

Transcend Services

Moderator: Larry Gerdes
April 28, 2010
10:00 a.m. CT

Operator: Good morning. My name is (Therese), and I will be your conference operator today. At this time, I would like to welcome everyone to the Transcend Services First Quarter 2010 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press star, then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. Thank you.

I would now like to turn the call over to Mr. Larry Gerdes, CEO.

You may begin, sir.

Larry Gerdes: Thank you, (Therese). Good morning. I'm Larry Gerdes, chairman of the board and chief executive officer of Transcend Services, Inc. Joining me today for this conference call are Lance Cornell, Transcend's chief financial officer; Susan McGrogan, our president and chief operating officer; and Leo Cooper, our executive vice president of sales and marketing.

This call is regarding Transcend's operating results for the quarter ended March 31, 2010. After we discuss our financial and operational results, we will conduct a question-and-answer period.

Now I will ask Lance to state our disclaimer.

Lance Cornell: Good morning, everyone. We'd like to ensure that everyone understands that are commentary and responses during this conference call may contain

forward-looking statements dealing with topics such as our business strategy, our anticipated future results, our service offerings, our relationships with other companies or customers and our ultimate role in the market. There is a risk that these forward-looking statements or predictions may differ materially from results because of factors such as company decisions, market conditions, business relationships and/or performance of various third parties associated with Transcend, including, but not limited to, their access to capital and their financial condition. Please realize that we will not necessarily provide updates to any such statements other than is required by law. Finally, more information about potential risk factors is included in the first quarter press release and the periodic reports that the company files from time to time with the Securities and Exchange Commission, including the company's form 10-K for the year ended December 31, 2009.

Larry Gerdes: Thanks, Lance. Before we discuss our results, I'd like to comment on our attempted acquisition of Spheris, which was the second largest transcription company in the industry until it was acquired last week by MedQuist. As many of you know we participated in a Chapter 11 auction to buy Spheris. Our due diligence had convinced us that Spheris was an attractive opportunity, and the chance to buy a large competitor doesn't come along often. Ultimately, however, the auction price exceeded the maximum price we were willing to pay, and we declined to bid further.

I'm proud of our team for the discipline we exhibited during the process. As a result of the acquisition of Spheris by MedQuist, we are now the second largest medical transcription company in the industry. I believe an intangible benefit to the process is that it raised the level of awareness of Transcend in the industry, which will hopefully provide us opportunities we otherwise might have missed.

We'd be happy to answer any questions you might have about this transaction.

Now I'd like to turn the call back over to Lance to discuss our financial results.

Lance Cornell: Thanks, Larry. Revenue for the first quarter of 2010 increased 49% to \$22,206,000 compared to \$14,930,000 for the first quarter of 2009. Excluding \$5,368,000 of revenue contributed in the first quarter of 2010 by our two most recent acquisitions, revenue increased 13%.

Gross profit increased 40% to \$7,480,000, or 34% of revenue for the first quarter of 2010 compared to \$5,343,000 or 36% of revenue for the first quarter of 2009. The decrease in the gross profit margin was primarily due to the impact of our August 2009 acquisition of Medical Dictation Services, Inc, or MDSI. Excluding MDSI, our gross profit margin was 36% in the first quarter of 2010.

Operating income was \$2,675,000 for the first quarter of 2010, which included \$678,000 of costs related to the bid for Spheris. Excluding these costs, non-GAAP operating income increased 32% to \$3,353,000 or 15% of revenue compared to \$2,546,000 or 17% of revenue for the first quarter of 2009. The two-point decrease in non-GAAP operating margin is primarily due to the two-point decrease in the gross profit margin.

Excluding the acquisition related costs and depreciation and amortization, selling, general and administrative expense was 16.6% of revenue this quarter versus 17.0% in the first quarter of 2009. I should point out that we do expect to incur another 400,000 to 500,000 of costs related to the Spheris bid in the second quarter of 2010 for a total of 1.1 to 1.2 million between the two quarters.

Our effective income tax rate for the quarter was approximately 38% compared to 37% in the first quarter of 2009. Net income for the first quarter of 2010 was \$1,632,000, or 15 cents per diluted share, including the \$678,000 related of costs related to the Spheris bid. Adjusting for these acquisition related costs, non-GAAP net income increased 30% to \$2,050,000 or 19 cents per diluted share for the first quarter of 2010 compared to \$1,578,000 or 18 cents per diluted share for the first quarter of 2009. It's also important to note that the dilutive impact of the issuance of 1,725,000 shares of common stock in a December 2009 public offering was approximately negative 3 cents per diluted share in the first quarter of 2010.

