite acquisition over the course of 2003, these savings have been offset by increased expenditures related to our ongoing efforts to comply with the Sarbanes-Oxley Act of 2002 compliance in the 2004 period (increase of \$0.9 million).

Laboratory Communication Solutions segment SG&A expenses for the nine months ended September 30, 2004 decreased by \$0.5 million, or 13% from the same period last year and segment SG&A expenses as a percentage of segment net revenues remained constant at 23% for both periods presented. As expected, the decreases in dollars are primarily due to a reduction in expenses related to the sale of our contract manufacturing assets on June 30, 2004.

*Depreciation and Amortization.* Consolidated depreciation and amortization increased by \$2.9 million to \$7.1 million for the nine months ended September 30, 2004 from \$4.2 million for the same period last year. This increase was primarily due to approximately \$2.5 million for the amortization of intangible assets acquired in the PlanVista acquisition. Depreciation and amortization classified by our reportable segments is as follows:

| <b>In thousands</b>                | <b>Nine Months Ended<br/>September 30,</b> |                 |
|------------------------------------|--|-----------------|
|                                    | <b>2004</b>                                | <b>2003</b>     |
| Transaction Services               | \$ 6,423                                   | \$ 3,431        |
| Laboratory Communication Solutions | 663  | 722             |
|                                    | <b>\$ 7,086</b>                            | <b>\$ 4,153</b> |

*(Gain) Loss on Disposal of Assets.* In the nine months ended September 30, 2004, we recorded a loss of \$68,000 primarily related to the disposition of contract manufacturing assets in our Laboratory Communication Solutions segment that were sold to a new entity formed by a former executive on September 30, 2004 offset by \$26,000 in gains on vehicles and other equipment sold in the same segment. As a result of the consolidation of the ProxyMed and MedUnite offices in Atlanta in February 2003, the Company recorded \$0.1 million in losses during the nine months ended September 30, 2003 primarily related to the disposition of certain assets owned and leased that were acquired in the acquisition of MDP Corporation in 2001.

*Operating Loss.* As a result of the foregoing, the consolidated operating loss for the nine months ended September 30, 2004 was \$0.8 million compared to an operating loss of \$3.0 million for the same period last year. Operating loss classified by our reportable segments is as follows:

| <b>In thousands</b>                | <b>Nine Months Ended<br/>September 30,</b> |             |
|------------------------------------|--|-------------|
|                                    | <b>2004</b>                                | <b>2003</b> |
| Transaction Services               | \$ (2,219)                                 | \$ (4,189)  |
| Laboratory Communication Solutions | 1,463                                      | 1,168       |

|          |            |
|----------|------------|
| _____    | _____      |
| \$ (756) | \$ (3,021) |
| _____    | _____      |

*Interest Expense, net.* Consolidated net interest expense for the nine months ended September 30, 2004 was \$1.4 million compared to \$0.6 million for the same period last year. This increase in expense is primarily due to the assumption of debt in conjunction with the

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PlanVista acquisition (increase of \$0.8 million). Interest expense for the 2004 year is expected to be at levels above those in the prior year due to the senior debt acquired from PlanVista.

*Other Income.* During the nine months ended September 30, 2004, we settled a long-term liability assumed in the acquisition of MedUnite for \$0.8 million. The liability was being carried at its present value of \$0.9 million. The resulting gain of \$0.1 million is reflected as other income.

*Net Loss.* As a result of the foregoing, consolidated net loss for the nine months ended September 30, 2004 was \$2.2 million compared to net loss of \$3.6 million for the same period last year.

## **Liquidity and Capital Resources**

In the nine months ended September 30, 2004, net cash used in operating activities totaled \$4,000, and included \$4.0 million to pay certain acquisition-related expenses of PlanVista outstanding as of the effective date of the acquisition. Cash provided by investing activities totaled \$1.1 million and consisted primarily of \$0.8 million in net cash acquired from PlanVista and \$4.5 million received from the sale of our contract manufacturing assets offset by \$0.9 million in costs related to the acquisitions of PlanVista and MedUnite, and \$3.5 million in capital expenditures and capitalized software. Cash provided by financing activities totaled \$5.8 million and consisted of a \$24.1 million private placement of our common stock, an exercise of warrants for \$8.8 million, and \$27.0 million in repayments of notes payable, other long-term debt, and payments related to capital leases (including \$23.4 million for the retirement of debts and other obligations of PlanVista upon the consummation of the acquisition).

