

PROXYMED INC /FT LAUDERDALE/

Form 10-K

March 15, 2006

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

**Form 10-K**

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 31, 2005**
- or
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the transition period from        to**

**Commission File Number 000-22052**

**PROXYMED, INC.**

*(Exact name of registrant as specified in its charter)*

**Florida**

*(State or other jurisdiction of  
incorporation or organization)*

**65-0202059**

*(I.R.S. Employer  
Identification No.)*

**1854 Shackleford Court, Suite 200,  
Norcross, Georgia**

*(Address of principal executive offices)*

**30093**

*(Zip Code)*

**Registrant's telephone number, including area code:**

**(770)-806-9918**

**Securities registered pursuant to Section 12(b) of the Act:**

**None**

**Securities registered pursuant to Section 12(g) of the Act:**

**Common Stock, \$.001 Par Value**

*(Title of class)*

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes  No

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant computed using \$7.84 per share, the closing price of the registrant's common stock on the Nasdaq National Market as of the last business day of the registrant's most recently completed second fiscal quarter was \$99,597,024.

As of March 14, 2006, 13,203,702 shares of the registrant's common stock were issued and outstanding.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive Proxy Statement for its Annual Meeting of Shareholders to be held on or about June 1, 2006, are incorporated by reference into Part III of this Annual Report on Form 10-K.

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**PART I**

**ITEM 1. BUSINESS**

MedAvant Healthcare Solutions was incorporated in 1989 in Florida as a pharmaceutical services company, under the name ProxyMed, Inc. In December 2005, we announced that we would begin doing business under our new operating name, MedAvant Healthcare Solutions. Our newly launched corporate identity unites all business units and employees under one brand identity ( MedAvant ) and is one of several outcomes resulting from a strategic analysis we completed in the third quarter of 2005 following the acquisition of seven companies between 1997 and 2004.

Today, MedAvant is focused on delivering secure, web technology-based solutions that remove paper from the exchange of healthcare transactions, both clinical and financial, to healthcare providers, payers, pharmacies, medical laboratories, and other healthcare suppliers. To facilitate these solutions, we operate Phoenix<sup>sm</sup>, a highly scalable and secure processing platform, which supports direct connectivity and transaction processing in real-time between all of our customers. Our success lies in the combination of our real-time technology and our expansive connectivity. We are the nation's second largest provider-based healthcare technology company with connections to more than 450,000 providers, 30,000 pharmacies, 500 laboratories, and over 1,500 payer organizations. In fact, we are the only healthcare technology company that offers both a nationwide claims clearinghouse and a nationwide Preferred Provider Organization (PPO) network.

We are uniquely positioned in our marketplace to make a contribution that our competitors do not. Our differentiators include our proprietary real-time technology, *Phoenix*<sup>sm</sup>, and our ability to offer both a nationwide claims clearinghouse and a nationwide PPO network. In addition, we maintain an open, neutral position with vendors, which enables us to attract partners who prefer a non-competitive environment. This allows us to offer more flexible options for our customers. Another differentiator is our deep footprint in the clinical arena. With the nation's largest clinical laboratories as long-time customers, we have worked in partnership with them to develop customized lab communication tools and services such as *Pilot*<sup>tm</sup>. Also, our prescription business operates one of the nation's largest and longest-established electronic and fax gateway infrastructure with extensive connectivity to all major pharmacies in the nation.

We operate two reportable segments that are separately managed: Transaction Services and Laboratory Communication Solutions. Transaction Services includes transaction, cost containment, business process outsourcing and other value-added services principally between physicians and insurance companies, and physicians and pharmacies. Laboratory Communication Solutions includes the sale, lease and service of communication devices principally to laboratories.

A more complete description of the products and services of each of our segments begins on page 3. For information regarding the results of operations of each of our segments, see Management's Discussion and Analysis of Financial Condition and Results of Operations beginning on page 23.

Our electronic transaction processing services support a broad range of financial, clinical, and administrative transactions. To facilitate these services, we are converting our non-clinical electronic healthcare transaction clients to *Phoenix* our secure, real-time proprietary national electronic information network, which provides physicians and other healthcare providers with direct connectivity to one of the industry's largest lists of payers.

Our cost containment and business process outsourcing solutions, included in the Transaction Services segment, are directed toward the medical insurance and managed care industries. Specifically, we provide integrated national PPO network access, electronic claims repricing, and network and data management to healthcare payers, including self

insured employers, medical insurance carriers, PPOs and Third Party Administrators.

Our corporate headquarters is located in Norcross, 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.

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### **Our Changing Market**

The healthcare industry is undergoing a number of significant changes that are increasingly supportive of MedAvant's business strategy to automate healthcare transactions and reduce the costs of healthcare for all. As payers progress toward non-par status in the transaction processing space, clearinghouses and healthcare technology companies like MedAvant must adjust their business models and solutions to address the declining revenue from payers. In addition, consolidation of the PPO networks in the cost containment space presents MedAvant with a huge opportunity to leverage its strengths and bring greater value to NPPN™.

With the advent of Electronic Medical/Health Records (EMRs and EHRs), the Medicare Modernization Act of 2003, and support from our legislators for secure, electronic solutions in healthcare, MedAvant is well-positioned to leverage its considerable clinical presence, proprietary real-time processing technology and connections to hundreds of thousands of providers and payers to play a larger role in the exchange of healthcare transactions and information.

Our provider solutions are focused on self-service tools and improved service levels that encourage providers to submit healthcare transactions electronically, ultimately lowering the costs of processing for all. We have invested millions of dollars in our processing platform called *Phoenix*<sup>sm</sup> which supports real-time processing at high volume between healthcare clients. Our suite of web-based tools provides revenue management and claims tracking. These new tools allow providers to access details of individual claims to confirm receipt by the payer and better understand error information for rejected claims.

Over the course of 2005, we made substantial progress on the integration of all products and services into one suite of services residing on the *Phoenix* platform. MedAvant's initiative to convert all customers to *Phoenix* allows us to improve the quality and speed of claims processing, reducing errors and rework and ensuring better tracking and faster turnaround times for clients. *Phoenix* also accepts claims in almost any format and converts every healthcare transaction to the HIPAA-approved ANSI format. As the industry's only scalable real-time processing platform of its kind, *Phoenix* primes all customers for real-time claims and healthcare transaction processing—a basic necessity for EMRs and EHRs at scale. In addition to the benefits for our clients, this integration enhances our ability to support multiple technologies and reduces our costs of processing. This suite of products covers platforms as old as DOS but also includes solutions for those with the latest platforms and technologies.

### **Industry Growth**

According to the Centers for Medicare and Medicaid Services, referred to as CMS, the U.S. spent \$1.9 trillion on health care goods and services in 2004. That was a 7.9% increase from the previous year, but slower growth than the 8.2 percent growth in 2003 and 9.1 percent growth in 2002. CMS projects that national health expenditures will reach \$3.6 trillion by 2014.

Per capita, health spending increased in 2004 by \$610 to \$6,280.

Health spending accounted for 16% of GDP in 2004

Health expenditures are projected to grow at an average annual rate of 7.1 percent through the year 2014.

According to *Modern Healthcare's* By the Numbers (December 20, 2004), 22% of the nation's healthcare dollars went to physician and clinical services, with 7% going to administrative costs. As one of the most transaction-oriented industries in the country, healthcare generates over 35 billion financial and clinical transactions each year, including new prescription orders, refill authorizations, laboratory orders and results, medical insurance claims, insurance eligibility inquiries, encounter notifications, and referral requests and authorizations. Current healthcare information

technology spending has been projected at \$41.6 billion for 2004, and is predicted to continue growing steadily at 7% annually through 2006. Even with healthcare information technology spending at these levels, we believe that the healthcare industry's use of technology lags behind many other transaction-intensive industries, with the vast majority of these healthcare transactions being performed manually and on paper.

For physician offices, payers, laboratories and pharmacies to meet the financial, clinical and administrative demands of an evolving managed care system, they will need to process many of these types of transactions electronically. The Health Insurance Portability and Accountability Act of 1996, referred to as HIPAA (see

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Healthcare and Privacy Related Legislation and regulation below) establishes electronic standards for eight major transaction types, including claims, eligibility inquiries and claims status inquiries. Our secure, proprietary systems provide an electronic link between healthcare payers and healthcare providers such as laboratories, hospitals, and physician office practices for these transactions.

## **Key Competitive Strengths**

We have competitive advantages in four critical areas:

(1) Our solutions allow us to reach out to providers AND payers with combined solutions that reduce their costs. We are the only healthcare technology company that offers both a nationwide claims clearinghouse and a nationwide PPO network. This allows us to offer discounts to both providers and payers, lowering the cost of healthcare for both.

(2) Our technology is superior. Phoenix<sup>sm</sup> our transaction processing platform, is a highly scalable secure national information platform, which supports real-time and batch transaction processing between our healthcare clients.

Built internally three years ago from the ground-up, Phoenix's robust throughput and scalability make it unique, but the value lies in the time and cost it saves our clients. Phoenix is HIPAA-compliant and supports a broad range of financial and clinical transactions. In addition, we offer Pilot<sup>sm</sup>, a smart routing delivery device that was built internally last year on a Linux operating system. Pilot is a physical device that allows our lab clients to send lab reports to providers in virtually any format, from PDF to PCL, TIFF, JPG, and Zip, opening the door to product differentiating factors such as graphical and color reporting.

(3) Our connectivity is extensive. Our broad existing connectivity to payers and providers positions us as the second largest independent medical claims clearinghouse in the industry. We have almost 150,000 providers using our claims processing solutions, and an additional 450,000 contracted directly and indirectly for our PPO Network, NPPN. To reach these direct and partnered providers, we have licensing and connectivity agreements with many national and regional companies, such as practice management system vendors, billing services, and electronic healthcare companies, and with physician offices directly. These relationships offer us an opportunity to cross-sell our products and services to our existing provider customer base. Our electronic healthcare transaction services support a broad range of financial transactions (such as claims, patient statements, claims status reports, eligibility verification, explanations of benefits and electronic remittance advices); clinical transactions (such as laboratory results, new prescription orders and prescription refills); and administrative transactions (such as referrals and pre-certifications). These connections allow information to reliably move back and forth from the provider office to the appropriate healthcare institution (payer, laboratory and pharmacy) facilitating diagnosis, treatment and payment. We are also the largest provider of intelligent laboratory results reporting devices and the nation's largest provider of retail pharmacy clinical connectivity.

(4) Our PPO network is national in scope but also has a strong rural presence. Our PPO network, which is comprised of both directly contracted providers and those accessed through our regional network partners, is the second largest in the nation in terms of number of providers (physicians, hospitals and ancillary providers) contracted. In terms of managed care lives accessing our network, we are currently ranked sixth in the nation.

## **Barriers to Entry**

We have expended considerable time, effort and expense developing the infrastructure, relationships, and interoperability of our back-end connectivity for both financial and clinical transactions. The cost and time demands of development and maintenance of the connections from both a technical and relationship perspective represent a barrier to entry for would-be competitors.



**Current Products and Services**

In our Transaction Services segment, we offer products and services for payers (both government and commercial insurance companies), providers (physicians and hospitals) and clinical institutions (pharmacies,

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clinical laboratories, others). We also provide medical cost containment and business process outsourcing solutions for the medical insurance and managed care industries. These new products are the foundation for our suite of solutions to our payer customers. These customers include healthcare payers such as self-insured employers, medical insurance carriers, third party administrators, Health Maintenance Organizations, referred to as HMOs, and other entities that pay claims on behalf of health plans. Our payer-focused solutions also include network and data management business process outsourcing services for providers, including individual providers, PPOs, and other provider groups.

Our provider-focused suite of solutions include electronic healthcare transaction services designed to interconnect with diverse technologies and connection capabilities. Our solutions are available through our suite of Windows-based products<sup>1</sup>, through our Internet portal and through various direct network connection programs. Each of these entry points connects providers to our network and then routes transactions to their contracted payer, laboratory and pharmacy partners.