Our balance sheet continues to be healthy. We generated approximately \$2.9 million of cash flow from operations in the first quarter and had \$28,785,000 of cash, cash equivalents and short-term investments on hand, and \$2,378,000 of debt outstanding as of March 31, 2010. The number of days of revenue in accounts receivable was 39 days as of March 31, and we're investing significant resources in the next generation of our transcription platform this year, capitalizing approximately \$630,000 of software development costs in the first quarter related to that platform, and this level of investment will continue through the bulk of 2010.

Now I'd like to turn the call over to Sue for our operational analysis.

Susan McGrogan: Thanks. As Lance just mentioned, we incurred significant cost to pursue the Spheris acquisition. In the auction process, much of the legal work had to be done in advance just to be qualified to participate in the auction. We decided to take the risks and incur the costs because the opportunity was too compelling to ignore.

Now that Spheris is behind us, we are actively pursuing other acquisition opportunities. In fact, we're hosting this call from the Annual Medical Transcription Industry Association Convention, which is attended by many other transcription companies, and is a wonderful venue to see how everyone is positioned. We certainly hope to complete one or more acquisitions in the second half of 2010.

We usually keep you updated on how we're doing at retaining our customers. I'm proud to report that no customers left Transcend during the first quarter. High customer retention will always be critical to our success, and we started off 2009 extremely well.

Let me comment for a moment on our sales results. We've closed new business that we expect to generate between 3.5 and 4.3 million of annual revenue once fully implemented. While pleased with these results and the momentum we see in sales, some of these sales were delayed from the fourth quarter and won't contribute revenue until the third quarter. One of the sales is to a hospital that is part of a larger system, and we hope to leverage our

success there and expand our presence within that system once we've proven ourselves. Looking forward, we know from our sales efforts that there are opportunities to win new business as a result of the Spheris MedQuist combination in the coming months.

Our most important gross profit margin initiative at this time is the conversion of as many of our acquired MDSI customers to Beyond Text as possible. This is our last significant integration project from our 2009 acquisitions. It has proven challenging to obtain commitments from some of the MDSI customers to move forward. In most cases, this is due to a lack of IT resources on the hospital side. We brought our first MDI customer live on Beyond Text in April, and we should convert a couple more by the end of the second quarter, but progress is slower than we would like. We will continue to work hard to convert as much of this business as possible by year-end.

Now I'd like to update you on our other gross profit margin improvement initiative. I'm very pleased to report that the percentage of revenue on our Beyond Text platform increased to 50% of total revenue compared to 45% in the fourth quarter of 2009. The increase was due in large part to customer conversions. On Beyond Text, we can take advantage of speech recognition technology to drive higher productivity and gross profit margins. Another key to improvement is maximizing the percentage of our Beyond Text volume that is edited using speech recognition technology versus traditional typing.

After we bring a customer up on Beyond Text, it takes several months before all the physician (inaudible) profiles are at a high enough quality threshold to start editing. We edited 67% of our Beyond Text volume in the second quarter compared to 53% in the first quarter of 2009. We've actually been hovering around 70% recently, and we're very pleased with this progress. We've also increased the volume of our work processed offshore in the first quarter of this year by 39% over the same quarter of last year. This still only represents 16% of our total volume, and we know there is a lot of room to grow. Our goal is to steadily increase our offshore volumes, although the percentage of total volume processed offshore can vary depending on the impact of acquisitions and the rate of top-line growth.

Lastly, let me applaud the efforts of our entire Transcend team in banding together to pursue this Spheris opportunity without missing a beat on all of our other initiatives.

Now I'll turn the call back to Larry to give some more flavor on our technology initiative.

Larry Gerdes: Thank you, Sue. Let me wrap up by giving you an update on our data and technology initiatives. As many of you know one advantage we have over most transcription companies is that our data is intelligently structured using XML tagging. We are currently concluding pilots for our first application developed to take advantage of this structured data which is called Beyond Alerts. With Beyond Alerts, we are minding the data contained in the reports we produce for certain conditions and occurrences, then we're porting the results to the hospital personnel to aid in the tracking of the hospital's core measures. This can increase sufficiency and ensure that patients who qualify for core measure tracking are not missed. Based on the results of our pilots, we should be able to commercialize this offering later this year. Although we don't expect it to be a significant source of revenue in the near term, we continue to expense most of the cost, and we believe that we'll increase customer loyalty because it extends our new reach into new areas of the hospital outside the HIM department.

