Emdeon Inc.
Form 10-Q
November 09, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2010
Commission file number 001-34435
EMDEON INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	**20-5799664**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
3055 Lebanon Pike, Suite 1000	
Nashville, TN	**37214**
(Address of Principal Executive Offices)	(Zip Code)

(615) 932-3000
(Registrant s Telephone Number, Including Area Code)

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

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

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

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

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

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

Class	Outstanding as of November 5, 2010
Class A common stock, $0.00001 par value	**90,869,542**
Class B common stock, $0.00001 par value	**24,689,142**

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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Emdeon Inc.
Condensed Consolidated Balance Sheets
(unaudited and amounts in thousands, except share and per share amounts)

	September 30, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 216,996	$ 211,999
Accounts receivable, net of allowance for doubtful accounts of $4,454 and $4,433 at September 30, 2010 and December 31, 2009, respectively	166,127	150,009
Deferred income tax assets	4,344	4,924
Prepaid expenses and other current assets	17,646	16,632
Total current assets	405,113	383,564
Property and equipment, net	200,486	152,091
Goodwill	740,252	703,027
Intangible assets, net	959,095	989,280
Other assets, net	9,501	1,451
Total assets	$ 2,314,447	$ 2,229,413
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 6,378	$ 9,910
Accrued expenses	85,850	72,493
Deferred revenues	10,108	11,140
Current portion of long-term debt	10,904	9,972
Total current liabilities	113,240	103,515
Long-term debt, excluding current portion	839,840	830,710
Deferred income tax liabilities	153,921	145,914
Tax receivable agreement obligations to related parties	139,430	142,044
Other long-term liabilities	40,035	27,361
Commitments and contingencies		
Equity:		
Preferred stock (par value, $0.00001), 25,000,000 shares authorized and 0 shares issued and outstanding		
Class A common stock (par value, $0.00001), 400,000,000 shares authorized and 90,869,542 and 90,423,941 shares outstanding at September 30, 2010 and December 31, 2009 respectively	1	1
Class B common stock, exchangeable (par value, $0.00001), 52,000,000 shares authorized and 24,689,142 and 24,752,955 shares outstanding at September 30, 2010 and December 31, 2009, respectively		
Additional paid-in capital	745,276	730,941
Contingent consideration	1,955	
Accumulated other comprehensive loss	(3,562)	(11,198)

Retained earnings	43,556	33,704
Emdeon Inc. equity	787,226	753,448
Noncontrolling interest	240,755	226,421
Total equity	1,027,981	979,869
Total liabilities and equity	$ 2,314,447	$ 2,229,413

See accompanying notes to unaudited condensed consolidated financial statements.

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Emdeon Inc.
Condensed Consolidated Statements of Operations
(unaudited and amounts in thousands, except share and per share amounts)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenue	$ 245,923	$ 235,462	$ 726,490	$ 679,888
Costs and expenses:				
Cost of operations (exclusive of depreciation and amortization below)	150,918	146,471	443,349	418,079
Development and engineering	8,596	10,045	25,845	24,425
Sales, marketing, general and administrative	28,494	34,305	80,856	85,888
Depreciation and amortization	30,001	26,667	87,054	77,051
Operating income	27,914	17,974	89,386	74,445
Interest income	(4)	(27)	(12)	(81)
Interest expense	16,163	17,219	47,747	52,330
Other	(2,370)		(4,140)	
Income before income tax provision	14,125	782	45,791	22,196
Income tax provision	7,498	9,245	27,650	12,885
Net income (loss)	6,627	(8,463)	18,141	9,311
Net income (loss) attributable to noncontrolling interest	2,890	(1,246)	8,289	2,871
Net income (loss) attributable to Emdeon Inc.	$ 3,737	$ (7,217)	$ 9,852	$ 6,440
Net income (loss) per share Class A common stock:				
Basic	$ 0.04	$ (0.09)	$ 0.11	$ 0.08
Diluted	$ 0.04	$ (0.09)	$ 0.11	$ 0.08
Weighted average common shares outstanding:				
Basic	90,271,216	84,522,085	90,011,783	79,809,140
Diluted	90,989,313	84,522,085	90,740,909	79,856,588

See accompanying notes to unaudited condensed consolidated financial statements.

