QUADRAMED CORP
Form 10-Q
November 05, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934**
FOR THE QUARTERLY PERIOD ENDED September 30, 2009

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: 001-32283

QUADRAMED CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	**52-1992861**
(State or Other Jurisdiction of	**(IRS Employer**
Incorporation or Organization)	**Identification No.)**
12110 SUNSET HILLS ROAD, SUITE 600	
RESTON, VIRGINIA	**20190**
(Address of Principal Executive Offices)	**(Zip Code)**

(703) 709-2300

(Registrant s Telephone Number, Including Area Code)

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

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

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

Large Accelerated Filer ¨		Accelerated Filer x
Non-accelerated Filer ¨	(Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of November 2, 2009, there were 8,307,277 shares of the Registrant s common stock outstanding, par value $0.01.

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QUADRAMED CORPORATION

REPORT ON FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2009

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

QUADRAMED CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

(unaudited)

	September 30, 2009	December 31, 2008
ASSETS		
Current assets		
Cash and cash equivalents	$ 7,879	$ 20,649
Short-term investments	7,650	4,213
Accounts receivable, net of allowance for doubtful accounts of $1,402 and $1,052, respectively	27,384	20,843
Unbilled receivables	6,817	6,177
Deferred contract expenses	5,678	5,005
Prepaid royalty expenses	1,094	7,831
Prepaid expenses and other current assets, net of allowance on other receivable of $919, respectively	4,330	4,485
Deferred tax asset, net of valuation allowance	6,241	6,240
Total current assets	67,073	75,443
Restricted cash	1,522	1,444
Long-term investments	3,506	3,043
Property and equipment, net of accumulated depreciation and amortization of $19,169 and $17,732, respectively	3,556	3,895
Goodwill	35,632	35,632
Other amortizable intangible assets, net of accumulated amortization of $30,932 and $29,305, respectively	7,760	9,387
Other long-term assets	2,831	2,829
Deferred tax asset, net of valuation allowance	48,009	47,921
Total assets	$ 169,889	$ 179,594
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable and accrued expenses	$ 5,794	$ 4,705
Accrued payroll and related benefits	5,221	7,228
Accrued exit cost of facility closing	346	888
Income tax payable	2,079	688
Other accrued liabilities	3,491	4,721
Dividends payable	1,375	1,375
Deferred revenue	43,004	53,190
Total current liabilities	61,310	72,795
Other long-term liabilities	1,458	1,834
Total liabilities	62,768	74,629
Commitments and Contingencies		
Stockholders equity		
Preferred stock, $0.01 par, 5,000 shares authorized, 4,000 shares issued and outstanding, respectively	96,144	96,144
	95	95

Common stock, $0.01 par, 30,000 shares authorized; 9,471 and 9,451 shares issued and 8,307 and 8,287 outstanding, respectively				
Shares held in treasury, 1,164, respectively		(9,031)		(9,031)
Additional paid-in-capital		317,868		316,027
Accumulated other comprehensive loss		(987)		(1,675)
Accumulated deficit		(296,968)		(296,595)
Total stockholders equity		107,121		104,965
Total liabilities and stockholders equity	$	169,889	$	179,594

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 ended, September 30, 2009	Three months ended, September 30, 2008	Nine months ended, September 30, 2009	Nine months ended, September 30, 2008
Revenue				
Services	$ 5,803	$ 5,930	$ 16,441	$ 17,102
Maintenance	16,849	18,205	49,349	51,734
Installation and other	3,064	3,153	9,133	9,614
Services and other revenue	25,716	27,288	74,923	78,450
Term licenses	8,500	8,099	25,925	23,651
Perpetual licenses	1,446	3,127	5,454	9,260
License revenue	9,946	11,226	31,379	32,911
Hardware	140	75	387	505
Total revenue	35,802	38,589	106,689	111,866
Cost of revenue				
Cost of services and other revenue	10,502	11,487	31,615	34,324
Royalties and other	3,592	3,671	10,944	11,365
Amortization of acquired technology and capitalized software	219	245	676	756
Cost of license revenue	3,811	3,916	11,620	12,121
Cost of hardware revenue	217	64	361	328
Total cost of revenue	14,530	15,467	43,596	46,773
Gross margin	21,272	23,122	63,093	65,093
Operating expense				
General and administration	4,876	5,027	16,619	14,907
Software development	9,316	8,328	25,937	25,362
Sales and marketing	4,247	4,968	13,117	14,105
Loss on sale of assets		46		1,161
Amortization of intangible assets and depreciation	856	761	2,387	2,400
Total operating expenses	19,295	19,130	58,060	57,935
Income from operations	1,977	3,992	5,033	7,158
Other income (expense)				
Interest expense, includes non-cash charges of $14, $18 and $47, $54	(16)	(26)	(51)	(99)
Interest income	58	136	179	460
Other income, net	160	1	268	9