We are also encouraged that this data initiative is just scratching the surface of ways in which we can help our customers improve their operations, and we expect to expand the applications in the coming months. Our partner, MultiModal Technologies, has been very supportive in this effort as it epitomizes their long-term strategy for data. We will closely with M Modal as we continue to expand this effort.

We're also making significant progress on the development of our next generation yet-to-be-named transcription workflow platform. This platform is being developed with the customer in mind and will be marketed directly to hospitals who want to license their own transcription platform either because they have in-house transcriptionists or because they want more control over the process. It will allow them to have access to the operating efficiencies

offered by the M Modal speech recognition technology that we have integrated into the platform. We expect to finish core development and enter beta testing in the fourth quarter of this year.

We are all excited about the role that Transcend can play in the industry as the need for healthcare documentation evolves and the adoption of electronic medical record, or EMR solutions, increases. I want to thank our customers for their continued trust in Transcend and our employees for their dedication to providing excellent service and innovative solutions to our customers.

Now Leo Cooper will join us for the question-and-answer period. At this point, we would like to open up the lines for your questions.

(Therese)?

Operator: Thank you. If you would like to ask a question, please press star then the number one on your telephone keypad. Your first question comes from Ryan Daniels with William Blair & Company.

Ryan Daniels: Yes. Good morning, everyone.

Larry Gerdes: Good morning, Ryan.

Ryan Daniels: I was hoping we could drill down a little bit more on the gross margins. I appreciate all the color you offered there. I guess I was a little surprised to see it down. Obviously it's just very modestly sequentially, but it sounds like you actually moved more people or more customers to Beyond Text, going from 45% I think in Q4 to 50% this quarter. I would have thought that would actually you know stabilize or maybe even boost the gross margins. So one, any color there, and then number two, maybe looking forward, do you think margins should be relatively flat going forward, or do you expect a modest improvement there? Thanks.

Larry Gerdes: Thanks. I'll let Lance touch base on that.

Lance Cornell: Sure. Related to your first question, I think the – what we saw in Q1 versus Q4 was really not much change. It was 34% both quarters, and we hadn't

planned on much impact at all from the MDSI conversions. In the first quarter, we knew that it would be late in the first quarter, into the second quarter before we started converting those customer bases. So we weren't expecting too much of a change there. Otherwise, it's been you know more or less business as usual.

Now, when we do convert customers, it's important to remember that once they come on Beyond Text, there's a lag before you see the improvement from the speech recognition. It takes – it's a – it's a curve that we work up pretty quickly, but a new hospital on Beyond Text will take about six months before you maximize all of the physician voice profiles. You start getting drafts within the first several weeks, but other physicians will take longer if they're lower volume and that sort of thing. So you have to keep that in mind too.

As far as the outlook for gross margins in the near term, I think that you need to look at the fact that we will continue to work on the BayScribe migrations. Of course we're always looking to improve the volume that we've added using speech recognition technology and increasing the offshore volume. And the only offsetting pressure going the other way would be that pricing in the industry, as we've said before, is very competitive right now in that, to the extent that we're selling larger systems in competitive systems we expect those to be at, on average, a lower price point than our existing base of business, and HMA is an example of that which has already been factored into the margins when we signed the agreement back at the beginning of the fourth quarter of last year.

Ryan Daniels: OK, great. That's helpful color. And then maybe – I don't know who wants to hit this, but maybe Sue. I think you commented on it. It sounds like the MDSI clients are a little bit more challenging than you may have initially thought to get them to move onto the Beyond Text platform, and I'm curious if you know that's kind of a normal challenge. I know you've probably faced that always with your integrations. But if you look at TRS or Deventure, it seems like that might have migrated a little more quickly than you expect of MDSI, so I don't know if it's a different customer base or maybe if just you know end market's a little more challenged today given everything going on

in healthcare so hospitals are less focused. But any color there would be helpful as well.

Susan McGrogan: Sure. I can tell you we're hitting it very, very hard. I think the reason that we're having it more of an issue with MDSI than we did with Deventure or TRS is that the industry's a little different now. IT – the IT resources on the hospital side have become with all this healthcare IT going on and EMR you know we're seeing those folks not having the bandwidth to help.