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Emdeon Inc.
Condensed Consolidated Statements of Equity
(unaudited and amounts in thousands, except share amounts)

	Class A Common Stock		Class B Common Stock		Additional Paid-in	Contingent	Retained	Other Comprehensive Income	Non-Controlling	Total
	Shares	Amount	Shares	Amount	Capital	Consideration	Earnings	(Loss)	Interest	Equity
Balance at January 1, 2009	77,413,610	$ 1	22,586,390	$	$ 670,702	$	$ 24,123	$ (23,195)	$ 206,522	$ 878,153
Capital contribution from stockholders					203					203
Distribution to stockholders					(434)					(434)
Reclassification of liability awards to equity awards					20,548				6,183	26,731
Equity-based compensation expense					3,022				832	3,854
Purchase of eRx Network L.L.C.			1,850,000		3,530			318	19,707	23,555
Issuance of Units of EBS Master to members of management, net of taxes			2,537,325		(11,979)			394	18,245	6,660
Issuance of Class A common stock to employees and directors, net of taxes	349,166				559			(18)	(851)	(310)
Conversion of EBS Master Units held by eRx to shares of Class A common stock, net of taxes	1,850,000		(1,850,000)		21,919			(376)	(17,443)	4,100
Issuance of Class A shares in connection	10,725,000				145,211					145,211

with IPO (includes costs paid in 2008)							
Issuance of Units of EBS Master to Emdeon Inc., net of taxes			13,799		(448)	(21,025)	(7,674)
Repurchase of Class A shares (to satisfy tax withholding obligation)	(101,515)		(1,573)				(1,573)
Repurchase of units of EBS Master issued to members of management, net of taxes		(370,760)	(1,115)		(74)	(3,500)	(4,689)
Tax receivable agreement with related parties, net of taxes			(131,556)				(131,556)
Issuance of Class A common stock upon vesting of Restricted Stock Units	2,632						
Comprehensive income:							
Net income				6,440		2,871	9,311
Change in the fair value of interest rate swap, net of taxes					3,806	1,112	4,918
Foreign currency translation adjustment					10	6	16
Other comprehensive income amortization, net of taxes					4,072	1,193	5,265
Total comprehensive income							19,510

Balance at September 30, 2009	90,238,893	$ 1	24,752,955	$	$ 732,836	$	$ 30,563	$ (15,511)	$ 213,852	$ 961,741
Balance at January 1, 2010	90,423,941	$ 1	24,752,955	$	$ 730,941	$	33,704	$ (11,198)	$ 226,421	$ 979,869
Equity-based compensation expense					10,104				2,587	12,691
Exchange of units of EBS Master to Class A common stock, net of taxes	36,829		(36,829)		425			(4)	(339)	82
Cancellation of Class B common stock, net of taxes			(26,984)		127			(2)	(197)	(72)
Issuance of Class A common stock upon vesting of Restricted Stock Units, net of taxes	47,214				126			(1)	(96)	29
Issuance of Class A common stock in connection with acquisitions, net of taxes	361,558				4,365	1,955		(7)	720	7,033
Tax receivable agreements with related parties, net of taxes					(51)					(51)
Settlement of liability related to IPO					100					100
Contribution of data sublicense intangible to EBS Master					(861)				1,358	497
Distribution to noncontrolling interest									(72)	(72)

Comprehensive income:										
Net income							9,852		8,289	18,141
Changes in the fair value of interest rate swap, net of taxes								4,587	1,249	5,836
Foreign currency translation adjustment								52	15	67
Other comprehensive income amortization, net of taxes								3,011	820	3,831
Total comprehensive income										27,875
Balance at September 30, 2010	90,869,542	$ 1	24,689,142	$	$ 745,276	$ 1,955	$ 43,556	$ (3,562)	$ 240,755	$ 1,027,981

See accompanying notes to unaudited condensed consolidated financial statements.

