DPW Holdings, Inc.
Form DEF 14A
January 30, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934

Filed by the Registrant
Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement
Confidential, For Use of the Commission Only (as Permitted by Rule 14a-6(e)(2))
Definitive Proxy Statement
Definitive Additional Materials
Soliciting Material Pursuant to §

240.14a-12

DPW HOLDINGS, INC.

(Name of Registrant as Specified in its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):
No fee required
Fee computed on table below per Exchange Act Rules 14a-6(i) (1) and 0-11.

(1) Title of each class of securities to which transaction applies:
(2) Aggregate number of securities to which transaction applies:
(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
(4) Proposed maximum aggregate value of transaction:
(5) Total fee paid:

Fee paid previously with preliminary materials:

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:
(2) Form, Schedule or Registration Statement No.:
(3) Filing Party:
(4) Date Filed:

DPW HOLDINGS, INC.

201 Shipyard Way

Newport Beach, CA 92663

Telephone: (949) 444-5464

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS

We cordially invite you to attend the Special Meeting of Stockholders of DPW Holdings, Inc. ("**DPW**" or the "**Company**"). Our Special Meeting will be held on February 28, 2019 at 9:00 a.m. PT at the Hyatt Regency Hotel Newport Beach, located at 1107 Jamboree Road, Newport Beach, CA 92660. You will be able to attend the Special Meeting and vote by visiting www.proxyvote.com if you are a beneficial owner and at www.investorvote.com/DPW if you are a registered holder. To enter the meeting, you must have your control number that is shown on the proxy card accompanying this Proxy Statement.

Details regarding logging onto and attending the meeting over the website and the business to be conducted are described in the Proxy Card included with this Proxy Statement.

The purpose of the meeting is to approve an amendment to our Certificate of Incorporation (the "**Certificate of Incorporation**") to effect a reverse stock split of our Class A Common Stock by a ratio of not less than one-for-four and not more than one-for-twenty at any time prior to February 28, 2020, with the exact ratio to be set at a whole number within this range as determined by the Board of Directors in its sole discretion, as well as to act on such other matters as may properly come before the meeting or any adjournment thereof.

Only stockholders of record at the close of business on January 22, 2019, will be entitled to attend and vote at the meeting. The proxy materials will be mailed to stockholders on or about January 30, 2019.

Important Notice Regarding the Availability of Proxy Materials for the Special Meeting of Stockholders to be held on February 28, 2019**:**

This Proxy Statement is available at www.edocumentview.com/DPW

BY ORDER OF THE BOARD OF DIRECTORS

Milton C. Ault III

Chief Executive Officer and Chairman of the Board

January 30, 2019

<u>HOW TO VOTE</u>: Your vote is important. Whether or not you plan to attend the Special Meeting, please vote as soon as possible by either (1) mailing your completed and signed proxy card(s) to DPW Holdings, Inc., 201 Shipyard Way, Newport Beach, CA 92663, Attention: Corporate Secretary, (2) calling the toll-free number printed on your proxy card(s) and following the recorded instructions or (3) visiting the website indicated on your proxy card(s) and following the on-line instructions. You may revoke a previously submitted proxy at any time prior to the Special Meeting. If you decide to attend the Special Meeting and wish to change your proxy vote, you may do so automatically by voting in person at the Special Meeting.

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DPW HOLDINGS, INC.

201 Shipyard Way

Newport Beach, CA 92663

Telephone: (949) 444-5464

PROXY STATEMENT

FOR THE SPECIAL MEETING OF STOCKHOLDERS

TO BE HELD ON FEBRUARY 28, 2019

INFORMATION CONCERNING THE SPECIAL MEETING

General

The enclosed proxy is solicited by the Board of Directors (the "**Board**") of DPW Holdings, Inc. (the "**Company**" or "**DPW**"), for use at the Special Meeting of the Company's stockholders (the "**Meeting**") to be held on February 28, 2019 at 9:00 a.m. PT at the Hyatt Regency Hotel Newport Beach, located at 1107 Jamboree Road, Newport Beach, CA 92660. You will be able to attend the Meeting and vote by visiting www.proxyvote.com if you are a beneficial owner and at www.investorvote.com/DPW if you are a registered holder. To enter the Meeting, you must have your control number that is shown on the proxy card accompanying this Proxy Statement.

Action to be taken under Proxy

Unless otherwise directed by the giver of the proxy, the persons named in the form of proxy, namely, Milton C. Ault, III, our Chief Executive Officer and Chairman of the Board, and William B. Horne, our Chief Financial Officer, or either one of them who acts, will vote FOR approval of an amendment to our Certificate of Incorporation (the "**Certificate of Incorporation**") to effect a reverse stock split of our Class A Common Stock by a ratio of not less than one-for-four and not more than one-for-twenty (the "**Reverse Stock Split**") at any time prior to February 28, 2020, with the exact ratio to be set at a whole number within this range as determined by the Board in its sole discretion.

Should any nominee named herein for election as a director become unavailable for any reason, it is intended that the persons named in the proxy will vote for the election of such other person in his stead as may be designated by the Board. The Board is not aware of any reason that might cause any nominee to be unavailable.

By submitting your proxy (via the Internet, telephone or mail), you authorize Mr. Milton C. "Todd" Ault, III, the Company's Chairman and Chief Executive Officer, and Mr. William B. Horne, the Company's Chief Financial Officer, to represent you and vote your shares at the meeting in accordance with your instructions. They also may vote your shares to adjourn the meeting and will be authorized to vote your shares at any postponements or adjournments of the meeting.

YOUR VOTE IS IMPORTANT. WHETHER OR NOT YOU PLAN TO LOG INTO THE MEETING, PLEASE PROMPTLY VOTE YOUR SHARES OVER THE INTERNET, BY TELEPHONE OR BY MAIL.

Who is Entitled to Vote; Vote Required; Quorum

As of the Record Date of January 22, 2019, there were 93,164,738 shares of Common Stock issued and outstanding and 125,000 shares of Series B Convertible Preferred Stock issued and outstanding, which constitute all of the outstanding capital stock of the Company. Stockholders are entitled to one vote for each share of Common Stock held by them. The 125,000 shares of Series B Convertible Preferred Stock carry the voting power of 1.88% of all votes entitled to be voted at the Meeting.

A majority of the 94,950,452 outstanding shares of capital stock will constitute a quorum at the Meeting.

Brokers holding shares of record for customers generally are not entitled to vote on "non-routine" matters, unless they receive voting instructions from their customers. As used herein, "uninstructed shares" means shares held by a broker who has not received such instructions from its customers on a proposal. A "broker non-vote" occurs when a nominee holding uninstructed shares for a beneficial owner does not vote on a particular proposal because the nominee does not have discretionary voting power with respect to that non-routine matter. In connection with the treatment of abstentions and broker non-votes, the proposal at this Meeting is considered a "routine" matter, and brokers are entitled to vote uninstructed shares with respect to such proposal.

For the amendment to the Company’s Certificate of Incorporation to effect the Reverse Stock Split, the affirmative vote of a majority of the issued and outstanding shares of capital stock is required for approval. Abstentions will be considered shares present by proxy and entitled to vote and, therefore, will have the effect of a vote against the proposal.

Directions to withhold authority to vote for directors, abstentions and broker non-votes will be counted for purposes of determining whether a quorum is present for the Meeting.

QUESTIONS AND ANSWERS ABOUT THESE PROXY MATERIALS AND VOTING

What is the purpose of the Special Meeting?

At the Special Meeting, the stockholders will be asked to approve an amendment to our Certificate of Incorporation (the "**Certificate of Incorporation**") to effect the Reverse Stock Split of our Class A Common Stock by a ratio of not less than one-for-four and not more than one-for-twenty at any time prior to February 28, 2020, with the exact ratio to be set at a whole number within this range as determined by the Board in its sole discretion

Who is entitled to vote?

The Record Date for the meeting is January 22, 2019. Only stockholders of record at the close of business on that date are entitled to vote at the meeting. The only class of stock entitled to be voted at the meeting is our Common stock and Series B Convertible Preferred Stock. On the Record Date, there were 93,164,738 shares of Common Stock outstanding; and 125,000 shares of Series B Convertible Preferred Stock issued and outstanding and entitled to vote. The issued and outstanding shares of Series B Convertible Preferred Stock carry the voting power of 1,785,714 shares of Common Stock.

Why am I receiving these materials?

We have sent you these proxy materials because the Board of DPW Holdings, Inc. (sometimes referred to as the "**Company**," "**DPW**," "**we**" or "**us**") is soliciting your proxy to vote at the Meeting of Stockholders. According to our records, you were a stockholder of the Company as of the end of business on January 22, 2019, the Record Date for the Meeting.

You are invited to vote on the proposals described in this proxy statement.

The Company intends to mail these proxy materials on or about January 30, 2019 to all stockholders of record on the Record Date.

What is included in these materials?

These materials include:

- this Proxy Statement for the Meeting; and
- a Certificate of Amendment to our Certificate Of Incorporation.

What is the proxy card?

The proxy card enables you to appoint Milton C. “Todd” Ault, III, the Company’s Chairman and Chief Executive Officer, and William B. Horne, the Company’s Chief Financial Officer, as your representative at the Meeting. By completing and returning a proxy card, you are authorizing these individuals to vote your shares at the Meeting in accordance with your instructions on the proxy card. This way, your shares will be voted whether or not you log in to the Meeting.

Can I view these proxy materials over the Internet?

Yes. The Notice of Meeting, this Proxy Statement and accompanying proxy card, and the other documents appended hereto are available at www.edocumentview.com/DPW.

How do I vote?

Either (1) mail your completed and signed proxy card(s) to DPW Holdings, Inc., 201 Shipyard Way, Newport Beach, CA 92663, Attention: Corporate Secretary, (2) call the toll-free number printed on your proxy card(s) and follow the recorded instructions or (3) visit the website indicated on your proxy card(s) and follow the on-line instructions. If you are a registered stockholder and attend the meeting, then you may deliver your completed proxy card(s) or vote in person. If your shares are held by your broker or bank, in “street name”, then you will receive a form from your broker or bank seeking instructions as to how your shares should be voted. If you do not instruct your broker or bank how to vote, then your broker or bank will vote your shares if it has discretionary power to vote on a particular matter.

Am I entitled to vote if my shares are held in "street name"?

If your shares are held by a bank, brokerage firm or other nominee, you are considered the "beneficial owner" of shares held in "street name." If your shares are held in street name, the proxy materials are being made available to you by your bank, brokerage firm or other nominee (the "record holder"), along with voting instructions. As the beneficial owner, you have the right to direct your record holder how to vote your shares, and the record holder is required to vote your shares in accordance with your instructions.

As the beneficial owner of shares, you are invited to log in to the Meeting. If you are a beneficial owner, however, you may not vote your shares at the meeting unless you obtain a legal proxy, executed in your favor, from the record holder of your shares.

You will be able to attend the Meeting, vote, and submit your questions during the meeting via live webcast by visiting www.proxyvote.com if you are a beneficial owner and hold your shares in "street" name and at www.investorvote.com/DPW if you are a registered holder.

How many shares must be present to hold the meeting?

A quorum must be present at the meeting for any business to be conducted. The presence at the meeting, in person or by proxy, of the holders of a majority of the shares of capital stock outstanding on the Record Date will constitute a quorum. Proxies received but marked as abstentions or treated as broker non-votes will be included in the calculation of the number of shares considered to be present at the meeting.

What if a quorum is not present at the meeting?

If a quorum is not present or represented at the meeting, the holders of a majority of the shares of capital stock entitled to vote at the meeting who are present in person or represented by proxy, or the chairman of the meeting, may adjourn the meeting until a quorum is present or represented. The time and place of the adjourned meeting will be announced at the time the adjournment is taken, and no other notice will be given.

Is there a deadline for submitting proxies electronically or by telephone or mail?

Proxies submitted electronically or by telephone as described above must be received by 11:59 pm PT on February 27, 2019. Proxies submitted by mail should be received before 9:00 a.m. PT on February 28, 2019.

Can I revoke my proxy and change my vote?

You may change your vote at any time prior to the taking of the vote at the meeting. If you are the stockholder of record, you may change your vote by (1) granting a new proxy bearing a later date (which automatically revokes the earlier proxy) using any of the methods described above (and until the applicable deadline for each method), (2) providing a written notice of revocation to the Company's CEO at DPW Holdings, Inc., 201 Shipyard Way, Newport Beach, CA 92663, prior to your shares being voted, or (3) attending the meeting and voting. Attendance at the meeting will not cause your previously granted proxy to be revoked unless you specifically so request. For shares you hold beneficially in street name, you may change your vote by submitting new voting instructions to your broker, bank, trustee or nominee following the instructions they provided, or, if you have obtained a legal proxy from your broker, bank, trustee or nominee giving you the right to vote your shares, by attending the meeting and voting.

Who can participate in the meeting?

Only stockholders eligible to vote or their authorized representatives in possession of a valid control number will be admitted as participants to the meeting.

Will my vote be kept confidential?

Yes, your vote will be kept confidential and not disclosed to the Company unless:

- required by law;
- you expressly request disclosure on your proxy; or
- there is a proxy contest.

How does the Board of Directors recommend I vote on the proposals?

Our Board recommends that you vote your shares "**FOR**" approval of an amendment to our Certificate of Incorporation (the "**Certificate of Incorporation**") to effect a reverse stock split of our Class A Common Stock by a ratio of not less than one-for-four and not more than one-for-twenty at any time prior to February 28, 2020, with the exact ratio to be set at a whole number within this range as determined by the Board in its sole discretion

Unless you provide other instructions on your proxy card, the persons named as proxy holders on the proxy card will vote in accordance with the recommendations of the Board as set forth in this Proxy Statement.

What if I do not specify how my shares are to be voted?

If you return a signed and dated proxy card without marking any voting selections, your shares will be voted in accordance with the Board's recommended votes set forth immediately above, and if any other matter is properly presented at the meeting, your proxy holder (one of the individuals named on your proxy card) will vote your shares using his best judgment.

Will any other business be conducted at the meeting?

The Company's bylaws require stockholders to give advance notice of any proposal intended to be presented at the meeting. The deadline for this notice has passed and we have not received any such notices. If any other matter properly comes before the stockholders for a vote at the meeting, however, the proxy holders will vote your shares in accordance with their best judgment.

How many votes are needed to approve each proposal?

Approval of the amendment to the Company's Certificate of Incorporation requires the favorable vote of a majority of the issued and outstanding shares of capital stock.

How will abstentions be treated?

Abstentions will be treated as shares present for quorum purposes and entitled to vote, and will have the same effect as votes against the proposal.

What are "broker non-votes"?

Broker non-votes occur when a beneficial owner of shares held in "street name" does not give instructions to the broker or nominee holding the shares as to how to vote on matters deemed "non-routine." Generally, if shares are held in street name, the beneficial owner of the shares is entitled to give voting instructions to the broker or nominee holding the shares. If the beneficial owner does not provide voting instructions, the broker or nominee can still vote the shares with respect to matters that are considered to be "routine," but not with respect to "non-routine" matters. Under the rules and interpretations of the New York Stock Exchange, "non-routine" matters include director elections (whether contested or uncontested) and matters involving a contest or a matter that may substantially affect the rights or privileges of stockholders.

In connection with the treatment of abstentions and broker non-votes, the proposals at this meeting to approve the amendment to the Company's Certificate of Incorporation to effect a reverse stock split is considered a "routine" matter, and brokers are entitled to vote uninstructed shares with respect to these proposals.

Who is paying for this proxy solicitation?

We will pay for the entire cost of soliciting proxies. In addition to these mailed proxy materials, our directors and employees may also solicit proxies in person, by telephone or by other means of communication. The Board has engaged Kingsdale Advisors to assist in the solicitation of proxies for a fee of $8,100, plus an additional per holder fee for any solicitation of individual holders and reimbursement of out-of-pocket expenses. Directors and employees will not be paid any additional compensation for soliciting proxies but may be reimbursed for out-of-pocket expenses incurred in connection with the solicitation. We will also reimburse brokerage firms, banks and other agents for their reasonable out-of-pocket expenses incurred in forwarding proxy materials to beneficial owners.

What does it mean if I receive more than one set of proxy materials?

If you receive more than one set of proxy materials, your shares may be registered in more than one name or in different accounts. Please complete, sign and return each proxy card to ensure that all of your shares are voted.

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I share the same address with another stockholder of the Company. Why has our household only received one set of proxy materials?

The Securities and Exchange Commission's ("**SEC's**") rules permit us to deliver a single set of proxy materials to one address shared by two or more of our stockholders. This practice, known as "householding," is intended to reduce the Company's printing and postage costs. We have delivered only one set of proxy materials to stockholders who hold their shares through a bank, broker or other holder of record and share a single address, unless we received contrary instructions from any stockholder at that address.

How can I find out the results of the voting at the Meeting?

Final voting results will be disclosed in a Form 8-K filed after the Meeting.

Who can help answer my questions?

You can contact our corporate headquarters, at DPW Holdings, Inc., 201 Shipyard Way, Newport Beach, CA 92663, by sending a letter to Milton C. "Todd" Ault, III, our Chief Executive Officer, with any questions about the proposal described in this proxy statement or how to execute your vote. In addition, you can also contact:

Kingsdale Advisors

Telephone (toll-free in North America): (866) 851-2638

Telephone (outside of North America): (416) 867-2272

E-mail: contactus@kingsdaleadvisors.com

PROPOSAL

AMENDMENT TO THE COMPANY'S CERTIFICATE OF

INCORPORATION TO EFFECT A REVERSE STOCK SPLIT OF COMMON STOCK

Our Board has adopted resolutions (1) declaring that submitting an amendment to the Company's Certificate of Incorporation to effect a reverse stock split, as described below, was advisable and (2) directing that a proposal to approve the Reverse Stock Split be submitted to the holders of our Common Stock for their approval.

The form of the proposed amendment to the Company's Certificate of Incorporation to effect a reverse stock split will be substantially as set forth on Annex A (subject to any changes required by applicable law). If approved by our stockholders, the Reverse Stock Split proposal would permit (but not require) our Board to effect a reverse stock split of our Common Stock at any time prior to February 28, 2020 by a ratio of not less than one-for-four and not more than one-for-twenty, with the exact ratio to be set at a whole number within this range as determined by our Board in its sole discretion. We believe that enabling our Board to set the ratio within the stated range will provide us with the flexibility to implement the Reverse Stock Split in a manner designed to maximize the anticipated benefits for our stockholders. In determining a ratio, if any, following the receipt of stockholder approval, our Board may consider, among other things, factors such as:

- The continued listing requirements of the NYSE American;
- the historical trading price and trading volume of our Common Stock;
- the number of shares of our Common Stock outstanding;
- the then-prevailing trading price and trading volume of our Common Stock and the anticipated impact of the Reverse Stock Split on the trading market for our Common Stock;
- the anticipated impact of a particular ratio on our ability to reduce administrative and transactional costs; and
- prevailing general market and economic conditions.

Our Board reserves the right to elect to abandon the Reverse Stock Split, including any or all proposed reverse stock split ratios, if it determines, in its sole discretion, that the Reverse Stock Split is no longer in the best interests of the Company and its stockholders.

Depending on the ratio for the Reverse Stock Split determined by our Board, no less than four and no more than twenty shares of existing Common Stock, as determined by our Board, will be combined into one share of Common Stock. The amendment to our Company's Certificate of Incorporation to effect a reverse stock split, if any, will include only the reverse split ratio determined by our Board to be in the best interests of our stockholders and all of the other proposed amendments at different ratios will be abandoned.

To avoid the existence of fractional shares of our Common Stock, the Company will pay cash in lieu of fractional shares as described below.

Background and Reasons for the Reverse Stock Split; Potential Consequences of the Reverse Stock Split

Our Board is submitting the Reverse Stock Split to our stockholders for approval with the primary intent of increasing the market price of our Common Stock to enhance our ability to meet the continued listing requirements of the NYSE American and to make our Common Stock more attractive to a broader range of institutional and other investors. In addition to increasing the market price of our Common Stock, the Reverse Stock Split would also reduce certain of our costs, as discussed below. Accordingly, for these and other reasons discussed below, we believe that effecting the Reverse Stock Split is in the Company's and our stockholders' best interests.

We believe that the Reverse Stock Split will enhance our ability to maintain our on the NYSE American. Reducing the number of outstanding shares of our Common Stock should, absent other factors, increase the per share market price of our Common Stock, although we cannot provide any assurance that our minimum bid price would remain following the Reverse Stock Split over the minimum bid price requirement of the NYSE American.

Additionally, we believe that the Reverse Stock Split will make our Common Stock more attractive to a broader range of institutional and other investors, as we have been advised that the current market price of our Common Stock may affect its acceptability to certain institutional investors, professional investors and other members of the investing public. Many brokerage houses and institutional investors have internal policies and practices that either prohibit them from investing in low-priced stocks or tend to discourage individual brokers from recommending low-priced stocks to their customers. In addition, some of those policies and practices may function to make the processing of trades in low-priced stocks economically unattractive to brokers. Moreover, because brokers' commissions on low-priced stocks generally represent a higher percentage of the stock price than commissions on higher-priced stocks, the current average price per share of Common Stock can result in individual stockholders paying transaction costs representing a higher percentage of their total share value than would be the case if the share price were substantially higher. We believe that the Reverse Stock Split will make our Common Stock a more attractive and cost effective investment for many investors, which will enhance the liquidity of the holders of our Common Stock.

Reducing the number of outstanding shares of our Common Stock through the Reverse Stock Split is intended, absent other factors, to increase the per share market price of our Common Stock. However, other factors, such as our financial results, market conditions and the market perception of our business may adversely affect the market price of our Common Stock. As a result, there can be no assurance that the Reverse Stock Split, if completed, will result in the intended benefits described above, that the market price of our Common Stock will increase following the Reverse Stock Split or that the market price of our Common Stock will not decrease in the future. Additionally, we cannot assure you that the market price per share of our Common Stock after a Reverse Stock Split will increase in proportion to the reduction in the number of shares of our Common Stock outstanding before the Reverse Stock Split. Accordingly, the total market capitalization of our Common Stock after the Reverse Stock Split may be lower than the total market capitalization before the Reverse Stock Split.