Ryan Daniels: Got you.

Susan McGrogan: So we're looking at a lot of different ideas. I mean for example, one of the things we're doing is you know talking to the customers. We're doing another sweep of going to visit them, offering them some resources that we have to help them. There's nothing more important to me right now than migrating those customers and the team. So we've got a team just really targeting on that, and I think on the next call you'll see a big improvement there.

Lance Cornell: Yes, typically – and I think we've talked about this before too – the conversions are the type of thing that we like to do by building the trust and building the relationship first before we move them over because the last thing that we want to do is open up contract negotiations or you know really get the customer to say, well, what's in it for me, because really it's our platform; it's not theirs. So we're asking them to do us a favor by providing a little bit of help to make sure the interfaces are working correctly, and it really is just that. It's a favor, and it can be difficult to get them to commit the resources.

Susan McGrogan: But I ...

Ryan Daniels: OK. No, that's very helpful (inaudible). Maybe two more quick ones, and I'll hop off. The first one, just any update on the M&A pipeline? I know you probably took your foot off the brake, one, for the MDSI integration efforts that are ongoing, and two, certainly while you're working on Spheris. But you know how do you see that shaping up if we look over the next two, three, four quarters, maybe what you're seeing in the marketplace?

Lance Cornell: Sure. Yes. The – I'd say it's fair to say that we did take the brake off for a good 30, 45 days in there while we were focused pretty intently on Spheris. But we already had a pipeline going into that process, and that really didn't change. Actually, within the first week after the Spheris auction, we added several potential opportunities to that pipeline. So it's active. I don't expect us to close anything in the second quarter, but I'd certainly hope that we can get some – at least one, if not more, done in the second half of the year.

Ryan Daniels: Sure. And I assume being part of the auction also helped your visibility there on the M&A front because people now know you're an acquirer. Is that safe?

Lance Cornell: I think so. I think you know obviously because we did the acquisitions last year, a lot of people already know that, but Spheris raised that level of awareness even further.

Ryan Daniels: OK, and then the last one I had, and again I'll hop off; just any update on Beyond Speech? I don't know that you mentioned that upfront, but I think you launched it in March or you know maybe the start of this quarter with HMA, and I'm curious how that went and how it's being received.

Susan McGrogan: Actually, we had some GE integration – I wouldn't say issues, just some GE integration delays. So we're actually launching that next week at one of our HMA sites, and we're very excited about how that's going to go. We spent a lot of time with them. You know obviously adoption is so important, physician adoption. We've got a team just dedicated to that. They're doing a great job. We really went slowly with this first one, and then I think they're going to roll out relatively quickly. So we'll have more information for you on the next call.

Larry Gerdes: I really – this is Larry, Ryan. I was very happy to see that last week GE certified the integration effort. And that's a good relationship to have.

Ryan Daniels: Sure.

Larry Gerdes: Even though we had hoped we would probably start these conversions early in April, it's now going to be at the end of April, it won't slow up the speed by

which they would like us to make these conversions because they'd like us to do them as quickly as we possibly can.

Ryan Daniels: Right.

Susan McGrogan: And HMA is such a good partner. They understand that you know it's – this is a new thing for us, and they're working very – we're working very closely together with their team. So I'm real excited about that.

Ryan Daniels: OK. Thanks for the color, and congrats on the – on a great retention and new sales this quarter.

Susan McGrogan: Thank you.

Larry Gerdes: Thanks, Ryan.

Operator: Thank you. Your next question comes from Tom Gallucci with Lazard Capital.

Lance Cornell: Hi, Tom.

Larry Gerdes: Morning, Tom.

Susan McGrogan: ... Tom.

Colleen Lang: Hi. This is actually Colleen Lang on for Tom this morning. How are you?

Larry Gerdes: Hi, Colleen. Fine.

Susan McGrogan: ... Colleen.

Colleen Lang: We just had a quick question, just to start. Did you guys see any negative impact at all from the severe weather we saw during the first quarter, and also a lack of flu? It seems like some of the hospital companies have been reporting somewhat weak volume numbers. Just if you have any thoughts on the impact you guys had on volume ...

Susan McGrogan: Definitely. This is Sue, and I'll take that. I mean we definitely did, especially with our MDSI customers. They were in the Mid-Atlantic states, and I mean

it was – they shut down for a few days a couple of – you know a couple of times, and we had the transcriptionists that were complaining that they didn't have enough work. We also were saying, well, we don't have the business either. So definitely an impact on the MDSI revenue. You know so yes. The answer to that's yes. But more so MDI, the MDSI.