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Emdeon Inc.
Condensed Consolidated Statements of Cash Flows
(unaudited and amounts in thousands)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Operating activities		
Net income	$ 18,141	$ 9,311
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	87,054	77,051
Equity compensation expense	12,691	21,499
Deferred income tax expense (benefit)	7,870	(1,360)
Amortization of debt discount and issuance costs	9,536	8,842
Amortization of discontinued cash flow hedge from other comprehensive loss	4,395	5,968
Change in contingent consideration	(4,140)	
Other	51	798
Changes in operating assets and liabilities:		
Accounts receivable	(8,418)	(3,990)
Prepaid expenses and other	(5,691)	4,911
Accounts payable	(3,444)	3,515
Accrued expenses and other liabilities	5,158	(6,199)
Deferred revenues	(2,045)	737
Tax receivable agreement obligations to related parties	(318)	
Net cash provided by operating activities	120,840	121,083
Investing activities		
Purchases of property and equipment	(63,835)	(30,563)
Payments for acquisitions, net of cash acquired	(42,477)	(75,871)
Other	(3,000)	
Net cash used in investing activities	(109,312)	(106,434)
Financing activities		
Proceeds from initial public offering		148,261
Repurchase of Class A common stock		(1,573)
Repurchase of Units of EBS Master LLC		(5,372)
Debt principal payments	(5,663)	(21,663)
Payments on revolver		(10,201)
Payment of loan costs		(359)
Other	(796)	203
Distribution to shareholders	(72)	(434)
Net cash (used in) provided by financing activities	(6,531)	108,862

Net increase in cash and cash equivalents	4,997	123,511
Cash and cash equivalents at beginning of period	211,999	71,478
Cash and cash equivalents at end of period	$ 216,996	$ 194,989

See accompanying notes to unaudited condensed consolidated financial statements.

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

1. Nature of Business and Organization

Nature of Business

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

Organization

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

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

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

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

Reorganization

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

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

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In the reorganization transactions, the Company became the sole managing member of EBS Master and acquired additional interests in EBS Master.

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

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

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

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

Principles of Consolidation

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

Reclassifications

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

Recent Accounting Pronouncements

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

On January 1, 2010, the Company adopted the clarification and additional disclosure provisions of FASB Accounting Standards Update No. 2010-06, an update to FASB ASC Fair Value Measurements and Disclosures Topic. This update clarifies that companies must provide fair value measurement disclosures for each class of assets and liabilities and expands the requirements to include disclosure of amounts and reasons for transfers among different levels within the fair value hierarchy and information within a reconciliation about purchases, sales, issuances and settlements on a gross basis. The adoption of the clarification and additional disclosure provisions of this update had no material impact on the Company s consolidated financial statements for the nine months ended September 30, 2010. The disclosures required by this

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

update are presented within Note 8 to the unaudited condensed consolidated financial statements. The remaining provisions become effective in the fiscal period beginning after December 31, 2010 (January 1, 2011 in the case of the Company). The Company does not expect that the pending adoption of the remaining provisions of the update will have a material effect on the Company s disclosures in its consolidated financial statements.

3. Concentration of Credit Risk

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

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

4. Business Combinations

2009 Acquisitions

Sentinel Group Acquisition

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

eRx Acquisition

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

2010 Acquisitions

FVTech Acquisition

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

The Company has valued the total consideration transferred at $34,158, which consisted of $20,005 cash at closing, estimated contingent consideration of $13,850 and a working capital settlement of $303. The contingent consideration arrangement requires the Company to pay additional consideration ranging from $0 to $40,000 based upon the financial performance of the acquired business for the two and three year periods following the acquisition. The Company has valued the contingent consideration at the acquisition date, using a probability-weighted

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discounted cash flow model, at $13,850. This fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement. The key assumptions in applying the income approach were as follows: 11.6% discount rate and a FVTech performance measure during the earnout period of between approximately $1,500 and $27,000. Through September 30, 2010, the Company has lowered its range of the FVTech performance measure during the earnout period which, combined with the reduced impact of discounting, resulted in a net increase to pre-tax income of $2,270 for the nine month period ended September 30, 2010.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date.

Cash	$ 372
Accounts receivable	1,736
Other current assets	35
Property and equipment	18,423
Other assets	29
Identifiable intangible assets:	
Customer contracts (16-year weighted average useful life)	560
Tradename (3-year weighted average useful life)	160
Goodwill	14,038
Accounts payable	(338)
Accrued expenses	(550)
Other long-term liabilities	(307)
Total consideration transferred	$ 34,158

Acquisition costs reflected within sales, marketing, general and administrative expenses in the nine months ended September 30, 2010	$ 143

As of the acquisition date, FVTech had gross contractual accounts receivable of $1,774, of which approximately $38 is not expected to be collected.

