QUADRAMED CORP
Form S-1
January 21, 2004
Table of Contents

As filed with the Securities and Exchange Commission on January 21, 2004

Registration No. 333-####

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

QUADRAMED CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Delaware	**7371**	**52-1992861**
(State or Other Jurisdiction of Incorporation or Organization)	**(Primary Standard Industrial Classification Code Number)**	**(I.R.S. Employer Identification Number)**

12110 Sunset Hills Road

Reston, Virginia 20190

(703) 709-2300

(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant s Principal Executive Offices)

Lawrence P. English

Chief Executive Officer

12110 Sunset Hills Road

Reston, Virginia 20190

(703) 709-2300

(Name, Address, Including Zip Code, and Telephone Number, Including Area Code, of Agent for Service)

Copy to:

Morris F. DeFeo, Jr.

Miles & Stockbridge, P.C.

1751 Pinnacle Drive, Suite 500

McLean, Virginia 22102

Approximate Date of Commencement of Proposed Sale to the Public: As soon as practicable on or after the effective date of this Registration Statement.

Table of Contents

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. ¨

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective statement for the same offering. ¨

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities registration number of the earlier effective registration statement for the same offering. ¨

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. ¨

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities To Be Registered	Amount To Be Registered	Proposed Maximum Offering Price Per Share	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
Common Stock, par value $0.01 per share	11,586,438(1)	$3.175(2)	$36,786,940(2)	$2,977
Senior Secured Notes due 2008			$72,293,780(3)	$5,849

(1) This number comprises (i) 11,303,842 shares of Common Stock (Shares) underlying warrants and (ii) 282,596 Shares previously issued upon the exercise of warrants.

(2) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457 (c) under the Securities Act of 1933, as amended, based upon the average of the high and low prices for a share of Common Stock reported on the Over-The-Counter Bulletin Board as of January 15, 2004.

(3) Represents the aggregate principal amount at maturity of the 2008 notes, for the purpose of calculating the registration fee pursuant to Rule 457(o) under the Securities Act of 1933, as amended.

The registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(A) of the Securities Act of 1933, as amended, or until the Registration Statement shall become effective on such dates as the Securities and Exchange Commission, acting pursuant to said Section 8(A), may determine.

Table of Contents

The information in this prospectus is not complete and may be changed. The selling security holders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities, and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

PRELIMINARY PROSPECTUS SUBJECT TO COMPLETION, DATED JANUARY 21, 2004

[GRAPHIC APPEARS HERE]

11,586,438 Shares of Common Stock, par value $0.01 per share

$72,293,780 10% Senior Secured Notes due 2008

QuadraMed Corporation

Shares of our common stock and our 10% senior secured notes due 2008 are being offered for a forty-five day period after the effective date of this Registration Statement to the public market by those individuals named in the section of this prospectus entitled Selling Holders . We will not receive any proceeds from the sale of the common stock or the notes, but we will bear the costs relating to the registration of the common stock and notes.

The selling holders may sell the common stock and notes covered by this prospectus through various means, including directly to purchasers or through underwriters, broker-dealers, and agents. If the common stock or notes are sold through underwriters, broker-dealers, or agents, these parties may be compensated for their services in the form of discounts or commissions, which is deemed to be underwriting compensation . If required, the selling holders will disclose the names of any underwriter(s), applicable commissions or discounts, and any other required information with respect to any particular sales in an accompanying prospectus supplement. For additional information on the selling holders possible methods of sale, you should refer to the section in this prospectus entitled Plan of Distribution .

We issued $71,000,000 of our senior secured notes due 2008 in a private placement in April 2003 (2008 notes). We sold the notes at the original principal amount and issue price of $1,000 per note. The notes bear interest at the initial rate of 10%. The interest rate will be reduced to 9% upon the listing of our common stock on a U.S. national securities exchange or upon the relisting of our common stock on the Nasdaq National Market or Nasdaq SmallCap Market. On November 13, 2003, we filed an application to list our common stock on the American Stock Exchange. The terms of the notes provide that interest is initially payable 6% in cash and 4% in additional notes through and including April 1, 2004. Interest is payable semiannually on April 1 and October 1 of each year. On October 1, 2003, notes in the aggregate principal amount of $1.3 million were issued as an interest payment on the 2008 notes. This additional amount of notes is reflected in the amount of notes registered by this registration statement. The notes are secured by substantially all of our intellectual property.

Along with the notes, we issued warrants to purchase 11,303,842 shares of our common stock. Additional warrants to purchase 2,047,978 shares of our common stock will be issued to holders of the 2008 notes if we do not file a registration statement within 90 days after receiving a request

from the holders on or after the date that is 270 days after April 17, 2003, the date of issuance of the 2008 notes. Furthermore, we also issued warrants to purchase 282,596 shares of our common stock to Philadelphia Brokerage Corporation as consideration in connection with the transaction. As of December 31, 2003, a total of 282,596 of these warrants had been exercised. The warrants have a term of 5 years, have an exercise price of $0.01 per share and are subject to certain anti-dilution provisions including dilution from any issuance of shares in settlement of existing litigation. The shares of common stock being registered in this registration statement constitute shares underlying, or issued upon the exercise of, these warrants.

Table of Contents

On October 23, 2003, pursuant to the registration rights agreement described in Description of Securities Registration Rights Agreement , we received a demand request from a holder of the 2008 notes requiring us to file a registration statement with the Securities and Exchange Commission (SEC) within 90 days of the demand request. On November 3, 2003, we mailed a request notice to all holders of the 2008 notes, notifying them of the demand request and informing them that they had fifteen (15) days within which to request that any or all of their notes or warrants be included in the registration statement to be filed. Those holders who elected to have their notes or warrants included in this registration statement are listed in this prospectus in the section entitled Selling Holders .

We may redeem for cash all or a portion of the notes at any time on or after April 17, 2006, at prices calculated as described in Description of Notes Redemption of Notes at Our Option .

We have not applied for listing of the notes on any securities exchange or for quotation through any automated quotation system. The notes were offered to qualified institutional buyers as defined in, and in reliance on, Rule 144A under the Securities Act, in transactions exempt from, or not subject to, the registration requirements of the Securities Act.

Our common stock is currently traded on the Over-The-Counter Bulletin Board (symbol: QMDC.OB). and on the Pink Sheets over-the-counter market (symbol: QMDC.PK). As of January 15, 2004, the high and low prices for our common stock were $3.25 and $3.10 per share on the Over-the-Counter Bulletin Board.

Investing in our common stock and the notes involves risks that are described in the Risk Factors section of this prospectus beginning on page 9.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is January __, 2004.

Table of Contents

TABLE OF CONTENTS

We have obtained trademark registrations in the United States for most of our corporate and product trademarks, including QuadraMed, Affinity, Quantim, and Complysource and We do technology. So you can do healthcare.This prospectus also contains product names, trade names and trademarks of ours as well as those of other organizations. All other brand names and trade names and trademarks appearing in this prospectus are the property of their respective holders.

Table of Contents

PROSPECTUS SUMMARY

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission to register the resale of the common stock and notes issued or issuable to the selling holders as explained in this prospectus. As permitted by the SEC s rules, this prospectus does not contain all of the information you can find in the registration statement or the exhibits to the registration statement. This prospectus summarizes some of the documents that are exhibits to the registration statement, and you should refer to the exhibits for more complete information as to the matters covered by these documents.

You should read this prospectus summary together with the more detailed information contained in this prospectus, including the risk factors, the financial statements and the notes to the financial statements. This prospectus contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements. Factors that might cause such a difference include those discussed in the Risk Factors section and elsewhere in this prospectus. For more information, please refer to the section entitled Cautionary Note Regarding Forward-Looking Statements located in this prospectus.

Unless we state otherwise, we , us , our , the company , and QuadraMed refer to QuadraMed Corporation, including all of our subsidiaries. Unl otherwise indicated, industry data in this prospectus is derived from publicly available sources, which we have not independently verified.

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with any information that is different from the information contained in this prospectus. The selling holders are offering to sell, and seeking offers to buy, common stock and notes only in jurisdictions where such offers and sales are permitted. The information contained in this prospectus is accurate only as of the date on the front cover of this prospectus, regardless of the time of the delivery of this prospectus or of any sale of the common stock or notes. Our business, financial condition, results of operation and prospects may have changed since that date.