Colleen Lang: OK, great. Thanks. And just any thoughts – what do you guys – what are you guys thinking about for this year in terms of organic volume growth?

Lance Cornell: Yes, I think – well, as you know last quarter – fourth quarter was 13%. We're still right around that 13-percent rate, and we'd love to get it up into the 15-percent range. That's still our goal, to grow about 15%, and we've been just a hair shy of that, although really our first-quarter revenue was – and frankly our – all of our operating results were right in line with our budget estimates.

Colleen Lang: OK, great. Thanks so much.

Larry Gerdes: Thank you.

Susan McGrogan: Thank you.

Operator: Thank you. Your next question comes from Brad Hoover with Sidoti & Company.

Brad Hoover: Hi. Good morning.

Lance Cornell: Good morning, Brad.

Lance Cornell: Good morning, Brad.

Susan McGrogan: ... Brad.

Brad Hoover: I'm just following up on Ryan's question. Do you expect to move all the MDSI customers in 2010, or is that going to trickle into 2011 a little bit?

Larry Gerdes: Well, it'll trickle into 2011. We've always felt like it would take us probably 15 months or so to do it. So we've always known that we wouldn't get it all done in 2010, and as Lance and Sue – and I'll let Lance comment here – but

as they've mentioned, we want to do it in a way that the customer cooperates, we don't have to make price concessions to do it, and we don't think that all of them will go. We think at the end of the day there'll still be two or three of their customers that might remain on their old platform. We'll have to see. We went through the same process really actually in a different light with HMA.

Lance, what were you going to ...

Lance Cornell: I was just going to add that in all of our acquisitions, Deventure, TRS and now MDSI, we never assume that we'll get 100% of it over; it's just how quickly can we get whatever portion of the business that we can get, and we're still hoping to get all of that by the end of the year. We have a lot of work to do to make sure that that does happen. But that would leave probably, like Larry said, a couple of customers that would be down the road at some point but with no definitive plan.

Brad Hoover: OK, great.

Susan McGrogan: And we've also – we've also established a good working relationship with the folks over at BayScribe who are – is the platform that all these clients are on, and we're looking at different ways to work with them so it could be a win-win and maybe go faster, and I believe we've established a pretty good partnership with them.

Brad Hoover: OK, great. Thanks for the color on that. And then on G&A, I think historically you know the first quarter's been lower as a% of revenue in terms of you know full year. We definitely saw noticeable increases in this first quarter. Is there anything there related to Spheris at all, or is that something else that G&A was up a little bit higher this year just relative to prior first quarters?

Lance Cornell: Well, we split out the – you know as much as we could capture the Spheris cost, we split that out separately so that you could identify it, and I'm sure there's a little bit of cost buried in everyone's efforts that didn't make it into that number. But for the most part, we've broken it out. Outside of that, if you – if you look at SG&A, I'll break it down a little bit. The depreciation

and amortization as a percentage of revenue is up primarily because of amortization of the intangibles from the acquisitions, but if you look at the rest of SG&A, excluding depreciation and amortization and adjusted for that the acquisition related costs for Spheris, we're actually doing a little bit better. We're at 16.6% of revenue, as I've stated a few minutes ago, in Q1 of this year versus 17.0% last year. Not a – not a huge difference, roughly around 17% of revenue in both quarters.

Brad Hoover: OK, and then with the – I know you've been working on a rebranding effort, and I just wanted to get an update on kind of where that stands and then how we should think about that in relation to sales and marketing expenses that you go through the year since that was flat from fourth quarter.

Leo Cooper: OK. Yes. This is Leo. Good morning.

Brad Hoover: Hi. Good morning, Leo.

Leo Cooper: Glad you asked that question because we have worked so hard on our rebranding and our marketing efforts, and we are literally in the process right now of rolling out the whole rebranding process starting with our new Web site, which you'll have an opportunity to see that next week. We'll have it up by Monday of next week. And as a part of this process, we also are very excited to have hired a new marketing manager to assist us you know in implementing and developing new programs going forward. So I guess the best way to say it is that we have outlined a very, very aggressive marketing plan as compared to what we've had in the past and are very, very much in the midst of rolling that process out, including trade shows, new sales collateral, which we've developed two pieces already with additional work in process and so on and so forth. So very excited about it, and I'm excited to have our new marketing manager on board as well.