The goodwill recorded in the FVTech acquisition was assigned to the Company s payer services and provider services segments based on revenue effects the acquisition is expected to have on each respective segment. The goodwill recognized is attributable to expected synergies and the assembled workforce of FVTech. The Company expects that approximately $18,700 of goodwill attributable to the FVTech acquisition is expected to be deductible for income tax purposes.

HTMS Acquisition

On March 24, 2010, the Company acquired Healthcare Technology Management Services, Inc. (HTMS), a consulting company focused primarily on the healthcare payer market.

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The Company has preliminarily valued the total consideration transferred at $18,710, which consisted of: (i) $7,841 in cash and 152,532 shares of Class A common stock (fair value of $2,263) paid at closing, (ii) estimated contingent consideration of $8,230 and (iii) an estimated working capital settlement of $409. The contingent consideration arrangement requires the Company to pay, to the extent a financial performance target is achieved, additional specified amounts in cash related to each of the calendar years 2010, 2011 and 2012. The Company has valued the contingent consideration at the acquisition date, using a probability-weighted discounted cash flow model, at $8,230**.** This fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement. The key assumptions in applying the income approach at the acquisition date were as follows: 20.5% discount rate and a probability of achieving the specified financial target of 80%, 90%, and 90% for each of the calendar years 2010, 2011 and 2012, respectively. Through September 30, 2010, the Company has lowered the probability of HTMS achieving the 2010 financial performance target. This change in probability, combined with the reduced impact of discounting, resulted in a net increase to pre-tax income of $1,060 for the nine month period ended September 30, 2010.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date. The preliminary values of the assets acquired and liabilities assumed are subject to change based on the outcome of a working capital settlement (expected to be finalized in 2011).

Cash	$ 1,029
Accounts receivable	3,270
Identifiable intangible assets:	
Tradename (3-year weighted average useful life)	190
Noncompetition agreements (5-year weighted average useful life)	3,150
Backlog (1-year weighted average useful life)	1,630
Goodwill (Provisional)	12,414
Accounts payable	(1,786)
Accrued expenses	(1,050)
Current maturities of long-term debt	(104)
Total consideration transferred	$ 18,743

Acquisition costs reflected within sales, marketing, general and administrative expenses in the nine months ended September 30, 2010	$ 184

As of the acquisition date, HTMS had gross contractual accounts receivable of $3,286, of which approximately $16 is not expected to be collected.

The goodwill recorded in the HTMS acquisition was assigned to the Company s payer services segment. The goodwill recognized is attributable to expected synergies and the assembled workforce of HTMS. The Company expects that approximately $9,100 of goodwill attributable to the HTMS acquisition will be deductible for income tax purposes.

Chapin Revenue Cycle Management, LLC

On June 21, 2010, the Company acquired all of the equity interests of Chapin Revenue Cycle Management, LLC (Chapin), a technology-enabled provider of hospital-based revenue cycle services.

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

The Company has preliminarily valued the total consideration transferred at $22,933, which consisted of (i) $16,096 in cash and 209,026 shares of Emdeon Inc. Class A common stock (fair value of $2,554) paid at closing, (ii) estimated contingent consideration of $3,885 and (iii) an estimated working capital settlement of $398. The contingent consideration arrangement requires the Company to issue, to the extent that certain financial performance targets are achieved, a maximum of 627,080 additional shares of Class A common stock to the former owners of Chapin. These shares are generally issuable in installments in each of the three years following the acquisition, to the extent that the specified financial performance measures are achieved with respect to those years. The Company has valued the contingent consideration at the acquisition date at $3,885 (including $1,955 classified within equity). This value was estimated as the product of a probability-weighted number of shares to be issued and the fair value of the Class A common stock at the acquisition date, as reduced by a discount for lack of marketability. This fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement. The key assumptions in estimating this fair value are as follows: closing price of the Class A common stock on the acquisition date of $13.28, discount for lack of marketability of 8% and a probability of achieving the specified financial performance targets of between 20% and 70%. Through September 30, 2010, the Company has lowered its range of the Chapin performance measures during the first earnout period which, combined with the reduced impact of discounting, resulted in a net increase to pre-tax income of $810.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date. The preliminary values of the assets acquired and liabilities assumed are subject to change based on the receipt of a final valuation of intangible assets and the outcome of a working capital settlement (expected to be finalized in 2011).

