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QUADRAMED CORP  
Form 10-Q  
May 15, 2001

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
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FORM 10-Q  
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QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2001

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  
(I.R.S. EMPLOYER  
IDENTIFICATION NO.)

22 PELICAN WAY  
SAN RAFAEL, CA 94901  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

94901  
(ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (415) 482-2100

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

As of May 11, 2001, there were 25,754,696 shares of the Registrant's Common Stock outstanding, par value \$0.01. This quarterly report on Form 10-Q consists of 29 pages of which this is page 1. The Exhibit Index is located at page 28.

QUADRAMED CORPORATION

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QUADRAMED CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS  
(In thousands, except per share amounts)

	March 31 2001
	----- (Unaudited)
ASSETS	
Current Assets:	
Cash and cash equivalents	\$ 42,87
Restricted cash	7,51
Short-term investments	2,06
Accounts receivable, net of allowance for uncollectible accounts of \$2,680 and \$2,404, respectively	41,98
Unbilled receivables	6,83
Notes and other receivables	60
Prepaid expenses and other current assets	2,17
	-----
Total current assets	104,04
	-----
Long-Term Investments	1,00
Long-Term Notes Receivable	3,60
Equipment, at cost:	
Equipment	29,33
Less accumulated depreciation and amortization	(21,14)
	-----
Equipment, net	8,18
	-----
Capitalized Software Development, net of accumulated	

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amortization of \$6,263 and \$5,517, respectively	8,96
Acquired Software, net of accumulated amortization of \$3,666 and \$3,441, respectively	1,15
Intangibles, net of accumulated amortization of \$18,890 and \$17,443, respectively	27,14
Marketable Investments	56
Other Long Term Assets	6,14
	-----
Total Assets	\$ 160,81
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current Liabilities:	
Current maturities of capital lease obligations	\$ 11
Accounts payable	37
Accrued payroll and related	7,04
Accrued interest	2,51
Other accrued liabilities	9,66
Deferred revenue	20,54
	-----
Total current liabilities	40,25
Capital Lease Obligations, less current portion	9
Convertible Subordinated Debentures	115,00
Net Liabilities of Discontinued Operations	4,13
	-----
Total liabilities	159,47
	-----
Stockholders' Equity:	
Common stock, \$0.01 par, 50,000 shares authorized, 25,755 shares issued and outstanding	19
Additional paid-in-capital	268,48
Accumulated other comprehensive loss	(4,08)
Accumulated deficit	(263,25)
	-----
Total stockholders' equity	1,33
	-----
Total Liabilities and Stockholders' Equity	\$ 160,81
	=====

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

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QUADRAMED CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(In thousands, except per share amounts)  
(Unaudited)

THREE MONTHS  
MARCH

2001

-----

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Revenues:

Licenses	\$ 22,441
Services	10,367
	-----
Total revenues	32,808
Operating Expenses:	
Cost of licenses	6,354
Cost of services	4,698
General and administration	13,846
Sales and marketing	3,832
Research and development	3,523
Amortization of intangibles and acquired software	1,671
Impairment of intangible assets	0
Non recurring charges	0
	-----
Total operating expenses	33,924
	-----
Loss from Operations	(1,116)
	-----
Other Income (Expense):	
Interest (expense)	(1,658)
Interest income	551
Other income (expense), net	(628)
	-----
Total other (expense), net	(1,735)
	-----
Loss Before Income Taxes	(2,851)
Income tax (provision) benefit	(81)
	-----
Loss from Continuing Operations	(2,932)
Income from discontinued operations (net of tax)	0
	-----
Net Loss Available to Common Stockholders	\$ (2,932)
	=====
Basic and Diluted Net Loss per Share from Continuing Operations	\$ (0.11)
	=====
Basic and Diluted Net Income per Share from Discontinued Operations	\$ --
	=====
Basic and Diluted Net Loss per Share Available to Common Stockholders	\$ (0.11)
	=====
Weighted Average Common and Equivalent Shares Outstanding:	
Basic and Diluted	25,755
	=====

- (1) Prior year financial statements have been restated to present the Release of Information ("ROI") Division as a discontinued operation.
- (2) Prior year financial statements have been restated to be consistent with current year reclassification of cost of licenses, cost of services, general and administration, sales and marketing, and research and development.

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

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QUADRAMED CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)  
(Unaudited)

Cash Flows from Operating Activities:

Net	\$
loss	
Adjustments to reconcile net loss to net cash used for operating activities:	
Depreciation and amortization	
Amortization of deferred compensation	
Write-off of long term investments	
Write-off of capital software	
Impairment of intangible assets	
Noncash settlement of litigation	
Cash flows from discontinued operations	
Changes in assets and liabilities, net of acquisitions:	
Accounts receivable and unbilled receivables, net	
Prepaid expenses and other	
Accounts payable and accrued liabilities	
Deferred revenue	

Cash provided by (used in) operating activities

Cash Flows from Investing Activities:

Cash paid for the acquisition of other companies, net of cash acquired
Maturity (purchase) of available-for-sale securities, net
Additions to equipment
Disposal of equipment
Change in restricted cash
Capitalization of computer software development costs

Cash provided by investing activities

Cash Flows from Financing Activities:

Payments of principal on capital lease obligations
Borrowings (repayments) under notes and loans payable
Issuance of common stock through Employee Stock Purchase Plan
Proceeds from exercise of common stock options and warrants to purchase common stock

Cash (used in) provided by financing activities

Net increase in cash and cash equivalents
Cash and Cash Equivalents, beginning of period

Cash and Cash Equivalents, end of period

\$

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Supplemental Disclosure of Cash Flow Information:  
Cash paid for taxes

=====  
\$

(1) Prior year financial statements have been restated to present the Release of Information ("ROI") Division as a discontinued operation.

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

## QUADRAMED CORPORATION

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS March 31, 2001

#### 1. QUADRAMED CORPORATION

QuadraMed Corporation is a healthcare information technology leader with software, web-enabled solutions, and professional consulting services that enable hospitals and providers to efficiently and effectively manage their delivery of healthcare. QuadraMed provides products and services facilitating all facets of healthcare information management, including clinical, patient, financial, compliance, and managed care. QuadraMed serves more than half of the U.S. hospitals and supports global healthcare initiatives with a dedicated staff of over 1000 professionals.

QuadraMed was incorporated in California in 1993 and reincorporated in Delaware in 1996. Its stock is publicly traded under the symbol "QMDC" on the Nasdaq SmallCap Market. From October 16, 1996 to August 30, 2000, QuadraMed's stock was traded on the Nasdaq National Market.

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES

##### (a) Basis of Presentation and Principles of Consolidation

These condensed consolidated financial statements include the accounts of QuadraMed Corporation and all significant business divisions and subsidiaries (hereinafter "QuadraMed") and have been prepared in conformity with (i) generally accepted accounting principles; and (ii) the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). All significant intercompany accounts and transactions between QuadraMed and its subsidiaries are eliminated in consolidation.

These financial statements reflect all adjustments that are, in management's opinion, necessary for a fair presentation of our results of operations and financial condition. All adjustments that have been included in these financial statements are of a normal recurring nature.

Results of QuadraMed's Release Of Information ("ROI") Division are reported as discontinued operations because control of that business was transferred in May of 2000. Unless otherwise indicated, amounts in these

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statements exclude the effects of all discontinued operations.

### (b) Reclassifications

Certain reclassifications have been made to the 2000 consolidated financial statements to conform to the 2001 presentation. Specifically, March 31, 2000 financial statements have been restated to be consistent with the current classification of cost of licenses, cost of services, general and administration, sales and marketing, research and development, marketable investments and discontinued operations.

