

Transcend Services

**Moderator: Larry Gerdes
July 29, 2010
10:00 a.m. CT**

Operator: Good morning. My name is (Janetta) and I'll be your conference operator today. At this time I'd like to welcome to the Transcend Services Second Quarter 2010 Earnings conference call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there'll 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. Mr. Gerdes you may begin your conference.

Larry Gerdes: Thank you (Janetta). 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 and Susan McGrogan, our President and Chief Operating Officer. This call is regarding Transcend's operating result for the quarter end in June 30 of 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: Thank. Good morning. We'd like to ensure that everyone understands that our commentary and responses during this conference call may contain forward-looking statements dealing with topics that is our business strategy, our anticipated future results, our service offerings, our relationships with other companies or customers and our ultimate goal in the market. There is the risk that this 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 conditions.

Please realize that we will not necessarily provide updates to any such statements other than as required by law. Finally, more information about potential risk factors is included in the second quarter press release and the periodic reports of the company files from time to time with the Securities and Exchange Commission including the company's form 10K for the year ended Dec 31st, 2009.

Larry Gerdes: Thanks Lance. Before I start my comments, I'd like to congratulate Lance on receiving an honor recently as CFO of the year for the State of Georgia by the Atlanta Business Chronicle. We're very proud of what Lance has done here the last five and a half years at Transcend. And it was recognition well deserved. We're very pleased with our results for the second quarter in the progress we've made on a number of our initiatives, particularly our gross profit margin improvement initiatives. We'll speak to these in more detail in a few minutes. Now I'd like to turn the call over to Lance to discuss our financial results.

Lance Cornell: Thank you. Revenue for the second quarter of 2010 increased 31 percent to 22,209,000 compared to 16,966,000 for the second quarter of 2009. Excluding revenue contributed by our two most recent acquisitions, revenue increased 12 percent which is in line with our goal of 10 to 15 percent organic growth. Gross profit increased 31 percent to \$8,031,000 for the second quarter of 2010 compared to \$6,115,000 for the second quarter of 2009. Gross profit as a percentage of revenue was 36 percent for both periods. But more importantly we increased our gross profit margin by two full percentage points compared to the first quarter of this year from 34 percent to 36 percent. And we'll cover the reasons for the increase in a moment when we discuss operations.

Operating income was \$2,692,000 for the second quarter of 2010 which included \$601,000 related to the bid to acquire (Spirus) and a \$445,000 pretax

none cash accumulative stock compensation expense adjustment for the period January 1st 2006 through March 31st of 2010. Excluding these costs, non-GAAP operating income increased 31 percent to \$3,738,000 or 17 percent of revenue compared to \$2,822,000 or 17 percent of revenue for the second quarter of 2009.

Like the gross profit margin, this also represents the two percentage point increase compared to the first quarter of this year on a non-GAAP adjusted basis. Our effective income tax rate for the quarter was approximately 41 percent compared to 37 percent in the second quarter of 2009. The increase in the effective rate is due primarily to permanent book tax differences related to the cumulative stock compensation adjustment. And this is a discrete item for the second quarter and we expect the rate to return to the 38 to 39 percent range for the balance of the year barring any unusual tax situations.

Net income for the second quarter of 2010 was \$1,568,000 or 15 cents per diluted share including the \$1,046,000 of costs that I just mentioned. Excluding these costs, non-GAAP net income increased 29 percent to \$2,273,000 or 21 cents per diluted share for the second quarter of 2010 compared to \$1,756,000 or 20 cents per diluted share for the second quarter of 2009.

Just as a reminder, the impact of our December 2009 issuance of 1,725,000 shares of common stock in a public offering is approximately negative three cents per diluted share each quarter. Our balance sheet continues to be healthy. We had \$27,735,000 of cash, cash equivalents and short-term investments on hand as of June 30th. This is down by a little over a million dollars from March 31 due primarily to a series of acquisition related expenses, settlement of outstanding lease obligations of higher than normal capital expenditures. Capital expenditures were \$1,373,000 for the second quarter bringing the total for the year to \$2,747,000.

And the year to date total includes \$1,635,000 of capitalized software development costs primarily related to our next generation transcription platform and approximately \$600,000 related to storage and voice capture capacity expansions at our data centers.

We expect capitalized software development costs to remain above typical historical rates for the remainder of the year. Two other balance sheet highlights are the fact that we have only 39 days of revenue in accounts receivable. And that we have only \$2,067,000 of debt outstanding as of June 30th.

Let me expand for a minute on our stock compensation adjustment. We implemented the new equity award tracking system in the second quarter. And during the implementation we determined that our previous compensation expense calculations for awards granted since January 1st of 2006 had used forfeiture rates, (they are) estimates that proved to be too high. As a result of higher employee retention, more equity awards were vesting and we realized we had to make an adjustment to ensure that the accumulative expense matched the value of the awards that had actually vested.

And this was partially offset by a discovery that our volatility factors were too high resulting in excessive compensation over that same period of time.