Cash	$ 62
Accounts receivable	1,681
Prepaid expenses and other current assets	46
Property and equipment	3,065
Other assets	12
Identifiable intangible assets:	
Tradename (2-year weighted average useful life)	50
Noncompetition agreements (5-year weighted average useful life)	3,350
Customer contracts (9 -year weighted average useful life)	4,640
Goodwill (Provisional)	10,521
Accounts payable	(146)
Accrued expenses	(348)
Total consideration transferred	$ 22,933

Acquisition costs reflected within sales, marketing, general and administrative expenses in the nine months ended September 30, 2010	$ 246

As of the acquisition date, Chapin had gross contractual accounts receivable of $1,720, of which $39 is not expected to be collected.

The goodwill recorded in the Chapin acquisition was assigned to the Company s provider services segment. The goodwill recognized is attributable to expected synergies and the assembled workforce of Chapin. The Company expects that approximately $17,400 of goodwill attributable to the Chapin acquisition will be deductible for tax purposes**.**

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

5. Goodwill and Intangible Assets

Goodwill activity during the nine months ended September 30, 2010 was as follows:

	Payer	Provider	Pharmacy	Total
Balance at December 31, 2009	$ 303,650	$ 315,647	$ 83,730	$ 703,027
Acquisitions	18,451	18,522		36,973
Other			252	252
Balance at September 30, 2010	$ 322,101	$ 334,169	$ 83,982	$ 740,252

Intangible assets subject to amortization as of September 30, 2010 consist of the following:

Amortization expense was $50,255 and $46,101 for the nine months ended September 30, 2010 and 2009, respectively. Aggregate future amortization expense for intangible assets is estimated to be:

	Weighted Average Remaining Life	Gross Carrying Amount	Accumulated Amortization	Net
Customer relationships	15.2	$ 970,722	$ (162,003)	$ 808,719
Trade names	17.1	117,948	(18,882)	99,066
Non-compete agreements	4.4	17,996	(11,534)	6,462
Data sublicense agreement	7.3	49,600	(5,532)	44,068
Backlog	0.5	1,630	(850)	780
Total		$ 1,157,896	$ (198,801)	$ 959,095

2010 (remainder)	$ 17,069
2011	67,008
2012	66,619
2013	66,406
2014	66,356
Thereafter	675,637
	$ 959,095

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6. Long-Term Debt

As of September 30, 2010, long-term debt consisted of the following:

	September 30, 2010	December 31, 2009
Credit Facilities		
$755 million First Lien Term Loan facility, expiring on November 16, 2013, bearing interest payable quarterly at a variable base rate (LIBOR) plus a spread rate (total rate 2.38% and 2.26%) and net of unamortized discount of $30,974 and $38,105 at September 30, 2010 and December 31, 2009, respectively (effective interest rate of 3.99% at September 30, 2010)	649,713	648,245
$170 million Second Lien Term Loan facility, expiring on May 16, 2014, bearing interest at a variable base rate (LIBOR) plus a spread rate (total rate 5.38% and 5.26%) and net of unamortized discount of $12,916 and $15,169 at September 30, 2010 and December 31, 2009, respectively (effective interest rate of 7.98% at September 30, 2010)	157,084	154,831
Obligation under data sublicense agreement	43,947	37,606
Less current portion	(10,904)	(9,972)
Long-term debt	$ 839,840	$ 830,710

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

The Revolver expires November 2012 and provides for revolving loans not to exceed $50,000, of which $12,000 may be used for letters of credit in support of payment obligations of the Company. As of September 30, 2010, the Company had no borrowings outstanding, undrawn letters of credit totaling $4,250 and $45,750 available for future borrowings under the Revolver. The Company pays a quarterly commitment fee on the unused portion of the Revolver that fluctuates, based upon certain leverage ratios, between 0.375% and 0.5% per annum.

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

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

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In October 2010, the Company borrowed an additional $100,000 under an incremental term loan facility through an amendment to the First Lien Term Loan (see Note 18).

