

AMERICAN HEALTHWAYS INC

Form 8-K/A

October 10, 2003

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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FORM 8-K/A

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): October 10, 2003 (September 5, 2003)

American Healthways, Inc.

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(Exact Name of Registrant as Specified in Charter)

Delaware

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(State or Other Jurisdiction of  
Incorporation)

000-19364

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(Commission File  
Number)

62-1117144

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(I.R.S. Employer  
Identification No.)

3841 Green Hills Village Drive  
Nashville, Tennessee

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(Address of Principal Executive Offices)

37215

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(Zip Code)

Registrant's telephone number, including area code: (615) 665-1122

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(Former name or former address, if changed since last report)

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**ITEM 7. FINANCIAL STATEMENTS AND EXHIBITS.**

This Form 8-K/A amends the Registrant's current report on Form 8-K dated September 9, 2003 to include the following financial information required to be filed pursuant to Item 7 (Financial Statements and Exhibits).

(a) Financial Statements of Businesses Acquired:

1. Independent Auditors' Report.
2. Balance sheets of StatusOne Health Systems, Inc. as of December 31, 2002 and 2001.
3. Statements of operations of StatusOne Health Systems, Inc. for the years ended December 31, 2002 and 2001.
4. Statements of stockholders' equity of StatusOne Health Systems, Inc. for the years ended December 31, 2002 and 2001.
5. Notes to audited financial statements.
6. Unaudited balance sheet of StatusOne Health Systems, Inc. as of May 31, 2003.
7. Unaudited statements of operations of StatusOne Health Systems, Inc. for the five months ended May 31, 2003 and 2002.
8. Unaudited statements of cash flows of StatusOne Health Systems, Inc. for the five months ended May 31, 2003 and 2002.
9. Notes to unaudited financial statements.

(b) Pro Forma Financial Information:

1. Unaudited pro forma combined balance sheet of American Healthways, Inc. as of May 31, 2003.
2. Unaudited pro forma combined statements of operations of American Healthways, Inc. for the year ended August 31, 2002 and the nine months ended May 31, 2003.
3. Notes to unaudited pro forma combined balance sheet and statements of operations.

(c) Exhibits:

- 10.1 Revolving Credit and Term Loan Agreement between American Healthways, Inc. and SunTrust Bank as Administrative Agent, National City Bank as Documentation Agent, and U.S. Bank, N.A., as Syndication Agent, dated September 5, 2003. (The schedules and exhibits to this agreement are omitted pursuant to SEC regulations but will be provided supplementary to the Commission upon request).
- 10.2 Form of Revolving Credit Note.
- 10.3 Form of Term Note.
- 10.4 Form of Swingline Note.
- 10.5 Form of Subsidiary Guaranty Agreement between American Healthways, Inc. and SunTrust Bank as Administrative Agent.
- 23.1 Consent of Ernst & Young LLP.

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**INDEPENDENT AUDITORS' REPORT**

To the Board of Directors of StatusOne Health Systems, Inc.

We have audited the accompanying balance sheets of StatusOne Health Systems, Inc. as of December 31, 2002 and 2001, and the related statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of StatusOne Health Systems, Inc. at December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP  
Nashville, Tennessee  
August 15, 2003 (except with respect to the matters discussed  
in Note 9, as to which the date is September 5, 2003)

**Table of Contents****STATUSONE HEALTH SYSTEMS, INC.****BALANCE SHEETS**

|                                                                                         | <b>December 31,</b> |             |
|-----------------------------------------------------------------------------------------|---------------------|-------------|
|                                                                                         | <b>2002</b>         | <b>2001</b> |
| <b>Assets:</b>                                                                          |                     |             |
| Current assets:                                                                         |                     |             |
| Cash and cash equivalents                                                               | \$3,692,163         | \$2,305,115 |
| Investments                                                                             | 392,006             | 188,570     |
| Accounts receivable                                                                     | 301,613             | 318,891     |
| Prepaid expenses and other current assets                                               | 109,050             | 128,851     |
| Deferred tax assets                                                                     | 262,234             | 94,694      |
| Total current assets                                                                    | 4,757,066           | 3,036,121   |
| Property and equipment:                                                                 |                     |             |
| Leasehold improvements                                                                  | 39,219              | 3,484       |
| Computer and phone equipment                                                            | 612,613             | 229,210     |
| Software development costs                                                              | 39,939              | 39,939      |
| Furniture and fixtures                                                                  | 258,126             | 151,280     |
| Total                                                                                   | 949,897             | 423,913     |
| Less accumulated depreciation                                                           | (248,316)           | (120,860)   |
| Net property and equipment                                                              | 701,581             | 303,053     |
| Other assets:                                                                           |                     |             |
| Security deposits                                                                       | 33,032              | 26,275      |
| Deferred tax assets                                                                     | 67,270              | 56,216      |
| Total assets                                                                            | \$5,558,949         | \$3,421,665 |
| <b>Liabilities:</b>                                                                     |                     |             |
| Current liabilities:                                                                    |                     |             |
| Trade accounts payable                                                                  | \$ 103,948          | \$ 152,595  |
| Employee compensation accruals                                                          | 1,903,135           | 892,821     |
| Deferred license fees                                                                   | 296,983             |             |
| Deferred start-up fees                                                                  | 90,000              | 84,442      |
| Other accrued expenses                                                                  | 117,153             | 13,452      |
| Accrued taxes                                                                           | 804,262             | 113,608     |
| Billings in excess of earnings                                                          | 233,468             | 1,471,995   |
| Total current liabilities                                                               | 3,548,949           | 2,728,913   |
| Deferred start-up fees                                                                  | 235,042             | 188,500     |
| <b>Stockholders' equity:</b>                                                            |                     |             |
| Common stock Class A                                                                    |                     |             |
| \$ .001 par value, 5,500,000 shares authorized; 5,152,000 shares issued and outstanding | 5,152               | 5,152       |
| Common stock Class B                                                                    |                     |             |
| \$ .001 par value, 4,500,000 shares authorized; 257,712 shares issued and outstanding   | 258                 | 258         |
| Additional paid-in capital                                                              | 22,590              | 22,590      |
| Retained earnings                                                                       | 1,773,132           | 496,009     |
| Unrealized losses on investments, net of income taxes                                   | (26,174)            | (19,757)    |
| Total stockholders' equity                                                              | 1,774,958           | 504,252     |

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|                                            |                    |                    |
|--------------------------------------------|--------------------|--------------------|
| Total liabilities and stockholders' equity | <u>\$5,558,949</u> | <u>\$3,421,665</u> |
|--------------------------------------------|--------------------|--------------------|

See accompanying notes to the financial statements.