### (c) Use of Estimates in Preparation of Financial Statements

In preparing these financial statements in conformity with generally accepted accounting principles, QuadraMed's management has made estimates and assumptions that affect the reported amounts of assets and liabilities, disclosed contingent assets and liabilities, and reported revenues and expenses. Actual results could differ from these estimates. Significant estimates and assumptions have been made regarding intangible assets, primarily goodwill, resulting from QuadraMed's acquisitions.

### (d) Cash and Cash Equivalents

QuadraMed treats all certificates of deposit, money market accounts, and commercial paper with maturities of three months or less, as cash equivalents.

### (e) Restricted Cash

As collateral for stand-by letters of credit, QuadraMed had restricted cash balances of \$7.5 million and \$1.0 million at March 31, 2001 and 2000, respectively. These balances are secured with certificates of deposit.

### (f) Investments

QuadraMed considers its short and long-term securities, consisting primarily of debt securities, to be available-for-sale securities. The difference between cost and amortized cost (cost adjusted for amortization of premiums and accretion of discounts that are recognized as adjustments to interest income) and fair value (representing unrealized holdings gains or losses) are recorded, until realized, as a separate component of stockholders' equity. Gains and losses on the sale of debt securities are determined on a specific identification basis. Realized gains and losses are included in other income (expense) in the accompanying consolidated statement of operations.

During the quarter ended March 31, 2001 \$10.3 million in short-term investments matured and is reflected as cash and cash equivalents on the current balance sheet.

### (g) Equipment

Equipment is stated at cost and depreciated using the straight-line method over its estimated useful life, which is generally from three to five years. Depreciation expense was \$1.0 million and \$1.1 million for quarter ending March 31, 2001, and 2000, respectively. Leasehold improvements are amortized over the term of the lease. Maintenance and repairs are expensed as incurred.

### (h) Intangibles

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Intangibles include goodwill, which is the amount of purchase price in excess of the fair value of the tangible net assets, and other identifiable intangible assets acquired through QuadraMed's acquisitions. Capitalized amounts are amortized on a straight-line basis over a period of five to ten years. Goodwill is evaluated quarterly for impairment and written down to net realizable value if necessary.

### (i) Revenue Recognition

QuadraMed's revenues are derived from two sources: (1) software products; and (2) consulting services. Software product revenues include amounts received for licenses and software-related services, such as installation and post-installation customer support fees, third-party hardware sales, and other software-related revenue. Consulting services revenues include amounts from QuadraMed's Health Information Management Outsourcing, Cash Flow Management Consulting Services, and Compliance Consulting Services.

QuadraMed's software products (enterprise-wide systems and specific applications) can be licensed individually or as a suite of interrelated products. Licenses are granted for a specified term (generally ranging from one to three years; typically paid monthly or annually) or in perpetuity. Revenues from enterprise-wide systems are recognized on the basis of percentage of completion. Term licenses for specific applications are recognized monthly or annually over the term of the license arrangement, beginning at the date of installation. Revenues from perpetual licenses for specific applications are recognized upon shipment of the software if there is persuasive evidence of an agreement, collection of the resulting receivable is probable, and the fee is fixed and determinable. If there is a contractual acceptance period, revenues are recognized on the earlier: of (i) acceptance; or (ii) the expiration of the acceptance period. Software-related service revenue is recognized upon completion of installation. Unbilled receivables consist of work performed or software delivered which has not been billed pursuant to the customer contract. Post-installation customer support is recognized ratably over the term of the support period. Deferred revenue is revenue received in advance from customers for future work. Costs of software products include hardware, royalties to third parties, and installation costs. QuadraMed also capitalizes a portion of software product costs for internally developed software products. These capitalized costs relate primarily to the development of new products and the extension of applications to new markets or platforms using existing technologies. The capitalized costs are amortized on a straight-line basis over the estimated lives of the products, commencing when each product is available to the market.

QuadraMed's consulting services are rendered under contracts with providers calling for fixed monthly payments and revenue is recognized at the end of each month as services are provided. Cash flow management contracts generally provide for incentive payments based on a percentage of dollars recovered for the provider. QuadraMed recognizes this additional incentive revenue upon receipt of payment from the provider. Cost of service revenues consists primarily of salaries, benefits and allocated costs related to providing such services.

### (j) Income Taxes

QuadraMed accounts for income taxes pursuant to Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," ("SFAS No. 109"). SFAS No. 109 provides for an asset and liability approach to accounting for income taxes under which deferred income taxes are provided based upon enacted tax laws and rates applicable to the periods in which taxes become payable.



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### (k) Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing net income (loss) by the sum of weighted average number of common 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 if converted method). Common equivalent shares are excluded from the diluted computation only if their effect is anti-dilutive. As the Company recorded a net (loss) in the three months ended March 31, 2001 and 2000, no common equivalent shares are included in diluted weighted average common shares outstanding for those periods.

### (l) Comprehensive Income

In 1997, the Financial Accounting Standards Board ("FASB") issued Statements of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income," which was adopted by the Company in the first quarter of 1998. SFAS No. 130 requires companies to report a new, additional measure of income on the income statement or to create a new financial statement that has the new measure of income on it.

The components of comprehensive income (loss) for the three months ended March 31, 2001 and 2000 are as follows:

	THREE MONTHS ENDED MARCH 31, (In thousands)	
	2001	2000
Net income (loss)	\$ (2,932)	\$ (25,529)
Unrealized gain (loss) on available-for-sale securities	\$ (53)	\$ (2,016)
	\$ (2,985)	\$ (27,545)
Comprehensive income (loss)	\$ (2,985)	\$ (27,545)

### 3. SUBORDINATED CONVERTIBLE DEBENTURES

In April 1998, QuadraMed completed an offering of \$115 million principal amount of Convertible Subordinated Debentures (the "Debentures"), including the underwriters' over-allotment option. The Debentures are due May 1, 2005 and bear interest at 5.25% per annum. The Debentures 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). Net proceeds to QuadraMed from the offering were \$110.8 million.

### 4. DISCONTINUED OPERATIONS

In connection with the acquisition of Compucare in March 1999, QuadraMed assumed the net liabilities of discontinued operations from

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previous Compucare acquisitions. Included in this net liability are balances related to Compucare's sale of two wholly owned subsidiaries. The two sales were as follows: (1) Antrim Corporation in November, 1996; and (2) Health Systems Integration, Inc. ("HSII").

Condensed and summarized balance sheet data for the discontinued operations of Antrim and HSII is summarized as follows, (in thousands):

	March 31, 2001	Balance as of December 31, 2000
<b>Assets:</b>		
Current assets:		
Cash and cash equivalents	\$ -	\$ -
Accounts receivable	-	-
Other current assets	205	205
Total current assets	205	205
Property and equipment, net	-	-
Other and intangible assets, net	-	-
Total assets	\$ 205	\$ 205
<b>Liabilities:</b>		
Current liabilities	4,338	4,338
Non-current liabilities	-	-
Total liabilities	4,338	4,338
Net liabilities of discontinued operations	\$ 4,133	\$ 4,133

QuadraMed created a wholly owned subsidiary named ChartOne, Inc. and transferred and assigned to ChartOne, Inc. the assets and liabilities of its ROI division pursuant to the terms of an Asset Contribution Agreement dated May 3, 2000. On June 7, 2000, ChartOne, Inc., completed the sale of 2,520,000 shares of its Series A Preferred Stock to Warburg, Pincus Equity Partners, L.P. and certain of its affiliates, and Prudential Securities Group, Inc. for an aggregate purchase of \$25.2 million representing 43 percent of the equity interest in ChartOne, Inc. The sale of the securities was made pursuant to the terms of the Securities Purchase Agreement, dated May 5, 2000. On October 19, 2000, QuadraMed sold its remaining 57 percent equity interest in ChartOne, Inc., represented by 2,130,000 shares of series B Preferred Stock, 1,200,000 shares of Series C Preferred Stock and 1 share of Common Stock to Warburg, Pincus Equity Partners, L.P. and certain of its affiliates, and Prudential Securities Group Inc. for an aggregate cash purchase price of \$26.6 million pursuant to a Securities Purchase Agreement dated September 28, 2000. On the basis of these transactions, QuadraMed recorded a gain on the sale of ChartOne for the year ended December 31, 2000 of \$ 23.3 million (net of income tax expense of \$1.0 million).