Other income, net	202	111	396	370
Income from operations before income taxes	$ 2,179	$ 4,103	$ 5,429	$ 7,528
Provision for income taxes	(669)	(1,634)	(1,677)	(2,963)
Net Income	1,510	2,469	3,752	4,565
Preferred stock dividends declared	(1,375)	(1,375)	(4,125)	(4,125)
Net income (loss) attributable to common shareholders	$ 135	$ 1,094	$ (373)	$ 440
Income (loss) per share				
Basic	$ 0.02	$ 0.12	$ (0.05)	$ 0.05
Diluted	$ 0.02	$ 0.12	$ (0.05)	$ 0.05
Weighted average shares outstanding				
Basic	8,300	8,931	8,296	8,930
Diluted	8,324	8,962	8,296	8,963

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)

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
Cash flows from operating activities				
Net income	$ 1,510	$ 2,469	$ 3,752	$ 4,565
Adjustments to reconcile net income to net cash (used in) provided by operating activities:				
Depreciation and amortization	1,075	1,006	3,063	3,156
Deferred compensation amortization		85		273
Stock-based compensation	295	805	1,740	2,445
Provision for bad debts	322	34	894	164
Provision for income taxes	669	1,634	1,677	2,963
Loss on sale of assets		46		1,161
Changes in operating assets and liabilities:				
Accounts receivable	(4,776)	(1,835)	(8,075)	(3,861)
Prepaid expenses and other	2,515	3,271	5,889	866
Accounts payable and accrued liabilities	(704)	960	(2,425)	(8,355)
Deferred revenue	(2,951)	(6,081)	(10,186)	11,155
Cash (used in) provided by operating activities	(2,045)	2,394	(3,671)	14,532
Cash flows from investing activities				
Decrease (increase) in restricted cash	6	173	(78)	833
Purchases of available-for-sale securities	(8,161)	(190)	(15,837)	(4,220)
Proceeds from sale of available-for-sale securities	9,210	190	11,734	6,049
Payment of acquisition costs		(10)		(56)
Purchases of property and equipment	(588)	(577)	(1,097)	(1,420)
Proceeds from sale of assets				106
Cash provided by (used in) investing activities	467	(414)	(5,278)	1,292
Cash flows from financing activities				
Payment of preferred stock dividends	(1,375)	(1,375)	(4,125)	(4,125)
Proceeds from issuance of common stock and other	53	395	101	544
Repurchase of common stock				(3,728)
Cash used in financing activities	(1,322)	(980)	(4,024)	(7,309)
Effect of exchange rate changes on cash	26	(193)	203	(224)
Net (decrease) increase in cash and cash equivalents	(2,874)	807	(12,770)	8,291
Cash and cash equivalents, beginning of period	10,753	14,603	20,649	7,119
Cash and cash equivalents, end of period	$ 7,879	$ 15,410	$ 7,879	$ 15,410
Supplemental disclosure of cash flow information				
Cash paid for taxes	49	96	150	410
Dividends declared	1,375	1,375	4,125	4,125

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

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QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE QUARTER ENDED SEPTEMBER 30, 2009

(unaudited)

1. THE COMPANY

The business mission of QuadraMed Corporation, along with our subsidiaries (QuadraMed or the Company), is to advance the success of healthcare organizations through IT solutions that leverage quality care into positive financial outcomes. Our driving principles include: maintaining long-term client relationships, building a culture of customer care, focusing on innovation as the key to winning, and striving to always deliver value. We offer innovative, user-friendly software applications designed and developed by the healthcare professionals and software specialists we employ.