**Table of Contents****STATUSONE HEALTH SYSTEMS, INC.****STATEMENTS OF OPERATIONS**

|                                          | <b>Year Ended December 31,</b> |                   |
|------------------------------------------|--------------------------------|-------------------|
|                                          | <b>2002</b>                    | <b>2001</b>       |
| Net revenues                             | \$ 14,102,241                  | \$ 7,267,816      |
| Expenses:                                |                                |                   |
| Employee compensation expenses           | 9,940,481                      | 5,946,467         |
| Other operating expenses                 | 1,963,503                      | 907,348           |
| Depreciation and amortization            | 127,456                        | 61,511            |
|                                          | <u>12,031,440</u>              | <u>6,915,326</u>  |
| Operating income                         | 2,070,801                      | 352,490           |
| Interest and dividend income             | 66,200                         | 111,767           |
|                                          | <u>2,137,001</u>               | <u>464,257</u>    |
| Income before provision for income taxes | 2,137,001                      | 464,257           |
| Provision for income taxes               | 859,878                        | 186,074           |
|                                          | <u>\$ 1,277,123</u>            | <u>\$ 278,183</u> |
| Net income                               |                                |                   |
|                                          | <u>\$ 0.24</u>                 | <u>\$ 0.05</u>    |
| Basic income per share                   |                                |                   |
|                                          | <u>\$ 0.23</u>                 | <u>\$ 0.05</u>    |
| Diluted income per share                 |                                |                   |
|                                          | <u>\$ 0.23</u>                 | <u>\$ 0.05</u>    |
| Weighted average shares and equivalents  |                                |                   |
| Basic                                    | 5,409,712                      | 5,409,712         |
| Diluted                                  | 5,623,725                      | 5,535,819         |

See accompanying notes to the financial statements.

**Table of Contents****STATUSONE HEALTH SYSTEMS, INC.****STATEMENTS OF STOCKHOLDERS EQUITY**

|                                                                 | Common Stock |         |         |        | Additional<br>Paid in<br>Capital | Retained<br>Earnings | Unrealized<br>Losses on<br>Investments | Total        |
|-----------------------------------------------------------------|--------------|---------|---------|--------|----------------------------------|----------------------|----------------------------------------|--------------|
|                                                                 | Class A      |         | Class B |        |                                  |                      |                                        |              |
|                                                                 | Shares       | Amount  | Shares  | Amount |                                  |                      |                                        |              |
|                                                                 |              |         |         |        |                                  |                      |                                        |              |
| Balance, December 31, 2000                                      | 5,152,000    | \$5,152 | 257,712 | \$ 258 | \$22,590                         | \$ 217,826           | \$ (5,932)                             | \$ 239,894   |
| Net income                                                      |              |         |         |        |                                  | 278,183              |                                        | 278,183      |
| Unrealized losses on securities, net of income taxes of \$9,217 |              |         |         |        |                                  |                      | (13,825)                               | (13,825)     |
| Total comprehensive income                                      |              |         |         |        |                                  |                      |                                        | 264,358      |
| Balance, December 31, 2001                                      | 5,152,000    | 5,152   | 257,712 | 258    | 22,590                           | 496,009              | (19,757)                               | 504,252      |
| Net income                                                      |              |         |         |        |                                  | 1,277,123            |                                        | 1,277,123    |
| Unrealized losses on securities, net of income taxes of \$4,278 |              |         |         |        |                                  |                      | (6,417)                                | (6,417)      |
| Total comprehensive income                                      |              |         |         |        |                                  |                      |                                        | 1,270,706    |
| Balance, December 31, 2002                                      | 5,152,000    | \$5,152 | 257,712 | \$ 258 | \$22,590                         | \$ 1,773,132         | \$ (26,174)                            | \$ 1,774,958 |

**Table of Contents****STATUSONE HEALTH SYSTEMS, INC.****STATEMENTS OF CASH FLOWS**

|                                                                                   | <b>Year Ended December 31,</b> |                    |
|-----------------------------------------------------------------------------------|--------------------------------|--------------------|
|                                                                                   | <b>2002</b>                    | <b>2001</b>        |
| <b>Cash flows from operating activities:</b>                                      |                                |                    |
| Net income                                                                        | \$ 1,277,123                   | \$ 278,183         |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                |                    |
| Depreciation and amortization                                                     | 127,456                        | 61,511             |
| Changes in operating assets and liabilities:                                      |                                |                    |
| Accounts receivable                                                               | 17,278                         | (268,761)          |
| Prepaid expenses and other current assets                                         | 19,801                         | (97,345)           |
| Security deposits                                                                 | (6,757)                        | (25,000)           |
| Trade accounts payable                                                            | (48,647)                       | (28,558)           |
| Accrued expenses                                                                  | 1,114,015                      | 761,226            |
| Deferred license fees                                                             | 296,983                        |                    |
| Accrued taxes                                                                     | 690,654                        | (4,403)            |
| Deferred tax assets                                                               | (178,594)                      | (84,492)           |
| Deferred start-up fees                                                            | 52,100                         | 157,550            |
| Billings in excess of earnings                                                    | (1,238,527)                    | 350,266            |
| Net cash provided by operating activities                                         | <u>2,122,885</u>               | <u>1,100,177</u>   |
| <b>Cash flows from investing activities:</b>                                      |                                |                    |
| Purchase of property and equipment, net                                           | (525,984)                      | (163,488)          |
| Sale (purchase) of investments, net                                               | (209,853)                      | 545,418            |
| Net cash provided by (used in) investing activities                               | <u>(735,837)</u>               | <u>381,930</u>     |
| Net increase in cash and cash equivalents                                         | 1,387,048                      | 1,482,107          |
| Cash and cash equivalents, beginning of year                                      | <u>2,305,115</u>               | <u>823,008</u>     |
| Cash and cash equivalents, end of year                                            | <u>\$ 3,692,163</u>            | <u>\$2,305,115</u> |
| <b>Supplemental disclosure of cash flow information:</b>                          |                                |                    |
| Cash paid during the year for interest                                            | <u>\$ 633</u>                  | <u>\$ 1,258</u>    |
| Cash paid during the year for income taxes                                        | <u>\$ 935,841</u>              | <u>\$ 250,662</u>  |

See accompanying notes to the financial statements.

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**STATUSONE HEALTH SYSTEMS, INC.**

**NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2002**

**1. Summary of Significant Accounting Policies**

**Organization**

StatusOne Health Systems, Inc. (the Company) was formed in 1997 and incorporated under the laws of Massachusetts on October 1, 1997. Under a reorganization plan effective January 1, 2001, a Delaware corporation was formed, and substantially all assets and liabilities of the Massachusetts corporation were transferred to the Delaware corporation. The Company provides managed care organizations the ability to lower medical costs, reduce hospital admissions and improve the functional status of its high-risk members. Managed care organizations have the option of purchasing the Company's complete outsourced solution for high-risk care management or, alternatively, they can license the Company's proprietary technology application, CareLink, along with training and consulting services to enable their own staff to provide the care management to high-risk members.

**Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

**Revenue Recognition and Accounts Receivable**

Fees under the Company's contracts with customers are generally determined by multiplying a contractually negotiated rate per health plan member per month (PMPM) by the total number of health plan members during the month. In some contracts, the PMPM rate may differ between health plan product groups (e.g., PPO, HMO, Medicare). These contracts are generally for terms of five years with provisions for subsequent renewal and are terminable with a required notice period at any time. Some of the Company's contracts in 2002 and 2001 (comprising approximately 18% and 52% of the Company's net revenues recorded in 2002 and 2001, respectively) are performance-based and subject to refund should certain performance targets not be met. The Company earns performance-based fees upon achieving a targeted percentage reduction in the customer's healthcare costs, in addition to clinical and other criteria that focus on improving the health of the members, compared to a baseline year.