Our provider solutions include claims submission and reporting, insurance eligibility verification, claims status inquiries, referral management, laboratory test results reporting and prescription refills, all available today through *medavanthealth.com*. We continue to expand our offerings through our portal to include new financial and clinical transactions such as claims response management, electronic remittance advices, encounters and new prescriptions. All of our existing Web-based applications can be private-labeled and are being marketed through our channel partners to increase distribution opportunities.

## **Transaction Services**

*Payer Services* We provide medical cost containment and business process outsourcing solutions for the medical insurance and managed care industries. These products are part of the foundation for our suite of solutions to our payer customers. These customers include healthcare payers such as self-insured employers, medical insurance carriers, third party administrators, HMOs, and other entities that pay claims on behalf of health plans. We also provide network and data management business process outsourcing services for healthcare providers, including individual providers, PPOs, and other provider groups.

*ClaimPassXL*<sup>®</sup> is our Internet claims repricing system and allows us to shift claims repricing submissions from paper or fax to the Internet, which reduces claims processing costs significantly. Faster turnaround of claims repricing will become more important to payers as state insurance regulators increase their scrutiny of claims payment turnaround times.

*National Preferred Provider Network*<sup>™</sup> The National Preferred Provider Network, referred to as NPPN<sup>®</sup>, is a nationwide physician network comprised of PPOs, independent physician associations, and individually contracted providers that agree to offer discounts on medical services. These providers and provider groups participate in NPPN to increase patient flow and benefit from NPPN's prompt, efficient claims repricing services. Healthcare payers access NPPN to benefit from the discounts offered by participating providers. The size of NPPN and the level of NPPN discounts provide our payer customers with significant reductions in medical claims costs.

NPPN access agreements generally require our customers to pay us a percentage of the cost savings generated by NPPN discounts. In the medical cost containment industry, this payment arrangement is called a percentage of savings revenue model. A typical percentage of savings customer maintains arrangements with more than one PPO network. Most of these payer customers utilize NPPN as an additional network to contain costs when a covered person obtains medical services from a provider outside of the payer's primary PPO network. When we receive a provider bill for medical services that are covered by NPPN discount arrangements, we electronically reprice it to conform to the negotiated discounted rate, which is typically lower than the invoiced amount. We derive the balance of our NPPN

operating revenue from payer customers that pay a flat fee per month based on the number of enrolled members. These customers generally access NPPN as their primary PPO network. More than 80% of our participating providers have been part of NPPN for more than three years, with some relationships spanning more than twelve years since NPPN's inception in 1994.

<sup>1</sup> Windows is a registered trademark of Microsoft Corporation.

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*Electronic Claims Repricing* In connection with our NPPN access business, we provide electronic claims repricing services that benefit both our payer clients and our participating providers. A participating provider submits a claim at the full, undiscounted provider rate. The provider sends the claim directly to us or to the payer which then forwards the bill to us. Because there is a wide variety of provider systems for submitting claims, we accept claims by traditional methods such as mail and fax, as well as through the Internet and by our electronic transaction services. We convert paper and faxed claims to an electronic format, and then electronically reprice the claims by calculating the reduced price based on our NPPN's negotiated discount. We return the repriced claims file to the payer electronically, in most cases within three business days.

*Network and Data Management* We use our information system capabilities to provide network and data management services for the payers that access NPPN. For some network access payers, we act as the payer's mailroom for receipt of all provider claims, converting paper and fax claims to an electronic format, identifying the correct network fee schedule applicable to each claim, and electronically repricing the claim accordingly. We prepare detailed reports regarding repricing turnaround times and the savings that each payer realizes, itemized by the total number of claims incurred, number of claims discounted, and the average discount. Payers can use this information to help design health plans that effectively control costs, enhance member benefits, and yield a more favorable loss ratio (ratio of paid medical claims compared to collected premiums). We integrate several components of certain licensed reporting software to provide both payer clients and participating PPOs with quick access to claims data, allowing them to produce a variety of analytical reports. We generally do not charge our NPPN access customers any additional fee for our standard network and data management services.

*Bill Review and Negotiation* We offer optional medical bill review and negotiation services to our payer clients. Many of our percentage of savings clients send us all claims that fall outside their primary PPO network arrangements. We offer payer customers the opportunity to realize cost savings on these out-of-network claims through our affiliations with bill review and negotiation companies. We can electronically transmit non-NPPN claims to experienced professionals at the contracted bill review and negotiation companies. These professionals use proprietary medical software to analyze each claim to detect any incorrect charges or billing irregularities. Once that phase of the analysis is completed, the detailed charges are compared to a proprietary database to determine the competitiveness of the charges in the provider's geographic area. The bill negotiator then contacts the provider to discuss the findings, and in many cases is able to reduce the claim amount. The reviewer obtains signed agreements from each provider to prevent the provider from later contesting the reduction or billing the patient for the balance. The bill review and negotiation vendor then returns the electronic file to us, and we forward it to the payer along with the payer's other repriced claims. Payers pay us a percentage of the savings that are generated by the bill review and negotiation service.

*Business Process Outsourcing* We traditionally provided claims repricing and network management services only with respect to claims that NPPN participating providers submitted to one of our network access payer customers. Through our network and data management outsourcing business, we have expanded our scope to offer payers and providers services that are independent of our network access business.

*Desktop* We offer several Windows and Unix based desktop products, including claims submission and tracking. Unix is a registered trademark of The Open Group.

*Online* For providers who prefer to use Internet based services, we developed and have been operating our provider transaction services Web portal, [www.medavanthealth.com](http://www.medavanthealth.com), for over five years. The portal's available Web-based financial and administrative transactions now include:

claims submission and reporting;

eligibility verification;

claims status inquiries;

ERA;

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referral management; and

pre-certifications.

*Real-Time* Our real-time suite of solutions provides a quick and easy way to streamline the patient registration process, insuring more accurate payment information through pre-certification, and to check the status of claims. Our real-time suite includes:

eligibility verification and benefits inquiry;

referral authorization and pre-certifications;

claim status inquiry.

*B2B* In addition to working directly with providers, we offer software developers, large customers and partners an Application Programming Interface ( API ) to connect to our real-time transaction platform and directly submit XML or X12 based transactions. This service is sold as our business-to-business ( B2B ) offering. The platform which supports the B2B offering is based on a proprietary XML transaction format and is HIPAA compliant.

## **Prescription Services**

We offer both new prescription ordering and refill management through our *PreScribe*<sup>®</sup> family of products. There are currently over 4,000 physician clients using *PreScribe*. *PreScribe* and *Phoenix*<sup>sm</sup> support the largest and oldest electronic and fax gateway infrastructure with connectivity to over 37,000 pharmacies nationwide. We also offer a private-label version of our Web-based refill prescription application.

## **Laboratory Communication Solutions**

Our Laboratory Communication Solutions segment is an integral part of our connectivity to the healthcare industry. We engineer and provide communication devices for clinical laboratories throughout the United States. We have over 100,000 devices in use in provider offices nationwide, providing unmatched service and reliability in the way they deliver patient lab reports. This direct connectivity into the physician office provides a critical link in the patient diagnosis and treatment cycle.

## **Product and Services Development**

Our goal is to drive all of our customers to our online portal where they can access our products and services. For both Transaction Services and Laboratory Communication Solutions, we are currently augmenting medavanthealth.com, our new online portal. These additions include customer-based products and services, along with multi-functional self-service tools.

We are uniquely positioned in the clinical laboratory industry with the onset of our new *Pilot*<sup>sm</sup> and *Navigator*<sup>tm</sup> solutions. *Pilot* was released in the first quarter of 2005 and provides enhanced reporting processes for results delivery to clinical laboratories. This product allows labs to customize report delivery, and to export results to their Electronic Medical Record and Practice Office Management Information System. They can review their results via Internet or dial-up. We have deployed over 6,000 of these devices since *Pilot*'s release. *Pilot*'s companion product, *Navigator*, provides the supportability function of fleet monitoring, usability data, and uptime management for remote printer devices. *Navigator* was released in the second quarter of 2005.

The total amount capitalized for purchased technology, capitalized software and other intangible assets as of December 31, 2005 and 2004, was approximately \$17.9 million and \$52.3 million, respectively, net of amortization.

### **Marketing**

We have a direct sales force and customer support staff who serve payers, providers, clinical laboratories and pharmacies. In addition, since we do not compete for the physician desktop and allow for private branding of our value-added products and services, we are able to leverage the marketing and sales efforts of our partners. Through the white labeling services we offer, we give our partners greater value and drive our revenues and transactions.

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We utilize the following distribution channels for our products and services to maximize connectivity between physician offices, payers, laboratories, pharmacies and other healthcare providers:

### **Channel Focus**

Direct	<p>We have a direct sales force of account executives, inside telemarketers, account managers and customer care representatives who serve our providers, payers, laboratories and pharmacies. We license access to our proprietary network, Phoenix<sup>sm</sup> and provide intelligent laboratory results reporting devices for communications between providers and clinical laboratories.</p> <p>We work with the vendors of POMIS and pharmacy office management systems to enable their existing applications to process transactions through us between providers and payers, laboratories and pharmacies. We also license these customers to offer our products and services under their own private label. In addition, we connect with other electronic transaction processing networks so that the participants on both networks can communicate with each other in National Council of Pharmacy Drug Program standard, HIPAA approved formats, and the HL-7 standard format for laboratories.</p>
Partners	<p>We provide comprehensive suites of products for financial, clinical, and administrative transaction processing services through our portal, <a href="http://www.medavanhealth.com">www.medavanhealth.com</a> which may be easily accessed by any payer, provider or business partner with an Internet connection. We are currently in development to customize those products by customer, so that every solution a payer will want to use will be available on one easy-to-use site. There will also be a customized portal for providers and partners.</p>
Internet	

### **Competition**

*Transaction Services* We face competition from many healthcare information systems companies and other technology companies. Many of our competitors are significantly larger and have greater financial resources than we do and have established reputations for success in implementing healthcare electronic transaction processing systems. Other companies, including EMDEON, NDCHealth Corporation, Per-Se Technologies, and other healthcare related entities have targeted this industry for growth, including the development of new technologies utilizing Internet-based systems. While our ability to compete has been enhanced by our unique national offerings and proprietary offerings, we cannot assure that we will be able to compete successfully with these companies or that these or other competitors will not commercialize products, services or technologies that render our products, services or technologies obsolete or less marketable.

*Preferred Provider Network* The PPO industry is highly fragmented. According to the American Association of Preferred Provider Organizations, the United States had 1,261 PPOs in 2004. A few companies, such as First Health Group Corporation, Preferred Medical Claims/eHealth Solutions, Concentra, Inc., Coalition America, Inc., and Multiplan, Inc., offer provider networks and claim volumes of meaningful size. The remainder of the competitive landscape is diverse, with major insurance companies and managed care organizations such as Blue Cross and Blue Shield plans, Aetna, WellPoint Health Networks, Inc., UnitedHealth Group, Humana Health Care Plans, private healthcare systems, and CIGNA Healthcare also offering proprietary preferred provider networks and services. In addition, the number of independent PPOs has decreased as managed care organizations and large hospital chains have acquired PPOs to administer their managed care business and increase enrollment. We expect consolidation to continue as the participants in the industry seek to acquire additional volume and access to PPO contracts in key geographic markets. This consolidation may give customers greater bargaining power and lead to more intense price competition.





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*Electronic Claims Repricing* The claims repricing service market is also fragmented. Our repricing competitors provide some or all of the services that we currently provide. Our competitors can be categorized as follows:

large managed care organizations and third party administrators with in-house claims processing and repricing systems, such as Blue Cross and Blue Shield plans, UnitedHealth Group, and Wellpoint Health Networks; and

healthcare information technology companies providing enterprise-wide systems to the payer market, such as MultiPlan, McKesson Corporation and Perot Systems Corporation.