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Results of the ROI Division have been included in discontinued operations for all periods, as required by APB-30. For the three months ended March 31, 2000, results from discontinued operations, net of income taxes, were \$0.7 million as follows, (in thousands):

	March 31, 2000
Revenues	\$ 14,111
Costs and expenses	13,001
Gain from discontinued operations before Income taxes	1,110
Provision for income taxes	(443)
Income from discontinued operations	\$ 667

There were no results from discontinued operations during the quarter ended March 31, 2001.

### 5. NON-RECURRING CHARGES

During the quarter ended March 31, 2001, QuadraMed recorded no non-recurring charges.

During the quarter ended March 31, 2000, QuadraMed recorded approximately \$12.1 million of non-recurring charges. Those charges were primarily related to the sunseting of the EnOvation product, the write-down of certain other receivables, and payments to employees for severance agreements and costs associated with office closures. In addition, there were costs related to further product integration efforts and product consolidation.

The following table sets forth QuadraMed's restructuring and non-specific litigation reserves and the activity against these reserves during the current three months ending March 31, 2001 (in thousands):

Description	Balance at December 31, 2000	Change (1)	Balance at March 31, 2001
Restructure/Other.....	\$ 3,206	\$ (923)	\$ 2,283
Non-Specific Legal.....	1,616	(874)	742
Total reserves.....	\$ 4,822	\$ (1,797)	\$ 3,025

(1) Termination benefits included in restructuring/other payments during 2001 amounted to \$0.4 million

### 6. INTANGIBLES

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During the quarter ended March 31, 2001 and 2000 amortization of intangibles was \$1.7 million and \$2.2 million, respectively. There were no charges or write-downs of intangible assets during the quarter ended March 31, 2001.

During the quarter ended March 31, 2000, QuadraMed recorded a \$0.9 million charge for the write-down of certain intangible assets determined to be impaired in accordance with SFAS No. 121, "Impairment of Long-Lived Assets."

### 7. CONTINGENCIES OR OTHER UNCERTAINTIES

In 1999, QuadraMed settled a legal action brought in 1998 against its subsidiary, The Compucare Company. Sunquest Corporation, which had purchased all of the stock of Antrim, Compucare's wholly owned subsidiary, alleged that Compucare breached certain representations and warranties, and misrepresented and or failed to disclose certain material facts in the course of the transaction. In 1999 and 1998, there was an accrual for the settlement in the net liabilities of discontinued operations in the accompanying consolidated balance sheets.

From time to time in the normal course of its business, QuadraMed may be involved in litigation relating to its operations. As of March 31, 2001, QuadraMed was not a party to any legal proceedings that, if decided adversely, would, individually or in the aggregate, have a material adverse effect on QuadraMed's business, financial condition or results of operations.

### 8. INFORMATION ON BUSINESS SEGMENTS

QuadraMed reorganized its operations in 2000 to focus on five operating segments: Enterprise Products and Services Division, HIM Software Division, HIM Services Division, EZ-Cap Division, and Financial Services Division. Although not reported as a business segment, QuadraMed also generated approximately five percent of its revenue from specialty product lines discontinued or not aligned with an operating division referenced as Other. This reorganization was undertaken to more closely align products targeted to shared markets, to more accurately measure financial performance by product/division, and to establish greater management accountability. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies. QuadraMed evaluates financial performance by division as summarized in the subsequent table. The financial results for these operating segments for prior years have been restated on an estimated basis.

QuadraMed's reportable segments are strategic business units that offer different products and services. Each segment, with its own unique position in the healthcare technology and services marketplace, provides customized expertise for the purchasers of healthcare IT and financial solutions.

The Enterprise Division consists of our Affinity Healthcare Information System and our Electronic Document Management product, which principally target acute care hospitals across the United States. The Affinity solution is a healthcare information system that provides financial and clinical applications. Affinity provides a patient-centered database designed to enable users to track each patient throughout the continuum of care in real time. Affinity integrates financial information such as patient accounting and DRG/case mix with clinical data such as medical charting and plan of care to automate federal and state reporting,

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scheduling, registration, and medical records information. This Division also includes our Electronic Document Management solution that enables users to create secure electronic patient folders that combine both computerized and scanned documents.

The HIM Software Division represents a suite of compliance, encoding and grouping, medical record management, and patient database applications, which enable a hospital to accurately track medical records for internal and external purposes. The compliance products assist hospitals in managing the complexities of evolving federal requirements and in submitting accurate billing and clinical data. The coding and grouping solutions protect the integrity of a healthcare organization's clinical data and improve accuracy and coding compliance for ICD-9, CPT, and HCPCS codes. The medical record management product locates and reserves charts and authenticates and distributes transcribed medical records. In addition, the Master Patient Index solution eliminates existing duplicate medical records and prevents creation of new duplicates at the point of registration.

The HIM Services Division provides healthcare information management departments with experienced, qualified, and if necessary, credentialed professionals to perform IT, coding, auditing, accounting, compliance, and medical record services. The Division also provides experienced executives for interim assignments in financial and management positions. These services are offered to acute care facilities as well as large physician, clinic, and ambulatory practices.

The EZ-CAP Division provides medical groups, independent practice associations, hospitals, and health plans with a complete managed care claims payment and management information system incorporating eligibility, plan benefits, providers, claims, capitation, case management, and customer service. This Division also includes education services, seminars, and training for healthcare organizations.

The Financial Services Division provides resources to healthcare providers to reduce accounts receivables' backlogs and accelerate cash flow. The Division conducts analysis of patient accounts to identify outstanding or underpaid third party payments, to re-bill, and to follow-up on third party claims.

FOR THE THREE MONTHS ENDED MARCH 31, 2001  
(in thousands)

Description	Enterprise	HIM Products	Him Services	Financial Services	EZ-CAP
Total revenues	\$ 13,271	\$ 6,449	\$ 4,809	\$ 3,049	\$ 3,653
Interest income	266	-	74	53	118
Interest expense	(669)	(326)	(242)	(154)	(184)
Interest income (expense), net	\$ (403)	\$ (326)	\$ (168)	\$ (101)	\$ (66)
Depreciation & amortization expense	\$ 845	\$ 1,594	\$ 358	\$ 195	\$ 212

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Income tax (provision) benefit	\$ (17)	\$ 72	\$ 3	\$ 0	\$ (16)
Segment earnings (loss)	\$ 562	\$ (2,372)	\$ (76)	\$ 10	\$ 525
Segment assets	\$ 28,875	\$ 52,937	\$ 28,561	\$ 6,324	\$18,455

(1) All Other includes specialty products, immaterial product lines and unallocated corporate charges.

FOR THE THREE MONTHS ENDED MARCH 31, 2000  
(in thousands)

Description	Enterprise	HIM Products	Him Services	Financial Services	EZ-CAP
Total revenues	\$ 9,365	\$ 5,889	\$ 9,531	\$ 2,870	\$ 2,862
Interest income	203	92	52	37	64
Interest expense	(468)	(295)	(476)	(143)	(137)
Interest income (expense), net	\$ (265)	\$ (203)	\$ (424)	\$ (106)	\$ (73)
Depreciation & amortization expense	\$ 315	\$ 1,536	\$ 513	\$ 159	\$ 26
Income tax (provision) benefit	\$ (88)	\$ (8)	\$ 90	\$ 2	\$ (25)
Segment earnings (loss)	\$ 2,945	\$ 261	\$ (3,000)	\$ (78)	\$ 818
Segment assets	\$ 42,009	\$ 50,827	\$ 36,420	\$ 7,619	\$11,678

(1) All Other includes specialty products, immaterial product lines and unallocated corporate charges.

