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QUADRAMED CORP
Form 10-Q
November 14, 2003

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2003

Or

Transition Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934

FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission File Number: 0-21031

QUADRAMED CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE
(State or Other Jurisdiction of
Incorporation or Organization)

52-1992861
(IRS Employer Identification No.)

12110 SUNSET HILLS ROAD, SUITE 600
RESTON, VIRGINIA 20190
(Address of Principal Executive Offices) (Zip Code)

(703) 709-2300
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act: NONE

Securities registered pursuant to Section 12(g) of the Act: Common Stock,
\$0.01 Par Value Per Share

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 X No ___

Indicate by check mark whether the registrant is an accelerated filer as defined in Rule 12b-2 of the Act. Yes X No ___

As of October 31, 2003, there were 27,645,610 shares of the Registrant's common stock outstanding, par value \$0.01.

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QUADRAMED CORPORATION
REPORT ON FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 2003
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PART I FINANCIAL INFORMATION	
Item 1. Financial Statements	

QUADRAMED CORPORATION
INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except per share amounts)

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ASSETS	September 30, 2003	December 31, 2002
	-----	-----
Current assets	(unaudited)	
Cash and cash equivalents	\$ 33,200	\$ 23,663
Short-term investments	2,380	2,528
Accounts receivable, net of allowance for doubtful accounts of \$3,016 and \$4,346, respectively	32,749	31,612
Unbilled receivables	4,920	3,475
Notes and other receivables	650	4,416
Prepaid expenses and other current assets	10,431	8,972
	-----	-----
Total current assets	84,330	74,666
Restricted cash	5,534	5,849
Property and equipment, net of accumulated depreciation and amortization of \$18,820 and \$16,170, respectively	5,861	6,019
Capitalized software development costs, net of accumulated amortization of \$9,655 and \$7,776, respectively	3,791	5,670
Goodwill	18,445	18,445
Other intangible assets, net of accumulated amortization of \$15,040 and \$13,316, respectively	7,551	9,275
Other long-term assets	7,840	7,003
	-----	-----
Total assets	\$ 133,352	\$ 126,927
	=====	=====
 LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities		
Accounts payable and accrued expenses	\$ 4,561	\$ 3,586
Accrued payroll and related	8,150	6,942
Other accrued liabilities	11,387	6,509
Deferred revenue	49,141	39,492
	-----	-----
Total current liabilities	73,239	56,529
5.25% Convertible subordinated debt due 2005	11,931	73,719
10% Senior secured debt due 2008, net of unamortized discount of \$11,705 and none, respectively	59,295	--
Other long-term liabilities	4,394	3,914
	-----	-----
Total liabilities	148,859	134,162
	-----	-----
 Commitments and contingencies		
Stockholders' deficit		
Preferred stock	--	--
Common stock	278	205
Additional paid-in-capital	289,271	275,631
Deferred compensation	(470)	(588)
Accumulated other comprehensive loss	(220)	(310)
Accumulated deficit	(304,366)	(282,173)
	-----	-----
Total stockholders' deficit	(15,507)	(7,235)
	-----	-----

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Total liabilities and stockholders' deficit	\$ 133,352	\$ 126,927
	=====	=====

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

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QUADRAMED CORPORATION
INTERIM CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2003	2002	2003	2002
	-----	-----	-----	-----
Revenue				
Services and other	\$ 19,340	\$ 18,564	\$ 58,294	\$ 57,419
Licenses	10,363	7,027	30,079	21,653
	-----	-----	-----	-----
Total revenue	29,703	25,591	88,373	79,072
	-----	-----	-----	-----
Cost of revenue				
Cost of services and other	9,418	10,250	31,190	26,508
Cost of licenses	1,754	2,121	5,363	6,193
	-----	-----	-----	-----
Total cost of revenue	11,172	12,371	36,553	32,701
	-----	-----	-----	-----
Gross margin	18,531	13,220	51,820	46,371
	-----	-----	-----	-----
Operating expenses				
Sales and marketing	5,548	5,743	16,858	16,030
Research and development	6,375	4,778	17,080	12,535
General and administrative	8,766	12,030	32,747	26,572
Amortization and other operating charges	615	774	1,756	2,401
	-----	-----	-----	-----
Total operating expenses	21,304	23,325	68,441	57,538
	-----	-----	-----	-----
Loss from operations	(2,773)	(10,105)	(16,621)	(11,167)
	-----	-----	-----	-----
Other income (expense)				
Interest expense	(2,661)	(866)	(6,766)	(2,596)
Interest income	151	129	438	453
Other income (expense), net	42	(374)	756	(945)
	-----	-----	-----	-----

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Other income (expense)	(2,468)	(1,111)	(5,572)	(3,088)
	-----	-----	-----	-----
Loss from continuing operations	(5,241)	(11,216)	(22,193)	(14,255)
Loss from discontinued operations	--	(240)	--	(1,528)
	-----	-----	-----	-----
Net loss	\$ (5,241)	\$ (11,456)	\$ (22,193)	\$ (15,783)
	=====	=====	=====	=====
Loss per share				
Basic and diluted				
Continuing operations	\$ (0.19)	\$ (0.42)	\$ (0.81)	\$ (0.53)
Discontinued operations	--	(0.01)	--	(0.06)
	-----	-----	-----	-----
Net	\$ (0.19)	\$ (0.43)	\$ (0.81)	\$ (0.59)
	=====	=====	=====	=====
Weighted average shares outstanding				
Basic and diluted	27,520	26,950	27,263	26,900
	=====	=====	=====	=====

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

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QUADRAMED CORPORATION
INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine months ended September 30,	
	2003	2002
	----	----
Cash flows from operating activities		
Net loss from continuing operations	\$ (22,193)	\$ (14,255)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	8,701	6,496
Provision for bad debts	487	915
Write-off of marketable investments	--	444
In-process research and development	--	400
Other	151	219
Changes in assets and liabilities:		
Accounts receivable	(1,624)	5,136
Prepaid expenses and other	(4,041)	(89)
Accounts payable and accrued liabilities	7,559	630
Deferred revenue	9,649	7,497
	-----	-----
Cash (used in) provided by continuing operations	(1,311)	7,393
Cash used in discontinued operations	--	(1,563)

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Cash (used in) provided by operating activities	(1,311)	5,830
Cash flows from investing activities		
Decrease (increase) in restricted cash	314	(92)
Purchases of available-for-sale securities	(620)	(367)
Proceeds from sale of available-for-sale securities	656	316
Acquisitions of businesses	--	(11,930)
Purchases of property and equipment	(2,491)	(1,508)
Proceeds from sale of assets	4,190	--
Capitalized software development costs	--	(1,700)
Cash provided by (used in) investing activities	2,049	(15,281)
Cash flows from financing activities		
Issuances (repayments) of debt	8,561	(438)
Proceeds from issuance of common stock	238	1,885
Cash provided by financing activities	8,799	1,447
Net increase (decrease) in cash and cash equivalents	9,537	(8,004)
Cash and cash equivalents, beginning of period	23,663	29,799
Cash and cash equivalents, end of period	\$ 33,200	\$ 21,795
Supplemental disclosure of cash flow information		
Cash paid for interest	\$ 1,854	\$ 1,935
Net cash (refunded) paid for taxes	\$ (1)	\$ 418
Supplemental disclosure of non-cash investing and financing transactions		
Issuances of restricted common stock	\$ 268	\$ 348
Issuance of warrants in connection with debt offering	\$ 13,209	\$ --

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

QUADRAMED CORPORATION
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2003

1. NATURE OF OPERATIONS

QuadraMed Corporation, along with all significant business divisions and subsidiaries (collectively, the "Company" or "QuadraMed"), is dedicated to improving healthcare delivery by providing innovative healthcare information

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technology and services. From clinical to patient information management and revenue cycle to health information management, QuadraMed delivers real-world solutions that help healthcare professionals deliver outstanding patient care with optimum efficiency. QuadraMed was reincorporated in Delaware in 1996, having been originally incorporated in California in 1993. QuadraMed is managed in three distinct business segments: Enterprise Division, Health Information Management Software Division, and Financial Services Division. In December 2002, QuadraMed sold its Health Information Management Services Division. Results of operations for this division are reflected as discontinued operations in the Statement of Operations.

2. BASIS OF PRESENTATION

Unaudited Interim Results

The condensed consolidated financial statements at September 30, 2003 and December 31, 2002 and for the three and nine months ended September 30, 2003 and 2002 have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The interim financial information is unaudited but reflects all adjustments that are, in the opinion of management, necessary for a fair presentation of QuadraMed's condensed consolidated financial position, operating results, and cash flows for the interim periods. The preparation of condensed consolidated financial statements, in conformity with GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods.

These condensed consolidated financial statements have been prepared in accordance with the instructions for a report on Form 10-Q as required by the SEC and, therefore, do not include all information and notes normally provided in annual financial statements. As a result, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto, together with management's discussion and analysis of financial condition and results of operations, contained in QuadraMed's annual report on Form 10-K for the fiscal year ended December 31, 2002. The results of operations for the three and nine months ended September 30, 2003 are not necessarily indicative of the results for the fiscal year ending December 31, 2003 or any other future periods.

3. LONG-TERM DEBT

On March 4, 2003, QuadraMed's common stock was delisted from the Nasdaq National Market. The delisting constituted a "Repurchase Event" under the provisions of QuadraMed's 5.25% Convertible Subordinated Debentures Agreements due 2005 (the "2005 Debt"). Upon such an event, the 2005 Debt Agreement grants to each debenture holder the right, at the holder's option, to require QuadraMed to repurchase all or any of the holder's debentures. On April 17, 2003, QuadraMed issued \$71.0 million of its Senior Secured Notes due 2008 (the "2008 Debt"). The proceeds from the issuance of the 2008 Debt were used to repurchase \$61.8 million (plus \$1.5 million in accrued interest) of the 2005 Debt required to be repurchased. Accordingly, the net proceeds as a result of the issuance of the 2008 Debt, less the costs (including fees) associated with the repurchase of the 2005 Debt, were \$8.5 million, with \$11.9 million of the 2005 Debt remaining outstanding. Additionally, the repurchase right on the 2005 Debt remaining outstanding expired on April 17, 2003.