The market for claims repricing services is competitive, rapidly evolving, and subject to rapid technological change. We believe that competitive conditions in the healthcare information industry in general will lead to continued consolidation as larger, more diversified organizations are able to reduce costs and offer an integrated package of services to payers and providers.

We compete on the basis of the strength of our electronic claims repricing technology, the size of our network and the level of our network discounts, our percentage of savings pricing model, and the diversity of services we offer through our business processing outsourcing products and other new initiatives. Many of our current and potential competitors have greater financial and marketing resources than we have. Furthermore, we believe that the increasing acceptance of managed care in the marketplace, the adoption of more sophisticated technology, legislative reform, and the consolidation of the industry will result in increased competition. There can be no assurance that we will continue to maintain our existing customer base, or that we will be successful with any new products that we have introduced or will introduce.

## **Healthcare and Privacy Related Legislation and Regulation**

We and our customers are subject to extensive and frequently changing federal and state healthcare laws and regulations. Political, economic and regulatory influences are subjecting the healthcare industry in the United States to fundamental change. Potential reform legislation may include:

mandated basic healthcare benefits;

controls on healthcare spending through limitations on the growth of private health insurance premiums and Medicare and Medicaid reimbursement;

the creation of large insurance purchasing groups;

fundamental changes to the healthcare delivery system;

enforcement actions of Federal and State privacy laws;

Medicare or Medicaid prescription benefit plans;

State licensing requirements; or

patient protection initiatives.

## **HIPAA**

HIPAA's Privacy Rule imposes extensive requirements on healthcare providers, healthcare clearinghouses, and health plans. These Covered Entities must implement standards to protect and guard against the misuse of individually identifiable health information. Certain functions of the Company have been or may be deemed to constitute a clearinghouse as defined by the Privacy Rule. However, in many instances, the Company also functions as a Business Associate of its health plan and provider customers. Among other things, the Privacy Rule requires us to adopt written privacy procedures, adopt sufficient and reasonable safeguards, and provide employee training with respect to compliance. Although we have undertaken several measures to ensure compliance with the privacy regulation and believe that we are in compliance, the privacy regulations are broad in scope, and will require constant vigilance for ongoing compliance.

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We also may be subject to state privacy laws, which may be more stringent than HIPAA in some cases.

### ***Transaction and Code Sets Compliance***

HIPAA also mandates the use of standard transactions for electronic claims and certain other healthcare transactions. The U.S. Department of Health and Human Services published regulations to govern eight of the most common electronic transactions involving health information. As a clearinghouse, we must comply with these regulations. However, covered entities, including us and our physician and payer customers, are permitted to continue to process non-compliant transactions after October 16, 2003 so long as that covered entity is compliant with the contingency planning guidelines provided by the CMS.

### ***Security Compliance***

HIPAA's Security Rule imposes standards for the security of electronic protected health information. The effective date for the Security Rule was April 20, 2005. We have implemented physical, technical and administrative safeguards for the protection of electronic protected health information. The Security Rule also introduced the concept of an addressable implementation standard, which requires ongoing vigilance to ensure that employed safeguards are sufficient given current technology capabilities and threats and reasonable industry expectations. Current internal and external security auditing procedures have addressed both the required and the addressable implementation specifications by conducting risk assessments and implementing appropriate safeguards to mitigate any apparent gaps.

### ***Identifiers***

On January 24, 2004 rules on implementation of a national provider identification number were published. This rule mandates the use of a single identifier for all healthcare providers throughout the United States by 2007. Because our customers use a variety of identification numbers today, we anticipate some modification to our transaction handling formats and processes to handle a new single identifier. Alterations to our systems will require some development cost, and we could lose customers if we are not ready on time to handle the national provider identifier.

### ***Gramm-Leach-Bliley***

Some of our customers may also be subject to the federal Gramm-Leach-Bliley Act, relating to certain disclosures of nonpublic personal health information and nonpublic personal financial information by insurers and health plans.

### ***Internet Privacy and Regulation***

Another area in which regulatory developments may impact the way we do business is privacy and other federal, state and local regulations regarding the use of the Internet. We offer a number of Internet-related products. Internet user privacy and the extent to which consumer protection and privacy laws apply to the Internet is an area of uncertainty in which future regulatory, judicial and legislative developments may have a significant impact on the way we do business, including our ability to collect, store, use and transmit personal information. Internet activity has come under heightened scrutiny in recent years, including several investigations in the healthcare industry by various state and federal agencies, including the Federal Trade Commission.

### ***Patient/Consumer Protection Initiatives***

State and federal legislators and regulators have proposed initiatives to protect consumers covered by managed care plans and other health coverage. These initiatives may result in the adoption of laws related to timely claims payment and review of claims determinations. These laws may impact the manner in which we perform services for our clients.



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### ***Provider Contracting and Claims Regulation***

Some state legislatures have enacted statutes that govern the terms of provider network discount arrangements and/or restrict unauthorized disclosure of such arrangements. Legislatures in other states are considering adoption of similar laws. Although we believe that we operate in a manner consistent with applicable provider contracting laws, there can be no assurance that we will be in compliance with laws or regulations to be promulgated in the future, or with new interpretations of existing laws.

Many of our customers perform services that are governed by numerous other federal and state civil and criminal laws, and in recent years have been subject to heightened scrutiny of claims practices, including fraudulent billing and payment practices. Many states also have enacted regulations requiring prompt claims payment. To the extent that our customers' reliance on any of the services we provide contributes to any alleged violation of these laws or regulations, then we could be subject to indemnification claims from its customers or be included as part of an investigation of its customers' practices. Federal and state consumer laws and regulations may apply to us when we provide claims services and a violation of any of these laws could subject us to fines or penalties.

### ***Licensing Regulation***

We are subject to certain state licensing requirements for the services we provide through NPPN. Some states require our PPO business to formally register and file an annual or one-time accounting of networks and providers with which we contract. Given the rapid evolution of healthcare regulation, it is possible that we will be subject to future licensing requirements in any of the states where we currently perform services, or that one or more states may deem our activities to be analogous to those engaged in by other participants in the healthcare industry that are now subject to licensing and other requirements, such as third party administrator or insurance regulations. Moreover, laws governing participants in the healthcare industry are not uniform among states. As a result, we may have to undertake the expense and difficulty of obtaining any required licenses, and there is a risk that we would not be able to meet the licensing requirements imposed by a particular state. It also means that we may have to tailor our products on a state-by-state basis in order for our customers to be in compliance with applicable state and local laws and regulations.

### **Summary**

We anticipate that Congress and state legislatures will continue to review and assess alternative healthcare delivery systems and payment methods, as well as Internet and healthcare privacy legislation, and that public debate of these issues will likely continue in the future. Because of uncertainties as to these reform initiatives and their enactment and implementation, we cannot predict which, if any, of such reform proposals will be adopted, when they may be adopted or what impact they may have on us.

While we believe our operations are in material compliance with applicable laws as currently interpreted, the regulatory environment in which we operate may change significantly in the future, which could restrict our existing operations, expansion, financial condition or opportunities for success.

Additional current HIPAA and privacy compliance information can be found on our website at [www.medavanthealth.com](http://www.medavanthealth.com).

### **Intellectual Property and Technology**

In large part, our success is dependent on our proprietary information and technology. We rely on a combination of contracts, copyright, trademark and trade secret laws and other measures to protect our proprietary information and technology. We have rights under a number of patent applications filed by us or our acquired entities, in addition to

rights under various trademarks and trademark applications. We acquired a number of copyright registrations covering our various software and proprietary products. As part of our confidentiality procedures, we generally enter into nondisclosure agreements with our employees, distributors and customers, and limit access to and distribution of our software, databases, documentation and other proprietary information. We cannot assure that the steps taken by us will be adequate to deter misappropriation of our proprietary rights or that third parties will not independently develop substantially similar products, services and technology. Although we

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believe our products, services and technology do not infringe on any proprietary rights of others, as the number of software products available in the market increases and the functions of those products further overlap, we and other software and Internet developers may become increasingly subject to infringement claims. These claims, with or without merit, could result in costly litigation or might require us to enter into royalty or licensing agreements, which may not be available on terms acceptable to us.

## **Employees**

As of December 31, 2005 we employed 388 employees. We are not and never have been a party to a collective bargaining agreement. We consider our relationship with our employees to be good.

## **Available Information**

Our Internet address is [www.medavanthealth.com](http://www.medavanthealth.com). We make available free of charge on or through our Internet website our annual report on Form 10-K, 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 Securities and Exchange Commission.

## **ITEM 1A. RISK FACTORS**

### **FACTORS THAT MAY AFFECT FUTURE RESULTS OF OPERATIONS FINANCIAL CONDITION OR BUSINESS**

As discussed under the caption, Cautionary Statements Pursuant to the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995 in Item 7, certain statements in the Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report that are not related to historical results are forward looking statements. Forward-looking statements present our expectations or forecasts of future events. You can identify these statements 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 words and terms of similar meaning. Actual results may differ materially from those projected or implied in the forward-looking statements. Subsequent written and oral forward looking statements attributable to us or to persons acting on our behalf are expressly qualified in their entirety by the cautionary statements and risk factors set forth below and elsewhere in this report and in other reports filed by us with the Securities and Exchange Commission. We disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of this report.

## **Risks Related to Acquisitions**

*Our business will suffer if we fail to successfully integrate into our business the customers, products, and technology of the companies we acquire.*

We have undertaken several acquisitions in the past few years as part of a strategy to expand our business, and we may continue in the future to acquire businesses, assets, services, products, and technologies from other persons or entities. The anticipated efficiencies and other benefits to be derived from these acquisitions and future acquisitions may not be realized if we are unable to successfully integrate the acquired businesses into our operations, including customers, personnel, product lines, and technology. We are in the process of integrating into our operations, the customers, products, personnel and technology of our prior acquisitions, including MedUnite, Inc. ( MedUnite ) and PlanVista Corporation ( PlanVista ). We may not be able to successfully integrate our past acquisitions, including



MedUnite and PlanVista, or any future acquired businesses into our operations. Integration of acquired businesses can be expensive, time consuming, and may strain our resources. Integration may divert management's focus and attention from other business concerns and expose us to unforeseen liabilities and risks. We may also lose key employees, strategic partners, and customers as a result of our inability to successfully integrate in a timely manner or as a result of relationships the acquired businesses may have with our competitors or

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the competitors of our customers and strategic partners. Some challenges we face in successfully integrating past and future acquired businesses into our operations include:

- conflicts or potential conflicts with customers, suppliers, and strategic partners;
- integration of platforms, product lines, networks, and other technology;
- migration of new customers and products to our existing network;
- ability to cross-sell products and services to our new and existing customer base;
- retention of key personnel;
- consolidation of accounting and administrative systems and functions;
- coordinating new product and process development;
- increasing the scope, geographic diversity and complexity of operations;
- difficulties in consolidating facilities and transferring processes and know-how; and
- other difficulties in the assimilation of acquired operations, technologies or products.

***Businesses we acquire may have undisclosed liabilities or contingent liabilities that are indeterminable and which may have a negative impact on our results of operations and require unanticipated expense.***

In pursuing our acquisition strategy, our investigations of the acquisition candidates may fail to discover certain undisclosed liabilities of the acquisition candidates, or may determine that certain contingent liabilities are indeterminable. If we acquire a company having undisclosed liabilities, as a successor owner we may be responsible for such undisclosed liabilities. If we acquire a company with liabilities that are indeterminable at the time of the acquisition, we may be required to make subsequent payments that could have a material adverse effect on our business. PlanVista did not indemnify us in connection with the merger between the Company and PlanVista in March 2004. In connection with the MedUnite acquisition, we have only limited indemnification rights that may not be sufficient in amount or scope to offset losses resulting from unknown and undisclosed liabilities. Furthermore, the introduction of new products and services from acquired companies may have a greater risk of undetected or unknown errors, bugs, or liabilities than our historic products.

