

Emdeon Inc.  
Form 10-Q  
May 07, 2010

Table of Contents

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

**Form 10-Q**

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

**For the quarterly period ended March 31, 2010**

**Commission file number 001-34435**

**EMDEON INC.**

*(Exact Name of Registrant as Specified in its Charter)*

**Delaware**

*(State or Other Jurisdiction of  
Incorporation or Organization)*

**20-5799664**

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

**3055 Lebanon Pike, Suite 1000**

**Nashville, TN**

*(Address of Principal Executive Offices)*

**37214**

*(Zip Code)*

**(615) 932-3000**

*(Registrant's Telephone Number, Including Area Code)*

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

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

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ Smaller reporting company ☐  
(Do not check if a smaller reporting company)

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

Edgar Filing: Emdeon Inc. - Form 10-Q

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

| <b>Class</b>                              | <b>Outstanding as of May 4, 2010</b> |
|-------------------------------------------|--------------------------------------|
| Class A common stock, \$0.00001 par value | 90,618,894                           |
| Class B common stock, \$0.00001 par value | 24,689,142                           |

---

**Emdeon Inc.**

**Table of Contents**

**Part I. Financial Information**

|                |                                                                                              |    |
|----------------|----------------------------------------------------------------------------------------------|----|
| <u>Item 1.</u> | <u>Financial Statements</u>                                                                  | 2  |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 24 |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures About Market Risk</u>                            | 39 |
| <u>Item 4.</u> | <u>Controls and Procedures</u>                                                               | 40 |

**Part II. Other Information**

|                      |                                                                    |    |
|----------------------|--------------------------------------------------------------------|----|
| <u>Item 1.</u>       | <u>Legal Proceedings</u>                                           | 41 |
| <u>Item 1A.</u>      | <u>Risk Factors</u>                                                | 41 |
| <u>Item 2.</u>       | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 42 |
| <u>Item 3.</u>       | <u>Defaults Upon Senior Securities</u>                             | 43 |
| <u>Item 4.</u>       | <u>Removed and Reserved</u>                                        | 43 |
| <u>Item 5.</u>       | <u>Other Information</u>                                           | 43 |
| <u>Item 6.</u>       | <u>Exhibits</u>                                                    | 43 |
| <u>Signatures</u>    |                                                                    | 44 |
| <u>Exhibit Index</u> |                                                                    | 45 |
| <u>EX-31.1</u>       |                                                                    |    |
| <u>EX-31.2</u>       |                                                                    |    |
| <u>EX-32.1</u>       |                                                                    |    |
| <u>EX-32.2</u>       |                                                                    |    |

---

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Emdeon Inc.****Condensed Consolidated Balance Sheets**

|                                                                                                                                             | March 31,<br>2010                                                              | December 31,<br>2009 |
|---------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------|----------------------|
|                                                                                                                                             | (Unaudited and amounts in<br>thousands, except share and<br>per share amounts) |                      |
| ASSETS                                                                                                                                      |                                                                                |                      |
| Current assets:                                                                                                                             |                                                                                |                      |
| Cash and cash equivalents                                                                                                                   | \$ 220,418                                                                     | \$ 211,999           |
| Accounts receivable, net of allowance for doubtful accounts of \$4,543 and \$4,433<br>at March 31, 2010 and December 31, 2009, respectively | 152,646                                                                        | 151,022              |
| Deferred income tax assets                                                                                                                  | 4,445                                                                          | 4,924                |
| Prepaid expenses and other current assets                                                                                                   | 15,146                                                                         | 16,632               |
| Total current assets                                                                                                                        | 392,655                                                                        | 384,577              |
| Property and equipment, net                                                                                                                 | 175,231                                                                        | 152,091              |
| Goodwill                                                                                                                                    | 730,819                                                                        | 703,027              |
| Intangible assets, net                                                                                                                      | 979,372                                                                        | 989,280              |
| Other assets, net                                                                                                                           | 1,380                                                                          | 1,451                |
| Total assets                                                                                                                                | \$ 2,279,457                                                                   | \$ 2,230,426         |
| LIABILITIES AND EQUITY                                                                                                                      |                                                                                |                      |
| Current liabilities:                                                                                                                        |                                                                                |                      |
| Accounts payable                                                                                                                            | \$ 8,677                                                                       | \$ 9,910             |
| Accrued expenses                                                                                                                            | 81,956                                                                         | 72,493               |
| Deferred revenues                                                                                                                           | 12,167                                                                         | 12,153               |
| Current portion of long-term debt                                                                                                           | 10,153                                                                         | 9,972                |
| Total current liabilities                                                                                                                   | 112,953                                                                        | 104,528              |
| Long-term debt, excluding current portion                                                                                                   | 831,726                                                                        | 830,710              |
| Deferred income tax liabilities                                                                                                             | 150,502                                                                        | 145,914              |
| Tax receivable agreement obligations to related parties                                                                                     | 140,704                                                                        | 142,044              |
| Other long-term liabilities                                                                                                                 | 50,725                                                                         | 27,361               |
| Commitments and contingencies                                                                                                               |                                                                                |                      |
| Equity:                                                                                                                                     |                                                                                |                      |

Edgar Filing: Emdeon Inc. - Form 10-Q

Preferred stock (par value, \$0.00001), 25,000,000 shares authorized and 0 shares issued and outstanding

Class A common stock (par value, \$0.00001), 400,000,000 shares authorized and 90,618,894 and 90,423,941 shares outstanding at March 31, 2010 and

December 31, 2009, respectively

1

1

Class B common stock, exchangeable (par value, \$0.00001), 52,000,000 shares authorized and 24,689,142 and 24,752,955 shares outstanding at March 31, 2010 and December 31, 2009, respectively

Additional paid-in capital

736,838

730,941

Accumulated other comprehensive loss

(9,334)

(11,198)

Retained earnings

35,593

33,704

Emdeon Inc. equity

763,098

753,448

Noncontrolling interest

229,749

226,421

Total equity

992,847

979,869

Total liabilities and equity

\$ 2,279,457 \$ 2,230,426

See accompanying notes to unaudited condensed consolidated financial statements.

**Table of Contents****Emdeon Inc.****Condensed Consolidated Statements of Operations**

|                                                                       | <b>Three Months Ended March 31,</b>                                             |             |
|-----------------------------------------------------------------------|---------------------------------------------------------------------------------|-------------|
|                                                                       | <b>2010</b>                                                                     | <b>2009</b> |
|                                                                       | <b>(Unaudited and amounts in thousands, except share and per share amounts)</b> |             |
| Revenue                                                               | \$ 237,279                                                                      | \$ 219,885  |
| Costs and expenses:                                                   |                                                                                 |             |
| Cost of operations (exclusive of depreciation and amortization below) | 143,986                                                                         | 134,739     |
| Development and engineering                                           | 8,554                                                                           | 7,075       |
| Sales, marketing, general and administrative                          | 26,119                                                                          | 24,160      |
| Depreciation and amortization                                         | 27,775                                                                          | 25,098      |
| Operating income                                                      | 30,845                                                                          | 28,813      |
| Interest income                                                       | (3)                                                                             | (21)        |
| Interest expense                                                      | 15,665                                                                          | 17,942      |
| Other                                                                 | 290                                                                             |             |
| Income before income tax provision                                    | 14,893                                                                          | 10,892      |
| Income tax provision                                                  | 10,630                                                                          | 7,602       |
| Net income                                                            | 4,263                                                                           | 3,290       |
| Net income attributable to noncontrolling interest                    | 2,374                                                                           | 2,072       |
| Net income attributable to Emdeon Inc.                                | \$ 1,889                                                                        | \$ 1,218    |
| Net income per share Class A common stock:                            |                                                                                 |             |
| Basic                                                                 | \$ 0.02                                                                         | \$ 0.02     |
| Diluted                                                               | \$ 0.02                                                                         | \$ 0.02     |
| Weighted average common shares outstanding:                           |                                                                                 |             |
| Basic                                                                 | 90,461,968                                                                      | 77,413,610  |
| Diluted                                                               | 90,468,057                                                                      | 77,413,610  |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**Emdeon Inc.****Condensed Consolidated Statements of Equity**

|                                                                                        | <b>Class A<br/>Common Stock</b>                                   |               | <b>Class B<br/>Common Stock</b> |               | <b>Additional<br/>Paid-in</b> | <b>Retained</b> | <b>Other<br/>Comprehensive<br/>Income</b> | <b>Non-<br/>Controlling</b> | <b>Total</b>  |
|----------------------------------------------------------------------------------------|-------------------------------------------------------------------|---------------|---------------------------------|---------------|-------------------------------|-----------------|-------------------------------------------|-----------------------------|---------------|
|                                                                                        | <b>Shares</b>                                                     | <b>Amount</b> | <b>Shares</b>                   | <b>Amount</b> | <b>Capital</b>                | <b>Earnings</b> | <b>(Loss)</b>                             | <b>Interest</b>             | <b>Equity</b> |
|                                                                                        | <b>(Unaudited and amounts in thousands, except share amounts)</b> |               |                                 |               |                               |                 |                                           |                             |               |
| <b>Balance at January 1, 2009</b>                                                      | 77,413,610                                                        | \$ 1          | 22,586,390                      | \$            | \$ 670,702                    | \$ 24,123       | \$ (23,195)                               | \$ 206,522                  | \$ 878,150    |
| Capital contribution from stockholders                                                 |                                                                   |               |                                 |               | 158                           |                 |                                           |                             | 158           |
| Comprehensive income:                                                                  |                                                                   |               |                                 |               |                               |                 |                                           |                             |               |
| Net income                                                                             |                                                                   |               |                                 |               |                               | 1,218           |                                           | 2,072                       | 3,290         |
| Change in the fair value of interest rate swap, net of taxes                           |                                                                   |               |                                 |               |                               |                 | 535                                       | 156                         | 691           |
| Other comprehensive income: amortization, net of taxes                                 |                                                                   |               |                                 |               |                               |                 | 1,334                                     | 389                         | 1,723         |
| Other comprehensive income                                                             |                                                                   |               |                                 |               |                               |                 |                                           |                             | 5,704         |
| <b>Balance at March 31, 2009</b>                                                       | 77,413,610                                                        | \$ 1          | 22,586,390                      | \$            | \$ 670,860                    | \$ 25,341       | \$ (21,326)                               | \$ 209,139                  | \$ 884,014    |
| <b>Balance at January 1, 2010</b>                                                      | 90,423,941                                                        | \$ 1          | 24,752,955                      | \$            | \$ 730,941                    | \$ 33,704       | \$ (11,198)                               | \$ 226,421                  | \$ 979,869    |
| Equity based compensation expense                                                      |                                                                   |               |                                 |               | 2,927                         |                 |                                           | 748                         | 3,675         |
| Change of units of S Master to Class A common stock, net of taxes                      | 36,829                                                            |               | (36,829)                        |               | 425                           |                 | (4)                                       | (339)                       | 81            |
| Cancellation of Class B common stock, net of taxes                                     |                                                                   |               | (26,984)                        |               | 127                           |                 | (2)                                       | (197)                       | (7)           |
| Quittance of Class A common stock upon vesting of Restricted Stock Units, net of taxes | 5,592                                                             |               |                                 |               | 16                            |                 |                                           | (11)                        |               |
| Quittance of Class A common stock in connection with acquisition, net of taxes         | 152,532                                                           |               |                                 |               | 2,391                         |                 | (4)                                       | 239                         | 2,628         |



|                                                               |            |      |            |    |            |           |            |            |    |         |
|---------------------------------------------------------------|------------|------|------------|----|------------|-----------|------------|------------|----|---------|
| Accounts receivable                                           |            |      |            |    |            |           |            |            |    |         |
| Prepayments with related parties, net of taxes                |            |      |            |    | (89)       |           |            |            |    | (89)    |
| Settlement of liability related to IPO                        |            |      |            |    | 100        |           |            |            |    | 100     |
| Comprehensive income:                                         |            |      |            |    |            |           |            |            |    |         |
| Net income                                                    |            |      |            |    |            | 1,889     |            | 2,374      |    | 4,263   |
| Changes in the fair value of interest rate swap, net of taxes |            |      |            |    |            |           | 822        | 225        |    | 1,047   |
| Foreign currency translation adjustment                       |            |      |            |    |            |           | 58         | 18         |    | 76      |
| Other comprehensive income amortization, net of taxes         |            |      |            |    |            |           | 994        | 271        |    | 1,265   |
| Total comprehensive income                                    |            |      |            |    |            |           |            |            |    | 6,651   |
| <b>Balance at March 31, 2010</b>                              | 90,618,894 | \$ 1 | 24,689,142 | \$ | \$ 736,838 | \$ 35,593 | \$ (9,334) | \$ 229,749 | \$ | 992,844 |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**Emdeon Inc.****Condensed Consolidated Statements of Cash Flows**

|                                                                                   | <b>For the Three Months Ended<br/>March 31,</b> |             |
|-----------------------------------------------------------------------------------|-------------------------------------------------|-------------|
|                                                                                   | <b>2010</b>                                     | <b>2009</b> |
|                                                                                   | <b>(Unaudited and amounts in<br/>thousands)</b> |             |
| <b>Operating activities</b>                                                       |                                                 |             |
| Net income                                                                        | \$ 4,263                                        | \$ 3,290    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                                 |             |
| Depreciation and amortization                                                     | 27,775                                          | 25,098      |
| Equity compensation expense                                                       | 3,675                                           | 2,576       |
| Deferred income tax expense                                                       | 4,666                                           | 2,659       |
| Amortization of debt discount and issuance costs                                  | 3,135                                           | 2,791       |
| Amortization of discontinued cash flow hedge from other comprehensive loss        | 1,453                                           | 1,972       |
| Other                                                                             | 571                                             | 104         |
| Changes in operating assets and liabilities:                                      |                                                 |             |
| Accounts receivable                                                               | 3,347                                           | (1,216)     |
| Prepaid expenses and other                                                        | 1,646                                           | 6,531       |
| Accounts payable                                                                  | (2,434)                                         | 2,429       |
| Accrued expenses and other liabilities                                            | 3,173                                           | (5,915)     |
| Deferred revenues                                                                 | 14                                              | 1,343       |
| Tax receivable agreement obligations to related parties                           | (1,480)                                         |             |
| Net cash provided by operating activities                                         | 49,804                                          | 41,662      |
| <b>Investing activities</b>                                                       |                                                 |             |
| Purchases of property and equipment                                               | (12,949)                                        | (7,055)     |
| Payments for acquisitions, net of cash acquired                                   | (26,444)                                        |             |
| Net cash used in investing activities                                             | (39,393)                                        | (7,055)     |
| <b>Financing activities</b>                                                       |                                                 |             |
| Debt principal payments                                                           | (1,888)                                         | (17,888)    |
| Payments on revolver                                                              |                                                 | (10,000)    |
| Other                                                                             | (104)                                           | 158         |
| Net cash used in financing activities                                             | (1,992)                                         | (27,730)    |
| Net increase in cash and cash equivalents                                         | 8,419                                           | 6,877       |
| Cash and cash equivalents at beginning of period                                  | 211,999                                         | 71,478      |

Edgar Filing: Emdeon Inc. - Form 10-Q

|                                            |    |         |    |        |
|--------------------------------------------|----|---------|----|--------|
| Cash and cash equivalents at end of period | \$ | 220,418 | \$ | 78,355 |
|--------------------------------------------|----|---------|----|--------|

See accompanying notes to unaudited condensed consolidated financial statements.