The 2008 Debt bears interest at an initial rate of 10%, of which 6% is due in semi-annual cash coupon payments in the first year with the remainder added to the outstanding principal balance of the notes. The interest rate on the

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2008 Debt will be reduced to 9% upon relisting of QuadraMed's common stock on the Nasdaq, including Nasdaq SmallCap or any U.S. National Market, and is secured by substantially all of QuadraMed's intellectual property. The 2008 Debt contains certain events of default. These events include: failure to timely repay principal or interest owed on the debentures, default under any other borrowing, and bankruptcy. As part of the transaction, QuadraMed also issued warrants to purchase 11.6 million shares of common stock, of which warrants for 11.3 million shares were issued to purchasers of the 2008 Debt and 283,000 shares were issued as compensation for services provided

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QUADRAMED CORPORATION NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) September 30, 2003

with the offering. The warrants have a term of five years, an exercise price of \$.01 per share, and are subject to certain anti-dilution provisions, including dilution from the issuance of shares in settlement of any existing litigation. QuadraMed valued the warrants using the Black-Scholes valuation model using a volatility of 142%, expected life of 5 years, 2.74% risk-free interest rate and no dividend yield. The result was a fair value of \$12.9 million for the warrants issued to debt holders. This amount was recorded as a discount to the debt and will be amortized to interest expense ratably over the 5-year term of the debt. In addition, costs associated with the debt offering, including the warrants for 283,000 shares, totaled \$1.0 million, which will be amortized to interest expense ratably over the same term. In June 2003, 283,000 warrants were exercised.

At September 30, 2003, long-term debt consisted of a principal balance of \$11.9 million for the 2005 debt, \$71.0 million for the 2008 debt and unamortized warrants of \$11.7 million.

4. STOCK-BASED COMPENSATION

SFAS No. 123, Accounting for Stock Based Compensation, encourages, but

does not require, companies to record compensation cost for stock-based employee compensation plans at fair value. QuadraMed has chosen to continue to account for stock-based employee compensation using the intrinsic value method prescribed in Accounting Principles Board (APB) Opinion No. 25, Accounting for

Stock Issued to Employees, and Related Interpretations. Accordingly,

compensation cost for stock options granted to employees is measured as the excess, if any, of the quoted market price of QuadraMed's stock at the date of the grant over the amount an employee must pay to acquire the stock.

QuadraMed has determined pro-forma information regarding net income and earnings per share as if QuadraMed had accounted for employee stock options under the fair value method as required by SFAS No. 123. The fair value of these stock-based awards to employees was estimated using the Black-Scholes option-pricing model. Had compensation cost for QuadraMed's stock option plan and employee stock purchase plan been determined consistent with SFAS No. 123, QuadraMed's reported net income (loss) and net earnings (loss) per share would have been changed to the amounts indicated below (in thousands except per share data):

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	Three months ended September 30,	
	2003	2002
	----	----
Net loss as reported	\$ (5,241)	\$ (11,456)
Add: Stock-based employee compensation expense included in reported net loss, net of related tax effects	117	139
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(920)	(1,671)
	-----	-----
Pro forma net loss	\$ (6,044)	\$ (12,988)
	=====	=====
 Earnings per share:		
Basic and diluted - as reported	\$ (0.19)	\$ (0.43)
	=====	=====
Basic and diluted - pro forma	\$ (0.22)	\$ (0.48)
	=====	=====

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QUADRAMED CORPORATION
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
September 30, 2003

	Nine months ended September 30,	
	2003	2002
	----	----
Net loss as reported	\$ (22,193)	\$ (15,783)
Add: Stock-based employee compensation expense included in reported net loss, net of related tax effects	385	417
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(3,402)	(4,842)
	-----	-----
Pro forma net loss	\$ (25,210)	\$ (20,208)
	=====	=====
 Earnings per share:		
Basic and diluted - as reported	\$ (0.81)	\$ (0.59)
	=====	=====
Basic and diluted - pro forma	\$ (0.92)	\$ (0.75)
	=====	=====

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the following assumptions:

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	2003 ----	2002 ----
Expected dividend yield	--	--
Expected stock price volatility	138.91%	135.55%
Risk-free interest rate	2.74%	2.26%
Expected life of options	5 years	5 years

5. NET LOSS PER SHARE AND COMPREHENSIVE INCOME (LOSS)

Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding during the period less restricted shares of common stock. Diluted net loss per share is computed by dividing income by the sum of the weighted average number of common shares, as adjusted for restricted shares, and common equivalent shares outstanding during the period. Common equivalent shares consist of shares issuable upon the exercise of stock options and warrants (using the treasury stock method) and convertible subordinated debentures (using the as-converted method). Common equivalent shares are excluded from the diluted computation only if their effect is anti-dilutive. As QuadraMed recorded net losses for the three and nine months ended September 30, 2003 and 2002, no common equivalent shares were included in the net loss per share calculation because they were anti-dilutive.

The components of QuadraMed's comprehensive income (loss) include the unrealized gain (loss) on available-for-sale securities which is not significant for any period presented.

6. SEGMENT REPORTING

QuadraMed aligns its operations into three business segments for management reporting purposes. These segments are based on product functionality and shared target markets. This alignment allows management to more accurately measure financial performance by product/division and to establish greater management accountability. QuadraMed's business segments are (i) the Enterprise Division, (ii) the Health Information Management Software Division, and (iii) the Financial Services Division. The operations and assets of these segments are primarily located in the United States. QuadraMed reports the Enterprise Division, the Health Information Management Software Division, and the Financial Services Division as reportable segments in accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related

Information. The accounting policies of the operating segments are the same as

those described in the summary of significant accounting policies described in notes to the financial statements in its Annual Report on Form 10-K for the year ended December 31, 2002. The financial results for these operating segments for prior periods have been reclassified to conform to the current period presentation.

Selected results of operations for these business segments are provided to QuadraMed's Chief Operating Decision Maker ("CODM"), who is the Chairman of the Board and Chief Executive Officer.

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QUADRAMED CORPORATION
 NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
 September 30, 2003

Summary financial data by business segment as reported to the CODM is presented below for the three and nine months ended September 30, 2003 and 2002 (in thousands):

Three months ended September 30, 2003					
Description	Enterprise	HIM Software	Financial Services	Other (1)	Consolidated Total
Total revenues	\$ 17,762	\$ 9,689	\$ 2,252	\$ --	\$ 29,703
Gross margin	\$ 11,255	\$ 6,619	\$ 657	\$ --	\$ 18,531
Interest income (expense), net	\$ (1,490)	\$ (562)	\$ (463)	\$ 5	\$ (2,510)
Segment assets	\$ 40,747	\$ 41,274	\$ 4,137	\$ 47,194	\$ 133,352
Total depreciation and amortization (2)	\$ 1,257	\$ 941	\$ 255	\$ 225	\$ 2,678

Three months ended September 30, 2002					
Description	Enterprise	HIM Software	Financial Services	Other (1)	Consolidated Total
Total revenues	\$ 16,246	\$ 6,786	\$ 2,559	\$ --	\$ 25,591
Gross margin	\$ 9,605	\$ 2,988	\$ 627	\$ --	\$ 13,220
Interest income (expense), net	\$ (454)	\$ (184)	\$ (145)	\$ 46	\$ (737)
Segment assets	\$ 40,374	\$ 44,512	\$ 4,959	\$ 31,256	\$ 121,101
Total depreciation and amortization (2)	\$ 713	\$ 1,155	\$ 148	\$ 18	\$ 2,034

Nine months ended September 30, 2003					
Description	Enterprise	HIM Software	Financial Services	Other (1)	Consolidated Total

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Total revenues	\$ 54,629	\$ 26,327	\$ 7,417	\$ --	\$ 88,373
Gross margin	\$ 32,502	\$ 17,773	\$ 1,545	\$ --	\$ 51,820
Interest income (expense), net	\$ (3,826)	\$ (1,446)	\$ (1,191)	\$ 135	\$ (6,328)
Segment assets	\$ 40,747	\$ 41,274	\$ 4,137	\$ 47,194	\$ 133,352
Total depreciation and amortization (2)	\$ 3,870	\$ 3,115	\$ 760	\$ 956	\$ 8,701

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QUADRAMED CORPORATION
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
September 30, 2003

Description	Nine months ended September 30, 2002					Consolidated Total
	Enterprise	HIM Software	Financial Services	Other (1)		
Total revenues	\$ 49,400	\$ 19,859	\$ 9,813	\$ --	\$ 79,072	
Gross margin	\$ 30,610	\$ 11,508	\$ 4,253	\$ --	\$ 46,371	
Interest income (expense), net	\$ (1,316)	\$ (529)	\$ (418)	\$ 120	\$ (2,143)	
Segment assets	\$ 40,374	\$ 44,512	\$ 4,959	\$ 31,256	\$ 121,101	
Total depreciation and amortization (2)	\$ 1,647	\$ 2,814	\$ 426	\$ 1,609	\$ 6,496	

7. MAJOR CUSTOMERS

For the three and nine month periods ended September 30, 2003 and 2002, no single customer accounted for more than 10% of total revenues. However, for the three and nine months ended September 30, 2003 and 2002, U.S. government revenue accounted for 21.8% and 22.0%, and 27.1% and 23.9%, respectively, of HIM Software Division revenues.

