QUADRAMED CORP
Form 10-Q
May 09, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x Quarterly Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2007

Or

¨ Transition Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934
FOR THE TRANSITION PERIOD FROM TO

Commission File Number: 001-32283

QUADRAMED CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

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

(703) 709-2300

(Registrant s Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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

As of May 1, 2007, there were 43,871,680 shares of the Registrant s common stock outstanding, par value $0.01.

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QUADRAMED CORPORATION

REPORT ON FORM 10-Q

FOR THE QUARTER ENDED MARCH 31, 2007

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

QUADRAMED CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

(unaudited)

	March 31, 2007	December 31, 2006
ASSETS		
Current assets		
Cash and cash equivalents	$ 28,499	$ 32,596
Short-term investments	23,181	10,703
Accounts receivable, net of allowance for doubtful accounts of $1,876 and $2,612, respectively	21,373	20,358
Unbilled receivables	2,807	4,253
Prepaid expenses and other current assets, net of allowance on other receivable of $909 and $833, respectively	11,109	10,848
Total current assets	86,969	78,758
Restricted cash	2,287	2,341
Long-term investments	1,109	1,244
Property and equipment, net of accumulated depreciation and amortization of $21,604, and $21,131, respectively	2,302	2,557
Goodwill	25,983	25,983
Other amortizable intangible assets, net of accumulated amortization of $29,266 and $28,354, respectively	1,220	2,132
Other long-term assets	3,180	3,183
Total assets	$ 123,050	$ 116,198
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable and accrued expenses	$ 2,375	$ 3,493
Accrued payroll and related expenses	5,479	8,720
Other accrued liabilities	5,829	5,666
Dividends payable	2,305	3,775
Deferred revenue	55,171	46,347
Total current liabilities	71,159	68,001
Accrued exit cost of facility closing	1,567	2,066
Deferred income taxes	1,117	1,042
Other long-term liabilities	2,599	2,618
Total liabilities	76,442	73,727
Commitments and Contingencies		

Stockholders equity		
Preferred stock, $0.01 par, 5,000 shares authorized, 4,000 shares issued and outstanding, respectively	94,598	93,290
Common stock, $0.01 par, 150,000 shares authorized; 44,300 and 43,678 shares issued and 43,843 and 43,221 outstanding, respectively	443	437
Shares held in treasury	(5)	(5)
Additional paid-in-capital	306,012	304,504
Accumulated other comprehensive loss	(50)	(49)
Accumulated deficit	(354,390)	(355,706)
Total stockholders equity	46,608	42,471
Total liabilities and stockholders equity	$ 123,050	$ 116,198

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

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QUADRAMED CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three months ended, March 31,	
	2007	**2006**
Revenue		
Services	$ 3,313	$ 2,915
Maintenance	13,924	13,562
Installation and other	2,414	2,872
Services and other revenue	19,651	19,349
Licenses	9,057	9,182
Hardware	498	397
Total revenue	29,206	28,928
Cost of revenue		
Cost of services and other revenue	7,027	6,867
Royalties and other	2,979	2,764
Amortization of acquired technology and capitalized software	471	995
Cost of license revenue	3,450	3,759
Cost of hardware revenue	492	363
Total cost of revenue	10,969	10,989
Gross margin	18,237	17,939
Operating expense		
General and administration	3,873	6,557
Software development	7,412	8,569
Sales and marketing	3,896	3,696
Amortization of intangible assets and depreciation	923	1,123
Total operating expenses	16,104	19,945
Income (loss) from operations	2,133	(2,006)
Other income (expense)		
Interest expense, includes non-cash charges of $51 and $119	(50)	(123)
Interest income	573	366
Other income (expense), net	77	18
Other income (expense), net	600	261

Income (loss) from continuing operations before income taxes	$ 2,733	$ (1,745)
Provision for income taxes	(109)	(98)
Income (loss) from continuing operations	2,624	(1,843)
Net income (loss)	$ 2,624	$ (1,843)
Preferred stock accretion and dividend premium	(1,308)	(1,489)
Net income (loss) attributable to common shareholders	$ 1,316	$ (3,332)
Income (loss) per share		
Basic	$ 0.03	$ (0.08)
Diluted	$ 0.03	$ (0.08)
Weighted average shares outstanding		
Basic	43,540	41,319
Diluted	79,355	41,319

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

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QUADRAMED CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF

CHANGES IN STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME (LOSS)

(in thousands)

(unaudited)

	Preferred Stock		Common Shares		Treasury Shares		Additional Paid-in	Accumulated Other Comprehensive	Accumulated	Total Stockholder	Other Comprehensive
	Shares	Amount	Shares	Amount	Shares	Amount	Capital	Loss	Deficit	Equity	Income (Loss)
Balance, December 31, 2006	4,000	$ 93,290	43,678	$ 437	(457)	$ (5)	$ 304,504	$ (49)	$ (355,706)	$ 42,471	$ (6,007)
Issuance of common stock			581	6			975			981	
Issuance of common stock under ESPP program			41				54			54	
Accretion of preferred stock		1,308							(1,308)		(1,308)
Amortization of deferred compensation							96			96	
Stock-based compensation							383			383	
Net unrealized gain (loss) on available-for- sale securities								15		15	15
Foreign currency translation								(16)		(16)	(16)
Net income									2,624	2,624	2,624
Balance, March 31, 2007	4,000	$ 94,598	44,300	$ 443	(457)	$ (5)	$ 306,012	$ (50)	$ (354,390)	$ 46,608	$ 1,315

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

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QUADRAMED CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three months ended March 31,	
	2007	**2006**
Cash flows from operating activities		
Net income (loss) attributable to common shareholders	$ 1,316	$ (3,332)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	1,394	2,118
Deferred compensation amortization	96	96
Dividend discount amortization	33	101
Provision for bad debts	156	386
Stock-based compensation	383	271
Gain on sale of investments	(11)	
Interest expense on note payable	18	18
Preferred stock accretion and dividend premium	1,308	1,489
Changes in assets and liabilities:		
Accounts receivable	290	(1,373)
Prepaid expenses and other	(230)	1,172
Accounts payable and accrued liabilities	(4,671)	(3,903)
Deferred revenue	8,824	8,246
Cash provided by operating activities	8,906	5,289
Cash flows from investing activities		
Decrease in restricted cash	54	80
Purchases of available-for-sale securities	(17,412)	(115)
Proceeds from sale of assets and available-for-sale securities	5,046	100
Purchases of property and equipment	(227)	(255)
Other	5	24
Cash used in investing activities	(12,534)	(166)
Cash flows from financing activities		
Payment of preferred stock dividends	(1,503)	(1,625)
Proceeds from issuance of common stock and other	1,034	246
Cash used in financing activities	(469)	(1,379)
Net increase (decrease) in cash and cash equivalents	(4,097)	3,744
Cash and cash equivalents, beginning of period	32,596	33,042
Cash and cash equivalents, end of period	$ 28,499	$ 36,786
Supplemental disclosure of cash flow information		
Cash paid for taxes	$ 249	$ 25
Non-cash transfer of liabilities for implementation of SAB 108 to accumulated deficit	$	$ 1,915

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

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QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2007

1. THE COMPANY

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

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

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

We do business directly and through our subsidiaries, all of which are wholly owned and operated under common management.

2. SIGNIFICANT ACCOUNTING POLICIES

Financial Statement Presentation

These condensed consolidated financial statements are unaudited and have been prepared in conformity with generally accepted accounting principles in the United States (GAAP) and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting. Accordingly, they do not include all of the information and disclosures required by accounting principles generally accepted in the United States for complete financial statements. We suggest that you read these interim financial statements in conjunction with the consolidated financial statements, and the notes thereto, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006, filed on March 16, 2007. In the opinion of management, the condensed consolidated financial statements for the periods presented herein include all normal and recurring adjustments that are necessary for a fair presentation of the results for these interim periods. The results of operations for the three months ended March 31, 2007 are not necessarily indicative of the results for the entire year ending December 31, 2007.

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QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2007

Principles of Consolidation

These condensed consolidated financial statements, which include the accounts of QuadraMed and all significant business divisions and wholly owned subsidiaries, have been prepared in conformity with (i) GAAP and (ii) the rules and regulations of the SEC. All significant intercompany accounts and transactions between QuadraMed and its subsidiaries are eliminated in consolidation.

Use of Estimates in Preparation of Financial Statements

QuadraMed makes estimates, assumptions and judgments that affect the reported amounts of assets and liabilities, contingent assets and liabilities, revenues and expenses. Significant estimates and assumptions have been made regarding revenue recognition, the allowance for doubtful accounts, contingencies, litigation, intangibles resulting from our purchase business combinations and other amounts. QuadraMed bases its estimates and assumptions on historical experience and on various other assumptions which management believes to be reasonable under the circumstances. Uncertainties inherent in these estimates include, among other things, significant estimates within percentage-of-completion accounting. In addition, QuadraMed annually reviews its estimates related to the valuations of intangibles including acquired technology, goodwill, customer lists, trademarks and other intangibles and capitalized software. Actual results may differ materially from these estimates and assumptions.

Reclassifications

QuadraMed has grown through multiple acquisitions based on a product-centric organizational structure. Acquired entities such as Tempus Software, Inc. and Détente Systems Pty Limited had been operated as standalone business units, rather than centralized business functions. Historically, our organizational structure contained several departments and remote locations which performed multiple levels of tasks in a cross-functional environment in order to manage and support specific product lines within the Company. In connection with our corporate vision, mission statement and executive management philosophy, in 2007 we implemented a new organizational structure designed to capitalize on our internal resources and strengths. The new structure supports centralized operations, standardized processes and optimizes functional-based expertise. As a result, certain reclassifications have been made to prior year balances and classification of expenses to conform to the current year presentation.

Revenue Recognition

QuadraMed s revenue is principally generated from three sources: (i) licensing arrangements, (ii) services and (iii) hardware.

The Company s license revenue consists of fees for licenses of the proprietary and third-party software. Cost of license revenue primarily includes the costs of third-party software, royalties and amortization of acquired technology and capitalized software. The Company s services revenue consists of maintenance, software installation, customer training and consulting services related to our license revenue, fees for providing management services, specialized staffing, and analytical services. Cost of services consists primarily of salaries, benefits and allocated costs related to providing such services. Hardware revenue includes third-party hardware used by our customers in connection with software purchased. Cost of hardware revenue consists of third-party equipment and installation.

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

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QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2007

QuadraMed recognizes revenue on its software products in accordance with AICPA Statement of Position (SOP) 97-2, *Software Revenue Recognition*, as amended; SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*; and SEC Staff Accounting Bulletin (SAB) 104, *Revenue Recognition*.

QuadraMed recognizes revenue when all of the following criteria are met: there is persuasive evidence of an arrangement; the product has been delivered; we no longer have significant obligations with regard to implementation; the fee is fixed and determinable; and collectibility is probable. Delivery is considered to have occurred when title and risk of loss have been transferred to the customer, which generally occurs when media containing the licensed programs is provided to a common carrier. The Company considers all arrangements with payment terms extending beyond 180 days to be neither fixed nor determinable. Revenue for arrangements with extended payment terms is recognized when the payments become due, provided all other recognition criteria are satisfied. If collectibility is not considered probable, revenue is recognized when the fee is collected.