**Table of Contents**

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements  
(unaudited and amounts in thousands, except share and per share amounts)**

**1. Nature of Business and Organization**

***Nature of Business***

Emdeon Inc. (the Company), through its subsidiaries and affiliates, is a provider of revenue and payment cycle management solutions, connecting payers, providers and patients of the U.S. healthcare system. The Company's product and service offerings integrate and automate key business and administrative functions for healthcare payers and healthcare providers throughout the patient encounter, including pre-care patient eligibility and benefits verification, clinical exchange capabilities, claims management and adjudication, payment distribution, payment posting and denial management, and patient billing and payment processing.

***Organization***

Prior to November 2006, the group of companies that comprised Emdeon Business Services (EBS) were owned by HLTH Corporation (HLTH). EBS Master LLC (EBS Master) was formed by HLTH to act as a holding company for EBS. EBS Master, through its 100% owned subsidiary, Emdeon Business Services LLC (EBS LLC), owns EBS.

In September 2006, EBS Acquisition LLC (EBS Acquisition) was formed as a Delaware limited liability company by affiliates of General Atlantic LLC (General Atlantic). On November 16, 2006, pursuant to the terms of an Amended and Restated Agreement and Plan of Merger, dated as of November 15, 2006, among HLTH and certain of its subsidiaries (including EBS Master) and EBS Acquisition and two of its subsidiaries, a subsidiary of EBS Acquisition merged into a subsidiary of HLTH. As a result of the merger, EBS Acquisition acquired a 52% interest in EBS Master, and HLTH received approximately \$1.2 billion in cash and retained a 48% interest in EBS Master. The transactions through which EBS Acquisition acquired a 52% interest in EBS Master are referred to herein as the 2006 Transaction. The 2006 Transaction was financed with \$925,000 in bank debt and an equity investment of approximately \$320,000 by EBS Acquisition. As the 2006 Transaction was deemed to be a highly leveraged transaction, the 2006 Transaction was accounted for in accordance with Emerging Issues Task Force Issue No. 88-16, *Basis in Leveraged Buyout Transactions*, and 52% of the net assets of EBS Master were stepped up to fair market value.

On February 8, 2008, HLTH sold its 48% noncontrolling interest in EBS Master to affiliates of General Atlantic and Hellman & Friedman LLC (H&F) for \$575,000 in cash (the 2008 Transaction). As a result, following the 2008 Transaction, EBS Master was owned 65.77% by affiliates of General Atlantic (including EBS Acquisition) and 34.23% by affiliates of H&F.

In September 2008, EBS Acquisition was converted into a Delaware corporation and its name was changed to Emdeon Inc.

***Reorganization***

On August 5, 2009 the Company completed a restructuring (collectively, the reorganization transactions) in anticipation of completing an initial public offering.

Prior to the reorganization transactions, the Company owned a 52% interest in EBS Master and affiliates of General Atlantic and H&F owned the remaining 48% interest in EBS Master. The Company did not engage in any business or other activities except in connection with its investment in EBS Master and the reorganization

**Table of Contents**

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)**

transactions, and had nominal assets other than its interest in EBS Master. In the reorganization transactions, the Company became the sole managing member of EBS Master and acquired additional interests in EBS Master.

Prior to the reorganization transactions, the Company was authorized to issue a single class of common stock. In connection with the reorganization transactions, the Company amended and restated its certificate of incorporation and is currently authorized to issue two classes of common stock: Class A common stock and Class B common stock.

This reorganization and the changes to the capital structure are reflected in all periods presented.

Effective August 11, 2009, the Company priced its initial public offering of Class A common stock (the IPO ).

**2. Basis of Presentation and Summary of Significant New Accounting Policies**

***Principles of Consolidation***

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X and, in the opinion of management, reflect all normal recurring adjustments necessary for a fair presentation of results for the unaudited interim periods presented. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. The results of operations for the interim period are not necessarily indicative of the results to be obtained for the full fiscal year. All material intercompany accounts and transactions have been eliminated in the unaudited condensed consolidated financial statements.

***Reclassifications***

Certain reclassifications have been made to the prior period financial statements to conform to the current period presentation.

***Recent Accounting Pronouncements***

In October 2009, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update No. 2009-13, an update to FASB ASC Revenue Recognition Topic, which amends existing accounting standards for revenue recognition for multiple-element arrangements. To the extent a deliverable within a multiple-element arrangement is not accounted for pursuant to other accounting standards, the update establishes a selling price hierarchy that allows for the use of an estimated selling price to determine the allocation of arrangement consideration to a deliverable in a multiple element arrangement where neither vendor-specific objective evidence nor third-party evidence is available for that deliverable. The update is to be applied prospectively for revenue arrangements entered into or materially modified after January 1, 2011 in the case of the Company. The Company is currently evaluating the impact, if any that the pending adoption of the update will have on the Company's consolidated financial statements.

On January 1, 2010, the Company adopted the clarification and additional disclosure provisions of FASB Accounting Standards Update No. 2010-06, an update to FASB ASC Fair Value Measurements and Disclosures



**Table of Contents**

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)**

Topic. This update clarifies that companies must provide fair value measurement disclosures for each class of assets and liabilities and expands the requirements to include disclosure of amounts and reasons for transfers among different levels within the fair value hierarchy and information within a reconciliation about purchases, sales, issuances and settlements on a gross basis. The adoption of the clarification and additional disclosure provisions of this update had no material impact on the Company's consolidated financial statements for the quarter ended March 31, 2010. The disclosures required by this update are presented within Note 8 to the unaudited condensed consolidated financial statements. The remaining provisions become effective in the fiscal period beginning after December 31, 2010 (January 1, 2011 in the case of the Company). The Company is currently evaluating the impact, if any, that the pending adoption of the remaining provisions of the update will have on the Company's disclosures in its consolidated financial statements.

**3. Concentration of Credit Risk**

The Company's revenue is primarily generated in the United States. Changes in economic conditions, government regulations or demographic trends, among other matters, in the United States could adversely affect the Company's revenue and results of operations.

The Company maintains its cash and cash equivalent balances in either insured depository accounts or money market mutual funds. The money market mutual funds are limited to investments in low-risk securities such as U.S. or government agency obligations, or repurchase agreements secured by such securities.

**4. Business Combinations**

***2009 Acquisitions***

***Sentinel Group Acquisition***

On June 5, 2009, the Company acquired substantially all of the assets of The Sentinel Group from Optimal Business Services, Inc., a subsidiary of Trustmark Mutual Holding Company, for \$3,067 in cash (which was funded with cash on hand). The Sentinel Group is a provider of payment integrity solutions.

***eRx Acquisition***

On July 2, 2009, the Company acquired all of the voting equity interests of eRx Network, L.L.C. (eRx). eRx is a provider of electronic pharmacy healthcare solutions. The Company valued the total consideration transferred for the eRx acquisition at approximately \$100,707, which consisted of approximately \$74,575 in cash, 1,850,000 EBS Units issued to certain members of eRx, valued at \$13.92 per unit or approximately \$25,754 in the aggregate, and a working capital settlement of approximately \$378.

***2010 Acquisitions***

***FVTech Acquisition***



On January 26, 2010, the Company acquired all of the voting interest of FutureVision Investment Group, L.L.C. and substantially all of the assets of two related companies, FVTech, Inc. and FVTech Arizona, Inc. (collectively, FVTech ). FVTech is a provider of outsourced services specializing in electronic data conversion and

**Table of Contents****Emdeon Inc.****Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)**

information management solutions. This acquisition will allow the Company the ability to electronically process virtually all patient and third party healthcare payments regardless of the format in which payments are submitted.

The Company has preliminarily valued the total consideration transferred at \$34,973, which consisted of \$20,005 cash at closing, estimated contingent consideration of \$14,910 and an estimated working capital settlement of \$58. The contingent consideration arrangement requires the Company to pay additional consideration ranging from \$0 to \$40,000 based upon the financial performance of the acquired business for the two and three year periods following the acquisition. The Company has preliminarily valued the contingent consideration at the acquisition date, using a probability-weighted discounted cash flow model, at \$14,910. This fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement. The key assumptions in applying the income approach are as follows: 11.6% discount rate and a probability adjusted FVTech performance measure during the earnout period of between approximately \$1,500 and \$27,000. As of March 31, 2010, there were no significant changes in the range of outcomes for the contingent consideration recognized as a result of the acquisition of FVTech, although the recognized amount increased to \$15,200 as a result of the passage of time and the resulting reduced impact of discounting.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date. The preliminary values of the assets acquired and liabilities assumed (and resulting provisional goodwill) are subject to change based on the outcome of a working capital settlement (expected to occur later in 2010).

|                                                                                                                                   |           |
|-----------------------------------------------------------------------------------------------------------------------------------|-----------|
| Cash                                                                                                                              | \$ 372    |
| Accounts receivable                                                                                                               | 1,730     |
| Other current assets                                                                                                              | 36        |
| Property and equipment                                                                                                            | 18,423    |
| Other assets                                                                                                                      | 29        |
| Identifiable intangible assets:                                                                                                   |           |
| Customer contracts (16-year weighted average useful life)                                                                         | 560       |
| Tradename (3-year weighted average useful life)                                                                                   | 160       |
| Goodwill (Provisional)                                                                                                            | 14,878    |
| Accounts payable                                                                                                                  | (361)     |
| Accrued expenses                                                                                                                  | (548)     |
| Other long-term liabilities                                                                                                       | (306)     |
| Total consideration transferred                                                                                                   | \$ 34,973 |
| Acquisition costs reflected within sales, marketing, general and administrative expenses in the three months ended March 31, 2010 | \$ 128    |

As of the acquisition date, FVTech had gross contractual accounts receivable of \$1,774, of which approximately \$44 is not expected to be collected.

The provisional goodwill recorded in the FVTech acquisition was assigned to the Company's payer services and provider services segments based on revenue effects the acquisition is expected to have on each respective segment. The provisional goodwill recognized is attributable to expected synergies and the assembled workforce of FVTech. All of the goodwill attributable to the FVTech acquisition is expected to be deductible for income tax purposes.

**Table of Contents****Emdeon Inc.****Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)**

As a result of the integration of the operations of FVTech into the Company's operations, disclosure of revenue and earnings included in the accompanying statement of operations since the acquisition date is not practical.

*Healthcare Technology Management Services Acquisition*

On March 24, 2010 the Company acquired Healthcare Technology Management Services, Inc. ( HTMS ), a management consulting company focused primarily on the healthcare payer market. This acquisition will allow the Company to assist payers in evaluating their existing technology strategies, systems and technologies in order to help its customers implement effective solutions. Under the terms of the purchase agreement, the purchase price consisted of \$8,500 (before the payment of HTMS obligations by the Company at closing of \$659), Class A common stock valued under the terms of the purchase agreement at \$2,500 and contingent payments of \$0 to \$14,000.

The Company has preliminarily valued the total consideration transferred at \$19,859, which consisted of (i) \$7,841 in cash and 152,532 shares of Class A common stock (fair value of \$2,532) paid at closing, (ii) estimated contingent consideration of \$9,060 and (iii) an estimated working capital settlement of \$426. The contingent consideration arrangement requires the Company to pay, to the extent a financial performance target is achieved, additional specified amounts in cash related to each of the calendar years 2010, 2011 and 2012. The Company has preliminarily valued the contingent consideration at the acquisition date, using a probability-weighted discounted cash flow model, at \$9,060. This fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement. The key assumptions in applying the income approach are as follows: 20.5% discount rate and a probability of achieving the specified financial target of 80%, 90%, and 90% for each of the calendar years 2010, 2011 and 2012, respectively. As of March 31, 2010, there were no significant changes in the range of outcomes for the contingent consideration recognized as a result of the acquisition of HTMS.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date. The preliminary values of the assets acquired and liabilities assumed (and resulting provisional goodwill) are subject to change based on the outcome of a working capital settlement (expected to occur later in 2010) and receipt of a final third party valuation of certain tangible and intangible assets.

|                                                                 |           |
|-----------------------------------------------------------------|-----------|
| Cash                                                            | \$ 1,029  |
| Accounts receivable                                             | 3,241     |
| Identifiable intangible assets:                                 |           |
| Tradenname (3-year weighted average useful life)                | 200       |
| Noncompetition agreements (5-year weighted average useful life) | 4,050     |
| Backlog (1-year weighted average useful life)                   | 1,530     |
| Goodwill (Provisional)                                          | 12,662    |
| Accounts payable                                                | (1,771)   |
| Accrued expenses                                                | (978)     |
| Current maturities of long-term debt                            | (104)     |
| Total consideration transferred                                 | \$ 19,859 |
|                                                                 | \$ 181    |

Acquisition costs reflected within sales, marketing, general and administrative expenses in the three months ended March 31, 2010

**Table of Contents****Emdeon Inc.****Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)**

As of the acquisition date, HTMS had gross contractual accounts receivable of \$3,286, of which approximately \$45 is not expected to be collected.

The provisional goodwill recorded in the HTMS acquisition was assigned to the Company's payer services segment. The provisional goodwill recognized is attributable to expected synergies and the assembled workforce of HTMS. The Company has not yet determined the amount of goodwill that will be deductible for income tax purposes.

The Company has not separately disclosed revenue and net income recognized in its accompanying unaudited condensed consolidated statement of operations related to the HTMS acquisition as the impact to the operations of the Company was insignificant for the period due to the timing of the acquisition.