***We may lose customers as a result of acquisitions which may have an adverse impact on our business or operations.***

Acquisitions may cause disruptions in our business or the business of the acquired company, which could have material adverse effects on our business and operations.

In addition, our customers, licensors and other business partners, in response to an acquisition or merger, may adversely change or terminate their relationships with us, which could have a material adverse effect on us. Certain of our current or potential customers may cancel or defer requests for our services. In addition, our customers may expect preferential pricing as a result of an acquisition or merger. An acquisition or merger may also adversely affect our ability to attract new customers which may have an adverse impact on our business or operations.

## **Risks Related to Our Industry**

*Government regulation and new legislation may have a negative impact on our business and results of operations.*

The healthcare industry is highly regulated and is subject to extensive and frequently changing federal and state healthcare laws. Several state and federal laws, including without limitation, the Health Insurance Portability and Accountability Act of 1996, commonly referred to as HIPAA, govern the collection, dissemination, use and confidentiality of patient healthcare information. The privacy regulations in particular are broad in scope, and will require constant vigilance for ongoing compliance. We cannot guarantee that we will be in compliance in the future.

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HIPAA also mandates the use of standard transactions, standard provider identifiers, security requirements and other provisions for electronic healthcare claims transactions. However, the Centers for Medicare and Medicaid Services, commonly referred to as CMS, announced that it would not take enforcement action against covered entities, such as us and our physician and payer customers, that continue to process non-compliant transactions after October 16, 2003 so long as we are making good faith efforts to become compliant and are operating under the contingency planning guidelines provided by CMS. Approximately 98% of our outbound transactions sent to payers are in a HIPAA-compliant format. However, in contrast, approximately 85% of our inbound transactions from our provider customers are being received in a legacy format, and are being translated by us on behalf of these customers.

Our contracts with our customers, strategic partners, providers, payers and other healthcare entities mandate or will mandate that our products and services be HIPAA compliant. If our products and services are not in compliance with HIPAA or any other alternative guidelines issued by the CMS on an ongoing basis, our customers, strategic partners, and other healthcare providers with whom we contract may terminate their contracts with us or sue us for breach of contract. Additionally, our revenues may be reduced as some of our non-compliant payer partners may be forced to accept paper-based transactions for which we may not be the recipient for processing. We may be subject to penalties for non-compliance by federal and state governments, and patients who believe that their confidential health information has been misused or improperly disclosed may have certain causes of actions under applicable state privacy or HIPAA-like laws against us, our partners or customers.

We may not be able to maintain compliance with HIPAA standards for transaction formats, provider identifiers and security. Any failure to be in compliance could result in regulatory penalties being assessed against us, and weaken demand for our affected services.

***There are a significant number of state initiatives regarding healthcare services. If we are unable to comply with the standards set by the states in which we operate, we or our operations could be harmed.***

In our Transaction Services segment, we contract with multiple Preferred Provider Organization networks, referred to as PPO s. These PPO networks are typically governed by the laws and regulations of the states in which they operate, in addition to federal Employee Retirement Income Security Act legislation, referred to as ERISA. Over the last few years, a number of states have been actively changing their laws and regulations governing PPOs, and this trend may continue. It is difficult to determine when ERISA preemption of state PPO law applies. Our failure to comply with existing state laws or any new laws in the future could jeopardize our ability to continue business in the affected states, which would reduce our revenues. In addition, compliance with additional regulation could be expensive and reduce our income.

***We are dependent on the growth of the Internet and electronic healthcare information markets.***

Many of our products and services are geared toward the Internet and electronic healthcare information markets. The perceived difficulty of securely transmitting confidential information over the Internet has been a significant barrier to conducting e-commerce and engaging in sensitive communications over the Internet. Our strategy relies in part on the use of the Internet to transmit confidential information. Any well-publicized compromise of Internet security may deter people from using the Internet to conduct transactions that involve transmitting confidential healthcare information and this may result in significantly lower revenues and operating income.

## **Risks Related to Our Business**

### ***General:***

*Recent management changes may disrupt our operations, and we may not be able to retain key personnel or replace them when they leave.*

Since May 2005, we have experienced a number of changes in our senior management, including changes in our Chief Executive Officer, Chief Financial Officer, and President and Chief Operating Officer. John G. Lettko assumed the position of Chief Executive Officer effective May 10, 2005. Douglas O Dowd became our interim

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Chief Financial Officer effective August 16, 2005, and was subsequently appointed as Chief Financial Officer in October 2005. Mr. Lettko has also been appointed President, and Mr. O Dowd was appointed Treasurer, each as of October 27, 2005. On June 9, 2005, we announced the resignation of Nancy J. Ham as President and Chief Operating Officer. Ms. Ham has not been replaced. On January 7, 2006, we entered into an agreement with David Oles pursuant to which Mr. Oles would resign as our General Counsel effective January 31, 2006, and terminate his employment agreement. These senior management changes could disrupt our ability to manage our business as we transition to and integrate a new management team, and any such disruption could adversely affect our operations, growth, financial condition and results of operations.

Additionally, although we have entered into employment agreements with many of our senior executives, the loss of any of their services could cause our business to suffer. Our success is also dependent upon our ability to hire and retain qualified operations, development and other personnel. Competition for qualified personnel in the healthcare information services industry is intense, and we cannot assure that we will be able to hire or retain the personnel necessary for our planned operations.

*We may not prevail in ongoing litigation and may be required to pay substantial damages.*

Our business entities are party to various legal actions as either plaintiff or defendant in the ordinary course of business. The ultimate outcome of these actions is uncertain. If we are not successful in these actions, we could be subject to monetary damages that could reduce our cash flows and results of operations. In addition, we will continue to incur additional legal costs in connection with pursuing and defending such actions. See footnote 17 of our consolidated financial statements concerning ongoing litigation matters.

*We have senior and subordinated debt that matures in December 2008 and 2010.*

We have senior and subordinated debt that matures in December 2008 and 2010. We currently do not have the resources to repay this debt in full. If we are unable to obtain additional funding to repay or refinance our senior and subordinated debt prior to maturity, the lenders could foreclose and take certain other action against us, the effect on our operations and stock price could be significantly negative and we may be unable to continue as a going concern.

***Transaction Services Segment:***

*Changes that reduce payer compensation for electronic claims may reduce our revenue and margins.*

Several payers recently terminated existing arrangements under which they paid us for electronic claims we submitted to them on behalf of our submitter customers. If we are unable to shift the cost of these claims to the submitting providers and vendors, or to enter into new payment arrangements with the payers for the affected claim volume, then our revenue will be reduced.

*As electronic transaction processing penetrates the healthcare industry more extensively, we will face increasing pressure to reduce our prices which may cause us to no longer be competitive.*

As electronic transaction processing extensively penetrates the healthcare market or becomes highly standardized, competition among electronic transaction processors will focus increasingly on pricing. This competition is putting intense pressure on us to reduce our pricing in order to retain market share. If we are unable to reduce our costs sufficiently to offset declines in our prices, or if we are unable to introduce new, innovative service offerings with higher margins, our results of operations could decline.

*Consolidation in the healthcare industry may give our customers greater bargaining power and lead us to reduce our prices.*

Many healthcare industry participants are consolidating to create integrated healthcare delivery systems with greater market power. As provider networks and managed care organizations consolidate, competition to provide products and services such as those we provide will become more intense, and the importance of establishing and maintaining relationships with key industry participants will become greater. These industry participants may try to

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use their market power to negotiate price reductions for our products and services. If we are forced to reduce prices, our margins will decrease, unless we are able to achieve corresponding reductions in expenses.

*Our business will suffer if we are unable to successfully integrate acquired IT platforms or if our existing Phoenix<sup>SM</sup> platform is unstable or unable to accommodate our clients' needs.*

Our business is dependent on the successful integration of operating platforms we have designed and acquired to provide a high quality service at a competitive cost to our customers. To the extent that we are unable to consolidate those acquired platforms without significant disruption to our customers, our business or our operations could be harmed. Additionally, if our Phoenix<sup>SM</sup> platform that is the backbone of our EDI business is unstable or does not provide satisfactory outcomes to a significant number of clients, our business and our operations will be harmed.

*Our business and future success may depend on our ability to cross-sell our products and services.*

Our ability to generate revenue and growth partly depends on our ability to cross-sell our products and services to our existing customers and new customers resulting from acquisitions. Our ability to successfully cross-sell our products and services is one of the most significant factors influencing our growth. We may not be successful in cross-selling our products and services, and our failure in this area would likely have an adverse effect on our business.

*We depend on connections to insurance companies and other payers, and if we lose these connections, our service offerings would be limited and less desirable to healthcare providers.*

Our business depends upon a substantial number of payers, such as insurance companies, Medicare and Medicaid agencies, to which we have electronic connections. These connections may either be made directly or through a clearinghouse. We may not be able to maintain our links with all these payers on terms satisfactory to us. In addition, we cannot assure that we will be able to develop new connections, either directly or through clearinghouses, on satisfactory terms. Lastly, some third-party payers provide systems directly to healthcare providers, bypassing us and other third-party processors. Our failure to maintain existing connections with payers and clearinghouses or to develop new connections as circumstances warrant, or an increase in the utilization of direct links between providers and payers, could cause our electronic transaction processing system to be less desirable to healthcare participants, which would slow down or reduce the number of transactions that we process and for which we are paid.

*We have important business relationships with other companies to market and sell some of our clinical and financial products and services. If these companies terminate their relationships with us, or are less successful in the future, we will need to add this emphasis internally, which may divert our efforts and resources from other projects.*

For the marketing and sale of some of our products and services, we entered into important business relationships with physician office management information system vendors, with electronic medical record vendors, and with other distribution partners. These business relationships, which have required and may continue to require significant commitments of effort and resources, are an important part of our distribution strategy and generate substantial recurring revenue. Most of these relationships are on a non-exclusive basis. We may not be able to continue our relationships with our electronic commerce partners and other strategic partners, most of whom have significantly greater financial and marketing resources than we do. Also, our arrangements with some of our partners involve negotiated payments to the partners based on percentages of revenues generated by the partners. If the payments prove to be too high, we may be unable to realize acceptable margins, but if the payments prove to be too low, the partners may not be motivated to produce a sufficient volume of revenues. The success of our important business relationships will depend in part upon our partners' own competitive, marketing and strategic considerations, including the relative advantages of alternative products being developed and marketed by such partners. If any such partners are unsuccessful in marketing our products, we will need to place added emphasis on these aspects of our business



internally, which may divert our planned efforts and resources from other projects.

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*A significant amount of our revenues in our Transaction Services segment is from one party. Loss of this relationship may adversely affect our profitability.*

NDCHealth Corporation, referred to as NDCHealth, represents approximately 8.0%, 8.0% and 15.0% of our consolidated revenues for the years ended December 31, 2005, 2004 and 2003, respectively and 10%, 10% and 10% of our Transaction Services revenues for the same periods. The relationship with NDCHealth is an important one and provides us with a base of physicians who utilize our services. Loss of this relationship without any ability to contact these physicians directly may significantly reduce our revenues and operating profits.

*The adoption of electronic processing of clinical transactions in the healthcare industry is proceeding slowly; thus, the future of our business is uncertain which may have an adverse impact on our business or operations.*

Our strategy anticipates that electronic processing of clinical healthcare transactions, including transactions involving prescriptions and laboratory results, will become more widespread and that providers and third-party institutions increasingly will use electronic transaction processing networks for the processing and transmission of data. The rate at which providers adopt the use of electronic transmission of clinical healthcare transactions (and, in particular, the use of the Internet to transmit them) continues to be slow, and the continued or accelerated conversion from paper-based transaction processing to electronic transaction processing in the healthcare industry, using proprietary healthcare management systems or the Internet, may not occur.