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

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

Contract accounting is applied where services include significant software modification, installation or customization. In such instances, the services and license fee is accounted for in accordance with SOP 81-1, whereby the revenue is recognized, generally using the percentage-of-completion method measured on labor input hours. If increases in projected costs-to-complete are sufficient to create a loss contract, the entire estimated loss is charged to operations in the period the loss first becomes known. The complexity of the estimation process and judgment related to the assumptions, risks and uncertainties inherent with the application of the percentage-of-completion method of accounting can affect the amounts of revenue and related expenses reported in its consolidated financial statements. The Company classifies revenues from these arrangements as license, installation, hardware, and services revenue based on the estimated fair value of each element using the residual method, and revenues are reflected in respective revenue categories in our consolidated financial statements.

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

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QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2007

Hardware revenue is generated primarily from transactions in which customers purchased bundled solutions that included the Company s software and third-party hardware. If the bundled solution includes services that provide significant modification, installation or customization, contract accounting is applied in accordance with SOP 81-1, whereby the revenue is recognized, generally using the percentage-of-completion method measured on labor input hours. Otherwise, hardware revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection is reasonably assured.

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

Cash and Cash Equivalents

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

Investments

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

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist primarily of amounts due to QuadraMed from its normal business activities. QuadraMed provides an allowance for doubtful accounts to reflect the expected non-collection of accounts receivable based on past collection history and specific identified risks.

Concentration of Credit Risk

Accounts receivable subject QuadraMed to its highest potential concentration of credit risk. QuadraMed reserves for credit losses and does not require collateral on its trade accounts receivable. In addition, QuadraMed maintains cash and investment balances in accounts at various domestic banks and brokerage firms. QuadraMed is insured by the Federal Deposit Insurance Corporation for up to $100,000 at each bank. Balances maintained at the brokerage firms are not insured.

Property and Equipment

Property and equipment are stated at cost and depreciated using the straight-line method over their estimated useful lives, which are generally three years for computer equipment and purchased software and five years for

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QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2007

office furnishings and equipment. Leasehold improvements are amortized over the shorter of the term of the lease or the useful life (generally 10 years). Maintenance and repair costs are expensed as incurred. QuadraMed reviews property and equipment for potential impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Goodwill

QuadraMed adopted Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, effective for fiscal years beginning after December 15, 2001, and ceased amortization of goodwill as of January 1, 2002. Prior to this point, goodwill was amortized using the straight-line method over its estimated useful life.

As of January 1, 2006 and 2007, QuadraMed reviewed goodwill for impairment and determined that the fair values of the analyzed reporting units exceeded the carrying values of the net assets. Accordingly, no indicators of impairment existed.

Other Intangible Assets

Other intangible assets primarily relate to customer lists, acquired technology including developed and core technology and trade names, and other intangible assets acquired in QuadraMed s purchase business combinations. On an annual basis, QuadraMed reviews its intangible assets for impairment based on estimated future undiscounted cash flows attributable to the assets in accordance with the provisions of SFAS No. 144. In the event such cash flows are not expected to be sufficient to recover the recorded value of the assets, the assets are written down to their net realizable values. In accordance with SFAS 142, amortization of other intangible assets is computed on a straight-line basis over lives ranging from 3-5 years, as the pattern of economic benefit is not otherwise determinable.

Accounting for and Disclosure of Guarantees and Indemnifications

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

Stock-Based Compensation

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment,* which is a revision of SFAS No. 123. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their grant-date fair values, using prescribed options-pricing models. We have adopted SFAS No. 123(R) for our fiscal year beginning January 1, 2006. See Note 11 Stock-based Compensation.

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QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2007

Net Income (Loss) Per Share

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

3. RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment*, which is a revision of SFAS No. 123. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their grant-date fair values, using prescribed options-pricing models. We adopted SFAS No. 123(R) beginning January 1, 2006. See Note 11 Stock-Based Compensation.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes,* FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We adopted FIN 48 effective January 1, 2007, see Note 13 Income Taxes.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for the Company s fiscal year ending December 31, 2006. We have adopted SAB 108 as of December 31, 2006 and have initially applied its provisions using the cumulative effect transition method in connection with the preparation of our annual financial statements for the year ended December 31, 2006.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Asset and Financial Liability: Including an amendment to FASB Statement No. 115* (SFAS 159). The standard permits all entities to elect to measure certain financial instruments and other items at fair value with changes in fair value reported in earnings. SFAS 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007. The adoption of SFAS No. 159 is not expected to have a material impact on our results of operations or our financial position.

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QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2007

4. DISCONTINUED OPERATION FINANCIAL SERVICES DIVISION AND EXIT COST OF FACILITY CLOSING

Financial Services Division

Due to increasing operating losses in our Financial Services Division (FSD), and the lack of a qualified buyer for the business, we announced the shutdown of this division on December 15, 2004. The shutdown of this division was completed on February 14, 2005. The lease associated with this facility does not terminate until May 2008. Our annual cost under the lease is approximately $0.5 million for the remainder of 2007 and $0.3 million in 2008. At the time of the facility closing, we estimated the facility closing costs based upon then current and available market information related to potential sublease rental income, sublease commission costs and the length of time expected to secure a sublease. We have continued to evaluate those assumptions on an annual basis and have adjusted our accrued liability in accordance with SFAS 146. During 2006, the Company secured a sub-tenant for 100% of the space.

Exit Cost of Facility Closing

During the fourth quarter of 2004, we vacated and closed our San Rafael, California facility as a result of the relocation of our headquarters to Reston, Virginia. The San Rafael lease payments total approximately $2.6 million for the years 2007 through 2009, including the Company s share of common costs. The Company estimated its liability under its operating lease agreement, such estimate being reduced by the estimated sublease rental income. The present value of the estimated liability was recorded as an accrued exit cost of facility closing. The lease for this facility terminates in December 2009. We actively marketed and subleased 33% of the vacant San Rafael, California facility in 2006. We continue to actively market for sublease the remaining space.

The following table sets forth a summary of the exit cost charges and accrued exit costs for both the San Marcos, California and San Rafael, California facilities as of March 31, 2007 and 2006 (in thousands):

	March 31, 2007	2006
Exit Costs for the San Rafael Facility:		
Accrued exit cost of facility closing, beginning of period	$ 3,078	$ 4,217
Principal reductions	(281)	(245)
Accrued exit cost of facility closing, end of period	$ 2,797	$ 3,972
Exit Cost for the San Marcus Facility:		
Accrued exit cost of facility closing, beginning of period	$ 534	$ 1,275
Principal reductions	(115)	(170)
Accrued exit cost of facility closing, end of period	$ 419	$ 1,105
Total Exit Cost Charges and Accrued Exit Costs	$ 3,216	$ 5,077
Summary:		
Accrued Exit Cost Liability		
Short-term	$ 1,649	$ 1,861
Long-term	1,567	3,216

Total	$ 3,216	$ 5,077

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QUADRAMED CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

March 31, 2007

5. REDUCTION IN FORCE

During the first quarter of fiscal year 2006, the Company announced a corporate reorganization and a reduction in our workforce of 37 positions. The Company recorded a charge for severance and related costs of approximately $315,000, associated with terminated employees, in the Company s results of operations for the quarter ended March 31, 2006.

6. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and other intangible assets for the three-month period ended March 31, 2007 were as follows (in thousands):

	As of December 31, 2006	Q1 2007 Activity	As of March 31, 2007
Cost			
Goodwill	37,896		37,896
Other intangible assets	43,529		43,529
	81,425		81,425
Accumulated amortization			
Goodwill	(11,913)		(11,913)
Other intangible assets	(41,397)	(912)	(42,309)
	(53,310)	(912)	(54,222)
Net book value			
Goodwill	25,983		25,983
Other intangible assets	2,132	(912)	1,220
	$ 28,115	$ (912)	$ 27,203

Amortization of acquired technology, a component of other intangible assets, for the three months ended March 31, 2007 and 2006 was $471,000 and $781,000, respectively, and was included in cost of license revenue. No impairment charges were recorded during the three months ended March 31, 2007 or 2006.

7. LINE OF CREDIT

On December 5, 2006, QuadraMed entered into a working capital line of credit agreement with our principal bank, under which we may borrow up to $2,000,000. This credit facility is secured by 90-Day Certificates of Deposits. Borrowings under the line of credit bear interest at varying rates based on an independent index which is defined as the rate charged by the Lender on the underlying Certificates of Deposit plus 1.5 basis points. The initial interest rate is established as 6.4% per annum. The line of credit has a stated maturity of December 1, 2007. There have been no borrowings, and there is no balance outstanding associated with this line of credit as of December 31, 2006 and March 31, 2007.

8. SERIES A PREFERRED STOCK

On June 17, 2004, QuadraMed issued 4.0 million shares of Series A Cumulative Mandatory Convertible Preferred Stock (the Series A Preferred Stock) in a private, unregistered offering to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933. The Series A

Preferred Stock was sold for

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March 31, 2007

$25 per share, and QuadraMed used the $96.1 million of net proceeds of the offering to repurchase all of our Senior Secured Notes due 2008 (the 2008 Notes) and our 5.25% Convertible Subordinated 2005 Notes (the 2005 Notes), together with accrued interest and related redemption premiums; the remainder was used for general corporate purposes.

The Series A Preferred Stock holders do not have any relative, participating, optional or other voting rights and powers, except that (i) if four quarterly dividend payments are in arrears, such holders are entitled to elect two substitute directors to the Board of Directors at any annual or special meeting, and (ii) in certain circumstances, such holders are entitled to vote on the authorization or creation of securities ranking on par with or above the Series A Preferred Stock, certain amendments to the Certificate of Incorporation or the Certificate of Designation for the Series A Preferred Stock and the incurrence of new senior indebtedness in an aggregate principal amount exceeding $8 million. Prior to the authorization or creation of, or increase in the authorized amount of, any shares of any class or series (or any security convertible into shares of any class or series) ranking senior to or on par with the Series A Preferred Stock in the distribution of assets upon any liquidation, dissolution or winding up of QuadraMed or in the payment of dividends, QuadraMed must have the affirmative vote of a majority of any outstanding shares of the Series A Preferred Stock (along with any shares of every other series or class of common stock ranking on par with the Series A Preferred Stock having like voting rights). In the event of any voluntary or involuntary liquidation, dissolution or winding up of the Company, before any payment or distribution of the Company s assets is made or set apart for the holders of common stock or any other class or series of shares of the Company s capital stock ranking junior to the Series A Preferred Stock as to the payment of dividends or as to the distribution of assets upon liquidation, dissolution or winding up, the holders of the Series A Preferred Stock shall be entitled to receive a liquidation preference of $25 per share plus an amount equal to all dividends (whether or not earned or declared) accumulated, accrued and unpaid to the date of final distribution. However, for purposes of the foregoing provision, (1) a consolidation or merger of the Company with one or more entities, (2) a statutory share exchange or (3) a sale or transfer of all or substantially all of the Company s assets shall not be deemed to be a liquidation, dissolution or winding up of the Company.

The Series A Preferred Stock is entitled to quarterly dividends of $0.34 (5.5% per annum) and is convertible into shares of common stock of the Company at a conversion price of $3.10, equivalent to a conversion rate of 8.0645 shares of common stock for each share of Series A Preferred Stock. The initial conversion price of $3.40 (conversion rate of 7.3529 shares of common stock for each share of Series A Preferred Stock) decreased to $3.10 as of August 1, 2005, pursuant to the terms of the Certificate of Designation relating to the Series A Preferred Stock, as the volume weighted average of the daily market price per share during a period of 30 consecutive trading days equaled $2.75 or less during the one year period beginning on the first anniversary of the issue date. Additionally, as provided in the Certificate of Designation, because the Company had not as of June 15, 2005 completed the registration of the Series A Preferred Stock with the SEC, the dividend rate for such stock increased to $0.40625 per quarter ($1.625 per annum) on June 16, 2005, and such rate applied through December 1, 2006, the date the registration statement for the four million Series A Preferred Stock shares, and the 32.3 million shares of common stock into which the Series A Preferred Stock may be converted, was declared effective. The Company has the right to demand conversion on or after May 31, 2007, in the event the volume weighted average of the daily market price per share during a period of 20 consecutive trading days equals or exceeds $5.10.