8. LITIGATION AND OTHER MATTERS

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In October 2002, a series of securities law class action complaints were filed in the United States District Court, California Northern District, against QuadraMed and certain of its officers and directors. The plaintiffs in these actions allege, among other things, violations of the Securities Exchange Act of 1934 due to issuing a series of allegedly false and misleading statements concerning its business and financial condition between May 11, 2000 and August 11, 2002. The complaints seek unspecified monetary damages and other relief. These matters are at an early stage and no discovery has taken place. QuadraMed intends to defend itself vigorously against these allegations. However, the ultimate outcome of these matters cannot presently be determined.

On February 28, 2003, QuadraMed reported that the SEC issued a formal non-public order of investigation concerning QuadraMed's accounting and financial reporting practices for the period beginning January 1, 1998. On October 10, 2003, QuadraMed announced that the Staff of the San Francisco District Office of the Securities and Exchange Commission ("the Staff") has informed QuadraMed that the Staff intends to recommend to the SEC that it institute an enforcement action against QuadraMed for violations of the antifraud, periodic filing and books and records provisions of the federal securities laws. The proposed recommendation concerns QuadraMed's accounting for transactions that it entered into with Health+Cast LLP in 1998 and 1999. The 1999 transactions were restated as part of QuadraMed's recent restatement of its 1999 financial statements. The Staff invited QuadraMed to make a Wells submission with respect to the proposed recommendation. QuadraMed plans to continue to discuss this matter with the Staff; however, QuadraMed cannot predict when the SEC will conclude its inquiry, or the outcome and impact thereof. The staff also indicated that it does not presently intend to recommend any action against QuadraMed's current officers, directors or employees.

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QUADRAMED CORPORATION
NOTES TO INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
September 30, 2003

9. SUBSEQUENT EVENTS

On October 23, 2003, QuadraMed received a written Demand Request from a Holder of Registrable Securities, pursuant to Section 2 of the Registration Rights Agreement (the "Agreement"), dated as of April 17, 2003. QuadraMed mailed a Request Notice to all Holders under the Agreement on November 3, 2003. QuadraMed is required to file for registration of the warrants within 90 days of receiving the Demand Request and is preparing such filing.

On November 5, 2003 QuadraMed consolidated the organization of the HIM Software Division and Enterprise Division into a single functional software organization. This reorganization is designed to use existing resources more efficiently and to facilitate the integration of products and technologies. The change does not affect the Financial Services Division.

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

Cautionary Statement on Risks Associated With Forward-Looking Statements -----

You should read the following discussion in conjunction with our Interim Condensed Consolidated Financial Statements and related Notes. This Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that are subject to risks and uncertainties. The words "believe," "expect," "target," "goal," "project," "anticipate," "predict," "intend," "plan," "estimate," "may," "will," "should," "could," and similar expressions and their negatives are intended to identify such statements. Forward-looking statements are not guarantees of future performance, anticipated trends and growth in businesses, or other characterizations of future events or circumstances and are to be interpreted only as of the date on which they are made. We undertake no obligation to update or revise any forward-looking statement. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us described below and elsewhere in this Report, and in other documents we file with the SEC from time to time.

Critical Accounting Policies and Estimates -----

Our critical accounting policies have a considerable impact on Management's Discussion and Analysis.

Principles of Consolidation -----

Our consolidated financial statements, which include our accounts and all our significant business divisions and subsidiaries, have been prepared in conformity with (i) GAAP; and (ii) the rules and regulations of the SEC. All significant intercompany accounts and transactions between us and our subsidiaries have been eliminated in the consolidated financial statements.

Use of Estimates -----

Management's discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. In preparing these financial statements, we make estimates, assumptions, and judgments that affect the reported amounts of assets and liabilities, contingent assets and liabilities, revenues, and expenses. Significant estimates and assumptions have been made regarding revenue recognition, the allowance for doubtful accounts, capitalized software, income taxes, pensions and other benefits, contingencies and litigation and intangibles, primarily goodwill and customer lists, resulting from our purchase business combinations. We base our estimates, assumptions, and judgments on historical experience and on various other assumptions which management believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Uncertainties inherent in these estimates include projections of future operating results and the discount rates used to determine the net present values of these future results and useful lives of

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the acquired assets as well as technological advances. In addition, for our fixed-price contracts, we make significant estimates within percentage-of-completion accounting, including estimating total costs to be incurred as calculated on a labor hour basis. We annually review and test our estimates, specifically those related to the valuations of intangibles including acquired software, goodwill, customer lists, trademarks and other intangibles, and capitalized software. Actual results may differ materially from these estimates.

Revenue Recognition

Our revenue in the ordinary course of business is principally generated from two sources: (i) licensing arrangements and (ii) services and other.

Our license revenue consists of fees for licenses of proprietary and third-party software. Cost of license revenue primarily includes third-party software and royalties and amortization of capitalized software. Our service revenue consists of maintenance, customer training, and consulting services and fees for providing management services, such as accounts receivable and payment collection outsourcing, specialized staffing, analytical services, seminars and

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hardware. Cost of services consists primarily of salaries, benefits, and allocated costs related to providing such services, labor costs for engineers performing implementation services, technical support, training personnel and hardware.

We license our products through our direct sales force. Our license agreements for such products do not provide for a right of return; and historically, product returns have not been significant.

We recognize revenue on our software products in accordance with Statement of Position ("SOP") 97-2, Software Revenue Recognition, as amended by SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions; SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts; and Staff Accounting Bulletin ("SAB") 101, Revenue Recognition in Financial Statements.

We recognize revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery of the product has occurred; no significant obligations by us with regard to implementation remain; the fee is fixed and determinable, and collectibility is probable. Delivery is considered to have occurred when title and risk of loss have been transferred to the customer, which generally occurs when media containing the licensed programs is provided to a common carrier. We consider all arrangements with payment terms extending beyond 180 days to be not fixed and determinable, and revenue is recognized as payments become due from the customer. If collectibility is not considered probable, revenue is recognized when the fee is collected.

SOP 97-2, as amended, generally requires revenue earned on software

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arrangements involving multiple elements to be allocated to each element based on the relative fair values of the elements. Revenue recognized from multiple-element arrangements is allocated to undelivered elements of the arrangement, such as maintenance, support and professional services, based on the relative fair values of the elements specific to us. Our determination of fair value of each element in multi-element arrangements is based on vendor-specific objective evidence ("VSOE"). We limit our assessment of VSOE for each element to either the price charged when the same element is sold separately or the price established by management, having the relevant authority to do so, for an element not yet sold separately.

If evidence of fair value of all undelivered elements exists but evidence does not exist for one or more delivered elements, then revenue is recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. Revenue from hosted applications is recognized ratably over the term of the arrangement. The proportion of revenue recognized upon delivery may vary from quarter to quarter depending upon the relative mix of licensing arrangements and the availability of VSOE of fair value for undelivered elements.

Certain of our perpetual and time-based licenses include unspecified additional products and/or payment terms that extend beyond 12 months. We recognize revenue from perpetual and time-based licenses that include unspecified additional software products ratably over the term of the arrangement.

Contract accounting is utilized for service revenue from fixed-price contracts and those requiring significant software modification, development or customization. In such instances, the arrangement fee is accounted for in accordance with SOP 81-1, whereby the arrangement fee is recognized, generally using the percentage-of-completion method measured on labor input costs. If increases in projected costs-to-complete are sufficient to create a loss contract, the entire estimated loss is charged to operations in the period the loss first becomes known. The complexity of the estimation process and judgment related to the assumptions, risks and uncertainties inherent with the application of the percentage-of-completion method of accounting affect the amounts of revenue and related expenses reported in our consolidated financial statements. A number of internal and external factors can affect our estimates, including labor rates, utilization, changes to specification and testing requirements and collectibility of unbilled receivables.

Service revenues from software maintenance and support are recognized ratably over the maintenance term, which in most cases is one year. Service revenues from training, consulting and other service elements are recognized as the services are performed.

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Service revenues from providing management services such as accounts receivable and payment collection outsourcing are recognized in accordance with SAB 101. When all criteria for revenue recognition, as noted above, have been met, revenue is recognized upon invoicing. If collectibility is not considered probable, revenue is recognized when the fee is collected.

Accounts Receivable and Allowance for Doubtful Accounts

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Accounts receivable consist primarily of amounts due us from our normal business activities. We maintain an allowance for doubtful accounts to reflect the expected non-collection of accounts receivable based on past collection history and specific risks identified within our portfolio. If the financial condition of our customers were to deteriorate resulting in an impairment of their ability to make payments, or if payments from customers are significantly delayed, additional allowances might be required.

Intangible Assets

Goodwill. In June 2001, the FASB issued SFAS No. 142, Goodwill and Other

Intangible Assets, effective for fiscal years beginning after December 15,

2001. Under SFAS No. 142, goodwill and intangible assets deemed to have indefinite lives are to be separately disclosed on the balance sheet, and no longer amortized but subject to annual impairment tests. With the adoption of SFAS No. 142, we ceased amortization of goodwill as of January 1, 2002. Prior to this point, goodwill was amortized using the straight-line method over its estimated useful life.

SFAS No. 142 requires that goodwill be tested for impairment at the reporting unit level (i.e., business segments) upon adoption and at least annually thereafter using a two-step impairment analysis. In accordance with SFAS No. 142, we performed the first of the required two-step impairment tests of goodwill and indefinite-lived assets as of January 1, 2002 utilizing an independent appraiser. The test results showed no indicators of impairment as of January 1, 2002.

As of January 1, 2003, we re-engaged the independent appraiser to review the goodwill as of this date for impairment. Once again, the test showed no indicators of impairment. We will continue to perform the tests of impairment for goodwill required by SFAS No. 142 on an annual basis or more often, as deemed necessary.