*An error by us in the process of providing clinical connectivity or transmitting prescription and laboratory data could result in substantial injury to a patient, and our liability insurance may not be adequate in a catastrophic situation which may have an adverse impact on our business or operations.*

Our business exposes us to potential liability risks that are unavoidably part of being in the healthcare electronic transaction processing industry. Since some of our products and services relate to the prescribing and refilling of drugs and the transmission of medical laboratory results, an error by any party in the process could result in substantial injury to a patient. As a result, our liability risks are significant.

Our insurance may be insufficient to cover potential claims arising out of our current or proposed operations, and sufficient coverage may not be available in the future at a reasonable cost. A partially or completely uninsured claim against us, if successful and of sufficient magnitude, would have significant adverse financial consequences. Our inability to obtain insurance of the type and in the amounts we require could generally impair our ability to market our products and services.

*Our businesses have many competitors.*

We face competition from many healthcare information systems companies and other technology companies. Many of our competitors are significantly larger and have greater financial resources than we do and have established reputations for success in implementing healthcare electronic transaction processing systems. Other companies have targeted this industry for growth, including the development of new technologies utilizing Internet-based systems. We may not be able to compete successfully with these companies, and these or other competitors may commercialize products, services or technologies that render our products, services or technologies obsolete or less marketable.

*Our PPO and provider arrangements provide no guarantee of long-term relationships.*

The majority of our contracts with PPOs and providers can be terminated without cause, generally on 90 days' notice. For our Transaction Services business, the loss of any one provider may not be material, but if large numbers of providers chose to terminate their contracts, our revenues and net income could be materially adversely affected. The

termination of any PPO contract would render us unable to provide our customers with network access to that PPO, and therefore would adversely affect our ability to reprice claims and derive revenues. Furthermore, we rely on our participating PPOs and provider groups to ensure participation by their providers. Our PPO contracts generally do not provide us with a direct recourse against a participating provider that chooses not to honor its obligation to provide a discount, or chooses to discontinue its participation in our National Preferred Provider Network, referred

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to as NPPN. Termination of provider contracts or other changes in the manner in which these parties conduct their business could negatively affect our ability to provide services to our customers.

*Some providers have historically been reluctant to participate in secondary networks.*

Our percentage of savings business model sometimes allows a payer to utilize our network discounts in circumstances where our NPPN is not the payer's primary network. In these circumstances, NPPN participating providers are not traditionally given the same assurances of patient flow that they receive when they are part of a primary network. Historically, some providers have been reluctant to participate in network arrangements that do not provide a high degree of visibility to patients. Although the steerage provided by our payers as a whole and the speed and efficiency with which we provide claims repricing services makes NPPN affiliation an attractive option for providers, our business model could discourage providers from commencing or maintaining an affiliation with NPPN.

*Our cost containment accounts receivable are subject to adjustment.*

We generally record revenue for our services when the services are performed, less amounts reserved for claim reversals and bad debts. The estimates for claim reversals and bad debts are based on judgment and historical experience. Many of the claims are not fully adjudicated for over 90 days. To the extent that actual claim reversals and bad debts associated with our business exceed the amounts reserved, such difference could have a material adverse impact on our results of operations and cash flows.

### ***Laboratory Services Segment:***

*Our Laboratory Services Communications Segment has a high customer concentration.*

We currently have more than 50% of our sales to one customer. If this customer chooses to do business with a competitor or chooses to handle the business on its own, the loss of the associated revenue could substantially harm our business.

### **Risks Related to Our Technology**

***Evolving industry standards and rapid technological changes could result in our products becoming obsolete or no longer in demand.***

Rapidly changing technology, evolving industry standards and the frequent introduction of new and enhanced Internet-based services characterize the market for our products and services. Our success will depend upon our ability to enhance our existing services, introduce new products and services on a timely and cost-effective basis to meet evolving customer requirements, achieve market acceptance for new products or services and respond to emerging industry standards and other technological changes. We may not be able to respond effectively to technological changes or new industry standards. Moreover, other companies may develop competitive products or services, or that any such competitive products or services will not cause our products and services to become obsolete or no longer in demand.

***We depend on uninterrupted computer access for our customers; any prolonged interruptions in operations could cause customers to seek alternative providers of our services.***

Our success is dependent on our ability to deliver high-quality, uninterrupted computer networking and hosting, requiring us to protect our computer equipment and the information stored in servers against damage by fire, natural disaster, power loss, telecommunications failures, unauthorized intrusion and other catastrophic events.

While we still continue to operate production networks in our Norcross facility, any damage or failure resulting in prolonged interruptions in our operations could cause our customers to seek alternative providers of our services. In particular, a system failure, if prolonged, could result in reduced revenues, loss of customers and damage to our reputation, any of which could cause our business to materially suffer. While we carry property and business interruption insurance to cover operations, the coverage may not be adequate to compensate us for losses that may occur.

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***Computer network systems like ours could suffer security and privacy breaches that could harm our customers and us.***

We currently operate servers and maintain connectivity from multiple facilities. Our infrastructure may be vulnerable to computer viruses, break-ins and similar disruptive problems caused by customers or other users. Computer viruses, break-ins or other security problems could lead to interruption, delays or cessation in service to our customers. These problems could also potentially jeopardize the security of confidential information stored in the computer systems of our customers, which may deter potential customers from doing business with us and give rise to possible liability to users whose security or privacy has been infringed. The security and privacy concerns of existing and potential customers may inhibit the growth of the healthcare information services industry in general, and our customer base and business in particular. A significant security breach could result in loss of customers, loss of revenues, damage to our reputation, direct damages, costs of repair and detection and other unplanned expenses. While we carry professional liability insurance to cover such breaches, the coverage may not be adequate to compensate us for losses that may occur.

***The protection of our intellectual property requires substantial resources.***

We rely largely on our own security systems and confidentiality procedures, and employee nondisclosure agreements for certain employees to maintain the confidentiality and security of our proprietary information, including our trade secrets and internally developed computer applications. If third parties gain unauthorized access to our information systems, or if anyone misappropriates our proprietary information, this may have a material adverse effect on our business and results of operations. We are in the process of acquiring patent protection for our Phoenix<sup>SM</sup> technology and other proprietary technology, however we have not traditionally sought patent protection for our technology. Trade secret laws offer limited protection against third party development of competitive products or services. Because we lack the protection of registered copyrights for our internally-developed software and software applications, we may be vulnerable to misappropriation of our proprietary technology by third parties or competitors. The failure to adequately protect our technology could adversely affect our business.

***We may be subject to infringement claims.***

As our competitors' healthcare information systems increase in complexity and overall capabilities, and the functionality of these systems further overlap, we could be subject to claims that our technology infringes on the proprietary rights of third parties. These claims, even if without merit, could subject us to costly litigation and could require the resources, time, and attention of our technical, legal, and management personnel to defend. The failure to develop non-infringing technology or trade names, or to obtain a license on commercially reasonable terms, could adversely affect our operations and revenues.

***We are currently involved in a trademark dispute with Metavante Corporation that may limit our ability to use our new name.***

We have recently been sued by Metavante Corporation over our use of the tradename MedAvant. We are defending this case vigorously. If we are unsuccessful, we may incur damages or have to limit or curtail further use of the MedAvant mark. Loss of the mark would require us to incur the cost to develop and implement a new mark, and may reduce our ability to compete effectively in the marketplace, and reduce our revenue.

***If our ability to expand our network infrastructure is constrained, we could lose customers, and that loss could adversely affect our operating results.***

We must continue to expand and adapt our network and technology infrastructure to accommodate additional users, increased transaction volumes, and changing customer requirements. We may not be able to accurately project the rate or timing of increases, if any, in the volume of transactions we process, reprice or otherwise service or be able to expand and upgrade our systems and infrastructure to accommodate such increases. We may be unable to expand or adapt our network infrastructure to meet additional demand or our customers' changing needs on a timely basis, at a commercially reasonable cost or at all. Our current information systems, procedures and controls may not continue to support our operations while maintaining acceptable overall performance and may hinder our

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ability to exploit the market for healthcare applications and services. Service lapses could cause our users to switch to the services of our competitors.

### **Risks Related to Our Stock**

***We incurred losses in 2003, 2004 and 2005. We may not be able to generate positive earnings in the future and this could have a detrimental effect on the market price of our stock.***

In the last three years we have incurred substantial losses, including losses of \$105.3 million for the year ended December 31, 2005, \$3.8 million for the fiscal year ended December 31, 2004, and \$5.0 million in the fiscal year ended December 31, 2003. As of December 31, 2005, December 31, 2004 and December 31, 2003, we had an accumulated deficit of \$209.4 million, \$104.1 million and \$100.3 million, respectively. Continued shortfalls could deplete our cash reserves, making it difficult for us to obtain credit at a favorable rate, or continue investing in infrastructure we need to compete in the future. Continued shortfalls may also cause our share price to decline.

***An inability to maintain effective internal controls over financial reporting as required by the Sarbanes-Oxley Act of 2002 could have an adverse affect on our stock price.***

Our certification that we have sufficient internal controls in place today is no guarantee that we will maintain those controls in the future or that those controls will be effective in ensuring the accuracy of the financial reports. An inability to maintain effective controls or our receiving an adverse or qualified opinion on the effectiveness of our internal controls from our independent registered public accounting firm could have a negative impact on our stock price.

***We may issue additional shares that could adversely affect the market price of our Common Stock.***

Certain events over which you have no control could result in the issuance of additional shares of our Common Stock which would dilute your ownership percentage in the Company and could adversely affect the market price of our Common Stock. We may issue additional shares of Common Stock or Preferred Stock for many reasons including:

to raise additional capital or finance acquisitions;

upon the exercise or conversion or an exchange of outstanding options, warrants and shares of convertible preferred stock; or

in lieu of cash payment of dividends.

In addition, the number of shares of common stock that we are required to issue in connection with our outstanding warrants may increase if certain anti-dilution events occur (such as, certain issuances of common stock, options and convertible securities).

***The trading price of our common stock may be volatile.***

The stock market, including the Nasdaq National Market, on which the shares of our common stock are listed, has from time to time experienced significant price and volume fluctuations that may be unrelated to the operating performance of particular companies. In addition, the market price of our common stock, like the stock prices of many publicly traded companies in the healthcare industry, has been and may continue to be highly volatile.

## **ITEM 1B. UNRESOLVED STAFF COMMENTS.**



None

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Our significant offices are located as followed:

<b>Business Segment</b>	<b>Location (1)</b>	<b>Description</b>	<b>Approximate Square Footage</b>
<b>Transaction Services</b>	Norcross, Georgia	Corporate headquarters/ operations office/data center	31,200
	Santa Ana, California	Operations office/data center	16,900
	Tampa, Florida	Operations office	8,200
	Middletown, New York	Operations office/data center	26,900
	Fort Lauderdale, Florida	Operations office	6,000
<b>Laboratory Communication Solutions</b>	Jeffersonville, Indiana	Operations office/warehouse	32,000

(1) All locations are leased from a third party.

We also maintain portions of our Phoenix<sup>SM</sup> network at a secure, third-party co-location center in Atlanta, Georgia. In addition, we also lease several mini-warehouses. Our leases and subleases generally contain renewal options and require us to pay base rent, plus property taxes, maintenance and insurance. We consider our present facilities adequate for our operations. In December 2005, we entered into a Sublease Agreement subletting out our entire Tampa office facility to a third-party beginning February 2006. We recently moved our Tampa offices in March 2006 to a 4,500 square foot facility. Also, in December 2005, we signed a lease for the Fort Lauderdale location for approximately 6,000 square feet.

**ITEM 3. LEGAL PROCEEDINGS**

From time to time, we may become party to other legal proceedings in the ordinary course of business. We, however, do not expect such other legal proceedings to have a material adverse effect on our financial condition, operating results and liquidity.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

There were no matters submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2005.