Upon the conversion of shares of the Series A Preferred Stock to shares of common stock on or before June 1, 2007, the Series A Preferred Stock holders have an option to convert and receive, when declared by the Board of Directors, dividends equal to the total previously unpaid dividends payable from the effective date of conversion through June 1, 2007 at a rate of $1.375 per annum, or 5.5% per annum, discounted to present value

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at a rate of 5.5% per annum, payable in cash or common shares or any combination thereof at the option of the Company.

As a result of the aforementioned discounted dividend feature, at the date of issuance of the Series A Preferred Stock, the Company recorded dividends payable of $15.2 million, which represents the present value of the three-year dividends. The present value adjustment of $1.3 million is being amortized over three years as interest expense using the effective interest rate method. For the three months ended March 31, 2007 and 2006, approximately $33,000 and $0.1 million was recorded as interest expense, respectively.

The carrying value of the Series A Preferred Stock was also reduced by $15.2 million, which represents the imputed discount on the Series A Preferred Stock and which is being accreted over three years using the effective interest rate method. For the three months ended March 31, 2007 and 2006, approximately $1.3 million and $1.2 million, respectively were accreted and charged to accumulated deficit. If any Series A Preferred Stock shares are converted prior to the end of the three-year period, the related accretion will be accelerated. The Company determined that there was no beneficial conversion feature attributable to the Series A Preferred Stock.

The following table summarizes the Series A Preferred Stock activities (in thousands):

		As of March 31, 2007
Total issued		$ 100,000
Less: Issuance cost		(3,856)
Less: Unaccreted discount		
Original present value of discount	(15,174)	
2007 preferred stock accretion	1,308	
2006 preferred stock accretion	5,059	
2005 preferred stock accretion	4,796	
2004 preferred stock accretion	2,465	(1,546)
Carrying value of preferred stock at March 31, 2007		$ 94,598

9. RESTRICTED STOCK GRANTS

During the three months ended March 31, 2007 and 2006, there was no common stock issued as a result of restricted stock grants. These grants are periodically made to certain senior executives for no monetary consideration. The majority of the Company s restricted shares fully vest over three to four years. QuadraMed has recorded the fair value of the restricted shares on the date they were granted as deferred compensation within the Stockholders Equity section of the Condensed Consolidated Balance Sheets. This amount is amortized over the period in which the restrictions lapse. Compensation expense associated with the grants of restricted stock total $96,000 for both the three month period ended March 31, 2007 and 2006.

As of March 31, 2007, 615,000 restricted shares remained subject to forfeiture.

10. NET INCOME (LOSS) PER SHARE AND COMPREHENSIVE INCOME (LOSS)

Basic income (loss) per share is determined using the weighted average number of common shares outstanding during the period. Diluted income (loss) per share is determined using the weighted average number of common shares and common equivalent shares outstanding during the period. Common equivalent shares consist of shares issuable upon the exercise of stock options and warrants (using the treasury stock

method) and

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conversion of the preferred stock and subordinated debentures (using the as-converted method). Common equivalent shares are excluded from the diluted computation if their effect is anti-dilutive.

The following table sets forth the computation of basic and diluted income (loss) per common share (in thousands):

	Three months ended March 31,	
	2007	2006
Numerator basic:		
Net income (loss) attributable to common shareholders	$ 1,316	$ (3,332)
Numerator diluted:		
Net income (loss)	$ 2,624	$ (1,843)
Denominator:		
Weighted average number of common shares outstanding:		
Basic	43,540	41,319
Diluted	79,355	41,319
Income (loss) per common share:		
Basic	$ 0.03	$ (0.08)
Diluted	$ 0.03	$ (0.08)

QuadraMed recorded net income for the three months ended March 31, 2007, and as such included the following common stock equivalent shares from the indicated equity instruments in the calculation of diluted earnings per share. As QuadraMed recorded a net loss for the three month period ended March 31, 2006 no common equivalent shares were included in diluted net loss per share calculation because they were anti-dilutive. If QuadraMed had reported net income for the three months ended March 31, 2006, the calculation of diluted earnings per share would have also included the following common stock equivalent shares from the indicated equity instruments (in thousands):

	Three months ended March 31,	
	2007	2006
Equity instruments:		
Preferred stock	32,258	32,258
Warrants	2,063	3,265
Stock options	1,494	621
Total common stock equivalent shares	35,815	36,144

The components of QuadraMed s comprehensive income (loss) include the unrealized gain (loss) on available-for-sale securities and foreign currency translation adjustment. The following table sets forth the computation of comprehensive income (loss) (in thousands):

	Three months ended March 31,	
	2007	2006

Net income (loss) attributable to common shareholders	$ 1,316	$ (3,332)
Unrealized gain (loss)	15	(23)
Foreign currency translation adjustment	(16)	(2)
Comprehensive income (loss)	$ 1,315	$ (3,357)

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March 31, 2007

11. STOCK-BASED COMPENSATION

In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment, which is a revision of SFAS No. 123. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their grant-date fair values, using prescribed option-pricing models. The fair value is expensed over the requisite service period of the individual grantees, which generally equals the vesting period. Since the adoption of SFAS No. 123(R) on January 1, 2006, pro forma disclosure is no longer an alternative.

Effective January 1, 2006, the Company adopted SFAS No. 123(R) s fair value method of accounting for share-based payments, using the modified prospective transition method. Accordingly, periods prior to adoption have not been restated and are not directly comparable to periods after adoption. However, had we adopted SFAS 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS 123 illustrated in the disclosure of pro forma net income and net income per share contained in our notes to condensed consolidated financial statements for those periods. Under the modified prospective method, compensation cost recognized in the three months ended March 31, 2007 and 2006 includes (a) compensation cost for all share-based payments granted prior to, but not yet vested as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, less estimated forfeitures, and (b) compensation costs for all share-based payments granted and vested subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R).

SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under previous literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. Stock-based compensation expense for the three months ended March 31, 2007 and 2006 totaled $0.4 million and $0.3 million, respectively, and is included in cost of services, general and administration, software development and sales and marketing expenses in the condensed consolidated statement of operations. There was no income tax benefit or excess tax benefit related to stock-based compensation or capitalized stock-based compensation costs during the three months ended March 31, 2007 and 2006.

Stock Incentive Plans

The Company has issued stock options and restricted stock under its 1996 Stock Incentive Plan (the 1996 Plan), the 1999 Supplemental Stock Option Plan (the 1999 Plan), and the 2004 Stock Compensation Plan (the 2004 Plan), all of which were approved by stockholders. The 2004 Plan superseded the 1996 Plan, as amended, and the 1999 Plan, as amended, although stock options and restricted stock under the 1996 and 1999 Plans outstanding as of that date remain subject to the terms of those plans. Significant grants were made outside these plans pursuant to contracts with executives as an inducement to employment. Total non-plan stock options outstanding at March 31, 2007 were 1,375,000.

1996 Stock Incentive Plan

Under the 1996 Plan, the Board of Directors may grant incentive and nonqualified stock options to employees, directors, and consultants. The 1996 Plan is divided into the following five separate equity programs: (i) the discretionary option grant program under which eligible persons may, at the discretion of the plan administrator, be granted options to purchase shares of common stock; (ii) the salary investment option grant program under which eligible employees may elect to have a portion of their base salary invested each year in special option grants; (iii) the stock issuance program under which eligible persons may, at the discretion of the

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March 31, 2007

plan administrator, be issued shares of common stock directly, either through the immediate purchase of such shares or as a bonus for services rendered to QuadraMed; (iv) the automatic option grant program under which eligible non-employee board members shall automatically receive option grants at periodic intervals to purchase shares of common stock; and (v) the director fee option program under which non-employee board members may elect to have all or any portion of their annual retainer fee otherwise payable in cash applied to a special option grant.

The exercise price per share for an incentive stock option cannot be less than the fair market value on the date of grant. The exercise price per share for a nonqualified stock option cannot be less than 85% of the fair market value on the date of grant. Option grants under the 1996 Plan generally expire 10 years from the date of grant and generally vest over a four-year period. Options granted under the 1996 Plan are exercisable subject to the vesting schedule. QuadraMed s stockholders had authorized a total of 8,651,097 shares of common stock for grant under the 1996 Plan, of which 3,305,977 were outstanding at March 31, 2007. There were no shares available for grant under this plan at March 31, 2007.

1999 Supplemental Stock Option Plan

In 1999, QuadraMed s Board of Directors approved the 1999 Plan. The 1999 Plan permits non-statutory option grants to be made to employees, independent consultants, and advisors who are not QuadraMed officers, directors, or Section 16 insiders. The 1999 Plan is administered by the Board of Directors or its Compensation Committee and was scheduled to terminate in March 2009. The exercise price of all options granted under the 1999 Plan may not be less than 100% of fair market value on the date of the grant. Options vest on a schedule determined by the Board of Directors or the Compensation Committee with a maximum option term of 10 years. QuadraMed s stockholders had authorized a total of 3,519,258 shares of common stock, for grant under the 1999 Plan, of which 1,034,887 were outstanding at March 31, 2007. There were no shares available for grant under this plan at March 31, 2007.

2004 Stock Compensation Plan

On April 1, 2004, QuadraMed s Board of Directors approved the 2004 Plan. QuadraMed s stockholders ratified the adoption of the 2004 Plan on May 6, 2004 at QuadraMed s 2004 Annual Meeting of Stockholders. The 2004 Plan replaces the 1996 Plan and 1999 Plan with respect to the unissued shares of common stock that were remaining in the 1996 Plan and the 1999 Plan on the date the 2004 Plan was ratified. Awards previously granted under the 1996 Plan and 1999 Plan remain subject to the terms of those plans. QuadraMed stockholders have authorized 1,536,369 shares of common stock for grant under the 2004 Plan, of which 1,432,992 were outstanding at March 31, 2007. There were 65,252 shares available for grant under this plan at March 31, 2007. QuadraMed has proposed to increase the number of shares available to the 2004 Plan by 3,000,000 shares; this proposal is included in the Company s Proxy Statement on Schedule 14A, filed with the SEC on April 25, 2007 for consideration and approval at the 2007 Annual Meeting of Stockholders to be held on June 7, 2007.

The 2004 Plan permits the grant of non-statutory options, incentive stock options, stock appreciation rights, restricted stock and restricted stock units to employees, prospective employees, directors, and advisors, consultants, and other individuals who provide services to QuadraMed. The exercise price of all options and stock appreciation rights granted under the 2004 Plan may not be less than 100% of fair market value on the date of the grant. The 2004 Plan also features (i) a Non-Employee Director Option Grant Program, whereby non-employee members of the Board automatically receive grants of options with an exercise price of the fair market value per share of common stock as of the date the options are granted as of the date of our annual

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meetings of stockholders or upon their initial election or appointment to the Board and (ii) a Director Fee Option Grant Program, whereby non-employee Board members may elect to have all or any portion of their annual cash retainer fee applied to special stock option grants with a below-market exercise price. The 2004 Plan is administered by the Compensation Committee and terminates in May 2014.

Employee Stock Purchase Plan

QuadraMed s 2002 Employee Stock Purchase Plan (the 2002 Purchase Plan) was adopted by the Board of Directors in January 2002. A total of 703,450 shares of common stock are reserved for issuance under the 2002 Purchase Plan, pursuant to which eligible employees are able to contribute up to 10% of their compensation for the purchase of QuadraMed common stock at a purchase price of 85% of the lower of the fair market value of the shares on the first or last day of the six-month purchase period. Stock-based compensation expense relating to shares purchased on behalf of plan participants for the three months ended March 31, 2007 and 2006 totaled $61,000 and $7,200, respectively.