Our Company

We provide healthcare information technology products and services that help healthcare providers to improve the quality of the care they deliver and the efficiency with which it is delivered. We accomplish our mission by developing and implementing sophisticated, user-friendly software applications designed and developed by the healthcare professionals and software specialists we employ.

Our products are designed to eliminate paper, improve processes, and decrease error through the efficient management of patient clinical and financial records. They are suitable for acute care hospitals, specialty hospitals, Veterans Health Administration facilities and associated/affiliated businesses such as outpatient clinics, long-term care facilities, and rehabilitation hospitals and are used by healthcare organizations of varying size from small single entity hospitals to large multi-facility care delivery organizations. Our products are sold as standalone, bundled, or fully integrated software packages. We also provide services to support the hospital s collection of receivables and its administration of contractual reimbursements from managed care companies. As of December 31, 2003, approximately 1,900 healthcare provider facilities were utilizing at least one QuadraMed product.

Our headquarters office is located at 12110 Sunset Hills Road, Reston, Virginia in the Washington, D.C. metropolitan area. The company was founded in 1993 and reincorporated in Delaware in 1996. Our telephone number is (703) 709-2300. Our website can be found at www.quadramed.com where all of our current SEC filings can be accessed free of charge.

4

Table of Contents

The Offering

Use of proceeds	We will not receive any of the proceeds from the sale of the shares of our common stock and the notes offered by the selling holders.
Risk Factors	An investment in our common stock and notes is subject to significant risks. You should carefully consider the information set forth in the Risk Factors section and the other sections of this prospectus, including our financial statements and related notes.
Common Stock	
Common Stock offered by the selling holders	Up to 11,586,438 shares, of which 282,596 shares are issued and outstanding and 11,303,842 shares which may be issued upon the exercise of warrants, held by the selling holders, including their transferees, pledgees, donees, or other successors.
Dividend Policy	We do not expect to pay dividends on our common stock in the foreseeable future. We anticipate that future earnings generated from operations, if any, will be retained to develop and expand our business.
Plan of Distribution	The shares of common stock offered for resale may be sold by the selling holders pursuant to this prospectus in the manner described under Plan of Distribution .
Trading and Symbol	Our common stock currently trades on the Over-the-Counter Bulletin Board market under the symbol QMDC.OB and on the Pink Sheets over-the-counter market under the symbol QMDC.PK .
Common Stock Outstanding	As of January 19, 2004, we had 27,727,924 shares of common stock outstanding.
Notes	
Notes offered by the selling holders	Up to $72,293,780 aggregate principal amount of notes
Maturity Date	April 1, 2008
Interest	The notes bear interest at an initial interest rate of 10% per year. The interest rate will be automatically reduced to 9% immediately following the next interest payment date upon (1) the listing of our common stock for trading on a U.S. national securities exchange or (2) the approval for trading on Nasdaq, including the Nasdaq SmallCap market. The terms of the notes provide that interest is initially payable 6% in cash and 4% in additional notes through and including April 1, 2004. Interest is payable semiannually in arrears on April 1 and October 1 in each year, commencing on October 1, 2003, to holders of record at the close of business on the March 15 or September 15 immediately preceding such interest payment due.
Tax Original Issue Discount	Because a portion of the interest in the first year is payable in additional notes, the notes will be considered issued with original issue discount for United States federal income tax purposes, regardless of the timing of receipt of the related cash payments.

Table of Contents

Guarantees	Our obligations under the notes are not guaranteed.
Ranking	The notes are our senior secured obligations. They rank on a par with, or senior to, all of our existing and future debt and liabilities. The notes are secured by any and all of our right, title, and interest in and to all existing and future copyrights, patents, trademarks, and licenses to use copyrights, patents, and trademarks. Accordingly, the claims of the holders of the notes will rank ahead of unsecured claims of our creditors to the extent of the value, priority, and validity of the liens securing the notes. The indenture under which the notes were issued prohibits us and our subsidiaries from incurring any indebtedness for borrowed money that ranks senior to or equal with the notes in the right of repayment. The indenture also prohibits us and our subsidiaries from making any investments other than those specifically allowed as permitted investments as defined in the indenture, unless we have cash or cash equivalents greater than $10 million.
Security	We assigned and pledged to the trustee on the indenture, under which the notes were issued, as security for the notes and for the benefit of the holders of the notes (and not for the benefit of our other creditors) any and all of our right, title, and interest in and to all existing and future copyrights, patents, trademarks, and licenses to use copyrights, patents, and trademarks.
Change of control	In the event of a change of control of QuadraMed as defined in the indenture, each holder will have the right, at the holder s option, subject to the terms and conditions of the indenture, to require us to purchase for cash all or any portion of the holder s notes. However, the original principal amount submitted for purchase by a holder must be $1,000 or an integral multiple of $1,000.
Sinking Fund	None
Redemption of notes at our option	Prior to April 17, 2006, we cannot redeem the notes at our option. Beginning on April 17, 2006, we may redeem the notes for cash, as a whole at any time or from time to time in part. We are required to give at least thirty (30) days but not more than sixty (60) days notice of redemption by mail to the holders of the notes. If we redeem the notes at our option, we will redeem them at the following prices, plus accrued and unpaid cash interest, if any, as of the applicable redemption dates: If redeemed between April 17, 2006 and March 31, 2007, the redemption price will be 101.50% of the original principal amount of such notes as of the applicable redemption date; If redeemed between April 1, 2007 and March 31, 2008, the redemption price will be 100.75% of the original principal amount of such notes as of the applicable redemption date; If redeemed on April 1, 2008 or thereafter, the redemption price will be 100% of the original principal amount of such notes as of the applicable redemption date.

Table of Contents

	If we redeem less than all of the outstanding notes, the trustee will select the notes to be redeemed in principal amounts at maturity of $1,000 or integral multiples of $1,000. In this case, the trustee may select the notes by lot, pro rata or by any other method the trustee considers fair and appropriate.
Mandatory redemption with excess cash	Within 10 days following the filing of our Form 10-K with the SEC, we are required to furnish the trustee with an officer s certificate setting forth (1) the amount of excess free cash, if any, for the immediately preceding year (plus any carryover excess free cash) and (2) an amount equal to 50% of the amount in clause (1). If this total excess cash is greater than $500,000 and we have not already called all of the notes for redemption, we will be required within 15 days to mail a redemption notice to all holders of notes. If the total excess cash is sufficient to redeem all notes, we must redeem all notes within 30 days for cash equal to 100% of the principal amount plus accrued and unpaid interest. If the amount is insufficient to redeem all of the notes, we will redeem them on a pro rata basis. The purchase price of a note will be equal to the original principal amount and accrued and unpaid cash interest, if any, on such notes as of the applicable purchase date.
Certain covenants	The indenture governing the notes among other things restricts, with certain exceptions, our ability and the ability of our subsidiaries to merge, sell assets, incur indebtedness, and create or incur liens.
Trading	The notes do not trade on any national securities exchange, nor do we intend to list the notes on any such national securities exchange.
Governing law	New York

Recent Events

As of January 21, 2004, we have agreed in principal to acquire all of the issued and outstanding capital stock of Détente Systems Pty Limited, an Australian proprietary limited company (Détente) and all of the units of trust ownership of the Détente Systems Trust, an Australian business trust (the Trust). Détente is engaged in the business of developing, selling and supporting clinical systems in Australia, New Zealand, and the United Kingdom. The Trust holds title to all of the intellectual property used or useful in Détente s business. The proposed purchase price for Détente s stock and the Trust s units is $4 million in cash. Of this amount, it is expected that $2.6 million will be paid on the closing date of the acquisition, and the balance will be deposited in an escrow account to be payable upon the satisfactory performance of certain technology and performance goals relating to the acquired Détente technology. There can be no assurance that we will consummate the acquisition.

Table of Contents

Summary Consolidated Financial Data

The following selected financial data for the fiscal years ended December 31, 2002, 2001, 2000, 1999, and 1998 included herein is derived from our audited consolidated Financial Statements and related notes thereto. The financial data for the nine months ended September 30, 2003 and 2002 are derived from the unaudited interim condensed consolidated Financial Statements included elsewhere in this prospectus, are prepared on the same basis as our audited consolidated Financial Statements, and include all adjustments, consisting of only normal recurring adjustments, that we consider necessary for a fair presentation of our financial position and results of operations at and for such periods. This selected consolidated financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations , and the audited consolidated Financial Statements and related notes thereto and the unaudited interim condensed consolidated Financial Statements and related notes thereto included elsewhere in this prospectus. Historical results are not necessarily indicative of future results.