Procedure for Implementing the Reverse Stock Split

The Reverse Stock Split, if approved by our stockholders, would become effective upon the filing (the "**Effective Time**") of a certificate of amendment to the Company's Certificate of Incorporation with the Secretary of State of the State of Delaware. The exact timing of the filing of the certificate of amendment that will effectuate the Reverse Stock Split will be determined by our Board based on its evaluation as to when such action will be the most advantageous to the Company and our stockholders. In addition, our Board reserves the right, notwithstanding stockholder approval and without further action by the stockholders, to elect not to proceed with the Reverse Stock Split if, at any time prior to filing the amendment to the Company's Certificate of Incorporation, our Board, in its sole discretion, determines that it is no longer in our best interest and the best interests of our stockholders to proceed with the Reverse Stock Split. If a certificate of amendment effectuating the Reverse Stock Split has not been filed with the Secretary of State of the State of Delaware by the close of business on February 28, 2020, our Board will abandon the Reverse Stock Split.

Effect of the Reverse Stock Split on Holders of Outstanding Common Stock

Depending on the ratio for the Reverse Stock Split determined by our Board, a minimum of four and a maximum of twenty shares of existing Common Stock will be combined into one new share of Common Stock. The table below shows, as of the Record Date, 2019, the number of outstanding shares of Common Stock (excluding Treasury shares) that would result from the listed hypothetical reverse stock split ratios (without giving effect to the treatment of fractional shares):

Reverse Stock Split Ratio	**Approximate Number of Outstanding Shares of Common Stock Following the Reverse Stock Split**
1-for-4	23,854,934
1-for-8	11,927,467
1-for-12	7,951,645
1-for-16	5,963,734
1-for-20	__4,770,987

The actual number of shares issued after giving effect to the Reverse Stock Split, if implemented, will depend on the reverse stock split ratio that is ultimately determined by our Board.

The Reverse Stock Split will affect all holders of our Common Stock uniformly and will not affect any stockholder's percentage ownership interest in the Company, except that as described below in "Fractional Shares," record holders of Common Stock otherwise entitled to a fractional share as a result of the Reverse Stock Split will receive cash in lieu of fractional shares. In addition, the Reverse Stock Split will not affect any stockholder's proportionate voting power (subject to the treatment of fractional shares).

The Reverse Stock Split may result in some stockholders owning "odd lots" of less than 100 shares of Common Stock. Odd lot shares may be more difficult to sell, and brokerage commissions and other costs of transactions in odd lots are generally somewhat higher than the costs of transactions in "round lots" of even multiples of 100 shares.

After the Effective Time, our Common Stock will have new Committee on Uniform Securities Identification Procedures (CUSIP) numbers, which is a number used to identify our equity securities, and stock certificates with the older CUSIP numbers will need to be exchanged for stock certificates with the new CUSIP numbers by following the procedures described below. After the Reverse Stock Split, we will continue to be subject to the periodic reporting and other requirements of the Securities Exchange Act of 1934, as amended. Our Common Stock will continue to be listed on the NYSE American under the symbol "DPW."

Beneficial Holders of Common Stock (i.e., stockholders who hold in street name)

Upon the implementation of the Reverse Stock Split, we intend to treat shares held by stockholders through a bank, broker, custodian or other nominee in the same manner as registered stockholders whose shares are registered in their names. Banks, brokers, custodians or other nominees will be instructed to effect the Reverse Stock Split for their beneficial holders holding our Common Stock in street name. However, these banks, brokers, custodians or other nominees may have different procedures than registered stockholders for processing the Reverse Stock Split. Stockholders who hold shares of our Common Stock with a bank, broker, custodian or other nominee and who have any questions in this regard are encouraged to contact their banks, brokers, custodians or other nominees.

Registered "Book-Entry" Holders of Common Stock (i.e., stockholders whose names are registered on the transfer agent's books and records but do not hold stock certificates)

Certain of our registered holders of Common Stock may hold some or all of their shares electronically in book-entry form with the transfer agent. These stockholders do not have stock certificates evidencing their ownership of the Common Stock. They are, however, provided with a statement reflecting the number of shares registered in their accounts.

Stockholders who hold shares electronically in book-entry form with the transfer agent will not need to take action (the exchange will be automatic) to receive whole shares of post-Reverse Stock Split Common Stock, subject to adjustment for treatment of fractional shares.

Holders of Certificated Shares of Common Stock

Stockholders holding shares of our Common Stock in certificated form will be sent a transmittal letter by the Exchange Agent after the Effective Time. The letter of transmittal will contain instructions on how a stockholder should surrender his, her or its certificate(s) representing shares of our Common Stock (the "**Old Certificates**") to the transfer agent in exchange for certificates representing the appropriate number of whole shares of post-Reverse Stock Split Common Stock (the "**New Certificates**").

No new post-Reverse Split Common Stock will be issued to a stockholder until such stockholder has surrendered all Old Certificates, together with a properly completed and executed letter of transmittal, to the Exchange Agent. No stockholder will be required to pay a transfer or other fee to exchange his, her or its Old Certificates. Stockholders will then receive a Direct Registration Statement representing the number of whole shares of Common Stock that they are entitled as a result of the Reverse Stock Split, subject to the treatment of fractional shares described below. Until surrendered, we will deem outstanding Old Certificates held by stockholders to be cancelled and only to represent the number of whole shares of post-Reverse Stock Split Common Stock to which these stockholders are entitled, subject to the treatment of fractional shares. Any Old Certificates submitted for exchange, whether because of a sale, transfer or other disposition of stock, will automatically be exchanged for post-Reverse Split Common Stock. If an Old Certificate has a restrictive legend on the back of the Old Certificate(s), a New Certificate will be issued with the same restrictive legends that are on the back of the Old Certificate(s).

STOCKHOLDERS SHOULD NOT DESTROY ANY STOCK CERTIFICATE(S) AND SHOULD NOT SUBMIT ANY STOCK CERTIFICATE(S) UNTIL REQUESTED TO DO SO.

Fractional Shares

Prevailing market prices

We will not issue fractional shares in connection with the Reverse Stock Split. Stockholders who would otherwise hold fractional shares because the number of shares of Common Stock they hold before the Reverse Stock Split is not evenly divisible by the split ratio ultimately determined by the Board will be entitled to receive a cash payment (without interest and subject to applicable withholding taxes) from our Exchange Agent in lieu of such fractional shares. The cash payment is subject to applicable U.S. federal and state income tax and state abandoned property laws. Stockholders will not be entitled to receive interest for the period of time between the Effective Time and the date payment is received.

We currently anticipate that, in lieu of issuing fractional shares, the aggregate of all fractional shares otherwise issuable to the holders of record of Common Stock shall be issued to the Exchange Agent for the Common Stock, as agent, for the accounts of all holders of record of Common Stock otherwise entitled to have a fraction of a share issued to them. The sale of all fractional interests will be effected by the Exchange Agent as soon as practicable after the Effective Time on the basis of prevailing market prices of the Common Stock at the time of sale. After such sale and upon the surrender of the stockholders' stock certificates, if any, the Exchange Agent will pay to such holders of record their pro rata share of the net proceeds (after customary brokerage commissions and other expenses) derived from the sale of the fractional interests.

After the Reverse Stock Split, a stockholder will have no further interest in the Company with respect to its fractional share interest, and persons otherwise entitled to a fractional share will not have any voting, dividend or other rights with respect thereto except the right to receive a cash payment as described above.

Effect of the Reverse Stock Split on Employee Plans, Options, Restricted Stock Awards, Warrants and Convertible or Exchangeable Securities

Based upon the reverse stock split ratio determined by the board of directors, proportionate adjustments are generally required to be made to the per share exercise price and the number of shares issuable upon the exercise or conversion of all outstanding options, warrants, convertible or exchangeable securities entitling the holders to purchase, exchange for, or convert into, shares of Common Stock. This would result in approximately the same aggregate price being required to be paid under such options, warrants, convertible or exchangeable securities upon exercise, and approximately the same value of shares of Common Stock being delivered upon such exercise, exchange or conversion, immediately following the Reverse Stock Split as was the case immediately preceding the Reverse Stock Split. The number of shares deliverable upon settlement or vesting of restricted stock awards will be similarly adjusted, subject to our treatment of fractional shares. The number of shares reserved for issuance pursuant to these securities will be proportionately based upon the reverse stock split ratio determined by the board of directors, subject to our treatment of fractional shares.

Accounting Matters

The proposed amendment to the Company's Certificate of Incorporation will not affect the par value of our Common Stock per share, which will remain $0.001. As a result, as of the Effective Time, the stated capital attributable to Common Stock and the additional paid-in capital account on our balance sheet will not change due to the Reverse Stock Split. Reported per share net income or loss will be higher because there will be fewer shares of Common Stock outstanding.

Certain Federal Income Tax Consequences of the Reverse Stock Split

The following summary describes certain material U.S. federal income tax consequences of the Reverse Stock Split to holders of our Common Stock.

Unless otherwise specifically indicated herein, this summary addresses the tax consequences only to a beneficial owner of our Common Stock that is a citizen or individual resident of the United States, a corporation organized in or under the laws of the United States or any state thereof or the District of Columbia or otherwise subject to U.S. federal income taxation on a net income basis in respect of our Common Stock (a “**U.S. holder**”). A trust may also be a U.S. holder if (1) a U.S. court is able to exercise primary supervision over administration of such trust and one or more U.S. persons have the authority to control all substantial decisions of the trust or (2) it has a valid election in place to be treated as a U.S. person. An estate whose income is subject to U.S. federal income taxation regardless of its source may also be a U.S. holder. This summary does not address all of the tax consequences that may be relevant to any particular investor, including tax considerations that arise from rules of general application to all taxpayers or to certain classes of taxpayers or that are generally assumed to be known by investors. This summary also does not address the tax consequences to (i) persons that may be subject to special treatment under U.S. federal income tax law, such as banks, insurance companies, thrift institutions, regulated investment companies, real estate investment trusts, tax-exempt organizations, U.S. expatriates, persons subject to the alternative minimum tax, traders in securities that elect to mark to market and dealers in securities or currencies, (ii) persons that hold our Common Stock as part of a position in a “straddle” or as part of a “hedging,” “conversion” or other integrated investment transaction for federal income tax purposes, or (iii) persons that do not hold our Common Stock as “capital assets” (generally, property held for investment).

If a partnership (or other entity classified as a partnership for U.S. federal income tax purposes) is the beneficial owner of our Common Stock, the U.S. federal income tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. Partnerships that hold our Common Stock, and partners in such partnerships, should consult their own tax advisors regarding the U.S. federal income tax consequences of the Reverse Stock Split.

This summary is based on the provisions of the Internal Revenue Code of 1986, as amended, U.S. Treasury regulations, administrative rulings and judicial authority, all as in effect as of the date of this proxy statement. Subsequent developments in U.S. federal income tax law, including changes in law or differing interpretations, which may be applied retroactively, could have a material effect on the U.S. federal income tax consequences of the Reverse Stock Split.

PLEASE CONSULT YOUR OWN TAX ADVISOR REGARDING THE U.S. FEDERAL, STATE, LOCAL, AND FOREIGN INCOME AND OTHER TAX CONSEQUENCES OF THE REVERSE STOCK SPLIT IN YOUR PARTICULAR CIRCUMSTANCES UNDER THE INTERNAL REVENUE CODE AND THE LAWS OF ANY OTHER TAXING JURISDICTION.

U.S. Holders

The Reverse Stock Split should be treated as a recapitalization for U.S. federal income tax purposes. Therefore, a stockholder generally will not recognize gain or loss on the reverse stock split, except to the extent of cash, if any, received in lieu of a fractional share interest in the post-reverse stock split shares. The aggregate tax basis of the post-split shares received will be equal to the aggregate tax basis of the pre-split shares exchanged therefore (excluding any portion of the holder’s basis allocated to fractional shares), and the holding period of the post-split shares received will include the holding period of the pre-split shares exchanged. A holder of the pre-split shares who receives cash will generally recognize gain or loss equal to the difference between the portion of the tax basis of the pre-split shares allocated to the fractional share interest and the cash received. Such gain or loss will be a capital gain or loss and will be short term if the pre-split shares were held for one year or less and long term if held more than one year. No gain or loss will be recognized by us as a result of the reverse stock split.

No Appraisal Rights

Under Delaware law and our charter documents, holders of our Common Stock will not be entitled to dissenter’s rights or appraisal rights with respect to the Reverse Stock Split.

Vote Required to Approve the Amendment and Recommendation

Under Delaware law and our charter documents, the affirmative vote of holders of a majority of the shares of Common Stock outstanding as of the Record Date is required to approve the Reverse Stock Split.

Our board of directors recommends that stockholders vote "FOR" the amendment to the Certificate of Incorporation to authorize the Reverse Stock Split.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information concerning the number of shares of our Common Stock owned beneficially based on 93,164,738 issued and outstanding shares of Common Stock as of the Record Date by: (i) each of our directors; (ii) each of our named executive officers; and (iii) each person known to us to be the beneficial owner of more than 5% of the outstanding shares of our Common Stock based upon Schedules 13G or 13D filed with the SEC.

Beneficial ownership is determined in accordance with the rules of the SEC and generally includes voting or investment power with respect to securities. Other than as described in the notes to the table, we believe that all persons named in the table have sole voting and investment power with respect to shares beneficially owned by them. All share ownership figures include shares issuable upon exercise of options or warrants exercisable within 60 days of the Record Date, which are deemed outstanding and beneficially owned by such person for purposes of computing his or her percentage ownership, but not for purposes of computing the percentage ownership of any other person.

Name and address of beneficial owner	Number of shares beneficially owned		Approximate Percent of class
Greater than 5% Beneficial Owners:			
Philou Ventures, LLC	6,297,289	(2)	6.51%
P.O. Box 3587 Tustin, CA 92705			
Ault & Company, Inc.	6,677,646	(3)	6.90%
Directors and executive officers: (1)			
Milton Ault, III	6,943,496	(4)	7.16%
Amos Kohn	1,589,945	(5)	1.68%
Robert Smith	392,759	(6)	*
William Horne	584,583	(7)	*
Moti Rosenberg	285,625	(7)	*
Jeffrey A. Bentz	125,056	(7)	*
All directors and executive officers as a group (six persons)	9,921,464		9.95%

* Less than one percent.

(1)

Unless otherwise indicated, the business address of each of the individuals is c/o DPW Holdings, Inc., 201 Shipyard Way, Newport Beach, CA 92663.

(2) Includes 125,000 shares of Series B Preferred Stock that are convertible into 1,785,714 shares of common stock and warrants to purchase 1,785,714 shares of common stock that are exercisable within 60 days of the Record Date. Each shares of Series B carries the voting power of 14.29 shares of common stock.

(3) Includes shares owned by Philou Ventures of which Ault & Company, Inc. is the Manager. Also includes options to purchase 75,000 shares of common stock that are exercisable within 60 days of the Record Date.

(4) Includes 6,297,289 shares owned by Philou Ventures, 305,357 shares and warrants to purchase 75,000 shares of common stock owned by Ault & Company, Inc. ("**Ault & Company**") that are exercisable within 60 days of the Record Date, which may be deemed beneficially owned by Mr. Ault. Also includes 34,600 shares and options owned by Mr. Ault to purchase 231,250 shares of common stock that are exercisable within 60 days of the Record Date. Mr. Ault is the Chief Executive Officer of Ault & Company.

(5) Includes options to purchase 1,031,250 shares and warrants to purchase 404,127 exercisable within 60 days of the Record Date.

(6) Includes options and warrants to purchase 349,426 shares of common stock that are exercisable within 60 days of the Record Date.

(7) Includes options to purchase shares of common stock that are exercisable within 60 days of the Record Date.

(8) Represents options to purchase shares of common stock that are exercisable within 60 days of the Record Date.

SPECIAL CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Proxy Statement contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements reflect the current view about future events. When used in this Proxy Statement the words "anticipate," "believe," "estimate," "expect," "future," "intend," "plan" or the negative of these terms and similar expressions as they relate to us or our management identify forward looking statements. Such statements, include, but are not limited to, statements contained in this Proxy Statement relating to our business, business strategy, and potential implementation of a reverse stock split and the impact thereunder. Forward-looking statements are based on our current expectations and assumptions regarding our business, the economy and other future conditions. Because forward looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. Our actual results may differ materially from those contemplated by the forward-looking statements. They are neither statement of historical fact nor guarantees of assurance of future performance. We caution you therefore against relying on any of these forward-looking statements. Important factors that could cause actual results to differ materially from those in the forward looking statements include, a continued decline in general economic conditions nationally and internationally, decreased demand for our products and services; market acceptance of our products; the ability to protect our intellectual property rights; impact of any litigation or infringement actions brought against us; competition from other providers and products; risks in product development; inability to raise capital to fund continuing operations; changes in government regulation, the ability to complete customer transactions and capital raising transactions, and other factors relating to our industry, our operations and results of operations and any businesses that may be acquired by us. Should one or more of these risks or uncertainties materialize, or should the underlying assumptions prove incorrect, actual results may differ significantly from those anticipated, believed, estimated, expected, intended or planned.

Factors or events that could cause our actual results to differ may emerge from time to time, and it is not possible for us to predict all of them. We cannot guarantee future results, levels of activity, performance or achievements. Except as required by applicable law, including the securities laws of the United States, we do not intend to update any of the forward-looking statements to conform these statements to actual results.

AVAILABILITY OF FORM 10-K

Copies of the Annual Report on Form 10-K for the fiscal year ended December 31, 2017, will be provided, without charge, upon the written request of any stockholder. No portion of the Annual Report is incorporated herein or is to be considered proxy soliciting material. This request should be directed to DPW Holdings, Inc., 201 Shipyard Way, Newport Beach, CA 92663; Attn: Chief Financial Officer. Our latest quarterly report on Form 10-Q is available from our Chief Financial Officer at the foregoing address. Our Annual Report on Form 10-K and our other periodic filings are available on the SEC's website at www.sec.gov as well as through our Company's website at www.dpwholdings.com under "Investor Relations, SEC Filings."

ADDITIONAL INFORMATION

We are subject to the informational requirements of the Exchange Act. Accordingly, we file periodic reports, proxy statements and other information with the SEC. The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington D.C. 20549 and may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site, *www.sec.gov*, through which all forms filed electronically may be accessed. Additionally, all forms filed with the SEC and additional stockholder information is available free of charge on our website www.dpwholdings.com, including our 2017 Annual Report to Stockholders, which includes our Annual Report on Form 10-K, which we previously delivered to all our stockholders or by contacting our Corporate Secretary at 201 Shipyard Way, Newport Beach, CA 92663, or by phone (510) 657-2635. We post these reports to its website as soon as reasonably practicable after filing them with the SEC. None of the information on or accessible through our website is incorporated into this Proxy.

PROPOSALS OF STOCKHOLDERS FOR THE 2019 ANNUAL MEETING

If you want to submit a proposal for inclusion in our proxy statement for the 2019 Annual Meeting of stockholders, you may do so by following the procedures in Rule 14a-8 under the Exchange Act. To be eligible for inclusion, stockholder proposals (other than nominees for directors) must be received at the Company’s principal executive office, at the following address 201 Shipyard Way, Newport Beach, CA 92663, Attention: Secretary, no later than July 24, 2019 (120 days before the anniversary of the mailing date of the 2018 Annual Meeting).

A stockholder’s notice to the Secretary must set forth as to each matter the stockholder proposes to bring before the Annual Meeting: (i) a description in reasonable detail of the business desired to be brought before the Annual Meeting and the reasons for conducting such business at the Annual Meeting, (ii) the name and address, as they appear on the Company’s books, of the stockholder proposing such business and of the beneficial owner, if any, on whose behalf the proposal is made, (iii) such information regarding each director nominee or each matter of business to be proposed by such stockholder as would be required to be included in a proxy statement filed pursuant to the proxy rules of the U.S. Securities and Exchange Commission, or the SEC, had the nominee been nominated, or intended to be nominated, or the matter been proposed, or intended to be proposed by the Board; (iv) if applicable, the consent of each nominee to be named in the proxy statement and to serve as director of the Company if so elected; (v) the class and number of shares of the Company that are owned beneficially and of record by the stockholder proposing such business and by the beneficial owner, if any, on whose behalf the proposal is made, and (vi) any material interest of such stockholder proposing such business and the beneficial owner, if any, on whose behalf the proposal is made in such business.

Stockholder proposals intended to be presented at the 2019 Annual Meeting must be received by the Company no later than reasonable time in advance of the date of the 2019 Annual Meeting, which in the Company’s opinion would be no less than 120 days before that date (pursuant to Rule 14a-8 of the Exchange Act) to be eligible for inclusion in the Company’s proxy statement and form of proxy for next year’s meeting. The Company has yet to determine the date of its 2019 Annual Meeting. Proposals should be addressed to DPW Holdings, Inc., Attention: Corporate Secretary, 201 Shipyard Way, Newport Beach, CA 92663.