9. SUBSEQUENT EVENTS.

None.

10. RECENT ACCOUNTING PRONOUNCEMENTS.

QuadraMed adopted The Financial Accounting Standards Board (FASB) Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133), as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities - An Amendment of FASB Statement No. 133," effective January 1, 2001. Because of QuadraMed's limited use of derivative instruments, QuadraMed has elected

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not to account for its derivative instruments as hedges. Accordingly, upon adoption the fair values of derivative instruments will be recorded as assets or liabilities on the balance sheet, and changes in fair values of these instruments beyond normal sales and purchases will be reflected in current income. QuadraMed may elect to apply hedge accounting, which has different financial statement effects, to possible future transactions involving derivative instruments, if significant. Such an election would reduce earnings volatility that might otherwise result if changes in fair values were recognized in current income. The adoption of SFAS No. 133 and SFAS No. 138 did not have a significant impact on QuadraMed's results of operations or financial position.

In September 2000, the FASB issued Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - A Replacement of FASB Statement No. 125" ("SFAS No. 140"). SFAS No. 140 is effective for transfers occurring after March 31, 2001, and for disclosures relating to securitization transactions and collateral for fiscal years ending after December 15, 2000. SFAS No. 140 has no significant effect on QuadraMed's accounting or disclosures for the types of transactions within the scope of the new standard.

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

In this Quarterly Report on Form 10-Q, QuadraMed and its management discuss and make statements regarding their intentions, beliefs, and current expectations regarding QuadraMed's future operations and performance. Such statements are "forward-looking" statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are often identified by words such as "anticipates," "believes," "expects," "will," "should" and "intends" and their negatives. QuadraMed and its management caution prospective investors that such forward-looking statements are not guarantees of future performance. Risks and uncertainties are inherent in QuadraMed's future performance. QuadraMed and its management make forward-looking statements based on currently available information and assume no obligation to update these statements due to changes in underlying factors, new information, future developments, or otherwise.

Risks and uncertainties that could cause QuadraMed's actual results to differ from these forward-looking statements are discussed in Item 3 entitled, "Quantitative and Qualitative Disclosures About Market Risk."

#### Overview

QuadraMed is a healthcare information and technology company. It provides software solutions and consulting services to hospitals and medical providers to meet their medical records, business and compliance needs. QuadraMed's solutions have been implemented in over 4000 sites, including approximately 60% of the hospitals in the United States. QuadraMed was reincorporated in Delaware in 1996 after having been originally incorporated in California in 1993.

From 1993 to 1999, acquisition-based growth was an integral part of QuadraMed's business strategy. During this time, QuadraMed completed twenty-eight (28) acquisitions, with twenty-three (23) occurring between 1997 and 1999. This rapid growth had several consequences. First, QuadraMed significantly increased the range of health information management products and services that it offers to healthcare providers. Second, QuadraMed

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increased its market share in the health information management industry. Third, QuadraMed acquired access to public markets and has lowered its capital costs. At the same time, however, integration issues have delayed anticipated synergies and efficiencies, and, since 1997, QuadraMed incurred annual after-tax losses. Further, the acquisitions have produced substantial goodwill that reduces future earnings.

During 2000 and the quarter ended March 31, 2001, QuadraMed focused on integrating its businesses and making financial and operational improvements. As part of this strategy, QuadraMed has reduced expenses, sold non-strategic assets for cash, settled outstanding litigation, made several management changes, and re-aligned the organization into five operating divisions:

- o Enterprise Products and Services Division, which provides acute care hospitals with integrated enterprise information systems to manage patient registration, clinical, and financial information.
- o Health Information Management Products Division, which provides software products that automate and support hospital and provider health information management departments in maintaining accurate and timely patient treatment information and in accurately coding for appropriate reimbursement.
- o Health Information Management Services Division, which provides (1) health information interim management, management consulting and outsourcing services; (2) coding, compliance and education services; (3) compliance, legal and regulatory services; and (4) charge description master reviews.
- o Financial Services Division, which identifies and collects receivables for hospitals and medical groups.
- o EZ-CAP Division, which provides (1) software designed to support managed care risk-taking organizations, such as medical groups, physician-health organizations, independent practice associations, and medical service organizations; and (2) seminars for doctors and medical professionals.

### Revenues

**Licenses.** License revenues include license, installation, consulting and post-contract support fees, third-party hardware sales and other revenues related to licensing of QuadraMed's software products. License revenues for the quarter ended March 31, 2001 were \$22.4 million, compared to \$18.2 million in the same period last year. The increase in license revenues was principally attributable to revenue recognized on several Affinity contracts.

**Services.** Service revenues for the quarter ended March 31, 2001 were \$10.4 million, compared to \$15.0 million in the same period last year. The decrease in service revenues was principally due to loss of two large medical records outsourcing contracts in the fourth quarter of 2000.

### Cost of Revenues

**Cost of Licenses.** Cost of licenses consists primarily of salaries, benefits and allocated costs related to software installations, hardware costs, customer support and royalties to third parties. Cost of licenses



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for the quarter ended March 31, 2001 were \$6.4 million, 9.6% less than \$7.0 million in the same period last year. As a percentage of license revenues, cost of licenses were 28.3% for the quarter ended March 31, 2001, compared with 38.7% in the same period last year. The decrease in the cost of licenses and associated increase in margin resulted primarily from tighter management of expenses.

**Cost of Services.** Cost of services includes expenses associated with services performed in connection with health information management and business office outsourcing, compliance and consulting services. Cost of services for the quarter ended March 31, 2001 were \$4.7 million, 53.1% less than \$10 million in the same period last year. As a percentage of service revenues, cost of services were 45.3% for the quarter ended March 31, 2001, compared with 66.7% in the same period last year. The decrease in the cost of services and associated increase in margin resulted from the aforementioned management of expenses.

### Operating Expenses

**General and Administration.** General and administration expenses for the quarter ended March 31, 2001 were \$13.8 million, 2.5% less than \$14.2 million in the same period last year. As a percentage of total revenues, general and administration expenses were 42.2% for the quarter ended March 31, 2001, compared to 42.8% in the same period last year. General and administration expenses decreased primarily as a result of the restructuring actions taken in 2000.

**Sales and Marketing.** Sales and marketing expenses for the quarter ended March 31, 2001 were \$3.8 million, 37.4% less than \$6.1 million in the same period last year. As a percentage of total revenues, sales and marketing expenses were 11.7% for the quarter ended March 31, 2001, compared to 18.5% in the same period last year. Sales and marketing expenses decreased primarily as a result of the restructuring actions taken in 2000.

**Research and Development.** Research and development expenses for the quarter ended March 31, 2001 were \$3.5 million, 39.6% less than \$5.8 million in the same period last year. As a percentage of total revenues, research and development costs were 10.7% for the quarter ended March 31, 2001, compared to 17.6% in the same period last year. Research and development expenses decreased primarily as a result of a reduction in product versions and associated maintenance requirements.

QuadraMed believes that research and development expenditures are essential to maintaining its competitive position. As a result, QuadraMed intends to continue to make investments in the development of new products and in the further integration of acquired technologies.

**Amortization of Intangibles.** Amortization of intangibles for the quarter ended March 31, 2001 decreased 23.2% to \$1.7 million, compared to \$2.2 million in the same period last year. The decrease in amortization of intangibles was primarily due to the write-down of certain intangible assets during 2000 and reclass of some from goodwill to capitalized software.

**Acquisition Costs.** There were no acquisition charges for the

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quarter ended March 31, 2001 and 2000.

Non-Recurring Charges. There were no non recurring charges for the quarter ended March 31, 2001.