In the healthcare market, clinical information and quality measurements are becoming drivers of revenue management. Access management, financial decision support, health information management (HIM) processes and systems combined with patient accounting systems are driving revenue management improvements and the movement to new quality-based reimbursement models. As evolving reimbursement scenarios will challenge hospitals to leverage quality of care into appropriate payment, we envision that customers committing to our Care-Based Revenue Cycle solutions will realize improved financial performance. Our goal is to assist our customers in attaining significant improvement in hospital financial success by leveraging quality of care into positive financial outcomes through performance-based IT solutions. We seek to accomplish this goal by delivering healthcare information technology products and services that support the healthcare organizations efforts to improve the quality of care they deliver and the efficiency with which it is delivered.

Using our end-to-end solutions to optimize the patient experience and leverage quality of care into payment, our clients seek to receive the proper reimbursement, in the shortest time, at the lowest administrative cost. Our products are designed to eliminate paper, improve processes, improve efficiencies and decrease error through the efficient management of patient clinical and financial records, resulting in better patient safety. Healthcare organizations of varying size from small single entity hospitals to large multi-facility care delivery organizations, acute care hospitals, specialty hospitals, Department of Veterans Affairs facilities and associated/affiliated businesses such as outpatient clinics, long-term care facilities, and rehabilitation hospitals can gain value from our solutions.

We conduct business directly and through our subsidiaries, all of which are wholly owned and operated under common management. The Company considers itself to be a single reporting segment, specifically a software provider segment.

2. SIGNIFICANT ACCOUNTING POLICIES

Financial Statement Presentation

These Condensed Consolidated Financial Statements are unaudited and have been prepared in conformity with generally accepted accounting principles in the United States (GAAP) and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Accordingly, they do not include all of the information and disclosures required by GAAP for complete financial statements. We suggest that you read these interim condensed consolidated financial statements in conjunction with the consolidated financial statements, and the notes thereto, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008, filed with the SEC on March 11, 2009. In the opinion of management, the condensed consolidated financial statements for the periods presented herein include all normal and recurring adjustments that are necessary for a fair presentation of the results for these interim periods. The results of operations for the three and nine months ended September 30, 2009 are not necessarily indicative of the results for the entire year ending December 31, 2009.

QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE QUARTER ENDED SEPTEMBER 30, 2009

(unaudited)

Principles of Consolidation and Basis of Presentation

These Condensed Consolidated Financial Statements, which include the accounts of QuadraMed and all wholly owned subsidiaries, have been prepared in conformity with GAAP and the rules and regulations of the SEC. The Accounting Standards Codification (ASC) has become the source of authoritative GAAP. The ASC only changes the referencing of financial accounting standards and does not change or alter existing GAAP. All significant intercompany accounts and transactions between QuadraMed and its subsidiaries are eliminated in consolidation. In preparing the financial statements, we have evaluated subsequent events, as defined by ASC 855 for subsequent event accounting through November 5, 2009, which is the date that the financial statements were issued.

Share and per share data (except par value) presented for all periods reflect the effect of a one-for-five reverse stock split effective on June 13, 2008, as discussed in Note 12 *Reverse Stock Split*. In addition, the number of shares of common stock issuable upon conversion of the Series A Preferred Stock, the exercise of outstanding stock options and the vesting of other stock awards, as well as the number of shares of common stock reserved for issuance under our various employee benefit plans, were proportionately adjusted in accordance with the terms of those respective agreements and plans.

Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates, assumptions and judgments that affect the reported amounts of assets and liabilities, revenues and expenses. Significant estimates and assumptions have been made regarding revenue recognition, the allowance for doubtful accounts, stock-based compensation input assumptions, the purchase price allocation related to the CPR business acquisition, the provision for income taxes, contingencies, litigation, intangibles, charges associated with exit activities and other amounts. We base our estimates and assumptions on historical experience and on various other assumptions which management believes to be reasonable under the circumstances. Uncertainties are inherent in all of these estimates including the estimates underlying percentage-of-completion accounting method of revenue recognition. In addition, we annually review and test our estimates related to the valuations of intangibles including acquired technology, goodwill, customer lists, trademarks and other intangibles and capitalized software. Actual results may differ materially from these estimates.

Reclassifications

Certain reclassifications to the consolidated balance sheets and condensed consolidated statement of cash flows have been made to prior year information to conform with the current year presentation.