For any proposal that is not submitted for inclusion in the proxy statement for the 2019 Annual Meeting (as described in the preceding paragraph), but is instead sought to be presented directly at the 2019 Annual Meeting, the federal securities laws require Stockholders to give advance notice of such proposals. The required notice must (pursuant to Rule 14a-4 of the Exchange Act), be given no less than a reasonable time in advance of the $0.8 million of revenue, as well as the delay of approximately $1.5 million of revenue, as previously mentioned, as all related expenses were recorded during 2004. Hospital Solutions' segment operating income increased approximately 3% in 2004 over 2003, and operating margins were approximately 22.0% in 2004 versus approximately 23.2% in 2003. The operating margin decline can be attributed to a large print and mail customer contract, signed in the second quarter of 2004, which was profitable for 2004 but below the normal profitability level for print and mail contracts, which negatively impacted margins by approximately 1.4% in 2004. As part of the transaction in signing the customer, the Company acquired substantially all of the production assets and personnel of the customer's hospital and physician patient statement and paper claims print and mail business. The division consolidated this operation into its existing print and mail facility located in Lawrenceville, Georgia during the first half of 2005, which improved margins for this contract. The operating margin decline was partially offset by unbilled maintenance revenue for certain resource management software customers that was recognized upon receipt of payment, which positively impacted margins by 1.2% in 2004. The Company's corporate overhead expenses, which include certain executive and administrative functions, increased approximately $6.5 million, or approximately 42% in 2004 over 2003. Corporate overhead expenses included approximately $6.3 million of expenses related to the additional procedures performed in 2004, approximately $1.9 million of professional services expense related to the Company's initiative to comply with the requirements of Section 404(a) of the Sarbanes-Oxley Act, a gain of approximately $1.5 million on the settlement with Lloyd's of London, a decrease in insurance expense of approximately $1.4 million, and an expense of approximately $1.0 million related to the relocation of the 29 Company's principal executive office (refer to Note 2 of Notes to Financial Statements in Item 8. Financial Statements and Supplementary Data on pages F-14 to F-15 for more information). Interest. Interest expense was approximately $6.8 million for the twelve months ended December 31, 2004, as compared to approximately $14.6 million for the same period in 2003. In 2003, the Company permanently retired $50 million of its then outstanding debt of $175 million. The Company refinanced the remaining balance of $125 million at substantially lower interest rates through the issuance of term loan debt. Subsequently, in June 2004, the Company refinanced its debt and further reduced its interest rate by issuing $125 million aggregate principal amount of 3.25% Convertible Subordinated Debentures due 2024. These actions resulted in the reduction of interest expense of approximately $7.8 million in 2004 as compared to 2003 (refer to Note 9 of Notes to Financial Statements in Item 8. Financial Statements and Supplementary Data on pages F-20 to F-22 for more information). Loss on Extinguishment of Debt. During the year ended December 31, 2004, in connection with the retirement of the Company's then-outstanding $118.8 million under the Term Loan B, the Company wrote off approximately $3.5 million of deferred debt issuance costs associated with the Term Loan B. Additionally, the Company incurred a prepayment penalty of approximately $2.4 million due to the early retirement of the Term Loan B. During the year ended December 31, 2003, the Company incurred a write-off of approximately $1.6 million of deferred debt issuance costs associated with the retirement of its then outstanding debt and incurred expenses associated with the retirement of approximately $4.7 million. Other Expenses. As a result of allegations of improprieties made during 2003 and 2004, the Company's external auditors advised the Company and the Audit Committee of the Board of Directors that additional procedures should be performed related to the allegations. These additional procedures were required due to Statement of Auditing Standards No. 99, Consideration of Fraud in a Financial Statement Audit, ("SAS No. 99"), which became effective for periods beginning on or after December 15, 2002. Due to the volume and, in some cases, vague nature of many of the allegations, the scope of the additional procedures was broad and extensive. The Company recorded costs related to the additional procedures totaling approximately $6.3 million during the twelve months ended December 31, 2004, and included these costs in other expenses in the Company's Consolidated Statements of Income. In segment reporting, these costs are classified in the Corporate segment. On May 10, 2004, the Company reached a settlement with the Company's former insurance carrier, Certain Underwriters at Lloyd's of London (collectively "Lloyd's"). On July 7, 2004, pursuant to the settlement, as amended, Lloyd's paid the Company $16.2 million in cash. As of the payment date, the Company had an approximately $14.7 million receivable from Lloyd's and recognized a gain of approximately $1.5 million on the settlement in the twelve months ended December 31, 2004. The gain has been reflected in the Company's Corporate segment. In the Consolidated Statement of Income, the gain is included in other expenses. On July 30, 2004, the Company relocated its principal executive office to Alpharetta, Georgia. The Company entered into a noncancelable, operating lease for that office space in February 2004 which will expire in July 2014. While the new landlord assumed the payments for the lease of the Company's former corporate office, the Company recorded an expense of approximately $1.0 million upon its exit of the former office facility. The expense has been reflected in the Company's Corporate segment. In the Consolidated Statement of Income, the expense is included in other expenses. During the year ended December 31, 2003, the Hospital Solutions and Corporate divisions incurred approximately $0.5 million and $0.3 million, respectively, of restructuring expenses related to the July 2003 realignment of the Company into the Physician Solutions and Hospital Solutions divisions following the Patient1 divestiture. Income Taxes. Income tax (benefit) expense, which is related to federal, state, local and foreign income taxes, was a benefit of approximately ($28.1) million and an expense of $27,000 during the years ended December 31, 2004, and 2003, respectively. The 2003 income tax expense was offset by a benefit for 30 a federal income tax refund of approximately $0.8 million related to the gain on the sale of Healthcare Recoveries, Inc. ("HRI"), resulting in a net tax expense of $27,000. As of December 31, 2004, and 2003, the Company reassessed the recoverability of its deferred tax asset. Based on its analysis, the Company determined a full valuation allowance against the deferred tax asset of $167.3 million was required as of December 31, 2003, and a partial valuation allowance of $137.4 million was required as of December 31, 2004. Realization of the net deferred tax asset is dependent upon the Company generating sufficient taxable income prior to the expiration of the federal and state net operating loss carryforwards. The Company determined during 2004 that it was more likely than not that a portion of the deferred tax asset would be realized during the foreseeable future; therefore, the valuation allowance was adjusted accordingly. The Company recognized a non-cash tax benefit of approximately $28.1 million during 2004 as a result of the valuation allowance adjustment. At December 31, 2004, the Company had federal net operating loss carryforwards ("NOLs") for income tax purposes of approximately $393.7 million. Discontinued Operations. In June 2003, the Company announced that it agreed to sell Patient1 to Misys for $30 million in cash. Patient1 was the Company's only clinical product line and its sale allowed the Company to better focus on improving reimbursement and administrative efficiencies for physician practices and hospitals. The sale was completed on July 28, 2003. The Company recognized a gain on the sale of Patient1 of approximately $10.4 million, subject to closing adjustments, in 2003. Net proceeds on the sale of Patient1 were approximately $27.9 million, subject to closing adjustments. The Company entered into binding arbitration with Misys regarding the final closing adjustments and on May 21, 2004, the arbitrator awarded the Company approximately $4.3 million. On June 1, 2004, the Company received payment of approximately $4.5 million, which included interest of approximately $0.2 million. In September 2003, the Company initiated a process to sell Business1. As with the sale of Patient1, the discontinuance of Business1 allowed the Company to focus resources on solutions that provide meaningful, strategic returns for the Company, its customers and its shareholders. Pursuant to SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("SFAS No. 144"), the Company wrote down the net assets of Business1 to fair market value less costs to sell and incurred an $8.5 million expense. On February 2, 2004, the Company announced the sale of Business1, effective January 31, 2004, to a privately held company for $0.6 million. Pursuant to SFAS No. 144, the consolidated financial statements of the Company have been presented to reflect Patient1 and Business1 as discontinued operations for all periods presented. Summarized operating results for the discontinued operations are as follows:

YEAR ENDED DECEMBER 31, (IN THOUSANDS)	2004 PATIENT1	2004 BUSINESS1	2004 TOTAL	2003 PATIENT1(1)	2003 BUSINESS1	2003 TOTAL
Revenue	$ --	$ 106	$ 106	$15,247	$ 474	$15,721
Loss from discontinued operations before income taxes	$(18)	$(303)	$(321)	$(1,270)	$(3,589)	$(4,859)
Income tax expense	--	--	--	46	--	46
Loss from discontinued operations, net of tax	$(18)	$(303)	$(321)	$(1,316)	$(3,589)	$(4,905)

(1) Patient1 financial information includes activity through the sale date of July 28, 2003. On November 30, 1998, the Company completed the sale of its MSC business segment. In 1999, the Company completed the sale of both divisions of its Impact business segment. Pursuant to APB No. 30, Reporting the Results of Operations -- Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, the consolidated financial statements of the Company have been presented to reflect the activity associated with MSC and Impact as discontinued operations for all periods presented. 31 During the years ended December 31, 2004, and 2003, the Company incurred expenses of approximately $14,000 and $0.9 million, respectively, which were primarily legal costs associated with MSC and Impact. These expenses were recognized through (loss) income from discontinued operations in the Company's Consolidated Statements of Income. LIQUIDITY AND CAPITAL RESOURCES The following table is a summary of the Company's cash balances and cash flows from continuing operations for the years ended December 31, 2005, and 2004 (in thousands):

	2005	2004
Unrestricted cash and cash equivalents at December 31	$ 61,161	$ 42,422
Cash provided by continuing operations	$ 48,773	$ 48,924
Cash used for investing activities from continuing operations	$(23,657)	$(10,581)
Cash used for financing activities from continuing operations	$ (6,377)	$(20,758)

Unrestricted cash and cash equivalents include all highly liquid investments with an initial maturity of no more than three months at the date of purchase. Restricted cash at December 31, 2005, and December 31, 2004, of approximately $20,000 and $51,000, respectively, represents amounts collected on behalf of certain Physician Solutions and Hospital Solutions clients, a portion of which is held in trust until it is remitted to such clients. During 2005, the Company generated approximately $48.8 million in cash from continuing operations which includes cash generated from normal operations offset by interest payments of approximately $4.5 million. During 2004, the Company generated approximately $48.9 million in cash from continuing operations which includes cash generated from normal operations as well as the receipt of the $16.2 million settlement from Lloyd's of London (refer to "Note 9 -- Legal Matters" in the Company's Notes to Consolidated Financial Statements for more information), offset by cash payments related to additional procedures necessary under SAS No. 99 totaling approximately $6.3 million (refer to "Note 2 -- Other Expenses" in the Company's Notes to Consolidated Financial Statements for more information), the payment of approximately $5.7 million in expenses and legal settlements related to the matter with Lloyd's of London and interest payments of approximately $5.7 million. During 2005, cash used for investing activities from continuing operations was approximately $23.7 million consisting primarily of approximately $14.2 million for capital expenditures and investment in software development costs, approximately $5.7 million of cash used for current and prior year acquisitions and $3.8 million in transaction costs related to the acquisition of NDCHealth. During the latter part of 2004, the Company initiated a project to enhance substantially its physician claims clearinghouse functionality. During 2005, the Company invested approximately $1.9 million for capital expenditures and capitalized software development costs related to this project. During 2004, cash used for investing activities from continuing operations was approximately $10.6 million consisting primarily of approximately $13.0 million for capital expenditures and investment in software development costs and approximately $1.1 million of cash used for an acquisition, partially offset by approximately $3.7 million of net proceeds related to the final closing adjustments from the July 2003 sale of Patient1. During 2005, the Company used approximately $6.4 million in cash for financing activities which included approximately $15.4 million used for the repurchase of the Company's Common Stock which was partially offset by proceeds from the exercise of stock options of approximately $9.2 million. On March 9, 2005, the Company announced that the Board authorized the repurchase of up to one million shares of the Company's outstanding Common Stock. Under the share repurchase program, the Company was able to repurchase shares from time to time at management's discretion in the open market, by block purchase, in privately negotiated transactions or as otherwise allowed by securities laws and regulations. All shares repurchased were placed into treasury to be used for general corporate purposes. 32 During 2005, the Company repurchased one million shares of its outstanding Common Stock at a cost of approximately $15.4 million. During 2004, the Company used approximately $20.8 million in cash for financing activities. On June 30, 2004 the Company raised $125 million from the sale of 3.25% Convertible Subordinated Debentures due 2024 (the "Debentures") and retired the $118.8 million then outstanding under the Term Loan B concurrently with the completion of the Convertible Debenture offering. On June 30, 2004, the Company also completed an amendment to the Revolving Credit Facility to increase its capacity and lower the Company's borrowing rate. The Revolving Credit Facility's capacity was expanded from $50 million to $75 million and the facility's maturity was extended to three years. The Company incurred a prepayment penalty on the early retirement of the Term Loan B totaling $2.4 million in addition to financing costs of approximately $3.5 million related to the Convertible Debenture offering and amendment to the Revolving Credit Facility. The Company also repurchased, for approximately $25 million, an aggregate of approximately 2.0 million shares of the Company's outstanding Common Stock, at the market price of $12.57 per share, in negotiated transactions concurrently with the Debentures offering. The cost of the refinancing and purchase of Common Stock is partially offset by proceeds from the exercise of stock options of approximately $7.4 million. For more information about the Company's long-term debt, refer to "Note 9 -- Long-Term Debt" in the Company's Notes to Consolidated Financial Statements. On January 6, 2006, Per-Se acquired Atlanta, GA-based NDCHealth. The acquisition included the physician, hospital and retail pharmacy businesses, for total consideration of approximately $665 million. As part of the transaction, Wolters Kluwer Health, Inc., wholly owned by Wolters Kluwer NV, based in Amsterdam, the Netherlands, purchased the pharmaceutical information management business from NDCHealth for $382 million in cash. The transaction resulted in consideration to NDCHealth's shareholders of $19.50 per share, with $14.05 paid in cash and $5.45 paid in Per-Se stock. As of December 31, 2005, the Company had incurred approximately $3.8 million of transaction costs that are included in other long-term assets in the Company's Consolidated Balance Sheet. In connection with the acquisition, the Company also secured financing in the form of a new senior credit facility consisting of a $435 million Term Loan B and a $50 million revolving credit facility ("Senior Credit Facility"). The Term Loan B bears interest at a rate of LIBOR plus 2.25% or Base Rate, as defined by the Senior Credit Facility, plus 1.25% and matures in seven years. The revolving credit facility has an interest rate that varies between LIBOR plus 1.50% and LIBOR plus 2.50% or between Base Rate plus 0.5% and Base Rate plus 1.50%, based on performance, and matures in five years. The Company has incurred no borrowings under the revolving credit facility. All outstanding debt of NDCHealth was retired in connection with the closing of the transaction. During 2004, the Company reached a settlement with Lloyd's. In the settlement, Lloyd's agreed to pay the Company $20 million in cash by July 9, 2004. Lloyd's also agreed to defend, settle or otherwise resolve at their expense the two remaining pending claims covered under the errors and omissions ("E&O") policies issued to the Company by Lloyd's. In exchange, the Company provided Lloyd's with a full release of all E&O and directors and officers and company reimbursement ("D&O") policies. The California Superior Court retained jurisdiction to enforce any aspect of the settlement agreement. As of the settlement date, the Company had an $18.3 million receivable from Lloyd's, of which approximately $4.9 million represented additional amounts to be paid by the Company under prior E&O settlements covered by Lloyd's. Effective on May 12, 2004, as a result of negotiations among the Company, Lloyd's, and a party to a prior E&O settlement with the Company, the Lloyd's settlement was amended to reduce by $3.8 million the additional amounts to be paid by the Company under the prior E&O settlements covered by Lloyd's. This amendment reduced the amount of cash payable by Lloyd's to the Company in the settlement from $20 million to $16.2 million, and reduced the amount of the Company's Lloyd's receivable by $3.8 million. On July 7, 2004, pursuant to the settlement as amended, Lloyd's paid the Company $16.2 million in cash. 33 During the course of litigation the Company funded the legal costs and any litigation settlements related to E&O claims covered by the Lloyd's E&O policies. These items negatively impacted the Company's cash flow for the year ended December 31, 2004, by approximately $5.7 million, which consisted of approximately $2.1 million related to the cost of pursuing the litigation against Lloyd's and approximately $3.6 million related to the funding of legal costs and litigation settlements covered by the Lloyd's E&O policies. The negative impact of these items on the Company's cash flow for the year ended December 31, 2003, was approximately $7.4 million, which consisted of approximately $2.1 million related to insurance premium increases for new insurance coverage and the cost of pursuing the litigation against Lloyd's and approximately $5.3 million related to the funding of legal costs and litigation settlements covered by the Lloyd's E&O policies. The Company is subject to claims, litigation and official billing inquiries arising in the ordinary course of its business. These matters include pending lawsuits involving claims that are not required to be separately described in this report. The Company believes that it has meritorious defenses to the claims and other issues asserted in such matters; however, there can be no assurance that such matters or any future legal matters will not have an adverse effect on the Company. Amounts of awards or losses, if any, in pending legal matters have not been reflected in the financial statements unless probable and reasonably estimable. The Company has not experienced material changes in the underlying components of cash generated by operating activities from continuing operations. The Company believes that existing cash and the cash provided by operations will provide sufficient capital to fund its working capital requirements, contractual obligations, investing and financing needs. CONTRACTUAL OBLIGATIONS The following table sets forth the Company's contractual obligations as of December 31, 2005: PAYMENTS DUE BY PERIOD AS OF DECEMBER 31, 2005 -- LESS THAN MORE THAN TOTAL 1 YEAR 1 - 3 YEARS 3 - 5 YEARS 5 YEARS -------- --------- ------------- ------------- --------- (IN THOUSANDS) CONTRACTUAL OBLIGATIONS Long-term debt................ $125,000 $ -- $ -- $ -- $125,000 Operating lease obligations... 59,216 12,028 17,764 13,002 16,422 Capital lease obligations..... 625 135 281 209 -- Purchase obligations Capital expenditure obligations............. 1,791 1,791 -- -- -- Other purchase obligations............. 874 874 -- -- -- Other long-term liabilities reflected on the Company's Balance Sheet under GAAP: Restructuring reserves and other(1)................ 807 232 366 198 11 Software maintenance agreements.............. 551 275 276 -- -- -------- ------- ------- ------- -------- Total........................... $188,864 $15,335 $18,687 $13,409 $141,433 ======== ======= ======= ======= ======== --------------- (1) The amounts reflected under restructuring reserves and other are amounts reserved for estimated lease termination costs associated with the Company's Physician Solutions division's 1995 restructuring. For more information, see "Note 5 -- Restructuring Expenses" in the Company's Notes to Consolidated Financial Statements. 34 ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK INTEREST RATE SENSITIVITY The Company invests excess cash in commercial paper, money market funds and other highly liquid short-term investments. Due to the limited amounts of these investments and their short-term nature, the Company does not expect any fluctuation in the prevailing interest rates to have a material effect on its financial statements. The Company has the option of entering into loans based on LIBOR or on