**5. Goodwill and Intangible Assets**

Goodwill activity during the three months ended March 31, 2010 was as follows:

|                              | <b>Payer</b> | <b>Provider</b> | <b>Pharmacy</b> | <b>Total</b> |
|------------------------------|--------------|-----------------|-----------------|--------------|
| Balance at December 31, 2009 | \$ 303,650   | \$ 315,647      | \$ 83,730       | \$ 703,027   |
| Acquisitions                 | 19,060       | 8,480           |                 | 27,540       |
| Other                        |              |                 | 252             | 252          |
| Balance at March 31, 2010    | \$ 322,710   | \$ 324,127      | \$ 83,982       | \$ 730,819   |

Intangible assets subject to amortization as of March 31, 2010 consist of the following:

|                           | <b>Weighted<br/>Average<br/>Remaining<br/>Life</b> | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Net</b> |
|---------------------------|----------------------------------------------------|--------------------------------------|-------------------------------------|------------|
| Customer relationships    | 15.7                                               | \$ 966,083                           | \$ (135,446)                        | \$ 830,637 |
| Trade names               | 17.7                                               | 117,908                              | (15,991)                            | 101,917    |
| Data sublicense agreement | 7.9                                                | 43,259                               | (2,588)                             | 40,671     |
| Non-compete agreements    | 4.7                                                | 15,546                               | (10,929)                            | 4,617      |
| Backlog                   | 1.0                                                | 1,530                                |                                     | 1,530      |
| Total                     |                                                    | \$ 1,144,326                         | \$ (164,954)                        | \$ 979,372 |

## Edgar Filing: Emdeon Inc. - Form 10-Q

Amortization expense was \$16,408 and \$15,206 for the three months ended March 31, 2010 and 2009, respectively. Aggregate future amortization expense for intangible assets is estimated to be:

|                  |            |
|------------------|------------|
| 2010 (remainder) | \$ 49,772  |
| 2011             | 65,104     |
| 2012             | 64,750     |
| 2013             | 64,547     |
| 2014             | 64,496     |
| Thereafter       | 670,703    |
|                  | \$ 979,372 |

**Table of Contents****Emdeon Inc.****Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)****6. Long-Term Debt**

Long-term debt consists of the following:

|                                                                                                                                                                                                                                                                                                                                                                    | <b>March 31,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|------------------------------|
| Credit Facilities                                                                                                                                                                                                                                                                                                                                                  |                           |                              |
| \$755 million First Lien Term Loan facility, expiring on November 16, 2013, bearing interest payable quarterly at a variable base rate (LIBOR) plus a spread rate (total rate 2.30% and 2.26%) and net of unamortized discount of \$35,759 and \$38,105 at March 31, 2010 and December 31, 2009, respectively (effective interest rate of 3.89% at March 31, 2010) | 648,704                   | 648,245                      |
| \$170 million Second Lien Term Loan facility, expiring on May 16, 2014, bearing interest at a variable base rate (LIBOR) plus a spread rate (total rate 5.30% and 5.26%) and net of unamortized discount of \$14,431 and \$15,169 at March 31, 2010 and December 31, 2009, respectively (effective interest rate of 7.71% at March 31, 2010)                       | 155,569                   | 154,831                      |
| Obligation under data sublicense agreement                                                                                                                                                                                                                                                                                                                         | 37,606                    | 37,606                       |
| Less current portion                                                                                                                                                                                                                                                                                                                                               | (10,153)                  | (9,972)                      |
| Long-term debt                                                                                                                                                                                                                                                                                                                                                     | \$ 831,726                | \$ 830,710                   |

In November 2006, EBS LLC entered into two credit agreements with several lenders that provided a \$755,000 term loan ( First Lien Term Loan ), a \$50,000 revolving credit agreement ( Revolver ) and a \$170,000 term loan ( Second Lien Term Loan ). In connection with these credit agreements, EBS LLC paid fees of approximately \$17,900 to the lenders of which the unamortized portion is classified as a reduction of the carrying value of the credit agreements in each period. Additionally, in connection with the 2008 Transaction, 48% of the carrying value of these credit agreements was adjusted to fair value which resulted in a discount of \$66,395, the unamortized portion of which has similarly been classified as a reduction of the carrying value of the credit agreements.

The Revolver expires November 2012 and provides for revolving loans not to exceed \$50,000, of which \$12,000 may be used for letters of credit in support of payment obligations of the Company. As of March 31, 2010, the Company had no borrowings outstanding, undrawn letters of credit totaling \$4,250 and \$45,750 available for future borrowings under the Revolver. The Company pays a quarterly commitment fee on the unused portion of the Revolver that fluctuates, based upon certain leverage ratios, between 0.375% and 0.5% per annum.

The First Lien Term Loan is payable in quarterly principal installments of approximately \$1,800, plus accrued interest, beginning in March 2007 through September 2013, with a balloon payment of the remaining principal amount outstanding due upon maturity in November 2013. These installment payments are subject to adjustment based upon optional and mandatory prepayment activity. Mandatory prepayments of principal related to excess cash flow, as defined, and other circumstances are also required.



The Second Lien Term Loan is subordinate to the First Lien Term Loan and matures in May 2014.

The credit agreements require EBS LLC to maintain certain financial covenants, including a maximum total leverage ratio and minimum interest coverage ratio. The credit agreements also impose restrictions related to capital expenditures, investments, additional debt or liens, asset sales, transactions with affiliates and equity interests, among other items. Additionally, the credit agreements include restrictions on the payment of dividends or distributions (other

**Table of Contents****Emdeon Inc.****Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)**

than to fund income tax liabilities) to or advances or loans to parties that are not party to the credit agreements. In the case of dividends, the credit agreements generally limit payments to non-loan parties (including the Company) with such limitations increasing based on achievement of certain leverage ratios. Transactions with affiliates are limited to those which are approved by a majority of the non-interested members of the EBS LLC board of directors and whose terms are no less favorable than those available to an unrelated person. Substantially all of the Company's net assets are subject to the restrictions of these credit agreements. EBS LLC believes it was in compliance with all debt covenants at March 31, 2010. This debt is secured by substantially all of the assets of EBS LLC.

***Obligation Under Data Sublicense Agreement***

On October 1, 2009, the Company acquired certain additional rights to specified uses of its data from HLTH in order to broaden the Company's ability to pursue business intelligence and data analytics solutions for payers and providers. The Company previously licensed exclusive rights to this data to HLTH pursuant to an Amended and Restated Data License Agreement in connection with the 2008 Transaction. The Company has recorded an amortizable intangible asset and a corresponding obligation related to this agreement. Additionally, the Company has an option exercisable on or before April 30, 2010, with an effective date of between April 1, 2010 and September 30, 2011 as elected by the Company, to acquire additional data rights. The Company exercised this option in April 2010 (see Note 18).

**7. Interest Rate Swap**

Derivative financial instruments are used to manage the Company's interest rate exposure. The Company does not enter into financial instruments for speculative purposes. Derivative financial instruments are accounted for in accordance with FASB ASC Derivatives and Hedging Topic and are measured at fair value and recorded on the balance sheet. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings (for example, in interest expense when the hedged transactions are interest cash flows associated with floating-rate debt). The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in interest expense in current earnings during the period of change.

**Fair Values of Derivative Instruments****Asset (Liability) Derivatives**

| <b>Balance Sheet Location</b>                         | <b>March 31,<br/>2010</b>   | <b>December 31,<br/>2009</b> |
|-------------------------------------------------------|-----------------------------|------------------------------|
| <b>Derivatives designated as hedging instruments:</b> |                             |                              |
| Interest rate swap                                    | Other long-term liabilities |                              |
|                                                       | \$ (20,135)                 | \$ (21,337)                  |

***Cash Flow Hedging Relationships***

In December 2006, the Company entered into an interest rate swap agreement, which matures in December 2011, to reduce the variability of interest payments associated with its total long-term debt. The notional amount of the swap was \$354,256 and \$355,200 as of March 31, 2010 and December 31, 2009, respectively. Changes in the cash flows of the interest rate swap are intended to offset the changes in cash flows attributable to fluctuations in the three month variable base rates underlying the Company's long-term debt obligations. As of March 31, 2010,

Table of Contents**Emdeon Inc.****Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)**

\$14,676 of net losses associated with the existing cash flow hedge, which have been recorded within accumulated other comprehensive income, are expected to be reclassified to interest expense within the next twelve months.

The 2008 Transaction represented a redesignation event. As the Company's interest rate swap did not meet all the criteria for hedge accounting at that time, changes in the fair value subsequent to the 2008 Transaction but prior to its redesignation as a cash flow hedge on September 30, 2008 were recorded within interest expense during the period from February 8, 2008 to September 30, 2008. Additionally, the amortization of the amounts reflected in other comprehensive income at the date of the 2008 Transaction related to the discontinued cash flow hedge are and continue to be reflected within interest expense in the unaudited condensed consolidated statement of operations. Amortization of amounts included in other comprehensive income related to the discontinued original hedge is expected to total approximately \$5,400 over the next twelve months.

The effect of the derivative instrument on the unaudited condensed consolidated statements of operations for the three month periods ended March 31, 2010 and 2009, respectively, is summarized in the following table:

|                                                                                                                                   | <b>For the Three Months<br/>Ended March 31,</b> |             |
|-----------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------|-------------|
|                                                                                                                                   | <b>2010</b>                                     | <b>2009</b> |
| <b>Derivatives in Cash Flow Hedging Relationships</b>                                                                             |                                                 |             |
| Gain/(loss) related to effective portion of derivative recognized in other comprehensive loss                                     | \$ 1,202                                        | \$ 790      |
| Gain/(loss) related to effective portion of derivative reclassified from accumulated other comprehensive loss to interest expense | \$ 5,620                                        | \$ 6,174    |
| Gain/(loss) related to ineffective portion of derivative recognized in interest expense                                           | \$                                              | \$          |

**8. Fair Value Measurements*****Assets and Liabilities Measured at Fair Value on a Recurring Basis***

The Company's assets and liabilities that are measured at fair value on a recurring basis consist principally of the Company's derivative financial instrument and contingent consideration associated with business combinations. The table below presents the Company's assets and liabilities measured at fair value on a recurring basis as of March 31, 2010, aggregated by the level in the fair value hierarchy within which those measurements fall.

| <b>Quoted<br/>in<br/>Markets</b> | <b>Significant<br/>Other</b> | <b>Significant<br/>Unobservable</b> |
|----------------------------------|------------------------------|-------------------------------------|
|----------------------------------|------------------------------|-------------------------------------|

| <b>Description</b>                    | <b>Balance at<br/>March 31,<br/>2010</b> | <b>Identical<br/>(Level 1)</b> | <b>Observable<br/>Inputs<br/>(Level 2)</b> | <b>Inputs<br/>(Level 3)</b> |
|---------------------------------------|------------------------------------------|--------------------------------|--------------------------------------------|-----------------------------|
| Interest Rate Swap                    | \$ (20,135)                              | \$                             | \$ (20,135)                                | \$                          |
| Contingent Consideration Obligations: |                                          |                                |                                            |                             |
| FVTech                                | (15,200)                                 |                                |                                            | (15,200)                    |
| HTMS                                  | (9,060)                                  |                                |                                            | (9,060)                     |
|                                       | \$ (24,260)                              | \$                             | \$                                         | \$ (24,260)                 |
| Total                                 | \$ (44,395)                              | \$                             | \$ (20,135)                                | \$ (24,260)                 |

**Table of Contents****Emdeon Inc.****Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)**

The valuation of the Company's derivative financial instrument is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivative, including the period to maturity, and uses observable market-based inputs, including interest rate curves. The fair value of the interest rate swap is determined using the market standard methodology of netting the discounted future fixed cash payments (or receipts) and the discounted expected variable cash receipts (or payments). The variable cash receipts (or payments) are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves.

The Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts and guarantees.

Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and by its counterparties. However, as of March 31, 2010, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

The valuation of the Company's contingent consideration obligations is determined using a probability weighted discounted cash flow method. This analysis reflects the contractual terms of the purchase agreements (e.g. minimum and maximum payments, length of earn-out periods, manner of calculating any amounts due, etc.) and utilizes assumptions with regard to future cash flows, probabilities of achieving such future cash flows and a discount rate.

The table below presents a reconciliation of the fair value of our liabilities that use significant unobservable inputs (Level 3).

**Fair Value Measurements Using Significant Unobservable Inputs (Level 3)**

|                                               | <b>Contingent Consideration<br/>FVTech<br/>Acquisition</b> | <b>HTMS<br/>Acquisition</b> | <b>Total</b> |
|-----------------------------------------------|------------------------------------------------------------|-----------------------------|--------------|
| Balance at January 1, 2010                    | \$                                                         | \$                          | \$           |
| Issuances                                     | (14,910)                                                   | (9,060)                     | (23,970)     |
| Total changes included in other income (loss) | (290)                                                      |                             | (290)        |
| Balance at March 31, 2010                     | \$ (15,200)                                                | \$ (9,060)                  | \$ (24,260)  |



**Table of Contents**

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)**

***Assets and Liabilities Measured at Fair Value upon Initial Recognition***

The carrying amount and the estimated fair value of financial instruments held by the Company as of March 31, 2010 were:

|                                    | <b>Amount</b> | <b>Fair Value</b> |
|------------------------------------|---------------|-------------------|
| Cash and cash equivalents          | \$ 220,418    | \$ 220,418        |
| Accounts receivable                | \$ 152,646    | \$ 152,646        |
| Long-term debt (credit facilities) | \$ 804,273    | \$ 838,351        |

The carrying amounts of cash equivalents and accounts receivable approximate fair value because of their short-term maturities. The fair value of long-term debt is based upon market trades by investors in partial interests of these instruments.

**9. Legal Proceedings**

In the normal course of business, the Company is involved in various claims and legal proceedings. While the ultimate resolution of these matters has yet to be determined, the Company does not believe that their outcomes will have a material adverse effect on the Company's consolidated financial position, results of operations or liquidity.

**10. Capital Stock**

***Common Stock***

Under the Company's amended and restated certificate of incorporation, the Company is authorized to issue 400,000,000 shares of Class A common stock and 52,000,000 shares of Class B common stock, each with a par value of \$0.00001. The Class A common stock and Class B common stock each provide holders with one vote on all matters submitted to a vote of stockholders; however, the holders of Class B common stock do not have any of the economic rights (including rights to dividends and distributions upon liquidation) provided to the holders of the Class A common stock. Shares of Class B common stock, together with the corresponding EBS Units, may be exchanged with the Company for shares of Class A common stock on a one-for-one basis, subject to customary conversion rate adjustments for stock splits, stock dividends and reclassifications. All shares of Class A common stock and Class B common stock generally vote together, as a single class, on all matters submitted to a vote of the Company's stockholders.

***Preferred Stock***

Under the Company's amended and restated certificate of incorporation, the Company is authorized to issue 25,000,000 shares of preferred stock, with a par value of \$0.00001 per share.

***Initial Public Offering***



On August 11, 2009, the Company priced the IPO of its Class A common stock pursuant to a Registration Statement on Form S-1 (File No. 333-153451), as amended, and Registration Statement on Form S-1MEF (File No. 333-161270) (collectively, the Registration Statements ) filed with the Securities and Exchange Commission. In the IPO, an aggregate of 27,255,000 shares of Class A common stock, consisting of 10,725,000 Class A shares registered on behalf of the Company and 16,530,000 Class A shares registered on behalf of selling stockholders

**Table of Contents****Emdeon Inc.****Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)**

(including 3,555,000 Class A shares representing an over-allotment option granted by the selling stockholders to the underwriters in the IPO) were offered and sold to the public at a price per share of \$15.50. The IPO closed on August 17, 2009, and the Company raised a total of approximately \$166,238 in gross proceeds from the IPO, or \$144,915 in net proceeds after deducting underwriting commissions and other associated costs (including approximately \$3,100 of offering expenses paid in 2008).