Stock Options:

Stock options generally vest over four years, 25% after the first year and monthly increments over the next three years, from date of grant and terminate ten years from date of grant. The exercise price of the options granted equaled or exceeded the market value of the common stock at the date of the grant. A summary of the stock option activity under all plans is as follows (in thousands except per share data):

	Number of Shares	Weighted Average Exercised Price
Options outstanding, January 1, 2007	7,833	$ 3.61
Granted	500	2.83
Exercised	(581)	1.69
Cancelled	(429)	10.16
Options outstanding, March 31, 2007	7,323	$ 3.33
Options exercisable, March 31, 2007	5,582	$ 3.68

Stock-based compensation expense relating to stock options for the three months ended March 31, 2007 and 2006 totaled $322,000 and $271,000, respectively.

The weighted average remaining contractual term and the aggregate intrinsic value for options outstanding at March 31, 2007 were 5.7 years and $5.0 million, respectively. The weighted average remaining contractual term and the aggregate intrinsic value for options exercisable at March 31, 2007 were 4.6 years and $3.6 million, respectively. As of March 31, 2007, unrecognized compensation expense related to stock options totaled approximately $2.3 million, which will be recognized over a weighted average period of 1.5 years.

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March 31, 2007

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

	Three Months Ended March 31,	
	2007	**2006**
Expected dividend yield		
Expected stock price volatility	85.97%	85.97%
Risk-free interest rate	4.48%	4.53%
Expected life of options	5.29 years	5.73 years

The dividend yield of zero is based on the fact that the Company has never paid cash dividends on its common stock, and has no present intention of doing so. The risk-free interest rate is based on U.S. treasury yield curve in effect at the time of the grant for a term equivalent to the expected life of the option. The expected life and expected volatility are based on historical experience. The Company uses an estimated forfeiture rate of 25.63% for calculating stock-based compensation expense related to stock options and this rate is based on historical experience.

Based on the above assumptions, the weighted average estimated fair value of options granted during the three month periods ended March 31, 2007 and 2006 was $2.25 and $1.39, respectively.

Restricted Share Awards:

The Company issues its common stock as restricted share awards at no exercise price as provided for under QuadraMed s stock compensation plans and other contractual commitments. The grants are generally made to certain senior executives for no monetary consideration. The majority of the restrictions lapse over three to four years. The Company records the fair value of the restricted shares on the date they are granted as deferred compensation within the Stockholders Equity section of the condensed consolidated balance sheets. Deferred compensation has been combined with additional paid-in-capital as a result of the adoption of SFAS No. 123(R). This amount is amortized as compensation expense over the period in which the restrictions lapse.

A summary of our restricted stock awards as of March 31, 2007 is as follows (in thousands except per share data):

	Number of Shares	**Weighted Average Grant Date Fair Value**
Restricted stock awards, as of January 1, 2007	615	$ 1.77
Granted Granted		
Exercised Restrictions released		
Cancelled Forfeited		
Restricted stock awards, as of March 31, 2007	615	$ 1.77

Stock-based compensation expense relating to restricted share grants for the three months ended March 31, 2007 and 2006 totaled $96,000 and $101,000, respectively.

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12. MAJOR CUSTOMERS

For the three months ended March 31, 2007, two customers accounted for more than 10% of total revenue. The Veterans Health Administration facilities accounted for 16% of our total revenues and the County of Los Angeles (LACO) accounted for 14% of our total revenues. For the three months ended March 31, 2006, sales to Veterans Health Administration facilities accounted for 12% of total revenues.

13. INCOME TAXES

The Company has adopted *FIN 48, Accounting for Uncertainty in Income Taxes*, as of January, 1, 2007. This standard modifies the previous guidance provided by *FAS 5, Accounting for Contingencies* and *FAS 109, Accounting for Income Taxes* for uncertainties related to the Company s global income tax liabilities. The company has analyzed its income tax posture using the criteria required by FIN 48 and concluded that there is no cumulative effect allocable to equity as a result of adopting this standard. The Company has derecognized approximately $8.1 million in deferred tax assets related to its general business credits and net operating loss carry forwards that were previously offset by a full valuation allowance as a result of adopting FIN 48, which has no net balance sheet impact and has not been charged to equity in the transition.

A condensed roll forward of the Company s unrecognized tax benefits is presented as follows (in thousands):

	Balance 12/31/06	Non-Equity Transition Adjustment	Adjusted Balance 1/1/07	Changes Through 3/31/07	Balance 3/31/07
Unrecognized tax benefits affecting tax rate upon recognition	$	$	$	$	$
Unrecognized tax benefits not affecting tax rate or are offset by valuation allowances		(8,100)	(8,100)		(8,100)
Interest					
Penalties					
Total unrecognized tax benefits	$	$ (8,100)	$ (8,100)	$	$ (8,100)

There is no material change to the amount of unrecognized tax benefits reported at March 31, 2007. The Company is maintaining its historical method of accruing interest (net of related tax benefits) and penalties associated with unrecognized income tax benefits as a component of its income tax expense.

As of January 1, 2007 open tax years in major jurisdictions date back to 1993 due to the taxing authorities ability to adjust operating loss carry forwards. No changes in settled tax years have occurred through March 31, 2007. The Company does not anticipate a material change to its total amount of unrecognized tax benefits within the next 12 months.

14. LITIGATION AND OTHER MATTERS

As previously disclosed, on November 15, 2004, QuadraMed Corporation (the Company) received a letter from MedCath Incorporated (MedCath), which provided notice of MedCath s decision to terminate the Master Software License and Services Agreement, dated November 20, 2002, by and between QuadraMed Affinity and MedCath (the Contract). On or about November 15, 2004, MedCath filed a complaint against the Company in Mecklenburg County, North Carolina, Superior Court Division (Case No. 04CVS20137). In its complaint, MedCath alleged that we were in breach of the Contract due to uncured deficiencies in the products and sought at

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March 31, 2007

least $5 million in damages, plus litigation costs. On December 9, 2004, we filed a motion to dismiss the MedCath complaint on the grounds that the complaint fails to state a claim upon which relief can be granted. We also filed a counterclaim against MedCath seeking no less than $1.14 million in unpaid amounts due to us, plus litigation costs, for MedCath s breach of the Contract by failing to pay licensing fees due to the Company.

On April 28, 2006, we settled this litigation with MedCath. Pursuant to the Release and Settlement Agreement (the Settlement Agreement), the Company paid MedCath a settlement payment of $2 million and the parties filed a Joint Stipulation of Dismissal, with prejudice, of this lawsuit on May 8, 2006. Further, the Contract and all obligations thereunder terminated, and the Company removed MedCath s name from all Company websites and marketing materials. The parties have entered into mutual general releases regarding the Contract and both will bear their own attorneys fees and costs.

QuadraMed funded the settlement amount from available operating cash. In addition to amounts already recorded at December 31, 2005 and amounts covered by insurance, the Company has recorded a charge of approximately $1.0 million related to the settlement in its three month period ended March 31, 2006.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statement on Risks Associated With Forward-Looking Statements

You should read the following discussion in conjunction with our Condensed Consolidated Financial Statements and related notes. This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that are subject to risks and uncertainties. The words believe , expect , target , goal , project , anticipate , predict , intend , plan , estim should , could , and similar expressions and their negatives are intended to identify such statements. Forward-looking statements are not guarantees of future performance, anticipated trends or growth in businesses, or other characterizations of future events or circumstances and are to be interpreted only as of the date on which they are made. We undertake no obligation to update or revise any forward-looking statement. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us described below and elsewhere in this Quarterly Report on Form 10-Q, and in other documents we file with the SEC from time to time.

Results of Operations (unaudited)

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

	Three months ended March 31,			
	2007		2006	
Revenue				
Services	$ 3,313	11%	$ 2,915	10%
Maintenance	13,924	48%	13,562	47%
Installation and other	2,414	8%	2,872	10%
Services and other	19,651	67%	19,349	67%
Licenses	9,057	31%	9,182	32%
Hardware	498	2%	397	1%
Total revenue	29,206	100%	28,928	100%
Cost of revenue				
Cost of services and other	7,027	36%	6,867	35%
Royalties and other	2,979	33%	2,764	30%
Amortization of acquired technology and capitalized software	471	5%	995	11%
Cost of licenses	3,450	38%	3,759	41%
Cost of hardware	492	99%	363	91%
Total cost of revenue	10,969	38%	10,989	38%
Gross margin	18,237	62%	17,939	62%
Operating expenses				
General and administration	3,873	13%	6,557	23%
Software development	7,412	25%	8,569	30%
Sales and marketing	3,896	13%	3,696	13%
Amortization of intangible assets and depreciation	923	3%	1,123	4%
Total operating expenses	$ 16,104	54%	$ 19,945	70%
Income (loss) from operations	$ 2,133		$ (2,006)	

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Revenue

Revenue is recognized during the respective periods from various sources, including but not limited to amounts initially recorded as deferred revenue and for which the Company has now completed its contractual commitments; service revenue relating to installation, consulting and training; maintenance contracts that renew periodically, typically on an annual basis; and revenues recognized on a cash-basis.

Total revenue. Total revenue for the three months ended March 31, 2007 was $29.2 million compared to $28.9 million for the three months ended March 31, 2006. The net increase of $0.3 million consisted of a $0.4 million increase in services revenue, a $0.4 million increase in maintenance revenue, and a $0.1 million increase in hardware revenue, all partially offset by a $0.5 million decrease in installation and other revenue and a $0.1 million decrease in license revenue.

Services and other revenue. Services and other revenue consist of professional services, such as implementation and installation services, training, maintenance (which consists of technical support and product upgrades), reimbursable expenses and other services revenue. Professional services are typically provided over a period of three to nine months for the Health Information Management Suite and two to three years for Patient Care and Revenue Management products. These services are provided subsequent to the signing of a software license arrangement and are related in large part on our software license revenues. Our maintenance revenue is a function of both licenses of our software products and renewals of maintenance agreements by our existing customer base.

Services revenue for the three months ended March 31, 2007 was $3.3 million or 11% of total revenue, compared to $2.9 million or 10% of total revenue for the three months ended March 31, 2006. An increase of approximately $0.4 million was attributable to the Smart Identity Management products, primarily clean up services provided to two significant customers during the three months ended March 31, 2007. An additional $0.3 million was attributable to the government solutions workflow analysis project completions. These increases were offset by decreases of approximately $0.2 million in the Acuity Plus products and approximately $0.1 million in the Patient Care and Revenue Management products due to customer delays.

Maintenance revenue for the three months ended March 31, 2007 was $13.9 million, compared to $13.6 million for the three months ended March 31, 2006. Maintenance revenue as a percentage of total revenue was 48% and 47% for the three month periods ended March 31, 2007 and 2006, respectively. Approximately $0.2 million of the increase was attributable to the Health Information Management Suite and another $0.2 million of the increase was attributable to Pharmacy products. These increases were principally due to revenue that was recognized from certain cash basis customers resulting in reactivation of revenue plans that were previously on hold as well as contractually-based increases. Maintenance revenue for Electronic Document Management, Lab & Radiology, Scheduling, Smart Identity Management and Acuity Plus products also increased approximately $0.2 million combined, mainly due to contractually-based increases in fees. These increases were partially offset by a $0.2 million decrease in the Patient Care and Revenue Management products as a result of cancellation of certain annual maintenance agreements in 2006.