Capitalized Software. Software development costs are capitalized upon the

establishment of technological feasibility. In accordance with SFAS No. 86, Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise

Marketed, we establish technological feasibility upon completion of a detailed

program design determined on a project-by-project basis, which substantiates that the computer software product can be produced in accordance with its design specifications. Software development costs are capitalized based upon an assessment of their recoverability. This assessment requires considerable judgment by management with respect to various factors, including, but not limited to, anticipated future gross margins, estimated economic lives, and changes in software and hardware technology. Amortization is based on the greater of the ratio that current revenues bear to total and anticipated future revenues for the applicable product, or the straight-line method over the remaining estimated economic life of the product, generally five years, and is charged to cost of licenses.

Other Intangible Assets. Other intangible assets primarily relate to

acquired software, trademarks and customer lists acquired in our purchase business combinations. On January 1, 2002, we adopted the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which

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generally requires impairment losses to be recorded on long-lived assets (excluding goodwill) used in operations, such as property, equipment and improvements, and intangible assets, when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of the assets. The provisions of this statement did not have a significant impact on our financial condition or operating results.

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Results of Operations

The following table sets forth selected data for the indicated periods. Percentages are expressed as a percentage of total revenues, except for cost of revenue, which is expressed as a percentage of the related revenue classification.

	Three months ended September 30,				Nine months ended September 30,			
	2003		2002		2003		2002	
Revenue								
Services and other	\$ 19,340	65.1%	\$ 18,564	72.5%	\$ 58,294	66.0%	\$ 57,419	72.5%
Licenses	10,363	34.9	7,027	27.5	30,079	34.0	21,653	27.5
Total revenue	29,703	100.0	25,591	100.0	88,373	100.0	79,072	100.0
Cost of revenue								
Cost of services and other	9,418	48.7	10,250	55.2	31,190	53.5	26,508	46.3
Cost of licenses	1,754	16.9	2,121	30.2	5,363	17.8	6,193	28.2
Total cost of revenue	11,172	37.6	12,371	48.3	36,553	41.4	32,701	41.4
Gross margin	18,531	62.4	13,220	51.7	51,820	58.6	46,371	58.6
Operating expenses								
Sales and marketing	5,548	18.7	5,743	22.4	16,858	19.1	16,030	20.3
Research and development	6,375	21.4	4,778	18.7	17,080	19.3	12,535	15.7
General and administrative	8,766	29.5	12,030	47.0	32,747	37.1	26,572	33.6
Amortization and other operating charges	615	2.1	774	3.0	1,756	2.0	2,401	3.0
Total operating expenses	21,304	71.7	23,325	91.1	68,441	77.5	57,538	72.6

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Revenue

Total Revenue. Total revenue for the three months ended September 30, 2003, was \$29.7 million, an increase of \$4.1 million or 16.1% from \$25.6 million for the three months ended September 30, 2002. Total revenue for the nine months ended September 30, 2003, was \$88.4 million, an increase of \$9.3 million or 11.8% from \$79.1 million for the nine months ended September 30, 2002. Total revenue for the three months ended September 30, 2003, was \$29.7 million, an increase of \$267,000 or 0.9% from \$29.4 million for the three months ended June 30, 2003.

As of September 30, 2003, deferred revenue was \$49.1 million, an increase of \$9.6 million or 24.4% from \$39.5 million as of December 31, 2002. Deferred revenue increased by \$9.6 million during the same period primarily due to \$5.4 million related to HIM government sales, \$2.7 million in other HIM software division and \$1.5 million in Enterprise division sales. Deferred revenue increased by \$2.1 million or 4.4% during the three months ended September 30, 2003 compared to June 30, 2003.

Services and Other. Services and other revenue consists of professional services, such as implementation services and training, maintenance, which consists of technical support and product upgrades, hardware, reimbursable expenses and other service revenue. Professional services are typically provided over a period of three months to six months for the Health Information Management (HIM) Software division and up to two years for the Enterprise division. These services are provided subsequent to the signing of a software license arrangement and depend in large part on our software license revenues. Financial Services' revenue is recognized as services are performed. Our maintenance revenues depend on both licenses of our software products and renewals of maintenance agreements by our existing customer base. Services and other revenue was \$19.3 million for the three months ended September 30, 2003, an increase of \$776,000 or 4.2% from \$18.6 million for the three months ended September 30, 2002. For the nine months ended September 30, 2003, services and other revenue was \$58.3 million, an increase of \$875,000 or 1.5% from \$57.4 million from the first nine months of 2002. Services and other revenue for the three months ended September 30, 2003 increased \$66,000 or 0.3% from the three months ended June 30, 2003.

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For the three months ended September 30, 2003, the Enterprise division's services and other revenue increased due to increased installations of our software products offset by a decrease in hardware revenue. For the nine months ended September 30, 2003, the Enterprise division's service and other revenue increased primarily due to a significant hardware sale and overall increased installations.

Service and other revenue for the HIM Software division improved slightly for the three and nine months ended September 30, 2003 primarily due to the increase in coding software and record management product's revenue resulting from increased customer installations and maintenance renewals. Revenue for the Financial Services division has decreased by approximately \$2.4 million for the nine months in 2003 compared to 2002 due to a decrease in the

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quality of assignments and average lower contract fees.

Licenses. License revenue consists of fees for licenses of proprietary

and third-party software. We market our products through our direct sales force. License revenue in the three months ended September 30, 2003 was \$10.4 million, an increase of \$3.3 million or 47.5% from \$7.0 million in the corresponding period of 2002. For the nine months ended September 30, 2003, license revenue was \$30.1 million, an increase of \$8.4 million or 38.9% compared to \$21.7 million in the first nine months of 2002. License revenue for the three months ended September 30, 2003 was \$10.4 million, an increase of \$202,000 or 2.0% from \$10.2 million for the three months ended June 30, 2003.

The increase in absolute dollar amount of license revenue for the three and nine months of 2003 was due to increases in the HIM software division. The HIM division increase was due primarily to migration sales and recognition of deferred revenue from coding software products and, to a lesser extent, government sales. The increase in absolute dollar amount of license revenue for the nine months ended September 30, 2003, was primarily due to recognition of software license revenue from the coding software products and an increase in government revenue due to growth in sales.

The Enterprise Division grew close to 22% quarter over quarter and 26% for the nine month period of 2003 compared to 2002. The increase was directly related to increased revenue for the Affinity suite of products, Performance Measurement products and the acquisition of Pharmacy Data Systems, Inc. (PDS) in June 2002.

Cost of Revenue -----

Cost of Services and Other. Cost of services and other consists of

salaries and related expenses associated with services performed for customer support and consulting services as well as third-party hardware costs. Cost of services and other for the three months ended September 30, 2003 was \$9.4 million, a decrease of \$832,000 or 8.1% less than the \$10.3 million recorded in the corresponding period of 2002. As a percentage of services and other revenue, cost of services and other was 48.7% and 55.2% for the three months ended September 30, 2003 and 2002, respectively. Cost of services and other for the nine months ended September 30, 2003 was \$31.2 million, an increase of \$4.7 million or 17.7% compared to the \$26.5 million recorded in the corresponding period of 2002. As a percentage of services and other revenue, cost of services and other was 53.5% and 46.2% for the nine months ended September 30, 2003 and 2002, respectively. Cost of services and other for the three months ended September 30, 2003 was \$9.4 million, a decrease of \$.6 million or 5.6% from \$10.0 million for the three months ended June 30, 2003.

The Enterprise division cost of services and other was relatively flat quarter over quarter but increased substantially for the nine months in 2003 compared to 2002 due to increased salary and bonus expense and hardware cost due to the related hardware revenue.

The HIM software division cost of services and other decreased slightly in operating expenses quarter over quarter and increased slightly for the nine months in 2003 compared to 2002, due to salary and related expenses.

The Financial Services division cost of services and other decreased slightly quarter over quarter and increased slightly for the nine months 2003 compared to 2002, due to salary and related expenses. The gross margin decreased for the nine months ended September 30, 2003 compared to 2002 due to the decline in service revenue while no change to cost of services.

Cost of Licenses. Cost of license consists primarily of third party

software and royalties and amortization of capitalized software. Cost of license for the three months ended September 30, 2003 was \$1.8 million, a decrease of \$367,000 or 17.3% compared to \$2.1 million for the same period of 2002. As a percentage of license revenues, cost of license was 16.9% and 30.2% for the three months ended September 30, 2003 and 2002, respectively. For the nine months ended September 30, 2003, cost of license was \$5.4 million, a decrease of \$830,000 or 13.4% from \$6.2 million from the same period of 2002. As a percentage of license revenues, cost of license was 17.8% and 28.6% for the nine months ended September 30, 2003 and 2002, respectively. Cost of licenses for the three months ended September 30, 2003 decreased \$67,000 from the three months ended June 30, 2003.

In absolute dollars, cost of license for the three months ended September 30, 2003 was down as compared to the prior period due to a decrease in the amortization of capitalized software. The decrease for the nine months ended September 30, 2003 was primarily due to a decrease in the cost of third party software licenses in the Enterprise division as a result of lower third party software license revenue. The gross margin in license revenue for the HIM software division improved in 2003 due to the mix of license revenue in comparison to the cost of licenses.

Operating Expenses

Sales and Marketing. Sales and marketing expense includes costs

associated with our sales and marketing personnel and product marketing personnel and consists primarily of compensation and benefits, commissions and bonuses and promotional and advertising expenses. Sales and marketing expense for the three months ended September 30, 2003 was \$5.5 million, a decrease of \$195,000 or 3.4% compared to \$5.7 million for the corresponding period of 2002. As a percentage of revenue, sales and marketing expense was 18.7% for the three months ended September 30, 2003 as compared to 22.4% for the same quarter of 2002. For the nine months ended September 30, 2003, sales and marketing expense was \$16.9 million, an increase of \$828,000 or 5.2% compared to \$16.0 million for the first nine months of 2002. As a percentage of total revenue, sales and marketing expense was 19.1% for the nine months ended September 30, 2003 as compared to 20.3% for the same quarter of 2002. Sales and marketing expense for the three months ended September 30, 2003 decreased \$1,000 from the three months ended June 30, 2003.