Base Rates under the Revolving Credit Facility and Term Loan B. As such, the Company could experience fluctuations in interest rates under the Revolving Credit Facility and Term Loan B. In connection with the acquisition of NDCHealth on January 6, 2006, the Company secured financing in the form of a new senior credit facility consisting of a $435 million Term Loan B and a $50 million revolving credit facility. Also on January 6, 2006, the Company entered into a four-year interest rate swap agreement, in order to hedge against potential interest rate fluctuations resulting from the variable interest rate under the terms of the new senior credit facility. Pursuant to the terms of the interest rate swap, the Company is obligated to periodically pay an amount based on a fixed interest rate, and the Company will receive an amount based on a variable rate. The variable rate is based on the three-month LIBOR rate available at the time. By entering into the interest rate swap, the Company has effectively fixed the maximum interest rate that the Company will pay on a portion of the $435 million outstanding under the Credit Facility at 4.76% per annum plus the applicable spread, which is 225 basis points. The amount of the Credit Facility that is covered by the swap is $125 million in years one and two, decreasing to $100 million in year three and $75 million in year four. The interest rate swap will terminate on December 31, 2009, unless sooner terminated pursuant to its terms. The floating rate debt outstanding under the Term Loan B which is not subject to the above referenced interest rate swap agreement subjects the Company to risk resulting from changes in short-term interest rates. The potential change in annual interest expense resulting from a hypothetical 100 basis point change in short-term interest rates applied to the Company's floating rate debt at January 6, 2006 would be approximately $3.1 million. EXCHANGE RATE SENSITIVITY The majority of the Company's sales and expenses are denominated in U.S. dollars. As a result, the Company has not experienced any significant foreign exchange gains or losses to date. The Company conducts only limited transactions in foreign currencies and does not expect material foreign exchange gains or losses in the future. The Company does not engage in any foreign exchange hedging activities. ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA The Company's Consolidated Financial Statements appear beginning at page F-1. ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE None ITEM 9A. CONTROLS AND PROCEDURES CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING AND CONCLUSION REGARDING THE EFFECTIVENESS OF DISCLOSURE CONTROLS AND PROCEDURES The Company's Chief Executive Officer and Chief Financial Officer have evaluated the Company's disclosure controls and procedures as of December 31, 2005. The Company's Chief Executive Officer and the Company's Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of December 31, 2005, to provide reasonable assurance that information the Company is required to disclose in reports that the Company files or submits under the Securities 35 Exchange Act of 1934 is recorded, processed, summarized and reported accurately. It should be noted that a control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues within the Company have been detected. Furthermore, the design of any control system is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how unlikely. Because of these inherent limitations in a cost-effective control system, misstatements or omissions due to error or fraud may occur and not be detected. In connection with efforts to comply with Section 404(a) of the Sarbanes-Oxley Act in 2006, the Company will continue to enhance its internal control structure, as necessary, on an ongoing basis. MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Under the supervision and with the participation of management, including the Company's Chief Executive Officer and Chief Financial Officer, the Company has conducted an evaluation of the effectiveness of its internal control over financial reporting based on the framework in Internal Control -- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based upon that evaluation, management of the Company has concluded that the Company's internal control over financial reporting was effective as of December 31, 2005. Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, has been audited by Ernst & Young LLP, the independent registered public accounting firm that audited the financial statements included herein, as stated in their report which is included herein. CHANGES IN INTERNAL CONTROLS There were no changes in the Company's internal controls over financial reporting during the quarter ended December 31, 2005 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. ITEM 9B. OTHER INFORMATION None. 36 PART III ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT The information required by this Item with respect to directors and executive officers of the Registrant, except certain information regarding executive officers that is contained in Part I of this Report pursuant to General Instruction G of this Form 10-K, is included in the sections entitled "Board of Directors" and "Compliance with Section 16(a) of the Securities Exchange Act of 1934" of the Proxy Statement for the Annual Meeting of Stockholders to be held on May 25, 2006, and is incorporated herein by reference. The Registrant has adopted Standards of Conduct, which meet the definition of a "code of ethics" under Item 406 of the Securities and Exchange Commission's Regulation S-K, and which are applicable to and binding upon all of the Registrant's employees (including the principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions) and, as required by the context, directors. Any waiver of the Standards of Conduct for officers or directors of the Registrant must be approved by the Board of Directors of the Registrant and must be publicly disclosed in accordance with Securities and Exchange Commission and Nasdaq rules. The Standards of Conduct are posted in the corporate governance area of the investors section of the Registrant's Internet website at www.per-se.com. ITEM 11. EXECUTIVE COMPENSATION The information required by this Item is included in the sections entitled "Certain Information Regarding Executive Officers," "Compensation Committee Report on Executive Compensation," "Compensation Committee Interlocks and Insider Participation" and "Stock Price Performance Graph" of the Proxy Statement for the Annual Meeting of Stockholders to be held on May 25, 2006, and is incorporated herein by reference. ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS The information required by this Item is included in the sections entitled "Director and Executive Officer Common Stock Ownership" "Principal Stockholders" and "Equity Compensation Plan Information" of the Proxy Statement for the Annual Meeting of Stockholders to be held on May 25, 2006, and is incorporated herein by reference. ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS The information required by this Item is included in the sections entitled "Certain Relationships and Related Transactions" of the Proxy Statement for the Annual Meeting of Stockholders to be held on May 25, 2006, and is incorporated herein by reference. ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES The information required by this Item is included in the section entitled "Selection of Independent Auditors" of the Proxy Statement for the Annual Meeting of Stockholders to be held on May 25, 2006, and is incorporated herein by reference. PART IV ITEM 15. EXHIBITS AND FINANCIAL STATEMENTS SCHEDULES (a) 1. Financial Statements Report of Independent Registered Public Accounting Firm; Consolidated Balance Sheets -- as of December 31, 2005 and 2004; 37 Consolidated Statements of Income -- years ended December 31, 2005, 2004 and 2003; Consolidated Statements of Cash Flows -- years ended December 31, 2005, 2004 and 2003; Consolidated Statements of Stockholders' Equity (Deficit) -- years ended December 31, 2005, 2004 and 2003; and Notes to Consolidated Financial Statements. 2. Financial Statement Schedules Included in Part IV of the report: Schedule II -- Valuation and Qualifying Accounts -- years ended December 31, 2005, 2004 and 2003; Schedules, other than Schedule II, are omitted because of the absence of the conditions under which they are required. 3. Exhibits The following list of exhibits includes both exhibits submitted with this Form 10-K as filed with the Commission and those incorporated by reference to other filings: EXHIBIT NUMBER DOCUMENT ------- -------- 2.1 -- Agreement and Plan of Merger, dated as of August 26, 2005, among Registrant, Royal Merger Co. and NDCHealth Corporation (incorporated by reference to Exhibit 2.1 to Current Report on Form 8-K filed on August 30, 2005) (schedules and similar attachments to this exhibit have not been filed; Registrant agrees to furnish supplementally a copy of any of these materials to the Securities and Exchange Commission upon request). 2.2 -- Stock Purchase Agreement, dated as of August 26, 2005, among Wolters Kluwer Health, Inc., NDC Health Information Services (Arizona) Inc., and NDCHealth Corporation (incorporated herein by reference to Exhibit 2.1 to NDCHealth Corporation's Current Report on Form 8-K filed on August 29, 2005) (schedules and similar attachments to this exhibit have not been filed; Registrant agrees to furnish supplementally a copy of any of these materials to the Securities and Exchange Commission upon request). 3.1 -- Restated Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 to Annual Report on Form 10-K for the year ended December 31, 1999 (the "1999 Form 10-K")). 3.2 -- Restated By-laws of Registrant, as amended (incorporated by reference to Exhibit 3.2 to Current Report on Form 8-K filed on July 29, 2005). 4.1 -- Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the 1999 Form 10-K). 4.2 -- Form of Option Agreement relating to Registrant's Amended and Restated Non-Employee

Director Stock Option Plan (incorporated by reference to Appendix B to Definitive Proxy Statement dated April 1, 2003, relating to Registrant's 2003 Annual Meeting of Stockholders). 4.3 -- Form of Option Agreement relating to Registrant's Second Amended and Restated Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 4.2 to the 1999 Form 10-K). 4.4 -- Form of Option Agreement relating to Registrant's Non-Qualified Stock Option Plan for Non-Executive Employees (incorporated by reference to Exhibit 4.6 to the 1999 Form 10-K). 4.5 -- Form of Option Agreement relating to Registrant's Non-Qualified Stock Option Plan for Employees of Acquired Companies (incorporated by reference to Exhibit 4.4 to Registration Statement on Form S-3, File No. 33-71552). 4.6 -- Rights Agreement dated as of February 11, 1999, between Registrant and American Stock Transfer & Trust Company (including form of rights certificates) (incorporated by reference to Exhibit 4 to Current Report on Form 8-K filed on February 12, 1999). 38 EXHIBIT NUMBER DOCUMENT ------- -------- 4.7 -- First Amendment to Rights Agreement dated as of February 11, 1999, between Registrant and American Stock Transfer & Trust Company, entered into as of May 4, 2000 (incorporated by reference to Exhibit 4.4 to Quarterly Report of Form 10-Q for the quarter ended March 31, 2000). 4.8 -- Second Amendment to Rights Agreement dated as of February 11, 1999, between Registrant and American Stock Transfer & Trust Company, entered into as of December 6, 2001, to be effective as of March 6, 2002 (incorporated by reference to Exhibit 4.12 to Annual Report on Form 10-K for the year ended December 31, 2001 (the "2001 Form 10-K")). 4.9 -- Third Amendment to Rights Agreement dated as of February 11, 1999, between Registrant and American Stock Transfer & Trust Company, entered into as of March 10, 2003 (incorporated by reference to Exhibit 4.13 to Annual Report on Form 10-K for the year ended December 31, 2002 (the "2002 Form 10-K")). 4.10 -- Fourth Amendment to Rights Agreement dated as of February 11, 1999, between Registrant and American Stock Transfer & Trust Company, entered into as of February 18, 2005 (incorporated by reference to Exhibit 4.1 to Current Report on Form 8-K filed on February 22, 2005). 4.11 -- Fifth Amendment to Rights Agreement dated as of February 11, 1999, between Registrant and American Stock Transfer & Trust Company, entered into as of August 26, 2005 (incorporated by reference to Exhibit 4.1 to Current Report on Form 8-K filed on August 26, 2005). 4.12 -- Indenture dated as of June 30, 2004, between Registrant and U.S. Bank National Association, as Trustee, relating to Registrant's 3.25% Convertible Subordinated Debentures Due 2024 (incorporated by reference to Exhibit 4.5 to Quarterly Report on Form 10-Q for the quarter ended June 30, 2004). 10.1 -- Amended and Restated Credit Agreement, dated as of January 6, 2006, among Registrant, certain domestic subsidiaries of Registrant, Bank of America, N.A., Wachovia Bank, National Association, and the other lenders party thereto (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed on January 12, 2006). 10.2 -- Amended and Restated Per-Se Technologies, Inc. Non-Employee Director Stock Option Plan (incorporated by reference to Appendix B to Definitive Proxy Statement dated April 1, 2003, relating to Registrant's 2003 Annual Meeting of Stockholders). 10.3 -- Second Amended and Restated Per-Se Technologies, Inc. Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.1 to the 1999 Form 10-K). 10.4 -- First Amendment to Second Amended and Restated Per-Se Technologies, Inc. Non-Qualified Stock Option Plan (incorporated by reference to Exhibit 10.45 to the 1999 Form 10-K). 10.5 -- Registrant's Non-Qualified Stock Option Plan for Non-Executive Employees (incorporated by reference to Exhibit 10.23 to Annual Report on Form 10-K for the year ended December 31, 1996 (the "1996 Form 10-K")). 10.6 -- First Amendment to Registrant's Non-Qualified Stock Option Plan for Non-Executive Employees (incorporated by reference to Exhibit 10.24 to the 1996 Form 10-K). 10.7 -- Second Amendment to Registrant's Non-Qualified Stock Option Plan for Non-Executive Employees (incorporated by reference to Exhibit 10.25 to Annual Report on Form 10-K for the year ended December 31, 1997 (the "1997 Form 10-K")). 10.8 -- Third Amendment to Registrant's Non-Qualified Stock Option Plan for Non-Executive Employees (incorporated by reference to Exhibit 10.26 to the 1997 Form 10-K). 10.9 -- Fourth Amendment to Registrant's Non-Qualified Stock Option Plan for Non-Executive Employees (incorporated by reference to Exhibit 10.27 to the 1997 Form 10-K). 10.10 -- Fifth Amendment to Registrant's Non-Qualified Stock Option Plan for Non-Executive Employees (incorporated by reference to Exhibit 10.28 to the 1997 Form 10-K). 10.11 -- Sixth Amendment to Registrant's Non-Qualified Stock Option Plan for Non-Executive Employees (incorporated by reference to Exhibit 10.32 to Annual Report on Form 10-K for the year ended December 31, 1998 (the "1998 Form 10-K")). 10.12 -- Seventh Amendment to Registrant's Non-Qualified Stock Option Plan for Non-Executive Employees (incorporated by reference to Exhibit 10.24 to the 1999 Form 10-K). 39 EXHIBIT NUMBER DOCUMENT ------- -------- 10.13 -- Eighth Amendment to Registrant's Non-Qualified Stock Option Plan for Non-Executive Employees (incorporated by reference to Exhibit 10.26 to Annual Report on Form 10-K for the year ended December 31, 2000 (the "2000 Form

10-K")). 10.14 -- Ninth Amendment to Registrant's Non-Qualified Stock Option Plan for Non-Executive Employees (incorporated by reference to Exhibit 10.2 to Quarterly Report on Form 10-Q for the quarter ended June 30, 2002). 10.15 -- Tenth Amendment to Registrant's Non-Qualified Stock Option Plan for Non-Executive Employees (incorporated by reference to Exhibit 10.31 to the 2002 Form 10-K). 10.16 -- Registrant's Non-Qualified Stock Option Plan for Employees of Acquired Companies (incorporated by reference to Exhibit 99.1 to Registration Statement on Form S-8, File No. 33-67752). 10.17 -- First Amendment to Registrant's Non-Qualified Stock Option Plan for Employees of Acquired Companies (incorporated by reference to Exhibit 99 to Registration Statement on Form S-8, File No. 33-71556). 10.18 -- Second Amendment to Registrant's Non-Qualified Stock Option Plan for Employees of Acquired Companies (incorporated by reference to Exhibit 99 to Registration Statement on Form S-8, File No. 33-88442). 10.19 -- Third Amendment to Registrant's Non-Qualified Stock Option Plan for Employees of Acquired Companies (incorporated by reference to Exhibit 10.14 to Annual Report on Form 10-K for the year ended December 31, 1995). 10.20 -- Fourth Amendment to Registrant's Non-Qualified Stock Option Plan for Employees of Acquired Companies (incorporated by reference to Exhibit 99.2 to Registration Statement on Form S-8, File No. 333-3213). 10.21 -- Fifth Amendment to Registrant's Non-Qualified Stock Option Plan for Employees of Acquired Companies (incorporated by reference to Exhibit 99.1 to Registration Statement on Form S-8, File No. 333-07627). 10.22 -- Sixth Amendment to Registrant's Non-Qualified Stock Option Plan for Employees of Acquired Companies (incorporated by reference to Exhibit 10.21 to the 1996 Form 10-K). 10.23 -- Seventh Amendment to Registrant's Non-Qualified Stock Option Plan for Employees of Acquired Companies (incorporated by reference to Exhibit 10.23 to the 1998 Form 10-K). 10.24 -- Eighth Amendment to Registrant's Non-Qualified Stock Option Plan For Employees of Acquired Companies (incorporated by reference to Exhibit 10.12 to the 1999 Form 10-K). 10.25 -- Ninth Amendment to Registrant's Non-Qualified Stock Option Plan For Employees of Acquired Companies (incorporated by reference to Exhibit 10.12 to the 2000 Form 10-K). 10.26 -- Tenth Amendment to Registrant's Non-Qualified Stock Option Plan For Employees of Acquired Companies (incorporated by reference to Exhibit 10.1 to Quarterly Report of Form 10-Q for the quarter ended June 30, 2002). 10.27 -- Per-Se Technologies, Inc. Employees' Retirement Savings Plan (incorporated by reference to Exhibit 10.3 to Current Report on Form 8-K filed on May 23, 2005). 10.28 -- First Amendment to the Per-Se Technologies, Inc. Employees' Retirement Savings Plan (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed on October 27, 2005). 10.29 -- Second Amendment to the Per-Se Technologies, Inc. Employees' Retirement Savings Plan (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed on December 19, 2005). 10.30 -- Retirement Savings Trust (incorporated by reference to Exhibit 10.10 to Registration Statement on Form S-1, File No. 33-42216). 10.31 -- Registrant's Deferred Compensation Plan (incorporated by reference to Exhibit 99 to Registration Statement on Form S-8, Registration No. 33-90874). 10.32 -- First Amendment to Registrant's Deferred Compensation Plan (incorporated by reference to Exhibit 10.2 to Quarterly Report on Form 10-Q for the quarter ended September 30, 1997). 40 EXHIBIT NUMBER DOCUMENT ------- -------- 10.33 -- Second Amendment to Registrant's Deferred Compensation Plan (incorporated by reference to Exhibit 10.3 to Quarterly Report on Form 10-Q for the quarter ended September 30, 1997). 10.34 -- Third Amendment to Registrant's Deferred Compensation Plan (incorporated by reference to Exhibit 10.76 to the 1997 Form 10-K). 10.35 -- Fourth Amendment to Registrant's Deferred Compensation Plan (incorporated by reference to Exhibit 10.32 to the 1999 Form 10-K). 10.36 -- Fifth Amendment to Registrant's Deferred Compensation Plan (incorporated by reference to Exhibit 10.36 to the 2000 Form 10-K). 10.37 -- Per-Se Technologies, Inc. Executive Deferred Compensation Plan effective as of January 1, 2002 (incorporated by reference to Exhibit 10.40 to the 2001 Form 10-K). 10.38 -- Per-Se Technologies, Inc. Non-Qualified Deferred Compensation Plan Trust Agreement dated as of February 12, 2002, between Registrant and Merrill Lynch Trust Company, FSB (incorporated by reference to Exhibit 10.1 to Quarterly Report on Form 10-Q for the quarter ended March 31, 2002). 10.39 -- Written description of Registrant's Non-Employee Director Compensation Plan (incorporated by reference to Exhibit 10.2 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2003). 10.40 -- Per-Se Technologies, Inc. Deferred Stock Unit Plan (incorporated by reference to Exhibit 10.44 to the 2001 Form 10-K). 10.41 -- First Amendment to Per-Se Technologies, Inc. Deferred Stock Unit Plan (incorporated by reference to Exhibit 10.3 to Quarterly Report on Form 10-Q for the quarter ended June 30, 2002). 10.42 -- Per-Se Technologies, Inc. Deferred Stock Unit Plan Trust Agreement dated as of May 1, 2002, between Registrant and Merrill Lynch Trust Company, FSB (incorporated by reference to Exhibit 10.2 to Quarterly Report on Form 10-Q for the quarter ended March 31, 2002). 10.43 -- Per-Se Technologies, Inc. 2005 Senior Executive Incentive Compensation Plan (incorporated by reference to Exhibit 10.1 to

Current Report on Form 8-K filed on May 23, 2005). 10.44 -- Per-Se Technologies, Inc. 2005 Senior Management Incentive Compensation Plan (incorporated by reference to Exhibit 10.2 to Current Report on Form 8-K filed on May 23, 2005). 10.45 -- Employment Agreement dated November 19, 1996, between Registrant and David E. McDowell (incorporated by reference to Exhibit 10.49 to the 1996 Form 10-K). 10.46 -- Amendment Number 1 to Employment Agreement between Registrant and David E. McDowell, dated October 20, 1999 (incorporated by reference to Exhibit 10.37 to the 1999 Form 10-K). 10.47 -- Amendment Number 2 to Employment Agreement between Registrant and David E. McDowell, dated December 14, 2005 (incorporated by reference to Exhibit 10.2 to Current Report on Form 8-K filed on December 19, 2005). 10.48 -- Employment Agreement dated as of November 13, 2000, between Registrant and Philip M. Pead (incorporated by reference to Exhibit 10.42 to the 2000 Form 10-K). 10.49 -- Amendment No. 1 to Employment Agreement between Registrant and Philip M. Pead, dated May 8, 2003 (incorporated by reference to Exhibit 10.1 to Quarterly Report on Form 10-Q for the quarter ended June 30, 2003). 10.50 -- Employment Agreement dated April 14, 2000, between Registrant and Chris E. Perkins (incorporated by reference to Exhibit 10.43 to the 2000 Form 10-K). 10.51 -- Amendment Number 1 to Employment Agreement between Registrant and Chris E. Perkins, dated as of February 7, 2001 (incorporated by reference to Exhibit 10.44 to the 2000 Form 10-K). 10.52 -- Employment Agreement dated July 1, 2003, between Registrant and Philip J. Jordan (incorporated by reference to Exhibit 10.3 to Quarterly Report on Form 10-Q for the quarter ended September 30, 2003). 10.53 -- Employment Agreement dated as of May 31, 2001, between Registrant and Paul J. Quiner (incorporated by reference to Exhibit 10.57 to Annual Report on Form 10-K for the year ended December 31, 2003). 41 EXHIBIT NUMBER DOCUMENT ------- -------- 10.54 -- Employment Agreement dated as of February 9, 2005, as amended effective as of December 29, 2005, between G. Scott MacKenzie and NDCHealth Corporation. 10.55 -- Data Supply and Services Agreement, dated as of January 6, 2006, among NDC Health Information Services (Arizona) Inc., NDCHealth Corporation and Registrant (incorporated by reference to Exhibit 10.2 to Current Report on Form 8-K filed on January 12, 2006). 10.56 -- Retail Informatics Data and Services Agreement, dated as of January 6, 2006, between NDC Health Information Services (Arizona) Inc. and NDCHealth Corporation (incorporated by reference to Exhibit 10.3 to Current Report on Form 8-K filed on January 12, 2006). 10.57 -- Per-Se Technologies, Inc. 2006 Senior Management Incentive Compensation Plan (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed on March 7, 2006). 21 -- Subsidiaries of Registrant. 23 -- Consent of Ernst & Young LLP. 31.1 -- Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. 31.2 -- Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. 32.1 -- Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. 32.2 -- Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. The exhibits, which are referenced in the above documents, are hereby incorporated by reference. Such exhibits have been omitted for purposes of this filing but will be furnished supplementary to the Commission upon request. 42 SIGNATURES Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized. PER-SE TECHNOLOGIES, INC. (Registrant) By: /s/ CHRIS E. PERKINS ----------------------------------- Chris E. Perkins Executive Vice President, Chief Operating Officer and Interim Chief Financial Officer /s/ RICHARD A. FLYNT ----------------------------------- Richard A. Flynt Senior Vice President and Corporate Controller (Principal Accounting Officer) Date: March 15, 2006 43 Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated. March 15, 2006 /s/ PHILIP M. PEAD ------------------------------ Philip M. Pead Chairman, President, Chief Executive Officer and Director March 15, 2006 /s/ CHRIS E. PERKINS ------------------------------ Chris E. Perkins Executive Vice President, Chief Operating Officer and Interim Chief Financial Officer March 15, 2006 /s/ RICHARD A. FLYNT ------------------------------ Richard A. Flynt Senior Vice President and Corporate Controller (Principal Accounting Officer) March 15, 2006 /s/ JOHN W. CLAY, JR. ------------------------------ John W. Clay, Jr. Director March 15, 2006 /s/ JOHN W. DANAHER, M.D. ------------------------------ John W. Danaher, M.D. Director March 15, 2006 /s/ CRAIG MACNAB ------------------------------ Craig Macnab Director March 15, 2006 /s/ DAVID E. MCDOWELL ------------------------------ David E. McDowell Director March 15, 2006 /s/ C. CHRISTOPHER TROWER ------------------------------ C. Christopher Trower Director March 15, 2006 /s/ JEFFREY W. UBBEN