The Company bills its customers each month for the entire amount of fees contractually due for that month's enrollments, which always includes the amount, if any, that may be subject to refund. The Company recognizes the fixed portion of the monthly fees during the period the services are performed and any performance-based fees are deferred until a final settlement is reached with the customer. The amounts deferred are included in billings in excess of earnings on the balance sheets. At the end of each contract year, a contract reconciliation is performed to determine if the cost savings targets have been met. Based on the results of the contract reconciliation and/or negotiations with the customer, the Company may recognize additional revenue and/or refund fees to the customer. During the years ended December 31, 2002 and 2001, the Company recognized approximately \$606,000 and \$0, respectively, of performance-based fees as the result of final settlements with customers.

Certain customers pay license fees in advance of the performance of services. These license fees are deferred and recognized in the period in which the services are performed.

At the inception of each contract, prior to the initiation of service, customers pay certain start-up fees to the Company. These fees are deferred over the original term of the contract.

During the years ended December 31, 2002 and 2001, approximately 62% and 72%, respectively, of the Company's

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revenues were derived from contracts with three healthcare organizations. During 2001, three contracts each comprised more than 10% of the Company's revenues. During 2002, one of these contracts was terminated and a contract with a new health plan comprising more than 10% of the Company's 2002 revenues was added.

### **Cash and Cash Equivalents**

The Company considers highly liquid investments with original maturities of three months or less to be cash equivalents.

### **Concentration of Credit Risk**

The Company's credit risks primarily relate to cash and cash equivalents and accounts receivable. Cash and cash equivalents are primarily held in bank accounts, whose balances may exceed federally-insured limits. Accounts receivable consists of amounts due from customers.

The Company had three customers that represented 92% of accounts receivable at December 31, 2002. The Company had a different customer that represented 74% of accounts receivable at December 31, 2001.

The Company considers all accounts receivable to be fully collectible and has not provided an allowance for uncollectible accounts. The Company continually reviews the collectibility of its accounts receivable.

### **Income Taxes**

The Company files Federal and state tax returns and computes its income tax provision under Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. This statement requires the Company to record deferred income taxes for the differences between the book and tax bases of its assets and liabilities.

### **Property and Equipment**

Property and equipment is recorded at cost and includes expenditures that increase value or extend useful lives. The cost of maintenance and repairs is expensed in the period incurred.

Depreciation is computed over the estimated useful lives of assets using the straight-line method. The company's leasehold improvements, computer and phone equipment, and software development costs are depreciated over five years. Furniture and fixtures are depreciated over seven years.

The Company has capitalized certain software development costs associated with the development of CareLink in accordance with SFAS No. 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed. Amortization of these software development costs for the years ended December 31, 2002 and 2001 was \$8,000. As of December 31, 2002 and 2001, the net value of the software development costs was approximately \$3,500 and \$11,500, respectively.

### **Comprehensive Income**

SFAS No. 130, Reporting Comprehensive Income requires that changes in the amounts of certain items, including unrealized gains and losses on marketable securities, be shown in the financial statements. The Company has elected to disclose comprehensive income, which includes net income and unrealized gains and losses on marketable securities, in the statements of stockholders' equity.

### **Net Income Per Share**

Net income per share is reported under SFAS No. 128, Earnings per Share. The presentation of basic earnings per share is based upon average common shares outstanding during the period. Diluted earnings per share is based on average common shares outstanding during the period plus the dilutive effect of stock options outstanding.

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### **Investments**

The Company considers its investments in debt and equity securities as available for sale securities. Unrealized gains and losses are recorded in stockholders' equity in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. Realized gains and losses are recorded in the statements of operations upon disposition. Realized gains and losses from securities sales are determined on the specific identification of the securities.

### **Medicare Coordinated Care Demonstration Project**

Effective July 20, 2001, the Company has contracted with the Washington University Physician Network ( WUPN ) to deliver care management services to members of the Medicare fee-for-service population in the St. Louis area under the Medicare Coordinated Care Demonstration ( MCCD ) Project, which is sponsored by the Centers for Medicare and Medicaid Services ( CMS ). The MCCD Project earns a monthly fee per enrollee from CMS by delivering care management service to Medicare beneficiaries who have agreed to participate in the program. PMPM fees earned are then allocated to the Company and WUPN based on the terms of the contract between the Company and WUPN. The contract between the Company and WUPN remains in effect through January 2006 but is terminable without cause by either party upon 180 days written notice. The Company first recorded revenue under the MCCD Project in 2002, recognizing approximately \$48,000 of such revenue through December 31, 2002.

### **Recently Issued Accounting Standards**

Effective January 1, 2002, the Company adopted SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121,

Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of, and the accounting and reporting provisions of Accounting Principles Board ( APB ) Opinion No. 30, Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, for the disposal of a segment of a business (as previously defined in that Opinion). The adoption of SFAS No. 144 has not had a material effect on the Company's financial position or results of operations.

On December 31, 2002, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. SFAS No. 148 amends SFAS No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition to SFAS No. 123's fair value method of accounting for stock-based employee compensation. SFAS No. 148 also amends the disclosure provisions of SFAS No. 123 and APB No. 28, Interim Financial Reporting, to require disclosure in the summary of significant accounting policies of the effects of an entity's accounting policy with respect to stock-based employee compensation on reported net income and earnings per share in annual and interim financial statements. While SFAS No. 148 does not amend SFAS No. 123 to require companies to account for employee stock options using the fair value method, the disclosure provisions of SFAS No. 148 are applicable to all companies with stock-based employee compensation, regardless of whether they account for the compensation using the fair value method of SFAS No. 123 or the intrinsic value method of APB No. 25, Accounting for Stock Issued to Employees.

At December 31, 2002, the Company had equity incentive plans, which are described more fully in Note 3. The Company accounts for those plans under the recognition and measurement principles of APB No. 25. No employee compensation cost for the Company's stock options is reflected in net income, as all options granted under those plans had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share for the years ended December 31, 2002 and 2001 if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation.

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|                                                                                               | For the Years Ended December 31, |            |
|-----------------------------------------------------------------------------------------------|----------------------------------|------------|
|                                                                                               | 2002                             | 2001       |
| Net income, as reported                                                                       | \$ 1,277,123                     | \$ 278,183 |
| Less: stock-based compensation expense, net of income taxes, as determined under SFAS No. 123 | (95,560)                         | (29,091)   |
| Pro forma net income                                                                          | \$ 1,181,563                     | \$ 249,092 |
| As reported:                                                                                  |                                  |            |
| Basic income per share                                                                        | \$ 0.24                          | \$ 0.05    |
| Diluted income per share                                                                      | \$ 0.23                          | \$ 0.05    |
| Pro forma:                                                                                    |                                  |            |
| Basic income per share                                                                        | \$ 0.22                          | \$ 0.05    |
| Diluted income per share                                                                      | \$ 0.21                          | \$ 0.04    |

The effect of applying SFAS No. 123 for disclosing compensation costs under such pronouncement may not be representative of the effects on reported net income available to common stockholders for future years.

**2. Investments**

Investments consist of the following:

|                         | December 31, 2002 |                   | December 31, 2001 |                   |
|-------------------------|-------------------|-------------------|-------------------|-------------------|
|                         | Cost              | Market Value      | Cost              | Market Value      |
| Available for sale:     |                   |                   |                   |                   |
| Certificates of deposit | \$ 195,000        | \$ 195,374        | \$                | \$                |
| Mutual funds            | 240,629           | 196,632           | 221,498           | 188,570           |
|                         | <u>\$ 435,629</u> | <u>\$ 392,006</u> | <u>\$ 221,498</u> | <u>\$ 188,570</u> |

There were no dispositions of investments during 2002. Proceeds from the sale of investments in available for sale securities during the year ended December 31, 2001 were \$606,000. Gross investment gains of \$3,091 were realized on these sales during the year ended December 31, 2001.