**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock trades on the National Market tier of The Nasdaq Stock Market under the symbol **PILL**. The following table sets forth the high and low sale prices of our Common Stock for the periods indicated.

**2005:**

First Quarter	\$ 10.74	\$ 7.81
Second Quarter	\$ 8.69	\$ 5.75
Third Quarter	\$ 7.97	\$ 5.01
Fourth Quarter	\$ 5.34	\$ 3.42

**2004:**

First Quarter	\$ 20.00	\$ 16.65
Second Quarter	\$ 20.10	\$ 16.19
Third Quarter	\$ 17.20	\$ 8.77
Fourth Quarter	\$ 11.38	\$ 6.78

On March 13, 2006, the last reported sale price of our Common Stock was \$7.30 per share. As of March 14, 2006, we estimate that there were approximately 335 registered holders of record of our Common Stock. We believe that, in addition, there are beneficial owners of our Common Stock where shares are held in street name, and consequently we are unable to determine the actual number of beneficial holders of our Common Stock.

We have never paid any dividends on our common stock; however, in prior years, we have paid dividends on our Series B and Series C Preferred Stock in cash and/or in shares of our common stock pursuant to the terms of the Articles of Incorporation, as amended. We intend to retain any earnings for use in our operations and the expansion of our business, and do not anticipate paying any dividends on the common or preferred stock in the foreseeable future. The payment of dividends on our common stock is within the discretion of our Board of Directors, subject to our Articles of Incorporation, as amended. Any future decision with respect to dividends on common stock will depend on future earnings, future capital needs and our operating and financial condition, among other factors.

**Securities Authorized for Issuance Under Equity Compensation Plans**

The following table sets forth information as of December 31, 2005 related to our equity compensation plans (including the potential effect of debt instruments convertible into common stock) in effect as of that date.

Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights(1)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
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<b>Plan Category</b>	<b>(a)</b>		<b>(b)</b>	<b>(c)</b>
Equity Compensation Plans approved by security holders	1,700,415	\$	9.74	289,483
Equity Compensation Plans not approved by security holder	920,301	\$	18.36	350,654
<b>Total</b>	<b>2,620,716</b>	<b>\$</b>	<b>12.77</b>	<b>640,137</b>

(1) The description of the material terms of the non-plan issuances of equity instruments is discussed in Note 13 of the accompanying consolidated financial statements.

**Table of Contents****Recent Sales of Unregistered Securities**

On December 7, 2005, we issued 500,000 shares of our Common Stock to Laurus Master Funds, Ltd. in connection with the extension of a \$5.0 million secured term loan and a \$15.0 million secured revolving credit facility.

The offer and sale of these securities was deemed to be exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act and/or Regulation D promulgated thereunder as a transaction by the issuer not involving a public offering. The recipient of these securities represented its intention to acquire the securities for investment only and not with a view to distribution, and appropriate legends were affixed to the share certificates issued in such transaction.

**ITEM 6. SELECTED FINANCIAL DATA**

The following table sets forth selected consolidated financial information for MedAvant as of and for each of the five years in the period ended December 31, 2005, and has been derived from our audited consolidated financial statements.

The data set forth below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our Consolidated Financial Statements and related notes.

	<b>Year Ended December 31,</b>				
	<b>2005</b>	<b>2004(1)</b>	<b>2003(2)</b>	<b>2002</b>	<b>2001</b>
	<b>(In thousands except for share and per share amounts)</b>				
<b>STATEMENT OF OPERATIONS DATA:</b>					
Net Revenues	\$ 77,519	\$ 90,246	\$ 71,556	\$ 50,182	\$ 43,230
Operating loss	\$ (103,177)	\$ (1,974)	\$ (3,642)	\$ (1,340)	\$ (6,712)
Loss from continuing operations	\$ (105,294)	\$ (3,800)	\$ (5,000)	\$ (1,950)	\$ (6,798)
Net loss applicable to common shareholders	\$ (105,294)	\$ (3,800)	\$ (5,000)	\$ (1,338)	\$ (19,060)
<b>PER SHARE DATA:</b>					
Basic and diluted net loss per share of common stock:					
Loss from continuing operations	\$ (8.29)	\$ (0.33)	\$ (0.74)	\$ (0.21)	\$ (8.81)
Net loss	\$ (8.29)	\$ (0.33)	\$ (0.74)	\$ (0.21)	\$ (8.81)
Basic and diluted weighted average common shares outstanding	12,707,695	11,617,601	6,783,742	6,396,893	2,162,352
<b>DIVIDEND DATA:</b>					
Dividends on cumulative preferred stock	\$	\$	\$	\$	\$ 1,665

	2005	2004	December 31, 2003	2002	2001
<b>BALANCE SHEET DATA:</b>					
Working capital (deficiency)	\$ 15	\$ (1,664)	\$ 10,512	\$ 8,749	\$ 9,393
Convertible notes	\$ 13,137	\$ 13,137	\$ 13,137	\$ 13,400	\$
Other long-term obligations	\$ 5,898	\$ 1,069	\$ 3,518	\$ 2,581	\$ 442
Total assets	\$ 75,641	\$ 184,403	\$ 73,130	\$ 88,704	\$ 35,882
Stockholders' equity	\$ 32,904	\$ 135,082	\$ 45,778	\$ 50,735	\$ 22,873

(1) includes operations of PlanVista from March 2, 2004

(2) includes operations of MedUnite from January 1, 2003

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**ITEM 7. 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 and notes thereto included in Part IV of this Form 10-K and to provide an understanding of our consolidated 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 we completed in the last three years, and provides a brief overview of our operating segments.

*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.

*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 were incorporated in Florida in 1989. In December 2005, we began doing business under a new operating name, MedAvant Healthcare Solutions. Our newly launched corporate identity unites all business units and employees under one brand identity ( MedAvant ) and is one of several outcomes resulting from a strategic analysis we completed in the third quarter of 2005 following the acquisition of seven companies between 1997 and 2004.

Since May 2005, we have experienced a number of changes in our senior management, including changes in our Chief Executive Officer, Chief Financial Officer, and President and Chief Operating Officer. John G. Lettko assumed the position of Chief Executive Officer effective May 10, 2005. Douglas O Dowd became our interim Chief Financial Officer effective August 16, 2005, and was subsequently appointed as Chief Financial Officer in October 2005. Mr. Lettko has also been appointed President and Mr. O Dowd was appointed Treasurer, each as of October 27, 2005. On June 9, 2005, we announced the resignation of Nancy J. Ham as President and Chief Operating Officer. On January 7, 2006, we entered into an agreement with David Edward Oles pursuant to which Mr. Oles would resign as General Counsel of the Company effective January 31, 2006, and terminate his employment agreement.

We are a healthcare transaction services company providing healthcare transaction processing, medical cost containment services, business process outsourcing solutions and related value-added products to physicians, payers, pharmacies, medical laboratories, and other healthcare suppliers. Our broad existing connectivity to payers and providers positions us as the second largest independent medical claims clearinghouse in the industry, serving more than 150,000 providers. Our cost containment business has the second largest Preferred Provider Organization in

terms of reach with more than 450,000 providers contracted, and currently is sixth in terms of managed care lives accessed through us.

Our business strategy is to leverage our leadership position in transaction services to establish ourselves as the premier provider of automated financial, clinical, cost containment, business outsourcing and administrative transaction services primarily between healthcare providers and payers, clinical laboratories and pharmacies.



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Our electronic transaction processing services support a broad range of financial, clinical, and administrative transactions. To facilitate these services, we are completing the conversion of all of our non-clinical Electronic Data Interchange clients to Phoenix .

Our cost containment and business outsourcing solutions businesses are included in the Transaction Services segment since our acquisition of PlanVista Corporation in March 2004 and are directed toward the medical insurance and managed care industries. Specifically, we provide integrated national Preferred Provider Organization, also known as PPO, network access, electronic claims repricing, and network and data management to healthcare payers, including self-insured employers, medical insurance carriers, PPOs and third party administrators.

We believe we are uniquely positioned in the marketplace to make a contribution that our competitors do not. The differentiators include our open electronic network for electronic transactions with no equity ownership in businesses engaged in the front-end (i.e., physician practice management software system vendors and other physician desk top vendors) or in the back-end (i.e., payers, laboratories and pharmacies). With our neutral position, we believe that we can better attract both front-end and back-end partners who may be more comfortable doing business with a non-competitive partner.

Another competitive differentiator is our presence in the clinical market. With the nation's largest clinical laboratories as long-time customers, we have worked in partnership with them to develop customized laboratory communication tools and services that are unparalleled in the industry.

We also have the oldest and most established e-prescribing network in the nation, offering connectivity to over 30,000 pharmacies nationwide. Our e-prescribing solutions improve efficiency by eliminating the need to process prescriptions and refill authorizations via paper. We offer both a front-end desktop solution, PreScribe<sup>tm</sup>, and online refill authorization via [www.medavanthealth.com](http://www.medavanthealth.com). Combined, we process more than 400,000 prescriptions or refills per month.

## ***Acquisitions***

On December 31, 2002, we acquired all of the outstanding stock of MedUnite, Inc. for \$10 million in cash and the issuance of 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. Interest on the convertible promissory 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 of 716,968 shares (originally 731,322 shares before the claim setoff) of our Common Stock if our revenues resulting from business with the former MedUnite owners exceed certain thresholds over a three and one-half year period from the date of acquisition. We do not anticipate that the former MedUnite owners will meet all of the thresholds defined in the promissory note.

On March 2, 2004, we acquired 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 healthcare 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, totaling \$46.4 million and paid \$1.3 million in acquisition-related costs. Additionally, we raised \$24.1 million in a private placement sale of 1,691,227 shares of our Common Stock to investment entities affiliated with General Atlantic LLC, 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 acquisition has enabled us to become the only

entity in healthcare that offers a nationwide clearinghouse and a nationwide PPO network, delivering end-to-end services to our customers.

Upon completion of the acquisition, each share of PlanVista's outstanding common stock was cancelled and converted into 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,

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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 the Company following the transaction. PlanVista's operations are included in our Transaction Services segment commencing March 2004.

On February 14, 2006, we acquired substantially all the assets and operations of Zeneks, Inc., a privately held bill negotiation services company based in Tampa, Florida, for \$225,000 plus assumed liabilities. Zeneks was incorporated in 1998 and was established as a medical cost containment company. They have relationships with numerous providers throughout the country. We expect to integrate the Zeneks operations into our current bill negotiation system by the end of the first quarter of fiscal 2006.

### ***Sale of Assets***

On June 30, 2004, we sold certain assets and liabilities of our Laboratory Communication Solutions segment that were used in our non-core contract manufacturing business to a new entity owned by a former executive of the Company 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 entity 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 December 31, 2005, this remaining commitment has been reduced to \$0. Additionally, we agreed to sublease a portion of our current facilities through July 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 year ended December 31, 2004. This loss includes the value of options to purchase 10,000 shares of our Common Stock granted to the former executive at an exercise price of \$16.00 in July 2004.

### ***Financing Transactions***

On December 7, 2005, we entered into a loan transaction with Laurus Master Fund, Ltd. ( Laurus ) pursuant to which Laurus extended \$20.0 million in financing to us in the form of a \$5.0 million secured term loan and a \$15.0 million secured revolving credit facility. The term loan has a stated term of five (5) years and will accrue interest at Prime plus 2%, subject to a minimum interest rate of 8%. The term loan is payable in equal monthly principal and interest installments of approximately \$89,300 beginning April 2006 and continuing until the maturity date on December 6, 2010. The revolving credit facility has a stated term of three (3) years and will accrue interest at the 90 day LIBOR rate plus 5% payable monthly, subject to a minimum interest rate of 7%, and a maturity date of December 6, 2008 with two (2) one-year options at the discretion of Laurus. In connection with the loan agreement, we issued 500,000 shares of our Common Stock to Laurus which was valued at approximately \$2.4 million on the date of issuance. We also granted Laurus a first priority security interest in substantially all of our present and future tangible and intangible assets (including all intellectual property) to secure our obligations under the loan agreement. Due to certain acceleration clauses contained in the agreement and a lockbox arrangement, the revolving credit facility is classified as current in the accompanying consolidated balance sheet.