	Nine months ended September 30,		Year Ended December 31,				
	(unaudited)		(In thousands, except per share amounts)				
	2003	2002	2002	2001	2000	1999	1998[1][2]
Consolidated Statement of Operations Data							
Revenue	$ 88,373	$ 79,072	$ 109,585	$ 117,046	$ 121,012	$ 199,162	$ 172,228
Restatement costs	6,500	3,300	7,463				
Extraordinary gain on redemption of debentures				12,907			
Income (loss) from continuing operations	(22,193)	(14,255)	(20,858)	11,952	(39,354)	(52,527)	(16,308)
Net income (loss)	(22,193)	(15,783)	(14,362)	9,413	(36,675)	(47,388)	(21,376)
Basic income (loss) per share from continuing operations	(0.81)	(0.53)	(0.77)	0.47	(1.53)	(2.20)	(0.85)
Basic net income (loss) per share	(0.81)	(0.59)	(0.53)	0.37	(1.43)	(1.99)	(0.91)
Diluted income (loss) per share from continuing operations	(0.81)	(0.53)	(0.77)	0.47	(1.53)	(2.20)	(0.85)
Diluted net income (loss) per share	(0.81)	(0.59)	(0.53)	0.37	(1.43)	(1.99)	(0.91)
Other Data[3]							
Ratio of earnings to fixed charges and preferred dividends[4]							
Deficiency of earnings to cover combined fixed charges and preferred dividends	22,193	14,255	20,858	805	38,737	52,527	21,376
Consolidated Balance Sheet Data:							
Cash, cash equivalents and short term investments	$ 35,580	$ 24,175	$ 26,191	$ 32,213	$ 39,664	$ 29,732	$ 89,574
Total assets	133,352	121,101	126,927	125,133	149,286	201,759	264,733
Deferred revenue	49,141	38,950	39,492	30,721	22,489	7,258	14,021
Working capital	11,091	10,480	18,137	32,509	46,107	61,030	94,963
Notes and debentures	71,226	73,719	73,719	73,719	115,000	115,000	115,000

(1) Revenue for 1998 does not reflect the adoption of EITF No. 01-14, *Income Statement Characterization of Reimbursements for Out-of-Pocket Expenses Incurred*. Accordingly, revenue has not been increased to reflect any billable out-of-pocket reimbursable expenses. All other periods presented reflect the adoption of this standard.

(2)

Discontinued operations have not been segregated from the 1998 results as the company structure was significantly different at that time. All other periods presented reflect the classification of HIM Services Division as a discontinued operation.

(3) For purposes of determining the ratio of earnings to combined fixed charges and preferred dividends and the deficiency of earnings to cover combined fixed charges and preferred dividends, earnings includes pre-tax income (loss) adjusted for fixed charges and preferred dividends. Fixed charges consist of interest expensed and capitalized, amortization of deferred financing charges, and that portion of operating lease rental expense (deemed to be 30% of rental expense) representative of interest.

(4) The ratios of combined fixed charges and preferred dividends to earnings are not presented for the years ended 2002, 2001, 2000, 1999 and 1998 and for the nine months ended September 3, 2003 and 2002 because earnings were inadequate to cover combined fixed charges and preferred dividends.

Table of Contents

RISK FACTORS

An investment in the shares of our common stock and the notes involves a high degree of risk. In considering whether to purchase the notes and shares of our common stock, you should carefully consider the following factors and other information set forth in this prospectus, including our financial statements and the related notes. The risks set forth below are in addition to risks that apply to most businesses.

Risks Related to the Notes and Our Common Stock

Our indebtedness could prevent us from fulfilling our obligations under the notes and may negatively affect our financial and operating flexibility.

We have now and will continue to have for the foreseeable future a considerable amount of indebtedness. As of December 31, 2003, we had approximately $84 million of outstanding indebtedness, which consists of the 2008 notes and the notes issued under a May 1, 1998 indenture agreement for $115 million in debentures maturing on May 1, 2005 (the 2005 notes). Our outstanding indebtedness could have important consequences to you. It could:

- Make it more difficult to satisfy our obligations with respect to the notes;
- Limit our ability to obtain additional financing to operate or grow our business;
- Limit our financial flexibility in planning for and reacting to industry changes;
- Require us to dedicate a material portion of our operating cash flow to fund interest payments on our indebtedness, thereby reducing the availability of our cash flow for other purposes; and
- Place us at a competitive disadvantage as compared to less leveraged companies.

We have incurred losses from continuing operations for the past five years, except 2001, and we will incur a loss from continuing operations in 2003. If we continue to incur substantial losses from continuing operations in the future, our ability to honor the notes may be impaired. Our ability to meet our debt service obligations depends on our future performance.

During the nine months ended September 30, 2003, we incurred a loss from continuing operations of $22.2 million. We will incur a loss from continuing operations for the year ended December 31, 2003. Although we had income from continuing operations of $9.4 million in 2001, we incurred losses from continuing operations of $14.4 million and $36.7 million for the years ended December 31, 2002 and 2000, respectively. If we are unable to achieve or sustain profitability, it may impair our ability to pay principal and interest on the notes and on our other indebtedness as it becomes due, to obtain future equity or debt financing, or to do so on economical terms and to sustain and expand our business.

Our ability to make such payments depends on our future operating performance. Future operating performance is subject to market conditions and business factors, which are often outside of our control. Therefore, we are not able to assure you that we will have sufficient cash flow to pay the principal and interest on our notes and other indebtedness. If our cash flow and capital resources are not enough to allow us to make our scheduled payments on the notes and other indebtedness, we may have to reduce or delay capital expenditures, sell assets, seek additional capital, or restructure or refinance our indebtedness. We cannot assure you that the terms of our indebtedness will allow these alternative measures or that such measures would satisfy the scheduled debt service obligations. If we are unable to make the scheduled payments on the notes or other indebtedness, we will be in default, and our debt holders could declare all outstanding principal and interest to be due and payable.

The notes are structurally subordinated. This may affect your ability to receive payments on the notes.

The notes are obligations exclusively of QuadraMed Corporation. We conduct a substantial portion of our operations through our subsidiaries. As a result, our cash flow and our ability to service our debt, including the 2008 notes, depend upon the earnings of our subsidiaries. In addition, we depend on the distribution of earnings, loans or other payments by our subsidiaries to us. Payments to us by our subsidiaries will be contingent upon our subsidiaries earnings and business considerations.

Table of Contents

Our subsidiaries are separate and distinct legal entities. Our subsidiaries have no obligation to pay any amounts due on the notes or to provide us with funds for our payment obligations, whether by dividends, distributions, loans or other payments. In addition, any payment of dividends, distributions, loans or advances by our subsidiaries to us could be subject to statutory or contractual restrictions. Payments to us by our subsidiaries will also be contingent upon our subsidiaries earnings and business considerations.

Our right to receive any assets of any of our subsidiaries upon their liquidation or reorganization and, as a result, our ability to use those assets to discharge our obligations to the holders of the 2008 notes, are effectively subordinated to the claims of that subsidiary s creditors, including trade creditors. In addition, even if we were a creditor of any of our subsidiaries, our rights as a creditor would be subordinate to any security interest in the assets of our subsidiaries and any indebtedness of our subsidiaries senior to indebtedness held by us.

We may not have the ability to raise the funds necessary to finance the change of control repurchase.

Upon the occurrence of specific kinds of change of control events, holders of notes may require us to repurchase their notes. However, it is possible that we would not have sufficient funds at that time to make the required repurchase of notes.

There is no public market for the notes, and the transfer of the notes is restricted.

There is no trading market for the notes, no market for the notes may develop, and any market that develops may not last. We do not intend to apply for listing of the notes on any securities exchange or other inter-dealer quotation service. Accordingly, we cannot assure you that a holder of the notes will be able to sell these notes in the future or as to the price at which any sale of the notes may occur. The liquidity of the market for the notes and the prices at which the notes trade will depend upon the amount of notes outstanding, the number of holders of the notes, the interest of securities dealers in maintaining a market in the notes and other factors beyond our control. The liquidity of, and the trading market for, the notes may also be adversely affected by general declines in the market for high yield securities. Even after we have registered the notes and the shares of common stock underlying the warrants, we will have the right, pursuant to the registration rights agreement, to suspend the use of this registration statement in certain circumstances. In the event of such a suspension, you would not be able to sell any notes or shares of common stock issuable upon exercise of the warrants.