In absolute dollars, marketing and sales expenses have been relatively comparable from quarter to quarter. The slight decrease for the three months ended September 30, 2003 was due to a decrease in marketing expenses. In absolute dollars, the increase in sales and marketing expense for the nine months ended September 30, 2003 was primarily due to an increase in salaries and bonus expense reduced by marketing expenses.

Research and Development. Research and development expense includes costs

associated with the development of new products, enhancements of existing products for which technological feasibility has not been achieved, and quality assurance activities and primarily relates to compensation and benefits costs.

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Research and development costs for the three months ended September 30, 2003 was \$6.4 million, an increase of \$1.6 million or 33.4% compared to \$4.8 million in the same period of 2002. As a percentage of revenue, research and development costs were 21.4% for the three months ended September 30, 2003 compared to 18.7% in the same quarter of 2002. For the nine months ended September 30, 2003, research and development costs were \$17.1 million, an increase of \$4.5 million or 36.3% from \$12.5 million in the first nine months of 2002. The increase in research and development expense was primarily due to product development efforts for the continued development of both the Affinity and HIM software suite of products. The level of research and development investments increased in the first nine months of 2003 with the primary funding of Affinity development.

Research and development expense for the three months ended September 30, 2003 increased by \$1.1 million or 22% over the three months ended June 30, 2003. The increase of approximately \$580,000 was due to management's decision to reverse previously capitalized software reported in the first half of the year. This decision was based on management's judgment of facts that emerged during the quarter. During the nine months ended September 30, 2003, there were no capitalized costs from software development compared to approximately \$1.7 million in the first nine months of 2002.

General and Administrative. General and administrative expense consists

of compensation and benefit costs for executive, finance, legal, information technology, and administrative personnel. General and administrative expense for the three months ended September 30, 2003 was \$8.8 million, a decrease of \$3.3 million or 27.1% compared to \$12.0 million in the same period of 2002. As a percentage of revenue, general and administrative expense was 29.5% for the three months ended September 30, 2003 as compared to 47.0% in the same quarter of 2002. For the nine months ended September 30, 2003, general and

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administrative expense was \$32.7 million, an increase of \$6.2 million or 23.2% from \$26.6 million in the comparable period in 2002. As a percentage of total revenue, general and administrative expense increased to 37.1% for the nine months ended September 30, 2003 from 33.6% in the nine months ended September 30, 2002. General and administrative expense for the three months ended September 30, 2003 was \$8.8 million, a decrease of \$1.7 million or 16.1% from \$10.5 million for the three months ended June 30, 2003.

The decrease in general and administrative expense for the three months ended September 30, 2003 was primarily due to a decrease of approximately \$3.0 million in restatement fees incurred in the prior period of 2002. The increase in general and administrative expense for the nine months ended September 30, 2003, was due to an increase in accountants, consultants and attorneys' fees and retention bonuses as part of the restatement process of \$3.5 million, and in increase in employee benefits and contractual services. General and administrative expenses decreased sequentially from the third quarter of 2003 compared to the second quarter of 2003 as a result of no restatement costs in the third quarter of 2003.

Amortization and Other Operating Charges. Amortization and other

operating charges represented amortization of identifiable intangible assets and in-process research and development. Amortization and other operating charges for the three months ended September 30, 2003 was \$615,000, a decrease of \$159,000 compared to \$774,000 in the same period of 2002. The expense for

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the third quarter of 2003 was for the amortization of identifiable intangible assets. For the same period in 2002, the charges consisted of amortization of identifiable intangible assets and acquired software, which became fully amortized in the fourth quarter of 2002. Expense for the nine months in 2002 also includes a \$400,000 write-off of in-process research and development expense associated with the acquisition of PDS. Amortization and other operating charges decreased slightly in the three months ended September 30, 2003, as compared to the three months ended June 30, 2003.

Other Income (Expense)

Other Income (Expense), Net. Net other expense was \$2.5 million and \$1.1 million for the three months ended September 30, 2003 and 2002, respectively. For the nine months ended September 30, 2003 and 2002, net other income (expense) was \$5.6 million and \$3.1 million, respectively. The increase for the three and nine months ended was due to the additional interest expense on the new debentures entered into April 2003, which have a current interest rate of 10%, and \$1.2 million of year-to-date amortization of the associated warrants, offset by \$565,000 income from a short swing profit from an investor. Net other expense for the three months ended September 30, 2003 was \$2.5 million, an increase of \$340,000 or 16.0% from \$2.1 million for the three months ended June 30, 2003.

Income Taxes

Provision for Income Taxes. There was no provision for income taxes for the three and nine months ended September 30, 2003 and 2002. For financial reporting purposes, a 100% valuation allowance has been recorded against our deferred tax assets under SFAS No. 109, Accounting for Income Taxes.

Liquidity and Capital Resources

Balance Sheet and Cash Flows

Prepaid expenses and other accrued liabilities increased by \$1.5 million and \$2.2 million, respectively from December 31, 2002 to September 30, 2003 due to third-party royalties owed on HIM government sales. An additional \$2.9 million of other accrued liabilities resulted from accrued interest on the 2008 debt. Deferred revenue increased by \$9.6 million during the same period primarily due to \$5.4 million related to HIM government sales, \$2.7 million in other HIM software division and \$1.5 million in Enterprise division sales.

On March 4, 2003, our common stock was delisted from the Nasdaq National Market. The delisting constituted a "Repurchase Event" under the provisions of our 5.25% Convertible Subordinated Debentures Agreements due 2005 (the "2005 Debt"). Upon such an event, the 2005 Debt Agreement grants to each debenture holder the right, at the holder's option, to require us to repurchase all or any of the holder's debentures. On April 17, 2003, we issued \$71.0 million of its Senior Secured Notes due 2008 (the "2008 Debt"). The proceeds from the

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issuance of the 2008 Debt were used to repurchase \$61.8 million (plus \$1.5 million in accrued interest) of the 2005 Debt required to be repurchased. Accordingly, the net proceeds as a result of the issuance of the 2008 Debt, less the costs (including fees) associated with the repurchase of the 2005 Debt, were \$8.5 million, with \$11.9 million of the 2005 Debt remaining outstanding. Additionally, the repurchase right on the 2005 Debt remaining outstanding expired on April 17, 2003.

The 2008 Debt bears interest at an initial rate of 10%, of which 6% is due in semi-annual cash coupon payments in the first year with the remainder added to the outstanding principal balance of the notes. The interest rate on the 2008 Debt will be reduced to 9% upon relisting of our common stock on the Nasdaq, including Nasdaq Small Cap or any U.S. National Market, and is secured by substantially all of our intellectual property. The 2008 Debt contains certain events of default. These events include: failure to timely repay principal or interest owed on the debentures, default under any other borrowing, and bankruptcy. As part of the transaction, we also issued warrants to purchase 11.6 million shares of common stock, of which warrants for 11.3 million shares were issued to purchasers of the 2008 Debt and 283,000 shares were issued as compensation for services provided with the offering. The warrants have a term of five years, an exercise price of \$.01 per share, and are subject to certain anti-dilution provisions, including dilution from the issuance of shares in settlement of any existing litigation. We valued the warrants using the Black-Scholes valuation model using a volatility of 142%, expected life of 5 years, 2.74% risk-free interest rate and no dividend yield. The result was a fair value of \$12.9 million for the warrants issued to debt holders. This amount was recorded as a discount to the debt and will be amortized to interest expense ratably over the 5-year term of the debt. In addition, costs associated with the debt offering, including the warrants for 283,000 shares, totaled \$1.0 million, which will be amortized to interest expense ratably over the same term. In June 2003, 283,000 warrants were exercised.

At September 30, 2003, long-term debt consisted of a principal balance of \$11.9 million for the 2005 debt, \$71.0 million for the 2008 debt and unamortized warrants of \$11.7 million at September 30, 2003.

Cash, and cash equivalents and short-term investments were \$35.6 million as of September 30, 2003 and \$26.2 million as of December 31, 2002, an increase of \$9.4 million or 35.8% during the period. Cash flows used by operating activities were \$1.3 million for the nine months ended September 30, 2003. These amounts primarily resulted from a net loss of \$22.2 million for the nine months ended September 30, 2003, offset by depreciation and amortization of \$8.7 million and a decrease of working capital of \$7.1 million. Cash flows from investing activities of \$2.0 million resulted from a \$2.7 million payment received for the HIM Services sale and \$1.5 million earn-out payment associated with the EZ-CAP sale offset by \$2.5 million in fixed asset purchases. In addition, \$8.6 million was provided from the restructuring of the long term debt.

Cash flows provided from operations for the three months ended September 30, 2003 were \$4.1 million, including \$6.4 million spent on research and development. Cash flows provided for operations improved in the third quarter of 2003 versus the second quarter, primarily as a result of a decrease in working capital of \$3.3 million.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, specifically the timing of our accounts receivable collections, and the timing of other payments. For the nine months ended September 30, 2003 we paid \$6.5 million related to the restatement and other

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non-recurring events. These expenses will be significantly reduced in future quarters. For the nine months ended September 30, 2003 we invested \$17.1 million in research and development of our software products. We expect to continue to invest in research and development in the future.