In the nine months ended September 30, 2003, cash provided by operating activities was \$0.5 million. Cash used in investing activities was \$8.1 million. During this period, we paid \$5.7 million in costs related to our December 2002 acquisition of MedUnite, \$3.3 million for fixed assets and capitalized software, and released a net of \$0.4 million from restricted cash as we terminated our MedUnite lease in San Diego. Cash used in financing activities was \$1.8 million for repayments of notes payable, other long-term debt, and payments related to capital leases. These activities were principally financed through available cash resources.

We had cash and cash equivalents totaling \$12.2 million as of September 30, 2004 compared to \$6.9 million at September 30, 2003. These available funds will be used for operations, strategic acquisitions, the further development of our products and services, and other general corporate purposes. We continue to evaluate other acquisition opportunities and strategic alternatives that may add synergies to our product offerings and business strategy.

On March 2, 2004, we acquired PlanVista through the issuance of 3,600,000 shares of our common stock (valued at \$59.8 million). In addition, we raised an additional \$24.1 million in a private placement sale of our common stock and drew down \$4.4 million on our asset-based line of credit. These funds, along with available cash resources, were used to satisfy \$27.4 million of PlanVista's debt and other obligations outstanding as of the effective time of the acquisition.

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As part of our sale of contract manufacturing assets on June 30, 2004, we agreed to purchase certain component parts from the new owner for use in our Laboratory Communication Solutions business on a non-exclusive basis at a fixed price deemed to be at fair market value by management. These parts were valued at \$0.4 million at June 30, 2004. As of September 30, 2004, this remaining commitment had been reduced to less than \$0.1 million. We do not have any material commitments for any other capital expenditures.

In the nine months ended September 30, 2004, we spent \$2.6 million towards hardware and software costs related to our technical infrastructure and administrative systems. We have also spent \$1.0 million towards capitalized development of our internal systems. For the balance of the 2004 year, we expect to spend an additional \$0.7 million towards these projects. Furthermore, in 2004, we have incurred costs of approximately \$1.0 million in connection with the implementation of our internal control procedures mandated by the Sarbanes-Oxley Act of 2002 and with our financial system consolidation efforts. For the balance of the year, we estimate that we will spend an additional \$0.5 million towards these items. Our Sarbanes-Oxley compliance efforts to date have focused primarily on documentation and remediation of our financial and operational systems across our companies and to a lesser extent, testing these systems. We expect further focus testing, both internally and with our external auditor, in the fourth quarter of 2004.

We have also spent the better part of two years on HIPAA compliance efforts, which has resulted in significant costs. We now have over 90% of our total transaction volume migrated to a HIPAA compliant connection to our payer customers. However, on our submitter customer side, the majority of our providers continue to submit their transactions to us in legacy formats and rely on us to help meet HIPAA format requirements. Our continued efforts on the submitter side for HIPAA compliance will force us to continue to spend additional funds in the future.

In December 2003, we closed on a \$12.5 million asset-based line of credit with our commercial bank. Borrowing under such facility is subject to eligible cash, accounts receivable, and inventory and other conditions. Borrowings bear interest at the prime rate plus 0.5% or at LIBOR plus 2.25% (or LIBOR plus 0.75% in the case of borrowings against eligible cash only). As a result of our acquisition of PlanVista, we drew down \$4.4 million against this line at the end of February 2004 (which was repaid in early March 2004) and had a \$0.5 million draw outstanding as of March 31, 2004 that we repaid in April 2004. At this time, the assets of PlanVista are not eligible collateral for this line of credit due to covenants of the senior debt in place at PlanVista. Additionally, PlanVista (as a wholly-owned subsidiary) is limited in its ability to transfer cash to ProxyMed (as the parent company) due to additional covenants under this instrument. The expiration date of this line of credit has been extended through December 31, 2004.