**3. Stockholders Equity***Common Stock*

The Company has authorized up to 5,500,000 shares of Class A common stock and 4,500,000 shares of Class B common stock. The holders of Class A common stock are entitled to one vote for each share of stock held, while holders of Class B common stock are not entitled to vote on any matter. Dividends may be declared on either class of common stock as funds are available; however, no dividends have been paid since inception.

*Stock Option Plan*

The Company has equity incentive plans under which, among other things, incentive stock options and nonqualified stock options may be granted to certain employees and non-employee directors by the executive committee of the Board of Directors. The options for the purchase of Class B common stock are granted with exercise prices equal to the estimated fair value of the Class B common stock at the date of grant.

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Options granted to employees are exercisable commencing on dates specified in the option agreements and generally vest ratably over a four-year period. Options granted to non-employee directors are generally exercisable immediately. Options expire ten years from the grant date.

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A summary of the status of the Company's options is as follows:

|                                  | <b>Number of<br/>Shares</b> | <b>Weighted<br/>Average<br/>Exercise Price</b> |
|----------------------------------|-----------------------------|------------------------------------------------|
| Outstanding at December 31, 2000 | 294,000                     | \$ 0.54                                        |
| Granted                          | 266,700                     | 1.88                                           |
| Canceled                         | (6,200)                     | 1.88                                           |
| Exercised                        |                             |                                                |
| Outstanding at December 31, 2001 | 554,500                     | 1.17                                           |
| Granted                          | 550,000                     | 3.44                                           |
| Canceled                         | (61,250)                    | 2.70                                           |
| Exercised                        |                             |                                                |
| Outstanding at December 31, 2002 | 1,043,250                   | 2.28                                           |

The weighted average fair value of options granted during 2002 and 2001 was \$0.67 and \$0.50 per option, respectively, based on the estimated fair value using the Black-Scholes option-pricing model.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions.

|                                 | <b>December 31,</b> |             |
|---------------------------------|---------------------|-------------|
|                                 | <b>2002</b>         | <b>2001</b> |
| Expected dividend yield         | 0.0%                | 0.0%        |
| Expected stock price volatility | 0.0%                | 0.0%        |
| Risk-free interest rate         | 3.4%                | 4.8%        |
| Expected life of options        | 7 years             | 7 years     |
| Forfeiture rate                 | 5.2%                | 5.2%        |

Stock options outstanding at December 31, 2002 are summarized below:

| <b>Exercise Price</b> | <b>Options outstanding<br/>at December 31,<br/>2002</b> | <b>Weighted<br/>average<br/>remaining<br/>contractual<br/>life in<br/>years</b> | <b>Options<br/>exercisable<br/>at December<br/>31,<br/>2002</b> | <b>Weighted<br/>average<br/>exercise<br/>price of<br/>options<br/>exercisable</b> |
|-----------------------|---------------------------------------------------------|---------------------------------------------------------------------------------|-----------------------------------------------------------------|-----------------------------------------------------------------------------------|
| \$0.54                | 294,000                                                 | 7.4                                                                             | 294,000                                                         | \$ 0.54                                                                           |
| \$1.88                | 231,250                                                 | 8.4                                                                             | 6,000                                                           | 1.88                                                                              |
| \$3.44                | 518,000                                                 | 9.4                                                                             |                                                                 |                                                                                   |
|                       | <b>1,043,250</b>                                        | <b>8.6</b>                                                                      | <b>300,000</b>                                                  | <b>0.57</b>                                                                       |

#### **4. Profit Sharing Plan**

The Company has a profit sharing plan that covers all employees as they become eligible. The Company's contributions to its profit sharing trust fund are based solely on management's discretion.

The Company also maintains a 401(k) plan that covers all employees as they become eligible. The Company's contributions to the 401(k) plan are made at the discretion of the management and are part of the profit sharing trust funds.

Profit sharing expenses for the years ended December 31, 2002 and 2001 were \$615,733 and \$310,462, respectively and are included in employee compensation expenses in the accompanying statements of operations.

**Table of Contents****5. Income Taxes**

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The tax effects of temporary differences related to income taxes as shown on the balance sheets are as follows:

|                                                                               | <b>2002</b>       | <b>2001</b>      |
|-------------------------------------------------------------------------------|-------------------|------------------|
| Current deferred tax assets:                                                  |                   |                  |
| Accrued expenses not yet deductible for tax purposes                          | \$ 89,991         | \$ 47,746        |
| Revenues recognized for tax purposes but not for financial reporting purposes | 154,794           | 33,777           |
| Unrealized losses on investments                                              | 17,449            | 13,171           |
| Net current deferred tax assets                                               | <u>\$ 262,234</u> | <u>\$ 94,694</u> |
| Non-current deferred tax assets (liabilities):                                |                   |                  |
| Revenues recognized for tax purposes but not for financial reporting purposes | \$ 94,017         | \$ 75,400        |
| Expenses deductible for financial reporting purposes but not for tax purposes | 11,500            |                  |
| Financial reporting over tax basis of long-lived assets                       | (38,247)          | (19,184)         |
| Net non-current deferred tax assets                                           | <u>\$ 67,270</u>  | <u>\$ 56,216</u> |

The provision for income taxes was composed of the following components for the years ended December 31, 2002 and 2001:

|                            | <b>2002</b>       | <b>2001</b>       |
|----------------------------|-------------------|-------------------|
| Current provision          | \$ 1,034,194      | \$ 261,348        |
| Deferred benefit           | (174,316)         | (75,274)          |
| Provision for income taxes | <u>\$ 859,878</u> | <u>\$ 186,074</u> |

A reconciliation of the statutory income tax rate and effective tax rate as a percentage of income before provision for income taxes for the years ended December 31, 2002 and 2001 is as follows:

|                                     | <b>2002</b>  | <b>2001</b>  |
|-------------------------------------|--------------|--------------|
| Statutory federal rate              | 35.0%        | 35.0%        |
| State taxes, net of federal benefit | 5.0          | 5.0          |
| Permanent differences               | 0.2          | 0.1          |
|                                     | <u>40.2%</u> | <u>40.1%</u> |

**6. Operating Leases**

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The Company has operating lease agreements principally for its corporate office space in Massachusetts and two operations centers in California. The present corporate office lease expires October 17, 2003. The two operations centers leases expire November 30, 2003 and January 31, 2006. Lease expense for the years ended December 31, 2002 and 2001 was \$311,000 and \$73,373, respectively, and is included in other operating expenses in the statements of operations.

## **Table of Contents**

Future minimum annual rental payments under these leases as of December 31, 2002 are as follows:

|      |            |
|------|------------|
| 2003 | \$ 373,852 |
| 2004 | 264,581    |
| 2005 | 271,195    |
| 2006 | 22,738     |

## **7. Commitments and Contingencies**

The Company is subject to claims and suits arising in the ordinary course of business. In the opinion of management, the ultimate resolution of any such legal proceedings would not have a material effect on the Company's results of operations or financial position.