***Noncontrolling Interests***

The Company has executed transactions that both increased and decreased its ownership interest in EBS Master. These changes are summarized in the following table:

|                                                                                                                                                            | <b>Three Months Ended<br/>March 31,</b> |             |
|------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------|-------------|
|                                                                                                                                                            | <b>2010</b>                             | <b>2009</b> |
| Net income attributable to Emdeon Inc.                                                                                                                     | \$ 1,889                                | \$ 1,218    |
| Transfers from the noncontrolling interest:                                                                                                                |                                         |             |
| Increase in Emdeon Inc. paid-in capital for issuance of 152,532 EBS Units in connection with the acquisition of HTMS                                       | 2,391                                   |             |
| Increase in Emdeon Inc. paid-in capital for issuance of 5,592 EBS Units in connection with vesting of restricted Class A common stock units of Emdeon Inc. | 16                                      |             |
| Increase in Emdeon Inc. paid-in capital for exchange of 36,829 EBS Units to Class A common stock of Emdeon Inc.                                            | 425                                     |             |
| Increase in Emdeon Inc. paid-in capital for cancellation of 26,984 EBS Units                                                                               | 127                                     |             |
| Net transfers from noncontrolling interest                                                                                                                 | 2,959                                   |             |
| Change from net income attributable to Emdeon Inc. and transfers from noncontrolling interest                                                              | \$ 4,848                                | \$ 1,218    |

**11. Equity-Based Compensation Plans**

During the three months ended March 31, 2010, the Company issued 264,450 restricted Class A common stock units and 1,362,200 options to purchase Class A common stock to certain of the Company's employees with an aggregate grant date fair value of \$14,836. These restricted Class A common stock units and options to purchase Class A common stock generally vest ratably over a four-year vesting period.

During the three months ended March 31, 2010 and 2009, the Company recognized equity-based compensation expense of \$3,675 and \$2,576, respectively.

**12. Income Taxes**

Income taxes for the three months ended March 31, 2010 and 2009 amounted to an expense of \$10,630 and \$7,602, respectively. The Company's effective tax rate was 71.4% for the three months ended March 31, 2010 compared with 69.8% during the same period in 2009. The Company's effective tax rate is affected by deferred tax

**Table of Contents**

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)**

expense resulting from differences between the book and income tax basis of its investment in EBS Master, as well by changes in the Company's valuation allowances. The Company has recorded a valuation allowance against \$295,756 of state net operating losses and \$7,931 of capital losses as of March 31, 2010. Changes in these valuation allowance resulted in \$4,363 of additional income tax expense for the three months ended March 31, 2010.

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

|                                               |          |
|-----------------------------------------------|----------|
| Unrecognized benefit January 1, 2010          | \$ 5,982 |
| Increase in three months ended March 31, 2010 | 668      |
| Unrecognized benefit March 31, 2010           | \$ 6,650 |

The Company increased its liability for uncertain tax positions by \$668 during the three months ended March 31, 2010 which was primarily related to state net operating losses (recorded as an adjustment to the valuation allowance), that if recognized, would affect the effective income tax rate.

The Company does not currently anticipate that the total amount of unrecognized tax positions will significantly increase or decrease in the next twelve months.

The Company recognizes interest income and expense (if any) related to income taxes as a component of income tax expense.

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. The Company's U.S. federal and state income tax returns for the tax years 2006 and beyond remain subject to examination by the Internal Revenue Service. With respect to state and local jurisdictions and countries outside of the United States, the Company and its subsidiaries are typically subject to examination for a number of years after the income tax returns have been filed. Although the outcome of tax audits is always uncertain, the Company believes that adequate amounts of tax, interest and penalties have been provided for in the accompanying unaudited condensed consolidated financial statements for any adjustments that may be incurred due to state, local or foreign audits.

**13. Tax Receivable Agreement Obligation to Related Parties**

In connection with the IPO, the Company entered into tax receivable agreements which obligate the Company to make payments to certain parties affiliated with General Atlantic, H&F and former EBS Master Grant Unit holders generally equal to 85% of the applicable cash savings that the Company realizes as a result of tax attributes arising from the 2006 Transaction, the 2008 Transaction and the former EBS Master Grant Unit holders' exchange of EBS Units for cash or shares of Class A common stock. The Company will retain the benefit of the remaining 15% of these tax savings.

All future exchanges of EBS Units for cash or shares of Class A common stock related to the affiliates of General Atlantic, H&F and the former EBS Master Grant Unit holders who are parties to the tax receivable agreements are

expected to result in an additional tax receivable obligation for the Company with a corresponding offset to the Company's additional paid in capital account. Subsequent adjustments of the tax receivable obligations due to certain events (e.g. realization of net operating losses, tax rate changes or the timing of cash settlement obligations) are expected to result in a corresponding adjustment of the Company's net income. As a result of a

Table of Contents**Emdeon Inc.****Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)**

change in the Company's income tax rate during the period, the Company recognized a change in estimate related to this obligation of approximately \$1,480 (increase to pretax income) for the three months ended March 31, 2010.

**14. Net Income Per Share**

The following tables sets forth the computation of basic and diluted net income per share of Class A common stock:

|                                                 | <b>Three Months Ended<br/>March 31,</b> |             |
|-------------------------------------------------|-----------------------------------------|-------------|
|                                                 | <b>2010</b>                             | <b>2009</b> |
| Basic net income per share:                     |                                         |             |
| Numerator:                                      |                                         |             |
| Net income attributable to Emdeon Inc.          | \$ 1,889                                | \$ 1,218    |
| Denominator:                                    |                                         |             |
| Weighted average common shares outstanding      | 90,461,968                              | 77,413,610  |
| Basic net income per share                      | \$ 0.02                                 | \$ 0.02     |
| Diluted net income per share:                   |                                         |             |
| Numerator:                                      |                                         |             |
| Net income attributable to Emdeon Inc.          |                                         | \$ 1,218    |
| Net loss excluding EBS Master                   | \$ (6,728)                              |             |
| Weighted average effect of dilutive securities  |                                         |             |
| Add:                                            |                                         |             |
| Emdeon Inc. allocation of EBS Master net income | 8,681                                   |             |
|                                                 | \$ 1,953                                | \$ 1,218    |
| Denominator:                                    |                                         |             |
| Number of shares used in basic computation      | 90,461,968                              | 77,413,610  |
| Weighted average effect of dilutive securities  |                                         |             |
| Add:                                            |                                         |             |
| Restricted Class A common stock units           | 6,089                                   |             |
|                                                 | 90,468,057                              | 77,413,610  |
| Diluted net income per share                    | \$ 0.02                                 | \$ 0.02     |

Due to their antidilutive effect, the following securities have been excluded from diluted net income per share for the respective periods:

|                                          | <b>Three Months Ended March 31,</b> |             |
|------------------------------------------|-------------------------------------|-------------|
|                                          | <b>2010</b>                         | <b>2009</b> |
| Class B common stock                     | 23,398,027                          | 22,586,390  |
| Options to purchase Class A common stock | 4,892,809                           |             |

**Table of Contents****Emdeon Inc.****Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)****15. Loss on Abandonment of Leased Properties**

During 2009, the Company ceased use of certain properties in Jessup, Maryland and Largo, Florida. During 2008, the Company ceased use of property subject to operating leases in Nashville, Tennessee and Scottsdale, Arizona.

The following table summarizes the activity related to these contract termination costs for three months ended March 31, 2010:

|                                 |          |
|---------------------------------|----------|
| Balance at December 31, 2009    | \$ 2,170 |
| Costs incurred                  | (109)    |
| Costs paid or otherwise settled | (408)    |
| Balance at March 31, 2010       | \$ 1,653 |

The estimate of the original loss, as well as all subsequent amortization associated with the abandonment of these operating leases, is classified within sales, general and administrative expense in the accompanying unaudited condensed consolidated statement of operations. As of March 31, 2010, the Company had incurred cumulative costs associated with the abandonment of these operating leases of \$4,646.

**16. Segment Reporting**

Management views the Company's operating results in three reportable segments: (a) payer services, (b) provider services and (c) pharmacy services. Listed below are the results of operations for each of the reportable segments. This information is reflected in the manner utilized by management to make operating decisions, assess performance and allocate resources. Segment assets are not presented to management for purposes of operational decision making, and therefore are not included in the accompanying tables. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies in the notes to the Company's 2009 audited consolidated financial statements included in the Annual Report on Form 10-K for the year ended December 31, 2009.

***Payer Services Segment***

The payer services segment provides claims management and payment distribution products and services to healthcare payers, both directly and through the Company's channel partners, that simplify the administration of healthcare related to insurance eligibility and benefit verification, claims filing, payment integrity and claims and payment distribution. Additionally, the payer services segment provides management consulting services primarily to healthcare payers.

***Provider Services Segment***

The provider services segment provides revenue cycle management solutions, patient billing and payment services and clinical exchange capabilities to healthcare providers, both directly and through the Company's channel partners, that simplify the providers' revenue cycle, reduce related costs and improve cash flow.





**Table of Contents****Emdeon Inc.****Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)*****Pharmacy Services Segment***

The pharmacy services segment provides electronic prescribing services and other electronic solutions to pharmacies, pharmacy benefit management companies and government agencies related to prescription benefit claim filing, adjudication and management.

***Other***

Inter-segment revenue and expenses primarily represent claims management and patient statement services provided between segments.

Corporate and eliminations includes personnel and other costs associated with the Company's management, administrative and other corporate services functions and eliminations to remove inter-segment revenues and expenses.

The revenue and total segment contribution for the reportable segments are as follows:

**For the Three Months Ended March 31, 2010**

|                                              | <b>Payer</b> | <b>Provider</b> | <b>Pharmacy</b> | <b>Corporate<br/>&amp;<br/>Eliminations</b> | <b>Consolidated</b> |
|----------------------------------------------|--------------|-----------------|-----------------|---------------------------------------------|---------------------|
| Revenue from external customers              |              |                 |                 |                                             |                     |
| Claims management                            | \$ 45,476    | \$              | \$              | \$                                          | \$ 45,476           |
| Payment services                             | 56,820       |                 |                 |                                             | 56,820              |
| Patient statements                           |              | 66,676          |                 |                                             | 66,676              |
| Revenue cycle management                     |              | 40,674          |                 |                                             | 40,674              |
| Dental                                       |              | 7,937           |                 |                                             | 7,937               |
| Pharmacy services                            |              |                 | 19,696          |                                             | 19,696              |
| Inter-segment revenues                       | 873          | 87              |                 | (960)                                       |                     |
| Net revenue                                  | 103,169      | 115,374         | 19,696          | (960)                                       | 237,279             |
| Costs and expenses:                          |              |                 |                 |                                             |                     |
| Cost of operations                           | 66,817       | 71,372          | 6,725           | (928)                                       | 143,986             |
| Development and engineering                  | 3,015        | 3,824           | 1,715           |                                             | 8,554               |
| Sales, marketing, general and administrative | 6,873        | 6,816           | 1,558           | 10,872                                      | 26,119              |
| Segment contribution                         | \$ 26,464    | \$ 33,362       | \$ 9,698        | \$ (10,904)                                 | 58,620              |
| Depreciation and amortization                |              |                 |                 |                                             | 27,775              |
| Interest income                              |              |                 |                 |                                             | (3)                 |

|                                    |           |
|------------------------------------|-----------|
| Interest expense                   | 15,665    |
| Other loss                         | 290       |
| Income before income tax provision | \$ 14,893 |

**Table of Contents****Emdeon Inc.****Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)****For the Three Months Ended March 31, 2009**

|                                              | <b>Payer</b> | <b>Provider</b> | <b>Pharmacy</b> | <b>Corporate<br/>&amp;<br/>Eliminations</b> | <b>Consolidated</b> |
|----------------------------------------------|--------------|-----------------|-----------------|---------------------------------------------|---------------------|
| Revenue to external customers                |              |                 |                 |                                             |                     |
| Claims management                            | \$ 45,112    | \$              | \$              | \$                                          | \$ 45,112           |
| Payment services                             | 50,346       |                 |                 |                                             | 50,346              |
| Patient statements                           |              | 68,672          |                 |                                             | 68,672              |
| Revenue cycle management                     |              | 37,746          |                 |                                             | 37,746              |
| Dental                                       |              | 7,760           |                 |                                             | 7,760               |
| Pharmacy services                            |              |                 | 10,249          |                                             | 10,249              |
| Inter-segment revenue                        | 70           | 464             |                 | (534)                                       |                     |
| Net revenue                                  | 95,528       | 114,642         | 10,249          | (534)                                       | 219,885             |
| Costs and expenses:                          |              |                 |                 |                                             |                     |
| Cost of operations                           | 59,876       | 73,434          | 1,849           | (420)                                       | 134,739             |
| Development and engineering                  | 2,632        | 3,422           | 1,021           |                                             | 7,075               |
| Sales, marketing, general and administrative | 5,854        | 7,492           | 978             | 9,836                                       | 24,160              |
| Segment contribution                         | \$ 27,166    | \$ 30,294       | \$ 6,401        | \$ (9,950)                                  | 53,911              |
| Depreciation and amortization                |              |                 |                 |                                             | 25,098              |
| Interest income                              |              |                 |                 |                                             | (21)                |
| Interest expense                             |              |                 |                 |                                             | 17,942              |
| Income before income tax provision           |              |                 |                 |                                             | \$ 10,892           |

**17. Accumulated Other Comprehensive (Loss) Income**

The following is a summary of the accumulated other comprehensive (loss) income balances, net of taxes and noncontrolling interest, as of and for the three months ended March 31, 2010.

| <b>Foreign<br/>Currency<br/>Translation<br/>Adjustment</b> | <b>Net Losses<br/>on Cash<br/>Flow<br/>Hedging<br/>Derivatives</b> | <b>Discontinued<br/>Cash Flow<br/>Hedge</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income</b> |
|------------------------------------------------------------|--------------------------------------------------------------------|---------------------------------------------|-----------------------------------------------------------|
|------------------------------------------------------------|--------------------------------------------------------------------|---------------------------------------------|-----------------------------------------------------------|

Edgar Filing: Emdeon Inc. - Form 10-Q

|                                                     |    |      |    |         |    |         |    |          |
|-----------------------------------------------------|----|------|----|---------|----|---------|----|----------|
| Balance at December 31, 2009                        | \$ | (32) | \$ | (4,439) | \$ | (6,727) | \$ | (11,198) |
| Change associated with foreign currency translation |    | 58   |    |         |    |         |    | 58       |
| Change associated with current period hedging       |    |      |    | (3,350) |    |         |    | (3,350)  |
| Reclassification into earnings                      |    |      |    | 4,168   |    | 988     |    | 5,156    |
| Balance at March 31, 2010                           | \$ | 26   | \$ | (3,621) | \$ | (5,739) | \$ | (9,334)  |

**Table of Contents**

**Emdeon Inc.**

**Notes to Condensed Consolidated Financial Statements (Continued)**  
**(unaudited and amounts in thousands, except share and per share amounts)**

**18. Subsequent Event**

In April 2010, the Company exercised its option (with a specified effective date of May 1, 2010) to acquire certain additional rights to specified uses of its data from HLTH. The Company expects to record an additional amortizable intangible asset with an estimated life of approximately eight years and an obligation of approximately \$6,300 based on the present value of the scheduled annual payments through 2018.

**Table of Contents**

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

The following discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements and the accompanying notes included in Part I, Item 1 of this Quarterly Report on Form 10-Q ( Quarterly Report ), together with the risk factors contained in the section titled Risk Factors Part II, Item 1A of this Quarterly Report and in our Annual Report on Form 10-K for the year ended December 31, 2009 ( Form 10-K ) on file with the Securities and Exchange Commission (the SEC ).