As noted above, with our acquisition of PlanVista on March 2, 2004, we utilized the \$24.1 million in proceeds raised from our private placement, drew \$4.4 million on our line of credit and used available cash to satisfy \$27.4 million of PlanVista's debt and other obligations and expenses outstanding as of the effective time of the acquisition. As a result of the acquisition, we acquired a cash flow positive company with \$20.4 million in senior debt due in May 2005 (at an interest rate of 6% until December 2004 when the interest rate increases to 10%). While it is our intent to satisfy this debt either through refinancing, obtaining a senior line of credit or by raising equity capital, we will incur substantial additional cash interest charges

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until we do so. We may be unable to raise additional funds on acceptable terms or at all. Such refinancing is expected to be completed in the first quarter of 2005.

The following table represents our contractual cash obligations due over the next several years (including obligations of PlanVista). Operating leases are shown net of any sublease agreements.

| <b>In thousands</b>               | <b>2004(1)</b> | <b>2005</b>     | <b>2006</b>    | <b>2007</b>  | <b>2008</b>     |
|-----------------------------------|----------------|-----------------|----------------|--------------|-----------------|
| Interest on convertible notes (2) | \$ 131         | \$ 526          | \$ 525         | \$525        | \$ 526          |
| Interest on senior and other debt | 347            | 744             |                |              |                 |
| Convertible notes (2)             |                |                 |                |              | 13,137          |
| Senior debt of PlanVista          | 800            | 18,395          |                |              |                 |
| Notes payable (3)                 | 1,162          | 1,758           | 207            |              |                 |
| Capital lease obligations (3)     | 2              | 5               | 6              | 1            |                 |
| Operating leases                  | 404            | 997             | 430            | 420          | 386             |
| Commitment for inventory          |                | 83              |                |              |                 |
|                                   | _____          | _____           | _____          | _____        | _____           |
| <b>Total</b>                      | <b>\$2,846</b> | <b>\$22,508</b> | <b>\$1,168</b> | <b>\$946</b> | <b>\$14,049</b> |
|                                   | _____          | _____           | _____          | _____        | _____           |

(1) Remaining quarter of 2004

(2) Assumes no conversion of convertible notes

(3) Includes principal and interest

We believe that we have sufficient cash and cash equivalents on hand to fund our future operational requirements and capital expenditures, and a sufficient level of capital in order to fund specific research and development projects or to pursue smaller additional strategic acquisitions. Even with the positive cash flow expected to be generated from our operations, we anticipate that we will need to refinance the PlanVista debt, by either obtaining a new senior line of credit or raising capital in order to satisfy this debt on or before maturity. If we require additional funding in the future to satisfy any of our outstanding future obligations, or further our strategic plans, there can be no assurance that any additional funding will be available to us, or if available, that it will be available on acceptable terms. If we are successful in obtaining additional financing, the terms of the financing may have the effect of significantly diluting or adversely affecting the holdings or the rights of the holders of our common stock. We believe that if we are not successful in obtaining additional financing for further product development or strategic acquisitions, such inability may adversely impact our ability to successfully execute our business plan and may put us at a competitive disadvantage.

**Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the

carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions



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or conditions, but we believe that any variation in results would not have a material effect on our financial condition. We evaluate our estimates on an ongoing basis.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements. For a detailed discussion on the application of these and other accounting policies, see Note 1 in the Notes to Consolidated Financial Statements of our Form 10-K/A for the year ended December 31, 2003.

**Revenue Recognition** Revenue is derived from our Transaction Services and Laboratory Communication Solutions segments.

In our Transaction Services segment, we provide transaction and value-added services principally between physicians and insurance companies, and physicians and pharmacies. Such transactions and services include Electronic Data Interchange ( EDI ) claims submission and reporting, insurance eligibility verification, claims status inquiries, referral management, electronic remittance advice, patient statement processing, encounters, and cost containment transaction services including claims repricing and bill renegotiation. In our Laboratory Communication Solutions segment, we sell, rent and service intelligent remote reporting devices and provide lab order entry and results reporting through our software products.