We used the proceeds of this loan transaction to repay our senior asset based debt facility with Wachovia Bank N.A. and for working capital.

### ***Operating Segments***

We currently operate in two reportable segments that are separately managed: Transaction Services and Laboratory Communication Solutions. Transaction Services includes transaction, cost containment and other value-added services

principally between physicians and insurance companies and physicians and pharmacies; 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. Commencing in March 2004, the operations of Plan Vista are included in our Transaction Services segment. As a result of a re-alignment of our corporate overhead functions in the second quarter of 2004, we now report these expenses as part of our Transaction Services segment. Accordingly, our corporate expenses in the comparable periods have been combined with our Transaction Services segment to facilitate a better comparison between periods in this section.

**Table of Contents****Results of Operations*****Year Ended December 31, 2005, Compared to Year Ended December 31, 2004***

*Net Revenues.* Consolidated net revenues for 2005 decreased by \$12.6 million, or 14%, to \$77.6 million from consolidated net revenues of \$90.2 million for 2004. Net revenues classified by our reportable segments are as follows:

	<b>2005</b>	<b>2004</b>
	<b>(In thousands)</b>	
Transaction Services	\$ 66,042	\$ 71,304
Laboratory Communication Solutions	11,477	18,942
	<b>\$ 77,519</b>	<b>\$ 90,246</b>

Net revenues in our Transaction Services segment for 2005 decreased by \$5.3 million, or 7%, over 2004. This decrease is primarily due to declines in volumes of electronic claims, statements and other real-time transactions processed (decrease \$1.8 million). Core transactions were down 5% compared to the prior year (see below). This negatively impacted our transaction services revenue from our EDI business that was partially offset by increased revenue from our cost containment business that was generating revenues for two additional months in 2005 compared to 2004 due to the acquisition of PlanVista in March 2004. However, our cost containment business has seen a drop in revenue per transaction as competitive pressures have impacted pricing.

For 2005, approximately 85% of our consolidated revenues came from our Transaction Services segment compared to 79% from this segment for 2004. This increase is attributable to the drop in revenue from our Laboratory Communication Solutions as a result of the sale of our manufacturing unit in June 2004.

Laboratory Communication Solutions segment net revenues for 2005 decreased by \$7.5 million, or 39%, from 2004 primarily as a result of the sale of the contract manufacturing assets in June 2004. This sale resulted in a decrease of \$4.7 million in this segments revenue in 2005 compared to 2004. Additionally, we experienced a drop in revenue from our largest customer of \$2.8 million as a result of budgeting issues with the customer. We anticipate that this revenue will remain at current levels during 2006.

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

	<b>2005</b>	<b>2004</b>
	<b>(In thousands)</b>	
Core transactions(1)	185,626	194,558
Additional core transactions	63,292	64,775
Encounters	18,349	29,172
Total transactions	267,267	288,505

(1) Includes 4.5 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 ensure 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 in 2004 and 2005.

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 Transactions above.

Encounters are administrative reporting transactions 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 analyze our quarter-over-quarter growth

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in our 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 34% for 2005 from 38% for 2004. Cost of sales classified by our reportable segments is as follows:

	<b>2005</b>	<b>2004</b>
	<b>(In thousands)</b>	
Transaction Services	\$ 20,523	\$ 22,401
Laboratory Communication Solutions	6,301	11,811
	<b>\$ 26,824</b>	<b>\$ 34,212</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 decreased by \$1.9 million, or 8%, for 2005 compared to 2004 primarily due to the 7% decrease in revenue in this segment. This decrease in cost of goods sold in 2005 would have been approximately \$1.8 million less due to the additional two months costs from PlanVista's cost containment as result of the acquisition in March 2004. As a percentage of revenues, cost of sales in this segment remained steady at 31% in 2005 and 2004.

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 for 2005 decreased \$5.5 million, or 47%, from 2004. This decrease is primarily due to the sale of our contract manufacturing assets. Cost of sales as a percentage of revenues in this segment was 55% for 2005 compared to 62% for the 2004 year.

*Selling, General and Administrative Expenses.* Consolidated SG&A remained flat for 2005 at \$48.0 million compared, to 2004. Consolidated SG&A expenses as a percentage of consolidated revenues increased to 62% in 2005 from 53% in 2004. SG&A expenses classified by our reportable segments are as follows:

	<b>2005</b>	<b>2004</b>
	<b>(In thousands)</b>	
Transaction Services	\$ 45,296	\$ 43,625
Laboratory Communication Solutions	2,666	4,398
	<b>\$ 47,962</b>	<b>\$ 48,023</b>

Transaction Services segment SG&A expenses for the year ended December 31, 2005, increased by \$1.7 million, or 4% over 2004. The primary reason for the increase was the inclusion of two additional months of expenses from the PlanVista acquisition in March 2004 of approximately \$1.8 million. Additionally, the Company incurred \$0.8 million for severance related to the reduction in work force in 2005 partially offset by lower payroll related costs for the remainder of 2005.

Laboratory Communication Solutions segment SG&A expenses for 2005 decreased by \$1.7 million, or 39% from 2004 and this segment's SG&A expenses as a percentage of segment net revenues remained steady at 23% in 2005 from 2004. The current year decrease is primarily due to a reduction in expenses of approximately \$0.9 million related to the sale of our contract manufacturing assets in June 2004.

*Impairment charges.* As a result of our stock price decline, a decrease in our revenues and a restructuring plan we initiated during the third quarter of 2005, we performed an interim goodwill impairment test as of September 30, 2005. In accordance with the provisions of SFAS No. 142, we performed a discounted cash flow analysis which indicated that the book value of the Transaction Services segment exceeded its estimated fair value. Step 2 of this impairment test, as prescribed by SFAS No. 142 led us to conclude that an impairment of our goodwill had occurred. In addition, as a result of our goodwill analysis, we also performed an impairment analysis of our long-lived assets in our Transaction Services segment in accordance with SFAS No. 144. This impairment analysis indicated that the carrying value of certain finite-lived intangible assets was greater than their expected



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undiscounted future cash flows. As a result, we concluded that these intangible assets were impaired and adjusted the carrying value of such assets to fair value. In addition, we also reduced the remaining useful lives of these intangible assets based on the foregoing analysis. Accordingly, we recorded a non-cash impairment charge of \$95.7 million at September 30, 2005 in our Transaction Services segment. The charges included \$68.1 million impairment of goodwill and \$27.6 million impairment of certain other intangibles. No further decline was noted as of our annual testing conducted at December 31, 2005.

In June 2005, we performed an impairment analysis of certain finite-lived intangible assets in our Laboratory Communication Solutions segment due to substantial decrease in revenues from one of our customers. This impairment analysis indicated that the carrying value of certain finite-lived intangible assets was greater than their expected undiscounted future cash flows. As a result, we concluded that these intangible assets were impaired and adjusted the carrying value of such assets to fair value by approximately \$0.7 million.

*Depreciation and Amortization.* Consolidated depreciation and amortization expense decreased by \$0.5 million to \$9.3 million for 2005 from \$9.8 million for 2004. Depreciation and amortization classified by our reportable segments is as follows:

	<b>2005</b>	<b>2004</b>
	<b>(In thousands)</b>	
Transaction Services	\$ 8,788	\$ 8,719
Laboratory Communication Solutions	517	823
Corporate		221
	<b>\$ 9,305</b>	<b>\$ 9,763</b>

We anticipate the Transaction Services segment depreciation will increase in 2006 as we continue to improve and consolidate our platforms. Additionally, we believe that the depreciation in the Laboratory Communication segment will stay at or near 2005 levels.

*Litigation settlement.* In September 2005 and December 2004, we settled outstanding preacquisition contingencies related to PlanVista for \$0.2 million, net of insurance reimbursement. Both amounts were recorded in our Transaction Services segment.

*Operating Income (Loss).* As a result of the foregoing, the consolidated operating loss for 2005 was (\$103.2) million compared to an operating loss of (\$2.0) million for 2004. Operating loss classified by our reportable segments is as follows:

	<b>2005</b>	<b>2004</b>
	<b>(In thousands)</b>	
Transaction Services	\$ (104,414)	\$ (2,815)
Laboratory Communication Solutions	1,238	1,938
Corporate		(1,097)
	<b>\$ (103,176)</b>	<b>\$ (1,974)</b>

*Interest Expense, net.* Consolidated net interest expense for 2005 was \$2.1 million compared to \$1.9 million for the same period last year. This increase in expense is primarily due to the accelerated amortization of prepaid financing costs on the Company's line of credit facility (\$0.1 million) that was refinanced in December 2005 coupled with higher effective interest charges on the new debt facility. Interest expense for the future is expected to be at levels above those in 2005 due to the new debt facility.

*Net Loss.* As a result of the foregoing, consolidated net loss for 2005 was (\$105.3) million compared to consolidated net loss of \$3.8 million for 2004.

**Table of Contents*****Year Ended December 31, 2004, Compared to Year Ended December 31, 2003***

*Net Revenues.* Consolidated net revenues for 2004 increased by \$18.7 million, or 26%, to \$90.2 million from consolidated net revenues of \$71.6 million for 2003. Net revenues classified by our reportable segments are as follows:

	<b>2004</b>	<b>2003</b>
	<b>(In thousands)</b>	
Transaction Services	\$ 71,304	\$ 46,673
Laboratory Communication Solutions	18,942	24,883
	<b>\$ 90,246</b>	<b>\$ 71,556</b>

Net revenues in our Transaction Services segment for 2004 increased by \$24.6 million, or 53%, over 2003. This increase is primarily due to the acquisition of PlanVista that increased revenue in this segment by \$26.9 million, offset by declines in volumes of electronic claims, statements and other real-time transactions processed (decrease \$2.1 million) and additional revenue reserves required due to a degradation in the aging of outstanding traditional accounts (increase of \$0.7 million). While core transaction growth was down 1.4% compared to the prior year (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 2004, approximately 79% of our consolidated revenues came from our Transaction Services segment compared to 65% from this segment for 2003. This increase is due to the inclusion of PlanVista revenue in March 2004 and the sale of the contract manufacturing assets in June 2004.

Laboratory Communication Solutions segment net revenues for 2004 decreased by \$5.9 million, or 24%, from 2003 primarily as a result of the asset sale discussed earlier in this report (decrease of \$5.6 million).

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

	<b>2004</b>	<b>2003</b>
	<b>(In thousands)</b>	
Core transactions(1)	194,558	197,284
Additional core transactions	64,775	50,502
Encounters	29,172	25,529
Total transactions	288,505	273,315

(1) Includes 4.5 million cost containment transactions in the 2004 period from ProxyMed's acquisition of PlanVista

*Cost of Sales.* Consolidated cost of sales decreased as a percentage of net revenues to 38% for 2004 from 45% for 2003. This increase is a result of the acquisition of PlanVista which has higher margins (67%) compared to our traditional segments. Cost of sales classified by our reportable segments is as follows:

	<b>2004</b>	<b>2003</b>
	<b>(In thousands)</b>	
Transaction Services	\$ 22,401	\$ 15,893
Laboratory Communication Solutions	11,811	16,528
	\$ 34,212	\$ 32,421

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 \$6.5 million, or 41%, for 2004 compared to 2003. As a percentage of revenues, cost of sales decreased to 31% in the 2004 compared to 34% in 2003 primarily due to a change in the mix of transaction types from higher cost patient statements to lower cost claim transactions offset by the addition of higher margin medical cost containment services from our acquisition of PlanVista that increased our costs in the segment by approximately \$8.8 million.