Unless stated otherwise or the context otherwise requires, references in this Quarterly Report to we, us, our, Emdeon and the Company refer to Emdeon Inc. and its subsidiaries.

**Forward-Looking Statements**

This Quarterly Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. You should not place undue reliance on those statements because they are subject to numerous uncertainties and factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control. Forward-looking statements include information concerning our possible or assumed future results of operations, including descriptions of our business strategy. These statements often include words such as may, will, should, believe, expect, anticipate, intend, plan, estimate or similar expressions. These statements are based upon assumptions that we have made in light of our experience in the industry, as well as our perceptions of historical trends, current conditions, expected future developments and other factors we believe are appropriate under the circumstances. As you read this Quarterly Report, you should understand that these statements are not guarantees of performance or results. They involve known and unknown risks, uncertainties and assumptions. Although we believe that these forward-looking statements are based upon reasonable assumptions, you should be aware that many factors could affect our actual financial results or results of operations and could cause actual results to differ materially from those in the forward-looking statements. For further information about these and other factors that could affect our future results, please see the risk factors contained in the section titled Risk Factors Part II, Item 1A of this Quarterly Report and in our Form 10-K.

Our forward looking statements made herein speak only as of the date on which made. We expressly disclaim any intent, obligation or undertaking to update or revise any forward-looking statements made herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statements are based. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements contained in this Quarterly Report.

**Overview**

We are a leading provider of revenue and payment cycle management solutions, connecting payers, providers and patients in the U.S. healthcare system. Our product and service offerings integrate and automate key business and administrative functions of our payer and provider customers throughout the patient encounter, including pre-care patient eligibility and benefits verification, clinical exchange capabilities, claims management and adjudication, payment integrity, payment distribution, payment posting and denial management, patient billing and payment processing. Our customers are able to improve efficiency, reduce costs, increase cash flow and more efficiently manage the complex revenue and payment cycle process by using our comprehensive suite of products and services.

We deliver our solutions and operate our business in three business segments: (i) payer services, which provides solutions to commercial insurance companies, third party administrators and governmental payers; (ii) provider services, which provides services to hospitals, physicians, dentists and other healthcare providers, such as labs and

home healthcare providers; and (iii) pharmacy services, which provides services to pharmacies, pharmacy benefit



## **Table of Contents**

management companies and other payers. Through our payer services segment, we provide payment cycle solutions, both directly and through our network of companies with which we have contracted, including healthcare information system vendors, such as physician practice management system, hospital information system, payer administration system and electronic medical record vendors ( channel partners ), to market and sell some of our products and services that simplify the administration of healthcare related to insurance eligibility and benefit verification, claims filing, payment integrity and claims and payment distribution. Additionally, we provide management consulting services through our payer services segment. Through our provider services segment, we provide revenue cycle management solutions, patient billing and payment services and clinical exchange capabilities, both directly and through our channel partners, that simplify providers' revenue cycle, reduce related costs and improve cash flow. Through our pharmacy services segment, we provide electronic prescribing services and other electronic solutions to pharmacies, pharmacy benefit management companies and government agencies related to prescription benefit claim filing, adjudication and management.

There are a number of company-specific initiatives and industry trends that may affect our transaction volumes, revenues, cost of operations and margins. As part of our strategy, we encourage our customers to migrate from paper-based claim, patient statement, payment and other transaction processing to electronic, automated processing in order to improve efficiency. Our business is aligned with our customers to support this transition, and as they migrate from paper-based transaction processing to electronic processing, even though our revenues for an applicable customer generally will decline, our margins and profitability will typically increase. For example, because the cost of postage is included in our revenues for patient statement and payment distribution services (which is then also deducted as a cost of operations), when our customers transition to electronic processing, our revenues and costs of operations are expected to decrease as we will no longer incur or be required to charge for postage. As another example, as our payer customers migrate to exclusive eligibility and benefits verification and/or claims management services agreements with us, which we refer to as Managed Gateway Agreements ( MGAs ), our electronic transaction volume usually increases while the rebates we pay and the per transaction rate we charge under these agreements is typically reduced.

Part of our strategy also includes the development and introduction of new products and services. Our new and updated products and services are likely to require us to incur development and engineering expenditures at levels similar to, and possibly greater than, recent years' expenditures in order to successfully develop and achieve market acceptance of such products and services. We also may acquire, or enter into agreements with third parties to assist us in providing, new products and services. For example, we offer, or plan to offer, our electronic payment solutions through banks or vendors who contract with banks and other financial service firms. The costs of these initiatives or the failure to achieve broad penetration in target markets with respect to new or updated products and services may negatively affect our results of operations and margins.

In addition to our internal development efforts, we actively evaluate opportunities to improve and expand our solutions through strategic acquisitions. Our acquisition strategy focuses on identifying acquisitions that improve and streamline the healthcare revenue and payment cycle. We believe our broad customer footprint allows us to deploy acquired products and services into our installed base, which, in turn, can help to accelerate growth of our acquired businesses. We also believe our management team's ability to identify acquisition opportunities that are complementary and synergistic to our business and to integrate them into our existing operations with minimal disruption, will continue to play an important role in the expansion of our business and in our growth. Our success in acquiring and integrating acquired businesses into our existing operations, the associated costs of such acquisitions, including integration costs, and the operating characteristics of the acquired businesses also may impact our results of operations and margins.

We also expect to continue to be affected by general economic, regulatory and demographic factors affecting the health care industry. For several years, there has been pricing pressure in our industry, which has led (and is expected

to continue to lead) to reduced prices for the same services. We have sought in the past and will continue to seek to mitigate pricing pressure by (i) providing additional value-added products and services, (ii) increasing the

## **Table of Contents**

volume of services we provide and (iii) managing our costs. In addition, significant changes in regulatory schemes, such as the updated Health Insurance Portability and Accountability Act of 1996 ( HIPAA ) Version 5010 standard electronic transaction code set requirements for ICD-10, American Recovery and Reinvestment Act of 2009 ( ARRA ), Patient Protection and Affordable Care Act (as amended by the Health Care and Education Reconciliation Act of 2010) (the PPACA ) and other federal healthcare policy initiatives could impact our customers' healthcare activities. Demographic trends affecting the healthcare industry, such as population growth and aging or higher unemployment rates as a result of the recent economic downturn, also could affect the frequency and nature of our customers' healthcare transactional activity. The impact of such changes could impact our revenues, cost of operations and infrastructure expenses and thereby affect our results of operations and the way we operate our business. For example, an increase in the U.S. population, if such increase is accompanied by an increase in the U.S. population that has health benefits, or the aging of the U.S. population, which requires an overall increased need for healthcare services, may result in an increase in our transaction volumes which, in turn, may increase our revenues and costs of operations. Alternatively, a general economic downturn which reduces the number of discretionary health procedures by patients or a persistent high unemployment rate, if such unemployment rate is accompanied by a decrease in the U.S. population that has health benefits, may result in a decrease in our transaction volumes, which, in turn, may decrease our revenues and cost of operations.

In March 2010, the President signed PPACA into law. PPACA will change how healthcare services are covered, delivered and reimbursed through expanded coverage of uninsured individuals, reduced Medicare program spending and insurance market reforms. By January 2014, PPACA requires states to expand Medicaid coverage significantly, requires states to establish health insurance exchanges to facilitate the purchase of health insurance by individuals and small employers and provides subsidies to states to create non-Medicaid plans for certain low-income residents. Effective in 2014, PPACA imposes penalties on individuals who do not obtain health insurance and employers that do not provide health insurance to their employees. PPACA also sets forth several health insurance market reforms, including increased dependent coverage, prohibitions on excluding individuals based on pre-existing conditions and mandated minimum medical loss ratios for health plans. In addition, PPACA provides for significant new taxes, including an industry user tax paid by health insurance companies beginning in 2014, as well as an excise tax on health insurers and employers offering high cost health coverage plans. PPACA also imposes significant Medicare Advantage funding cuts and material reductions to Medicare and Medicaid program spending. PPACA provides for additional resources to combat healthcare fraud, waste and abuse and also requires the Department of Health & Human Services ( HHS ) to adopt standards for electronic transactions in addition to those required under HIPAA and to establish operating rules to promote uniformity in the implementation of each standardized electronic transaction.

In addition to federal reform, several states are considering, or may consider, legislative proposals that could affect our business or our customers. Because of the many variables involved, including PPACA's complexity, lack of implementing regulations or interpretive guidance, gradual implementation, and possible amendment or repeal, we are unable to predict all of the ways in which PPACA could impact us. See Risk Factors Part II, Item 1A of this Quarterly Report. While many of the provisions of PPACA will not be directly applicable to us, PPACA will affect the business of our payer, provider and pharmacy customers and will also affect the Medicaid programs of the states with which we have contracts. Because it is too early to fully understand the impacts of the legislation on our business or on the business of our customers, we are currently unable to predict with any reasonable certainty or otherwise quantify the likely impact of PPACA on our business model, financial condition or result of operations.

## **Organizational Structure**

The Company is a Delaware corporation. A brief history of our organizational structure is as follows:

Prior to November 2006, the group of companies that comprised Emdeon Business Services ( EBS ) was owned by HLTH Corporation ( HLTH ). EBS Master LLC ( EBS Master ) was formed by HLTH to act as a



## **Table of Contents**

holding company for EBS. EBS Master, through its 100% owned subsidiary, Emdeon Business Services LLC ( EBS LLC ), owns EBS.

In September 2006, we were formed by General Atlantic LLC ( General Atlantic ) as a Delaware limited liability company for the purpose of making an investment in EBS Master. In November 2006, we acquired a 52% interest in EBS Master from HLTH (the 2006 Transaction ). HLTH retained a 48% interest in EBS Master upon closing of the 2006 Transaction.

In February 2008, HLTH sold its remaining 48% interest in EBS Master (the 2008 Transaction ) to affiliates of General Atlantic and Hellman & Friedman LLC ( H&F ). As a result, following the 2008 Transaction, EBS Master was owned 65.77% by affiliates of General Atlantic (including us) and 34.23% by affiliates of H&F. General Atlantic and H&F are sometimes referred to herein as the Principal Equityholders.

In connection with our initial public offering ( IPO ), we were converted into a Delaware corporation and changed our name to Emdeon Inc. in September 2008 and completed a corporate restructuring on August 5, 2009 (collectively, the reorganization transactions ).

On August 11, 2009, we priced the IPO of our Class A common stock and began trading on the New York Stock Exchange ( NYSE ) under the symbol EM .

## **Recent Developments**

In January 2010, we acquired Future Vision Investment Group L.L.C. and the assets of two related companies (collectively, FVTech ), a provider of outsourced services specializing in electronic data conversion and information management solutions, for consideration of \$20.0 million in cash at closing, and additional contingent payments of \$0.0 to \$40.0 million in cash based upon the financial performance of the acquired business for the two and three year periods following the closing. This acquisition will allow us to electronically process virtually all patient and third party healthcare payments regardless of the format in which the payments are submitted.

In March 2010, we acquired Healthcare Technology Management Services ( HTMS ), a management consulting company focused primarily on the healthcare payer market. Under the terms of the purchase agreement, the purchase price consisted of \$8.5 million (before the payment of HTMS obligations by us at closing of approximately \$0.7 million), 152,532 shares of our Class A common stock and contingent payments of \$0.0 to \$14.0 million in cash based upon the financial performance of the acquired business for the calendar years 2010, 2011 and 2012. This acquisition will allow us to assist payers in evaluating their existing information technology strategies, systems and technologies in order to help our customers implement effective solutions.

In April 2010, we exercised our option (with a specified effective date of May 1, 2010) to acquire certain additional rights to specified uses of its data from HLTH. The Company expects to record an additional amortizable intangible asset with an estimated life of approximately eight years and an obligation of approximately \$6.3 million based on the present value of the scheduled annual payments through 2018.

## **Our Revenues and Expenses**

We generate virtually all of our revenue by providing products and services that automate and simplify business and administrative functions for payers and providers, generally on either a per transaction, per document, per communication or per member per month basis; or, in some cases, on a monthly flat-fee basis. For certain services, we may charge an implementation fee in conjunction with related setup and connection to our network and other systems. We also receive software license fees and software and hardware maintenance fees, primarily from payers who license

our systems for converting paper claims into electronic ones, and occasionally, sell additional software

**Table of Contents**

and hardware products to such payers. Additionally, we receive management consulting services fees on an hourly, and in some instances, project basis through our payer services segment.

Cost of operations consists primarily of costs related to products and services we provide to customers and costs associated with the operation and maintenance of our networks. These costs include (i) postage and materials costs related to our patient statement and payment distribution services, (ii) rebates paid to our channel partners and (iii) data communications costs, all of which generally vary with our revenues. Cost of operations also includes (i) personnel costs associated with production, network operations, customer support and other personnel, (ii) facilities expenses and (iii) equipment maintenance, which vary less directly with our revenue due to the fixed or semi-fixed nature of these expenses.

The largest component of our cost of operations is currently postage which is primarily incurred in our patient statements and payment services businesses and which is also a component of our revenue in those businesses. Our postage costs increase as our patient statement and payment distribution volumes increase and also when the U.S. Postal Service increases postal rates. U.S. postage rate increases, while generally billed as pass-through costs to our customers, affect our cost of operations as a percentage of revenue. In recent years, we have offset the impact of postage rate increases through cost reductions from efficiency measures, including data communication expense reductions and production efficiencies. Though we plan to continue our efficiency measures, we may not be able to offset the impact of postage rate increases in the future and, as a result, cost of operations as a percentage of revenue may rise if postage rate increases continue. Although the U.S. Postal Service increased postal rates annually from 2006 to 2009, such annual increases may not occur as regularly in the future. For example, in November 2009, the U.S. Postal Service announced that there would be no postal rate increase for 2010.

Rebates are paid to channel partners for electronic and other volumes delivered through our network to certain payers and can be impacted by the number of MGAs we execute with payers, the associated rate structure with our payer customers, the success of our direct sales efforts for provider revenue cycle management products and services and the extent to which direct connections to payers are developed by channel partners.

Our data communication expense consists of telecommunication and transaction processing charges. Over the last several years, we have been able to reduce our data communication expense due to efficiency measures and contract pricing changes. Due to the significance of these past reductions in recent years, further reductions may have a lesser impact in future periods.

Our material costs relate primarily to our patient statement and payment distribution volumes, and consist primarily of paper and printing costs.

Development and engineering expense consists primarily of personnel costs related to the development, management and maintenance of our current and future products and services. We plan to invest more in this area in the future as we develop new products and enhance existing products.

Sales, marketing, general and administrative expense (excluding corporate expense described in the next paragraph) consists primarily of personnel costs associated with our sales, account management and marketing functions and management and administrative services related to the operations of our business segments.

Our corporate expense relates to personnel costs associated with management, administrative, finance, human resources, legal, marketing, public relations and other corporate service functions as well as professional services, costs incurred in connection with acquisitions, certain facilities costs, advertising and promotion, insurance and other expenses related to our overall business operations. Since the IPO, we have incurred costs and we expect to incur additional costs related to operating as a public company, including additional directors and officers liability

insurance, outside director compensation, additional personnel costs and Sarbanes-Oxley Act of 2002  
( Sarbanes-Oxley ) and other compliance costs.