Interest Expense. Interest expense was \$1.7 million for both the quarter ended March 31, 2001 and 2000. Interest expense for the quarter ended March 31, 2001 and 2000 was principally related to QuadraMed's \$115 million convertible subordinated debentures, which were issued in May 1998, partially offset by interest income from QuadraMed's cash and investments.

### Interest Income

Interest income for the quarters ended March 31, 2001 and March 31, 2000 was \$0.6 million and \$0.4 million, respectively. The slight increase in the quarter ending March 31, 2001 was due to QuadraMed's increased holdings of cash and cash equivalents and short term investments.

### Liquidity and Capital Resources

At March 31, 2001, QuadraMed had \$42.9 million in cash and cash equivalents, compared to \$27.4 million at December 31, 2000.

In October 1996, QuadraMed completed its initial public offering of common stock, which resulted in net proceeds of approximately \$26.4 million. In October 1997, QuadraMed completed a follow-on offering of common stock, which resulted in net proceeds of approximately \$57.3 million. In April 1998, QuadraMed completed an offering of \$115.0 million principal amount of convertible subordinated debentures, including the initial purchasers' over-allotment option. The debentures are due May 1, 2005 and bear interest, which is payable semi-annually at 5.25 percent per annum. Proceeds from the offering were \$110.8 million.

Net cash provided by (used in) operating activities was \$5.6 million and (\$6.2) million for the quarter ended March 31, 2001 and 2000, respectively. The increase in cash provided by operating activities principally reflected the improvement in collections on receivables balances and the lower operating expenses.

Net cash provided by investing activities was \$10.2 million and \$7.6 million for the quarter ended March 31, 2001 and 2000, respectively. Investing activities for the quarter ended March 31, 2001 and 2000 primarily related to the maturity of short-term investments.

Net cash (used in) provided by financing activities was (\$0.2) million and \$0.9 million for the quarter ended March 31, 2001 and 2000, respectively. Net cash used in financing activities for the quarter ended March 31, 2001 related to payments of principal capital lease obligations. Net cash provided by financing activities for the quarter ended March 31, 2000 primarily related to the proceeds from the exercise of common stock options and purchases through the Employee Stock Purchase Plan.

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QuadraMed believes that its cash and investments and borrowing capacity on March 31, 2001 is sufficient to fund operations at least through December 31, 2001.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS.

#### Interest Rate Risk

QuadraMed's exposure to market risk for changes in interest rates primarily relates to its investment portfolio and its convertible subordinated debentures. QuadraMed intends to ensure the safety and preservation of its invested principal funds by limiting default risk, market risk and reinvestment risk. QuadraMed invests in high-quality issuers, including money market funds, corporate debt securities, and debt securities issued by the United States government. QuadraMed has a policy of investing in securities with maturities of two years or less. QuadraMed does not invest in derivative financial or foreign investments. The table below presents fair values of principal amounts and weighted average interest rates for QuadraMed's investment portfolio as of March 31, 2001 (in thousands, except average interest rates):

	Aggregate Fair Value	Weighted Average Inte Rate
Cash and cash equivalents:		
Cash.....	\$ 3,179 -----	--
Money market funds.....	\$ 39,694 -----	5.21%
Total cash and cash equivalents.....	\$ 42,873 =====	
Short-term investments:		
Corporate debt securities.....	\$ 2,065 -----	6.58%
Total short-term investments.....	\$ 2,065 =====	
Long-term investments:		
Corporate debt securities.....	\$ 475	6.96%
Debt securities issued by the U.S. government.....	531 -----	6.40%
Total long-term investments.....	\$ 1,006	

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Outstanding Debt. As of March 31, 2001, QuadraMed had outstanding long-term debt of \$115,000,000, consisting of its convertible subordinated debentures that mature as follows (in thousands, except average interest rates):

Maturity Date ----	Carrying Amount -----	Fair Value -----	Weighted Average Interest Rate -----
2005	\$115,000	\$54,050	5.25%

QuadraMed is not exposed to material changes in interest rate because the interest rate on its convertible subordinated debentures, the bulk of QuadraMed's debt, is fixed at 5.25%.

### Foreign Currency Risk

Although QuadraMed from time to time sells its products internationally, all such transactions are denominated in U.S. currency and there is no foreign currency fluctuation risk.

QuadraMed has encountered significant challenges integrating acquired businesses, and its business, operations, and financial condition have been adversely affected.

Since its inception, QuadraMed has completed twenty-eight (28) acquisitions. QuadraMed has encountered significant challenges related to integrating acquired businesses into its operations and expects these challenges to continue until incorporation is complete. Some of the challenges QuadraMed has encountered or may encounter in integrating acquired businesses include:

- o Interruption, disruption or delay of QuadraMed's ongoing business;
- o Distraction of management's attention from other matters;
- o Additional operational and administrative expense;
- o Difficulty managing geographically dispersed operations;
- o Failure of acquired businesses to achieve expected results resulting in failure of QuadraMed to realize anticipated benefits;
- o Failure to retain key acquired personnel and difficulty and expense of training those retained;
- o Increases in stock compensation expense and increased compensation expense resulting from newly hired employees;
- o Assumption of liabilities of acquired businesses and potential for

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disputes with the sellers;

- o Customer dissatisfaction or performance problems related to acquired businesses;
- o Exposure to the risks of entering markets in which QuadraMed has no direct prior experience and to risks associated with market acceptance of acquired products and technologies; and
- o Platform and technical issues related to integrating systems from various acquired companies.

All of these factors have had, and QuadraMed expects will continue to have, an adverse effect on its business, financial condition and results of operations at least until the integration of the acquired businesses is complete. In addition, these problems have led QuadraMed to refocus its business strategy away from acquisitions, which could lead to slower future growth and negatively impact its financial condition.

QuadraMed has incurred losses in each of the past three years and could continue to incur losses in future periods.

QuadraMed incurred net losses of \$54.8 million, \$12.3 million, and \$21.4 million in 2000, 1999, and 1998, respectively, and a net loss of \$2.9 million for the quarter ended March 31, 2001. As of March 31, 2001, QuadraMed's accumulated deficit was \$263.3 million. Included in these losses are the effect of both operating losses and write-offs for in-process research and development of \$1.7 million and \$14.5 million in 1999 and 1998, respectively. No in-process research and development write-offs occurred in 2000, or in the quarter ended March 31, 2001. Furthermore, in connection with its acquisitions, QuadraMed may be required to amortize significant expenses related to goodwill and other intangible assets in future periods. Accordingly, if QuadraMed's operating results do not improve to offset these and other expenses, QuadraMed may continue to experience losses in future periods and may never be profitable.

QuadraMed's quarterly operating results are subject to fluctuations, which could adversely affect its net income and financial results.

QuadraMed's quarterly operating results have varied significantly in the past and may fluctuate significantly in the future as a result of a variety of factors, many of which are outside its control. Accordingly, quarter to quarter comparisons of QuadraMed's operating results may not be a good indication of QuadraMed's future performance. Some of the factors causing these fluctuations include:

- o Variability in demand for products and services;
- o Introduction of product enhancements and new products by QuadraMed and its competitors;
- o Timing and significance of announcements concerning present or prospective strategic alliances;
- o Divestiture of discontinuation of, or reduction in, the products and services QuadraMed offers;

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- o Loss of customers due to consolidation in the healthcare industry;
- o Delays in product delivery requested by its customers;
- o Customer budget cycle fluctuation;
- o Investment in marketing, sales, research and development, and administrative personnel necessary to support anticipated operations;
- o Costs incurred for marketing and sales promotional activities;
- o Software defects and other product quality factors;
- o General economic conditions and their impact on the healthcare industry;
- o Cooperation from competitors on interfaces and implementation when a customer chooses systems from various vendors;
- o Delays in implementation due to product readiness or to customer induced delays in training or installation;
- o Final negotiated sales prices of systems;
- o Federal regulations (i.e., OIG, HIPAA, ICD-10) that can increase demand for new, updated systems;
- o Federal regulations that directly affect reimbursements received, and therefore the amount of money available for purchasing information systems; and
- o The fines and penalties a healthcare provider or system may incur due to fraudulent billing practices.