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Commitments

The following table summarizes financial data for our contractual obligations and other commercial commitments, including interest obligations, as of September 30, 2003 (in thousands):

Contractual Obligations	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
Principal on long-term debt	\$ 85,671	\$ --	\$11,931	\$73,740	\$ --
Interest on long term debt	34,858	4,736	15,374	14,748	--
Operating leases	26,739	4,660	7,663	7,077	7,339
Other long-term obligations	966	483	483	--	--
Total contractual cash obligations	\$148,234	\$ 9,879	\$35,451	\$95,565	\$ 7,339
	=====	=====	=====	=====	=====
Other Commercial Commitments					

Standby letters of credit (1)	\$ 4,076	\$ 1,100	\$ --	\$ 2,620	\$ 356
Total commercial commitments	\$ 4,076	\$ 1,100	\$ --	\$ 2,620	\$ 356
	=====	=====	=====	=====	=====

In addition, as of September 30, 2003, we had approximately \$26.7 million in minimum operating lease commitments that will be repaid through 2011. Finally, we have a Supplemental Executive Retirement Plan ("SERP") that will require total payments from 2008 through 2027 estimated at \$7.8 million. We owe annual premiums of \$483,000 on the SERP through 2005 to fund our obligations.

We believe that we will have sufficient liquidity and capital resources to fund our scheduled debt and other obligations through the next twelve months.

Business Risks

Factors that have affected our results of operations in the past and are likely to affect our results of operations in the future, include the following:

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We Are Currently the Target of Securities Litigation and May Be the Target

of Further Actions, Which May Be Costly and Time Consuming to Defend.

In October 2002, a series of securities law class action complaints were filed in the United States District Court, California Northern District, against us and certain of our officers and directors. The plaintiffs in these actions allege, among other things, violations of the Securities Exchange Act of 1934 due to issuing a series of allegedly false and misleading statements concerning our business and financial condition between May 11, 2000 and August 11, 2002. The complaints seek unspecified monetary damages and other relief.

The ultimate outcome of these matters cannot presently be determined and may require significant commitment of our financial and management resources and time, which may seriously harm our business, financial condition and results of operations. We cannot assure you that any of the allegations discussed above can be resolved without costly and protracted litigation, and the outcome may have a materially adverse impact upon our financial position, results of operations and cash flows.

In addition, securities class action litigation has often been brought against a company following a decline in the market price of its securities. The uncertainty of the currently pending investigation and litigation could lead to more volatility in our stock price. We may in the future be the target of securities class action claims similar to those described above.

We Are Subject to a Formal SEC Inquiry as a Result of the Restatement of

Our Financial Statements.

Following our August 12, 2002 announcement that we intended to restate prior period financial statements, the staff of the San Francisco District Office of the SEC requested certain information concerning the anticipated restatement as part of an informal, preliminary inquiry.

On February 28, 2003, we reported that the SEC had issued a formal non-public order of investigation concerning our accounting and financial reporting practices for the period beginning January 1, 1998. On October 10, 2003, we

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announced that the Staff of the San Francisco District Office of the Securities and Exchange Commission has informed us that the Staff intends to recommend to the SEC that it institute an enforcement action against us for violations of the antifraud, periodic filing and books and records provisions of the federal securities laws. The proposed recommendation concerns our accounting for transactions that we entered into with Health+Cast LLP in 1998 and 1999. The 1999 transactions were restated as part of our recent restatement of our 1999 financial statements. The Staff invited us to make a Wells submission with respect to the proposed recommendation. We plan to continue to discuss this matter with the Staff; however, we cannot predict when the SEC will conclude its inquiry, or the outcome and impact thereof. The staff also indicated that it does not presently intend to recommend any action against our current officers, directors or employees.

Our Common Stock Has Been Delisted from the Nasdaq Stock Market.

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We received a notice from the Nasdaq Stock Market that required us to file Forms 10-Q for the quarters ended June 30, and September 30, 2002 as well as restated financial statements for the years ended December 31, 2001, 2000 and 1999 and the quarter ended March 31, 2002. Our trading symbol as of August 22, 2002 was amended from "QMDC" to "QMDCE", as a result of the delinquent filings. We requested an appeals hearing before a Nasdaq Listing Qualifications Panel (the "Panel"). The Panel notified us on February 6, 2003, that Nasdaq would continue to list our common shares on the Nasdaq National Market until February 28, 2003, by which date we must file our Quarterly Report on Form 10-Q for the interim periods ended June 30, 2002 and September 30, 2002 and our amended SEC filings for the years ended December 31, 2001, 2000 and 1999 and the interim period ended March 31, 2002. Further, we were required to file timely all other annual and periodic reports with the SEC and evidence our continued compliance with all requirements for continued listing on the Nasdaq National Market upon the filing of these documents as well as an ability to sustain compliance with those requirements over the long term.

We were unable to meet these requirements in a timely manner, and on March 4, 2003, our common stock was delisted from the Nasdaq National Market. Delisting from the Nasdaq National Market subjects us to numerous consequences that may adversely affect our business, including the loss of investors. We may no longer qualify for exemptions from state securities registration requirements. Without an exemption from registration, we may need to file time-consuming and costly registration statements for future securities transactions and issuances and to amend our stock option and stock option purchase plans. Furthermore, delisting may result in decreased coverage by securities analysts.

As of the date of this report, we have filed with the SEC all annual and periodic reports required under the Exchange Act. Although we intend to comply with all other listing requirements and to apply for relisting on the Nasdaq Small Cap or other National Market as soon as practicable, we can offer no assurances that we will be relisted on either market.

Our Debentures Have Been Partially Refinanced with Notes that Are Subject

to New Terms.

We issued Debentures through a public offering on May 1, 1998 that mature on May 1, 2005 in the principal amount of \$115 million (the "2005 Notes"). Our net proceeds from the offering were \$110.8 million. The 2005 Notes bear interest at 5.25% per annum and are convertible into common stock at any time prior to the redemption or final maturity, initially at the conversion price of \$33.25 per share (resulting in an initial conversion ratio of 30.075 shares per \$1,000 principal amount).

We are obligated to provide holders of the 2005 Notes with notice of and the holders have the individual option to redeem the 2005 Notes should we, (i) cease to be traded on a U.S. national securities exchange or cease to be approved for trading on a U.S. automated over-the-counter securities market; or (ii) experience defined Changes of Control, including a merger in which we are not the surviving entity or our shareholders do not control 50% of the new entity, the sale of substantially all of our assets, a liquidation, or if there is a substantial change in the board of directors over a two-year period. Additionally, we are obligated to redeem the 2005 Notes upon defined Events of Default, including failure to timely repay principal or interest under the 2005 Notes, default under any other borrowing, and bankruptcy. On March 4, 2003, our common stock was delisted from the Nasdaq Stock Market, and a repurchase event was triggered.

On April 17, 2003, we closed the partial refinancing of our 2005 Notes. In conjunction with our repurchase of \$61.8 million of our outstanding 2005 Notes pursuant to our offer to repurchase such Notes previously announced on March 19, 2003, we issued \$71 million of our Senior Secured Notes due 2008 (the "2008 Notes"), together with warrants to purchase 11,303,842 shares of our common stock. Investors in the 2008 Notes included certain holders of 2005 Notes as well as new investors. Additional warrants to purchase 2,047,978 shares of our common stock will be issued to holders of the 2008 Notes if we do not file a registration statement within 90 days after receiving a request from the holders on or after the date that is 270 days after April 17, 2003, the date of issuance of the 2008 Notes. We also issued warrants to purchase 282,596 shares of our common stock to Philadelphia Brokerage Corporation as consideration in connection with the transaction. The warrants have a term of five years, have an exercise price of \$0.01 per share and are subject to certain anti-dilution provisions including dilution from any issuance of shares in settlement of existing litigation.

The 2008 Notes bear an initial interest rate of 10%, which interest rate is required to be reduced to 9% upon relisting of our common stock on the Nasdaq, including Nasdaq SmallCap or any U.S. National Market. The terms of the 2008 Notes provide that interest is initially payable 6% in cash and 4% in additional notes for the first year and payable entirely in cash thereafter. The 2008 Notes are also secured by substantially all of our intellectual property.

On October 23, 2003, we received a written Demand Request from a Holder of Registrable Securities, pursuant to Section 2 of the Registration Rights Agreement (the "Agreement"), dated as of April 17, 2003. We mailed a Request Notice to all Holders under the Agreement on November 3, 2003. We are required to file for registration of the warrants within 90 days of receiving the Demand Request and are preparing such filing.

The terms of the new debt could result in increased dilution to existing shareholders as a result of the warrants issued and potential future issuances. In addition, the higher rate of interest on the new debt will result in increased interest costs.

The Trading Price of Our Common Stock Has Been, and Is Expected to

Continue to Be, Volatile.

The Nasdaq SmallCap Market on which our common stock was listed, the "Pink Sheets" over-the-counter market, where our stock currently trades, and stock markets in general, have historically experienced extreme price and volume fluctuations that have affected companies unrelated to their individual operating performance. The trading price of our common stock has been and is likely to continue to be volatile due to such factors as:

- o Variations in quarterly results of operations;
- o Announcements of new products or acquisitions by our competitors;
- o Governmental regulatory action;
- o Resolution of pending or unasserted litigation, including the existing

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shareholder lawsuits and SEC investigation;

- o Developments or disputes with respect to proprietary rights; and
- o General trends in our industry and overall market conditions.

Movements in prices of equity securities in general may also affect the market price of our common stock.

Future Sales of Our Common Stock in the Public Market or Warrant or Option

Exercises and Sales Could Lower Our Stock Price.

A substantial number of the unissued shares of our common stock are subject to outstanding stock options and warrants. In addition, our outstanding 2005 Notes may be converted into shares of common stock. We cannot predict the effect, if any, that future sales of shares of common stock, or the availability of shares of common stock for future sale, will have on the market price of our common stock. Sales of substantial amounts of common stock, including shares issued upon the exercise of stock options or warrants or the conversion of our outstanding 2005 Notes, or the perception that such sales could occur, may adversely affect prevailing market prices for our common stock.

Governmental Regulation of the Confidentiality of Patient Health

Information Could Result in Our Customers Being Unable to Use Our Products

Without Significant Modification, which Could Require Us to Expend Substantial

Amounts.