Installation and other services revenue decreased to $2.4 million or 8% of total revenue during the three months ended March 31, 2007, from $2.9 million or 10% of total revenue during the three months ended March 31, 2006. The net decrease of $0.5 million was the result of a $0.3 million decrease for Patient Care and Revenue Management products, a $0.2 million decrease in the Health Information Management Suite and a $0.1 million decrease for Electronic Document Management products, partially offset by a $0.1 million increase in the government solutions products. Installation and other revenue for Patient Care and Revenue Management products decreased due to decreased hours worked on contracts that were being recognized on the percentage of completion (POC) method in the three months ended March 31, 2007. Hours worked for Patient Care and Revenue Management projects were 38% less in the three months ended March 31, 2007 compared to the

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corresponding period in 2006, resulting in decreased revenue for these POC contracts. The decrease in installation and other services revenue for Health Information Management Suite was principally due to a decreased number of significant contracts completed in the three months ended March 31, 2007, compared to the corresponding prior period. The $0.1 million increase in the installation and other services revenue for government solution products was attributable to revenue recognized on installation and training services in conjunction with a new government solution product. Installation revenue related to the Health Information Management Suite term licenses is recognized ratably over the license term. Installation and other revenue for Health Information Management Suite perpetual licenses, Patient Access and government solution products are typically recognized upon completion of a contract, whereas the installation and other revenue for many of our other products, including Patient Care and Revenue Management, are recognized on a POC basis of accounting.

Licenses. License revenue consists of fees and licenses for our owned, proprietary software, as well as third-party owned software that we bundle into our suite of products. License revenue for the three months ended March 31, 2007 was $9.1 million, compared to $9.2 million in the corresponding period in 2006. License revenue, as a percentage of total revenue, was 31% and 32% for the three month period ended March 31, 2007 and 2006, respectively. The net decrease of $0.1 million was principally due to a $0.4 million decrease in license revenue for the Health Information Management Suite which was attributable to the decreased number of significant contracts being completed during the three months ended March 31, 2007 and a $0.3 million decrease in license revenue of Electronic Document Management products, offset by a $0.4 million increase in government solution product revenue, a $0.1 million increase in Acuity Plus product revenue and a $0.1 million increase in Decision Support product revenue. The $0.4 million increase in license revenue for government solution products was attributable to license revenue recognized on a new product sold as a term license. License revenue for the Acuity Plus products increased principally due to completion of projects during the three months ended March 31, 2007. License revenue for the Decision Support product increased as a result of an increased number of term licenses during the three months ended March 31, 2007, compared to the corresponding period in 2006.

Hardware. Hardware revenue consists of the sale of third-party hardware purchased specifically for use by our customers. Hardware revenue was $0.5 million during the three months ended March 31, 2007 compared to $0.4 million during the three months ended March 31, 2006. Hardware revenue, as a percentage of total revenue, was 2% and 1% for the three months ended March 31, 2007 and 2006, respectively.

Deferred Revenue

The following table is a summary roll forward schedule of deferred revenue (in thousands):

	For the Three Months Ended March 31,	
	2007	**2006**
Deferred revenue, beginning balance	$ 46,347	$ 52,169
Add: revenue deferred	38,013	36,993
Add: SAB 108 implementation		1,314
Less: deferred revenue recognized	(29,189)	(28,747)
Deferred revenue, ending balance	$ 55,171	$ 61,729

Deferred revenue includes amounts billed to or received from customers for which revenue has not been recognized. Fluctuation within the deferred revenue balance is dependent upon the timing associated with reaching billing milestones and revenue recognition criteria. Deferred revenue is typically increased when the Company invoices a customer based on the terms of the contracts and is decreased when revenue is recognized based on percentage of completion or the attainment of a milestone in the customer contract, or the passage of time in the case of an apportionment contract.

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The majority of the Company s revenue flows through the deferred revenue accounts and is attributable to favorable payment terms such as execution payments and achievement of billing milestones prior to meeting all revenue recognition requirements.

The deferred revenue balance decreased approximately $6.5 million to $55.2 million at March 31, 2007 when compared to $61.7 million at March 31, 2006. Approximately $4.0 million of the decrease in the deferred revenue balance was attributable to revenue recognized as a result of settlements of disputed contracts, resolution of stalled projects and amounts received from cash-basis customers whose revenue plans were put on hold until collectability of amounts due became certain. Approximately $1.4 million of the decrease was attributable to revenue recognized upon completion of four large perpetual license contracts. Approximately $1.1 million of the decrease was attributable to the cancellation of four large annual maintenance agreements in 2006.

The deferred revenue balance of $55.2 million as of March 31, 2007 consisted of approximately $15.5 million in deferred license revenue, approximately $28.0 million in deferred maintenance revenue, and approximately $11.7 million in deferred services and other revenue. Included in the deferred revenue balance as of March 31, 2007 was $0.8 million in deferred license revenue, $2.7 million in hardware revenue and $0.3 million in deferred services revenue related to a hardware deal with a single customer, totaling $3.8 million, which will be recognized during the second quarter of 2007. The $55.4 million in deferred revenue balance as of March 31, 2007 also included approximately $6.3 million for Veterans Health Administration contracts compared to $6.1 million included in the deferred revenue balance as of March 31, 2006.

The deferred revenue balance of $61.7 million as of March 31, 2006 consisted of approximately $22.0 million in deferred license revenue, approximately $26.3 million in deferred maintenance revenue, and approximately $13.4 million in deferred services and other revenue. The $3.8 million related to the aforementioned hardware deal to a single customer was also included in deferred revenue as of March 31, 2006.

Cost of Revenue

Cost of services and other. Cost of services and other consist of salaries and related expenses associated with services performed for customer support, installation, maintenance and consulting services. Cost of services and other for the three months ended March 31, 2007 was $7.0 million, compared to $6.9 million in the corresponding period in 2006. As a percentage of services and other revenue, cost of services and other was 36% and 35% for the three months ended March 31, 2007 and 2006, respectively. The net $0.1 million increase was primarily attributable to an increase in maintenance costs associated with third-party applications as a result of higher maintenance revenue being recognized in 2007.

Cost of licenses. Cost of licenses consists primarily of the cost of third-party software, royalties and amortization of capitalized software and acquired technology. A significant percentage of our total cost of revenue is attributable to the cost of third-party software royalties and licenses relating to software embedded within our software applications. Generally, third-party royalty fees fluctuate based on revenue, or the number of customers or licensed users, and therefore may fluctuate on a quarter-to-quarter basis. Cost of licenses for the three months ended March 31, 2007 was $3.5 million, compared to $3.8 million for the three months ended March 31, 2006. As a percentage of license revenue, cost of licenses was 38% and 41% for the three months ended March 31, 2007 and 2006, respectively. The net decrease of $0.3 million was primarily attributable to decreases in amortization of acquired technologies of $0.1 million related to the PDS acquisition, $0.2 million lower amortization associated with developed technologies from the Détente acquisition, and $0.2 million lower amortization of capitalized software, all partially offset by a $0.3 million increase in third party costs.

Cost of hardware. Cost of hardware consists of third-party hardware and installation costs, primarily related to Patient Care and Revenue Management contracts. Cost of hardware for the three months ended March 31, 2007 was $0.5 million, compared to $0.4 million for the three months ended March 31, 2006. Cost of hardware increased in 2007 due to the completion of a milestone contract with one of our major customers. As a percentage of hardware revenue, cost of hardware was 99% and 91% for the three months ended March 31, 2007 and 2006, respectively.

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Gross Margin

Overall, gross margin remained constant at 62% for both of the three month periods ended March 31, 2007 and 2006. Gross margin on license revenue increased by 3% from 59% in the three months ended March 31, 2006 to 62% during the three months ended March 31, 2007 due to lower acquired technology and capitalized software amortization. Gross margin on services and other revenue decreased by 1% for the three months ended March 31, 2007 to 64% as compared to 65% for the three months ended March 31, 2006. The gross margin on hardware revenue declined from 9% for the first three months of 2006 to 1% for the three month period ending March 31, 2007.

Operating Expenses

General and administration. General and administration expense consists of compensation and benefit costs for executive, finance, legal, information technology, and administrative personnel. General and administration expense decreased to $3.9 million for the three months ended March 31, 2007, compared to $6.6 million for the three months ended March 31, 2006. As a percentage of total revenue, general and administration expense was 13% and 23% for the three month period ended March 31, 2007 and 2006, respectively. The overall $2.7 million decrease is primarily attributable to the absence of any legal settlement charges in 2007 compared to a $1.0 million settlement charge recorded in 2006 resulting from the MedCath litigation, lower legal fees due to the $0.4 million associated with the MedCath litigation and other legal matters during the 2006 period, and the absence of costs in the 2007 period for our S-3 filings which were declared effective in December 2006; also, as compared to the 2006 period the three months ended March 31, 2007 reflected $0.2 million less professional and consulting fees related to compliance with the Sarbanes Oxley Act of 2002 and strategic activities, $0.2 million lower bad debt expense, and $0.4 million lower personnel-related costs associated with the 2006 reduction in force. The remaining decrease is principally due to the implementation of cost savings initiatives at the end of the 2006 period.

Software development. Software development expense includes costs associated with the development of new products for which technological feasibility has not been achieved, enhancements of existing products, maintenance and quality assurance activities, and is primarily comprised of compensation and benefits costs. Software development costs during the three months ended March 31, 2007 were $7.4 million compared to $8.6 million during the three months ended March 31, 2006. As a percentage of total revenue, software development costs were 25% and 30% for the three month period ended March 31, 2007 and 2006, respectively. The net decrease of $1.2 million was primarily attributable to a $1.0 million decrease in personnel costs associated with the 2006 reduction in force and the implementation of cost savings initiatives.

Sales and marketing. Sales and marketing expense includes costs associated with our sales and marketing personnel and consists primarily of compensation and benefits, commissions, bonuses, promotional and advertising expenses. Sales and marketing expense increased $0.2 million for the three months ended March 31, 2007 to $3.9 million, from $3.7 million for the three months ended March 31, 2006. As a percentage of total revenue, sales and marketing expenses remained consistent at 13% for both quarterly periods. The net increase was primarily attributable to a $0.1 million increase in personnel related costs, a $0.1 million increase in expenses related to our corporate re-branding and marketing initiatives, a $0.1 million increase in training, conferences, professional fees and shareholder relations costs, offset by $0.1 million of lower travel expenses.

Amortization of intangible assets and depreciation. Amortization of intangible assets and depreciation expense decreased to $0.9 million for the three months ended March 31, 2007 from $1.1 million during the three months ended March 31, 2006. The net decrease was principally the result of the expiration of the amortization periods associated with intangibles from the PDS, Détente and Tempus acquisitions during the twelve months ended March 31, 2007.

Other Income (Expense)

Other income (expense), net. Net other income was $0.6 million during the three months ended March 31, 2007 compared to net other income of $0.3 million in the corresponding quarter in 2006. The increase was

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primarily due to the interest income earned on our investment portfolios. Interest expense for both of the quarters ended March 31, 2007 and 2006 was approximately $0.1 million. The majority of interest expense for both periods was the result of non-cash charges.

Income Taxes

Income taxes. The provision for income taxes for both of the three month periods ended March 31, 2007 and 2006 was $0.1 million as a result of recording of deferred income tax expense related to the amortization of goodwill for tax purposes.