**Table of Contents**

Our development and engineering expense, sales, marketing, general and administrative expense and our corporate expense, while related to our current operations, are also affected and influenced by our future plans (including the development of new products and services), business strategies and enhancement and maintenance of our infrastructure.

**Significant Items Affecting Comparability**

Certain significant items or events should be considered to better understand differences in our results of operations from period to period. We believe that the following items or events have had a significant impact on our results of operations for the periods discussed below or may have a significant impact on our results of operations in future periods:

***Acquisitions and Divestitures***

We actively evaluate opportunities to improve and expand our business through targeted acquisitions that are consistent with our strategy. On occasion, we also may dispose of certain components of our business that no longer fit within our overall strategy. Because of our acquisition and divestiture activity, our results of operations may not be directly comparable among periods. The following summarizes our acquisition and divestiture transactions from January 1, 2009 through March 31, 2010 and the affected segments:

| <b>Date</b>  | <b>Acquisition</b>             | <b>Description</b>                                                                | <b>Affected Segment</b> |
|--------------|--------------------------------|-----------------------------------------------------------------------------------|-------------------------|
| June 2009    | The Sentinel Group             | Fraud and abuse management solutions                                              | Payer                   |
| July 2009    | eRx Network, L.L.C.<br>( eRx ) | Electronic pharmacy healthcare solutions                                          | Pharmacy                |
| October 2009 | Data Rights                    | Acquired certain additional rights to specified uses of data from HLTH/WebMD Corp | N/A                     |
| January 2010 | FVTech                         | Electronic data conversion and management solutions                               | Provider; Payer         |
| March 2010   | HTMS                           | Management consulting solutions                                                   | Payer                   |

| <b>Effective Date</b> | <b>Divestiture</b> | <b>Description</b>                 | <b>Affected Segment</b> |
|-----------------------|--------------------|------------------------------------|-------------------------|
| October 2009          | Control-o-Fax      | Office supplies and print services | Provider                |

***Income Taxes***

Our statutory federal and state income tax rate generally ranges from 38% to 40%. Several factors, however, can affect the Company's effective tax rate for particular periods. Among these factors are the following items:

*Valuation allowance changes* We record valuation allowances or reverse existing valuation allowances related to assumed future income tax benefits depending on circumstances and factors related to our business. During the three months ended March 31, 2010, the Company recognized an increase in income tax expense of approximately \$4.4 million related to changes in valuation allowances.

*Changes in our book and tax basis in EBS Master* Certain items, including certain equity-based compensation, other comprehensive income and income of corporate consolidated subsidiaries of EBS Master, affect our book basis in EBS Master without similarly affecting our tax basis in EBS Master.

*Changes in apportioned state income tax rate* Changes in our operations also may cause our apportioned state income tax rate to change from period to period. Such rate changes may require adjustment to our existing deferred income tax assets and liabilities that have been recorded primarily as a result of our investment in EBS Master, as well as the 2006 Transaction and 2008 Transaction.

**Table of Contents*****Stock-Based and Equity-Based Compensation Expense***

Prior to the IPO, certain of our employees and directors participated in one of two equity-based compensation plans the Amended and Restated EBS Executive Equity Incentive Plan (the EBS Equity Plan) and the Amended and Restated EBS Incentive Plan (the EBS Phantom Plan). In connection with the IPO, outstanding awards under the EBS Phantom Plan were converted into awards under the 2009 Equity Incentive Plan adopted by the Company's stockholders in July 2009 (the 2009 Plan) and outstanding awards under the EBS Equity Plan were converted into units of membership interest in EBS Master (EBS Units) that are governed by individual agreements with certain directors and members of executive management, as well as awards under the 2009 Plan. The EBS Equity Plan consisted of a class of non-voting EBS Master equity units called Grant Units. The Grant Units represented profits interests in EBS Master and appreciated with increases in value of EBS Master. The EBS Phantom Plan was designed to allow individual employees to participate economically in the future growth and value creation at EBS LLC. Each participant received a specified number of units in the EBS Phantom Plan called Phantom Units. These Phantom Units appreciated with increases in value of EBS Master. These Phantom Units did not give employees an ownership interest in the Company and had no voting rights.

We incurred stock-based and equity-based compensation expense of \$3.7 million and \$2.6 million during the three months ended March 31, 2010 and 2009, respectively. Comparability among the respective periods has been impacted by the following factors:

*Change in the estimated fair value of liability awards.* All equity-based awards granted under the EBS Equity Plan and EBS Phantom Plan prior to the second quarter of 2009 were classified as liabilities due to certain repurchase features. As liabilities, we were required to adjust the equity-based awards to fair value at the end of each quarter. The fair value of these liabilities generally fluctuated with the value of the underlying EBS Units.

*Modification of equity-based awards.* In June 2009, we modified the repurchase features of all Grant Units previously granted under the EBS Equity Plan. Following this modification, all Grant Units were reclassified as equity awards. Immediately prior to this reclassification, we adjusted the value of these Grant Units to their fair value. In addition to a change in estimate recognized at the modification date, we also began recognizing compensation expense prospectively based on the increased fair value of these Grant Units at the modification date as compared to the fair value of such awards at March 31, 2009.

*Conversion in connection with the IPO.* In connection with the IPO and reorganization transactions, the Phantom Units were converted into shares of our Class A common stock, restricted Class A common stock units and options to purchase shares of our Class A common stock under the 2009 Plan. As a result of the IPO and this conversion, in addition to a change in estimate recognized at the IPO date, we also began recognizing compensation expense prospectively based on the increased fair value of these Phantom Units at the IPO date as compared to the fair value of the Phantom Units at March 31, 2009.

*Grant of options.* On and since the IPO date, we have granted restricted Class A common stock units and options to purchase shares of our Class A common stock to certain of our employees and directors.

**Critical Accounting Policies**

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expense and related disclosures. We base our estimates and assumptions on the best information available to us at the time the estimates and assumptions are

made, on historical experience and on various other factors that we believe to be reasonable under the circumstances. We evaluate our estimates and assumptions on an ongoing basis. Our actual results may differ from these estimates under different assumptions or conditions.

**Table of Contents**

We believe there have been no significant changes during the three months ended March 31, 2010 to the items we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Form 10-K.

**Results of Operations**

The following table summarizes our consolidated results of operations for the three months ended March 31, 2010 and the three months ended March 31, 2009.

|                                                               | <b>For the Three Months<br/>Ended<br/>March 31, 2010</b> |                                       | <b>For the Three Months<br/>Ended<br/>March 31, 2009</b> |                                       |
|---------------------------------------------------------------|----------------------------------------------------------|---------------------------------------|----------------------------------------------------------|---------------------------------------|
|                                                               | <b>Amount</b>                                            | <b>% of<br/>Revenue<sup>(1)</sup></b> | <b>Amount</b>                                            | <b>% of<br/>Revenue<sup>(1)</sup></b> |
| Revenues <sup>(2)</sup>                                       |                                                          |                                       |                                                          |                                       |
| Payer Services                                                | \$ 103,169                                               | 43.5%                                 | \$ 95,528                                                | 43.4%                                 |
| Provider Services                                             | 115,374                                                  | 48.6                                  | 114,642                                                  | 52.1                                  |
| Pharmacy Services                                             | 19,696                                                   | 8.3                                   | 10,249                                                   | 4.7                                   |
| Eliminations                                                  | (960)                                                    | (0.4)                                 | (534)                                                    | (0.2)                                 |
| Total revenues                                                | 237,279                                                  | 100.0                                 | 219,885                                                  | 100.0                                 |
| Costs of operations                                           |                                                          |                                       |                                                          |                                       |
| Payer Services                                                | 66,817                                                   | 64.8                                  | 59,876                                                   | 62.7                                  |
| Provider Services                                             | 71,372                                                   | 61.9                                  | 73,434                                                   | 64.1                                  |
| Pharmacy Services                                             | 6,725                                                    | 34.1                                  | 1,849                                                    | 18.0                                  |
| Eliminations                                                  | (928)                                                    |                                       | (420)                                                    |                                       |
| Total costs of operations                                     | 143,986                                                  | 60.7                                  | 134,739                                                  | 61.3                                  |
| Development and engineering                                   |                                                          |                                       |                                                          |                                       |
| Payer Services                                                | 3,015                                                    | 2.9                                   | 2,632                                                    | 2.8                                   |
| Provider Services                                             | 3,824                                                    | 3.3                                   | 3,422                                                    | 3.0                                   |
| Pharmacy Services                                             | 1,715                                                    | 8.7                                   | 1,021                                                    | 10.0                                  |
| Eliminations                                                  |                                                          |                                       |                                                          |                                       |
| Total development and engineering                             | 8,554                                                    | 3.6                                   | 7,075                                                    | 3.2                                   |
| Sales, marketing, general and admin                           |                                                          |                                       |                                                          |                                       |
| Payer Services                                                | 6,873                                                    | 6.7                                   | 5,854                                                    | 6.1                                   |
| Provider Services                                             | 6,816                                                    | 5.9                                   | 7,492                                                    | 6.5                                   |
| Pharmacy Services                                             | 1,558                                                    | 7.9                                   | 978                                                      | 9.5                                   |
| Eliminations                                                  | (32)                                                     |                                       | (114)                                                    |                                       |
| Total sales, marketing, general and admin excluding corporate | 15,215                                                   | 6.4                                   | 14,210                                                   | 6.5                                   |
| Income from segment operations                                | 69,524                                                   | 29.3                                  | 63,861                                                   | 29.0                                  |

Edgar Filing: Emdeon Inc. - Form 10-Q

|                                                    |          |       |          |       |
|----------------------------------------------------|----------|-------|----------|-------|
| Corporate expense                                  | 10,904   | 4.6   | 9,950    | 4.5   |
| Depreciation and amortization                      | 27,775   | 11.7  | 25,098   | 11.4  |
| Operating income                                   | 30,845   | 13.0  | 28,813   | 13.1  |
| Interest income                                    | (3)      | (0.0) | (21)     | (0.0) |
| Interest expense                                   | 15,665   | 6.6   | 17,942   | 8.2   |
| Other loss                                         | 290      | 0.1   |          |       |
| Income before income tax provision                 | 14,893   | 6.3   | 10,892   | 5.0   |
| Income tax provision                               | 10,630   | 4.5   | 7,602    | 3.5   |
| Net income                                         | 4,263    | 1.8%  | 3,290    | 1.5%  |
| Net income attributable to noncontrolling interest | 2,374    |       | 2,072    |       |
| Net income attributable to Emdeon Inc.             | \$ 1,889 |       | \$ 1,218 |       |

(1) All references to percentage of revenues for expense components refer to the percentage of revenues for such segment.

(2) See Note 16-Segment Reporting to our unaudited condensed consolidated financial statements for further detail of our revenues within each reportable segment.

**Table of Contents****Three Months Ended March 31, 2010 Compared to Three Months Ended March 31, 2009*****Revenues***

Our total revenues were \$237.3 million for three months ended March 31, 2010 as compared to \$219.9 million for the three months ended March 31, 2009, an increase of approximately \$17.4 million, or 7.9%.

Our payer services segment revenue is summarized by product line in the following table:

|                      | <b>March 31,<br/>2010</b> | <b>March 31,<br/>2009</b> | <b>\$ Change</b> |
|----------------------|---------------------------|---------------------------|------------------|
| Claims management    | \$ 45,476                 | \$ 45,112                 | \$ 364           |
| Payment services     | 56,820                    | 50,346                    | 6,474            |
| Intersegment revenue | 873                       | 70                        | 803              |
|                      | <b>\$ 103,169</b>         | <b>\$ 95,528</b>          | <b>\$ 7,641</b>  |

Claims management revenues for the three months ended March 31, 2010 increased by approximately \$0.4, or 0.8%, from the three months ended March 31, 2009 primarily due to increased payment integrity revenue, as well as the impact of the acquisition of FVTEch in January 2010. Our claims management revenues were also affected by weather conditions and a milder than expected flu season during the current year period and by market pricing pressures on our average transaction rates. Payment services revenues for the three months ended March 31, 2010 increased by approximately \$6.5 million, or 12.9%. This increase was primarily driven by new sales and implementations, as well as the impact of the U.S. postage rate increase effective in May 2009.

Our provider services segment revenue is summarized by product line in the following table:

|                          | <b>March 31,<br/>2010</b> | <b>March 31,<br/>2009</b> | <b>\$ Change</b> |
|--------------------------|---------------------------|---------------------------|------------------|
| Patient statements       | \$ 66,676                 | \$ 68,672                 | \$ (1,996)       |
| Revenue cycle management | 40,674                    | 37,746                    | 2,928            |
| Dental                   | 7,937                     | 7,760                     | 177              |
| Intersegment revenue     | 87                        | 464                       | (377)            |
|                          | <b>\$ 115,374</b>         | <b>\$ 114,642</b>         | <b>\$ 732</b>    |

Patient statements revenues for the three months ended March 31, 2010 decreased by approximately \$2.0 million, or 2.9%, primarily due to the sale of our office supplies and print services business in October 2009 and customer attrition. This decrease was partially offset by new sales and implementations and the impact of the U.S. postage rate increase in May 2009. Revenue cycle management revenues for the three months ended March 31, 2010 increased by approximately \$2.9 million, or 7.8%, primarily from new sales and implementations, partially offset by attrition in legacy products and the impact of weather conditions and the mild flu season. Dental revenues for the three months

ended March 31, 2010 were generally consistent with those reflected in the comparable prior year period.



## **Table of Contents**

Our pharmacy services segment revenues were \$19.7 million for the three months ended March 31, 2010 as compared to \$10.2 million for the three months ended March 31, 2009, an increase of approximately \$9.4 million, or 92.2%. This increase was primarily due to our acquisition of eRx in July 2009, as well as new sales and implementations.

### ***Cost of Operations***

Our total cost of operations was \$144.0 million for the three months ended March 31, 2010 as compared to \$134.7 million for the three months ended March 31, 2009, an increase of approximately \$9.2 million, or 6.9%.

Our cost of operations for our payer services segment was approximately \$66.8 million for the three months ended March 31, 2010 as compared to \$59.9 million for the three months ended March 31, 2009, an increase of approximately \$6.9 million, or 11.6%. As a percentage of revenue, our payer services costs of operations increased to 64.8% for the three months ended March 31, 2010 as compared to 62.7% for the three months ended March 31, 2009. Costs of operations for our payer services segment includes approximately \$0.5 million and \$0.4 million of equity-based compensation for the three months ended March 31, 2010 and 2009, respectively. The increase in our payers services cost of operations is primarily due to revenue growth in payment services, including increased postage costs resulting from the U.S. postage rate increase effective in May 2009, and the inclusion of revenue and associated costs of The Sentinel Group and FVTech businesses which were acquired in May 2009 and January 2010, respectively. The increase as a percentage of revenue was primarily due to changes in revenue mix between our payment services solutions, which generally have higher cost of operations, and claims management services, which generally have lower cost of operations as well as the impact of the acquisitions.