## **8. Related Party Transactions**

The Company has a contract to provide access to its CareLink application with a clinic that owns 168,000 shares of the Company's Class B common stock. In addition, the chief operating officer of this clinic is a member of the Company's Board of Directors. For the year ended December 31, 2002 and 2001, the Company recorded revenues of \$100,800 and \$113,500, respectively, from this customer.

## **9. Subsequent Events**

On April 7, 2003, the Company's Board of Directors granted 25,000 shares of restricted Class B common stock to an employee at \$3.44 per share in exchange for a non-negotiable promissory note of \$86,000. The promissory note bears interest at 3.25% per annum and is due December 31, 2006.

On May 1, 2003 and July 7, 2003, the Company entered into two capital lease agreements for a new phone system and related equipment. The leases each have initial terms of 60 months and have total payments of \$535,477 and \$381,005, respectively.

On August 29, 2003, the Company's Board of Directors accelerated the vesting provisions of 386,125 outstanding and previously unvested stock options, resulting in additional employee compensation expense in 2003 of approximately \$2,700,000.

On August 29, 2003, the Company's Board of Directors authorized and issued 1,000,000 shares of Class C common stock to certain holders of Class A and Class B common stock and to certain members of senior management. The Company received no consideration for the issuance of the Class C common stock. The Class C common stock is not entitled to vote on any matter.

On September 5, 2003, under an agreement and plan of merger, American Healthways, Inc. ( "AMHC" ), a provider of comprehensive disease management and care enhancement services, acquired 100% of the Company's Class A, Class B and Class C common stock for \$65,000,000 in cash through the merger of the Company with a wholly-owned subsidiary of AMHC. The cash was distributed to the holders of the Company's Class A, Class B, and Class C common stock and holders of vested options to purchase Class B common stock. The Company's agreement with AMHC requires AMHC to make an additional cash payment in September 2004 of up to \$12,500,000 to certain holders of Class C common stock if certain revenue targets are achieved in the twelve months following AMHC's acquisition of the Company.

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**STATUSONE HEALTH SYSTEMS, INC.  
UNAUDITED FINANCIAL INFORMATION**

**UNAUDITED BALANCE SHEET  
MAY 31, 2003**

|                                                                             | <b>May 31,<br/>2003</b> |
|-----------------------------------------------------------------------------|-------------------------|
| <hr/>                                                                       |                         |
| Current assets:                                                             |                         |
| Cash and cash equivalents                                                   | \$4,989,175             |
| Investments                                                                 | 228,308                 |
| Accounts receivable                                                         | 284,004                 |
| Prepaid expenses and other current assets                                   | 118,461                 |
| Deferred tax assets                                                         | 252,843                 |
|                                                                             | <hr/>                   |
| Total current assets                                                        | 5,872,791               |
| Property and equipment:                                                     |                         |
| Phone system                                                                | 479,373                 |
| Leasehold improvements                                                      | 48,498                  |
| Computer equipment                                                          | 637,846                 |
| Software development                                                        | 61,707                  |
| Furniture and fixtures                                                      | 264,449                 |
|                                                                             | <hr/>                   |
|                                                                             | 1,491,873               |
| Less accumulated depreciation                                               | (320,136)               |
|                                                                             | <hr/>                   |
|                                                                             | 1,171,737               |
| Other assets:                                                               |                         |
| Security deposits                                                           | 33,032                  |
| Deferred tax assets                                                         | 67,270                  |
|                                                                             | <hr/>                   |
|                                                                             | \$7,144,830             |
|                                                                             | <hr/>                   |
| Current liabilities:                                                        |                         |
| Accounts payable                                                            | \$ 104,985              |
| Accrued employee compensation                                               | 1,376,201               |
| Deferred license fees                                                       | 296,983                 |
| Deferred start-up fees                                                      | 95,680                  |
| Accrued taxes                                                               | 955,892                 |
| Billings in excess of earnings                                              | 233,468                 |
| Other accrued expenses                                                      | 68,297                  |
| Current portion of capital lease                                            | 26,269                  |
|                                                                             | <hr/>                   |
| Total current liabilities                                                   | 3,157,775               |
| Deferred start-up fees                                                      | 191,862                 |
| Capital lease                                                               | 390,168                 |
| Stockholders' equity:                                                       |                         |
| Common stock - Class A                                                      |                         |
| \$.001 par value, 5,500,000 shares authorized, 5,152,000 shares outstanding | 5,152                   |
| Common stock - Class B                                                      |                         |
| \$.001 par value, 4,500,000 shares authorized, 259,712 shares outstanding   | 260                     |
| Additional paid-in capital                                                  | 26,348                  |
| Retained earnings                                                           | 3,385,352               |
| Unrealized loss on investments, net of income taxes                         | (12,087)                |

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Total stockholders' equity

3,405,025

\$7,144,830

See accompanying notes to the financial statements.

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**STATUSONE HEALTH SYSTEMS, INC.**

**UNAUDITED STATEMENTS OF OPERATIONS**

|                                          | <b>Five Months Ended<br/>May 31,</b> |                   |
|------------------------------------------|--------------------------------------|-------------------|
|                                          | <b>2003</b>                          | <b>2002</b>       |
| Net revenues                             | \$9,916,119                          | \$4,603,193       |
| Expenses:                                |                                      |                   |
| Employee compensation expenses           | 6,086,019                            | 3,438,715         |
| Other operating expenses                 | 1,096,043                            | 671,695           |
| Depreciation and amortization            | 71,820                               | 13,545            |
|                                          | <u>7,253,882</u>                     | <u>4,123,955</u>  |
| Operating income                         | 2,662,237                            | 479,238           |
| Interest and dividend income             | 24,800                               | 19,232            |
|                                          | <u>2,687,037</u>                     | <u>498,470</u>    |
| Income before provision for income taxes | 2,687,037                            | 498,470           |
| Provision for income taxes               | 1,074,817                            | 199,388           |
|                                          | <u>\$ 1,612,220</u>                  | <u>\$ 299,082</u> |
| Net income                               |                                      |                   |
| Basic income per share                   | \$ 0.30                              | \$ 0.06           |
|                                          | <u>\$ 0.28</u>                       | <u>\$ 0.05</u>    |
| Diluted income per share                 |                                      |                   |
| Weighted average shares and equivalents  |                                      |                   |
| Basic                                    | 5,411,712                            | 5,409,712         |
| Diluted                                  | 5,677,540                            | 5,630,255         |

See accompanying notes to the financial statements.