Brad Hoover: OK, great. So fair to assume that sales and marketing will increase sequentially as we go through the year.

Leo Cooper: We certainly will see that, yes.

Brad Hoover: OK, and then just lastly, guys, you mentioned the pilots for the hospitals core measures, and you're obviously incurring those you know cost centers associated with that. Is that in the gross margin line, or is that one of the operating expenses? Or where do you – where do you see that as cost breaking out?

Lance Cornell: The bulk of that cost is actually down in G&A with some extra consultants and that sort of thing. So that does explain – you know if you look at year-over-year, we certainly didn't have those costs last year.

Brad Hoover: Yes, OK. All right, thanks a lot.

Larry Gerdes: Thanks, Brad.

Susan McGrogan: Thank you.

Operator: Thank you. Your next question comes from Harvey Poppel at Poptech L.P.

Harvey Poppel: Yes. Very good revenue performance in first quarter. Very appreciated.

Larry Gerdes: Thanks.

Harvey Poppel: A couple of questions on the margin side. Once – what is your target to – for gross margins once you've converted these acquisitions? What level do you seek to achieve in gross margins?

Lance Cornell: Well, I think if we – just with the MDSI conversions alone, if we were able to maximize that once we see the full impact of speech, that takes the company's gross margins back into the roughly 36% range, and then the question is just the degree to which we expand speech rec offshore and what happens with pricing on new contracts and that sort of thing, which it's kind of difficult to predict what the net result of the impact of those three things will be.

Harvey Poppel: OK, but to the extent you have such an active acquisition program, one would expect that you're constantly going to have new MDSI-like situations to integrate and that you'll consistently, therefore, be below the 36% number on an ongoing basis.

Lance Cornell: Yes, if you – if you look at the core because, then you know clearly the plan is to – our plan is to improve the margins post integration, and more than offset any lower pricing on bigger system contracts by the use of editing in offshore, and you know and we've got to prove that we can do that. But you are right. Generally speaking, and every acquisition is unique, but generally speaking we'll see acquisitions come in at lower gross margins until we can integrate the businesses fully.

Larry Gerdes: There is one unique twist to that, and that is as we finish the development of our Beyond Text generation for platform at the end of this year and early next year, we're not only going to make that platform available for large hospital systems, we'll also make it available for transcription companies that need a new technology. So even though it's not – it's not predictable, I would hope that there might even be opportunities for some of that migration or transition to happen prior to us making an acquisition, which would be a much better scenario if it could be accomplished.

Harvey Poppel: Yes. Just to shift on the new platform that you're developing, will this change your revenue model? Will you be selling this more or less upfront as opposed to achieving the recurring revenue that you get now from these customers?

Lance Cornell: The plan is to license the new platform as an ASP, and the licenses is – would be based on the volume of work processed each month. So it will be a recurring revenue stream just like the transcription is; however, we would expect it to be at higher margin because obviously we don't have the significant labor component related to that that we do now. Likewise, the Front End Speech or Beyond Speech is – affords the radiologists in particular the opportunity to do their own editing of their documents, and so the hospital is paying us a technology charge, basically, to have that system implemented, and it's still volume-based recurring revenue, but it's at a higher margin because, again, in that particular case, the doctor's providing the labor, not Transcend.

Harvey Poppel: Good. Thank you very much.

Larry Gerdes: You're welcome.

Operator: Thank you. Your next question comes from Lenny Dunn with Freedom Investors Corp.

Lenny Dunn: Yes, good morning.

Larry Gerdes: Good morning, Lenny.

Susan McGrogan: Good morning.

Lenny Dunn: Most of my questions have been answered, but I did have something I'd like you to address. It's – Spheris received quite a bit of business from MedQuist when people wanted to leave MedQuist for the problems they had with them. Now MedQuist has repurchased Spheris, so these customers are kind of forced back into MedQuist, where they really didn't have a very good relationship. Do we have a shot at getting some of that?

Larry Gerdes: Very good question, Lenny. You know with consolidation like this and major mergers, there's always some turmoil in the customer base. I'm going to let Leo respond in a second to some of the efforts that he and his team are doing out in the marketplace just to make sure that we're available. But you know we know that you know MedQuist is a – is a good, big company, and they're going to do everything they can to retain those customers in the Spheris base. But we hope that the opportunity presents itself for those hospitals that would like to make a change or they were a previous customer that there's an opportunity for us. So I think that's a – that's a very pertinent question.