------------------------------ Jeffrey W. Ubben Director 44 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM The Board of Directors and Stockholders Per-Se Technologies, Inc. We have audited the accompanying consolidated balance sheets of Per-Se Technologies, Inc. and subsidiaries (the "Company") as of December 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedule listed in the Index at Item 15(a)2. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Per-Se Technologies, Inc. and subsidiaries at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein. We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Per-Se Technologies, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control -- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 13, 2006, expressed an unqualified opinion thereon. /s/ Ernst & Young LLP Atlanta, Georgia March 13, 2006 F-1 REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING The Board of Directors and Stockholders Per-Se Technologies, Inc. We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that Per-Se Technologies, Inc. and subsidiaries (the "Company") maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control -- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. In our opinion, management's assessment that Per-Se Technologies, Inc. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Per-Se Technologies, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria. We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Per-Se Technologies, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2005, and our report dated March 13, 2006, expressed an unqualified opinion thereon. /s/ Ernst & Young LLP Atlanta, Georgia March 13, 2006 F-2 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS DECEMBER 31, ------------------------ 2005 2004 ----------- ----------- (IN THOUSANDS, EXCEPT PAR VALUE DATA) Current Assets: Cash and cash equivalents................................ $ 61,161 $ 42,422 Restricted cash.. 20 51 --------- --------- Total cash and cash equivalents.................. 61,181 42,473 Accounts receivable, billed (less allowances of $3,035 and $3,229, respectively)................................. 54,135 49,105 Accounts receivable, unbilled (less allowances of $313 and $371, respectively).................................. 262 302 Deferred income taxes -- current, net.................... 4,056 3,264 Prepaid expenses... 3,004 2,823 Other.. 3,535 4,906 --------- --------- Total current assets............................. 126,173 102,873 Property and equipment, net of accumulated depreciation..... 16,843 15,512 Goodwill.. 38,199 32,549 Other intangible assets, net of accumulated amortization.... 21,946 20,784 Deferred income taxes, net................................ 26,238 24,851 Other... 10,124 6,122 --------- --------- Total assets.................................... $ 239,523 $ 202,691 ========= ========= Current Liabilities: Accounts payable... $ 5,982 $ 5,290 Accrued compensation.................................... 15,265 14,562 Accrued expenses... 17,002 14,628 Current portion of long-term debt and capital lease obligations... 135 98 Deferred revenue... 25,821 24,127 --------- --------- Total current liabilities........................ 64,205 58,705 Long-term debt and capital lease obligations............... 125,490 125,527 Other obligations.. 5,312 5,484 --------- --------- Total liabilities................................ 195,007 189,716 --------- --------- Commitments and contingencies (Notes 10 and 11) Stockholders' Equity: Preferred stock, no par value, 20,000 shares authorized; none issued.. -- -- Common stock, voting, $0.01 par value, 200,000 shares authorized, 33,511 and 32,324 shares issued and 30,523 and 30,336 shares outstanding as of December 31, 2005, and December 31, 2004, respectively................... 335 323 Common stock, non-voting, $0.01 par value, 600 shares authorized; none issued.............................. -- -- Paid-in capital.. 804,875 795,263 Accumulated deficit...................................... (719,759) (757,128) Treasury stock at cost, 2,988 and 1,988 shares as of December 31, 2005, and December 31, 2004, respectively.. (41,817) (26,510) Deferred stock unit plan obligation...................... 1,429 1,511 Accumulated other comprehensive loss..................... (547) (484) --------- --------- Total stockholders' equity....................... 44,516 12,975 --------- --------- Total liabilities and stockholders' equity........ $ 239,523 $ 202,691 ========= ========= See notes to consolidated financial statements. F-3 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF INCOME YEAR ENDED DECEMBER 31, ------------------------------------ 2005 2004 2003 ----------- ----------- ----------- (IN THOUSANDS, EXCEPT PER SHARE DATA) Revenue.. $372,718 $352,791 $335,169 Operating expenses: Cost of services.. 248,372 232,661 217,895 Selling, general and administrative...................... 83,226 85,351 79,936 Other expenses.. 1,018 5,845 830 -------- -------- -------- Operating income... 40,102 28,934 36,508 Interest expense.. 6,088 6,825 14,646 Interest income... (1,655) (525) (297) Loss on extinguishment of debt............................ -- 5,896 6,255 -------- -------- -------- Income before income taxes............................... 35,669 16,738 15,904 Income tax (benefit) expense.............................. (1,286) (28,101) 27 -------- -------- -------- Income from continuing operations........................ 36,955 44,839 15,877 -------- -------- -------- Discontinued operations (see Note 4) Loss from discontinued operations, net of tax -- Patient1...................................... -- (18) (1,316) Gain on sale of Patient1, net of tax..................... 434 3,784 10,417 Loss from discontinued operations, net of tax -- Business1..................................... -- (303) (3,589) Loss on sale of Business1, net of tax.................... -- (130) (8,528) Loss from discontinued operations, net of tax -- Other.... (20) (14)

(872) -------- -------- -------- 414 3,319 (3,888) -------- -------- -------- Net income...................................... $ 37,369 $ 48,158 $ 11,989 ======== ======== ======== Net income per common share-basic: Income from continuing operations......................... $ 1.23 $ 1.45 $ 0.52 Loss from discontinued operations, net of tax -- Patient1...................................... -- -- (0.04) Gain on sale of Patient1, net of tax...................... 0.01 0.12 0.34 Loss from discontinued operations, net of tax -- Business1..................................... -- (0.01) (0.12) Loss on sale of Business1, net of tax.................... -- -- (0.28) Loss from discontinued operations, net of tax -- Other.... -- -- (0.03) -------- -------- -------- Net income per common share-basic................ $ 1.24 $ 1.56 $ 0.39 ======== ======== ======== Weighted average shares used in computing basic income per common share... 30,084 30,843 30,594 ======== ======== ======== Net income per common share-diluted: Income from continuing operations......................... $ 1.11 $ 1.36 $ 0.49 Loss from discontinued operations, net of tax -- Patient1...................................... -- -- (0.04) Gain on sale of Patient1, net of tax...................... 0.01 0.11 0.32 Loss from discontinued operations, net of tax -- Business1..................................... -- (0.01) (0.11) Loss on sale of Business1, net of tax.................... -- -- (0.26) Loss from discontinued operations, net of tax -- Other.... -- -- (0.03) -------- -------- -------- Net income per common share-diluted.............. $ 1.12 $ 1.46 $ 0.37 ======== ======== ======== Weighted average shares used in computing diluted income per common share... 33,386 33,082 32,661 ======== ======== ======== See notes to consolidated financial statements. F-4 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS YEAR ENDED DECEMBER 31, ------------------------------- 2005 2004 2003 -------- --------- --------- (IN THOUSANDS) Cash Flows From Operating Activities: Net income... $ 37,369 $ 48,158 $ 11,989 Adjustments to reconcile net income to net cash provided by operating activities: Depreciation and amortization......................... 14,959 15,456 16,509 Loss from discontinued operations..................... 20 465 14,305 Gain on sale of Patient1.............................. (434) (3,784) (10,417) Amortization of deferred financing costs............. 1,336 1,275 1,269 Loss on extinguishment of debt........................ -- 5,896 6,255 Changes in assets and liabilities, excluding effects of acquisitions and divestitures: Restricted cash.................................... -- -- 4,162 Accounts receivable, billed......................... (3,344) (1,303) (4,370) Accounts receivable, unbilled....................... 40 275 129 Accounts payable................................... 506 (1,315) 3,062 Accrued compensation................................ 783 (3,502) (1,639) Accrued expenses................................... (1,854) (1,158) (7,177) Deferred tax asset................................. (2,179) (28,115) -- Deferred revenue................................... 1,694 3,793 1,962 Other, net... (123) 12,783 (7,568) -------- --------- --------- Net cash provided by continuing operations.......... 48,773 48,924 28,471 Net cash used for discontinued operations........... -- (434) (10,419) -------- --------- --------- Net cash provided by operating activities........ 48,773 48,490 18,052 -------- --------- --------- Cash Flows From Investing Activities: Purchases of property and equipment..................... (8,108) (6,337) (6,367) Software development costs.............................. (6,121) (6,681) (3,976) Net proceeds from sale of Patient1 and Business1, net of tax.. -- 3,654 27,925 Acquisition, net of cash acquired........................ (5,405) (1,141) -- Capitalized acquisition costs........................... (3,763) -- -- Other.. (260) (76) (55) -------- --------- --------- Net cash (used for) provided by continuing operations.................................... (23,657) (10,581) 17,527 Net cash used for discontinued operations........ -- -- (2,288) -------- --------- --------- Net cash (used for) provided by investing activities.................................... (23,657) (10,581) 15,239 -------- --------- --------- Cash Flows From Financing Activities: Proceeds from borrowings................................ -- 125,000 125,000 Treasury stock purchase................................ (15,404) (24,999) -- Proceeds from the exercise of stock options............. 9,219 7,398 7,969 Debt issuance costs.................................... -- (6,378) (9,797) Payments of debt... (76) (121,875) (178,145) Other.. (116) 96 205 -------- --------- --------- Net cash used for financing activities........... (6,377) (20,758) (54,768) -------- --------- --------- Cash and Cash Equivalents: Net change... 18,739 17,151 (21,477) Balance at beginning of period.......................... 42,422 25,271 46,748 -------- --------- --------- Balance at end of period............................... $ 61,161 $ 42,422 $ 25,271 ======== ========= ========= See notes to consolidated financial statements. F-5 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT) DEFERRED ACCUMULATED STOCK OTHER COMMON COMMON PAID-IN ACCUMULATED TREASURY UNIT PLAN COMPREHENSIVE SHARES STOCK CAPITAL WARRANTS DEFICIT STOCK OBLIGATION (LOSS)/INCOME ------ ------ -------- -------- ---------- -------- --------- ------------- (IN THOUSANDS) BALANCE AT DECEMBER 31, 2002................. 30,163 $302 $778,021 $ 1,495 $(817,275) $ (1,045) $1,045 $(515) Net

income............. -- -- -- -- 11,989 -- -- -- Foreign currency translation adjustment........... -- -- -- -- -- -- -- 84 TOTAL COMPREHENSIVE INCOME............... Exercise of stock options.............. 1,159 11 7,958 -- -- -- -- -- Tax effect of exercise of stock options...... -- -- 318 -- -- -- -- -- Deferred stock unit plan activity............. -- -- -- -- -- (258) 258 -- ------ ---- -------- ------- --------- -------- ------ ----- BALANCE AT DECEMBER 31, 2003................. 31,322 313 786,297 1,495 (805,286) (1,303) 1,303 (431) Net income............. -- -- -- -- 48,158 -- -- -- Foreign currency translation adjustment........... -- -- -- -- -- -- -- (53) TOTAL COMPREHENSIVE INCOME............... Exercise of stock options.............. 1,002 10 7,388 -- -- -- -- -- Tax effect of exercise of stock options...... -- -- 68 -- -- -- -- -- Treasury stock purchase............. -- -- -- -- -- (24,999) -- -- Expiration of warrants............. -- -- 1,495 (1,495) -- -- -- -- Other.................. -- -- 15 -- -- -- -- -- Deferred stock unit plan activity............. -- -- -- -- -- (208) 208 -- ------ ---- -------- ------- --------- -------- ------ ----- BALANCE AT DECEMBER 31, 2004................. 32,324 323 795,263 -- (757,128) (26,510) 1,511 (484) Net income............. -- -- -- -- 37,369 -- -- -- Foreign currency translation adjustment........... -- -- -- -- -- -- -- (63) TOTAL COMPREHENSIVE INCOME............... Exercise of stock options.............. 1,187 12 9,207 -- -- -- -- -- Tax effect of exercise of stock options...... -- -- 405 -- -- -- -- -- Treasury stock purchase............. -- -- -- -- -- (15,404) -- -- Other.................. -- -- -- -- 15 -- -- Deferred stock unit plan activity............. -- -- -- -- -- 82 (82) -- ------ ---- -------- ------- --------- -------- ------ ----- BALANCE AT DECEMBER 31, 2005................. 33,511 $335 $804,875 $ -- $(719,759) $(41,817) $1,429 $(547) ====== ==== ======== ======= ========= ======== ====== ===== TOTAL STOCKHOLDERS' EQUITY (DEFICIT) --------------- (IN THOUSANDS) BALANCE AT DECEMBER 31, 2002................. $(37,972) Net income............. 11,989 Foreign currency translation adjustment........... 84 -------- TOTAL COMPREHENSIVE INCOME............... 12,073 Exercise of stock options.............. 7,969 Tax effect of exercise of stock options...... 318 Deferred stock unit plan activity............. -- -------- BALANCE AT DECEMBER 31, 2003................. (17,612) Net income............. 48,158 Foreign currency translation adjustment........... (53) -------- TOTAL COMPREHENSIVE INCOME............... 48,105 Exercise of stock options.............. 7,398 Tax effect of exercise of stock options...... 68 Treasury stock purchase............. (24,999) Expiration of warrants............. -- Other.................. 15 Deferred stock unit plan activity............. -- -------- BALANCE AT DECEMBER 31, 2004................. 12,975 Net income............. 37,369 Foreign currency translation adjustment........... (63) -------- TOTAL COMPREHENSIVE INCOME............... 37,306 Exercise of stock options.............. 9,219 Tax effect of exercise of stock options...... 405 Treasury stock purchase............. (15,404) Other.................. 15 Deferred stock unit plan activity............. -- -------- BALANCE AT DECEMBER 31, 2005................. $ 44,516 ======== See notes to consolidated financial statements. F-6 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Basis of Presentation. The consolidated financial statements include the accounts of Per-Se Technologies, Inc. and its subsidiaries ("Per-Se" or the "Company"). All intersegment accounts have been eliminated. The Hospital Solutions division's revenue includes intersegment revenue for services provided to the Physician Solutions division, which has been eliminated in total consolidated revenue. Certain amounts in the prior years' consolidated financial statements have been reclassified to conform to the current year presentation. The consolidated financial statements of the Company have been presented to reflect the operations of the Hospital Solutions division's Patient1 clinical product line ("Patient1") and Business1-PFM patient accounting product line ("Business1") as discontinued operations. Patient1 was sold on July 28, 2003, and Business1 was sold effective January 31, 2004. Additionally, the activity related to the Medaphis Services Corporation ("MSC") and Impact Innovations Group ("Impact") businesses, which were sold in 1998 and 1999, respectively, are also reflected as discontinued operations for all periods presented. For more information about the Company's discontinued operations, refer to "Note 4 -- Discontinued Operations and Divestitures" in the Company's Notes to Consolidated Financial Statements. Recent Accounting Pronouncements. In May 2005, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 154, Accounting Changes and Error Correction, ("SFAS No. 154"). SFAS No. 154 supersedes Accounting Principles Board ("APB") Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS No. 154 requires the retroactive application of changes in accounting principles to prior periods' financial statements, unless it is impracticable to determine either the period specific effects or the cumulative effect of the change. SFAS No. 154 does not change the guidance for reporting the correction of an error in previously issued financial statements or the change in an accounting estimate. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 31, 2005. The Company does not believe SFAS No. 154 will have a significant impact on the Company. On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment ("SFAS No. 123(R)"), which is a revision of SFAS No. 123, Accounting for Stock-Based Compensation ("SFAS No. 123"). SFAS No. 123(R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees ("APB No. 25"), and amends SFAS No. 95, Statement of Cash Flows. Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. The original effective date of SFAS No. 123(R) was for interim periods beginning after June 15, 2005. On April 14, 2005, the SEC announced the adoption of a rule that amends the compliance date for SFAS No. 123(R). SFAS No. 123(R) must be adopted by the Company no later than January 1, 2006. The Company adopted SFAS No. 123(R) on January 1, 2006, and elected the modified prospective method. For the years ended December 31, 2005, 2004, and 2003, the Company accounted for share-based payments to employees using APB Opinion No. 25 and the intrinsic value method and, as a result, generally recognizes no compensation cost for employee stock options. Accordingly, the adoption of SFAS No. 123(R)'s fair value method could have a significant impact on the Company's results of operations, although it will have no impact on the Company's overall cash flow. The impact of adoption of SFAS No. 123(R) cannot be determined at this time because it will depend on levels of share-based payments granted in the future. Had the Company adopted SFAS No. 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described on page F-12. F-7 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) In September 2004, the Emerging Issues Task Force ("EITF") reached a tentative conclusion on Issue Number 04-8, The Effect of Contingently Convertible Debt on Diluted Earnings per Share ("EITF No. 04-8"). The EITF concluded that contingently convertible debt instruments should be included in diluted earnings per share computations regardless of whether the market price trigger has been met. The effective date of this consensus is for periods ending after December 15, 2004. In November 2004, the Company exercised its irrevocable option to pay the principal of its Convertible Subordinated Debentures in cash and therefore, EITF No. 04-8 did not have any effect on the Company's Consolidated Statements of Income. Use of Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Bad debt estimates. The Company relies on estimates to determine the bad debt expense and the adequacy of the reserve for doubtful accounts receivable. These estimates are based on the historical experience of the Company and the industry in which it operates. If the financial condition of the Company's customers deteriorated, resulting in an impairment of their ability to make payments, additional allowances may be required. The Company actively reviews its accounts receivable and does not believe actual results will vary materially from the Company's estimates. Accrued expenses. The Company relies on estimates to determine the amounts that are recorded in accrued expenses. Estimates of requirements for legal services and settlements expected to be incurred in connection with a loss contingency and to meet regulatory demands within the Company's business and industry are used to accrue legal expenses. Income tax accruals are estimated based on historical experience of the Company, prevailing tax rates and the current business environment. Restructuring and severance cost accruals are made using estimates of the costs required to effect the desired change within the Company. Revenue Recognition. The Company derives revenue from services and products delivered to the healthcare industry through its two operating divisions: Physician Solutions provides Connective Healthcare solutions that manage the revenue cycle for physician groups. The division provides outsourced revenue cycle management services that are targeted at hospital-affiliated and academic physician practices. Fees for these services are primarily based on a percentage of net collections on the Company's clients' accounts receivable. The division recognizes revenue and bills its customers when the customers receive payment on those accounts receivable. Contracts are typically multi-year in length and require no payment from the customer upon contract signing. Since this is an outsourced service delivered on the Company's proprietary technology, there are no license or maintenance fees to be paid by the physician group customers. The division also recognized approximately 3%, 4% and 5% of its revenue, (or 2%, 3% and 3% of total company revenue), on a monthly service fee and per-transaction basis from the MedAxxis product line, an application service provider ("ASP") physician practice management system, for the years ended December 31, 2005, 2004 and 2003, respectively. The Physician Solutions division does not rely, to any material extent, on estimates in the recognition of this revenue. Revenue is recognized in accordance with Staff Accounting Bulletin ("SAB") No. 104, Revenue Recognition ("SAB No. 104"). Hospital Solutions provides Connective Healthcare solutions that improve revenue cycle and resource management for hospitals. F-8 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) Revenue cycle management solutions primarily include services that allow a hospital's central billing office to more effectively manage its cash flow. These services include electronic and paper transactions, such as claims processing, which can be delivered via the Web or through dedicated electronic data interfaces and high-speed print and mail services. Revenue related to these transaction services are billed and recognized when the services are performed on a per transaction basis. Contracts are typically multi-year in length. The division also recognizes revenue related to direct and indirect payments it receives from payers for the electronic transmission of transactions to the payers. The division recognizes revenue on these transactions at the time the electronic transactions are sent. Revenue is recognized in accordance with SAB No. 104. Resource management solutions include staff and patient scheduling software that enable hospitals to efficiently manage resources, such as personnel and the operating room, to reduce costs and improve their bottom line. The resource management software is sold as a one-time license fee plus implementation services and an annual maintenance fee. Contracts are typically structured to require a portion of the license fee and implementation services to be paid periodically throughout the installation process, including a portion due upon signing. For software contracts that require the division to make significant production, modification or customization changes, the division recognizes revenue for the license fee and implementation services using the percentage-of-completion method over the implementation period. The Hospital Solutions division relies on estimates of work to be completed to determine the amount of revenue to be recognized related to each contract using the percentage of completion method. Because estimates of the extent of completion that differ from actual results could affect revenue, the division periodically reviews the estimated hours to complete major projects and compares these estimates to budgeted hours or days to support the revenue recognized on that project. Approximately 7%, 8% and 9% of the division's revenue (or 2%, 2% and 2% of total Company revenue) was determined using the percentage-of-completion method of accounting for the years ended December 31, 2005, 2004, and 2003, respectively. When the division receives payment prior to shipment or fulfillment of its significant obligations, the Company records such payments as deferred revenue and recognizes them as revenue upon shipment or fulfillment of significant obligations. An unbilled receivable is recorded when the division recognizes revenue on the percentage-of-completion basis prior to achieving a contracted billing milestone. Additionally, an unbilled receivable is recorded when revenue is earned, but the customer has not been invoiced due to the terms of the contract. For minor add-on software license sales where no significant customization remains outstanding, the fee is fixed, an agreement exists and collectibility is probable, the division recognizes revenue upon shipment. For software maintenance, the division defers billed maintenance and recognizes revenue ratably over the term of the maintenance agreement, which is typically one year. Revenue recognized on the percentage-of-completion basis is done so in accordance with AICPA Statement of Position ("SOP") 81-1, Accounting for Performance of Construction Type and Certain Production Type Contracts. Revenue recognized upon software shipment is done so in accordance with SOP 97-2, Software Revenue Recognition ("SOP 97-2"). For arrangements that include one or more elements, or multiple-element arrangements, to be delivered at a future date, revenue is recognized in accordance with SOP 97-2 as amended by SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, with Respect to Certain Transactions. SOP 97-2, as amended, requires the Company to allocate revenue to each element in a multiple-element arrangement based on the element's respective vendor-specific objective evidence, or VSOE, of fair value. Where VSOE does not exist for all delivered elements (typically software license fees) revenue from multiple-element arrangements is recognized using the residual method. Under the residual method, if VSOE of the fair value of the undelivered elements exists, the Company defers revenue recognition of the fair value of the undelivered elements. The remaining portion of the arrangement fee is then recognized either by using the percentage-of-completion method if significant F-9 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) production, modification or customization is required or upon delivery, assuming all other conditions for revenue recognition have been satisfied. VSOE of fair value of maintenance services is based upon the amount charged for maintenance when purchased separately, which is the renewal rate. Maintenance services are typically stated separately in an arrangement. VSOE of fair value of professional services (i.e., implementation, consulting services and training classes not essential to the functionality of the software) is based upon the price charged when professional services are sold separately and is based on an hourly rate for professional services or per training class fees. Cash and Cash Equivalents. Cash and cash equivalents include all highly liquid investments with an initial maturity of no more than 90 days at the date of purchase. Restricted Cash. At December 31, 2005, and 2004, restricted cash primarily represents amounts collected on behalf of certain Physician Solutions and Hospital Solutions clients, a portion of which is held in trust until it is remitted to such clients. Fair Value of Financial Instruments. The carrying amount of all of the Company's financial instruments approximates fair value. Additionally, the Company had unused letters of credit in the amount of $2.9 million and $2.8 million at December 31, 2005, and 2004, respectively. Property and Equipment. Property and equipment, including equipment under capital leases, are stated at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally ten years for furniture and fixtures, three to ten years for equipment and twenty years for buildings. Leasehold improvements are recorded at cost and amortized over the remaining term of the lease or the useful life of the asset, whichever period is shorter. The Company recorded depreciation expense of approximately $6.8 million, $7.8 million and $9.4 million in 2005, 2004 and 2003, respectively. Goodwill. Goodwill represents the excess of the cost of businesses acquired and the value of their workforce in the Physician Solutions division in 1995 and the Hospital Solutions division from 1995 to 2005 over the fair market value of their identifiable net assets. The Company performs a periodic review of its goodwill and other indefinite lived intangible assets for impairment as of December 31 each year or sooner if indicators of impairment exist. The Company's initial impairment and periodic review of its goodwill and other indefinite lived intangible assets were based upon a discounted future cash flow analysis that included revenue and cost estimates, market growth rates and appropriate discount rates. As of December 31, 2005, and 2004, the Company did not record an impairment of goodwill or indefinite-lived intangible assets as a result of the review. Trademarks. Trademarks represent the value of the trademarks acquired in the Hospital Solutions division from 2000 to 2005. The Company expects the trademarks to contribute to cash flows indefinitely and therefore deems the trademarks to have indefinite useful lives. Client Lists. Client lists represent the value of clients acquired in the Physician Solutions division from 1992 to 1996 and the Hospital Solutions division from 1995 to 2005. The Company amortizes client lists over their estimated useful lives, which range from five to ten years. Developed Technology. Developed technology represents the value of the systems acquired in the Hospital Solutions division from 2000 to 2005. The Company amortizes these intangible assets over their estimated useful lives of five years. Software Development Costs. Software development includes costs incurred in the development or the enhancement of software in the Physician Solutions and Hospital Solutions divisions for resale or internal use. F-10 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) Software development costs, related to external use software, are capitalized upon the establishment of technological feasibility for each product and capitalization ceases when the product or process is available for general release to customers. Technological feasibility is established when all planning, designing, coding and testing activities required to meet a product's design specifications are complete. Technological feasibility for relatively minor enhancements to an existing product may also be established using a working model provided that there are no major changes to the functions of the product and there are no high-risk development issues. The Company amortizes external use software development costs over the greater of the ratio that current revenues bear to total and anticipated future revenues for the applicable product or the straight-line method over the estimated economic lives of the assets, which are generally three to five years. The Company monitors the net realizable value of all capitalized external use software development costs to ensure that it can recover its investment through future sales. Software development costs, related to internal use software, are capitalized after the preliminary project stage is complete, when management with the relevant authority authorizes and commits to the funding of the software project and it is probable that the project will be completed and the software will be used to perform the function intended. Capitalization of development costs related to upgrades and enhancements of existing internal use software are capitalized only when such expenditures result in additional functionality. Capitalization ceases no later than the point at which the project is substantially complete and ready for its intended use. The Company expenses software development costs, related to internal use software, as incurred during the planning and post implementation phases of development. The Company amortizes internal-use software on a straight-line basis over its estimated useful life, generally five years. Research and Development Costs. The Company expenses research and development costs as incurred. The Company recorded research and development costs of approximately $11.2 million, $8.3 million and $8.0 million in 2005, 2004 and 2003, respectively. These amounts are included in Selling, General and Administrative expenses in the Company's Consolidated Statements of Income. Advertising Costs. The Company expenses advertising costs as incurred. The Company recorded advertising costs of approximately $0.5 million, $0.7 million and $0.7 million in 2005, 2004, and 2003, respectively. Shipping and Postage Costs. The Company expenses shipping and postage costs as incurred. These costs are primarily incurred related to providing print and mail services to customers, which are billed to the customer and included in revenue. The Company recorded shipping and postage costs of approximately $26.3 million, $23.8 million and $19.3 million in 2005, 2004, and 2003, respectively. These amounts are included in Cost of Services in the Company's Consolidated Statements of Income. Stock-Based Compensation Plans. In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure ("SFAS No. 148"). SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123, to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based compensation and the effect of the method used on reported results. SFAS No. 148 is effective for financial statements for fiscal years ending after December 15, 2002 and for interim periods beginning after December 15, 2002. The annual disclosure requirements of SFAS No. 148 were adopted by the Company on January 1, 2003. As previously discussed, SFAS No. 123(R) was issued on December 16, 2004, with a revised effective date no later than January 1, 2006. The Company adopted SFAS 123(R) on January 1, 2006. F-11 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) At December 31, 2005, the Company has four stock-based compensation plans described more fully in Note 13. The Company accounts for its stock-based compensation plans under APB Opinion No. 25. No stock-based compensation cost is reflected in the Company's Consolidated Statements of Income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and net income per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation. YEAR ENDED DECEMBER 31, -------------------------- 2005 2004 2003 ------- ------- ------- (IN THOUSANDS, EXCEPT PER SHARE DATA) Net income as reported................................. $37,369 $48,158 $11,989 Deduct: total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects.................... (4,661) (4,334) (4,210) ------- ------- ------- Pro forma net income................................... $32,708 $43,824 $ 7,779 ======= ======= ======= Net income per common share: Basic -- as reported................................. $ 1.24 $ 1.56 $ 0.39 ======= ======= ======= Basic -- pro forma.................................. $ 1.09 $ 1.42 $ 0.25 ======= ======= ======= Diluted -- as reported............................... $ 1.12 $ 1.46 $ 0.37 ======= ======= ======= Diluted -- pro forma................................. $ 0.98 $ 1.32 $ 0.24 ======= ======= ======= Legal Costs. The Company expenses ordinary legal and administrative fees, costs and expenses as incurred. Legal and administrative fees, costs, expenses, damages or settlement losses for specific legal matters that the Company determines to be probable are accrued at such time when they are reasonably estimable. Income Taxes. The Company recognizes deferred income taxes for the tax consequences of "temporary differences" between financial statement carrying amounts and the tax bases of existing assets and liabilities. The Company determines deferred tax assets and liabilities by reference to the tax laws and changes to such laws. Management includes the consideration of future events in assessing the likelihood that the Company will realize tax benefits. See Note 15 where the Company discusses the realizability of the deferred tax assets. F-12 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) Net Income Per Share. Net income per common share-basic is calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period. Net income per common share-diluted reflects the potential dilution that could occur from common shares issuable through stock options and warrants. The following sets forth the computation of basic and diluted net income per common share (in thousands, except per share data): YEAR ENDED DECEMBER 31, -------------------------- 2005 2004 2003 ------- ------- ------- Net income.. $37,369 $48,158 $11,989 ======= ======= ======= Common shares outstanding: Shares used in computing net income per common share-basic....................................... 30,084 30,843 30,594 Effect of potentially dilutive stock options and warrants.. 3,302 2,239 2,067 ------- ------- ------- Shares used in computing net income per common share-- diluted... 33,386 33,082 32,661 ======= ======= ======= Net income per common share: Basic... $ 1.24 $ 1.56 $ 0.39 ======= ======= ======= Diluted... $ 1.12 $ 1.46 $ 0.37 ======= ======= ======= Options to purchase 0.4 million and 1.6 million shares of common stock outstanding during 2005 and 2004, respectively, were excluded from the computation of diluted earnings per share because the exercise prices were greater than the average market price of the common shares, and therefore, the effect would have been antidilutive. During the year ended December 31, 2005, the Company's average market price exceeded the market trigger price of the Company's contingently convertible debt instrument and as such, the computation of diluted earnings per share includes approximately 0.6 million shares, related to the convertible debt instrument (see Note 9 for additional information). Foreign Currency Translation and Comprehensive (Loss) Income. The functional currency of the Company's operations outside of the United States is the local country's currency. Consequently, assets and liabilities of operations outside the United States are translated into dollars using exchange rates at the end of each reporting period. Revenue and expenses are translated at the average exchange rates prevailing during the period. Cumulative translation gains and losses are reported in accumulated other comprehensive (loss) income. For the years ended December 31, 2005, 2004, and 2003, the only component of other comprehensive loss is the net foreign currency translation, which was $(0.1) million, ($0.1) million and $0.1 million, respectively. Guarantees. In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ("FIN No. 45"). FIN No. 45 requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken by issuing the guarantee. FIN No. 45 also requires additional disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees it has issued. Certain of the Company's sales agreements contain infringement indemnity provisions that are covered by FIN No. 45. Under these sales agreements, the Company agrees to defend and indemnify a customer in connection with infringement claims made by third parties with respect to the customer's authorized use of the Company's products and services. The indemnity obligations contained in sales agreements generally have no specified expiration date and generally limit the award to the amount of fees paid. The Company has not previously incurred costs to settle claims or pay awards under these indemnification obligations. Also, the Company maintains F-13 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) membership in a group captive insurance company for its workers compensation insurance. The member companies agree to jointly insure the group's liability risks up to a certain threshold. As a member, the Company guarantees to pay an assessment, if an assessment becomes due, as a result of insured losses by its members. This guarantee will never exceed a percentage of the Company's loss funds (an amount that is based on the Company's insured five-year loss history). The Company issues a letter of credit to the group captive insurance company as security for potential assessments and to meet any surplus needs. At December 31, 2005 and 2004, the Company had outstanding letters of credit to the group captive insurance company amounting to approximately $1.8 million and $1.5 million, respectively. As a result, the Company's estimated fair value of the infringement indemnity provision obligations and the captive insurance guarantee is nominal. Related Party Transactions. In November 2000, pursuant to the employment agreement between the Company and Philip M. Pead, the Company's Chairman of the Board, Chief Executive Officer, and President, the Company entered into a promissory note agreement with Mr. Pead for $250,000. This amount is included in other long-term assets in the accompanying consolidated balance sheets at December 31, 2005 and 2004. The loan is secured by an aggregate of 74,000 shares of Common Stock, which Mr. Pead purchased in the open market with the proceeds of the note, and is payable in full upon the earlier to occur of the termination of Mr. Pead's employment or the sale of all or any part of those shares. Any overdue payment on the loan bears interest at a rate equal to the rate of interest then imputed by the Internal Revenue Service plus 4% per annum, or the maximum rate permitted by law, whichever is lower. Because the shares were purchased in the open market by Mr. Pead, and the note only bears interest in the event of an overdue payment, the Company did not record any compensation expense associated with this arrangement at inception, and has not recorded any compensation expense in any subsequent period. 2. OTHER EXPENSES BINDING ARBITRATION On March 10, 2006, the Company concluded binding arbitration for a claim of breach of contract arising from an acquisition completed in 2000. The binding arbitration resulted in an award to be paid by Per-Se of approximately $1.3 million, including interest of $0.3 million. The Company included the award in Other Expenses and the interest in Interest Expense in the Company's 2005 Consolidated Statement of Income. In Note 18, the costs associated with the award are classified in the Corporate segment. NDCHEALTH TRANSITION On August 29, 2005, Per-Se and NDCHealth Corporation ("NDCHealth") announced that they had signed definitive agreements for the acquisition of NDCHealth, a leading provider of healthcare technology and information solutions by Per-Se. The transaction was completed on January 6, 2006 (for more information about the Company's acquisition of NDCHealth, refer to "Note 19 -- Subsequent Events").