So, we concluded that we needed to record additional pre-tax non-cash stock compensation expense of \$445,000 in the second quarter. We'll also record an additional \$231,000 pre-tax stock compensation adjustment effective in the first quarter of 2010 bringing the pre-tax total to \$676,000 year to date.

We determined that these adjustments weren't material to any prior period and therefore did not require restatement of any previous filings. Again, these are non-cash adjustments. And we do expect the impact to future stock compensation expense to be immaterial.

Let me wrap up by commenting briefly on acquisitions. We did continue to work an active acquisition pipeline and we're anxious to put the money we raised in December to good use. But we will remain disciplined in our valuation approach as well as our assessment of the cultural and technological fit of the potential acquired companies. And we hope to complete one or more acquisitions before year end.

Now, I'd like to turn the call over to Susan for a discussion of our operations.

Susan McGrogan: Thanks Lance. I'm pleased to report that our customer retention rate remains strong at approximately 99 percent based on annualized revenue. We estimate the sales closed during the second quarter will generate between 1.6 and 2 million of annual revenue per year once fully implemented.

And in addition, we also signed two important agreements with significant future revenue potential. The first is an agreement with HealthTrust Purchasing Group which enables us to market under the HPG umbrella to roughly 1100 member hospitals including over 160 Hospital Corporation of America HCA hospitals. Second, we recently signed an agreement with Child Health Corporation of America, CHCA, a system with over 20,000 physicians and 43 member hospitals as one of two preferred vendors of transcription services.

Our sales over the last year or two have been satisfactory. But we know we can do better. I'm encouraged by the recent momentum we're seeing under our preferred vendor agreements. The most gratifying highlight of the second quarter for me was our two percentage point improvement in our gross profit margin over the first quarter of this year. Numerous people in our organization deserve credit for the roles they played in this improvement.

Our implementation team and field ops team increase our BeyondText speech recognition uses to 72 percent of our BeyondText volume up from 57 percent in the first quarter of this year. They also continue to migrate customers to our BeyondText platform, even though our progress in migrating former (MBSI) customers to BeyondText continued to be slower than we would like. We are moving ahead and have visibilities to converting at least 40 percent of the (MBI) business by year end. But customer retention is our first priority and we will move at our customer's pace.

Our operation managers worked to increase our offshore volume to approximately 70 percent – 17 percent of our total volume in the second quarter up from 16 percent in the first. We bought out from equipment leases to reduce expenses, our human resources team worked closely with our operations managers to reduce operating costs and improve the productivity of

our medical language specialists. All of these initiatives came together to contribute to the overall improvement in gross margins. And I'm very proud of the team for this accomplishment.

Now, I'll turn the call back over to Larry.

Larry Gerdes: Thanks Susan. I'd like to give you our perspective on the industry and the status of our technology initiatives. The transcription industry is evolving rapidly in response to our customers. Technology is increasingly becoming a barrier to growth for smaller transcription companies.

Competition continues to be strong and several of our competitors are pricing very aggressively. Transcend has never chased extremely low margin business and we know that our level of service is a differentiator. Overall pricing in the industry is certainly down compare to where it was five years ago, yet we have been able to improve gross margins during this timeframe.

Our strategy will be to continue to offer the best service at a reasonable price. We believe this is the best approach for long term success. Under the banner of healthcare reform, hospitals are analyzing how the newly released definition of meaningful use of electronic health records applies to them.

We continue to believe that robust narrative content should and will continue to be an important component of medical records and that dictation volume should actually increase as more types of work are dictated. This increased volume may be offset to some degree by having physicians input certain types of data into template based electronic medical record systems.

The net result will be more complex records that are hybrids of discrete data entry in narrative content. We maintain that verifying and editing narrative content is a task performed most efficiently by our medical language specialists. But we will also provide solutions to hospitals that prefer to mandate that their physicians do their own editing.

In response to the needs of our market, we are undertaking two smaller and one very large technology initiative. The first of our two smaller initiatives

take advantage of XML tag structured data formats of our (reports) to provide data to our hospitals that can't be retrieved from simple text based reports.

Our first application in this area is called BeyondAlert. It is basically an alerting system to help hospital personnel track core measures by mining transcribed data for certain word patterns and conditions and may indicate a patient needs to be tracked more closely. We are still in the pilot phase. And we don't expect this offering to produce significant revenue until at least 2012.

But these types of offerings increase the value of our core transcription service and could prove transformative in the long run. Our second initiative is BeyondSpeech, our physician's self edit solution. With BeyondSpeech, physicians dictate, receive a draft immediately and edit that draft themselves, or send it back to us if they are too busy.

Our initial implementations will be in radiology. We're close to going live at our first two hospitals and have several more lined up behind those. We are excited about expanding BeyondSpeech to areas outside of radiology, in the future.