Risks Related to Our Business

We Are Currently the Target of Securities Litigation and May Be the Target of Further Actions, Which May Be Costly and Time Consuming to Defend.

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

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

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

Table of Contents

We Are Subject to a Formal SEC Inquiry as a Result of the Restatement of Our Financial Statements.

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

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

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

We received a notice from the Nasdaq Stock Market on March 4, 2003 that required us to file Forms 10-Q for the quarters ended June 30 and September 30, 2002 as well as restated financial statements for the years ended December 31, 2001, 2000, and 1999 on or before February 28, 2003. Because we were unable to meet these requirements in a timely manner, on March 4, 2003 our common stock was delisted from the Nasdaq Stock Market. The delisting of our stock triggered a repurchase event under the terms of a May 1, 1998 indenture agreement for our 2005 notes. This repurchase event required us to partially refinance our 2005 notes. On April 17, 2003, we repurchased $61.8 million of our outstanding 2005 notes and issued $71 million in 2008 notes and warrants to purchase 11,303,842 shares of our common stock. We also issued warrants to purchase 282,596 shares of our common stock to Philadelphia Brokerage Corporation as consideration for their assistance with the issuance of the 2008 notes.

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

We Have a Limited Trading Market.

There is currently a limited trading market for our common stock on the Over-the-Counter Bulletin Board and the Pink Sheets . The ability to trade our common stock on the over-the-counter market depends on the presence and investment decisions of willing buyers and sellers. Therefore, the market of investors who are willing to purchase our common stock is limited, the volume of our common stock traded on a daily basis is low, and the liquidity of our common stock is limited. All of these will affect your ability to sell and the price you may receive for our common stock. While we have applied for quotation of our common stock on the American Stock Exchange (AMEX), there can be no assurance that our common stock will be accepted for quotation by the AMEX or any other exchange.

The Trading Price of Our Common Stock Has Been, and Is Expected to Continue to Be, Volatile.

The Nasdaq National Market on which our common stock was listed, the Pink Sheets over-the-counter market and the Over-the-Counter Bulletin Board, where our stock currently trades, and stock markets in general,

Table of Contents

have historically experienced extreme price and volume fluctuations that have affected companies unrelated to their individual operating performance. The trading price of our common stock has been and is likely to continue to be volatile due to such factors as:

- Variations in quarterly results of operations;
- Announcements of new products or acquisitions by our competitors;
- Government regulatory action;
- Resolution of pending or unasserted litigation, including the existing stockholder lawsuits and SEC investigation;
- Developments or disputes with respect to proprietary rights; and
- General trends in our industry and overall market conditions.

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

Our Quarterly Operating Results Are Subject to Fluctuations, which Could Adversely Affect Our Financial Results and the Market Price of Our Common Stock.

Our quarterly operating results have varied significantly in the past and may fluctuate in the future as a result of a variety of factors, many of which are outside our control. Accordingly, quarter-to-quarter comparisons of our operating results may not be indicative of our future performance. Some of the factors causing these fluctuations include:

- Variability in demand for products and services;
- Introduction of product enhancements and new products by us and our competitors;
- Timing and significance of announcements concerning present or prospective strategic alliances;
- Discontinuation of, or reduction in, the products and services we offer;
- Loss of customers due to consolidation in the healthcare industry;

Delays in product delivery requested by our customers;

Customer budget cycle fluctuation;

Investment in marketing, sales, research and development, and administrative personnel necessary to support anticipated operations;

Costs incurred for marketing and sales promotional activities;

Software defects and other product quality factors;

General economic conditions and their impact on the healthcare industry;

Cooperation from competitors on interfaces and implementation when a customer chooses a QuadraMed software application to use with various vendors;

Delays in implementation due to product readiness, customer induced delays in training or installation, and third party interface development delays;

Final negotiated sales prices of systems;

Federal regulations (*i.e.*, OIG, HIPAA, ICD-10) that can increase demand for new, updated systems;

Federal regulations that directly affect reimbursements received, and therefore the amount of money available for purchasing information systems;

The fines and penalties a healthcare provider or system may incur due to fraudulent billing practices; and

Increases in third party royalty fees associated with embedded products in QuadraMed software applications.

Table of Contents

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

Future Sales of Our Common Stock in the Public Market, Warrants or Option Exercises and Sales Could Lower Our Stock Price.

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

Provisions in Our Certificate of Incorporation and Bylaws and Delaware Law Could Delay or Discourage a Takeover which Could Adversely Affect the Price of Our Common Stock.

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

Certain provisions of our certificate of incorporation and bylaws could discourage potential takeover attempts and make attempts to change management by stockholders difficult. Our Board of Directors has the authority to impose various procedural and other requirements that could make it more difficult for our stockholders to effect certain corporate actions. In addition, our certificate of incorporation provides that directors may be removed only by the affirmative vote of the holders of two-thirds of the shares of our capital stock entitled to vote. Any vacancy on our Board of Directors may be filled only by a vote of the majority of directors then in office. Further, our certificate of incorporation provides that the affirmative vote of two-thirds of the shares entitled to vote, voting together as a single class, subject to certain exceptions, is required for certain business combination transactions. These provisions, and certain other provisions of our certificate of incorporation, could have the effect of delaying or preventing (i) a tender offer for our common stock or other changes of control of QuadraMed that could be at a premium price or (ii) changes in our management.

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

We Do Not Expect to Pay Cash Dividends in the Foreseeable Future.

We have not declared or paid cash or other dividends on our common stock and do not expect to pay cash dividends for the foreseeable future. Also, under the terms of our 2008 notes, our excess cash must be used to redeem the notes. We currently intend to retain all future earnings for use in the operation of our business and to fund future growth. Any future cash dividends will depend upon our results of operations, financial conditions, cash requirements, the availability of a surplus and other factors.

Table of Contents

We May Be Liable for Violating the Intellectual Property Rights of Third Parties.

We do not believe that the intellectual property important to the operation of our business, whether owned by us or licensed to us by a third party, infringes or violates the intellectual property rights of any other party. However, intellectual property litigation is increasingly common in the software industry. The risk of an infringement claim against us may increase over time as the number of competitors in our industry segment grows and the functionality of products overlaps. Third parties have, in the past, asserted infringement claims and could assert infringement claims against us in the future. Regardless of the merits, we could incur substantial litigation expenses in defending any such asserted claim. In the event of an unfavorable ruling on any such claim, a license or similar agreement may not be available to us on reasonable terms, if at all. Infringement may also result in significant monetary liabilities that could have a material adverse effect on our business, financial condition, and results of operations. We may not be successful in the defense of these or similar claims. We have taken steps to contractually limit our liability for the use of intellectual property licensed to us by third parties. However, there can be no guarantee that we have adequate protection.

Our Inability to Protect Our Intellectual Property Could Lead to Unauthorized Use of Our Products, which Could Have an Adverse Effect on Our Business.

We rely on a combination of trade secret, copyright and trademark laws, nondisclosure, non-compete, and other contractual provisions to protect our proprietary rights. In 2001, we filed our first patent application covering our developed technology, the Affinity CPOE software application. This application lapsed, and we have no patents. Measures taken by us to protect our intellectual property may not be adequate, and our competitors could independently develop products and services that are substantially equivalent or superior to our products and services. Any infringement or misappropriation of our proprietary software and databases could put us at a competitive disadvantage in a highly competitive market and could cause us to lose revenues, incur substantial litigation expense, and divert management s attention from other operations.

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

We Face Product Development Risks Associated with Rapid Technological Changes.

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

Offer a broad range of software products;

Enhance existing products and expand product offerings;

Respond promptly to new customer requirements and industry standards;

Remain compatible with popular operating systems and develop products that are compatible with the new or otherwise emerging operating systems; and

Develop new interfaces with competing HIS vendors to fully integrate our Quantim product suite in order to maximize features and functionality of the new products.

Table of Contents

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

A Significant Amount of Our Assets Comprise Goodwill, Customer Lists and Other Intangible Items Subject to Impairment and Adjustment That Could Possibly Negatively Impact Our Results of Operations and Stockholders Equity.

A significant amount of our assets comprise intangible assets, such as the value of the installed customer base, core technology, capitalized software, goodwill, and other identifiable intangible assets acquired through our acquisitions, such as trademarks.