The Company recorded integration costs related to the NDCHealth acquisition totaling approximately $74,000 during the year ended December 31, 2005, and included these costs in other expenses in the Company's Consolidated Statements of Income. In Note 18, these expenses are classified in the Corporate segment. ADDITIONAL PROCEDURES As a result of allegations of improprieties made during 2003 and 2004, the Company's external auditors advised the Company and the Audit Committee of the Board of Directors that additional procedures should be performed related to the allegations. These additional procedures were required due to Statement of Auditing Standards No. 99, Consideration of Fraud in a Financial Statement Audit, that F-14 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) became effective for periods beginning on or after December 15, 2002. Due to the volume and, in some cases, vague nature of many of the allegations, the scope of the additional procedures was broad and extensive. The additional procedures included the review of certain of the Company's revenues, expenses, assets and liabilities accounts for the years 2001 through 2003. The Company recorded costs related to the additional procedures totaling approximately $6.3 million during the year ended December 31, 2004, and included these costs in other expenses in the Company's Consolidated Statements of Income. In Note 18, these expenses are classified in the Corporate segment. GAIN ON SETTLEMENT WITH LLOYD'S On May 10, 2004, the Company reached a settlement with the Company's former insurance carrier, Certain Underwriters at Lloyd's of London (collectively "Lloyd's"). On July 7, 2004, pursuant to the settlement, as amended, Lloyd's paid the Company $16.2 million in cash. As of the payment date, the Company had an approximately $14.7 million receivable from Lloyd's and recognized a gain of approximately $1.5 million on the settlement for the year ended December 31, 2004. EXECUTIVE OFFICE RELOCATION On July 30, 2004, the Company relocated its principal executive office to Alpharetta, Georgia. The Company entered into a noncancelable operating lease for that office space commencing July 1, 2004, which will expire in July 2014. While the new landlord will assume the payments for the lease of the Company's former corporate office space, the Company recorded a non-cash expense related to the lease expense of approximately $1.0 million upon its exit of the former office facility. Amounts received from the landlord are considered incentives, which were recorded as a liability and are being amortized over the lease term. OTHER In 2003, the Company recorded net expenses of $0.8 million for severance costs and restructuring expenses related to the realignment of the Company into the Physician Solutions and Hospital Solutions divisions. 3. ACQUISITIONS On December 1, 2005, the Company acquired privately held Integra Solutions ("Integra"), a hospital revenue cycle management outsourcing firm located in Norcross, Georgia, for a purchase price of approximately $10.8 million. The Company paid approximately $5.4 million of the purchase price at closing and will pay the remaining purchase price of approximately $5.4 million at the one-year anniversary. In addition, if Integra achieves certain revenue objectives over the first two years, the Company will pay an additional purchase price amount of approximately $3.8 million. Since the amount is contingent, the additional purchase price is not included in the Company's December 31, 2005, Consolidated Balance Sheet. Integra Solutions offers a comprehensive suite of services designed to help healthcare providers improve their bottom line results. This includes a full range of outsourcing options, from health information and patient accounting management consulting to auditing and accounts receivable services. The Company currently provides outsourcing services to more than 80 hospitals, and Integra will be a key component of its outsourcing growth strategy in the hospital market. The Company recorded the acquisition using the purchase method of accounting and, accordingly, has preliminarily allocated the purchase price to the assets acquired and liabilities assumed based on their estimated fair market value at the date of acquisition. Approximately $2.0 million of the purchase price was allocated to client lists and other with a four to seven-year life, approximately $0.9 million was F-15 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) allocated to a developed technology with a five-year life and approximately $5.9 million of the purchase price was allocated to indefinite lived intangible assets. The remaining $1.7 million of the purchase price was allocated to tangible assets acquired. The operating results of the acquisition are included in the Company's Consolidated Statements of Income from the date of acquisition in the Hospital Solutions division. The pro-forma impact of this acquisition was immaterial to the financial statements of the Company and therefore has not been presented. On May 28, 2004, the Company entered into a five-year contract to provide print and mail services for a new customer. As part of the transaction, the Company purchased substantially all of the production assets and personnel of that customer's hospital and physician patient statement and paper claims print and mail business for cash consideration of approximately $1.1 million. In addition, the Company recorded acquisition liabilities of approximately $1.0 million associated with the transaction. The Company recorded the acquisition using the purchase method of accounting and, accordingly, allocated the purchase price to the assets acquired and liabilities assumed based on their estimated fair market value at the date of acquisition. Approximately $1.9 million of the purchase price was allocated to a finite-lived intangible asset with a five-year life. The remaining $0.2 million of the purchase price was allocated to tangible assets acquired. The operating results of the acquisition are included in the Company's Consolidated Statements of Income from the date of acquisition in the Hospital Solutions division. The pro forma impact of this acquisition was immaterial to the financial statements of the Company and therefore has not been presented. 4. DISCONTINUED OPERATIONS AND DIVESTITURES In June 2003, the Company announced that it agreed to sell Patient1 to Misys Healthcare Systems, a division of Misys plc ("Misys") for $30 million in cash. Patient1 was the Company's only clinical product line, and its sale allowed the Company to better focus on optimizing reimbursement and improving administrative efficiencies for physician practices and hospitals. The sale was completed on July 28, 2003, and the Company recognized a gain on the sale of Patient1 of approximately $10.4 million, net of taxes of approximately $0.5 million, subject to closing adjustments. Net proceeds on the sale of Patient1 were approximately $27.9 million, subject to closing adjustments. The Company and Misys entered into binding arbitration regarding the final closing adjustments, and on May 21, 2004, the arbitrator awarded the Company approximately $4.3 million. On June 1, 2004, the Company received payment of approximately $4.5 million, which included interest of approximately $0.2 million. The Company recognized an additional gain on sale of approximately $3.8 million, net of taxes of approximately $0.2 million, in 2004. In December 2005, the Company determined that payment was not required on a Patient1 tax liability that was not included in the sale to Misys. Therefore, the approximately $0.4 million liability was reversed and recognized as income in the Company's Consolidated Statement of Income. In September 2003, the Company initiated a process to sell Business1. As with the sale of Patient1, the discontinuance of Business1 allowed the Company to focus resources on solutions that provide meaningful, strategic returns for the Company, its customers and its shareholders. Pursuant to SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("SFAS No. 144"), the Company wrote down the net assets of Business1 to fair market value, less costs to sell, and incurred an $8.5 million expense. The Company completed the sale of Business1 effective January 31, 2004, to a privately held company for $0.6 million. No cash consideration was received at closing and the Company has not recognized proceeds on the sale. The Company does not anticipate receiving payment for the sale of Business1, however, the sale improved the Company's profitability and cash flow. F-16 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) Pursuant to SFAS No. 144, the consolidated financial statements of the Company have been presented to reflect Patient1 and Business1 as discontinued operations for all periods presented. Summarized operating results for the discontinued operations are as follows: YEAR ENDED DECEMBER 31, -- 2004 2003 --------------------------- ---------------------------- PATIENT1 BUSINESS1 TOTAL PATIENT1 BUSINESS1 TOTAL -------- --------- ----- -------- --------- ------- (IN THOUSANDS) Revenue..................... $ -- $ 106 $ 106 $15,247 $ 474 $15,721 ==== ===== ===== ======= ======= ======= Loss from discontinued operations before income taxes..................... $(18) $(303) $(321) $(1,270) $(3,589) $(4,859) Income tax expense........... -- -- -- 46 -- 46 ---- ----- ----- ------- ------- ------- Loss from discontinued operations, net of tax..... $(18) $(303) $(321) $(1,316) $(3,589) $(4,905) ==== ===== ===== ======= ======= ======= There were no assets and liabilities for the discontinued operations at December 31, 2005, and 2004. In October of 2001, the Company received $1.0 million in cash from the buyer of the government division of Impact when the term of the purchase agreement escrow expired. This amount was recorded as a component of discontinued operations. In May of 2001, the Company received an insurance settlement related to a matter filed against the commercial division of Impact of approximately $3.0 million, which was recorded as a component of discontinued operations. The Company continues to pursue claims against a former vendor of this division for damages incurred in this matter. During the years ended December 31, 2005, 2004, and 2003, the Company also incurred expenses of approximately $20,000, $14,000 and $0.9 million, respectively, which were primarily legal costs, associated with MSC and Impact. Pursuant to SFAS No. 144, the consolidated financial statements of the Company have been presented to reflect the activity associated with MSC and Impact as discontinued operations for all periods presented. The net operating results of these segments have been reported in the Consolidated Statements of Income as "Loss from discontinued operations, net of tax -- Other" and the net cash flows have been reported in the Consolidated Statements of Cash Flows as "Net cash used for discontinued operations." 5. RESTRUCTURING EXPENSES In early 1995, the Company initiated a reengineering program focused upon its billing and accounts receivable management operations (the "Reengineering Project"). As part of the Physician Solutions Restructuring Plan, the Company recorded restructuring reserves in 1995 through 1996. In 1996, the Company abandoned its Reengineering Project. The Company periodically reevaluates the adequacy of the reserves established for the Physician Solutions Restructuring Plan. In 1997 and 1999 the Company recorded an additional expense of $1.7 million and $0.3 million, respectively, for lease termination costs. A description of the type and amount of restructuring costs, recorded at the commitment date and subsequently incurred for the restructurings discussed above, is as follows: RESERVE COSTS RESERVE COSTS RESERVE COSTS RESERVE BALANCE PAID OR BALANCE PAID OR BALANCE PAID OR BALANCE JANUARY 1, OTHERWISE DECEMBER 31, OTHERWISE DECEMBER 31, OTHERWISE DECEMBER 31, 2003 SETTLED 2003 SETTLED 2004 SETTLED 2005 ---------- --------- -------------- --------- -------------- --------- --------------- (IN THOUSANDS) Lease termination $1,980 $(550) $1,430 $(326) $1,104 $(297) $807 costs.............. F-17 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) The terminated leases have various expiration dates through 2011. The estimated lease termination costs to be incurred within the next 12 months are classified in accrued expenses in the Company's Consolidated Balance Sheets. The estimated lease termination costs to be incurred beyond the next 12 months are classified in other obligations in the Company's Consolidated Balance Sheets. 6. PROPERTY AND EQUIPMENT Property and equipment consists of the following: AS OF DECEMBER 31, -------------------- 2005 2004 --------- --------- (IN THOUSANDS) Land... $ 406 $ 590 Buildings.. 2,751 2,751 Furniture and fixtures..................................... 14,936 14,876 Equipment.. 105,212 106,539 Equipment under capital leases............................. 711 625 Leasehold improvements..................................... 6,797 6,250 --------- --------- 130,813 131,631 Less accumulated depreciation.............................. (113,970) (116,119) --------- --------- $ 16,843 $ 15,512 ========= ========= 7. INTANGIBLE ASSETS Intangible assets consist of the following: AS OF AS OF DECEMBER 31, 2005 DECEMBER 31, 2004 ---------------------- ---------------------- ESTIMATED GROSS ACCUMULATED GROSS ACCUMULATED USEFUL LIFE AMOUNT AMORTIZATION AMOUNT AMORTIZATION ----------- -------- ----------- -------- ------------ Goodwill................... Indefinite $ 44,707 $ (6,508) $ 39,057 $ (6,508) Client lists................ 5-10 years 48,052 (42,795) 46,181 (39,305) Developed technology........ 5 years 5,486 (4,319) 4,616 (3,229) Trademarks................. Indefinite 1,586 -- 1,316 -- Software development costs..................... 5 years 31,914 (18,121) 25,794 (14,589) Other....................... 1 year 150 (7) -- -- -------- -------- -------- -------- $131,895 $(71,750) $116,964 $(63,631) ======== ======== ======== ======== On December 1, 2005, the Company acquired Integra for a purchase price of approximately $10.8 million. The Company paid approximately $5.4 million of the purchase price at closing and will pay the remaining purchase price of approximately $5.4 million at the one-year anniversary. In addition, if Integra achieves certain revenue objectives over the first two years, the Company will pay an additional purchase price amount of approximately $3.8 million. Since the amount is contingent, the additional purchase price is not included in the Company's December 31, 2005, Consolidated Balance Sheet. The Company recorded the acquisition using the purchase method of accounting and, accordingly, has preliminarily allocated the purchase price to the assets acquired and liabilities assumed based on their estimated fair market value at the date of acquisition. Approximately $2.0 million of the purchase price was allocated to client lists and other with a four to seven-year life, approximately $0.9 million was allocated to a developed technology with a five-year life and approximately $5.9 million of the purchase F-18 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) price was allocated to indefinite lived intangible assets. The remaining $1.7 million of the purchase price was allocated to tangible assets acquired. On May 28, 2004, the Company entered into a five-year contract to provide print and mail services for a new customer. As part of the transaction, the Company purchased substantially all of the production assets and personnel of that customer's hospital and physician patient statement and paper claims print and mail. The Company recorded the acquisition using the purchase method of accounting and, accordingly, allocated the purchase price to the assets acquired and liabilities assumed based on their estimated fair market value at the date of acquisition. Approximately $1.9 million of the purchase price was allocated to a finite-lived intangible asset with a five-year life. Expenditures on capitalized software development costs were approximately $6.1 million, $6.7 million and $4.0 million in 2005, 2004 and 2003, respectively. Amortization expense related to the Company's capitalized software costs totaled $3.5 million, $2.6 million and $2.1 million in 2005, 2004 and 2003, respectively. The unamortized balance of software development costs at December 31, 2005, and 2004 was $13.8 million and $11.2 million, respectively. The Company amortizes software development costs using the straight-line method over the estimated useful lives of the assets, which are generally three to five years. The acquisition related intangible asset amortization expense estimated as of December 31, 2005, for the five years following 2005 and thereafter is as follows (in thousands): 2006.. $1,823 2007.. 1,326 2008.. 1,273 2009.. 1,055 2010.. 835 Thereafter.. 255 ------ $6,567 ====== 8. ACCRUED EXPENSES Accrued expenses consist of the following: AS OF DECEMBER 31, ------------------ 2005 2004 -------- -------- (IN THOUSANDS) Accrued restructuring and severance costs, current.......... $ 232 $ 262 Accrued legal and accounting costs......................... 1,653 3,494 Accrued legal settlements.................................. 944 400 Accrued taxes... 887 1,301 Accrued interest... 312 4 Funds due clients.. 3,117 3,107 Accrued costs -- businesses acquired....................... 5,485 502 Other.. 4,372 5,558 ------- ------- $17,002 $14,628 ======= ======= F-19 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) 9. LONG-TERM DEBT Long-term debt consists of the following: AS OF DECEMBER 31, ------------------ 2005 2004 -------- -------- (IN THOUSANDS) 3.25% Convertible Subordinated Debentures due 2024.......... $125,000 $125,000 Capital lease obligations, weighted average effective interest rate of 1.6% and 3.1% in 2005 and 2004, respectively.. 625 625 -------- -------- 125,625 125,625 Less current portion...................................... (135) (98) -------- -------- $125,490 $125,527 ======== ======== On February 20, 1998, the Company issued $175 million of 9 1/2 Senior Notes due 2005 (the "Notes"). On March 17, 2003, the Company repurchased $15.0 million of the Notes at par plus accrued interest of approximately $0.1 million. The Company wrote off approximately $0.2 million of deferred debt issuance costs associated with the original issuance of the Notes related to this repurchase, which is included in loss on extinguishment of debt in the Company's Consolidated Statement of Income for the year ended December 31, 2003. On August 12, 2003, the Company commenced a cash tender offer for its then outstanding $160 million of Notes (the "Tender Offer"). On September 11, 2003, the Company repurchased $143.6 million of the Notes that were tendered at the redemption price of 102.625% of the principal amount, as required under the Indenture governing the Notes, and accrued interest of approximately $1.0 million. The remaining $16.4 million of the Notes were retired on September 18, 2003, through a call initiated by the Company on August 12, 2003, at the redemption price of 102.375% of the principal amount plus accrued interest of approximately $10,000 (the "Call"). The Company wrote-off approximately $1.4 million of deferred issuance costs associated with the original issuance of the Notes related to their retirement through the Tender Offer and the Call, which are included in loss on extinguishment of debt in the Company's Consolidated Statements of Income. In addition, the Company incurred expenses associated with the retirement of the Notes of approximately $4.7 million, including the Tender Offer premium and the Call premium which are also included in loss on extinguishment of debt in the Company's Consolidated Statement of Operations. On September 11, 2003, the Company entered into a $175 million Credit Agreement (the "Credit Agreement"), consisting of a $125 million Term Loan B (the "Term Loan B") and a $50 million revolving credit facility (the "Revolving Credit Facility"). The Company had approximately $118.8 million outstanding under the Term Loan B as of June 30, 2004, under a LIBOR-based interest contract bearing interest at 5.36%. The Company has had no borrowings outstanding under the Revolving Credit Facility since its inception. On June 30, 2004, the Company issued $125 million aggregate principal amount of 3.25% Convertible Subordinated Debentures due 2024 (the "Debentures") to qualified institutional buyers pursuant to Rule 144A of the Securities Act of 1933, as amended. As originally issued, the Debentures were convertible into shares of the Company's Common Stock at an initial conversion rate of 56.0243 shares per $1,000 principal amount (a conversion price of approximately $17.85) once the Company's Common Stock share price reaches 130% of the conversion price, or a share price of approximately $23.20. In November 2004, the Company exercised its irrevocable option to pay, when due, the principal of Debentures submitted for conversion in cash rather than shares of the Company's Common Stock. The Company will satisfy any amount above the conversion trigger price of $17.85 through the issuance of F-20 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) Common Stock. The Debentures mature on June 30, 2024, and are unsecured. Interest on the Debentures is payable semiannually at the rate of 3.25% per annum on June 30 and December 30 of each year, beginning on December 30, 2004. The Company may redeem the Debentures either in whole or in part beginning July 6, 2009. The holders may require the Company to repurchase the Debentures on June 30, 2009, 2014,