The credit agreements require EBS LLC to maintain certain financial covenants, including a maximum total leverage ratio and minimum interest coverage ratio. The credit agreements also impose restrictions related to capital expenditures, investments, additional debt or liens, asset sales, transactions with affiliates and equity interests, among other items. Additionally, the credit agreements include restrictions on the payment of dividends or distributions (other than to fund income tax liabilities) to or advances or loans to parties that are not party to the credit agreements. In the case of dividends, the credit agreements generally limit payments to non-loan parties (including the Company) with such limitations increasing based on achievement of certain leverage ratios. Transactions with affiliates are limited to those which are approved by a majority of the non-interested members of the EBS LLC board of directors and whose terms are no less favorable than those available to an unrelated person. Substantially all of the Company s net assets are subject to the restrictions of these credit agreements. EBS LLC believes it was in compliance with all debt covenants at September 30, 2010. This debt is secured by substantially all of the assets of EBS LLC.

Obligation Under Data Sublicense Agreement

In October 2009, the Company acquired certain additional rights to specified uses of its data from WebMD in order to broaden the Company s ability to pursue business intelligence and data analytics solutions for payers and providers. The Company previously licensed exclusive rights to this data to WebMD pursuant to an Amended and Restated Data License Agreement in connection with the 2008 Transaction. The Company has recorded an amortizable intangible asset and a corresponding obligation related to this agreement.

In April 2010, the Company exercised an option to acquire certain additional rights to specified uses of its data from WebMD. The Company recorded an additional amortizable intangible asset with an estimated life of approximately eight years and an obligation of approximately $6,300 based on the present value of the scheduled annual payments through 2018.

7. Interest Rate Swap

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

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The following table summarizes the fair value of the Company s derivative instrument at September 30, 2010 and December 31, 2009:

		Fair Values of Derivative Instruments Asset (Liability) Derivatives	
	Balance Sheet Location	September 30, 2010	December 31, 2009
Derivatives designated as hedging instruments:			
Interest rate swap	Other long-term liabilities	$ (14,646)	$ (21,337)

Cash Flow Hedging Relationships

In December 2006, the Company entered into an interest rate swap agreement, which matures in December 2011, to reduce the variability of interest payments associated with its total long-term debt. The notional amount of the swap was $352,369 and $355,200 as of September 30, 2010 and December 31, 2009, respectively. Changes in the cash flows of the interest rate swap are intended to offset the changes in cash flows attributable to fluctuations in the variable base rates underlying the Company s long-term debt obligations. As of September 30, 2010, $12,411 of net losses associated with the existing cash flow hedge, which have been recorded within accumulated other comprehensive income, are expected to be reclassified to interest expense within the next twelve months.

The 2008 Transaction represented a redesignation event. As the Company s interest rate swap did not meet all the criteria for hedge accounting at that time, changes in the fair value subsequent to the 2008 Transaction but prior to its redesignation as a cash flow hedge on September 30, 2008 were recorded within interest expense during the period from February 8, 2008 to September 30, 2008. Additionally, the amortization of the amounts reflected in other comprehensive income at the date of the 2008 Transaction related to the discontinued cash flow hedge are and continue to be reflected within interest expense in the accompanying unaudited condensed consolidated statements of operations. Amortization of amounts included in other comprehensive income related to the discontinued original hedge is expected to total approximately $4,450 over the next twelve months.

The effect of the derivative instrument on the accompanying unaudited condensed consolidated statements of operations for the three and nine month periods ended September 30, 2010 and 2009, respectively, is summarized in the following table:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Derivatives in Cash Flow Hedging Relationships				
Gain related to effective portion of derivative recognized in other comprehensive loss	$ 2,224	$ 1,113	$ 6,690	$ 5,596
Gain related to effective portion of derivative reclassified from accumulated other comprehensive loss to interest	$ 5,460	$ 7,338	$ 16,712	$ 20,030

expense

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Effective October 1, 2010, the Company removed the designation of its interest rate swap agreement as a cash flow hedge. Accordingly, all subsequent changes in the fair value of the interest rate swap during each quarter are expected to be recorded within interest expense.

8. Fair Value Measurements

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The Company s assets and liabilities that are measured at fair value on a recurring basis consist principally of the Company s derivative financial instrument and contingent consideration associated with business combinations. The table below presents the Company s assets and liabilities measured at fair value on a recurring basis as of September 30, 2010, aggregated by the level in the fair value hierarchy within which those measurements fall.