Pursuant to SFAS No. 142, we must test goodwill and other intangible assets for impairment at least annually and adjust them when impaired to the appropriate net realizable value. We engaged a valuation firm to perform an impairment test on the carrying value of our goodwill and intangibles as of December 31, 2002 and 2001. The valuation firm determined that there was no impairment as of these dates. We have engaged a valuation firm to perform the impairment test as of December 31, 2003, but we have not yet received that report. In addition, our internally-developed software has been capitalized assuming our earnings from these product developments exceeds the costs incurred to develop them. If it is determined that these assets have been impaired and our future operating results will not support the existing carrying value of our intangible assets, we will be required to adjust the carrying value of such assets to net realizable value.

We, however, cannot predict that all of our intangible assets will continue to remain unimpaired. Our future operating results and stockholders equity could possibly decrease with any future impairment and write-down of goodwill, customer lists, or other such intangibles.

The Nature of Our Products Makes Us Particularly Vulnerable to Undetected Errors or Bugs that Could Reduce Revenues, Market Share or Demand for Our Products and Services.

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

Loss of customers and revenue;

Delay in market acceptance;

Diversion of resources;

Damage to our reputation; or

Increased service and warranty costs.

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

Table of Contents

If Our Products Fail to Accurately Assess, Process, or Collect Healthcare Claims or Administer Managed Care Contracts, We Could Be Subject to Costly Litigation and Be Forced to Make Costly Changes to Our Products.

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

Changes in Procurement Practices of Hospitals Have and May Continue to Have a Negative Impact on Our Revenues.

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

Changes in the Healthcare Financing and Reimbursement System Could Adversely Affect the Amount of and Manner in which Our Customers Purchase Our Products And Services.

Changes in current healthcare financing and reimbursement systems could result in unplanned product enhancements, delays, or cancellations of product orders or shipments, or reduce the need for certain systems. We could also have the endorsement of products by hospital associations or other customers revoked. Any of these occurrences could have a material adverse effect on our business. Alternatively, the federal government recently mandated that all but small health care providers submit claims to Medicare in electronic format, which may positively affect our systems and product.

The healthcare industry in the United States is subject to changing political, economic, and regulatory influences that may affect the procurement practices and operations of healthcare organizations. The traditional hospital delivery system is evolving as more hospital services are being provided by niche, free standing practices and outpatient providers. The commercial value and appeal of our products may be adversely affected if the current healthcare financing and reimbursement system were to change. During the past several years, the healthcare industry has been subject to increasing levels of governmental regulation. Proposals to reform the healthcare system have been and are being considered by the United States Congress. These proposals, if enacted, could adversely affect the commercial value and appeal of our products or change the operating environment of our customers in ways that cannot be predicted. Healthcare organizations may react to these proposals by curtailing or deferring investments, including those for our products and services. In addition, the regulations promulgated under HIPAA could lead healthcare organizations to curtail or defer investments in non-HIPAA related features in the next several years.

The Variability and Length of Our Sales Cycle for Our Products May Exacerbate the Unpredictability and Volatility of Our Operating Results.

We cannot accurately forecast the timing of customer purchases due to the complex procurement decision processes of most healthcare providers and payers. How and when to implement, replace, expand or substantially

Table of Contents

modify an information system are major decisions for hospitals, and such decisions require significant capital expenditures by them. As a result, we typically experience sales cycles that extend over several quarters. In particular, our Affinity enterprise software has a higher average selling price and longer sales cycle than many of our other products. As a result, we have only a limited ability to forecast the timing and size of specific sales, making the prediction of quarterly financial performance more difficult.

We Operate in a Highly Competitive Market.

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

- In the market for enterprise healthcare information systems: McKesson Corporation, Inc., Shared Medical Systems, Inc., a division of Siemens, MediTech Corporation, Eclipsys Corporation, Cerner, and IDX Corporation;

- In the market for electronic document management products: McKesson Corporation, SoftMed Corporation Inc., FileNet, Lanvision, MedPlus, and Eclipsys Corporation;

- In the market for MPI products and services: Madison Technologies, Inc., McKesson Corporation, Shared Medical Systems, Inc., a division of Siemens, and Medibase;

- In the market for decision support products: Eclipsys Corporation, Healthcare Microsystems, Inc., a division of Health Management Systems Inc., McKesson Corporation, Shared Medical Systems, Inc., a division of Siemens, and MediQual Systems, Inc., a division of Cardinal Health, Inc.;

- In the market for coding, compliance, data, and record management products in the Health Information Management Software Division: 3M Corporation, SoftMed Corporation, Inc., MetaHealth, Eclipsys Corporation and HSS, Inc.;

- In the market for financial services: Advanced Receivables Strategy, Inc., a division of Perot Systems Corporation, NCO Group, Inc., Outsourcing Solutions, Inc., Health Management Systems, Inc., and Triage Consulting Group.

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

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

our business, financial condition, and operating results.

Table of Contents

We Have Encountered Significant Challenges Integrating Acquired Businesses, and Future Transactions May Adversely Affect Our Business, Operations, and Financial Condition.

From 1993 to 1999, we completed 28 acquisitions, and we encountered significant challenges integrating the acquired businesses into our operations. From 2000 through 2003, we made significant progress toward that integration. However, we continue to support several different technology platforms. In the future, we plan to make investments in or acquire additional complementary businesses, products, services or technologies. These investments and acquisitions will create new integration challenges. Some of the challenges we have encountered, and may encounter with acquisitions in the future, in integrating acquired businesses have included:

- Interruption, disruption or delay of our ongoing business;
- Distraction of management s attention from other matters;
- Additional operational and administrative expenses;
- Difficulty managing geographically dispersed operations;
- Failure of acquired businesses to achieve expected results, resulting in our failure to realize anticipated benefits;
- Write-down or reclassification of acquired assets;
- Failure to retain key acquired personnel and difficulty and expense of training those retained;
- Increases in stock compensation expense and increased compensation expense resulting from newly hired employees;
- Assumption of liabilities and potential for disputes with the sellers of acquired businesses;
- Customer dissatisfaction or performance problems related to acquired businesses;
- Failure to maintain good relations with customers or suppliers;
- Exposure to the risks of entering markets in which we have no direct prior experience and to risks associated with market acceptance of acquired products and technologies; and
- Platform and technical issues related to integrating systems from various acquired companies.

All of these factors have had an adverse effect on our business, financial condition, and results of operations in the past, and could have an adverse effect in the future.

No Mirror Processing Site for Our Customer Data Processing Facilities Exists; Our Business, Financial Condition, and Results of Operations Could Be Adversely Affected if These Facilities Were Subject to a Closure from a Catastrophic Event or Otherwise.

We currently process substantially all of our customer data at several of our facilities across the United States. Although we back up our data nightly and have safeguards for emergencies, such as power interruption or breakdown in temperature controls, we have no mirror processing site to which processing could be transferred in the case of a catastrophic event at any of these facilities. If a major catastrophic event occurs at these facilities possibly leading to an interruption of data processing, or any other interruption or closure, our business, financial condition, and results of operations could be adversely affected.

Table of Contents

We May Be Required to Make Substantial Changes to Our Products if They Become Subject to FDA Regulation, which Could Require a Significant Capital Investment.

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

Governmental Regulation of the Confidentiality of Patient Health Information Could Result in Our Customers Being Unable to Use Our Products Without Significant Modification, which Could Require Us to Expend Substantial Amounts.

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

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) is a federal law that affects the use, disclosure, transmission and storage of individually identifiable health information. As directed by HIPAA, the United States Department of Health and Human Services (HHS) must promulgate standards and implementation guidelines for certain electronic health transactions, code sets, data security, unique identification numbers, and privacy of individually identifiable health information. HHS has issued some of these regulations in final form while others remain in development. Moreover, HHS could, at any time in the future, modify any existing final regulations in a manner that could require us to change our systems or operations.

First, HHS published a final regulation governing transaction and code set standards that had an initial compliance date of October 16, 2002. If a covered entity (health care providers that transmit certain covered transactions in electronic form, health plans and health care clearinghouses) or its agent filed a timely extension, the covered entity would have received an additional year to comply with the HIPAA transaction and code sets requirements, until October 16, 2003. As a consequence, all covered entities must now comply with this regulation. As noted above, HHS may make further revisions to the transactions and code sets standards which could require us to change our products and systems to enable our covered entity customers to meet such obligations.