Revenue Recognition

Our revenue is principally generated from licensing arrangements, services and hardware.

The Company s license revenue consists of fees for licenses of its proprietary software as well as the software of third-party providers. Cost of license revenue primarily includes the costs of third-party software, royalties and amortization of acquired technology and capitalized software. The Company s services revenue consists of maintenance, software installation, customer training and consulting services related to our license revenue, fees for providing management services, specialized staffing, and analytical services. Cost of services consists primarily of salaries, benefits and allocated costs related to providing such services. Hardware revenue

QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE QUARTER ENDED SEPTEMBER 30, 2009

(unaudited)

includes third-party hardware used by our customers in connection with software purchased. Cost of hardware revenue consists of third-party equipment and installation.

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

We recognize revenue on software products in accordance with the Software Revenue Recognition guidance of ASC 605 and ASC 985.

We recognize revenue when all of the following criteria are met: there is persuasive evidence of an arrangement; the product has been delivered; we no longer have significant obligations with regard to implementation; the fee is fixed and determinable; and collectability is probable. Delivery is considered to have occurred when title and risk of loss have been transferred to the customer, which generally occurs when media containing the licensed programs is provided to a common carrier. The Company considers all arrangements with payment terms extending beyond 180 days to be neither fixed nor determinable. Revenue for arrangements with extended payment terms is recognized when the payments become due, provided all other recognition criteria are satisfied. The Company typically defers revenue and recognizes revenue on a cash basis for renewals of term license and support if the Company s initial assessment is modified by facts and circumstances and collection is no longer deemed probable. Revenue may also be deferred and recognized on a cash basis if there is a contractual dispute and payments are delayed. Revenue is recognized when the collection becomes reasonably assured and/or the contract dispute is resolved.

We allocate revenue to each element in a multiple-element arrangement based on the element s respective fair value, with the fair value determined by the price charged when that element is sold separately. Specifically, we determine the fair value of the maintenance portion of the arrangement based on the substantive renewal rate approach: a renewal rate specified in a contractual arrangement is representative of vendor-specific objective evidence of fair value (VSOE). The professional services portion of the arrangement is based on hourly rates that we charge for these services when sold separately from software. If evidence of fair value of all undelivered elements exists but evidence does not exist for one or more delivered elements, then revenue is recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue. The proportion of revenue recognized upon delivery varies from quarter-to-quarter depending upon the mix of licensing arrangements, perpetual or term-based, and the determination of VSOE for undelivered elements. Many of our licensing arrangements include fixed implementation fees and do not allow us to recognize license revenue until these services have been performed. We recognize revenue only after establishing that we have VSOE for all undelivered elements.

Some of the licenses are term or time-based licenses. We recognize revenue from these contracts ratably over the term of the arrangement. Post-contract Customer Support (PCS) for all of the license term is bundled together with the term license and is included in term license revenue in our consolidated financial statements.

Contract accounting is applied where services include significant software modification, installation or customization. In such instances, the services and license fee is accounted for in accordance with ASC 605, whereby the revenue is recognized, generally using the percentage-of-completion method measured on labor input hours. We use the completed-contract method of revenue recognition rather than the percentage-of-completion method for contracts with short implementation service periods (typically less than 3-9 months) and in circumstances in which the Company s financial position and results of operations would not

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QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE QUARTER ENDED SEPTEMBER 30, 2009

(unaudited)

vary materially from those resulting from the use of the percentage-of-completion method. If increases in projected costs-to-complete are sufficient to create a loss contract, the entire estimated loss is charged to operations in the period the loss first becomes known. The complexity of the estimation process and judgment related to the assumptions, risks and uncertainties inherent with the application of the percentage-of-completion method of accounting can affect the amounts of revenue and related expenses reported in the Company s consolidated financial statements. The Company classifies revenues from these arrangements as license, installation, hardware, and services revenue based on the estimated fair value of each element using the residual method, and revenues are reflected in respective revenue categories in our consolidated financial statements.

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

Hardware revenue is generated primarily from transactions in which customers purchase bundled solutions that include the Company s software and third-party hardware. If the bundled solution includes services that provide significant modification, installation or customization, contract accounting is applied in accordance with ASC 605, whereby the revenue is recognized generally using the percentage-of-completion method measured on labor input hours. Otherwise, hardware revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection is reasonably assured.