Our cost of operations for our provider services segment was \$71.4 million for the three months ended March 31, 2010 as compared to \$73.4 million for the three months ended March 31, 2009, a decrease of approximately \$2.1 million, or 2.8%. As a percentage of revenue, our provider services segment costs of operations decreased to 61.9% for the three months ended March 31, 2010 as compared to 64.1% for the three months ended March 31, 2009. Costs of operations for our provider services segment includes approximately \$0.1 million and \$0.1 million of equity-based compensation for the three months ended March 31, 2010 and 2009, respectively. The decrease in our provider services cost of operations and as a percentage of revenue is primarily due to changes in revenue mix between our patient statements services, which generally have higher cost of operations, and revenue cycle management services, which generally have lower cost of operations.

Our cost of operations for our pharmacy services segment was \$6.7 million for the three months ended March 31, 2010 as compared to \$1.8 million for the three months ended March 31, 2009, an increase of approximately \$4.9 million, or 263.7%. This increase is primarily related to the inclusion of the revenues and associated costs of the eRx business following the eRx acquisition in July 2009.

### ***Development and Engineering Expense***

Our total development and engineering expense was \$8.6 million for the three months ended March 31, 2010 as compared to \$7.1 million for the three months ended March 31, 2009, an increase of approximately \$1.5 million, or 20.9%. Development and engineering expense includes approximately \$0.3 million and \$0.0 million of equity-based compensation for the three months ended March 31, 2010 and 2009, respectively. In addition to equity-based compensation, the increase is primarily related to increased product development activity in our payer services and provider services segments and the inclusion of the product development infrastructure associated with our eRx and FVTech acquisitions in July 2009 and January 2010, respectively.

## **Table of Contents**

### ***Sales, Marketing, General and Administrative Expense (Excluding Corporate Expense)***

Our total sales, marketing, general and administrative expense (excluding corporate expense) was \$15.2 million for the three months ended March 31, 2010 as compared to \$14.2 million for the three months ended March 31, 2009, an increase of approximately \$1.0 million, or 7.1%.

Our sales, marketing, general and administrative expense for our payer services segment was approximately \$6.9 million for the three months ended March 31, 2010 as compared to \$5.9 million for the three months ended March 31, 2009, an increase of approximately \$1.0 million, or 17.4%. Sales, marketing, general and administrative expense for our payer services segment includes approximately \$0.6 million and \$0.5 million of equity-based compensation for the three months ended March 31, 2010 and 2009, respectively. The increase in our payer services sales, marketing, general and administrative expense is primarily due to the inclusion of the infrastructure associated with The Sentinel Group and FVTEch acquisitions in May 2009 and January 2010, respectively.

Our sales, marketing, general and administrative expense for our provider services segment was approximately \$6.8 million for the three months ended March 31, 2010 as compared to \$7.5 million for the three months ended March 31, 2009, a decrease of approximately \$0.7 million, or 9.0%. Sales, marketing, general and administrative expense for our provider services segment includes approximately \$0.4 million and \$0.3 million of equity-based compensation for the three months ended March 31, 2010 and 2009, respectively. The decrease in our provider services sales, marketing, general and administrative expense is primarily due to certain efficiency measures related to personnel consolidations, which reduced compensation costs as compared to the prior year period. This decrease was partially offset by a moderate increase in bad debt expense related to our revenue cycle management business.

Our sales, marketing, general and administrative expense for our pharmacy services segment was approximately \$1.6 million for the three months ended March 31, 2010 as compared to \$1.0 million for the three months ended March 31, 2009, an increase of approximately \$0.6 million, or 59.3%. This increase is primarily related to the inclusion of the infrastructure associated with the eRx acquisition in July 2009.

### ***Corporate Expense***

Our corporate expense was \$10.9 million for the three months ended March 31, 2010 as compared to \$10.0 million for the three months ended March 31, 2009, an increase of approximately \$1.0 million, or 9.6%. Corporate expense includes approximately \$1.8 million and \$1.3 million of equity-based compensation for the three months ended March 31, 2010 and 2009, respectively. Excluding this equity-based compensation, corporate expense was \$9.1 million for the three months ended March 31, 2010 as compared to \$8.7 million for the three months ended March 31, 2009, an increase of approximately \$0.4 million, or 4.5%. The increase in the current year period was primarily due to incremental costs associated with the infrastructure required to operate as a public company, such as increased directors and officers insurance costs, increased compliance costs and additional finance, legal and other personnel costs. Additionally, corporate expense for three months ended March 31, 2010 includes legal and other professional fees incurred in connection with our acquisitions of FVTEch in January 2010 and HTMS in March 2010, for which no similar fees were incurred in the comparable prior year period. These increases were partially offset by a change in estimate of our tax receivable obligations which reduced corporate expense for the three months ended March 31, 2010 by approximately \$1.5 million.

### ***Depreciation and Amortization Expense***

Our depreciation and amortization expense was \$27.8 million for the three months ended March 31, 2010 as compared to \$25.1 million for the three months ended March 31, 2009, an increase of approximately \$2.7 million, or 10.7%. This increase was primarily due to depreciation of property and equipment placed in service subsequent to March 31,

2009, as well as additional depreciation and amortization expense related to purchase accounting

## **Table of Contents**

adjustments associated with: (i) the eRx and FVTech acquisitions in July 2009 and January 2010, respectively; and (ii) our acquisition from HLTH of certain additional rights to specified uses of our data in October 2009.

### ***Interest Income***

We had minimal interest income for each of the three months ended March 31, 2010 and March 31, 2009. While our interest-bearing cash and cash equivalent balances have increased since March 31, 2009, this increase was more than offset by the effect of a reduction in the market interest rates available to us during the three months ended March 31, 2010.

### ***Interest Expense***

Our interest expense was \$15.7 million for the three months ended March 31, 2010 as compared to \$17.9 million for the three months ended March 31, 2009, a decrease of approximately \$2.3 million, or 12.7%. This decrease is primarily due to a scheduled decrease in the notional amount of our interest rate swap agreement of approximately \$123.6 million that occurred on December 31, 2009. The decrease in the notional amount of our interest rate swap agreement caused interest expense to decline because the fixed rate we paid during three months ended March 31, 2010 under the interest rate swap agreement exceeded the interest rate on our term loans. As a result, less of our debt was subject to the higher fixed rate of our interest rate swap agreement during three months ended March 31, 2010 as compared to the prior period.

### ***Income Taxes***

Our income tax expense was \$10.6 million for the three months ended March 31, 2010 as compared to \$7.6 million for the three months ended March 31, 2009, an increase of approximately \$3.0 million, or 39.8%. Differences between the federal statutory rate and the effective income tax rates for these periods principally relate to the change in our book basis versus tax basis in our investment in EBS Master, including the effect of income allocated to a noncontrolling interest, valuation allowance changes, state income tax rate changes and the impact of other permanent differences relative to pre-tax income. During the three months ended March 31, 2010, the Company recognized an increase in income tax expense of approximately \$4.4 million related to changes in valuation allowances.

## **Liquidity and Capital Resources**

### ***General***

We are a holding company with no material business operations. Our principal asset, other than cash proceeds from the IPO, is the equity interests we own in EBS Master. We conduct all of our business operations through the direct and indirect subsidiaries of EBS Master. Accordingly, our only material sources of cash are the IPO proceeds and dividends or other distributions or payments that are derived from earnings and cash flow generated by the subsidiaries of EBS Master.

We have financed our operations primarily through cash provided by operating activities, private sales of EBS Units to the Principal Equityholders, borrowings under our credit agreements and the IPO. We believe that our existing cash on hand, the net proceeds from the IPO, cash generated from operating activities and available borrowings under our revolving credit agreement (\$45.7 million as of March 31, 2010) will be sufficient to service our existing debt, finance internal growth, fund capital expenditures and fund small to mid-size acquisitions. As of March 31, 2010, we had cash and cash equivalents of \$220.4 million as compared to \$212.0 million as of December 31, 2009.



## **Table of Contents**

Our cash balances in the future may be reduced if we expend our cash on capital expenditures, future acquisitions or elect to make optional prepayments under our credit agreements. In addition, if as a result of the current conditions in the credit markets, any of the lenders participating in our revolving credit agreement become insolvent, it may make it more difficult for us to borrow under our revolving credit agreement, which could adversely affect our liquidity. Credit market instability also may make it more difficult for us to obtain additional financing or refinance our existing credit facilities in the future on acceptable terms. If we were unable to obtain such additional financing when needed or were unable to refinance our credit facilities, our financial condition could be adversely affected.

### ***Cash Flows***

#### ***Operating Activities***

Cash provided by operations for the three months ended March 31, 2010 was \$49.8 million as compared to \$41.7 million for the three months ended March 31, 2009. This \$8.1 million increase is related primarily to business growth and lower interest payments.

#### ***Investing Activities***

Cash used in investing activities for the three months ended March 31, 2010 was \$39.4 million as compared to \$7.1 million for the three months ended March 31, 2009. This increase is due to the acquisitions of FVTech in January 2010 and HTMS in March 2010, as well as increased capital expenditures due to the timing and extent of efficiency measures and product development projects as compared to the prior year period.

#### ***Financing Activities***

Cash used in financing activities for the three months ended March 31, 2010 was \$2.0 million as compared to \$27.7 million for the three months ended March 31, 2009. During the three months ended March 31, 2009, in addition to scheduled principal payments, we also paid amounts previously borrowed under our revolving credit facility and made an optional principal payment under our first lien credit agreement.

### ***Credit Facilities***

In November 2006, our subsidiary, EBS LLC, entered into the first lien credit agreement, which we refer to as the First Lien Credit Agreement, and the second lien credit agreement, which we refer to as the Second Lien Credit Agreement. Together, we refer to the First Lien Credit Agreement and the Second Lien Credit Agreement as the Credit Agreements. The First Lien Credit Agreement provided us \$805.0 million of total available financing, consisting of a secured \$755.0 million term loan facility and a secured \$50.0 million revolving credit facility. The revolving credit facility provides for the issuance of standby letters of credit, in an aggregate face amount at any time not in excess of \$12.0 million. The issuance of standby letters of credit reduces the available capacity under our revolving credit facility. In addition, under the terms of the First Lien Credit Agreement, we can borrow up to an additional \$200.0 million in incremental term loans and increase the available capacity under the revolving credit facility by \$25.0 million, provided that the aggregate amount of such increases may not exceed \$200.0 million. There were no borrowings on our revolving credit facility as of March 31, 2010.

In July 2009, the Credit Agreements were amended to, among other things, provide EBS LLC with the right to fund certain tax obligations, as well as accounting, legal and other costs of the Company (subject to an annual limit of \$5.0 million of these other costs).

Borrowings outstanding under the First Lien Credit Agreement amounted to \$684.5 million as of March 31, 2010, and currently bear interest, at our option, at either an adjusted LIBOR rate plus 2.00% or the lenders' alternate

## **Table of Contents**

base rate plus 1.00%, or a combination of the two. Not including optional prepayments, we are generally required to make quarterly principal payments of approximately \$1.8 million on the term loan facilities of the First Lien Credit Agreement through 2013.

We are required to pay a commitment fee of 0.5% per annum, provided that our total leverage ratio is greater than or equal to 4.0:1, and otherwise 0.375% per annum on the undrawn portion of the revolving credit facility. We are permitted to prepay the revolving credit facility or the term loan under the First Lien Credit Agreement at any time. We are required to prepay amounts outstanding under the First Lien Credit Agreement with proceeds we receive from asset sales that generate proceeds in excess of \$1.0 million if not reinvested (as defined in the Credit Agreements), from indebtedness we incur that is not specifically permitted to be incurred under the First Lien Credit Agreement, with any excess cash flow (as defined in the First Lien Credit Agreement) we generate in any fiscal year and from casualty events.

Our Second Lien Credit Agreement is a term loan facility with an aggregate principal amount of \$170.0 million, which was the amount outstanding as of March 31, 2010. Borrowings outstanding under the Second Lien Credit Agreement currently bear interest, at our option, at either an adjusted LIBOR rate plus 5.00% or the lenders' alternate base rate plus 4.00%, or a combination of the two. We are required to make quarterly interest payments. Although we are permitted to prepay the loans under our Second Lien Credit Agreement at any time, the terms of our First Lien Credit Agreement restrict our ability to make such prepayments to the amount of previous years' retained excess cash flow (as defined under the Credit Agreements) and only if our total leverage ratio is 4.0:1 or better.

The revolving portion of the First Lien Credit Agreement matures in November 2012 and the term loan matures in November 2013. The Second Lien Credit Agreement matures in May 2014. We anticipate refinancing our Credit Agreements prior to or as of their maturity dates. Given the state of the current credit environment resulting from, among other things, a general weakening of the economy, we cannot be certain that we will be successful in our refinancing efforts on acceptable terms, which could have an adverse effect on our liquidity.

The obligations of EBS LLC under the Credit Agreements are unconditionally guaranteed by EBS Master and all of its subsidiaries and are secured by liens on substantially all of EBS Master's assets, including the stock of its subsidiaries.

As of March 31, 2010, total borrowings outstanding under the Credit Agreements amounted to \$854.5 million (before unamortized debt discount of \$50.2 million primarily related to the adjustment of our long-term debt to fair value in connection with the 2008 Transaction). Under the revolving portion of our First Lien Credit Agreement, net of \$4.3 million of outstanding but undrawn letters of credit issued, we had \$45.7 million in available borrowing capacity at March 31, 2010. In connection with the 2008 Transaction, our long-term debt was adjusted to fair value, which resulted in the recording of a debt discount of \$66.4 million.

During the three months ended March 31, 2010, the weighted average cash interest rate of our borrowings under our Credit Agreements was approximately 4.8%. Approximately \$355.2 million of our weighted average debt outstanding during the period was subject to a fixed interest rate of 4.94% under our interest rate swap agreement.

### *Covenants*

The Credit Agreements require us to satisfy specified financial covenants, including a minimum interest coverage ratio and a maximum total leverage ratio, as set forth in the Credit Agreements. The minimum interest coverage ratio permitted was 2.4:1.0 at March 31, 2010 and increases at varying intervals over time until October 1, 2011, at which time it is fixed at 3.5:1.0. At March 31, 2010, we estimate our interest coverage ratio as defined under the Credit Agreements to be approximately 5.4 to 1.0. The maximum total leverage ratio permitted was 4.5:1.0 at March 31,



2010 and declines at varying intervals over time until October 1, 2011, at which time it is fixed

## **Table of Contents**

at 3.0:1.0. At March 31, 2010, we estimate our total leverage ratio to be approximately 3.4 to 1.0 which, under the terms of the Credit Agreements, reflected only \$35.0 million of the cash on our balance sheet at March 31, 2010 as a reduction of our net debt.