Leo, would you add to that?

Leo Cooper: Just simply add to what Larry just said in that a lot of the customers that are out there today are going to be in a wait-and-see mode. We do know we had an opportunity to do a lot of due diligence with those customers, so we know that – we know many of those that did come originally from MedQuist. So Lenny, we would – we would hope that as time goes by those particular customers would give us an opportunity since they're going to be in a state of change, they're going to be in a state of transition of some sort, that they would give us the opportunity to compete for the business, and again, time will tell. But we know who those folks are, we're in contact with those

people, and we want to make sure that they understand the Transcend story and that they are aware that we are a viable alternative whenever they're willing to take a look.

Lenny Dunn: Yes, I would think they would've – because when you're doing your due diligence, that they would have become very aware of you at that point.

Larry Gerdes: Well you know one thing I will add, Lenny, this process with the Spheris auction was so quick, and it had to be done in – to make a level playing field. We weren't provided access to the customers' names. All we were provided were financial information. So when Leo and his team talked to customers, it was through previous relationships, people they already knew out in the field. And so it wasn't through anything that we could determine from any kind of due diligence effort. But you know it's a small marketplace. Everybody has pretty good feel for their individual territory, and so you know some of our sales folks have worked at the previous companies too, so they had some knowledge of where the customers stood. So it was one of those deals where it's just not that simple that we would have gotten any customer information or knowledge or from the due diligence. That due diligence had to be done on an awfully global basis.

Leo Cooper: That's an excellent point, Larry, and that is, in fact, why were able to even talk to the ones that we did talk to because they had so many different people trying to reach out to them from the other transcription companies as well. But I do think it's important to point out that particularly in the large systems, these are big installations that are very, very intricate and can be time consuming. So I think we would have to look at those folks that may have been with MedQuist at one time that went to Spheris. So you know those were a number of years ago as well, and I suspect that they are certainly going to evaluate whether or not they want to jump to make a change, or do they want to sit back and see how the performance level's going to be given a different day and a different time. So I think that we'll see a lot of wait-and-see. But we're certainly optimistic that as time goes by, that Transcend will be given an opportunity, and we certainly intend to stay in contact with those customers that we – you know that we are aware of.

Susan McGrogan: And one thing that I'd like to add is that you know if customers do start to depart MedQuist/Spheris, we have a scorecard, and you know we want to get – we want to get a big percentage of those customers, and that's the expectations. So we are working very hard to continue to you know continue to provide the excellent service that we do, get our name out there in the market. People know Transcend now a little bit better than they have. We just want you know – if someone's going to leave, we hope they come to us.

Lenny Dunn: Well, thank you. That kind of answers my question. I mean you know obviously we're a large player now, where a few years back we were a very small player. So they may not have looked at you.

Larry Gerdes: Yes, exactly.

Lance Cornell: Exactly.

Larry Gerdes: Matter of fact, that's why you're seeing us participate in larger decisions now too.

Operator: Thank you.

Larry Gerdes: Thank you.

Operator: Your next question comes from Andy Plimpton with Mast Capital.

Andy Plimpton: Yes. Hi, guys. I was curious if there was any restrictions on you guys talking to the Spheris customers as a result of a confidentiality agreement or anything like that. And in addition, what percentage of the Spheris customers are former MedQuist customers?

Lance Cornell: As far as prohibitions, the only prohibition is that we can't use confidential information that we obtained during due diligence in order to you know exploit any market opportunities. But in our case, because we weren't able to access detailed customer information during the due diligence, there's not much of an opportunity to do that anyway. So it's mostly using the information that we already have from just being in the marketplace. And so we'll continue on that basis.

Larry Gerdes: Ten% of the ...

Lance Cornell: Oh, and the percentage – I don't know the answer to that. We know there – that there are you know quite a few that are former MedQuist clients that moved to Spheris, but I don't know that we know the exact percentages.

Larry Gerdes: No, we don't. We were never given that information, so we have no way of knowing.

Susan McGrogan: No. We knew there was a lot of them. We did – you know we made a lot of phone calls. We were never given a customer list, and you know but I think there is a lot of opportunity out there, but we were stacked. I mean we were stacked to Spheris' team. We had great meetings with them. I think they're a good company, and I just can't say enough about how much our team enjoyed you know meeting with the Spheris team, and we wouldn't do anything underhanded or anything like that to get business. Like I said, I think we could work good enough that we can win business fair and square, and if customers want to leave them, hopefully they'll come to us.