Description	Balance at September 30, 2010	Quoted in Markets Identical (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest Rate Swap	$ (14,646)	$	$ (14,646)	$
Contingent Consideration Obligations	(19,870)			(19,870)
Total	$ (34,516)	$	$ (14,646)	$ (19,870)

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

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

Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and by its counterparties. However, as of September 30, 2010, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

The valuation of the Company s contingent consideration obligations is determined using a probability weighted discounted cash flow method. This analysis reflects the contractual terms of the purchase agreements (e.g., minimum and maximum payments, length

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of earn-out periods, manner of calculating any amounts due, etc.) and utilizes assumptions with regard to future cash flows, probabilities of achieving such future cash flows and a discount rate.

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

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

	For the Three Months Ended September 30, 2010	For the Nine Months Ended September 30, 2010
Balance at beginning of period	$ (21,875)	$
Issuances of contingent consideration	(365)	(24,010)
Total changes included in other income (loss)	2,370	4,140
Balance at end of period	$ (19,870)	$ (19,870)

Assets and Liabilities Measured at Fair Value upon Initial Recognition

The carrying amount and the estimated fair value of financial instruments held by the Company as of September 30, 2010 were:

	Carrying Amount	Fair Value
Cash and cash equivalents	$ 216,996	$ 216,996
Accounts receivable	$ 166,127	$ 166,127
Long-term debt (credit facilities)	$ 806,797	$ 830,165
Cost method investment	$ 3,000	$ 3,800

The carrying amounts of cash equivalents and accounts receivable approximate fair value because of their short-term maturities. The fair value of long-term debt is based upon market trades by investors in partial interests of these instruments. The fair value of the cost method investment is estimated using a probability-weighted discounted cash flow model.

9. Legal Proceedings

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

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10. Capital Stock

Common Stock

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

Preferred Stock

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

Initial Public Offering

On August 11, 2009, the Company priced the IPO of its Class A common stock pursuant to a Registration Statement on Form S-1 (File No. 333-153451), as amended, and Registration Statement on Form S-1MEF (File No. 333-161270) (collectively, the Registration Statements) filed with the Securities and Exchange Commission. In the IPO, an aggregate of 27,255,000 shares of Class A common stock, consisting of 10,725,000 Class A shares registered on behalf of the Company and 16,530,000 Class A shares registered on behalf of selling stockholders (including 3,555,000 Class A shares representing an over-allotment option granted by the selling stockholders to the underwriters in the IPO) were offered and sold to the public at a price per share of $15.50. The IPO closed on August 17, 2009, and the Company raised a total of approximately $166,238 in gross proceeds from the IPO, or $144,915 in net proceeds after deducting underwriting commissions and other associated costs (including approximately $3,100 of offering expenses paid in 2008).

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Noncontrolling Interests

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

	Nine Months Ended September 30,	
	2010	**2009**
Net income attributable to Emdeon Inc.	$ 9,852	$ 6,440
Transfers from the noncontrolling interest:		
Increase in Emdeon Inc. paid-in capital for the issuance of 1,850,000 EBS Units in connection with the acquisition of eRx		3,530
Decrease in Emdeon Inc. paid-in capital for the issuance of 2,537,325 EBS Units to management		(11,979)
Increase in Emdeon Inc. paid-in capital for the issuance of 10,703,406 EBS Units		14,358
Increase in Emdeon Inc. paid-in capital related to exchange of EBS Units held by eRx selling stockholders for shares of Emdeon Inc. Class A common stock		21,919
Decrease in Emdeon Inc. paid-in capital for purchase of 370,760 EBS Units from management		(1,115)
Increase in Emdeon Inc. paid-in capital for issuance of 361,558 EBS Master Units in connection with the acquisition of HTMS and Chapin	4,365	
Increase in Emdeon Inc. paid-in capital for issuance of 47,214 EBS Master Units in connection with vesting of restricted Class A common stock units of Emdeon Inc.	126	
Increase in Emdeon Inc. paid-in capital for exchange of 36,829 EBS Master Units to Class A common stock of Emdeon Inc.	425	
Increase in Emdeon Inc. paid-in capital for cancellation of 26,984 EBS Master Units	127	
Net transfers from noncontrolling interest	5,043	26,713
Change from net income attributable to Emdeon Inc. and transfers from noncontrolling interest	$ 14,895	$ 33,153

11. Equity-Based Compensation Plans

During the nine months ended September 30, 2010, the Company issued 283,035 restricted Class A common stock units and 1,417,200 options to purchase Class A common stock to certain of the Company s employees and directors with an aggregate grant date fair value of $15,345. These restricted Class A common stock units and options to purchase Class A common stock generally vest ratably over a four-year period.