Deferred revenue includes amounts billed to or received from customers for which revenue has not been recognized. This generally results from deferred maintenance, software installation, consulting and training services not yet rendered. License revenue is deferred until all revenue requirements have been met or as services are performed. Additionally, there are term-based licenses for which revenues are recognized over the term of the contract, which is generally one year. Unbilled receivables are established when revenue is deemed to be recognized based on our revenue recognition policy, however the Company does not have the right to bill the customer per the contract terms.

Cash and Cash Equivalents

Cash and cash equivalents are comprised principally of money market instruments and demand deposits with financial institutions. These instruments carry insignificant interest rate risk.

Investments

We consider our holdings of short-term and long-term securities, consisting primarily of fixed income securities to be available-for-sale securities. The difference between cost or 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, net of the related tax effect, if any, is 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 Statements of Operations.

As of September 30, 2008, the Company s long-term investments included $1.9 million of auction rate securities. Auction rate securities are collateralized long-term debt instruments that provide liquidity through a Dutch auction process that resets the applicable interest rate at pre-determined intervals, typically every 7 to 28

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QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE QUARTER ENDED SEPTEMBER 30, 2009

(unaudited)

days. Beginning in February 2008, auctions failed for our holdings because sell orders had exceeded buy orders. The funds associated with these failed auctions were not accessible until the issuer called the security, a successful auction occurred, or a buyer was found outside of the auction process. The underlying assets of the auction rate securities we held, including the securities for which auctions had failed, were preferred shares of closed-end mutual funds. Given the Company s holdings of cash, cash equivalents and short-term investments, our expected operating cash flows and our access to funds through our corporate credit facility, the Company had the ability and intent to hold these securities until liquidity returned to this market or the securities were redeemed. The Company has subsequently successfully liquidated these positions during the third and fourth quarters of 2008 without any significant loss and no permanent impairment occurred. As of September 30, 2009, our investment portfolio does not contain any auction rate securities.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist primarily of amounts due to us from our customers for the delivery of products and services. We provide an allowance for doubtful accounts, which reflects our estimate of non-collection of accounts receivable based on past collection history and other specifically identified risks.

Concentration of Credit Risk

Accounts receivable represent our highest potential concentration of credit risk. We reserve for credit losses and do not require collateral on our trade accounts receivable. In addition, we maintain cash and investment balances in accounts at various domestic banks and brokerage firms. Our balances at banks are insured by the Federal Deposit Insurance Corporation for up to $250,000 at each bank.

Property and Equipment

Property and equipment are stated at cost and depreciated using the straight-line method over their estimated useful lives, which are generally three years for computer equipment and purchased software and five years for office furnishings and equipment. Leasehold improvements are amortized over the shorter of the term of the lease or the useful life (generally 10 years). Maintenance and repair costs are expensed as incurred. We review property and equipment for potential impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For property and equipment sales and disposals, the cost and related accumulated depreciation are removed from the accounts and net amounts, less proceeds from disposals, are included in income. Accordingly, no indications of impairment exist.

Goodwill

We record as goodwill the excess of purchase price over the fair value of the identifiable net assets acquired in accordance with ASC 805 guidance related to business combinations. The determination of fair value of the identifiable net assets acquired is determined based upon a valuation analysis, performance of fair value calculations, financial projections and evaluation of other information.

ASC 350 prescribes a two-step process for impairment testing of goodwill and intangibles with indefinite lives, which is performed annually, and when an event triggering impairment may have occurred. The first step tests determine impairment, while the second step, if necessary, measures the impairment. We elected to perform our annual analysis at year end and no indicators of impairment have been identified.

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QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE QUARTER ENDED SEPTEMBER 30, 2009

(unaudited)

Intangible assets subject to amortization include trademarks, customer marketing and technology related assets. Such intangible assets are amortized based on the estimated economic benefit over their estimated useful lives, which are generally two to ten years.

Other Intangible Assets

Other intangible assets primarily relate to customer lists, acquired technology including developed and core technology and trade names, and other intangible assets acquired in our purchase business combinations. On an annual basis, or upon the occurrence of a triggering event, we review our intangible assets for impairment based on estimated future undiscounted cash flows attributable to the assets in accordance with the provisions of ASC 350 at year-end and no indicators of impairment have been identified. In the event such cash flows are not expected to be sufficient to recover the recorded value of the assets, the assets are written down to their net realizable values. Intangible assets are amortized over a period of two to ten years, which the Company estimated to reflect their useful lives.