Transaction Services revenues are derived from insurance payers, pharmacies and submitters (physicians and other entities including billing services, practice management software vendors, and claims aggregators). Such revenues are recorded on a per transaction fee basis or a flat fee basis (per physician) and are recognized in the period the service is rendered. Agreements with payers or pharmacies are for one to three years on a non-exclusive basis. Agreements with submitters are for one year, renew automatically, and are generally terminable thereafter upon 30 to 90 days notice. Transaction fees vary according to the type of transaction and other factors, including volume level commitments primarily for payers.

Revenue from Medical Cost Containment business in our Transaction Services segment is recognized when the services are performed and are recorded net of their estimated allowance. These revenues are primarily in the form of fees generated from the discounts we secure for the payers that access our provider network. We enter into agreements with healthcare payer customers that require them to pay a percentage of the cost savings generated from our network discounts with participating providers. These agreements are generally terminable upon 90 days notice. Revenue from a percentage of savings contract is generally recognized when the related claims processing and administrative services have been performed. The remainder of the revenue from our Medical Cost Containment business is generated from customers that pay a monthly fee based on eligible employees enrolled in a benefit plan covered by our health benefits payer clients.

Also in our Transaction Services segment, certain transaction fee revenue is subject to revenue sharing pursuant to agreements with resellers, vendors or gateway partners and is recorded as gross revenues in accordance with EITF No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent. Such revenue sharing amounts are based on a per transaction amount or a percentage of revenue basis and may involve increasing amounts or percentages based on transaction or revenue volumes achieved.

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Revenue from certain up-front fees charged primarily for the development of EDI for payers and the implementation of services for submitters in our Transaction Services segment is amortized ratably over three years, which is the expected life of the customer in accordance with Staff Accounting Bulletin No. 104, Revenue Recognition ( SAB No. 104 ).

Revenue from support and maintenance contracts on our products in both our Transaction Services and Laboratory Communications Solutions segments is recognized ratably over the contract period, which does not exceed one year. Such amounts are billed in advance and established as deferred revenue.

In our Laboratory Communication Solutions segment, revenue from sales of inventory and manufactured goods is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collectibility is probable in accordance with SAB No. 104.

Revenues from maintenance fees on laboratory communication devices are charged on an annual or quarterly basis and are recognized ratably over the service period. Service fees may also be charged on a per event basis and are recognized after the service has been performed.

Revenue from the rental of laboratory communication devices is recognized ratably over the applicable period of the rental contract. Such contracts require monthly rental payments and are for a one to three year term, then renewing for a similar period after the initial term is expired. Contracts may be cancelled upon 30 days notice. A significant amount of rental revenues are derived from contracts that are no longer under the initial non-cancelable term. At the end of the rental period, the customer may return or purchase the unit for fair market value. Upon sale of the revenue earning equipment, the gross proceeds are included in net revenues and the undepreciated cost of the equipment sold is included in cost of sales.

Goodwill We adopted the provisions of SFAS No. 142, Goodwill and Other Intangible Assets effective January 1, 2002. Under SFAS No. 142, goodwill is reviewed at least annually for impairment. SFAS No. 142 requires that goodwill be tested for impairment at the reporting unit level at adoption and at least annually thereafter, utilizing a fair value methodology versus an undiscounted cash flow method required under previous accounting rules. In accordance with our adoption of SFAS No. 142, we completed our most recent annual test at December 31, 2003 and 2002 utilizing various valuation techniques including a market value analysis. No impairment charges were recorded as a result of these tests.