Second, HHS has published a final HIPAA privacy regulation which had a compliance date of April 14, 2003. The HIPAA privacy regulation is complex and far reaching. Similar to the HIPAA transaction and code sets regulation, the HIPAA privacy regulation applies to covered entities. Covered entities are, in most instances, required to execute a contract with any business associate that performs certain services on the covered entity s behalf involving protected health information. Under the regulations, QuadraMed s Financial Services and Electronic Data Interchange businesses are considered covered entities and are therefore governed by HIPAA regulations. QuadraMed s hospital customers are covered entities, and to the extent that QuadraMed customers use the software to manipulate protected health information and submit electronic transactions, QuadraMed is required by its customer contracts to ensure that the software complies with all relevant regulations. The HIPAA privacy regulation and state healthcare privacy regulations could materially restrict the ability of healthcare providers to disclose protected health

information from patient records using our products and services or could require us to make additional capital expenditures to be in compliance. Accordingly, the HIPAA privacy regulation and state privacy laws may significantly impact our product s use in the health care delivery system and therefore, decrease our revenue, increase working capital requirements and decrease future business prospects.

Table of Contents

Third, HHS has published the final HIPAA security regulation with a compliance date of April 21, 2005. The HIPAA security regulation applies to the use, disclosure, transmission, storage and destruction of electronic protected health information by covered entities. Covered entities must implement stringent security measures to ensure the confidentiality of the electronic protected health information, and to protect against the unauthorized use of the electronic protected health information. Implementing such measures will require us to expend substantial capital due to required product, service, and procedure changes.

QuadraMed has completed modifications to its business practices and software offerings and is currently in full compliance with HIPAA regulations. However, HHS continues to publish change notices to existing rules and propose new rules. There is no certainty that QuadraMed will be able to respond to all such rules in a timely manner and our inability to do so could adversely affect our business.

Government Regulation to Adopt and Implement ICD-10-CM and ICD-10-PCS Medical Code Set Standards Could Require Substantial Modification of our Coding and Compliance Software.

The American Health Information Management Association (AHIMA) and other prominent healthcare industry advocacy groups are calling on the Department of Health and Human Services (HHS) and the healthcare industry to take action to adopt and implement ICD-10-CM and ICD-10-PCS code sets, rules, and guidelines as a replacement for current ICD-9-CM guidelines used in our software products. Adoption of these new code sets would require us to change our systems and our methods which could require a significant expenditure of research and development capital and decrease future business prospects for our current product line.

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains certain forward-looking statements that we believe are within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbors created by such acts. For this purpose, any statements that are not statements of historical fact may be deemed to be forward-looking statements, including the statements made in the section of the prospectus under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations regarding our strategy, future operations, future expectations or future estimates, financial position and objectives of management. In some cases, you can identify forward-looking statements by terminology such as believes, anticipates, plans, should, expects, predicts, intends estimates, may, will , could , would , pro forma , seek , continue , or the negative of those terms or comparable terminology. Not all for statements contain such identifying words. These forward-looking statements are based on our current expectations and are subject to a number of risks, uncertainties and assumptions relating to our operations, results of operations, competitive factors, shifts in market demand and other risks and uncertainties. These statements are only predictions and we can give no assurance that such expectations will prove to be correct.

We discuss risks, uncertainties, and assumptions that could cause our actual results to differ from these forward looking statements elsewhere in this prospectus, including in the section entitled Risk Factors , and in our periodic reports filed with the SEC. These are factors that we believe could cause our actual results to differ materially from our expected and historical results.

Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of the assumptions could be inaccurate and actual results may differ from those indicated by the forward-looking

Table of Contents

statements included in this prospectus. You should not place undue reliance on these forward-looking statements. In light of the significant uncertainties inherent in the forward-looking statements included in this prospectus, you should not consider the inclusion of such information as a representation by us or anyone else that we will achieve such results. We undertake no obligation to publicly update any forward-looking statements, whether as the result of new information, future events, or otherwise. You are advised, however to consult any further disclosures we make in our subsequent current reports on Form 8-K, quarterly reports on Form 10-Q, annual reports on Form 10-K and other reports filed with the SEC.

WHERE YOU CAN FIND MORE INFORMATION

We have filed with the Securities and Exchange Commission a registration statement on Form S-1, including exhibits under the Securities Act with respect to the shares and notes to be sold in this offering. This prospectus does not contain all of the information set forth in the registration statement. For further information regarding QuadraMed Corporation and the common stock and notes offered by this prospectus, we refer you to the registration statement, including the exhibits thereto, and the financial statements and notes filed as a part thereof. With respect to each such document filed with the SEC as an exhibit to the registration statement, reference is made to the exhibit for a more complete description of the matter involved.

We file quarterly and annual reports, proxy statements and other information with the SEC. You may read and copy any document that we file at the public reference facilities of the SEC in Washington, D.C. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. Our SEC filings are also available to the public from the SEC s web site at http://www.sec.gov and on our website, http://www.quadramed.com, where all of our current SEC filings can be accessed free of charge.

USE OF PROCEEDS

The selling holders will receive all of the proceeds from the resale of the shares of common stock and notes that may be sold using this prospectus. We will not receive any of the proceeds from the resale of these shares of common stock and notes.

Table of Contents

PRICE RANGE OF OUR COMMON STOCK

Our common stock currently trades on the Over-the-Counter Bulletin Board market under the symbol QMDC.OB and on the Pink Sheets over-the-counter market under the symbol QMDC.PK .

The following table shows the trading history of our common stock:

Start Date	End Date	Market	Symbol
October 9, 1996	August 29, 2000	Nasdaq National Market	QMDC
August 30, 2000	May 22, 2002	Nasdaq SmallCap Market	QMDC
May 23, 2002	August 22, 2002	Nasdaq National Market	QMDC
August 23, 2002	March 3, 2003	Nasdaq National Market	QMDCE
March 4, 2003*	Present (January 21, 2004)	Pink Sheets	QMDC.PK
December 10, 2003	Present (January 21, 2004)	Over the Counter Bulletin Board	QMDC.OB

* On March 4, our common stock was delisted from the Nasdaq National Market.

On January 15, 2004, the high and low prices for our common stock on the Over-the-Counter Bulletin Board were $3.25 and $3.10 per share respectively. On January 8, 2004, there were 284 holders of record and approximately 4,600 beneficial holders of our common stock. This approximation is based on the number of the holders of record in addition to the number of proxy reports distributed to our beneficial holders as of the record date for our 2003 Annual Meeting held in October 2003.

The following table sets forth the high and low prices for our common stock traded on the Over-the-Counter Bulletin Board for the periods indicated.

Fiscal Year Ended December 31, 2003	High	Low
Quarter ended December 31 (December 10 December 30)	$ 2.650	$ 2.250
Fiscal Year Ending December 31, 2004	**High**	**Low**
Quarter ending March 31 (through January 15)	$ 3.180	$ 2.650

The following table sets forth the high and low bid and asked prices for our common stock traded on the Pink Sheets for the periods indicated.

Fiscal Year Ended December 31, 2003	High	Low
Quarter ended March 31 (March 4 March 31)	$ 1.160	$ 0.349
Quarter ended June 30	$ 1.950	$ 0.950

Quarter ended September 30	$ 2.700	$ 1.740
Quarter ended December 31 (through December 16)	$ 2.870	$ 2.250

The following table sets forth the range of our common stock with high and low closing sales prices as reported on the applicable Nasdaq Market for the periods indicated.

Fiscal Year Ended December 31, 2002 [1]	**High**	**Low**
Quarter ended March 31	$ 11.550	$ 8.110
Quarter ended June 30	$ 9.640	$ 5.570
Quarter ended September 30	$ 6.980	$ 1.470
Quarter ended December 31	$ 3.000	$ 1.160

Fiscal Year Ended December 31, 2003 [2]	**High**	**Low**
Quarter ended March 3 (January 1 March 4)	$ 2.670	$ 0.349

(1) Stock traded on Nasdaq SmallCap Market until May 22, 2002. Stock traded on the Nasdaq National Market starting May 23,2002.
(2) Stock traded on the Nasdaq National Market.