**Table of Contents****STATUSONE HEALTH SYSTEMS, INC.****UNAUDITED STATEMENTS OF CASH FLOWS**

|                                                                                   | <b>Five Months Ended<br/>May 31,</b> |              |
|-----------------------------------------------------------------------------------|--------------------------------------|--------------|
|                                                                                   | <b>2003</b>                          | <b>2002</b>  |
| <b>Cash flows from operating activities:</b>                                      |                                      |              |
| Net income                                                                        | \$ 1,612,220                         | \$ 299,082   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                      |              |
| Depreciation and amortization                                                     | 71,820                               | 13,545       |
| Changes in operating assets and liabilities:                                      |                                      |              |
| Accounts receivable                                                               | 17,609                               | 234,926      |
| Prepaid expenses and other current assets                                         | (9,411)                              | 40,499       |
| Trade accounts payable                                                            | 1,037                                | (12,728)     |
| Deferred license fees                                                             |                                      | 129,000      |
| Accrued taxes                                                                     | 151,630                              | 28,283       |
| Deferred tax assets                                                               | 9,391                                | 45           |
| Deferred start-up fees                                                            | (37,500)                             | 103,733      |
| Accrued expenses                                                                  | (575,790)                            | 360,221      |
| Other, net                                                                        |                                      | 107,713      |
| Net cash provided by operating activities                                         | 1,241,006                            | 1,304,319    |
| <b>Cash flows from investing activities:</b>                                      |                                      |              |
| Purchase of property and equipment, net                                           | (125,539)                            | (318,994)    |
| Sale (purchase) of investments, net                                               | 177,785                              | (8,988)      |
| Net cash provided by (used in) investing activities                               | 52,246                               | (327,982)    |
| <b>Cash flows from financing activities:</b>                                      |                                      |              |
| Exercise of stock options                                                         | 3,760                                |              |
| Net cash flows provided by financing activities                                   | 3,760                                |              |
| Net increase in cash and cash equivalents                                         | 1,297,012                            | 976,337      |
| Cash and cash equivalents, beginning of period                                    | 3,692,163                            | 2,305,115    |
| Cash and cash equivalents, end of period                                          | \$ 4,989,175                         | \$ 3,281,452 |
| <b>Supplemental disclosure of cash flow information:</b>                          |                                      |              |
| Cash paid during the period for interest                                          | \$ 3,473                             | \$ 312       |
| Cash paid during the period for income taxes                                      | \$ 972,360                           | \$ 171,105   |

**Non-cash investing and financing activities:**

During the five months ended May 31, 2003, a capital lease obligation of \$416,437 was incurred when the Company entered into a lease for a new phone system and related equipment

See accompanying notes to the financial statements.

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**STATUSONE HEALTH SYSTEMS, INC.**

**NOTES TO FINANCIAL STATEMENTS  
MAY 31, 2003 (UNAUDITED)**

**1. Unaudited Interim Information**

The unaudited interim financial statements include all adjustments, consisting only of normal recurring adjustments, which management considers necessary for a fair presentation of the financial position and results of operations of StatusOne Health Systems, Inc. (the Company). The results of operations for the five months ended May 31, 2003 and 2002 are not necessarily indicative of the results that may be expected for a full year. The accompanying consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included herein for the fiscal years ended December 31, 2002 and 2001.

**2. Revenue Recognition**

Fees under the Company's contracts with customers are generally determined by multiplying a contractually negotiated rate per health plan member per month ( PMPM ) by the total number of health plan members during the month. In some contracts, the PMPM rate may differ between health plan product groups (e.g., PPO, HMO, Medicare). These contracts are generally for terms of five years with provisions for subsequent renewal and are terminable with a required notice period at any time. The Company has previously earned performance-based fees upon achieving a targeted percentage reduction in the customer's healthcare costs, in addition to clinical and other criteria that focus on improving the health of the members, compared to a baseline year. As of May 31, 2003, none of the Company's contracts provide for performance-based fees.

The Company bills its customers each month for the entire amount of fees contractually due for that month's enrollments, which always includes the amount, if any, that may be subject to refund. The Company recognizes the fixed portion of the monthly fees during the period the services are performed, and any performance-based fees are deferred until a final settlement is reached with the customer. The amounts deferred are included in billings in excess of earnings on the balance sheet. At the end of each contract year, a contract reconciliation is performed to determine if the cost savings targets have been met. Based on the results of the contract reconciliation and/or negotiations with the customer, the Company may recognize additional revenue and/or refund fees to the customer. During the five months ended May 31, 2003 and 2002, the Company did not recognize any performance-based fees as revenue.

**3. Concentration of Credit Risk**

The Company's credit risks primarily relate to cash and cash equivalents and accounts receivable. Cash and cash equivalents are primarily held in bank accounts, whose balances may exceed federally-insured limits. Accounts receivable consists of amounts due from customers.

One of the Company's customers represents approximately 87% of accounts receivable at May 31, 2003. The Company considers all accounts receivable to be fully collectible and has not provided an allowance for uncollectible accounts. The Company continually reviews the collectibility of its accounts receivable.

**4. Comprehensive Income**

SFAS No. 130, Reporting Comprehensive Income requires that changes in the amounts of certain items, including unrealized gains and losses on marketable securities, be shown in the financial statements. The components of comprehensive income for the five month periods ended May 31, 2003 and May 31, 2002 are as follows:

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|                                                                                          | Five Months Ended<br>May 31, |            |
|------------------------------------------------------------------------------------------|------------------------------|------------|
|                                                                                          | 2003                         | 2002       |
| Net income                                                                               | \$ 1,612,220                 | \$ 299,082 |
| Unrealized gains on securities, net of income<br>taxes of \$9,391 and \$45, respectively | 14,087                       | 68         |
| Total comprehensive income                                                               | \$ 1,626,307                 | \$ 299,150 |

**5. Net Income Per Share**

Net income per share is reported under SFAS No. 128, Earnings per Share. The presentation of basic earnings per share is based upon average common shares outstanding during the period. Diluted earnings per share is based on average common shares outstanding during the period plus the dilutive effect of stock options outstanding.

**6. Recently Issued Accounting Standards**

On December 31, 2002, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. SFAS No. 148 amends SFAS No. 123 Accounting for Stock-Based Compensation , to provide alternative methods of transition to SFAS No. 123 's fair value method of accounting for stock-based employee compensation. SFAS No. 148 also amends the disclosure provisions of SFAS No. 123 and Accounting Principles Board ( APB ) No. 28, Interim Financial Reporting, to require disclosure in the summary of significant accounting policies of the effects of an entity 's accounting policy with respect to stock-based employee compensation on reported net income and earnings per share in annual and interim financial statements. While SFAS No. 148 does not amend SFAS No. 123 to require companies to account for employee stock options using the fair value method, the disclosure provisions of SFAS No. 148 are applicable to all companies with stock-based employee compensation, regardless of whether they account for the compensation using the fair value method of SFAS No. 123 or the intrinsic value method of APB No. 25, Accounting for Stock Issued to Employees.

At May 31, 2003, the Company had equity incentive plans. The Company accounts for those plans under the recognition and measurement principles of APB No. 25. No employee compensation cost for the Company 's stock options is reflected in net income, as all options granted under those plans had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share for the five months ended May 31, 2003 and 2002 if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation.

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|                                                                                               | <b>Five Months Ended May 31,</b> |             |
|-----------------------------------------------------------------------------------------------|----------------------------------|-------------|
|                                                                                               | <b>2003</b>                      | <b>2002</b> |
| Net income, as reported                                                                       | \$ 1,612,220                     | \$ 299,082  |
| Less: stock-based compensation expense, net of income taxes, as determined under SFAS No. 123 | (22,672)                         | (95,443)    |
| Pro forma net income                                                                          | \$ 1,589,548                     | \$ 203,639  |
| As reported:                                                                                  |                                  |             |
| Basic income per share                                                                        | \$ 0.30                          | \$ 0.06     |
| Diluted income per share                                                                      | \$ 0.28                          | \$ 0.05     |
| Pro forma:                                                                                    |                                  |             |
| Basic income per share                                                                        | \$ 0.29                          | \$ 0.04     |
| Diluted income per share                                                                      | \$ 0.28                          | \$ 0.04     |

The effect of applying SFAS No. 123 for disclosing compensation costs under such pronouncement may not be representative of the effects on reported net income available to common stockholders for future years.