Capitalized Software Development and Research and Development Costs incurred internally and fees paid to outside contractors and consultants during the application development stage of our internally used software products are capitalized. Costs of upgrades and major enhancements that result in additional functionality are also capitalized. Costs incurred for maintenance and minor upgrades are expensed as incurred. All other costs are expensed as incurred as research and development expenses (which are included in Selling, general and administrative expenses ). Application development stage costs generally include software configuration, coding, installation to hardware and testing. Once the project is completed, capitalized costs are amortized over their remaining estimated economic life. Our judgment is used in determining whether costs meet the criteria for immediate expense or capitalization. We periodically review projected cash flows and other criteria in assessing the impairment of any internal-use capitalized software and take impairment charges as needed.

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**Reserve for Doubtful Accounts/Bad Debt Estimates** We rely on estimates to determine the bad debt expense and the adequacy of the reserve for doubtful accounts receivable. These estimates are based on our historical experience and the industry in which we operate. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Additionally, in our Medical Cost Containment business, we evaluate the collectibility of our accounts receivable based on a combination of factors. In circumstances where we are aware of a specific customer's inability to meet its financial obligations to us, we record a specific reserve for bad debts against amounts due to reduce the net recognized receivable to the amount we reasonably believe will be collected. For all other customers, we recognize reserves for bad debts based on past write-off history, average percentage of receivables written off historically, and the length of time the receivables are past due. To the extent historical credit experience is not indicative of future performance or other assumptions used by management do not prevail, loss experience could differ significantly, resulting in either higher or lower future provision for losses.

**New Accounting Pronouncements**

In September 2004, the Financial Accounting Standards Board ( FASB ) issued EITF No. 04-8, Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share ( EITF No. 04-8 ). EITF No. 04-8 addresses when the dilutive effect of contingently convertible debt instruments should be included in diluted earnings per share and requires that contingently convertible debt instruments are to be included in the computation of diluted earnings per share regardless of whether the market price or other trigger has been met. EITF No. 04-8 also requires that prior period diluted earnings per share amounts presented for comparative purposes be restated. EITF No. 04-8 is effective for reporting periods ending after December 15, 2004. As a result of the adoption of EITF No. 04-8, shares convertible from our \$13.1 million convertible notes may be required to be included in the calculation of our earnings per share in periods of net income; however, the FASB has yet to reach a conclusion as to the effect of non market price triggers on earnings per share calculations in situations where the instrument contain only non-market price trigger, such as our convertible notes, and therefore the impact to the Company is not determinable at this time.

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**Cautionary Statement Pursuant to Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995**

Statements contained in the Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report may contain information that includes or is based upon forward-looking statements within the meaning of the Securities Litigation Reform Act of 1995. Forward-looking statements present our expectations or forecasts of future events. These statements can be identified by the fact that they do not relate strictly to historical or current facts. They frequently are accompanied by words such as anticipate, estimate, expect, project, intend, plan, believe, and other words and terms of similar meaning. In particular, these include statements relating to: our ability to identify suitable acquisition candidates; our successful integration of PlanVista, MedUnite and any other future acquisitions; our ability to successfully develop, market, sell, cross-sell, install and upgrade our clinical and financial transaction services and applications to new and current physicians, payers, medical laboratories and pharmacies; our ability to compete effectively on price and support services; our ability to increase revenues and revenue opportunities; and our ability to meet expectations regarding future capital needs and the availability of credit and other financing sources.

All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including any projections of earnings, revenues, synergies, accretion, margins or other financial items; any statements of the plans, strategies and objectives of management for future operations, including the execution of integration and restructuring plans and the anticipated timing of filings, approvals and closings relating to the merger or other planned acquisitions; any statements concerning proposed new products, services, developments or industry rankings; any statements regarding future economic conditions or performance; any statements of belief; and any statements of assumptions underlying any of the foregoing.

Actual results may differ significantly from projected results due to a number of factors, including, but not limited to, the soundness of our business strategies relative to perceived market opportunities; our assessment of the healthcare industry's need, desire and ability to become technology efficient; market acceptance of our products and services; and our ability and that of our business associates to comply with various government rules regarding healthcare information and patient privacy. These and other risk factors are more fully discussed starting on Page 23 and elsewhere in our Form 10-K/A for the year ended December 31, 2003, which we strongly urge you to read.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Our future results and shareholder values may differ materially from those expressed in the forward-looking statements. Many of the factors that will determine these results and values are beyond our ability to control or predict. Shareholders are cautioned not to put undue reliance on any forward-looking statements. For those statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. We expressly disclaim any intent or obligation to update any forward-looking statements.