Liquidity and Capital Resources

Balance Sheet

As of March 31, 2007, we had $52.8 million in cash and investments, compared to $44.5 million as of December 31, 2006. The increase in cash and investments was attributable to the collection efforts associated with our annual maintenance invoicing. As of March 31, 2007, our working capital was $15.8 million compared to $10.8 million as of December 31, 2006. Our positive working capital of $15.8 million was primarily a result of $21.4 million of accounts receivable and $51.7 million of cash and short-term investments, offset by $55.2 million of deferred revenue and $2.3 million of dividends payable. We have the option to pay the accelerated dividends, as discussed in Note 8 Series A Preferred Stock in our notes to consolidated financial statements included herein, in cash or common stock. We do not have any bank borrowing outstanding at March 31, 2007. We believe that we have sufficient liquidity to meet our short-term cash requirements.

Accounts receivable increased by $1.0 million to $21.4 million as of March 31, 2007 from $20.4 million as of December 31, 2006, on a net basis. Accounts receivable increased mainly due to the timing of annual maintenance billings, partially offset by strong cash collections during the first quarter of 2007. For the three months ended March 31, 2007, bad debt expense was $0.2 million and the allowance for doubtful accounts decreased $0.7 million to $1.9 million from $2.6 million as of December 31, 2006. QuadraMed maintains an allowance for doubtful accounts to reflect the expected non-collection of accounts receivable based on past collection history and specific risks identified within the portfolio. If the financial condition of QuadraMed s customers were to deteriorate resulting in an impairment of their ability to make payments, or if payments from customers are significantly delayed, additional allowance might be required. Approximately $0.8 million of accounts receivable were written off during the current quarter. Our days sales outstanding (DSO) was 62 at March 31, 2007 compared to 60 at December 31, 2006.

Unbilled receivables decreased by $1.5 million to $2.8 million as of March 31, 2007 from $4.3 million as of December 31, 2006. This decrease was mainly attributable to the larger number of contracts the Company was able to invoice in accordance with billing milestones, in advance of revenue recognition during the three month period ended March 31, 2007.

Prepaid expenses and other current assets increased by approximately $0.3 million from December 31, 2006 to $11.1 million at March 31, 2007, primarily due to an increase of $0.7 million in prepaid government royalties and a $0.1 million increase in prepaid maintenance contracts, offset by $0.3 million in lower customer related deferred expenses due to revenue recognized during the quarter for milestones achieved and a $0.2 million decrease in prepaid insurance.

Accounts payable and accrued expenses decreased by $1.1 million to $2.4 million at March 31, 2007 from $3.5 million at December 31, 2006. This decrease was principally due to a $0.3 million decrease in accrued commissions, a $0.2 million decrease in taxes payable, a $0.2 million decrease in our quarterly GSA funding fee, and a $0.9 million decrease due to the timing of payments on vendor invoices, all partially offset by a $0.5 million increase in accrued royalties.

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Accrued payroll and related expenses decreased by $3.2 million to $5.5 million at March 31, 2007 from $8.7 million at December 31, 2006, primarily due to payments of annual employee bonuses under our incentive compensation program during March 2007.

Deferred revenue increased by $8.8 million from $46.4 million at December 31, 2006, to $55.2 million at March 31, 2007. The increase was primarily related to annual maintenance billings during the first quarter of 2007.

Cash Flows

The Company s condensed consolidated statement of cash flows is summarized below (in thousands):

	For the Three Months Ended March 31,	
	2007	2006
Cash provided by operating activities	$ 8,906	$ 5,289
Cash used in investing activities	(12,534)	(166)
Cash used in financing activities	(469)	(1,379)
Net increase (decrease) in cash	$ (4,097)	$ 3,744

During the three months ended March 31, 2007, $8.9 million was provided by operating activities, as compared to the same period in 2006, where $5.3 million was provided by operating activities. Net income of $1.3 million was increased by non-cash charges totaling $3.4 million, including depreciation and amortization of $1.5 million, bad debt expense of $0.2 million, preferred stock accretion of $1.3 million, and $0.4 million of stock-based compensation expense. A decrease in prepaid expenses of $0.2 million, an increase in accounts receivable of $0.3 million, and an increase in accounts payable of $4.7 million used cash from operating activities. These uses of cash were offset by an increase in deferred revenue of $8.8 million resulting in a net increase in cash from operating activities of $8.9 million for the quarter. During the three months ended March 31, 2006, the $5.3 million of cash flow provided by operating activities, resulted primarily from a net loss of $3.3 million, offset by $4.5 million of non-cash charges including $2.3 million of depreciation and amortization, $1.5 million of preferred stock accretion, $0.4 million of bad debt expense and $0.3 million of stock-based compensation expense. An increase in accounts receivable used $1.4 million of cash from operating activities primarily due to annual maintenance billings to our customers in the first quarter of 2006. Decreases in accounts payable and accrued liabilities during the first quarter of 2006 in the amount of $3.9 million further reduced operating cash. These reductions were offset in part by a $1.2 million decrease in prepaid expenses and the $8.2 million increase in deferred revenues.

Cash flows from investing activities used $12.5 million during the three months ended March 31, 2007. This resulted primarily from the investment of excess cash in short-term available-for-sale securities. For the three months ended March 31, 2006, investing activities used $0.2 million, primarily due to the purchase of property and equipment.

Financing activities used cash of $0.5 million for the three months ended March 31, 2007, primarily due to the payment of $1.5 million for dividends on the Series A Preferred Stock, offset by $1.0 million in proceeds from the issuance of common stock under the employee stock purchase plan and the issuance of common stock upon the exercise of employee stock options. For the three months ended March 31, 2006, financing activities used cash of $1.4 million primarily due to the payment of $1.6 million for dividends on the Series A Preferred Stock, offset by $0.2 million provided from the issuance of common stock under the employee stock purchase plan and the issuance of common stock upon the exercise of employee stock options.

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Commitments

The following table summarizes financial data for our contractual obligations and other commercial commitments, including interest obligations, as of March 31, 2007 (in thousands):

		Payments Due by Period			
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Contractual Obligations					
Accrued dividends (1)	$ 2,305	$ 2,305	$	$	$
Operating leases (2)	14,706	4,117	9,695	894	
Total contractual obligations	$ 17,011	$ 6,422	$ 9,695	$ 894	$
Other Commercial Commitments					
Standby letters of credit (3)	$ 2,366	$ 2,000	$	$ 366	$
Total commercial commitments	$ 2,366	$ 2,000	$	$ 366	$

(1) The Series A Preferred Stock holders have an option to convert and receive, when declared by the Board, dividends equal to the total previously unpaid dividends payable from effective date of conversion through June 1, 2007 at a rate of $1.375 per annum, discounted to present value at a rate of 5.5% per annum, payable in cash or common shares or any combination thereof at the option of the Company. See Note 8 of our notes to consolidated financial statements included herein.

(2) In 2006, the Company subleased 33% of the San Rafael, California facility and 100% of the San Marcos, California facility. In the schedule above, the sublease income has been deducted from the future minimum rentals required under each master lease.

(3) The less than 1 year amount of $2.0 million includes a $1.0 million letter of credit in favor of the State of New Jersey under its contract and a $1.0 million letter of credit in favor of another customer under its contract. The remainder represents security deposits for leased facilities.

We believe that we will have sufficient liquidity and capital resources to fund our obligations through the next twelve months. We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, specifically the timing of when we recognize revenue, our accounts receivable collections and the timing of other payments. In addition, cash used in investing activities may fluctuate due to our software development efforts, any acquisition or disposition we may undertake, and costs associated with our investments in fixed assets and information technology. For additional discussion, see *Part II, Item 1A. Risk Factors*.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

In addition to the market risks discussed herein, refer to our discussion of business risks in *Part II, Item 1A. Risk Factors.*

Interest Rate Risk

Our exposure to market risk for changes in interest rates primarily relates to our investment portfolio. It is our intent to ensure the safety and preservation of our invested principal funds by limiting default risk, market risk, and reinvestment risk. We invest in high-quality issuers, including money market funds, corporate debt securities, and debt securities issued by the U. S. government and U.S. governmental agencies. We do not invest in derivative financial or foreign investments.

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The table below presents fair values of principal amounts and weighted average interest rates for our investment portfolio as of March 31, 2007 (in thousands, except average interest rates):

	Aggregate Fair Value
Cash and cash equivalents:	
Cash (1)	$ 19,601
Money Market funds	8,898
Total cash and cash equivalents	$ 28,499
Short-term investments:	
Certificates of Deposit	$ 2,049
Corporate debt securities	15,318
Debt issued by the US government	4,814
Municipal Bonds	1,000
Total short-term investments	$ 23,181
Investments:	
Corporate debt securities	$
Debt securities issued by the US governement	1,109
Total long-term investments	$ 1,109

	Aggregate Fair Value	Weighted Average Interest Rate
Summary:		
Cash	$ 19,601	
Money Markets	8,898	5.19%
Certificates of Deposit	2,049	5.00%
Corporate debt securities	15,318	5.03%
Debt issued by US government	5,923	4.90%
Municipal Bonds	1,000	5.24%
	$ 52,789	

(1) Excluded from the fair value of the principal amounts of cash is $2.3 million, which is restricted cash that is held in escrow for rental properties, and meeting customer performance expectations.

Performance of Equity Markets

The performance of the equity markets can have an effect on our operations as certain of our variable life insurance policies have premiums invested in equity securities.

Foreign Currency Risk

Our primary market risk exposure relates to changes in foreign currency exchange rates and potentially adverse effects of differing tax structures. Changes in foreign exchange rates did not materially impact our results of operations. For the three months ended March 31, 2007, less than 2% of total revenue was denominated in currencies other than the U. S. dollar and less than 2% of our total direct and operating costs were incurred in currencies other than the U. S. dollar.

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Item 4. Controls and Procedures

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

We have established disclosure controls and procedures to ensure that material information relating to the Company is made known to the officers who certify the financial statements and to other members of senior management and the Audit Committee of the Board of Directors. As of March 31, 2007, an evaluation was performed under the supervision and with the participation of the Company s management, including the Chief Executive Officer (the CEO) and the Chief Financial Officer (the CFO), of the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in Rules 13a-15(e), and 15d-15(e) under the Securities Exchange Act of 1934). Based on their evaluation, the Company s CEO and CFO have concluded that the Company s disclosure controls and procedures were effective as of the date of such evaluation to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in our internal control over financial reporting that occurred during the quarter ended March 31, 2007, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1A. Risk Factors

The Company believes there have been no material changes to risk factors previously disclosed in our Form 10-K for the fiscal year ended December 31, 2006 filed with the Securities and Exchange Commission (SEC) on March 16, 2007. You should carefully consider the following factors and other information set forth in this report, including our financial statements and the related notes. The risks set forth below are in addition to risks that apply to most businesses. Our business and future performance may be affected by the following:

We Have Incurred Losses from Continuing Operations for the Four Years Prior to 2006. Our Losses Have Adversely Affected Our Ability to Compete.

While we had income from continuing operations of $11.9 million for the year ended December 31, 2006 and $2.6 million for the three months ended March 31, 2007, we incurred losses from continuing operations of $1.5 million, $34.8 million, $19.0 million and $19.9 million for the years ended December 31, 2005, 2004, 2003 and 2002, respectively.

Our historical losses have impaired our ability to market our products and services in competition against companies that are more profitable. If we are unable to sustain profitability, it may impair our ability to compete effectively.

Failure to Maintain Effective Internal Controls Could Have a Material Adverse Effect on Our Business, Operating Results and Stock Price.

We have documented and tested our internal control procedures in connection with Section 404 of the Sarbanes-Oxley Act of 2002. Our annual management assessment of the effectiveness of our internal control over financial reporting was included in our Annual Report on Form 10-K, filed with the SEC on March 16, 2007, under *Item 9A. Controls and Procedures*. As reported in that Annual Report, our management believes that our internal control over financial reporting and disclosure controls and procedures are effective as of December 31, 2006. Further, our management believes that our internal control over financial reporting and disclosure controls and procedures are effective as of March 31, 2007.