We have authorized 150,000,000 shares of common stock, par value $0.01 per share. We have authorized 5,000,000 shares of preferred stock, par value $0.01 per share. Our Board of Directors has authority to provide for the issuance of our shares of preferred stock in series, to establish from time to time the number of shares to be included in each such series and to fix the designation, powers, preferences and rights of the shares of each such

Table of Contents

series and the qualifications, limitations or restrictions thereof, without any further vote or action by the stockholders. As of January 19, 2004, we had 27,727,924 shares of common stock outstanding and no outstanding preferred stock.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our common stock and do not anticipate paying any cash dividends in the foreseeable future. We anticipate that we will retain earnings, if any, to finance the growth and development of our business. Additionally, the terms of our 2008 notes require us to use excess cash to buy back 2008 notes. Therefore, we do not expect to pay cash dividends on our common stock for the foreseeable future. Any future determination to pay cash dividends will be at the discretion of our Board of Directors and will depend upon our financial condition, operating results, capital requirements, plans for expansion, restrictions imposed by any financing arrangements and whatever other factors that our Board of Directors determines are relevant.

Table of Contents

SELECTED FINANCIAL DATA

The following selected financial data for the fiscal years ended December 31, 2002, 2001, 2000, 1999, and 1998 included herein is derived from our audited consolidated Financial Statements and related notes thereto. The financial data for the nine months ended September 30, 2003 and 2002 are derived from the unaudited interim condensed consolidated Financial Statements included elsewhere in this prospectus, are prepared on the same basis as our audited consolidated Financial Statements, and include all adjustments, consisting of only normal recurring adjustments, that we consider necessary for a fair presentation of our financial position and results of operations at and for such periods. This selected consolidated financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations , and the audited consolidated Financial Statements and related notes thereto and the unaudited interim condensed consolidated Financial Statements and related notes thereto included in this prospectus. Historical results are not necessarily indicative of future results.

	Nine months ended September 30,		Year Ended December 31,				
	(unaudited)		(In thousands, except per share amounts)				
	2003	2002	2002	2001	2000	1999	1998[1][2]
Consolidated Statement of Operations Data							
Revenue	$ 88,373	$ 79,072	$ 109,585	$ 117,046	$ 121,012	$ 199,162	$ 172,228
Restatement costs	6,550	3,300	7,463				
Extraordinary gain on redemption of debentures				12,907			
Income (loss) from continuing operations	(22,193)	(14,255)	(20,858)	11,952	(39,354)	(52,527)	(16,308)
Net income (loss)	(22,193)	(15,783)	(14,362)	9,413	(36,675)	(47,388)	(21,376)
Basic income (loss) per share from continuing operations	(0.81)	(0.53)	(0.77)	0.47	(1.53)	(2.20)	(0.85)
Basic net income (loss) per share	(0.81)	(0.59)	(0.53)	0.37	(1.43)	(1.99)	(0.91)
Diluted income (loss) per share from continuing operations	(0.81)	(0.53)	(0.77)	0.47	(1.53)	(2.20)	(0.85)
Diluted net income (loss) per share	(0.81)	(0.59)	(0.53)	0.37	(1.43)	(1.99)	(0.91)
Other Data[3]							
Ratio of earnings to fixed charges and preferred dividends[4]							
Deficiency of earnings to cover combined fixed charges and preferred dividends	22,193	14,255	20,858	805	38,737	52,527	21,376
Consolidated Balance Sheet Data:							
Cash, cash equivalents and short term investments	$ 35,580	$ 24,175	$ 26,191	$ 32,213	$ 39,664	$ 29,732	$ 89,574
Total assets	133,352	121,101	126,927	125,133	149,286	201,759	264,733
Deferred revenue	49,141	38,950	39,492	30,721	22,489	7,258	14,021
Working capital	11,091	10,480	18,137	32,509	46,107	61,030	94,963
Notes and debentures	71,226	73,719	73,719	73,719	115,000	115,000	115,000

(1) Revenue for 1998 does not reflect the adoption of EITF No. 01-14, *Income Statement Characterization of Reimbursements for Out-of-Pocket Expenses Incurred*. Accordingly, revenue has not been increased to reflect any billable out-of-pocket reimbursable expenses. All other periods presented reflect the adoption of this standard.

(2) Discontinued operations have not been segregated from the 1998 results as the company structure was significantly different at that time. All other periods presented reflect the classification of HIMS Services Division as a discontinued operation.

(3) For purposes of determining the ratio of earnings to combined fixed charges and preferred dividends and the deficiency of earnings to cover combined fixed charges and preferred dividends, earnings includes pre-tax income (loss) adjusted for fixed charges and preferred dividends. Fixed charges consist of interest expensed and capitalized, amortization of deferred financing charges, and that portion of operating lease rental expense (deemed to be 30% of rental expense) representative of interest.

(4) The ratios of combined fixed charges and preferred dividends to earnings are not presented for the years ended 2002, 2001, 2000, 1999 and 1998 and for the nine months ended September 3, 2003 and 2002 because earnings were inadequate to cover combined fixed charges and preferred dividends.

Table of Contents

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our consolidated Financial Statements appearing elsewhere in this prospectus.

Critical Accounting Policies and Estimates

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

Principles of Consolidation

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

Use of Estimates

Management s discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements included herein, which have been prepared in accordance with GAAP. In preparing these financial statements, we make estimates, assumptions, and judgments that affect the reported amounts of assets and liabilities, contingent assets and liabilities, revenues, and expenses. Significant estimates and assumptions have been made regarding revenue recognition, the allowance for doubtful accounts, capitalized software, income taxes, pensions and other benefits, contingencies and litigation and intangibles, primarily goodwill and customer lists, resulting from our purchase business combinations. We base our estimates, assumptions, and judgments on historical experience and on various other assumptions which management believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Uncertainties inherent in these estimates include projections of future operating results and the discount rates used to determine the net present values of these future results and useful lives of the acquired assets as well as technological advances. In addition, for our fixed-price contracts, we make significant estimates within percentage-of-completion accounting, including estimating total costs to be incurred as calculated on a labor hour basis. We annually review and test our estimates, specifically those related to the valuations of intangibles including acquired software, goodwill, customer lists, trademarks and other intangibles, and capitalized software. Actual results may differ materially from these estimates.

Revenue Recognition

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

Our license revenue consists of fees for licenses of proprietary and third-party software. Cost of license revenue primarily includes third-party software and royalties and amortization of capitalized software. Our service revenue consists of maintenance, customer training, and consulting services and fees for providing management services, such as accounts receivable and payment collection outsourcing, specialized staffing, analytical services, seminars and hardware. Cost of services consists primarily of salaries, benefits, and allocated costs related to providing such services, labor costs for engineers performing implementation services, technical support, training personnel and hardware.

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

Table of Contents

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

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

SOP 97-2, as amended, generally requires revenue earned on software arrangements involving multiple elements to be allocated to each element based on the relative fair values of the elements. Revenue recognized from multiple-element arrangements is allocated to undelivered elements of the arrangement, such as maintenance, support and professional services, based on the relative fair values of the elements specific to us. Our determination of fair value of each element in multi-element arrangements is based on vendor-specific objective evidence (VSOE). We limit our assessment of VSOE for each element to either the price charged when the same element is sold separately or the price established by management, having the relevant authority to do so, for an element not yet sold separately.

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

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

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

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

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

Table of Contents

Accounts Receivable and Allowance for Doubtful Accounts

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

Intangible Assets

Goodwill. In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 142, *Goodwill and Other Intangible Assets*, effective for fiscal years beginning after December 15, 2001. Under SFAS No. 142, goodwill and intangible assets deemed to have indefinite lives are to be separately disclosed on the balance sheet, and no longer amortized but subject to annual impairment tests. With the adoption of SFAS No. 142, we ceased amortization of goodwill as of January 1, 2002. Prior to this point, goodwill was amortized using the straight-line method over its estimated useful life.

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

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

Capitalized Software. Software development costs are capitalized upon the establishment of technological feasibility. In accordance with SFAS No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed*, we establish technological feasibility upon completion of a detailed program design determined on a project-by-project basis, which substantiates that the computer software product can be produced in accordance with its design specifications. Software development costs are capitalized based upon an assessment of their recoverability. This assessment requires considerable judgment by management with respect to various factors, including, but not limited to, anticipated future gross margins, estimated economic lives, and changes in software and hardware technology. Amortization is based on the greater of the ratio that current revenues bear to total and anticipated future revenues for the applicable product, or the straight-line method over the remaining estimated economic life of the product, generally five years, and is charged to cost of licenses.