and 2019 or upon a fundamental change, as defined in the Indenture governing the Debentures. The Company used the proceeds from issuance of the Debentures, together with cash on hand, to retire the $118.8 million outstanding under the Term Loan B, as well as to repurchase, for approximately $25 million, an aggregate of approximately 2.0 million shares of the Company's outstanding common stock, at the market price of $12.57 per share, in negotiated transactions concurrently with the Debentures offering. In addition, the Company incurred expenses associated with the retirement of the Term Loan B of approximately $5.9 million, which included the write-off of approximately $3.5 million of deferred debt issuance costs, and which is classified as loss on extinguishment of debt in the Company's Consolidated Statements of Income. On June 30, 2004, the Company also amended the Revolving Credit Facility to increase its capacity from $50 million to $75 million, to extend its maturity to three years, and to lower the interest rate from LIBOR plus amounts ranging from 3.0% to 3.5% to LIBOR plus amounts ranging from 2.5% to 3.0%. The Company is required to pay an annual commitment fee of 0.5% of the unused capacity related to the Revolving Credit Facility. The Company did not incur any borrowings under the Revolving Credit Facility in connection with the retirement of the Term Loan B or the share repurchase. The Company intends to use the Revolving Credit Facility, as needed, for future investments in operations, including capital expenditures, strategic acquisitions, to secure its letters of credit, as needed, and other general corporate purposes. The Company has not incurred any borrowings under the Revolving Credit Facility as of December 31, 2005. All obligations under the Revolving Credit Facility are fully and unconditionally guaranteed, on a senior secured basis, jointly and severally by all of the Company's present and future domestic and material foreign subsidiaries (the "Subsidiary Guarantors"). The financial statements of the Subsidiary Guarantors have not been presented, as all subsidiaries, except for certain minor foreign subsidiaries, have provided guarantees, and the parent company does not have any significant operations or assets separate from its investment in those subsidiaries. Any non-guarantor subsidiaries are minor individually and in the aggregate to the Company's consolidated financial statements. There are no restrictions on the Subsidiary Guarantors that would prohibit the transfer of funds or assets to the parent company by dividend or loan. The Revolving Credit Facility contains financial and other restrictive covenants, including, without limitation, those restricting additional indebtedness, lien creation, dividend payments, asset sales and stock offerings, and those requiring a minimum net worth, maximum leverage and minimum fixed charge coverage, each as defined in the Revolving Credit Facility. The Company was in compliance with all applicable covenants as of December 31, 2005. The Company's policy is to amortize debt issuance costs using the straight-line method over the life of the debt agreement. Amortization expense related to debt issuance costs on the Notes, the Revolving Credit Facility, Credit Agreement and the Debentures for the years ended 2005, 2004, and 2003 were $1.3 million, $1.3 million and $1.5 million, respectively. F-21 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) The aggregate maturities of long-term debt, including capital leases, are as follows at December 31, 2005 (in thousands):
2006.. $ 135 2007.. 138
2008.. 143 2009.. 147
2010.. 62 Thereafter.. 125,000 -------- $125,625
======== The Company's capital leases consist principally of leases for equipment. As of December 31, 2005, the net book value of equipment subject to capital leases totaled $0.6 million. 10. LEASE COMMITMENTS The Company leases office space and equipment under noncancelable operating leases, which expire at various dates through 2016. The Company's operating leases generally have one to three year terms with renewal options and may contain customary rent holidays, rent concessions or leasehold improvement incentives. Rent expense is recognized on a straight-line basis over the term of the lease, including, when applicable, rent holidays, rent concessions and leasehold improvement incentives. Rent expense was $14.2 million, $14.1 million and $14.4 million for the years ended December 31, 2005, 2004, and 2003, respectively. Future minimum lease payments under noncancelable operating leases are as follows (in thousands): 2006.. $12,028
2007.. 9,726 2008.. 8,038
2009.. 7,197 2010.. 5,805
Thereafter.. 16,422 ------- $59,216 ======= 11. LEGAL MATTERS PENDING LEGAL MATTERS The Company is subject to claims, litigation and official billing inquiries arising in the ordinary course of its business. These matters include, but are not limited to, lawsuits brought by former customers with respect to the operation of the Company's business. The Company has also received written demands from customers and former customers that have not resulted in legal action. Within the Company's industry, federal and state civil and

criminal laws govern medical billing and collection activities. These laws provide for various fines, penalties, multiple damages, assessments and sanctions for violations, including possible exclusion from federal and state healthcare payer programs. The Company believes that it has meritorious defenses to the claims and other issues asserted in pending legal matters; however, there can be no assurance that such matters or any future legal matters will not have an adverse effect on the Company. Amounts of awards or losses, if any, in pending legal matters have not been reflected in the financial statements unless probable and reasonably estimable. F-22 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) SETTLED LEGAL MATTERS On March 10, 2006, the Company concluded binding arbitration for a claim of breach of contract arising from an acquisition completed in 2000. The binding arbitration resulted in an award to be paid by Per-Se of approximately $1.3 million, including interest of $0.3 million. The Company included the award in Other Expenses and the interest in Interest Expense in the Company's 2005 Consolidated Statement of Income. In Note 18, the costs associated with the award are classified in the Corporate segment. On May 10, 2004, the Company reached a settlement with the Company's former insurance carrier, Lloyd's. In the settlement, Lloyd's agreed to pay the Company $20 million in cash by July 9, 2004. Lloyd's also agreed to defend, settle or otherwise resolve, at their expense, the two remaining pending claims covered under the errors and omissions ("E&O") policies issued to the Company by Lloyd's. In exchange, the Company provided Lloyd's with a full release of all E&O and directors and officers and company reimbursement ("D&O") policies. The California Superior Court retained jurisdiction to enforce any aspect of the settlement agreement. As of the settlement date, the Company had an $18.3 million receivable from Lloyd's, of which approximately $4.9 million represented additional amounts to be paid by the Company under prior E&O settlements covered by Lloyd's. Effective on May 12, 2004, as a result of negotiations among the Company, Lloyd's, and a party to a prior E&O settlement with the Company, the Lloyd's settlement was amended to reduce by $3.8 million the additional amounts to be paid by the Company under the prior E&O settlements covered by Lloyd's. This amendment reduced the amount of cash payable by Lloyd's to the Company in the settlement from $20 million to $16.2 million, and reduced the amount of the Company's receivable from Lloyd's by $3.8 million. On July 7, 2004, pursuant to the settlement, as amended, Lloyd's paid the Company $16.2 million in cash. As of the payment date, the Company had an approximately $14.7 million receivable from Lloyd's and recognized a gain of approximately $1.5 million on the settlement in the year ended December 31, 2004. 12. STOCKHOLDERS' RIGHTS PLAN On January 21, 1999, the Board approved a stockholders' rights agreement (the "Rights Agreement"). Pursuant to the Rights Agreement, the Company declared a dividend of one right for each outstanding share of Common Stock to stockholders of record at the close of business on February 16, 1999. Each right entitles the registered holder to purchase from the Company a unit (a "Unit") consisting of one one-hundredth of a share of Series A Junior Participating Preferred Stock, without par value, at a purchase price of $75 per Unit. Initially, the rights are deemed to be attached to certificates representing all outstanding shares of Common Stock, and they are not represented by separate rights certificates. Subject to certain exceptions specified in the Rights Agreement, the rights will separate from the Common Stock and become exercisable upon the earlier to occur of (i) 10 business days following a public announcement that a person or group of affiliated or associated persons (an "Acquiring Person") has acquired beneficial ownership of 15% or more of the outstanding Common Stock or (ii) 10 business days following the commencement of a tender offer for the Common Stock. In the event that a person becomes an Acquiring Person, except pursuant to an offer for all outstanding shares of Common Stock that the independent directors of the Company determine to be fair and otherwise in the best interests of the Company and its stockholders (after receiving advice from one or more investment banking firms), each holder of a right will thereafter have the right to receive, upon exercise, Common Stock (or, in certain circumstances, cash, property or other securities of the Company) having a value equal to two times the exercise price of the right (i.e., $150 per Unit). F-23 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) Until a right is exercised, the holder thereof, as such, will have no rights as a stockholder of the Company, including, without limitation, the right to vote or to receive dividends. While the distribution of the rights will not be taxable to stockholders or to the Company, stockholders may, depending upon the circumstances, recognize taxable income in the event that the rights become exercisable for Common Stock (or other consideration) of the Company, or for common stock of the acquiring company, or in the event of the redemption of the rights as set forth above. As of December 31, 2005, and 2004, no rights have become exercisable under this agreement. On May 4, 2000, the Company amended the Rights Agreement to provide that the meaning of the term "Acquiring Person" shall not include Basil P. Regan and Regan Partners, L.P. (collectively, "Regan Fund Management"), so long as Regan Fund Management does not become the beneficial owner of 20% or more of the outstanding shares of Common Stock. Effective March 6, 2002, the Company amended the Rights Agreement to rescind the May 4, 2000, amendment, thereby making Regan Fund Management subject to the 15% beneficial ownership threshold described above. On March 10, 2003, the Company amended the Rights Agreement to provide that the term "Acquiring Person" shall not include ValueAct Capital Partners, L.P. ("ValueAct Partners"), ValueAct Capital Partners II, L.P. ("ValueAct Partners II"), ValueAct Capital International, Ltd. ("ValueAct International"), VA Partners, L.L.C. ("VA Partners"), Jeffrey W. Ubben, George F. Hamel, Jr., and Peter H. Kamin (ValueAct Partners, ValueAct Partners II, ValueAct International, VA Partners and Messrs. Ubben, Hamel and Kamin, and their affiliates, collectively, ("ValueAct"), so long as ValueAct does not become the Beneficial Owner of 20% or more of the then outstanding shares of Common Stock. As of December 31, 2005, and 2004, ValueAct was the beneficial owner of approximately 17.6% and 17.7%, respectively, of the outstanding shares of Common Stock. On February 18, 2005, the Company amended the Rights Agreement to remove Section 23(c) thereof (the "slow hand" provision) in its entirety. Section 23(c) previously provided that if, within 180 days of a public announcement by a third party of an intent or proposal to engage in an acquisition of or business combination with the Company or otherwise to become an Acquiring Person there was an election of directors resulting in a majority of the Board being comprised of persons who were not nominated by the Board in office immediately prior to such election, then following the effectiveness of such election, the rights could not be redeemed for a period of 180 days unless (1) the rights were otherwise then redeemable absent the provisions of paragraph 23(c) and (2) the Board fulfilled certain specified procedural obligations. This amendment also amended and restated Section 29 of the Rights Agreement to create a three-year independent director evaluation ("TIDE") Committee, consisting of independent members of the Board, that will review and evaluate the Rights Agreement at least once every three years to consider whether the maintenance of the Rights Agreement continues to be in the best interest of the Company, its stockholders and other relevant constituencies of the Company. The TIDE Committee may also review and evaluate the Rights Agreement if (1) any person has made an acquisition proposal to the Company or its stockholders, or taken any other action that could cause such person to become an Acquiring Person, and (2) a majority of the members of the TIDE Committee deems such review and evaluation appropriate after giving due regard to all relevant circumstances. On August 26, 2005, the Company and NDCHealth Corporation entered into an Agreement and Plan of Merger (the "Merger Agreement") providing for the Company's acquisition of NDCHealth Corporation. Effective immediately prior to the execution of the Merger Agreement, the Company amended the Rights Agreement with the purpose and intent of rendering the Rights Agreement inapplicable to the transaction. F-24 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) 13. COMMON STOCK OPTIONS AND STOCK AWARDS The Company has several stock option plans including a Non-Qualified Stock Option Plan, a Non-Qualified Stock Option Plan for Employees of Acquired Companies and a Non-Qualified Stock Option Plan for Non-Executive Employees. Options expire ten to eleven years after the date of grant and generally vest over a three-to-five year period. The total number of options available for future grant under these stock option plans was approximately 0.8 million at December 31, 2005. The Company also has a Non-Qualified Non-Employee Director Stock Option Plan (the "Director Plan") for non-employees who serve on the Company's Board of Directors. The Director Plan provides for an initial grant of 10,000 options at a strike price equal to the average of the fair market values for the five trading days prior to the date of the grant. Additionally, each non-employee director receives an annual grant of 10,000 options at each subsequent annual meeting in which the non-employee director is a member of the Board of Directors. All options granted under the Director Plan originally vested over a five-year period and expired eleven years from the date of grant. On April 1, 1999, the Director Plan was amended so that all future options granted under the Director Plan fully vest as of the date of grant but are not exercisable until one year after the date of grant. As of December 31, 2005, the Company had 108,539 options available for future grant under this plan. In June of 1999, in connection with the settlement with the former shareholders of Medical Management Sciences, Inc., the Company issued warrants to purchase 166,667 shares of Common Stock. These warrants expired unexercised on June 25, 2004. Activity related to all stock option plans is summarized as follows (shares in thousands): 2005 2004 2003 ------------------------- ------------------------- ------------------------- WEIGHTED-AVERAGE WEIGHTED-AVERAGE WEIGHTED-AVERAGE SHARES EXERCISE PRICE SHARES EXERCISE PRICE SHARES EXERCISE PRICE ------- --------------- ------- --------------- ------- --------------- Options outstanding as of January 1........ 6,584 $10.19 6,635 $ 8.94 7,319 $ 8.36