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**Available Information**

Our Internet address is [www.proxymed.com](http://www.proxymed.com). We make available free of charge on or through our Internet website our annual report on Form 10-K/A, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after such material was electronically filed with, or furnished to, the SEC.

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

We own no derivative financial instruments or derivative commodity instruments. Revenues derived from international sales are transacted in US dollars and therefore, we do not believe that we are exposed to material risks related to foreign currency exchange rates.

**ITEM 4. CONTROLS AND PROCEDURES**

As of the end of the period covered by this report, the Company evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)), under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer. Based upon such evaluation, management has concluded that the Company's disclosure controls and procedures are effective to ensure that the information the Company is required to disclose in reports that it files or submits under the Exchange Act is communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure, and is recorded, processed, summarized and reported within the time periods specified in the Commission rules and forms.

There have not been any changes in our internal control over financial reporting during this quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****Item 1. Legal Proceedings**

In December of 2001, Insurdata Marketing Services, Inc. ( IMS ) filed a lawsuit against HealthPlan Services, Inc. ( HPS ), a former subsidiary of the Company's PlanVista subsidiary, for unspecified damages in excess of \$75,000. The complaint alleges that HPS failed to pay commissions to IMS pursuant to an arbitration award rendered in 1996. Fiserv Health, Inc. ( Fiserv ) is a third party defendant. IMS, HPS, and Fiserv each filed a motion for summary judgment on the issue of liability only, in or around June 2004, and a decision is expected. The Company denies all liability in this case and will continue to vigorously defend itself. No trial date has been established.

**Item 6. Exhibits and Reports on Form 8-K.**

(a) Exhibits:

**Exhibit**

| <b>No.</b> | <b>Description</b>   |
|------------|--|
| 3.1        | Articles of Incorporation, as amended (incorporated by reference to Exhibit 3.1 of the Registration Statement on Form SB-2, File No. 333-2678).  |
| 3.2        | Bylaws, as amended (incorporated by reference to Exhibit 3.1 of the Registration Statement on Form SB-2, File No. 333-2678).   |
| 3.3        | Articles of Amendment to Restated Articles of Incorporation of the Registrant dated March 1, 2004 (incorporated by reference to Exhibit 3.1 of Form 8-K File No. 000-22052, reporting an event dated March 2, 2004). |
| 3.4        | Articles of Amendment to Articles of Incorporation of the Registrant effective August 22, 2002 (incorporated by reference to Exhibit 3.4 of Form 10-K/A for the period ended December 31, 2003).                     |
| 3.5        | Articles of Amendment to Articles of Incorporation of the Registrant dated December 21, 2001 (incorporated by reference to Exhibit 3.1 of Form 8-K File No. 000-22052, reporting an event dated December 13, 2001).  |
| 3.6        | Articles of Amendment to Articles of Incorporation dated August 21, 2001 (incorporated by reference to Exhibit 2.2 of Form 8-K, File No. 000-22052, reporting an event dated August 17, 2001).                       |
| 3.7        | Articles of Amendment to Articles of Incorporation dated July 25, 2001 (incorporated by reference to Exhibit 2.1 of Form 8-K, File No. 000-22052, reporting an event dated August 17, 2001).                         |