Other Intangible Assets. Other intangible assets primarily relate to acquired software, trademarks and customer lists acquired in our purchase business combinations. On January 1, 2002, we adopted the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which generally requires impairment losses to be recorded on long-lived assets (excluding goodwill) used in operations, such as property, equipment and improvements, and intangible assets, when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount of the assets. The provisions of this statement did not have a significant impact on our financial condition or operating results.

New Accounting Standards

In November 2002, the Emerging Issues Task Force (EITF) reached consensus on issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables* on a model to be used to determine when a revenue arrangement with multiple deliverables should be divided into separate units of accounting and, if separation is appropriate, how the arrangement consideration should be allocated to the identified accounting units. The EITF also reached a consensus that this guidance should be effective for all revenue arrangements entered into for fiscal periods beginning after June 15, 2003, which for QuadraMed would be the quarter ending September 30, 2003. The company does not expect the adoption of EITF No. 00-21 to have a material impact on the company s consolidated financial position, results of operations or cash flows.

Table of Contents

In January 2003, the FASB issued FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, as amended in December 2003 by No. 46-R, which addresses the consolidation of variable interest entities in which an enterprise absorbs a majority of the entity s expected losses, receives a majority of the entity s expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity. FIN No. 46 was effective upon issuance for certain disclosure requirements and for variable interest entities created after January 1, 2003, and in the first fiscal year or interim period beginning after June 15, 2003 for all other variable interest entities. Adoption of the standard is not expected to have a material impact on the company s consolidated financial position, results of operations or cash flows.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. SFAS No. 149 amends and clarifies financial reporting for certain derivative instruments and for hedging activities accounted for under SFAS No. 133 and is effective for contracts entered into or modified, and for hedges designated, after June 30, 2003. Adoption of the standard is not expected to have a material impact on the company s consolidated financial position, results of operations or cash flows.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with characteristics of both Liabilities and Equity*. SFAS No. 150 requires that certain financial instruments issued in the form of shares that are mandatorily redeemable as well as certain other financial instruments be classified as liabilities in the financial statements. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003. The provisions of this statement are not expected to have a material impact on the company s consolidated financial position, results of operations or cash flows.

Results of Operations for the Nine Months ended September 30, 2003 and 2002

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

	Nine months ended September 30,			
	2003		2002	
	(unaudited)		(unaudited)	
Revenue				
Services and other	$ 58,294	66.0%	$ 57,419	72.6%
Licenses	30,079	34.0	21,653	27.4
Total revenue	88,373	100.0	79,072	100.0
Cost of revenue				
Cost of services and other	31,190	53.5	26,508	46.2
Cost of licenses	5,363	17.8	6,193	28.6
Total cost of revenue	36,553	41.4	32,701	41.4
Gross margin	51,820	58.6	46,371	58.6
Operating expenses				
Sales and marketing	16,858	19.1	16,030	20.3

Research and development	17,080	19.3	12,535	15.9
General and administration	32,747	37.1	26,572	33.6
Amortization and other operating charges	1,756	2.0	2,401	3.0
Total operating expenses	68,441	77.5	57,538	72.8

Table of Contents

Revenue

Total Revenue. Total revenue for the nine months ended September 30, 2003, was $88.4 million, an increase of $9.3 million or 11.8% from $79.1 million for the nine months ended September 30, 2002.

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

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

For the nine months ended September 30, 2003, the Enterprise division s service and other revenue increased primarily due to a significant hardware sale and overall increased installations.

Service and other revenue for the HIM Software division improved slightly for the nine months ended September 30, 2003 primarily due to the increase in coding software and record management products revenue resulting from customer installations and maintenance renewals.

Revenue for the Financial Services division has decreased by approximately $2.4 million for the nine months in 2003 compared to 2002 due to a decrease in the quality of assignments and average lower contract fees.

Licenses. License revenue consists of fees for licenses of proprietary and third-party software. We market our products through our direct sales force. For the nine months ended September 30, 2003, license revenue was $30.1 million, an increase of $8.4 million or 38.9% compared to $21.7 million in the first nine months of 2002.

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

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

Cost of Revenue

Cost of Services and Other. Cost of services and other consists of salaries and related expenses associated with services performed for customer support, consulting services as well as third-party hardware costs. Cost of services and other for the nine months ended September 30, 2003 was $31.2 million, an increase of $4.7 million or 17.7% compared to the $26.5 million recorded in the corresponding period of 2002. As a percentage of services and other revenue, cost of services and other was 53.5% and 46.2% for the nine months ended September 30, 2003 and 2002, respectively.

Table of Contents

The Enterprise division cost of services and other increased substantially for the nine month period in 2003 compared to 2002 due to increased salary and bonus expense and hardware cost due to the related hardware revenue.

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

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

Cost of Licenses. Cost of license consists primarily of third party software and royalties and amortization of capitalized software. For the nine months ended September 30, 2003, cost of license was $5.4 million, a decrease of $830,000 or 13.4% from $6.2 million from the same period of 2002. As a percentage of license revenues, cost of license was 17.8% and 28.6% for the nine months ended September 30, 2003 and 2002, respectively.

The decrease for the nine months ended September 30, 2003 was primarily due to a decrease in the cost of third party software license in the Enterprise division as a result of lower third party software license revenue. The gross margin in license revenue for the HIM software division improved in 2003 due to the mix of license revenue in comparison to the cost of licenses.

Operating Expenses

Sales and Marketing. Sales and marketing expense includes costs associated with our sales and marketing personnel and product marketing personnel and consists primarily of compensation and benefits, commissions and bonuses, promotional and advertising expenses. For the nine months ended September 30, 2003, sales and marketing expense was $16.9 million, an increase of $828,000 or 5.2% compared to $16.0 million in the first nine months of 2002. As a percentage of total revenue, sales and marketing expense was 19.1% for the nine months ended September 30, 2003 as compared to 20.3% in the same quarter of 2002.

In absolute dollars, the increase in sales and marketing expense for the nine months ended September 30, 2003 was primarily due to an increase in salaries and bonus expense reduced by marketing expenses.

Research and Development. Research and development expense includes costs associated with the development of new products, enhancements of existing products for which technological feasibility has not been achieved, and quality assurance activities and primarily includes compensation and benefits costs. For the nine months ended September 30, 2003, research and development costs were $17.1 million, an increase of $4.5 million or 36.3% from $12.5 million in the first nine months of 2002. The increase in research and development expense was primarily due to product development efforts for the continued development of both the Affinity and HIM software suite of products. The level of research and development investments increased in the first nine months of 2003 with the primary funding of Affinity development.

During the nine months ended September 30, 2003, there were no capitalized costs from software development compared to approximately $1.7 million in the first nine months of 2002.

General and Administration. General and administration expense consists of compensation and benefit costs for executive, finance, legal, information technology, and administrative personnel. For the nine months ended September 30, 2003, general and administration expense was $32.7 million, an increase of $6.2 million or 23.2% from $26.6 million in the comparable period in 2002. As a percentage of total revenue, general and administration expense increased to 37.1% for the nine months ended September 30, 2003 from 33.6% in the nine months ended September 30, 2002.

The increase in general and administration expense for the nine months ended September 30, 2003, was due to an increase in accountants, consultants and attorneys fees and retention bonuses as part of the restatement process of $3.5 million, and in increase in employee benefits and contractual services.

Table of Contents

Amortization and Other Operating Charges. Amortization and other operating charges represented amortization of identifiable intangible assets and in process research and development. Expense for the nine months in 2002 also includes a $400,000 write-off of in-process research and development expense associated with the acquisition of PDS.

Other Income (Expense)

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

Income Taxes

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

Results of Operations for the Years ended December 31, 2002, 2001, and 2000

The following table sets forth certain items from our consolidated statement of operations, expressed as percentage of total revenue.

	Year ended December 31,		
	2002	**2001**	**2000**
Revenue			
Services	70.1%	70.5%	76.4%
Licenses	29.9	29.5	23.6
Total revenue	100.0	100.0	100.0
Cost of revenue			
Cost of services	32.9	29.1	45.3
Cost of licenses	8.3	7.4	5.9
Total cost of revenue	41.2	36.5	51.2
Gross margin	58.8	63.5	48.8

Operating expenses			
General and administration	37.5	30.5	47.1
Sales and marketing	19.7	17.7	19.6
Research and Development	15.7	12.3	20.3
Amortization, impairment and other operating charges	2.8	7.7	9.2
Total operating expenses	75.7	68.2	96.2
Loss from operations	(16.9)	(4.7)	(47.4)