**7. Commitments and Contingencies**

The Company is subject to claims and suits arising in the ordinary course of business. In the opinion of management, the ultimate resolution of any such legal proceedings would not have a material effect on the Company's results of operations or financial position.

**8. Related Party Transactions**

The Company has a contract to provide access to its CareLink application with a clinic that owns 168,000 shares of the Company's Class B common stock. In addition, the chief operating officer of this clinic is a member of the Company's Board of Directors. Revenues from this customer were \$42,000 for each of the five months ended May 31, 2003 and 2002.

**9. Subsequent Events**

On August 29, 2003, the Company's Board of Directors accelerated the vesting provisions of outstanding and previously unvested stock options, resulting in additional employee compensation expense in 2003 of approximately \$2,700,000.

On August 29, 2003, the Company's Board of Directors authorized and issued 1,000,000 shares of Class C common stock to certain holders of Class A and Class B common stock and to certain members of senior management. The Company received no consideration for the issuance of the Class C common stock. The Class C common stock is not entitled to vote on any matter.

On September 5, 2003, under an agreement and plan of merger, American Healthways, Inc. ( "AMHC" ), a provider of comprehensive disease management and care enhancement services, acquired 100% of the Company's Class A, Class B and Class C common stock for \$65,000,000 in cash through the merger of the Company with a wholly-owned subsidiary of AMHC. The cash was distributed to the holders of the Company's Class A, Class B, and Class C common stock and holders of vested options to purchase Class B common stock. The Company's agreement with AMHC requires AMHC to make an additional cash payment in September 2004 of up to \$12,500,000 to certain holders of Class C common stock if certain revenue targets are achieved in the twelve months following AMHC's acquisition of the Company.

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**AMERICAN HEALTHWAYS, INC.**

**UNAUDITED PRO FORMA COMBINED FINANCIAL INFORMATION**

The unaudited pro forma combined statements of operations of American Healthways, Inc. for the year ended August 31, 2002 and nine months ended May 31, 2003, are presented to show the effects of the acquisition of StatusOne Health Systems, Inc. ( StatusOne ) as if it had occurred on September 1, 2001. The unaudited pro forma combined balance sheet reflects the pro forma balance sheet of American Healthways as if the acquisition had occurred as of May 31, 2003. The pro forma information is based on the historical financial statements of American Healthways and StatusOne, giving effect to the acquisition under the purchase method of accounting and the assumptions and adjustments in the accompanying notes to the pro forma combined financial information.

The unaudited pro forma financial information does not purport to represent what American Healthways' results of operations would have been had the transactions in fact occurred on the dates indicated above, nor to project American Healthways' financial position or results of operations for any future date or period. In the opinion of American Healthways' management, all adjustments necessary for a fair presentation have been made. This unaudited pro forma financial information should be read in conjunction with the accompanying notes and the consolidated financial statements of American Healthways, Inc. and the related notes included in American Healthways' 2002 Annual Report on Form 10-K and Quarterly Report on Form 10-Q for the quarter ended May 31, 2003.

**Table of Contents****AMERICAN HEALTHWAYS, INC.****UNAUDITED PRO FORMA COMBINED BALANCE SHEET**

MAY 31, 2003

(All amounts expressed in thousands)

|                                                     | Historical<br>AMHC | Historical<br>StatusOne | Pro forma<br>Adjustments | Pro forma<br>Combined<br>Totals |
|-----------------------------------------------------|--------------------|-------------------------|--------------------------|---------------------------------|
| Current assets:                                     |                    |                         |                          |                                 |
| Cash and cash equivalents                           | \$ 34,602          | \$4,989                 | \$ (5,496)(1)            | \$ 30,966                       |
|                                                     |                    |                         | (2,314)(2)               |                                 |
|                                                     |                    |                         | (815)(3)                 |                                 |
| Restricted cash and cash equivalents                | 6,000              |                         |                          | 6,000                           |
| Investments                                         |                    | 228                     |                          | 228                             |
| Accounts receivable, net                            |                    |                         |                          |                                 |
| Billed                                              | 19,091             | 284                     |                          | 19,375                          |
| Unbilled                                            | 5,207              |                         |                          | 5,207                           |
| Prepaid expenses and other current assets           | 3,825              | 118                     |                          | 3,943                           |
| Deferred tax assets                                 | 1,313              | 253                     |                          | 1,566                           |
|                                                     |                    |                         |                          |                                 |
| Total current assets                                | 70,038             | 5,872                   | (8,625)                  | 67,285                          |
| Property and equipment                              | 48,740             | 1,492                   |                          | 50,232                          |
| Accumulated depreciation                            | (22,607)           | (320)                   |                          | (22,927)                        |
|                                                     |                    |                         |                          |                                 |
|                                                     | 26,133             | 1,172                   |                          | 27,305                          |
| Long-term deferred tax asset                        | 942                | 67                      |                          | 1,009                           |
| Other assets, net                                   | 687                | 33                      | 23,644(1)                | 26,678                          |
|                                                     |                    |                         | 2,314(2)                 |                                 |
| Goodwill, net                                       | 44,438             |                         | 39,263(1)                | 83,701                          |
|                                                     |                    |                         |                          |                                 |
|                                                     | \$142,238          | \$7,144                 | \$56,596                 | \$205,978                       |
|                                                     |                    |                         |                          |                                 |
| Current liabilities:                                |                    |                         |                          |                                 |
| Accounts payable                                    | \$ 2,074           | \$ 105                  |                          | \$ 2,179                        |
| Accrued employee compensation                       | 7,042              | 1,376                   |                          | 8,418                           |
| Accrued liabilities                                 | 2,914              | 461                     |                          | 3,375                           |
| Billings in excess of earnings                      | 16,767             | 234                     |                          | 17,001                          |
| Income taxes payable                                | 3,777              | 956                     |                          | 4,733                           |
| Current portion of long-term liabilities            | 853                | 26                      |                          | 879                             |
|                                                     |                    |                         |                          |                                 |
| Total current liabilities                           | 33,427             | 3,158                   |                          | 36,585                          |
| Long-term debt                                      | 212                | 390                     | \$60,000(1)              | 60,602                          |
| Other long-term liabilities                         | 3,977              | 192                     |                          | 4,169                           |
| Stockholders' equity:                               |                    |                         |                          |                                 |
| Preferred Stock                                     |                    |                         |                          |                                 |
| Common stock                                        | 16                 | 5                       | (5)(1)                   | 16                              |
| Additional paid-in capital                          | 71,358             | 26                      | (26)(1)                  | 71,358                          |
| Retained earnings                                   | 33,248             | 3,385                   | (815)(3)                 | 33,248                          |
|                                                     |                    |                         | (2,570)(1)               |                                 |
| Unrealized loss on investments, net of income taxes |                    | (12)                    | 12(1)                    |                                 |
|                                                     |                    |                         |                          |                                 |
| Total stockholders' equity                          | 104,622            | 3,404                   | (3,404)                  | 104,622                         |
|                                                     |                    |                         |                          |                                 |
|                                                     | \$142,238          | \$7,144                 | \$56,596                 | \$205,978                       |
|                                                     |                    |                         |                          |                                 |

See accompanying notes to the pro forma combined financial statements.