Reports of our management and our independent auditors pursuant to Section 404 were included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, filed with the SEC on March 16, 2006, as amended by Amendment No. 1, filed with the SEC on August 17, 2006; in our Annual Report on Form 10-K for the fiscal year ended December 31, 2004, filed with the SEC on March 25, 2005, as amended by Amendment No. 1, filed with the SEC on April 29, 2005, and Amendment No. 2, filed with the SEC on January 4, 2006; and in the Company s Quarterly Reports on Form 10-Q, filed with the SEC on May 10, 2005 (as amended and filed on January 4, 2006), August 9, 2005 and November 9, 2005. In our Annual Report for the fiscal year ended December 31, 2004, our management identified control deficiencies and material weaknesses in internal control over financial reporting and in our disclosure controls and procedures as of December 31, 2004 and as of the end of each quarter in 2005 through September 30, 2005.

During 2005, the Company invested significant time and resources to remediate such material weaknesses, and as such, there were significant changes in our internal control over financial reporting during 2005 that materially affected our internal control over financial reporting in a positive way. These changes were aimed at eliminating internal control deficiencies in both the Company s revenue and closing cycles.

If we fail to maintain the adequacy of our internal control over financial reporting and disclosure controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal control over financial reporting in accordance

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with Section 404 of the Sarbanes-Oxley Act of 2002. Moreover, effective internal controls, particularly those related to revenue recognition, are important in helping ensure that we produce reliable financial reports and prevent financial fraud. If we cannot provide reliable financial reports or prevent fraud, our business and operating results could be harmed, investors could lose confidence in our reported financial information and the trading price of our stock could drop significantly.

Additional Costs for Complying With Recent and Proposed Future Changes in SEC, American Stock Exchange and Accounting Rules Could Adversely Affect Our Profits.

Recent and proposed future changes in SEC and American Stock Exchange rules, as well as changes in accounting rules, have caused us, and will continue to cause us, to incur additional costs including professional fees and added personnel costs in order to keep informed of the changes and operate in a compliant manner. We incurred, and expect to continue to incur, additional general and administrative expenses in order to maintain compliance with Section 404 of the Sarbanes-Oxley Act of 2002, which requires management to report on, and (in future periods) our independent auditors to attest to, our internal controls. These additional costs may be significant enough to cause our financial position and results of operation to be adversely affected. In addition, compliance with these rules could also result in continued diversion of management s time and attention, which could prove to be disruptive to our normal business operations. Failure to comply with any of the laws and regulations could adversely impact market perception of our Company, which could make it difficult to access the capital markets or otherwise finance our operations in the future.

Our Ability to Borrow or Issue Additional Shares of Preferred Stock Is Restricted by the Terms of Our Series A Preferred Stock.

The Certificate of Designation governing our Series A Preferred Stock provides that so long as at least 600,000 shares of Series A Preferred Stock are outstanding, at least 66 $^{2}/_{3}$% of the votes entitled to be cast by the holders of the Series A Preferred Stock shall be required to approve the incurrence by QuadraMed of any long-term senior indebtedness of QuadraMed in an aggregate principal amount exceeding $8,000,000, excluding certain prior existing indebtedness. Furthermore, the Certificate of Designation requires the affirmative vote of a majority of any outstanding shares of the Series A Preferred Stock prior to the authorization or creation of, or increase in the authorized amount of, any shares of any class or series (or any security convertible into shares of any class or series) ranking senior to or on par with the Series A Preferred Stock in the distribution of assets upon any liquidation, dissolution or winding up of QuadraMed or in the payment of dividends. This may hinder or delay our ability to borrow funds or issue preferred stock.

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

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

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

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Customer budget cycle fluctuation;

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

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

Costs incurred for marketing and sales promotional activities;

Software defects and other product quality factors;

General economic conditions and their impact on the healthcare industry;

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

Final negotiated sales prices of systems;

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

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

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

In addition to the foregoing, a significant percentage of our total cost of revenue is attributable to the cost of third-party software royalties and licenses relating to third-party software embedded within our software applications. The cost of third-party software royalties and licenses, as a percentage of total cost of revenue, was approximately 26%, 21%, and 20% for the years ended December 31, 2006, 2005, and 2004. For the quarters ended March 31, 2007 and 2006, third-party software royalties and licenses, as a percentage of total cost of revenue, was 26.3% and 22.8%, respectively. Generally, royalty fees for third-party licenses will fluctuate based on revenue or the number of our customers and therefore will fluctuate on a quarter-to-quarter basis.

Our Operating Expenses are Relatively Fixed, and We May Not Be Able to Reduce Them to Offset a Potential Future Revenue Decrease.

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

We Could Experience a Significant Impact on Our Revenue if Our Customers Do Not Renew Maintenance Contracts.

We derive a significant percentage of our revenue, including 47% of our total revenue for the three month period ended March 31, 2006 and 48% of our total revenue for the three month period ended March 31, 2007, from maintenance services. We provide maintenance services under maintenance contracts to many of our customers in connection with our healthcare information technology products. In general, these maintenance contracts renew on an annual basis. If a significant portion of these maintenance contracts were not renewed, our maintenance revenues would decline which could have a material adverse effect on our total revenue for the period(s) in which the maintenance contracts were discontinued.

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

A substantial number of shares of our common stock are issuable upon the exercise of stock options and warrants and upon conversion of our Series A Preferred Stock. We cannot predict the effect, if any, those future sales of such shares of common stock, or the availability of shares of common stock for future sale, will have on the market price of our common stock. Sales of substantial amounts of common stock issued or issuable upon the exercise of stock options or warrants or upon the conversion of our Series A Preferred Stock, or the perception that such sales could occur, may adversely affect prevailing market prices for our common stock.

If Our Series A Preferred Stock is Converted into Common Stock, these Converting Stockholders Will Have Significant Voting Power, and They Will Have the Ability to Exert Substantial Influence Over Matters Requiring Stockholder Approval.

Each share of our Series A Preferred Stock is convertible into 8.0645 shares of our common stock, and the Series A Preferred Stockholders may convert at any time. If all of our Series A Preferred Stock is converted into common stock, the shares issued upon this conversion will total approximately 42.4% of our outstanding common stock. In addition, many of our Series A Preferred Stockholders own common stock. Therefore, although these stockholders may not acquire majority control upon conversion of their Series A Preferred Stock, if these distinct stockholders were to act together, they will have the ability to exert substantial influence over all matters requiring approval of our stockholders, including the election and removal of directors, the approval of mergers or other business combinations, and other significant corporate actions. This ability to influence our affairs might not be advantageous to our other stockholders.

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

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

Variations in quarterly results of operations;

Announcements of new products or acquisitions by our competitors;

Government regulatory action;

Resolution of pending or unasserted litigation;

Developments or disputes with respect to proprietary rights; and

General trends in our industry and overall market conditions.

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

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

Our Board of Directors has the authority to issue an additional one million shares of preferred stock over and above the four million shares already issued, and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by holders of our common stock. If additional preferred stock is issued, the voting and other rights of the holders of our common stock may be subject to, and may be adversely affected by, the rights of the holders of our preferred stock. The issuance of preferred stock may have the effect of delaying or preventing a change of control of the Company that could have been at a premium price to our stockholders. Our Board of Directors has issued four million shares of such preferred stock as Series A Preferred Stock and the holders of the

Series A Preferred Stock have certain voting and board appointment rights.

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

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

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

We have not declared or paid cash or other dividends on our common stock and do not expect to pay cash dividends for the foreseeable future. Our ability to pay dividends is also restricted by the terms of our Series A Preferred Stock which require us to pay full cumulative dividends on the Series A Preferred Stock before making any dividend payment on our common stock. Further, the Series A Preferred Stock is entitled to quarterly dividends of $0.34375 (5.5% per annum) per share. Upon conversion of the Series A Preferred Stock into shares of common stock, the Series A Preferred stockholders have the right to receive, when declared by our Board of Directors, dividends equal to the total previously unpaid dividends payable from the effective date of conversion through June 1, 2007 at a rate of $1.375 (5.5%) per share per annum, discounted to present value at a rate of 5.5% per annum, payable in cash or common shares, or any combination thereof at our option. We currently intend to retain all future earnings for use in the operation of our business and to fund future growth. Any future cash dividends will depend upon our results of operations, financial conditions, cash requirements, the availability of a surplus and other factors.

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

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

We are Dependent Upon Third-Party Software Licenses in Connection with the Sale of Our Software. If These Licenses Are Not Renewed or Are Terminated, We May Not Be Able to Continue to Use the Related Technology on Commercially Reasonable Terms or at All.

We depend on licenses from a number of third-party vendors for certain technology, including the computer hardware, operating systems, database management systems, programming language and runtime environment upon which we develop and operate our products. We are materially reliant upon licenses with the following third-party vendors: InterSystems Corporation, Document Storage Systems, Inc., Megas Corporation, Unicor

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Medical, Oracle, Microsoft, Quovadx, the American Medical Association and the American Hospital Association. Most of these licenses expire within three to five years. Such licenses can be renewed only by mutual consent and may be terminated if we breach the license terms and fail to cure the breach within a specified time period. If such licenses are terminated, we may not be able to continue using the technology on commercially reasonable terms or at all. As a result, we may have to discontinue, delay or reduce product shipments until equivalent technology is obtained, which could have a material adverse effect on our business, financial condition and results of operations. However, as all application software companies, including QuadraMed and our competitors, are reliant on licensed technology and third-party components, we believe our reliance on such technology and licenses does not place us at a competitive disadvantage.

At present, there is no equivalent technology for the InterSystems Corporation technology which is an integral component of our Patient Care and Revenue Management product line. The Company has entered into several agreements with InterSystems Corporation regarding the licensed technology relating to our Patient Care and Revenue Management product line. However, if InterSystems Corporation ceased to offer this technology and no other vendor provided the technology, we would be required to migrate our Patient Care and Revenue Management products to a new database platform or redesign our products to work with new software tools. This could be very costly and difficult to achieve and could have a material adverse effect on our business, financial condition and results of operations. There can be no assurance that we would successfully migrate our Patient Care and Revenue Management products to a new platform.

Most of our third-party licenses are non-exclusive and competitors may obtain the same or similar technology. In addition, if vendors choose to discontinue support of the licensed technology, we may not be able to modify or adapt our products.

We Face Product Development Risks Associated with Rapid Technological Changes.

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

- Offer a broad range of software products;
- Enhance existing products and expand product offerings;
- Respond promptly to new customer requirements and industry standards;
- Remain compatible with popular operating systems and develop products that are compatible with new or otherwise emerging operating systems; and
- Develop new interfaces with competing healthcare information system vendors to fully integrate our Health Information Management product suite in order to maximize features and functionality of the new products.

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

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

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

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

A substantial portion of our revenues has been and is expected to continue to be derived from sales of software products and services to hospitals. Hospitals are slow to make changes and generally favor their existing vendor when considering an upgrade in their systems. Consolidation in the healthcare industry, particularly in the hospital and managed care markets, could decrease the number of existing or potential purchasers of products and services and could adversely affect our business. In addition, the decision to purchase our products often involves a committee approval. Consequently, it is difficult for us to predict the timing or outcome of the buying decisions of our customers or potential customers. In addition, many healthcare providers are consolidating to create integrated delivery networks with greater regional market power. Others are participating in the regional health information organizations (RHIOs) or health information networks (HINs), some of which may seek to implement a single electronic health information solution for participating organizations. These emerging systems RHIOs, and HINs could have greater bargaining power, which may lead to decreases in prices for our products, and consequently could adversely affect our business, financial condition and results of operations.