Software Development Costs

In accordance with ASC 985, we capitalize software development costs from establishment of technological feasibility to the point at which the product is generally available to the market. No costs were capitalized during the nine month period ended September 30, 2009.

Income Taxes

We account for income taxes in accordance with ASC 740. Under ASC 740, deferred tax assets and liabilities are computed based on the difference between the financial statement and income tax basis of assets and liabilities using the enacted marginal tax rate. ASC 740 requires that the net deferred tax asset be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the net deferred tax asset will not be realized.

This process requires our management to make assessments regarding the timing and probability of the ultimate tax impact. We record valuation allowances on deferred tax assets if we determine it is more likely than not that the asset will not be realized. Additionally, we establish reserves for uncertain tax positions based upon our judgment regarding potential future challenges to those positions. Actual income taxes could vary from these estimates due to future changes in income tax law, significant changes in the jurisdictions in which we operate, our inability to generate sufficient future taxable income or unpredicted results from the final determination of each year s liability by taxing authorities. These changes could have a significant impact on our financial position.

The accounting estimate related to the tax valuation allowance requires us to make assumptions regarding the timing of future events, including the probability of expected future taxable income and available tax planning opportunities. These assumptions require significant judgment because actual performance has fluctuated in the past and may do so in the future. The impact that changes in actual performance versus these estimates could have on the realization of tax benefits as reported in our results of operations could be material.

On January 1, 2007, we adopted the provision of ASC 740 related to accounting for uncertainty in income taxes. The accounting estimates related to liabilities for uncertain tax positions require us to make judgments

QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE QUARTER ENDED SEPTEMBER 30, 2009

(unaudited)

regarding the sustainability of each uncertain tax position based on its technical merits. If we determine it is more likely than not that a tax position will be sustained based on its technical merits, we record the impact of the position in our consolidated financial statements at the largest amount that is greater than fifty percent likely of being realized upon ultimate settlement. These estimates are updated at each reporting date based on the facts, circumstances and information available. We are also required to assess at each reporting date whether it is reasonably possible that any significant increases or decreases to our unrecognized tax benefits will occur during the next twelve months. See Note 18 *Income Taxes*.

Sales Taxes

In accordance with ASC 605, we report sales taxes collected from clients and remitted to governmental authorities on a net basis.

Accounting for and Disclosure of Guarantees and Indemnifications

Our software license agreements generally include a performance guarantee that our software products will substantially operate as described in the applicable program documentation for a period of 90 days after delivery. We also generally warrant that services performed will be provided in a manner consistent with reasonably applicable industry standards. To date, we have not incurred any material costs associated with these warranties. Our software license agreements typically provide for indemnification of customers for claims for infringement of intellectual property. To date, no such claims have been filed against the Company.

Stock-Based Compensation

We adopted ASC 718 for stock-based compensation using the modified prospective method as of January 1, 2006. Under this method, compensation cost is recognized based on the requirements of ASC 718 for all share-based awards granted subsequent to January 1, 2006, and for all awards granted, but not vested, prior to January 1, 2006.

Net (Loss) Income Per Share

Basic (loss) income per share is determined using the weighted average number of common shares outstanding during the period. Diluted (loss) income per share is determined using the 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 conversion of preferred stock (using the as-converted method). Common equivalent shares are excluded from the diluted computation if their effect is anti-dilutive.

3. RECENT ACCOUNTING PRONOUNCEMENTS

In October 2009, the FASB issued ASU No. 2009-14, *Software (Topic 985): Certain Revenue Arrangements That Include Software Elements a consensus of the FASB Emerging Issue Task Force* (ASU No. 2009-14). The objective of this Update is to address the accounting for revenue arrangements that contain tangible products and software for which vendor-specific objective evidence of selling price does not exist. We are assessing the impact ASU No. 2009-14 will have on our consolidated financial position, results of operations or cash flows when it becomes effective for our fiscal year beginning January 1, 2011.