Larry Gerdes: I would say this too, and this is very anecdotal, but now that Transcend, as Lenny said, is at the size we are, and now that we are the only other somewhat large transcription provider and our profile has been raised through this process, any customers across the country that want to make a decision – especially if they're larger – I'll be surprised if there isn't a larger% of the time where they'll consider Transcend just because of that.

Andy Plimpton: Great. The other quick question I had was I guess in one of the MedQuist filings, they said that (CUA) is no longer going to be marketing for a new business in the U.S., and I was curious if you've seen that to be true and if you're you know expecting to see benefits from that in terms of you know two of the top five or six players are now into longer marketing in the industry.

Susan McGrogan: I – this is Sue. I've heard that. I don't know how it will affect us much because it's – that's really what we expected. We expected that MedQuist would have you know an – they'd offer both you know a blended model, an offshore model and you know domestic. And it's very hard I think to go out there as a strictly offshore company and try to sell just that. So that makes a

lot of sense. I don't think it will affect us either way. It just – because MedQuist and (Sea Bay), we always thought of them as one anyway. So that – you know I just think it's hard in this industry. A lot of people still want domestic only or a blend. Very, very hard still 100% offshore.

Andy Plimpton: OK, great. Thanks a lot.

Lance Cornell: Thank you.

Operator: Thank you. And at this time, there are no further questions.

Lance Cornell: Thank you, (Therese). Well, I just want to close by thanking you again for the support for Transcend. You know we've gotten mixed reactions from our investors on our participation in the Spheris auction, but I do want our shareholders to know that the reason we participated in that auction was because, not only did we see it as an opportunity, but it's really an endorsement of the fact that our company's come so far in its depth and breadth and capacity to do major acquisitions and major integrations.

You know one thing we didn't say in our comments about the BayScribe migrations from MDSI, and that is the great job that Sue and her team have done on integrating MDSI into Transcend. We've lost no customers, which is always our goal. They have remained very happy. We've done a great job with that. So I think the Spheris exercise, although it was hard work and it took a lot of our team's time, was well worth it, and I'm very proud of the teams of managers at Transcend and others that were involved in that because they've shown very well, and we would have been a great match for Spheris, but I'm equally proud of the fact that we had the discipline to stop when we did because we knew what our valuation models would lead to.

So we're very excited about the future. As Lance mentioned, we're excited about what we've gotten accomplished this year to date. We're tracking right on our business plans and our internal budgets, and we feel good about it. We're going to work very hard on our gross margin initiatives, as many of you have asked us. We like the new momentum we're seeing in sales and the sales pipelines we're building.

And so we're also seeing one other thing that Sue just mentioned to me, and we're starting to see recognition among major hospital organizations and groups, and we just recently signed as a preferred vendor for the Children's Hospital Association for the country, and even though that's a preferred vendor where we still will compete with others for that business, it's a real endorsement of where Transcend is. So I would hope that in the next few months you'll see more of that coming from us, announcements of large relationships.

So thank you again for your support. We look forward to the next call and the rest of this year.

Susan McGrogan: Thank you.

Operator: Excuse me, Mr. Gerdes. We did have one more question come in. Can we take it?

Larry Gerdes: Sure can.

Operator: And this question comes from (Simon Baroch). He's a private investor.

(Simon Baroch): Good morning. There was an item in the 10-K regarding the contingent consideration for the TRS acquisition where they claimed an additional 1.9 million. Is there any update on that? And does this effect the way you may calculate in the future any contingent considerations?

Larry Gerdes: There's really no update. They did submit a dispute on the calculation. We feel pretty strongly that the calculation is very plain contractually and that there's – that there's nothing there, but we're still working through that process to resolve it.

As far as how we book contingent consideration in the future you know with the new rules, you obviously need to make an estimate of the correct value upfront. It's just an estimate, so I don't know that we'll ever be able to nail it down exactly, and it really just depends on what the formula is in each particular acquisition. So you can't really answer that without knowing what the specific deal is.

(Simon Baroch): OK, thank you.

Larry Gerdes: Thank you.

Operator: Thank you. And there are no further questions.

Lance Cornell: Great. Well, thank you.

Susan McGrogan: Thank you.

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