Granted.............. 220 $17.39 1,532 $14.15 685 $11.66 Exercised............ (1,187) $ 7.77 (1,003) $ 7.38 (1,159) $ 6.87 Canceled............. (231) $13.76 (580) $11.16 (210) $ 8.84 ------- ------- ------- Options outstanding as of December 31...... 5,386 $10.86 6,584 $10.19 6,635 $ 8.94 ======= ======= ======= Options exercisable as of December 31...... 3,590 $ 9.82 3,731 $ 9.16 3,838 $ 9.31 ======= ======= ======= Weighted-average fair value of options granted during the year................ $ 6.92 $ 5.50 $ 5.25 ======= ======= ======= F-25 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) The following table summarizes information about stock options outstanding and exercisable at December 31, 2005 (shares in thousands): OPTIONS OUTSTANDING -- OPTIONS EXERCISABLE WEIGHTED- ------------------------- NUMBER AVERAGE WEIGHTED- NUMBER WEIGHTED-OUTSTANDING AT REMAINING AVERAGE EXERCISABLE AT AVERAGE DECEMBER 31, CONTRACTUAL EXERCISE DECEMBER 31, EXERCISE RANGE OF EXERCISE PRICES 2005 LIFE (YEARS) PRICE 2005 PRICE ----------------------- -------------- ----------- --------- ------------- --------- $3.75 to $6.25............ 879 6.10 $ 5.90 758 $ 5.88 $6.64 to $7.53............ 1,354 6.20 $ 7.10 1,113 $ 7.10 $7.63 to $12.70............ 1,060 7.25 $10.54 752 $ 9.75 $12.92 to $14.02........... 816 8.96 $13.75 301 $13.62 $14.61 to $16.13........... 937 6.65 $15.54 486 $15.88 $16.14 to $29.34........... 339 7.05 $19.87 178 $20.77 $30.00.................... 1 1.49 $30.00 1 $30.00 ----- ----- $3.75 to $30.00............ 5,386 6.95 $10.86 3,589 $ 9.82 ===== ===== The Company accounts for its stock-based compensation plans under APB No. 25. As a result, the Company has not recognized compensation expense for stock options granted to employees with an exercise price equal to the quoted market price of the Common Stock on the date of grant and that vest based solely on continuation of employment by the recipient of the option award. The Company adopted SFAS No. 123 for disclosure purposes in 1996. For SFAS No. 123 purposes, the Company estimates the fair value of each option grant as of the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions: 2005 2004 2003 ----- ----- ----- Expected life (years)...................................... 3.4 4.5 5.0 Risk-free interest rate.................................... 3.90% 3.60% 3.00% Dividend rate.. 0.00% 0.00% 0.00% Expected volatility.. 47.31% 54.31% 53.05% Per-Se has never paid cash dividends on its Common Stock. The Credit Agreement entered into on September 11, 2003, as amended, contains restrictions on the Company's ability to declare or pay cash dividends on its Common Stock. 14. DEFERRED STOCK UNIT PLAN Effective October 1, 2001, and approved by the stockholders at the annual meeting held on May 2, 2002, the Board of Directors adopted the Per-Se Technologies, Inc. Deferred Stock Unit Plan (the "Plan"). The purpose of the Plan is to further align the interests of the Company's non-employee directors and a select group of key employees of the Company (and its affiliates) with the interests of stockholders by encouraging additional ownership of the Common Stock. The Plan also provides the participants with an opportunity to defer taxation of income in consideration of the valuable services that they provide to the Company. Non-employee directors of the Company are automatically eligible to participate in the Plan. The Compensation Committee of the Board of Directors may select key employees of the Company from time to time as eligible participants. Currently, seven non-employee directors and six executives (including two employee directors) are eligible to participate in the Plan. Pursuant to the Plan, a non-employee director may elect to defer up to 100% of his Board and committee meeting fees and his annual retainer each year. Eligible employees may elect each year to defer F-26 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) up to 50% of their annual incentive bonus and receive an enhancement bonus equal to $0.25 for each dollar of compensation deferred. The Compensation Committee may also from time to time in its sole discretion designate such other enhancement bonus contributions as it deems appropriate. The cash amount of such deferrals and, in the case of employee participants, the enhancement bonuses will be converted to stock units, by dividing the amount to be deferred, plus any enhancement bonus, by the fair market value of the Common Stock on the date the amounts are credited to the participant's account. Participants are always fully vested in the stock units converted from deferrals of compensation. However, stock units that are converted from an enhancement bonus credited to an employee participant, and any related dividend equivalent stock units, will vest at the rate of 20% each year over a period of five years from the date of deferral of the related compensation. If a participant's employment is terminated for "cause" (as defined in the Plan) or if he or she resigns without "good reason" (as defined in the Plan) before the enhancement bonus stock units are vested, he or she will forfeit any such unvested stock units. For the years ended December 31, 2005, and 2004, the Plan purchased a total of 11,193 shares and 19,925 shares, respectively, of the Company's Common Stock at a total cost of approximately $0.4 million and $0.3 million, respectively. For the years ended December 31, 2005, and 2004, the Plan distributed a total of 40,023 shares and 7,672 shares, respectively. In accordance with EITF Issue No. 97-14, Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested, the shares purchased and the Company's obligation are reflected as treasury stock and deferred compensation obligation, respectively, in the financial statements. 15. INCOME TAXES Income tax (benefit) expense attributable to continuing operations comprises the following: FOR THE YEAR ENDED DECEMBER 31, ------------------------------- 2005 2004 2003 --------- --------- --------- (IN THOUSANDS) Current: Federal.. $ 569 $ 83 $ (701) State.. 316 (82) 728 Foreign.. 8 13 -- -------- -------- -------- 893 14 27 ======== ======== ======== Deferred: Federal.. 13,183 1,485 6,624 State.. 2,178 879 10,869 Valuation benefit.................................. (17,540) (30,479) (17,493) -------- -------- -------- (2,179) (28,115) -- -------- -------- -------- Income tax (benefit) expense attributable to continuing operations............................. $ (1,286) $(28,101) $ 27 ======== ======== ======== F-27 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) A reconciliation between the amount determined by applying the federal statutory rate to income before income taxes and income tax (benefit) expense is as follows: FOR THE YEAR ENDED DECEMBER 31, ------------------------------- 2005 2004 2003 --------- --------- --------- (IN THOUSANDS) Income tax expense at federal statutory rate......... $ 12,484 $ 5,858 $ 5,566 State taxes, net of federal benefit................. 1,936 825 480 Change in tax rates................................ 552 (4,428) 10,869 Valuation allowance................................ (17,540) (30,479) (17,493) Expiration of net operating losses and credits....... 1,219 -- -- Other.. 63 123 605 -------- -------- -------- $ (1,286) $(28,101) $ 27 ======== ======== ======== Deferred taxes are recorded based upon differences between the financial statement and tax bases of assets and liabilities and available tax credit carryforwards. The components of deferred taxes at December 31, 2005, and 2004, are as follows: AS OF DECEMBER 31, --------------------- 2005 2004 --------- --------- (IN THOUSANDS) CURRENT: Accounts receivable, unbilled.............................. $ (100) $ (91) Accrued expenses.. 4,627 5,336 Net operating loss carryforwards........................... 14,616 12,799 Valuation allowance.. (16,781) (15,955) Other.. 1,694 1,175 --------- --------- $ 4,056 $ 3,264 ========= ========= NONCURRENT: Net operating loss carryforwards........................... $ 129,278 $ 138,512 Valuation allowance.. (108,537) (121,473) Depreciation and amortization.............................. 3,033 7,316 Credits.. 861 485 Other.. 1,603 11 --------- --------- $ 26,238 $ 24,851 ========= ========= The 2004 current and non-current deferred tax asset balances have been reclassified to conform to the 2005 presentation. This reclassification resulted in a $9.5 million reduction of the previously reported 2004 current deferred tax asset and a corresponding $9.5 million increase to the non-current deferred tax asset. This reclassification resulted from a reallocation of the valuation allowance between current and non-current deferred tax assets. At December 31, 2005, the Company had alternative minimum tax ("AMT") credits of approximately $0.9 million that may be carried forward indefinitely as a credit against regular tax liability. In addition, the Company had federal net operating loss carryforwards ("NOLs") for income tax purposes of approximately $375.4 million, which consist of $346.8 million of consolidated NOLs and $28.6 million of separate return limitation year NOLs. Of the $375.4 million of NOLs available, $105.1 million relate to F-28 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) non-qualified stock option deductions. When realized, the resulting benefits of those deductions will be credited to stockholder's equity. The NOLs will expire at various dates from 2006 through 2024 as follows: AMOUNTS EXPIRING ------------ (IN MILLIONS) 2006 to 2007.. $ 20.6 2008 to 2010.. 69.1 2011 to 2014.. 136.1 2015 to 2024.. 149.6 ------ $375.4 ====== In addition to the NOL's above, the Company's state net operating loss carryforwards at December 31, 2005, for income tax purposes was approximately $298.5 million. These NOL's will expire at various dates from 2006 through 2024. Prior to 2004, the Company had a full valuation allowance against its deferred tax asset due to the uncertainty regarding its ability to generate sufficient future taxable income prior to the expiration of its NOLs. In the fourth quarter of 2004, the Company reassessed the valuation allowance previously established and determined that it was more likely than not that a portion of the deferred tax asset would be realized in the foreseeable future. This determination was based upon the Company's projection of taxable income for 2005 and 2006. As a result, the Company released a portion of the allowance resulting in an income tax benefit of $28.1 million for 2004. The valuation allowance for deferred tax assets decreased by $12.1 million in 2005, primarily due to the utilization of NOLs to offset current taxable income. Approximately $2.2 million of the $12.1 million decrease relates to an additional release of the valuation allowance in the fourth quarter of 2005 based upon the Company's projection of taxable income for 2006 and 2007. The Company will continue to assess the potential realization of the remaining deferred tax asset, and will adjust the valuation allowance in future periods, as appropriate. Approximately $37.0 million of the total valuation allowance of $125.3 million at December 31, 2005, relates to non-qualified stock option deductions. The Company will continue to release its valuation allowance as a benefit to continuing operations until only the stock option benefit remains. Any release of valuation allowance related to stock option benefit will be recorded to Stockholders' Equity. 16. EMPLOYEE BENEFIT PLANS The Company has various defined contribution plans whereby employees meeting certain eligibility requirements can make specified contributions to the plans. The Company matches a percentage of the employee contributions. The Company's contribution expense was $2.2 million, $2.1 million and $1.8 million for the years ended December 31, 2005, 2004, and 2003, respectively. 17. CASH FLOW INFORMATION Supplemental disclosures of cash flow information and non-cash investing and financing activities are as follows: 2005 2004 2003 ------ ------ ------- (IN THOUSANDS) Non-cash investing and financing activities: Additions to capital lease obligations................. $ -- $ 625 $ -- Liabilities assumed in acquisitions.................... 241 947 -- Cash paid for: Interest... 4,518 5,686 18,296 Extinguishment of debt................................ -- 6,378 5,412 Income taxes... 626 640 565 F-29 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) 18. SEGMENT REPORTING The Company's reportable segments are operating units that offer different services and products. Per-Se provides its services and products through its two operating divisions: Physician Solutions and Hospital Solutions. Both operating divisions generate approximately 100% of their revenue in the U.S. The Physician Solutions division provides Connective Healthcare services and solutions that manage the revenue cycle for physician groups. The division is the largest provider of business management outsourced services that supplant all or most of the administrative functions of a physician group. The target market is primarily hospital-affiliated physician groups in the specialties of radiology, anesthesiology, emergency medicine and pathology as well as physician groups practicing in the academic setting and other large physician groups. The division recognizes revenue primarily on a contingency fee basis, which aligns the division's interests with the interests of the physician groups it services. The outsourced services business recognizes revenue as a percentage of the physician group's cash collections for the services performed. Since this is an outsourced service delivered on the Company's proprietary technology, license fees or maintenance fees are not required to be paid by the division's hospital-affiliated physician groups. The division also sells a physician practice management ("PPM") solution that is delivered via an ASP model. The PPM solution collects a monthly usage fee from the office-based physician practices using the system. The division's revenue model is 100% recurring in nature due to the transaction-based nature of its fee revenue in the outsourced services business and the monthly usage fee in the PPM business. The business of the Physician Solutions division is conducted by PST Services, Inc. a Georgia corporation d/b/a "Per-Se Technologies," which is a wholly owned subsidiary of the Company. The Hospital Solutions division provides Connective Healthcare solutions designed to increase revenue and decrease expenses for hospitals, with a focus on revenue cycle management and resource management. The division's revenue cycle management solutions enable a hospital's central billing office to improve its revenue cycle. The division has one of the largest clearinghouses in the medical industry, which provides an important infrastructure to support its revenue cycle offering. The division also provides resource management solutions that enable hospitals efficiently to manage resources, such as personnel and the operating room, to reduce costs and improve their bottom line. The division primarily recognizes revenue on a per-transaction basis for its revenue cycle management solutions and primarily recognizes revenue on a percentage-of-completion basis or upon software shipment for sales of its resource management software solutions. Approximately 90% of the division's revenue is recurring due to its transaction-based business and the maintenance revenue from its substantial installed base for the revenue cycle management and resource management software solutions. The business of the Hospital Solutions division is conducted by the following wholly owned subsidiaries of the Company: Per-Se Transaction Services, Inc., an Ohio corporation; Patient Account Management Services, Inc., an Ohio corporation; PST Products, LLC, a California limited liability company; and Knowledgeable Healthcare Solutions, Inc., an Alabama corporation. All of these subsidiaries do business under the name "Per-Se Technologies." The Company evaluates each segment's performance based on its segment operating income. Segment operating income is revenue less cost of services, selling, general and administrative expenses and other expenses. The Hospital Solutions segment revenue includes intersegment revenue for services provided to the Physician Solutions segment, which are shown as Eliminations to reconcile to total consolidated revenue. F-30 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) The Company's segment information from continuing operations is as follows: FOR THE YEAR ENDED DECEMBER 31, -------------------------------- 2005 2004 2003 --------- --------- --------- (IN THOUSANDS) Revenue: Physician Solutions............................... $274,576 $260,473 $251,251 Hospital Solutions............................... 112,282 105,923 97,240 Eliminations...................................... (14,140) (13,605) (13,322) -------- -------- -------- $372,718 $352,791 $335,169 ======== ======== ======== Segment operating expenses: Physician Solutions............................... $243,231 $232,907 $221,895 Hospital Solutions............................... 87,915 82,600 74,671 Corporate... 15,610 21,955 15,417 Eliminations...................................... (14,140) (13,605) (13,322) -------- -------- -------- $332,616 $323,857 $298,661 ======== ======== ======== Segment operating income: Physician Solutions............................... $ 31,345 $ 27,566 $ 29,356 Hospital Solutions............................... 24,367 23,323 22,569 Corporate... (15,610) (21,955) (15,417) -------- -------- -------- $ 40,102 $ 28,934 $ 36,508 ======== ======== ======== Interest expense.................................... $ 6,088 $ 6,825 $ 14,646 ======== ======== ======== Interest income..................................... $ (1,655) $ (525) $ (297) ======== ======== ======== Loss on extinguishment of debt...................... $ -- $ 5,896 $ 6,255 ======== ======== ======== Income before income taxes.......................... $ 35,669 $ 16,738 $ 15,904 ======== ======== ======== Depreciation and amortization: Physician Solutions............................... $ 8,092 $ 9,331 $ 10,475 Hospital Solutions............................... 6,492 5,661 5,270 Corporate... 369 464 764 -------- -------- -------- $ 14,953 $ 15,456 $ 16,509 ======== ======== ======== Capital expenditures and capitalized software development costs: Physician Solutions............................... $ 7,224 $ 6,547 $ 5,467 Hospital Solutions............................... 6,073 5,667 4,655 Corporate... 932 804 221 -------- -------- -------- $ 14,229 $ 13,018 $ 10,343 ======== ======== ======== F-31 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) AS OF DECEMBER 31, ------------------- 2005 2004 -------- -------- (IN THOUSANDS) Identifiable Assets: Physician Solutions(1)................................... $ 66,380 $ 63,611 Hospital Solutions(1).................................... 71,482 59,964 Corporate.. 101,661 79,116 -------- -------- $239,523 $202,691 ======== ======== -------------- (1) Identifiable assets in the Physician Solutions division include approximately $8,936 of goodwill for all periods presented. Identifiable assets in the Hospital Solutions division include approximately $29,263 and $23,613 of goodwill as of December 31, 2005, and 2004, respectively. 19. SUBSEQUENT EVENTS (UNAUDITED) On August 29, 2005, Per-Se and NDCHealth Corporation ("NDCHealth") announced that they had signed definitive agreements for the acquisition of NDCHealth, a leading provider of healthcare technology and information solutions by Per-Se. The transaction was completed on January 6, 2006. The acquisition included the NDCHealth physician, hospital and retail pharmacy businesses for total consideration of approximately $665 million. The transaction resulted in consideration to NDCHealth's shareholders of $19.50 per share, with $14.05 paid in cash and $5.45 paid in Per-Se stock. As part of the transaction, Wolters Kluwer, based in Amsterdam, the Netherlands, purchased the pharmaceutical information management business from NDCHealth for $382 million in cash. In connection with the acquisition, the Company secured financing in the form of a new senior credit facility consisting of a $435 million Term Loan B and a $50 million revolving credit facility ("Senior Credit Facility"). The Term Loan B bears interest at a rate of LIBOR plus 2.25% or Base Rate, as defined by the Senior Credit Facility agreement, plus 1.25% and matures in seven years. The revolving credit facility has an interest rate that varies between LIBOR plus 1.50% and LIBOR plus 2.50% or between Base Rate plus 0.5% and Base Rate plus 1.50%, based on performance, and matures in five years. The Company has incurred no borrowings under the revolving credit facility. All outstanding debt of NDCHealth was retired in connection with the closing of the transaction. Also on January 6, 2006, the Company entered into a four-year interest rate swap agreement, in order to hedge against potential interest rate fluctuations resulting from the variable interest rate under the terms of the new senior credit facility. Pursuant to the terms of the interest rate swap, the Company is obligated to periodically pay an amount based on a fixed interest rate, and the Company will receive an amount based on a variable rate. The variable rate is based on the three-month LIBOR rate available at the time. By entering into the interest rate swap, the Company has effectively fixed the maximum interest rate that the Company will pay on a portion of the $435 million outstanding under the Credit Facility at 4.76% per annum plus the applicable spread, which is 225 basis points. The amount of the Credit Facility that is covered by the swap is $125 million in years one and two, decreasing to $100 million in year three and $75 million in year four. The interest rate swap will terminate on December 31, 2009, unless sooner terminated pursuant to its terms. As of December 31, 2005, the Company had incurred approximately $3.8 million of transaction costs related to the acquisition of NDCHealth that are included in other long-term assets in the Company's Consolidated Balance Sheet. The Company will record the acquisition using the purchase method of accounting and, accordingly, will allocate the purchase price to the assets acquired and liabilities assumed based on their estimated fair F-32 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) market value at the date of acquisition. The Company has not yet obtained all the information related to the fair value of acquired assets, contingent liabilities, total expenses related to the acquisition and acquisition liabilities required to finalize the purchase price allocation. In the first quarter of 2006, the Company will reassess the valuation allowance recorded against its deferred tax assets. This assessment will be based upon projections of taxable income for the next two years including the operations of the businesses acquired in the NCDHealth transaction. The Company anticipates releasing an additional portion of its valuation allowance in the first quarter of 2006 as a result of the assessment. For additional information, refer to the Company's Form S-4/A-2 filed on November 30, 2005. 20. QUARTERLY FINANCIAL INFORMATION (UNAUDITED) QUARTER ENDED --- MARCH 31 JUNE 30 SEPTEMBER 30 DECEMBER 31 -------- ------- ------------ ----------- (IN THOUSANDS, EXCEPT PER SHARE DATA) 2005 Revenue.................................. $92,030 $93,300 $94,006 $93,382 Cost of services......................... 60,037 62,470 63,089 62,776 Income from continuing operations........ 9,431 7,546 9,823 10,155 Discontinued operations, net of tax...... -- -- -- 414 Net income.............................. 9,431 7,546 9,823 10,569(1) Net income per common share -- basic from continuing operations................. 0.31 0.25 0.33 0.34 Discontinued operations, net of tax, per common share................... -- -- -- 0.01 Net income per common share -- basic... 0.31 0.25 0.33 0.35 Shares used to compute net income per common share -- basic............... 30,294 29,773 29,994 30,277 Net income per common share -- diluted from continuing operations............. 0.29 0.23 0.29 0.29 Discontinued operations, net of tax, per common share................... -- -- -- 0.01 Net income per common share -- diluted.................... 0.29 0.23 0.29 0.30 Shares used to compute net income per common share -- diluted............. 32,552 32,410 33,792 34,792 F-33 PER-SE TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED) QUARTER ENDED -- MARCH 31 JUNE 30 SEPTEMBER 30 DECEMBER 31 ----------- ---------- -------------- -------------- (IN THOUSANDS, EXCEPT PER SHARE DATA) 2004 Revenue.................................. $84,601 $88,141 $90,641 $89,408 Cost of services......................... 55,398 56,939 60,486 59,838 Income (loss) from continuing operations............................ 1,607 (1,387) 8,807 35,812 Discontinued operations, net of tax...... (580) 3,791 (107) 215 Net income.............................. 1,027 2,404 8,700 36,027(1) Net income (loss) per common share -- basic from continuing operations............................ 0.05 (0.04) 0.29 1.18 Discontinued operations, net of tax, per common share........................... (0.02) 0.12 -- 0.01 Net income per common share -- basic..... 0.03 0.08 0.29 1.19 Shares used to compute net income per common share -- basic................. 31,531 31,530 30,088 30,238 Net income (loss) per common share -- diluted from continuing operations..... 0.05 (0.04) 0.27 1.10 Discontinued operations, net of tax, per common share........................... (0.02) 0.12 -- 0.01 Net income per common share -- diluted... 0.03 0.08 0.27 1.11 Shares used to compute net income per common share -- diluted............... 34,200 31,530 32,168 32,511 --------------- (1) Includes the release of $2.2 million and $28.1 million of the valuation allowance against the Company's deferred tax asset resulting in an income tax benefit that was recorded in the fourth quarter of 2005 and 2004, respectively. F-34 PER-SE TECHNOLOGIES, INC. SCHEDULE II -- VALUATION AND QUALIFYING ACCOUNTS YEARS ENDED DECEMBER 31, 2005, 2004, AND 2003 ADDITIONS ----------------------- BALANCE AT CHARGED TO CHARGED TO BEGINNING COSTS AND OTHER BALANCE AT DESCRIPTION OF YEAR EXPENSES ACCOUNTS DEDUCTIONS END OF YEAR ----------- ---------- ---------- ---------- ---------- ----------- YEAR ENDED DECEMBER 31, 2005 Allowance for doubtful accounts................ $3,600 $ 891 -- $(1,143) $3,348 YEAR ENDED DECEMBER 31, 2004 Allowance for doubtful accounts................ $4,795 $ 603 -- $(1,798) $3,600 YEAR ENDED DECEMBER 31, 2003 Allowance for doubtful accounts................ $4,288 $1,159 -- $ (652) $4,795 F-35