The Emdeon Inc. Employee Stock Purchase Plan (ESPP) became effective July 1, 2010. Under the ESPP, the Company is authorized to issue up to 8,900,000 shares of Class A common stock to qualifying employees. Eligible employees may direct the Company, during each six month option period, to withhold between 1% and 10% of their base pay, the proceeds from which are used to purchase shares of Class A common stock at a price equal to the lesser of 85% of the closing market price on the exercise date or the grant date. For accounting purposes, the ESPP is considered a compensatory plan such that the Company recognizes equity-based compensation expense based on the fair value of the options held by the employees to purchase the Company s shares.

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During the nine months ended September 30, 2010 and 2009, the Company recognized equity-based compensation expense of $12,691 and $21,499, respectively.

12. Income Taxes

Income taxes for the nine months ended September 30, 2010 and 2009 amounted to an expense of $27,650 and $12,885, respectively. The Company s effective tax rate was 60.4% for the nine months ended September 30, 2010 compared with 58.1% during the same period in 2009. The Company s effective tax rate is affected by deferred tax expense resulting from differences between the book and income tax basis of its investment in EBS Master, as well by changes in the Company s valuation allowances. The Company has recorded a valuation allowance against $337,272 of state net operating losses and $7,935 of capital losses as of September 30, 2010. Changes in these valuation allowances resulted in $1,140 and $6,902 of additional income tax expense for the three and nine months ended September 30, 2010, respectively, and $1,898 of income tax expense and $8,123 of income tax benefit for the three and nine months ended September 30, 2009, respectively.

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

Unrecognized benefit January 1, 2010	$ 5,982
Increase in nine months ended September 30, 2010	1,906
Unrecognized benefit September 30, 2010	$ 7,888

The Company increased its liability for uncertain tax positions by $1,853 during the nine months ended September 30, 2010 which was primarily related to state net operating losses (recorded as an adjustment to the valuation allowance), that if recognized, would affect the effective income tax rate.

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

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

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. The Company s U.S. federal and state income tax returns for the tax years 2007 and beyond remain subject to examination by the Internal Revenue Service. With respect to state and local jurisdictions and countries outside of the United States, the Company and its subsidiaries are typically subject to examination for a number of years after the income tax returns have been filed. Although the outcome of tax audits is always uncertain, the Company believes that adequate amounts of tax, interest and penalties have been provided for in the accompanying unaudited condensed consolidated financial statements for any adjustments that may be incurred due to state, local or foreign audits.

13. Tax Receivable Agreement Obligation to Related Parties

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

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All future exchanges of EBS Master Units for cash or shares of Class A common stock related to the affiliates of General Atlantic, H&F and the former EBS Master Grant Unit holders who are parties to the tax receivable agreements are expected to result in an additional tax receivable obligation for the Company with a corresponding offset to the Company s additional paid in capital account. Subsequent adjustments of the tax receivable obligations due to certain events (e.g., realization of net operating losses, tax rate changes or the timing of cash settlement obligations) are expected to result in a corresponding adjustment of the Company s net income. As a result of changes in the Company s income tax rate during the period, the Company recognized changes in estimate related to this obligation of approximately $1,162 (decrease to pre-tax income) and $318 (increase to pre-tax income) for the three and nine month periods ended September 30, 2010, respectively.

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14. Net Income Per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Basic net income per share:				
Numerator:				
Net income (loss) attributable to Emdeon Inc.	$ 3,737	$ (7,217)	$ 9,852	$ 6,440
Denominator:				
Weighted average common shares outstanding	90,271,216	84,522,085	90,011,783	79,809,140
Basic net income per share	$ 0.04	$ (0.09)	$ 0.11	$ 0.08
Diluted net income per share:				
Numerator:				
Net loss excluding EBS Master	$ (6,822)	$ (3,346)	$ (20,324)	$ (3,804)
Weighted average effect of dilutive securities				
Add:				
Emdeon Inc. allocation of EBS Master net income	10,563	(4,011)	30,107	10,169
	$ 3,741	$ (7,357)	$ 9,783	$ 6,365
Denominator:				
Number of shares used in basic computation	90,271,216	84,522,085	90,011,783	79,809,140
Weighted average effect of dilutive securities				
Add:				
Restricted Class A common stock units	124,402		77,951	47,448
Contingently issuable Class A common stock				