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

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

Healthcare Regulations and Reform Proposals Could Adversely Affect Demand for Our Products.

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

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regulations promulgated under the Health Insurance Portability and Accountability Act of 1996 (HIPAA) could lead healthcare organizations to curtail or defer investments in non-HIPAA related features in the next several years.

Government Regulation of E-Prescribing and Electronic Health Record Technologies Could Increase Administrative Costs and Decrease Product Demand.

The U.S. Department of Health and Human Services (DHHS) has issued final rules protecting certain eligible entities that provide electronic prescribing (e-prescribing) and electronic health record (EHR) items and services to certain eligible recipients. The final rules became effective October 10, 2006. The EHR safe harbor protects, among other things, donations of software or information technology. The rule requires that a recipient pay 15% of the donor s cost for the items and services and also requires that reference to the donor s cost of the items or services be included in the agreement between the parties. The safe harbor will sunset on December 31, 2013. The e-prescribing safe harbor is largely reflective of the Congressional mandate requiring its implementation under MMA. This safe harbor does not include a requirement that the provider bear 15% of costs. The EHR and e-prescribing exceptions to the physician self-referral (Stark) law are very similar to the anti-kickback safe harbors, described above, while nevertheless accounting for the differences in the underlying statutes. For example, the EHR exception requires a receiving physician to pay 15% of the cost of the items or services, and the exception will sunset in 2013.

One or more of the above-referenced rules may increase the administrative costs typically associated with the sale of our products to the extent we are required to provide more detailed cost estimates to both parties participating in a proposed donation of technology. Failure on our part to provide accurate cost estimates could lead to contractual or legal exposure. In addition, we may be asked to execute agreements between prospective donors and recipients as a third party. Such requests may require additional review and analysis. In some cases, an agreement may provide either or both parties with the option to terminate the agreement upon either a change in law or experienced counsel s opinion of the law. As these safe harbors and exceptions may be subject to ambiguity, differing interpretation, and potential future sub-regulatory guidance, and given the inherent sensitivities to achieving compliance with safe harbors and exceptions, such termination provisions may have a negative impact on contractual certainty, especially in the context of certain longer-term arrangements, including servicing arrangements.

Customer frustration with the compliance obligations associated with the above-referenced rules, or fear that failure to comply fully with these rules could result in legal exposure, could decrease demand for our products. Alternatively, the protection afforded by these rules for the donation of electronic health information technologies may positively affect sales of our systems and products.

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

We cannot accurately forecast the timing of customer purchases due to the complex procurement decision processes of most healthcare providers and payers. How and when to implement, replace, expand or substantially modify an information system are major decisions for hospitals, and such decisions require these entities to make significant capital expenditures. As a result, we typically experience sales cycles that extend over several quarters. In particular, our Patient Care and Revenue Management software has a higher average selling price and longer sales cycle than many of our other products. As a result, we have only a limited ability to forecast the timing and size of specific sales, making the prediction of quarterly financial performance more difficult.

We Operate in a Highly Competitive Market.

Competition for our products and services is intense and is expected to increase. Increased competition could result in reductions in our prices, gross margins and market share and have a material adverse effect on our

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business, financial condition and results of operations. We compete with other providers of healthcare information software and services, as well as healthcare consulting firms. Some competitors have formed business alliances with other competitors that may affect our ability to work with some potential customers. In addition, if some of our competitors merge, a stronger competitor may emerge. Some principal competitors include:

- In the market for healthcare information systems: McKesson Corporation, Inc., Siemens Health Services, a division of Siemens Medical Solutions of Siemens AG, MediTech Corporation, Eclipsys Corporation and Cerner;
- In the market for electronic document management products: McKesson Corporation, SoftMed Corporation Inc., FileNet, Streamlined Health, MedPlus and Eclipsys Corporation;
- In the market for Smart Identity Management products and services: Initiate Systems, Inc., McKesson Corporation, Siemens Health Services, a division of Siemens Medical Solutions of Siemens AG, and Medibase;
- In the market for decision support products: Eclipsys Corporation, Healthcare Microsystems, Inc., a division of Health Management Systems Inc., McKesson Corporation, Siemens Health Services, a division of Siemens Medical Solutions of Siemens AG, and MediQual Systems, Inc., a division of Cardinal Health, Inc.; and
- In the market for coding, compliance, data, and record management products in the Health Information Management Software Division: 3M Corporation, SoftMed Corporation, Inc., MetaHealth, Eclipsys Corporation and HSS, Inc., an Ingenix Corporation.

Prospective customers may evaluate our products capabilities against the merits of their existing information systems and expertise and decide to stay with their incumbent vendor due to the cost associated with conversion. In addition, existing and prospective customers may be reluctant to buy from us because of the losses we have incurred in past years.

Many of our current and potential competitors have significantly greater financial, technical, product development, marketing and other resources, and market recognition than we have. These competitors may be in a position to devote greater resources to the development, promotion and sale of their products than we can. Our competitors also have, or may develop or acquire, substantial installed customer bases in the healthcare industry. As a result of these factors, our competitors may be able to respond more quickly to new or emerging technologies, changes in customer requirements and changes in the political, economic or regulatory environment in the healthcare industry.

As a result of the current emphasis on patient safety, the selection of a new hospital information system is frequently based on the strength of the vendor s clinical application and many of our competitors have invested considerably more in clinical development than we have.

Major software information systems companies, including those specializing in the healthcare industry, that do not presently offer competing products may enter our markets.

We may not be able to compete successfully against current and future competitors, and such competitive pressures could have a materially adverse affect on our business, financial condition and operating results.

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

Throughout our history, we have made many acquisitions and have encountered significant challenges integrating the acquired businesses into our operations. In recent years, we have made significant progress

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toward that integration. However, we continue to support different technology platforms. In the future, we plan to make investments in or acquire additional complementary businesses, products, services or technologies. These investments and acquisitions will create new integration challenges. Some of the challenges we have encountered, and may encounter with acquisitions in the future, in integrating acquired businesses include:

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

In the past, all of these factors have had an adverse effect on our business, financial condition and results of operations. We could also face these same challenges in the future.

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

Computer products used or intended for use in the diagnosis, cure, mitigation, treatment or prevention of diseases or other conditions or that affect the structure or function of the body are subject to regulation by the U.S. Food and Drug Administration (FDA) under the Federal Food, Drug and Cosmetic Act (Act). Our Laboratory solutions are considered Class I medical devices that are regulated under the Act and amendments to the Act (Class I is the least restrictive and regulated of the three classes for medical devices under the Act). While we were required to register our Laboratory solutions with the FDA, they are exempted from the FDA s more onerous and costly premarket notification procedures.

In the future, the FDA could determine that some of our products, because of their predictive aspects, are clinical decision tools and subject them to regulation, including registration and, perhaps, premarket notification requirements. Compliance with such FDA regulations could be burdensome, time consuming and expensive. Other new laws and regulations affecting healthcare software development also could be enacted in the future. If so, it is possible that our costs and the length of time for product development could increase and that other unforeseeable consequences could arise.

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

There is substantial state and federal regulation of the confidentiality of patient health information and the circumstances under which such information may be used by, disclosed to, or processed by us as a consequence of our contacts with various health plans and healthcare providers. This includes state and federal requirements designed to prevent I.D. theft. Although compliance with these laws and regulations is presently the principal responsibility of our customers (*e.g.*, health plans, hospitals, physicians or other healthcare providers), regulations governing patient confidentiality rights are dynamic and rapidly evolving. As such, laws and regulations currently applicable only to certain healthcare entities could be modified so that they could directly apply to us. Additionally, changes to the laws and regulations that would require us to change our systems and our methods may be made in the future, which could require significant expenditure of capital and decrease future business prospects. Also, additional federal and state legislation governing the dissemination of patient health information may be proposed and adopted, which may also significantly affect our business. Finally, certain existing laws and regulations require healthcare entities to contractually pass on their obligations to other entities with which they do business; as such, we are indirectly impacted by various additional laws and regulations.

HIPAA is a federal law that affects the use, disclosure, transmission and storage of individually identifiable health information referred to as protected health information. As directed by HIPAA, DHHS must promulgate standards or rules for certain electronic health transactions, code sets, data security, unique identification numbers and privacy of protected health information. DHHS has issued some of these rules in final form, while others remain in development. In general, under these rules, we function as a business associate to some of our customers (who are considered to be covered entities under HIPAA). The three rules primarily relevant to us and our customers the Transactions Rule, the Privacy Rule and the Security Rule are discussed below. It is important to note that DHHS could, at any time in the future, modify any existing final rule in a manner that could require us to change our systems or operations.

First, DHHS has published a final HIPAA rule governing transactions and code set standards (Transactions Rule). The Transactions Rule had a compliance date of October 16, 2003. To the extent necessary to help our covered entity customers conduct transactions, we believe that our current products and services meet the requirements of the Transactions Rule. Nevertheless, as noted above, DHHS may make further revisions to the Transactions Rule, which could require us to change our products and systems to enable our covered entity customers to meet such obligations.

Second, DHHS has published a final HIPAA privacy rule (Privacy Rule) which had a compliance date of April 14, 2003. The Privacy Rule is complex and far reaching. Similar to the Transactions Rule, as noted above, the Privacy Rule directly applies to covered entities. Also, covered entities are, in most instances, required to execute a contract with any business associate that performs certain services on the covered entity s behalf involving the exchange or creation of protected health information. Our hospital and health plan customers are covered entities, and to the extent that we are required by our customers to comply with various contractual safeguards mandated by the Privacy Rule, we believe that we meet the requirements. The Privacy Rule and other similar state healthcare privacy regulations could materially restrict the ability of healthcare providers and health plans to disclose protected health information from patient records using our products and services, or it could require us to make additional capital expenditures to be in compliance. Accordingly, the Privacy Rule and state privacy laws may significantly impact our products use in the healthcare delivery system and, therefore, decrease our revenues, increase working capital requirements and decrease future business prospects.

Third, DHHS has published the final HIPAA security rule (Security Rule) with a compliance date of April 20, 2005. The Security Rule applies to the use, disclosure, transmission, storage and destruction of electronic protected health information by covered entities. The Security Rule requires that covered entities must implement administrative, technical and physical security measures to safeguard electronic protected health

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information. Also, as with the Privacy Rule, under the Security Rule, covered entities are required to enter into contracts with their business associates that include certain mandatory health information safeguards. As such, where we function as a business associate to a customer that is a covered entity, we are required to enter into a business associate contract with that customer. Implementing such measures may require us to expend substantial capital due to required product, service and procedure changes.

We have completed modifications to our business practices and software offerings so that we are able to assist our customers in complying with the Transactions Rule, Privacy Rule and Security Rule. However, DHHS continues to publish change notices to the existing rules and propose new rules. There is no certainty that we will be able to respond to all such rules in a timely manner and our inability to do so could adversely affect our business.

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

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

Item 6. Exhibits

The exhibits listed on the accompanying Exhibit Index are filed as part of this Quarterly Report on Form 10-Q.

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SIGNATURES

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, thereunto duly authorized.

QUADRAMED CORPORATION

Date: May 9, 2007 By: /s/ KEITH B. HAGEN
Keith B. Hagen

Chief Executive Officer

Date: May 9, 2007 By: /s/ DAVID L. PIAZZA
David L. Piazza

Chief Financial Officer

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EXHIBIT INDEX

Exhibit Number	Exhibit Description
31.1**	Certification of the Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2**	Certification of the Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of the Chief Executive Officer under Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of the Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002.

** Filed herewith