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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 for 2004 decreased \$4.8 million, or 29%, from 2003. These decreases are primarily due to the sale of our contract manufacturing assets. Cost of sales as a percentage of revenues in this segment was 62% for 2004 compared to 66% for the 2003 year.

*Selling, General and Administrative Expenses.* Consolidated SG&A increased for 2004 by \$12.2 million, or 34%, to \$48.0 million from consolidated SG&A of \$35.8 million for 2003. Consolidated SG&A expenses as a percentage of consolidated revenues increased to 53% in 2004 from 50% in 2003. SG&A expenses classified by our reportable segments are as follows:

	<b>2004</b>	<b>2003</b>
	<b>(In thousands)</b>	
Transaction Services	\$ 43,625	\$ 30,283
Laboratory Communication Solutions	4,398	5,526
	<b>\$ 48,023</b>	<b>\$ 35,809</b>

Transaction Services segment SG&A expenses for the year ended December 31, 2004 increased by \$13.3 million, or 44% over 2003. The primary cause of the increase was the addition of SG&A expenses from PlanVista for ten months in the 2004 period (increase of \$10.5 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 during 2004 (increase of \$1.7 million).

Laboratory Communications Solutions segment SG&A expenses for 2004 decreased by \$1.1 million, or 20% from 2003 and segment SG&A expenses as a percentage of segment net revenues increased to 23% in 2004 from 22% in 2003. The decreases in dollars are primarily due to a reduction in expenses related to the sale our contract manufacturing assets on June 30, 2004.

*Depreciation and Amortization.* Consolidated depreciation and amortization increased by \$3.4 million to \$9.8 million for 2004 from \$6.3 million for 2003. This increase was primarily due to approximately \$3.5 million for the amortization of intangible assets acquired in the PlanVista acquisition in the transaction services segment; offset by a decrease in depreciation expense in the Laboratory Communication Solutions segment due to the sale of our manufacturing assets. Depreciation and amortization classified by our reportable segments is as follows:

	<b>2004</b>	<b>2003</b>
	<b>(In thousands)</b>	
Transaction Services	\$ 8,719	\$ 4,754
Laboratory Communication Solutions	823	1,369
Corporate	221	193
	<b>\$ 9,763</b>	<b>\$ 6,316</b>

*Loss on Disposal of Assets.* In 2004, we recorded a consolidated loss of disposal asset \$47,000. This loss is 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 June 30, 2004 of \$68,000; and \$5,000 of miscellaneous items offset by \$26,000 in gains on vehicles and other equipment sold. As a result of the consolidation of the ProxyMed and MedUnite offices in Atlanta in February 2003, we recorded \$0.1 million in losses during 2003 primarily related to the disposition of certain assets owned and leased that were acquired in the acquisition of MDP Corporation in 2001.

*Litigation settlement.* In December 2004, we settled an outstanding preacquisition contingency related to PlanVista for \$0.2 million, net of insurance reimbursement and is recorded in our Transaction Services segment.

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*Operating Income (Loss).* As a result of the foregoing, the consolidated operating loss for 2004 was \$2.0 million compared to an operating loss of \$3.6 million for 2003. Operating loss classified by our reportable segments is as follows:

	2004	2003
	(In thousands)	
Transaction Services	\$ (2,815)	\$ (920)
Laboratory Communication Solutions	1,938	1,119
Corporate	(1,097)	(3,841)
	\$ (1,974)	\$ (3,642)

*Other Income (Expense), net.* During 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. Additionally, in conjunction with our distribution and marketing agreement with PlanVista for claims repricing services signed in June 2003, we received a warrant to purchase up to 15% of PlanVista common stock that expired in December 2003. The warrant was initially valued at \$0.5 million and recorded as an asset. Upon expiration of the warrant in December 2003, we recorded an impairment loss in the amount of \$0.5 million (representing the original value of the warrant) for the 2003 year.

*Interest Expense, net.* Consolidated net interest expense for the 2004 was \$1.9 million compared to \$0.9 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 \$1.2 million). Interest expense for the future is expected to be at levels above those in 2004 due to the senior debt assumed from PlanVista.

*Net Loss.* As a result of the foregoing, consolidated net loss for 2004 was \$3.8 million compared to consolidated net loss of \$5.0 million for 2003.

**Liquidity and Capital Resources**

During the years ended December 31, 2005 and 2004, net cash provided by operating activities totaled \$5.2 million and \$1.8 million, respectively. The 2004 amounts included \$4.0 million to pay certain acquisition-related expenses of PlanVista outstanding as of the effective date of the acquisition. Cash (used in) provided by investing activities for the years ended December 31, 2005 and 2004 totaled (\$2.8) million and \$0.7 million, respectively. The 2005 amounts relate primarily to the funding of capital expenditures for our technical infrastructure, administrative systems and capitalization of internally developed systems, while the 2004 amounts 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 \$4.3 million in capital expenditures and capitalized software. Cash (used in) provided by financing activities for the years ended December 31, 2005 and 2004, totaled (\$9.2) million and \$4.5 million, respectively. The 2005 amounts consist primarily of repayment of notes payable, other long term debt and capital leases, offset by proceeds from the sale of our Common Stock to our Chief Executive Officer during the second quarter of 2005 and borrowings on our lines of credit and notes payable. The 2004 amounts consisted of a \$24.1 million private placement of our common stock, and proceeds from the exercise of stock options and warrants for \$8.8 million, offset by \$28.3 million in repayments of notes payable, other long-term debt, and payments related to capital leases (including \$27.4 million for the retirement of debts and other obligations of PlanVista upon the consummation of the acquisition).

On April 18, 2005, we closed a three year, \$15.0 million senior asset based facility which was secured by all assets of the combined entities with Wachovia Bank, N.A. During the second quarter of 2005, we defaulted on a financial covenant under this credit facility. We subsequently obtained a waiver of this default and renegotiated the covenant. During the third quarter of 2005, we were in compliance with all financial covenants related to this credit facility. As of September 30, 2005, our principal source of liquidity was our cash and revolving credit facility with Wachovia. The facility with Wachovia was repaid in full and terminated in December 2005 in connection with the Laurus transaction described below.



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During the year ended December 31, 2005, and the year ended 2004, we spent \$2.8 million and \$4.3 million, respectively, towards hardware and software costs, including internally developed software primarily related to our technical infrastructure and administrative systems. Furthermore, in 2005 and 2004, we incurred costs of approximately \$0.6 million and \$1.7 million, respectively, 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. We anticipate that our capital expenditures for fiscal 2006 will be approximately \$5.4 million.

We have also spent the better part of two years on HIPAA compliance efforts, which has resulted in significant costs. We now have over 98% of our total transaction volume migrated to a HIPAA compliant connection to our payer customers. However, on our submitter customer side, 85% 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.

On December 7, 2005, we entered into a loan transaction with Laurus pursuant to which Laurus extended \$20 million in financing to us in the form of a \$5.0 million secured term loan and a \$15.0 million secured revolving credit facility. The term loan has a stated term of five (5) years and will accrue interest at Prime plus 2%, subject to a minimum interest rate of 8%. The term loan is payable in equal monthly principal installments of approximately \$89,300 plus interest until the maturity date on December 6, 2010. The revolving credit facility has a stated term of three (3) years, with two one-year options, and will accrue interest at the 90 day LIBOR rate plus 5%, subject to a minimum interest rate of 7%, and a maturity date of December 6, 2008. In connection with the loan agreement, we issued 500,000 shares of our Common Stock to Laurus. We also granted Laurus a first priority security interest in substantially all of our present and future tangible and intangible assets (including all intellectual property) to secure our obligations under the loan agreement.

The loan agreement with Laurus contains various customary representation and warranties by us, as well as customary affirmative and negative covenants, including, without limitation, limitations on property liens, maintaining specific forms of accounting and record maintenance, and limiting the incurrence of additional debt. The loan agreement does not contain restrictive covenants regarding minimum earning requirements, historical earning levels, fixed charge coverage, or working capital requirements. The loan agreement also contains certain customary events of default, including, among others, non-payment of principal and interest, violation of covenants, and in the event we are involved in certain insolvency proceedings. Upon the occurrence of an event of default, Laurus is entitled to, among other things, accelerate all of our obligations under the loans. In the event Laurus accelerates the loans, the amount due will include all accrued interest plus 120% of the then outstanding principal amount of the loans being accelerated as well as all unpaid fees and expenses of Laurus. In addition, if the revolving credit facility is terminated for any reason, whether because of a prepayment or acceleration, we are required to pay an additional premium of up to 5% of the total amount of the revolving credit facility. In the event we elect to prepay the term loan, the amount due shall be the accrued interest plus 115% of the then outstanding principal amount of the term loan.

We had cash and cash equivalents totaling \$5.5 million as of December 31, 2005, compared to \$12.4 million at December 31, 2004. These available funds will be used for operations, strategic acquisitions, the further development of our products and services, repayment of debt and other general corporate purposes.

We do not have any material commitments for any other capital expenditures; however, we have budgeted approximately \$5.4 million for capital expenditures and capitalized development for 2006.

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 then 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.

At the time of its acquisition by the Company, PlanVista was involved in various lawsuits and threatened litigation. To date, a significant number of these cases have been settled or dismissed and resulted in \$0.7 million charged to goodwill and \$0.2 million charged to expense in 2004.

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In 2003, net cash provided by operating activities totaled \$1.5 million. Cash used for investing activities totaled \$9.6 million and consisted primarily of payments of costs related to the acquisition of MedUnite, capital expenditures and capitalized software. Cash used in financing activities totaled \$3.0 million mainly due to repayments of notes payable, other long-term debt, and payments related to capital leases.

In December 2003, we closed on a \$12.5 million asset-based line of credit with our commercial bank. Borrowing under such facility was 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 line was repaid in early March 2004 and terminated in April 2005).

The following table represents our contractual cash obligations due over the next several years as of December 31, 2005. Operating leases are shown net of any sublease agreements.

	2006	2007	2008	2009	2010
	(In thousands)				
Interest on convertible notes(1)	\$ 525	\$ 525	\$ 526	\$	\$
Interest on senior and other debt	420	297	208	119	31
Convertible notes(1)			13,137		
Senior debt	804	1,071	1,071	1,071	983
Notes payable(2)	350				
Litigation settlement(3)	1,410	1,080	327		
Capital lease obligations(2)	6	1			
Operating leases(4)	1,783	1,791	1,220	957	181
<b>TOTAL</b>	<b>\$ 5,298</b>	<b>\$ 4,765</b>	<b>\$ 16,489</b>	<b>\$ 2,147</b>	<b>\$ 1,195</b>

(1) Assumes no conversion of convertible notes

(2) Includes principal and interest

(3) Net of insurance reimbursement

(4) Includes new office leases entered into in 2006.

Additionally, the balance of the Revolving Credit Facility on December 31, 2005 is approximately \$7.5 million. Under the terms of the agreement, the Revolving Credit Facility has a stated term of three years and will accrue interest at the 90 day LIBOR rate plus 5%, subject to a minimum interest rate of 7%, and a maturity date of December 6, 2008.

We believe that we have sufficient cash and cash equivalents on hand or available to us under our credit facility, through December 31, 2006, and we anticipate sufficient cash from operations, to fund our future operational requirements and capital expenditures, and to provide a sufficient level of capital in order to fund specific research and development projects or to pursue smaller additional strategic acquisitions. 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 of America. The preparation of our consolidated financial statements requires us to make estimates

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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 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 beginning on Page F-8.

**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 healthcare providers and insurance companies, and physicians and pharmacies. Such transactions and services include 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 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 either a per transaction fee basis or on a flat fee basis (per physician, per tax ID, etc.) 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.

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 recognized monthly from customers that pay a monthly fee based on eligible employees enrolled in a benefit plan covered by our health benefits payers 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.

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 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