The Credit Agreements also limit us with respect to amounts we may spend on capital expenditures. As defined in the Credit Agreements, capital expenditures exclude certain items such as the expenditures made with the retained portion of excess cash flow, replacement of property and equipment, additions funded with equity offering proceeds and additions funded with proceeds of asset sales. The limitation varies based on certain base expenditure levels included in the Credit Agreements and the amount of unused capital expenditures from the previous calendar year, if any, as well as allowable amounts transferred from future year expenditure limits. For the year ending December 31, 2010, our capital expenditures (as defined under the Credit Agreements) are limited to approximately \$60.5 million including allowable transfers from 2011. For the years ending December 31, 2011 and 2012, our capital expenditures are limited to \$41.0 million and \$42.0 million, respectively, excluding any carryovers from previous years and allowable transfers from future years. During 2010, in addition to our normal level of capital expenditures, we currently expect to incur up to \$20.0 to \$25.0 million to replace our primary data center in Nashville, Tennessee and approximately \$12.0 to \$15.0 million for equipment upgrades in our patient statements business.

The Credit Agreements contain negative covenants that may restrict the operation of our business, including our ability to incur additional debt, create liens, make investments, engage in asset sales, enter into transactions with affiliates, enter into sale-leaseback transactions and enter into hedging arrangements. In addition, our Credit Agreements restrict the ability of EBS Master and its subsidiaries to make dividends or other distributions to us, issue equity interests, repurchase equity interests or certain indebtedness or enter into mergers or consolidations.

As of at March 31, 2010, we were in compliance with all of the financial and other covenants under the Credit Agreements.

The Credit Agreements do not contain provisions that would accelerate the maturity date of the loans under the Credit Agreement upon a downgrade in our credit rating. However, a downgrade in our credit rating could adversely affect our ability to obtain other capital sources in the future and could increase our cost of borrowings.

Events of default under the Credit Agreements include non-payment of principal, interest, fees or other amounts when due; violation of certain covenants; failure of any representation or warranty to be true in all material respects when made or deemed made; cross-default and cross-acceleration to indebtedness with an aggregate principal amount in excess of \$20.0 million; certain ERISA events; dissolution, insolvency and bankruptcy events; actual or asserted invalidity of the guarantees or security documents. In addition, a Change of Control (as such term is defined in the Credit Agreements) is an event of default under the Credit Agreements. Some of these events of default allow for grace periods and materiality qualifiers.

## ***Commitments and Contingencies***

The Form 10-K discloses certain commitments and contractual obligations that existed as of December 31, 2009. During the three months ended March 31, 2010, we acquired FVTech and HTMS. The consideration transferred in connection with these acquisitions included contingent obligations to make additional payments based on the achievement of certain financial performance targets. At March 31, 2010, based on current facts and circumstances, we have estimated the aggregate fair value of these contingent obligations at \$24.3 million which we anticipate will be paid at various intervals, if earned, over the next three years.

## **Table of Contents**

### ***Off-Balance Sheet Arrangements***

As of at March 31, 2010, we had no off-balance sheet arrangements or obligations, other than those related to our letters of credit, our interest rate swap agreement, operating leases, contingent consideration arrangements related to certain of our acquisitions and surety bonds of an insignificant amount.

### **Recent Accounting Pronouncements**

In October 2009, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update No. 2009-13, an update to FASB ASC Revenue Recognition Topic, which amends existing accounting standards for revenue recognition for multiple-element arrangements. To the extent a deliverable within a multiple-element arrangement is not accounted for pursuant to other accounting standards, the update establishes a selling price hierarchy that allows for the use of an estimated selling price to determine the allocation of arrangement consideration to a deliverable in a multiple element arrangement where neither vendor-specific objective evidence nor third-party evidence is available for that deliverable. The update is to be applied prospectively for revenue arrangements entered into or materially modified after January 1, 2011 in the case of the Company. The Company is currently evaluating the impact, if any that the pending adoption of the update will have on the Company's consolidated financial statements.

On January 1, 2010, the Company adopted the clarification and additional disclosure provisions of FASB Accounting Standards Update No. 2010-06, an update to FASB ASC Fair Value Measurements and Disclosures Topic. This update clarifies that companies must provide fair value measurement disclosures for each class of assets and liabilities and expands the requirements to include disclosure of amounts and reasons for transfers among different levels within the fair value hierarchy and information within a reconciliation about purchases, sales, issuances and settlements on a gross basis. The adoption of the clarification and additional disclosure provisions of this update had no material impact on the Company's unaudited condensed consolidated financial statements for the quarter ended March 31, 2010. The disclosures required by this update are presented within Note 8 to the unaudited condensed consolidated financial statements. The remaining provisions become effective in the fiscal period beginning after December 31, 2010 (January 1, 2011 in the case of the Company). The Company is currently evaluating the impact, if any, that the pending adoption of the remaining provisions of the update will have on the Company's disclosures in its consolidated financial statements.

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

We have interest rate risk primarily related to borrowings under the Credit Agreements. Term loan borrowings under the First Lien Credit Agreement bear interest, at our option, at either an adjusted LIBOR rate plus 2.00% or the lenders' alternate base rate plus 1.00%, or a combination of the two, and borrowings under the Second Lien Credit Agreement bear interest, at our option, at either an adjusted LIBOR rate plus 5.00% or the lenders' alternate base rate plus 4.00%, or a combination of the two. As of March 31, 2010, we had outstanding borrowings (before unamortized debt discount of \$50.2 million) of \$684.5 million under the First Lien Credit Agreement and \$170.0 million under the Second Lien Credit Agreement.

We manage our interest rate risk through the use of an interest rate swap agreement. Effective December 31, 2006, we entered into an interest rate swap to exchange three month LIBOR rates for fixed interest rates, resulting in the payment of an all-in fixed rate of 4.944% on an initial notional amount of \$786.3 million which amortizes on a quarterly basis until maturity at December 30, 2011. At March 31, 2010, the notional amount of the interest rate swap was \$354.3 million. As a result, as of March 31, 2010, \$500.2 million of our total borrowings were effectively subject to a variable interest rate.

A change in interest rates on variable rate debt impacts our pre-tax earnings and cash flows. Since its redesignation on September 30, 2008, our interest rate swap qualifies for hedge accounting as a cash flow hedge.

## **Table of Contents**

Therefore, future changes in market fluctuations related to the effective portion of this cash flow hedge do not impact our pre-tax earnings until the accrued interest is recognized on the derivative and the associated hedged debt. Based on our outstanding debt as of March 31, 2010, and assuming that our mix of debt instruments, interest rate swap and other variables remain the same, the annualized effect of a one percentage point change in variable interest rates would have a pre-tax impact on our earnings and cash flows of approximately \$5.3 million.

In the future, in order to manage our interest rate risk, we may enter into additional interest rate swaps, modify our existing interest rate swap or make changes that may impact our ability to treat our interest rate swap as a cash flow hedge. However, we do not intend or expect to enter into derivative or interest rate swap transactions for trading or speculative purposes.

## **ITEM 4. *CONTROLS AND PROCEDURES***

### **Disclosure Controls and Procedures**

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, management has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934) as of March 31, 2010. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2010, our disclosure controls and procedures were effective in causing material information relating to us (including our consolidated subsidiaries) to be recorded, processed, summarized and reported by management on a timely basis and to ensure the quality and timeliness of our public disclosures with SEC disclosure obligations.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, with the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error and mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of controls.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, a control may become inadequate because of changes in conditions or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

### **Changes in Internal Control Over Financial Reporting**

There has been no change to our internal control over financial reporting during the three months ended March 31, 2010, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

In the normal course of business, the Company is subject to claims, lawsuits and legal proceedings. While it is not possible to ascertain the ultimate outcome of such matters, in management's opinion, the liabilities, if any, in excess of amounts provided or covered by insurance, are not expected to have a material adverse effect on our consolidated financial position, results of operations or liquidity.

**ITEM 1A. RISK FACTORS**

The discussion of the Company's business and operations should be read together with the risk factors contained in this Part II, Item 1A and under the heading "Risk Factors" of our Form 10-K, which describes various risks and uncertainties to which we are or may be subject. These risks and uncertainties have the potential to affect our business, financial condition and results of operations, cash flows and prospects in a material adverse manner. There have been no material changes to the risk factors set forth in our Form 10-K, except as follows:

***Recent and future developments in the healthcare industry could adversely impact our business.***

*In March 2010, the President signed PPACA into law.* PPACA will change how healthcare services are covered, delivered and reimbursed through expanded coverage of uninsured individuals, reduced Medicare program spending and insurance market reforms. By 2014, PPACA requires states to expand Medicaid coverage significantly, requires states to establish health insurance exchanges to facilitate the purchase of health insurance by individuals and small employers and provides subsidies to states to create non-Medicaid plans for certain low-income residents. Effective in 2014, PPACA imposes penalties on individuals who do not obtain health insurance and employers that do not provide health insurance to their employees. PPACA also sets forth several insurance market reforms, including increased dependent coverage, prohibitions on excluding individuals based on pre-existing conditions and mandated minimum medical loss ratios for health plans. In addition, PPACA provides for significant new taxes, including an industry user tax paid by health insurance companies beginning in 2014, as well as an excise tax on health insurers and employers offering high cost health coverage plans. PPACA also imposes significant Medicare Advantage funding cuts and material reductions to Medicare and Medicaid program spending. PPACA provides for additional resources to combat healthcare fraud, waste and abuse and also requires HHS to adopt standards for electronic transactions in addition to those required under HIPAA and to establish operating rules to promote uniformity in the implementation of each standardized electronic transaction.

The provisions of PPACA that are designed to expand health coverage potentially will result in an increase in transactions for our business; however, our customers may attempt to reduce spending to account for the costs associated with meeting the various PPACA insurance market reforms. Likewise, as the Medicare payment reductions and other reimbursement changes impact our customers, our customers may attempt to pass the reductions on to us or reduce their use of our services. Thus, PPACA may result in a reduction of expenditures by customers or potential customers in the healthcare industry, which could have an adverse effect on our business. Further, we may experience increased costs from responding to new standardized transactions and implementation rules.

Because of the many variables involved, including PPACA's complexity, lack of implementing regulations or interpretive guidance, gradual implementation, and possible amendment or repeal, we are unable to predict all of the ways in which PPACA could impact us. While many of the provisions of PPACA will not be directly applicable to us, PPACA will affect the business of our payer, provider and pharmacy customers and will also affect the Medicaid

programs of the states with which we have contracts. Because it is too early to fully understand the impacts of the legislation on our business or on the business of our customers, we are currently unable to predict with any

## **Table of Contents**

reasonable certainty or otherwise quantify the likely impact of PPACA on our business model, financial condition or result of operations.

Moreover, there currently are numerous federal, state and private initiatives and studies seeking ways to increase the use of information technology in healthcare as a means of improving care and reducing costs. These initiatives may result in additional or costly legal or regulatory requirements that are applicable to us and our customers, may encourage more companies to enter our markets, may provide advantages to our competitors and may result in the development of technology solutions that compete with ours. Any such initiatives may result in a reduction of expenditures by customers or potential customers in the healthcare industry, which could have an adverse effect on our business. Other general reductions in expenditures by healthcare industry constituents could result from, among other things:

government regulation or private initiatives that affect the manner in which providers interact with patients, payers or other healthcare industry constituents, including changes in pricing or means of delivery of healthcare products and services;

reductions in governmental funding for healthcare, in addition to cuts required by PPACA; and

adverse changes in business or economic conditions affecting payers, providers, pharmaceutical companies, medical device manufacturers or other healthcare industry constituents.

Even if general expenditures by industry constituents remain the same or increase, other developments in the healthcare industry may result in reduced spending on information technology and services or in some or all of the specific markets we serve or are planning to serve. In addition, our customers' expectations regarding pending or potential industry developments may also affect their budgeting processes and spending plans with respect to the types of products and services we provide. For example, use of our products and services could be affected by:

changes in the billing patterns of providers;

changes in the design of health insurance plans;

changes in the contracting methods payers use in their relationships with providers; and

decreases in marketing expenditures by pharmaceutical companies or medical device manufacturers, as a result of governmental regulation or private initiatives that discourage or prohibit promotional activities by pharmaceutical or medical device companies.

The healthcare industry has changed significantly in recent years, and we expect that significant changes will continue to occur. The timing and impact of developments in the healthcare industry are difficult to predict. Furthermore, we are unable to predict how providers, payers and other market participants will respond to the various reform provisions contained in PPACA, many of which will not be implemented for several years. We cannot be sure that the markets for our products and services will continue to exist at current levels or that we will have adequate technical, financial and marketing resources to react to changes in those markets.

## **ITEM 2. *UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS***

### ***Use of Proceeds from Registered Securities***



On August 11, 2009, we commenced the IPO of our Class A common stock, par value of \$0.0001. Pursuant to the Registration Statement on Form S-1 (File No. 333-153451), as amended, that was declared effective on August 11, 2009 and its Registration Statement on Form S-1MEF (File No. 333-161270) (collectively, the Registration Statements ).

**Table of Contents**

Following is a description of our use of IPO proceeds since February 2010:

In March 2010, we used approximately \$8.5 million of the proceeds from the IPO (including the payment of HTMS obligations by us at closing of approximately \$0.7 million) to purchase HTMS.

From February 2010 through March 2010, we used approximately \$0.7 million of the proceeds from the IPO to fund expenses related to operating as a public company.

As of March 31, 2010, we have used an aggregate of approximately \$41.0 million of the total net proceeds from the IPO of \$144.9 million, leaving a balance of \$103.9 million. We anticipate that we will use the remaining net proceeds from the IPO for working capital and other general corporate purposes, including repayment of indebtedness and future acquisitions. Prior to application of such proceeds, we may hold the net proceeds in cash or invest them in short-term securities or investments. There has been no material change in the planned use of the IPO net proceeds from that described in the Registration Statements.

***Issuances of Class A common stock***

On February 1, 2010, we issued an aggregate of 36,829 shares of Class A common stock to a former participant in the EBS Equity Plan in exchange for 36,829 vested EBS Units (and corresponding shares of Class B common stock) previously held by him. The shares of Class A common stock were issued in a private offering pursuant to Section 4(2) of the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder.

On March 24, 2010, we issued an aggregate of 152,532 shares of Class A common stock to the owners of HTMS as partial consideration for the HTMS acquisition. The shares of Class A common stock were issued in a private offering pursuant to Section 4(2) of the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder.

**ITEM 3. *DEFAULTS UPON SENIOR SECURITIES***

Not Applicable

**ITEM 4. *(REMOVED AND RESERVED)***

**ITEM 5. *OTHER INFORMATION***

Not Applicable

**ITEM 6. *EXHIBITS***

The exhibits listed on the accompanying Exhibit Index are filed, furnished or incorporated by reference (as stated therein) as part of this Quarterly Report.

**Table of Contents**

**SIGNATURES**

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

Date: May 7, 2010

By: /s/ George I. Lazenby

George I. Lazenby, Chief Executive Officer and Director  
(Principal Executive Officer)

Date: May 7, 2010

By: /s/ Bob A. Newport

Bob A. Newport, Jr., Chief Financial Officer  
(Principal Financial and Accounting Officer)

**Table of Contents**

**Exhibit Index**

**Exhibit No.**

- |      |                                                                                                                                                                                                                             |
|------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1 | Emdeon Management Bonus Program (included as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed on March 12, 2010, and incorporated herein by reference).                                                      |
| 31.1 | Certification of Chief Executive Officer required by Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith). |
| 31.2 | Certification of Chief Financial Officer required by Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith). |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).                                                     |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).                                                     |