QuadraMed's operating expense levels, which increase with the addition of acquired businesses, are relatively fixed. Accordingly, if future revenues are below expectations, QuadraMed would experience a disproportionate adverse affect on its net income and financial results. In the event of a revenue shortfall, QuadraMed will likely be unable to, or may elect not to, reduce spending quickly enough to offset any such shortfall. As a result, it is possible that QuadraMed's future revenues or operating results may fall below the expectations of securities analysts and investors. In such a case, the price of QuadraMed's publicly traded securities may be adversely affected.

The variability and length of QuadraMed's sales cycle for its products may exacerbate the unpredictability and volatility of QuadraMed's operating results.

QuadraMed cannot accurately forecast the timing of its customer purchases due to the complex procurement decision processes of most healthcare providers and payors. How and when to implement, replace, expand or substantially modify an information system are major decisions for customers, and such decisions require significant capital expenditures by them. As a result, QuadraMed typically experiences sales cycles that extend over several quarters and QuadraMed has only a limited ability to forecast the timing and size of specific sales, making the prediction of quarterly financial performance more difficult.

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QuadraMed may not be able to hire and retain necessary qualified personnel and the uncertainty caused by QuadraMed's management changes could adversely affect the price of its Common Stock.

In large part, QuadraMed's future success will depend upon its ability to attract and retain executive officers, product managers, and other key sales, marketing and development personnel. Competition for personnel in the software and healthcare information management industry is intense. At times, QuadraMed has had difficulty attracting and retaining highly qualified candidates within specific geographic areas or with specific industry experience. If QuadraMed's competitors increase their use of valid non-compete agreements, the pool of candidates may narrow in some geographic areas. The failure to attract, retain, train, and effectively manage personnel could increase QuadraMed's costs and impair its development, sales, and customer service efforts.

In 2000, QuadraMed made several changes in senior executive management. Uncertainty created by these changes could lead some employees to seek other employment, and QuadraMed could experience difficulty replacing them. Moreover, the trading price of QuadraMed's Common Stock could fluctuate due to uncertainties about its senior executive management.

Changes in procurement practices of hospitals have and may continue to have a negative impact on QuadraMed's revenues.

A substantial portion of QuadraMed's revenues has been and is expected to continue to be derived from sales of software products and services to hospitals. Consolidation in the healthcare industry, particularly in the hospital and managed care markets, could decrease the number of existing or potential purchasers of products and services and could adversely affect QuadraMed's business. In addition, the decision to purchase QuadraMed's products often involves a committee approval. Consequently, it is difficult for QuadraMed to predict the timing or outcome of the buying decisions of its customers or potential customers. In the quarter ended March 31, 2001, QuadraMed's service revenues decreased due to the loss of hospital service contracts. In addition, many healthcare providers are consolidating to create integrated healthcare delivery systems with greater regional market power. These emerging systems could have greater bargaining power, which may lead to decreases in prices for QuadraMed's products, which could adversely affect QuadraMed's business, financial condition and results of operations.

Changes in the healthcare financing and reimbursement system could adversely affect the amount of and manner in which QuadraMed's customers purchase its products and services.

Changes in current healthcare financing and reimbursement systems could result in unplanned product enhancements, delays or cancellations of product orders or shipments or reduce the need for certain systems. QuadraMed could also have the endorsement of products by hospital associations or other customers revoked. Any of these occurrences could have a material adverse effect on QuadraMed's business.

The healthcare industry in the United States is subject to

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changing political, economic and regulatory influences that may affect the procurement practices and operations of healthcare organizations. The commercial value and appeal of QuadraMed's products may be adversely affected if the current healthcare financing and reimbursement system were to revert to a fee-for-service model. In addition, many of QuadraMed's customers provide services under capitated service agreements, and a reduction in the use of capitation arrangements as a result of regulatory or market changes could have a material adverse effect on QuadraMed's business. During the past several years, the healthcare industry has been subject to increasing levels of governmental regulation of, among other things, reimbursement rates and capital expenditures. Proposals to reform the healthcare system have been and are being considered by the United States Congress. These proposals, if enacted, could change the operating environment of QuadraMed's customers in ways that cannot be predicted. Healthcare organizations may react to these proposals by curtailing or deferring investments, including those for QuadraMed's products and services. In addition, the regulations promulgated under HIPAA could lead healthcare organizations to curtail or defer investments in non-HIPAA related features in the next several years.

If QuadraMed is unable to compete effectively, it could experience price reduction, reduced gross margins and loss of market share.

Competition for QuadraMed's products and services is intense. Increased competition could result in reductions in QuadraMed's prices, gross margins, and market share and have a material adverse affect on QuadraMed's business, financial condition and results of operations. QuadraMed competes 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 QuadraMed's ability to work with some potential customers. In addition, if some of QuadraMed's competitors merge, a stronger competitor may emerge. Some principal competitors include:

- o McKesson HBOC, Inc., SoftMed Corporation Inc., FileNet, Lanvision, MedPlus, and Eclipsys Corporation in the market for electronic document management products in the Enterprise Products and Services Division;
- o Eclipsys Corporation, Healthcare Microsystems, Inc., a division of Health Management Systems Inc., McKesson HBOC, Shared Medical Systems, Inc., a division of Siemens, and MediQual Systems, Inc., a division of Cardinal Health, Inc., in the market for decision support products in the Enterprise Products and Services Division;
- o McKesson HBOC, Inc., Shared Medical Systems, Inc., a division of Siemens, MediTech Corporation, Eclipsys Corporation, Cerner, and IDX/Phamis in the market for enterprise healthcare information systems in the Enterprise Products and Services Division;
- o Madison, McKesson HBOC, Shared Medical Systems, Inc., a division of Siemens, and Medibase in the market for MPI products and services in the Enterprise Products and Services Division;
- o 3M, SoftMed Corporation, Inc., MetaHealth, Eclipsys Corporation, Cascade, and HSS in the market for medical records products in the Health Information Management Product Division;
- o PriceWaterhouseCoopers, KPMG and Ernst and Young for compliance products and services and health information management consulting



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services in the Health Information Management Services Division;

- o Physmark, Perot System's Health System Design, Healtheon/WebMD's Medical Manager Corp., IDX Corporation and Trizetto's Erisco, for at-risk managed care systems in the EZ-CAP Division; and
- o National consulting firms and on-line providers for physician and other medical professional seminars in the EZ-CAP Division.

Current and prospective customers evaluate QuadraMed's capabilities against the merits of their existing information systems and expertise. Furthermore, major software information systems companies, including those specializing in the healthcare industry, that do not presently offer competing products may enter QuadraMed's markets. Many of QuadraMed's competitors and potential competitors have significantly greater financial, technical, product development, marketing and other resources and market recognition than QuadraMed. 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, QuadraMed's 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 QuadraMed. QuadraMed may not be able to compete successfully against current and future competitors, and such competitive pressures could materially adversely affect QuadraMed's business, financial condition and operating results.

QuadraMed may not be able to introduce or market new products or product enhancements successfully or in a timely manner, which could adversely affect its competitive position.

QuadraMed's performance depends in large part upon its ability to provide the increasing functionality required by its customers through the timely development and successful introduction of new products and enhancements to its existing suite of products. QuadraMed 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 QuadraMed also may not meet the requirements of hospitals or other healthcare providers and payors or achieve or sustain market acceptance. QuadraMed's failure to either estimate accurately the resources and related expenses required for a project, or to complete its contractual obligations in a manner consistent with the project plan upon which a contract was based, could have a material adverse effect on its business, financial condition and results of operations. In addition, QuadraMed's failure to meet a customer's expectations in the performance of its services could damage its reputation and adversely affect QuadraMed's ability to attract new business.