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QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE QUARTER ENDED SEPTEMBER 30, 2009

(unaudited)

In October 2009, the FASB issued ASU No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issue Task Force* (ASU No. 2009-13). The objective of this Update is to address the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. We are assessing the impact ASU No. 2009-13 will have on our consolidated financial position, results of operations or cash flows when it becomes effective for our fiscal year beginning January 1, 2011.

In June 2009, the FASB issued guidance now codified as FASB ASC Topic 105 (ASC 105) with regard to GAAP. The Accounting Standards Codification (ASC) has become the source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities. This only changes the referencing of financial accounting standards and does not change or alter existing GAAP. For financial statements issued for interim and annual periods ending after September 15, 2009, the ASC supersedes all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the ASC will become nonauthoritative. The adoption of ASC 105 did not have a material impact on our consolidated financial position, results of operations or cash flows.

On May 28, 2009, the FASB issued guidance now codified as FASB ASC Topic 855 related to subsequent events (ASC 855). ASC 855 introduces the concept of financial statements being *available to be issued.* This statement requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, whether that date represents the date the financial statements were issued or were available to be issued. The adoption of this standard did not have a material impact on our consolidated financial statements. The Company has evaluated subsequent events through November 5, 2009, which is the date these financial statements were issued.

On April 9, 2009, the FASB issued three related Staff Positions: (i) FSP 157-4 now codified within FASB Topic 820 (ASC 820) which is related to fair value measurements and disclosures (ii) SFAS 115-2 and SFAS 124-2 now codified within FASB ASC Topic 320 (ASC 320) with regard to investments in debt or equity securities, and (iii) SFAS 107-1 and APB 28-1 now codified within FASB ASC Topic 825 (ASC 825) related to financial instruments, which are effective for interim and annual periods ending after June 15, 2009. ASC 820 provides guidance on how to determine the fair value of assets and liabilities under ASC 820 in the current economic environment and reemphasizes that the objective of a fair value measurement remains an exit price. If we were to conclude that there has been a significant decrease in the volume and level of activity of the asset or liability in relation to *normal* market activities, quoted market values may not be representative of fair value and we may conclude that a change in valuation technique or the use of multiple valuation techniques may be appropriate. ASC 320 modifies the requirements for recognizing other-than-temporarily impaired debt securities and revises the existing impairment model for such securities, by modifying the current *intent and ability* indicator in determining whether a debt security is other-than-temporarily impaired. ASC 825 enhances the disclosure of instruments under the scope of ASC 820 for both interim and annual periods. Our adoption of these staff positions did not have a material impact on our consolidated financial position, results of operations, or cash flows.

4. RESTRUCTURING AND DISCONTINUED OPERATIONS

In April 2009, we closed and vacated our Oakland, California office. We estimated the facility closing costs in accordance with ASC 420 with regard to exit or disposal cost obligations, and accrued $0.2 million of exit costs as the master lease associated with this facility does not terminate until July 2011. Previously, in February

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QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FOR THE QUARTER ENDED SEPTEMBER 30, 2009

(unaudited)

2005, we completed the shutdown of our Financial Services division in San Marcos, California. At that time, we estimated our liability under the operating lease and accrued $1.8 million of exit costs as the lease did not terminate until May 2008. In addition, we also vacated and closed our San Rafael, California facility during the fourth quarter of 2004 as a result of the relocation of our headquarters to Reston, Virginia. We estimated our liability under the operating lease agreement and accrued $5.1 million of exit costs as the lease does not terminate until December 2009. The aggregate lease payments for the remainder of 2009 through 2011 for the Oakland and San Rafael facilities will be approximately $0.5 million.

The following table sets forth a summary of the exit cost charges and accrued exit costs for the San Marcos, California, the San Rafael, California and the Oakland, California facilities as of September 30, 2009 and December 31, 2008 (in thousands):

	September 30, 2009	December 31, 2008
Exit Costs for the San Rafael Facility:		
Accrued exit cost of facility closing, beginning of period	$ 888	$ 1,931
Principal reductions	(661)	(1,043)
Accrued exit cost of facility closing, end of period	$ 227	$ 888
Exit Cost for the Oakland Facility:		
Accrued exit cost of facility closing, beginning of period	$	$
Exit cost of facility closing, April 2009	216	
Principal reductions	(54)	
		&nb