There is substantial state and federal regulation of the confidentiality of patient health information and the circumstances under which such information may be used by, disclosed to or processed by us as a consequence of our contacts with various health care providers. Although compliance with these laws and regulations is presently the principal responsibility of the hospital, physician, or other healthcare provider, regulations governing patient confidentiality rights are dynamic and rapidly evolving. Changes may be made which require us to change our systems and our methods which could require significant expenditure of capital and decrease future business prospects. Additional federal and state legislation governing the dissemination of individually identifiable information have been proposed and may be adopted, which may also significantly affect our business.

The Health Insurance Portability and Accountability Act of 1996 ("HIPAA") is a federal law that affects the use, disclosure, transmission and storage of individually identifiable health information. As directed by HIPAA, the United States Department of Health and Human Services ("HHS") must promulgate standards and implementation guidelines for certain electronic health transactions, code sets, data security, unique identification numbers, and privacy of individually identifiable health information. HHS has made several regulatory proposals, which are in various stages of development.

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First, HHS has published a final regulation governing transaction and code-set standards that had a compliance date of October 16, 2002. If a covered entity (health care providers that transmit certain covered transactions in electronic form, health plans and health care clearinghouses) or its agent file an extension by October 16, 2003, the covered entity would receive an additional year to comply with the HIPAA transaction and code sets requirements.

Second, HHS has published a final HIPAA privacy rule which had a compliance date of April 14, 2003. The HIPAA privacy rule is complex and far reaching. Similar to the HIPAA transaction and code sets rule, the HIPAA privacy rule applies to covered entities. Covered entities are required to execute a contract with any business associate that performs certain services on the covered entity's behalf. We may be implicated by the HIPAA privacy rule as a business associate of a covered entity. The HIPAA privacy rule and state healthcare privacy regulations could materially restrict the ability of healthcare providers to disclose individually identifiable health information from patient records using our products and services or could require us to make substantial capital expenditures to be in compliance. Accordingly, the HIPAA Privacy Rule and state privacy laws may significantly impact our product's use in the health care delivery system and therefore decrease our revenue, increase working capital requirements and decrease future business prospects.

Third, HHS published the final HIPAA security rule with a compliance date of April 20, 2005. The HIPAA security rule applies to the use, disclosure, transmission, storage and destruction of electronic protected health information by covered entities. Covered entities must implement stringent security measures to ensure the confidentiality of the electronic protected health information, and to protect against the unauthorized use of the electronic protected health information. Implementing such measures will require us to expend substantial capital due to required product, service, and procedure changes.

Provisions in Our Certificate of Incorporation and Bylaws and Delaware Law

Could Delay or Discourage a Takeover which Could Adversely Affect the Price of

Our Common Stock.

Our board of directors has the authority to issue up to 5 million shares of preferred stock and to determine the price, rights, preferences, privileges, and restrictions, including voting rights, of those shares without any further vote or action by holders of our common stock. If preferred stock is issued, the voting and other rights of the holders of our common stock may be subject to, and may be adversely affected by, the rights of the holders of our preferred stock. The issuance of preferred stock may have the effect of delaying or preventing a change of control of the Company that could have been at a premium price to our stockholders.

Certain provisions of our certificate of incorporation and bylaws could discourage potential takeover attempts and make attempts to change management by stockholders difficult. Our board of directors has the authority to impose various procedural and other requirements that could make it more difficult for our stockholders to effect certain corporate actions. In addition, our

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certificate of incorporation provides that directors may be removed only by the affirmative vote of the holders of two-thirds of the shares of our capital stock entitled to vote. Any vacancy on our board of directors may be filled only by a vote of the majority of directors then in office. Further, our certificate of incorporation provides that the affirmative vote of two-thirds of the shares entitled to vote, voting together as a single class, subject to certain exceptions, is required for certain business combination transactions. These provisions, and certain other provisions of our certificate of incorporation, could have the effect of delaying or preventing (i) a tender offer for our common stock or other changes of control of the Company that could be at a premium price, or (ii) changes in our management.

In addition, certain provisions of Delaware law could have the effect of delaying or preventing a change in control of the Company. Section 203 of the Delaware General Corporation Law, for example, prohibits a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years from the date the person became an interested stockholder unless certain conditions are met.

Future Sales of a Substantial Number of Shares of Our Common Stock Could

Cause the Price of the Stock to Decrease or Fluctuate Substantially.

Our existing stockholders hold a significant number of shares of common stock that may be sold in the future under Rule 144 of the Securities Act or through the exercise of registration rights. Sales of a substantial number of the aforementioned shares in the public markets or the prospect of such sales could adversely affect or cause substantial fluctuations in the market price of our common stock and debt securities and impair our ability to raise additional capital through the sale of our securities.

We Face Product Development Risks Associated with Rapid Technological

Changes.

The healthcare software market is highly fragmented and characterized by ongoing technological developments, evolving industry standards, and rapid changes in customer requirements. Our success depends on our ability to timely and effectively:

- o Offer a broad range of software products;
- o Enhance existing products and expand product offerings;
- o Respond promptly to new customer requirements and industry standards;
- o Remain compatible with popular operating systems and develop products that are compatible with the new or otherwise emerging operating systems; and
- o Develop new interfaces with competing HIS vendors to fully integrate our Quantim product suite in order to maximize features and functionality of the new products.

Our performance depends in large part upon our ability to provide the increasing functionality required by our customers through the timely development and successful introduction of new products and enhancements to our existing suite of products. We may not successfully, or in a timely manner, develop, acquire, integrate, introduce, or market new products or product enhancements. Product enhancements or new products developed by us also may not meet the requirements of hospitals or other healthcare providers and payers

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or achieve or sustain market acceptance. Our failure to either estimate accurately the resources and related expenses required for a project, or to complete our contractual obligations in a manner consistent with the project plan upon which a contract was based, could have a material adverse effect on our business, financial condition, and results of operations. In addition, our failure to meet a customer's expectations in the performance of our services could damage our reputation and adversely affect our ability to attract new business.

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Our Inability to Protect Our Intellectual Property Could Lead to

Unauthorized Use of Our Products, which Could Have an Adverse Effect on Our

Business.

We rely on a combination of trade secret, copyright and trademark laws, nondisclosure, non-compete, and other contractual provisions to protect our proprietary rights. In 2001, we filed our first patent application covering our developed technology, the Affinity CPOE software application. Measures taken by us to protect our intellectual property may not be adequate, and our competitors could independently develop products and services that are substantially equivalent or superior to our products and services. Any infringement or misappropriation of our proprietary software and databases could put us at a competitive disadvantage in a highly competitive market and could cause us to lose revenues, incur substantial litigation expense, and divert management's attention from other operations.

We depend on licenses from a number of third-party vendors for certain technology used to develop and operate our products. Most of these licenses expire within three to five years. Such licenses can be renewed only by mutual consent and may be terminated if we breach the license terms and fail to cure the breach within a specified time period. If such licenses are terminated, we may not be able to continue using the technology on commercially reasonable terms or at all. As a result, we may have to discontinue, delay or reduce product shipments until equivalent technology is obtained, which could have a material adverse effect on our business, financial condition, and results of operations. Most of our third-party licenses are non-exclusive and competitors may obtain the same or similar technology. In addition, if vendors choose to discontinue support of the licensed technology, we may not be able to modify or adapt our products.

Intellectual property litigation is increasingly common in the software industry. The risk of an infringement claim against us may increase over time as the number of competitors in our industry segment grows and the functionality of products overlaps. Third parties could assert infringement claims against us in the future. Regardless of the merits, we could incur substantial litigation expenses in defending any such asserted claim. In the event of an unfavorable ruling on any such claim, a license or similar agreement may not be available to us on reasonable terms, if at all. Infringement may also result in significant monetary liabilities that could have a material adverse effect on our business, financial condition, and results of operations. We may not be successful in the defense of these or similar claims.

The Nature of Our Products Makes Us Particularly Vulnerable to Undetected

Errors or Bugs that Could Reduce Revenues, Market Share or Demand for Our

Products and Services.

Products such as those we offer may contain errors or failures, especially when initially introduced or when new versions are released. Although we conduct extensive testing on our products, software errors have been discovered in certain enhancements and products after their introduction. Despite such testing by us and by our current and potential customers, products under development, enhancements, or shipped products may contain errors or performance failures, resulting in, among other things:

- o Loss of customers and revenue;
- o Delay in market acceptance;
- o Diversion of resources;
- o Damage to our reputation; or
- o Increased service and warranty costs.

Any of these consequences could have a material adverse effect on our business, financial condition, and results of operations.

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If We Are Unable to Compete Effectively, We Could Experience Price

Reduction, Reduced Gross Margins and Loss of Market Share.

Competition for our products and services is intense and is expected to increase. Increased competition could result in reductions in our prices, gross margins, and market share and have a material adverse effect on our business, financial condition, and results of operations. We compete with other providers of healthcare information software and services, as well as healthcare consulting firms. Some competitors have formed business alliances with other competitors that may affect our ability to work with some potential customers. In addition, if some of our competitors merge, a stronger competitor may emerge. Some principal competitors include:

- o In the market for enterprise healthcare information systems in the Enterprise Division: McKesson Corporation, Inc., Shared Medical Systems, Inc., a division of Siemens, MediTech Corporation, Eclipsys Corporation, Cerner, and, IDX Corporation;
- o In the market for electronic document management products in the Enterprise Division: McKesson Corporation, SoftMed Corporation Inc., FileNet, Lanvision, MedPlus, and, Eclipsys Corporation;
- o In the market for MPI products and services in the Enterprise Division: Madison Technologies, Inc., McKesson Corporation, Shared Medical Systems, Inc., a division of Siemens, and, Medibase;
- o In the market for decision support products in the Enterprise Division:

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Eclipsys Corporation, Healthcare Microsystems, Inc., a division of Health Management Systems Inc., McKesson Corporation, Shared Medical Systems, Inc., a division of Siemens, and, MediQual Systems, Inc., a division of Cardinal Health, Inc.;

- o In the market for coding, compliance, data, and record management products in the Health Information Management Software Division: 3M Corporation, SoftMed Corporation, Inc., MetaHealth, Eclipsys Corporation, and HSS, Inc.;
- o In the Financial Services Division: Advanced Receivables Strategy, Inc., a division of Perot Systems Corporation, NCO Group, Inc., Outsourcing Solutions, Inc., Health Management Systems, Inc., and Triage Consulting Group.