**Table of Contents****AMERICAN HEALTHWAYS, INC.****UNAUDITED PRO FORMA COMBINED STATEMENT OF OPERATIONS  
FOR THE YEAR ENDED AUGUST 31, 2002**

(All amounts expressed in thousands, except per share data)

|                                              | <b>Historical<br/>AMHC</b> | <b>Historical<br/>StatusOne</b> | <b>Pro forma<br/>Adjustments</b> | <b>Pro forma<br/>Combined<br/>Totals</b> |
|----------------------------------------------|----------------------------|---------------------------------|----------------------------------|------------------------------------------|
| Revenues                                     | \$ 122,762                 | \$ 11,353                       |                                  | \$ 134,115                               |
| Cost of services                             | 84,845                     | 7,612                           |                                  | 92,457                                   |
| Gross margin                                 | 37,917                     | 3,741                           |                                  | 41,658                                   |
| Selling, general and administrative expenses | 12,726                     | 2,265                           |                                  | 14,991                                   |
| Depreciation and amortization                | 7,271                      | 90                              | \$ 3,860(4)                      | 11,221                                   |
| Interest expense (income)                    | 370                        | (72)                            | 3,511(5)                         | 3,809                                    |
| Income before income taxes                   | 17,550                     | 1,458                           | (7,371)                          | 11,637                                   |
| Income tax expense                           | 7,195                      | 583                             | (3,022)(6)                       | 4,756                                    |
| Net income                                   | \$ 10,355                  | \$ 875                          | \$ (4,349)                       | \$ 6,881                                 |
| Earnings per share:                          |                            |                                 |                                  |                                          |
| Basic                                        | \$ 0.69                    |                                 |                                  | \$ 0.46                                  |
| Diluted                                      | \$ 0.64                    |                                 |                                  | \$ 0.43                                  |
| Weighted average shares and equivalents      |                            |                                 |                                  |                                          |
| Basic                                        | 14,973                     |                                 |                                  | 14,973                                   |
| Diluted                                      | 16,094                     |                                 |                                  | 16,094                                   |

See accompanying notes to the pro forma combined financial statements.

**Table of Contents****AMERICAN HEALTHWAYS, INC.****UNAUDITED PRO FORMA COMBINED STATEMENT OF OPERATIONS  
FOR THE NINE MONTHS ENDED MAY 31, 2003**

(All amounts expressed in thousands, except per share data)

|                                              | <b>Historical<br/>AMHC</b> | <b>Historical<br/>StatusOne</b> | <b>Pro forma<br/>Adjustments</b> | <b>Pro forma<br/>Combined<br/>Totals</b> |
|----------------------------------------------|----------------------------|---------------------------------|----------------------------------|------------------------------------------|
| Revenues                                     | \$ 119,461                 | \$ 16,107                       |                                  | \$ 135,568                               |
| Cost of services                             | 76,170                     | 10,297                          |                                  | 86,467                                   |
| Gross margin                                 | 43,291                     | 5,810                           |                                  | 49,101                                   |
| Selling, general and administrative expenses | 12,230                     | 1,490                           |                                  | 13,720                                   |
| Depreciation and amortization                | 7,923                      | 149                             | \$ 2,895(4)                      | 10,967                                   |
| Interest expense (income)                    | 438                        | (48)                            | 2,633(5)                         | 3,023                                    |
| Income before income taxes                   | 22,700                     | 4,219                           | (5,528)                          | 21,391                                   |
| Income tax expense                           | 9,307                      | 1,688                           | (2,267)(6)                       | 8,728                                    |
| Net income                                   | \$ 13,393                  | \$ 2,531                        | \$(3,261)                        | \$ 12,663                                |
| Earnings per share:                          |                            |                                 |                                  |                                          |
| Basic                                        | \$ 0.87                    |                                 |                                  | \$ 0.82                                  |
| Diluted                                      | \$ 0.82                    |                                 |                                  | \$ 0.77                                  |
| Weighted average shares and equivalents      |                            |                                 |                                  |                                          |
| Basic                                        | 15,460                     |                                 |                                  | 15,460                                   |
| Diluted                                      | 16,405                     |                                 |                                  | 16,405                                   |

See accompanying notes to the pro forma combined financial statements.

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**AMERICAN HEALTHWAYS, INC.**

**NOTES TO UNAUDITED PRO FORMA COMBINED FINANCIAL INFORMATION**

(All amounts expressed in thousands)

The accompanying pro forma combined balance sheet reflects the pro forma balance sheet of American Healthways, Inc. as if the acquisition of the outstanding common stock of StatusOne Health Systems, Inc. had occurred as of May 31, 2003. The accompanying pro forma combined statements of operations reflect the pro forma results of American Healthways, Inc. as if the acquisition of StatusOne Health Systems, Inc. had occurred on September 1, 2001.

**PRO FORMA ADJUSTMENTS**

1. To reflect the allocation of the purchase price (consisting of a \$60,000 term loan, cash payment of \$5,000, and acquisition-related costs of \$496) and eliminate equity of purchased company as follows:

|                               |          |
|-------------------------------|----------|
| Fair value of assets acquired | \$ 2,589 |
| Intangible assets:            |          |
| Acquired technology           | 10,163   |
| Customer contracts            | 9,137    |
| Trade name                    | 4,344    |
| Goodwill                      | 39,263   |
|                               | <hr/>    |
| Total purchase price          | \$65,496 |
|                               | <hr/>    |

2. To record deferred financing costs associated with \$60,000 term loan.
3. To adjust working capital of StatusOne to \$1,900 in accordance with the agreement and plan of merger.
4. To reflect additional amortization of identifiable intangible assets using the straight-line method of amortization and a five-year estimated useful life. The StatusOneSM trade name has an indefinite life and will not be amortized. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill will not be amortized but will be reviewed for impairment by reporting unit on an annual basis or more frequently whenever events and circumstances indicate that the carrying value of a reporting unit may not be recoverable.
5. To reflect interest expense on \$60,000 term loan and amortization of deferred financing costs associated with term loan.
6. To record estimated federal and state income tax benefit at a combined rate of 41% as a result of the decrease in pro forma combined earnings before income taxes due to interest expense and the amortization of identifiable intangible assets.

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**SIGNATURE**

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

American Healthways, Inc.

By: /s/ Mary A. Chaput

Name: Mary A. Chaput  
Title: Chief Financial Officer

Date: October 10, 2003

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**Exhibit Index**

| <b>Exhibit<br/>No.</b> | <b>Description</b>                                                                                                                                                                                                                  |
|------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1                   | Revolving Credit and Term Loan Agreement between American Healthways, Inc. and SunTrust Bank as Administrative Agent, National City Bank as Documentation Agent, and U.S. Bank, N.A., as Syndication Agent, dated September 5, 2003 |
| 10.2                   | Form of Revolving Credit Note                                                                                                                                                                                                       |
| 10.3                   | Form of Term Note                                                                                                                                                                                                                   |
| 10.4                   | Form of Swingline Note                                                                                                                                                                                                              |
| 10.5                   | Form of Subsidiary Guaranty Agreement between American Healthways, Inc. and SunTrust Bank as Administrative Agent                                                                                                                   |
| 23.1                   | Consent of Independent Auditors                                                                                                                                                                                                     |