QuadraMed's inability to protect its intellectual property could lead to unauthorized use of its products, which could have an adverse effect on its business.

QuadraMed relies on a combination of trade secret, copyright and trademark laws, nondisclosure, noncompete and other contractual provisions to protect its proprietary rights. QuadraMed has not filed any patent applications covering its technology. Measures taken by QuadraMed to

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protect its intellectual property may not be adequate, and QuadraMed's competitors could independently develop products and services that are substantially equivalent or superior to QuadraMed's products and services. Any infringement or misappropriation of its proprietary software and databases could put QuadraMed at a competitive disadvantage in a highly competitive market and could cause QuadraMed to lose revenues, incur substantial litigation expense and divert management's attention from other operations.

QuadraMed depends on licenses for certain technology used to develop its products from a number of third-party vendors. Most of these licenses expire within three to five years. Such licenses can be renewed only by mutual consent and may be terminated if QuadraMed breaches the license terms and fails to cure the breach within a specified time period. If such licenses are terminated, QuadraMed may not be able to continue using the technology on commercially reasonable terms or at all. As a result, QuadraMed may have to discontinue, delay or reduce product shipments until equivalent technology is obtained, which could have a material adverse effect on QuadraMed's business, financial condition and results of operations. Most of QuadraMed's 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, QuadraMed may not be able to modify or adapt its products.

Intellectual property litigation is increasingly common in the software industry. The risk of an infringement claim against QuadraMed may increase over time as the number of competitors in its industry segment grows and the functionality of products overlaps. Third parties could assert infringement claims against QuadraMed in the future. Regardless of the merits, QuadraMed 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 QuadraMed on reasonable terms, if at all. Infringement may also result in significant monetary liabilities that could have a material adverse effect on QuadraMed's business, financial condition and results of operations. QuadraMed may not be successful in the defense of these or similar claims.

The nature of QuadraMed's products makes them particularly vulnerable to undetected errors, or bugs, that could reduce revenues, market share or demand for the company's products and services.

Products such as QuadraMed's may contain errors or failures, especially when initially introduced or when new versions are released. Although QuadraMed conducts extensive testing on its products, software errors have been discovered in certain enhancements and products after their introduction. Despite such testing by QuadraMed and by its 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 revenues;
- o delay in market acceptance;
- o diversion of resources;
- o damage to QuadraMed's reputation; or

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- o increased service and warranty costs.

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

Because no mirror processing site for its two customer data processing facilities exists, QuadraMed's business, financial condition, and results of operations could be adversely affected if either of these facilities were subject to a closure from a catastrophic event or otherwise.

QuadraMed currently processes substantially all of its customer data at its facilities in Austin, Texas and Neptune, New Jersey. Although QuadraMed backs up its data nightly and has safeguards for emergencies, such as power interruption or breakdown in temperature controls, QuadraMed has no mirror processing site to which processing could be transferred in the case of a catastrophic event at either of these facilities. If a major catastrophic event occurs at either the Austin or the Neptune facility, possibly leading to an interruption of data processing, or any other interruption or closure, QuadraMed's business, financial condition, and results of operations could be adversely affected.

QuadraMed may not be able to respond effectively to an increase in its outsourcing business, which could have a negative impact on revenues.

QuadraMed provides compliance, consulting, and health information management outsourcing and accounts receivable management services, including the billing and collection of receivables. If QuadraMed experiences a period of substantial expansion in its outsourcing business, QuadraMed may be required to make substantial investments in capital assets and personnel. QuadraMed may not be able to assess accurately, or have the funds required for, any investment, and it may not be able to negotiate and perform in a profitable manner any of the outsourcing contracts it may be awarded.

QuadraMed may be required to make substantial changes to its products if they become subject to FDA regulation, which could require a significant capital investment.

Computer products used or intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease or other conditions or that affect the structure or function of the body are subject to regulation by the FDA under the Federal Food, Drug and Cosmetic Act. At present, none of QuadraMed's software products are so regulated. In the future, the FDA could determine that some of QuadraMed's products, because of their predictive aspects, are clinical decision tools and subject them to regulation. Compliance with FDA regulations could be burdensome, time consuming, and expensive. Other new laws and regulations affecting healthcare software development and marketing also could be enacted in the future. If so, it is possible that QuadraMed's costs and lengths of time for product development and marketing could increase and that other unforeseeable consequences could arise.

Governmental regulation of the confidentiality of patient records could result in QuadraMed's customers being unable to use its products without

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significant modification, which could require substantial expenditures by QuadraMed.

There is substantial state regulation of the confidentiality of patient medical records and the circumstances under which such records may be disclosed to or processed by QuadraMed as a consequence of its contacts with various health 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 rapidly evolving. Additional legislation governing the dissemination of medical record information also has been proposed and may be adopted at the state level.

HIPAA and, in particular, its administrative simplification provisions, require the promulgation of regulations that will set standards for electronic transactions, code sets, data security, unique identification numbers, and privacy of individually identifiable health information. The regulations are in various stages of development. A final regulation governing transaction and code set standards has been published and is expected to become effective on October 16, 2002. The privacy regulation has been published as a final regulation and became effective on April 14, 2001. The HIPAA privacy regulation is complex and far reaching. Compliance will be required of certain covered entities, including healthcare providers, health plans, and healthcare clearinghouses. QuadraMed may be implicated by these regulations either as a covered entity or as a business associate of a covered entity. The HIPAA and state healthcare privacy regulations could materially restrict the ability of healthcare providers to submit information from patient records using QuadraMed products and services or could require QuadraMed to make substantial capital expenditures to be in compliance.

HIPAA's data security regulation has been published as a proposal. At this time, no information is available on when the regulation will be published as final or whether the regulation will be revised prior to final publication. At this time, it is not possible to assess the specific implications of the security regulation on QuadraMed. The regulation may require holders of individual personal healthcare information, including QuadraMed, to implement stringent security measures. Implementing such measures may require substantial capital expenditures by QuadraMed due to required product, service, and procedure changes.

In addition, during the past several years, the healthcare industry has been subject to, among other things, increasing levels of governmental regulation of reimbursement rates and certain capital expenditures. Certain proposals to reform the healthcare system have been and are being considered by Congress. These proposals, if enacted, could change the operating environment for QuadraMed's clients in ways that could have a negative impact on QuadraMed's business, financial condition and results of operations. QuadraMed is unable to predict what, if any, changes will occur.

If QuadraMed's products fail to accurately assess, process, or collect healthcare claims or administer managed care contracts, QuadraMed could be subject to costly litigation and be forced to make costly changes to its products.

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Some of QuadraMed's products and services are used in the payment, collection, coding and billing of healthcare claims and the administration of managed care contracts. If QuadraMed's employees or QuadraMed's products fail to accurately assess, process or collect these claims, customers could file claims against QuadraMed. QuadraMed's insurance coverage may not adequately cover such claims. A successful claim that is in excess of, or is not covered by, insurance coverage could adversely affect QuadraMed's business, financial condition, and results of operations. Even a claim without merit could result in significant legal defense costs and could consume management time and resources. In addition, claims could increase QuadraMed's premium such that appropriate insurance could not be found at commercially reasonable rates. Furthermore, if QuadraMed were found liable, QuadraMed may have to significantly alter one or more of its products, possibly resulting in additional unanticipated research and development expenses.

Provisions in QuadraMed's certificate of incorporation and bylaws and Delaware law could delay or discourage third parties from acquiring QuadraMed at a premium, which could adversely affect the price of its Common Stock.

QuadraMed's board of directors has the authority to issue up to 5,000,000 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 QuadraMed's Common Stock. If preferred stock is issued, the voting and other rights of the holders of QuadraMed's Common Stock may be subject to, and may be adversely affected by, the rights of the holders of QuadraMed's preferred stock. The issuance of preferred stock may have the effect of delaying or preventing a change of control of QuadraMed that would have been at a premium price to QuadraMed's stockholders.