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| <b>Exhibit<br/>No.</b> | <b>Description</b>   |
|------------------------|--|
| 3.8                    | Articles of Amendment to Articles of Incorporation of the Registrant effective July 14, 2000 (incorporated by reference to Exhibit 3.8 of Form 10-K/A for the period ended December 31, 2003).   |
| 3.9                    | Articles of Amendment to Articles of Incorporation of the Registrant dated June 15, 2000 (incorporated by reference to Exhibit 3.4 of Form 10-Q/A for the period ended September 30, 2000).  |
| 4.1                    | Common Stock Purchase Warrants issued to First Data Corporation (incorporated by reference to Exhibit 10.1 of Form 8-K, File No. 000-22052, reporting an event dated July 8, 2003).  |
| 4.2                    | Form of 4% Convertible Promissory Notes dated December 31, 2002 issued in connection with the Agreement and Plan of Merger and Reorganization dated December 31, 2002 between ProxyMed, Inc., Davie Acquisition Corp., and MedUnite, Inc. (incorporated by reference to Exhibit 10.1 of Form 8-K File No. 000-22052, reporting an event dated December 31, 2002).  |
| 4.3                    | Form of Common Stock Purchase Warrants issued to General Atlantic Partners 74, L.P., GAP Coinvestment Partners II, L.P., GAPCO GmbH & Co., KG and GapStar, LLC (incorporated by reference to Exhibit 10.2 of Form 8-K, File No. 000-22052, reporting an event dated March 26, 2002).   |
| 4.4                    | Form of Exchanged Warrant to Purchase Common Stock of the Registrant dated May 4, 2000, issued to certain investors (incorporated by reference to Exhibit 4.1 of Form 8-K, File No. 000-22052, reporting an event dated May 4, 2000).  |
| 4.5                    | Form of New Warrant to Purchase Common Stock of the Registrant dated May 4, 2000, issued to certain investors (incorporated by reference to Exhibit 4.2 of Form 8-K, File No. 000-22052, reporting an event dated May 4, 2000).  |
| 4.6                    | Form of Warrant to Purchase Common Stock of the Registrant dated December 23, 1999, issued to certain investors (incorporated by reference to Exhibit 4.1 of Form 8-K, File No. 000-22052, reporting an event dated December 23, 1999).  |
| 10.1                   | Amended and Restated Registration Rights Agreement among the Registrant, General Atlantic Partners 77, L.P., General Atlantic Partners 74, L.P., GAP Coinvestment Partners II, L.P., GAP Coinvestments III, LLC, GAP Coinvestments IV, LLC, GapStar, LLC, GAPCO GmbH & Co. KG, PVC Funding Partners, LLC, ComVest Venture Partners, L.P., Shea Ventures, LLC, and Robert Priddy, dated March 2, 2004 (incorporated by reference to Exhibit 4.1 of Form 8-K, File No. 000-22052, reporting an event dated March 2, 2004). |

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**Exhibit**

| <b>No.</b> | <b>Description</b>   |
|------------|--|
| 10.2       | Letter Agreement dated July 14, 2004 between ProxyMed, Inc. and Gregory J. Eisenhauer  |
| 31.1       | Certification by Michael K. Hoover, Chief Executive Officer, pursuant to Exchange Act Rules 13a-14 and 15d-14.   |
| 31.2       | Certification Gregory J. Eisenhauer, Chief Financial Officer, pursuant to Exchange Act Rules 13a-14 and 15d-14.  |
| 32.1       | Certification by Michael K. Hoover, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.     |
| 32.2       | Certification by Gregory J. Eisenhauer, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

\*Denotes management contract or compensating plan or arrangement.



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(b) Reports on Form 8-K:

- July 2, 2004 The Company disclosed its sale of assets, liabilities, properties and business related to its contract manufacturing unit of its Laboratory Communication Solutions segment to a new entity formed by a former officer of the Company on June 30, 2004, including a press release dated June 28, 2004 announcing the transaction.
- August 9, 2004 Pursuant to Regulation FD, the Company reported on the Company's second quarter 2004 teleconference call held on August 6, 2004, including press release dated August 5, 2004 and additional disclosures made available to the public.
- August 17, 2004 The Company announced a change in its independent auditors from PricewaterhouseCoopers, LLP to Deloitte & Touche LLP.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

**PROXYMED, INC.**

Date: December 15, 2004

By: /s/ Michael K. Hoover

Michael K. Hoover  
Chairman and Chief Executive Officer

Date: December 15, 2004

By: /s/ Gregory J. Eisenhauer

Gregory J. Eisenhauer  
EVP and Chief Financial Officer