Current and prospective customers also evaluate our products' capabilities against the merits of their existing information systems and expertise. Major software information systems companies, including those specializing in the healthcare industry, that do not presently offer competing products may enter our markets. Many of our competitors and potential competitors have significantly greater financial, technical, product development, marketing and other resources, and market recognition than we have. Many of these competitors also have, or may develop or acquire, substantial installed customer bases in the healthcare industry. As a result of these factors, our competitors may be able to respond more quickly to new or emerging technologies, changes in customer requirements, and changes in the political, economic or regulatory environment in the healthcare industry.

These competitors may be in a position to devote greater resources to the development, promotion, and sale of their products than we can. We may not be able to compete successfully against current and future competitors, and such competitive pressures could materially adversely affect our business, financial condition, and operating results.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

Our exposure to market risk for changes in interest rates primarily relates to our investment portfolio. It is our intent to ensure the safety and preservation of our invested principal funds by limiting default risk, market risk, and re-investment risk. We invest in high-quality issuances, including money market funds and corporate and United States government debt securities. We have a policy of investing in securities with maturities of two years or less. We do not invest in derivatives or foreign investments.

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The table below presents fair values of principal amounts and weighted average interest rates for our investment portfolio as of September 30, 2003 (in thousands, except average interest rates):

Aggregate	Weighted Average
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	Fair Value -----	Interest Rate -----
Cash and cash equivalents:		
Cash.....	\$ 10,689	
Money Market funds.....	22,511	0.83%

Total cash and cash equivalents.....	\$ 33,200	
	=====	
Short-term investments:		
Corporate debt securities.....	\$ 2,380	1.70%

Total short-term investments.....	\$ 2,380	
	=====	
Long-term investments:		
Corporate debt securities.....	\$ 472	5.17%
U.S. government debt securities.....	876	5.02%

Total long-term investments.....	\$ 1,348	
	=====	

On September 30, 2003, our long-term debt consisted of our 2005 debt balance of \$11.9 million at a fixed interest rate of 5.25%, and our 2008 senior secured notes of \$71.0 million with an initial fixed interest rate of 10% which may be reduced to 9%.

Performance of Equity Markets -----

The performance of equity markets can have an effect on our operations, and recent declines in equity markets, if sustained, will have an adverse effect on us related to certain variable life insurance policies in which we have an investment interest.

Foreign Currency Risk -----

Although we sell our products internationally from time to time, all such transactions are denominated in U.S. Dollars and, accordingly, there is no foreign currency fluctuation risk associated with such sales.

Item 4. Controls and Procedures -----

Our Chief Executive Officer and Chief Financial Officer, with the participation of our management, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e), and 15d to 15(e) under the Securities Exchange Act of 1934) as of September 30, 2003. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were designed to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Our Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of our Internal Controls as of the Evaluation Date and concluded

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that our current practices and procedures, albeit not as mature or as formal as management intends them to be in the future, are appropriate under the circumstances. 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. Because of the inherent limitations in all control systems no evaluation of controls can provide absolute assurance that all control issues within a company have been detected. No significant changes were made to our internal controls or other factors that could significantly affect these controls subsequent to the date of their evaluation.

In addition, our Chief Executive Officer and Chief Financial Officer and Audit Committee were made aware of conditions that were considered to be reportable conditions in internal controls under standards established by the American Institute of Certified Public Accountants. These reportable conditions allowed errors to go undetected in some of our 2002 internal financial statements and in our previously issued consolidated financial statements reported in our 2001 Annual Report on Form 10-K and March 31, 2002 Quarterly Report on Form 10-Q. The 2001 Amended and Restated Annual Report on

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Form 10-K/A was filed in June 2003 and the March 31, 2002 Amended and Restated Quarterly Report on Form 10Q/A was filed in August 2003 to correct these errors in our previously issued consolidated financial statements.

The aforementioned weaknesses in our internal controls pertained to the following areas:

- o Revenue recognition, billings, collections and allowances;
- o Formal policies and procedures for significant transactions;
- o Timely analysis and reconciliation of general ledger accounts; and
- o Depth of technical accounting knowledge and training.

We implemented certain new procedures and corrective actions that address the cited weaknesses. These corrective actions included:

- o We engaged Deloitte & Touche LLP (D&T) to perform forensic analysis of the Company's accounting records and reported results for the years 2000 through 2002. D&T's forensic analysis also covered years 1999 and prior to the extent any items originating in earlier years impact 2000, 2001 or 2002;
- o We engaged a team of accounting consultants, most of whom are CPAs with technology industry experience, to lead the restatement effort of the financial statements for 1999, 2000 and 2001 and the first quarter of 2002. D&T transitioned detailed work and reconciliations to this group of professionals. These professionals filled in gaps in the financial organization where temporary vacancy occurred. They reviewed all material business transactions including revenue contracts, acquisitions & dispositions of businesses, impairment of assets, accrued and actual expenses, stockholders' equity transactions and accounting and financial reporting thereof for 1999, 2000 and 2001 and the first quarter of 2002;
- o We retained Charles Stahl, formerly an audit partner with Deloitte & Touche, LLP, as a full-time consultant to lead the final phase of the restatement effort. We then hired him as Executive Vice President and

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Chief Financial Officer, and he built a complete permanent finance department to replace the one that was based, in part, on consultants to strengthen our internal controls; and

- o Our Audit Committee has strengthened its role in corporate governance.

PART II. OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders

At 9:00 AM on October 29, 2003, the Company held its Annual Meeting of Stockholders at the Company's offices at 12110 Sunset Hills Road, Reston, Virginia 20190. The stockholders of the Company voted on five items at the Annual Meeting:

- a. A proposal to amend the Company's Certificate of Incorporation and Bylaws of QuadraMed Corporation eliminating the Company's classified Board of Directors;
b. The election of three Class I directors, each for a term of three years or, in the event the amendments to QuadraMed's Certificate of Incorporation and Bylaws described in the first proposal were approved, the election of eight directors, each for a one-year term expiring in 2004;
c. A proposal to amend the Certificate of Incorporation of QuadraMed Corporation to increase the number of authorized common shares of QuadraMed Corporation from 50,000,000 to 150,000,000 and the total number of shares the Company is authorized to issue from 55,000,000 shares to 155,000,000 shares;
d. A proposal to approve the amendment of the Company's 1996 Stock Incentive Plan to increase the number of shares authorized for issuance thereunder from 7,430,160 to 9,930,160, an increase of 2,500,000 shares, and to increase the maximum number of shares for which any one person may receive options, separately exercisable stock appreciation rights and direct stock issuance by an additional 500,000 shares to 1,500,000 in the aggregate per calendar year; and
e. A proposal to appoint BDO Seidman LLP as independent public accountants for the fiscal year ending December 31, 2003.

The amendment of the Company's Certificate of Incorporation and Bylaws of QuadraMed Corporation to eliminate the Company's classified Board of Directors was approved as follows:

Table with 3 columns: For, Against, Abstentions. Values: For: 26,247,482; Against: 73,512; Abstentions: 23,698.

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As the stockholders approved the proposal to eliminate the classified Board of Directors, the eight nominees for directors were approved as follows:

Nominee -----	For ---	Against -----
F. Scott Gross	25,709,839	634,853
William K. Jurika	25,718,289	626,403
Robert L. Pevenstein	25,734,289	610,403
Michael J. King	25,695,653	649,039
Cornelius T. Ryan	25,688,386	656,306
Lawrence P. English	25,722,149	622,543
Joseph L. Feshbach	25,725,839	618,853
Robert W. Miller	25,725,309	619,383

The amendment of the Certificate of Incorporation of QuadraMed Corporation to increase the number of authorized common shares of QuadraMed Corporation from 50,000,000 to 150,000,000 and the total number of shares the Company is authorized to issue from 55,000,000 shares to 155,000,000 shares was approved as follows:

For ---	Against -----	Abstentions -----
24,986,713	1,341,599	16,380

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The amendment of the Company's 1996 Stock Incentive Plan to increase the number of shares authorized for issuance to 9,930,160 shares, and to increase the maximum number of shares for which any one person may receive options, separately exercisable stock appreciation rights and direct stock issuance to 1,500,000 in the aggregate per calendar year was approved as follows:

For ---	Against -----	Abstentions -----
10,101,665	2,975,809	34,214

The appointment of BDO Seidman LLP as independent public accountants for the fiscal year ending December 31, 2003 was approved as follows:

For	Against	Abstentions
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26,281,227	51,069	12,396

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

- 31.1 Certification of the Chairman of the Board and Chief Executive Officer under 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer under 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chairman of the Board and Chief Executive Officer and Chief Financial Officer under 18 U.S.C. Section 1350.

(b) Reports filed on Form 8-K during the period of this Quarterly Report on Form 10-Q:

There were no reports filed on Form 8-K during the period of this Quarterly Report on Form 10-Q.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

QUADRAMED CORPORATION

Date: November 14, 2003

By: /s/ Lawrence P. English

Lawrence P. English
Chairman of the Board
Chief Executive Officer

Date: November 14, 2003

By: /s/ Charles J. Stahl

Charles J. Stahl
Chief Financial Officer