Certain provisions of QuadraMed's certificate of incorporation and bylaws could discourage potential takeover attempts and make attempts by stockholders to change management difficult. For example, QuadraMed's board of directors, which is classified into three classes of directors serving staggered, three-year terms, has the authority to impose various procedural and other requirements that could make it more difficult for QuadraMed's stockholders to effect certain corporate actions. In addition, QuadraMed's certificate of incorporation provides that directors may be removed only by the affirmative vote of the holders of two-thirds of the shares of QuadraMed's capital stock entitled to vote. Any vacancy on QuadraMed's board of directors may be filled only by vote of the majority of directors then in office. Further, QuadraMed's 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 QuadraMed's certificate of incorporation, could have the effect of delaying or preventing (i) a tender offer for QuadraMed's Common Stock or other changes of control of QuadraMed that could be at a premium price, or (ii) changes in its management.

In addition, certain provisions of Delaware law could have the effect of delaying or preventing a change in control of QuadraMed, 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.

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The trading price of QuadraMed's Common Stock has been, and is expected to continue to be, extremely volatile.

The NASDAQ SmallCap Market on which QuadraMed is listed, 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 QuadraMed's Common Stock has been and is likely to continue to be highly volatile due to such factors as:

- o Variations in quarterly results of operations;
- o Announcements of new products or acquisitions by QuadraMed's competitors;
- o Governmental regulatory action;
- o Developments or disputes with respect to proprietary rights;
- o General trends in QuadraMed's industry and overall market conditions.

The market price of QuadraMed's Common Stock may also be affected by movements in prices of equity securities in general.

Future sales of a substantial number of shares of QuadraMed's Common Stock could cause the price of the stock to decrease or fluctuate substantially.

Existing stockholders of QuadraMed 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 QuadraMed's Common Stock and convertible debentures and impair QuadraMed's ability to raise additional capital through the sale of its securities.

If QuadraMed is unable to achieve profitability, it may be forced to file for bankruptcy.

If QuadraMed's financial condition deteriorates and QuadraMed is unable to reduce its losses or obtain additional financing, QuadraMed may be forced to seek relief under Chapter 11 of the U.S. Bankruptcy Code. Chapter 11 permits a company to remain in control of its business, protected by a stay of all creditor action while the company attempts to negotiate and confirm a plan of reorganization with its creditors. If QuadraMed commenced a Chapter 11 case it would expect deterioration in its customer relationships, a reduction in orders, the loss of suppliers, and an erosion of employee morale. QuadraMed may be unsuccessful in its attempts to confirm a plan of reorganization with its creditors. Many Chapter 11 cases are unsuccessful, and virtually all involve substantial expense and damage to the business. If QuadraMed were unsuccessful in obtaining confirmation of a plan of reorganization, its assets could be liquidated and could be insufficient to pay all of its securityholders.

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QuadraMed may lose some or all of its equity investments in early stage companies if such companies become bankrupt or insolvent or do not succeed in executing their business strategy appropriately.

QuadraMed has made equity investments and acquired minority interests in certain early stage companies. QuadraMed does not have the ability to control the operations of these companies and these investments are subject to significant risks. There is no guarantee that QuadraMed will realize any return on such investments. QuadraMed could also lose some or all of its principal investment if these companies become bankrupt or insolvent or do not succeed in executing their business strategy.

### Review of Financial Statements.

The financial information required in this Form 10-Q by Rule 10-01 of Regulation S-X has been subject to a review by Pimenti & Brinker LLP, the Company's independent certified public accountants, as described in their report dated May 3, 2001.

The unaudited condensed consolidated financial statements contained herein have been prepared on the same basis as QuadraMed's audited consolidated financial statements and, in the opinion of management, include all adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of the information for the periods presented. Management is continuing to review QuadraMed's financial statements and will obtain the assistance of outside resources as deemed necessary. Management's review is not expected to result in any material adjustments or charges; however, there can be no assurance that additional adjustments and/or charges will not be required.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS.

None.

### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

None.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

### ITEM 4. SUBMISSION OF MATTERS TO VOTE OF SECURITY HOLDERS.

None.

### ITEM 5. OTHER INFORMATION.

None.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

#### (a) EXHIBITS.

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The exhibits listed on the accompanying Exhibit Index are filed as part of this quarterly report.

(b) REPORTS ON FORM 8-K:

None.

### SIGNATURES

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

QUADRAMED CORPORATION (Company)

Date: May 15, 2001

By: /s/ Lawrence P. English

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Lawrence P. English  
Chief Executive Officer  
(Principal Executive Officer)

By: /s/ Mark N. Thomas

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Mark N. Thomas  
Chief Financial Officer  
(Principal Financial Officer)

### EXHIBIT INDEX

- 3.4 Amended and Restated Bylaws of QuadraMed. (1)
- 3.5 Third Amended and Restated Certificate of Incorporation of QuadraMed. (5)
- 4.1 Reference is made to Exhibits 3.4 and 3.5. (1) (5)
- 4.2 Form of Common Stock certificate. (1)
- 4.11 Form of Warrant to Purchase Common Stock. (1)
- 4.12 Registration Rights Agreement dated December 5, 1996, by and between QuadraMed and the investors listed on Schedule A thereto. (2)
- 4.14 Registration Rights Agreement, dated as of June 5, 1998, by and among QuadraMed Corporation and the stockholders of Pyramid Health Group, Inc. named therein. (3)
- 4.15 Subordinated Indenture, dated as of May 1, 1998 between QuadraMed and The Bank of New York. (4)
- 4.16 Officers' Certificate delivered pursuant to Sections 2.3 and 11.5 of the Subordinated Indenture. (4)



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- 4.17 Registration Rights Agreement dated April 27, 1998 by and among QuadraMed and the Initial Purchasers named therein. (4)
- 4.18 Form of Global Debenture. (4)
- 4.19 Form of Certificated Debenture. (4)
- 4.21 Registration Rights Agreement dated December 23, 1998 by and between QuadraMed and the shareholders listed therein. (7)
- 4.22 Registration Rights Agreement, dated as of March 3, 1999, by and among QuadraMed Corporation and the stockholders of The Compucare Company named therein. (6)
- 15 Accountant's Letter.
  - (1) Incorporated herein by reference from the exhibit with the same number to our Registration Statement on Form SB-2, No. 333-5180-LA, as filed with the Commission on June 28, 1996, as amended by Amendment No. 1, Amendment No. 2 and Amendment No. 3 thereto, as filed with the Commission on July 26, 1996, September 9, 1996, and October 2, 1996, respectively.
  - (2) Incorporated herein by reference from the exhibit with the same number to our Quarterly Report on Form 10-Q for the quarter ended June 30, 1997, as filed with the Commission on August 14, 1997, as amended September 4, 1997.
  - (3) Incorporated by reference from our Current Report on Form 8-K, as filed with the Commission on June 11, 1998.
  - (4) Incorporated by reference from our Registration Statement on Form S-3, No. 333-55775, as filed with the Commission on June 2, 1998, as amended by Amendment No. 1 thereto, as filed with the Commission on June 17, 1998.
  - (5) Incorporated by reference from the exhibit with the same number to our Quarterly Report on Form 10-Q for the quarter ended June 30, 1998, as filed with the Commission on August 14, 1998, as amended on August 24, 1998.
  - (6) Incorporated herein by reference from our Current Report on Form 8-K/A filed with the Commission on March 22, 1999.
  - (7) Incorporated herein by reference from our Registration Statement on Form S-3, No. 333-80617, as filed with the Commission on June 14, 1999, as amended by Amendment No. 1 thereto, as filed with the Commission on August 4, 1999.