By far our largest initiative is the development of our next generation transcription platform. This platform will be offered under a software as a service or (SaaS) model and as being designed for hospitals that have their own in-house transcription department and want to increase efficiency by moving to a speech recognition enabled platform. The new platform will continue to integrate speech recognition capabilities from our speech partner, Multi-Modal Technologies.

This offering will allow us to compete in the in house market which was previously closed to Transcend. Combined with BeyondSpeech, it allows us to offer larger systems, a broad set of solutions to meet a variety of clinical documentation models from in-house transcription, to physician self added, to full outsourcing. We are still on track for general availability of the beginning of 2011.

We are very excited about Transcend's role in the industry as the need for healthcare documentation evolves and the adoption of meaningful use of

electronic medical records increases. I want to thank our customers for placing their trust in Transcend, and our employees for providing excellent service to and innovative solutions for our customers.

At this point we would like to open up the lines for your questions. (Janetta)?

Operator: Thank you. At this time if you'd like to ask audio an question press star one on your telephone keypad.

Your first audio question comes from the line of (Tom Galluci) with Lazard Capital Market.

(Tom Galluci): Thank you. Good morning. Thanks for the color.

Larry Gerdes: Good morning, Tom. Hi Tom.

Susan McGrogan: Good morning.

(Tom Galluci): A couple of questions, if I could, I guess this first is sort of a macro question, seems like hospital utilization has been weak. I'm wondering how you're sort of factoring that into your expectations or budgets. And if it sort of changed at all year-to-date. And if you've seen any particular geographies that are maybe worse or better than others.

Lance Cornell: No, we've read the reports that hospital utilization is down. And you know we have a normal ebb and flow within our hospital, it's possible that that did have some impact on us in the second quarter but it's difficult for us to quantify and it's not large enough to have a real meaningful impact for us at this time.

(Tom Galluci): Thanks. On the acquisition side you gave a little bit of color in terms of thoughts about you know an active pipeline, I guess, and hoping to get a deal done or more by the end of the year. Maybe can you just provide some more perspective on that topic? Have you actually passed on opportunities you know due to pricing or other issues? And maybe sort of what are the pricing dynamics that you're seeing out there? And when you say there's an active pipeline, is there any way to give us a little bit better frame of reference?

Lance Cornell: Sure. We have had several opportunities this year that we haven't been able to get together on valuation. And you know it's always our strategy to remain disciplined about valuation. And sometimes it's just not the right time so some of those have gone away or at least are back in the wings for at least for the current time frame.

We've also you know we've had a number of smaller opportunities that, frankly, we sort of put in a second tier in terms of our pipeline as we focused on some of the larger ones. And by larger I typically differentiate them between under \$10 million and over \$10 million transcription companies. And so our primary focus is on the ones that are over \$10 million although we certainly aren't opposed to looking at some in the 5 to 10 range as well.

So that's where we are right now you know of course it' – we can't say a whole lot more than that in terms of likelihood of timing of any particular transaction.

Larry Gerdes: One thing, Tom that I would add, you had a question about valuations. I think it's as much a factor of the ownership structure o the company and the needs of the company as it is valuation. So like we said in our comments, where a company needs access to our technology or needs access to some other capacity that Transcend provides, I think that will impact the valuation.

If the company is larger and more independent with its technology and with its future strategy, that might be a place which – where valuation will be higher than you know than we can support. And it's not loss on any of us here that we really wanted to try to get an acquisition done by the end of the second quarter because we want to make use of the funds we raised in the offering, but we also want to do it at the right way. So it's just taking us a little longer than we thought.

(Tom Galluci): Right. The ones that you said maybe couldn't agree on valuation, were they ultimately acquired? Or have they sort of found no buyers at this point?

Larry Gerdes: They have not been acquired. It doesn't mean they won't continue to try, but they have not.

(Tom Galluci): Right. OK, that's interesting.

Susan McGrogan: This is (Sue). I'd also like to say, we place a high value on cultural fit and the integration of what platforms we're on, we really look at that very closely.

(Tom Galluci): Sure.

Susan McGrogan: That's important.

Larry Gerdes: Yes.

Lance Cornell: Some of the valuation issues had been because the sellers or – see significant upside potential in their pipelines and things like that in the future. And the issue is that to what degree do you pay for that future now. And some of them would prefer to run the company for a little bit and execute. And if they're successful in generating those kind of results then their valuations will go up.

(Tom Galluci): Right, right. My last question here just for now, I noticed on the announcement on the Child Health Corporation of America, that you sort of said that they had 20,000 physicians in addition to the 43 hospitals. I think in the past, you've sort of talked about the physician market not necessarily being that attractive. Is there some signal that you might go after some of those physicians for transcription? Or was that just to sort of frame the entity?

Susan McGrogan: I think both frame the entity, and we're also seeing a trend, is that physician's the end user. We're seeing more and more of the physicians especially as we get into front end speech dealing with physicians directly. And as hospitals are buying clinics, we're seeing a lot more clinic dictation and dealing with physicians directly.

Larry Gerdes: But that's associated with hospital.

Susan McGrogan: Exactly, associated with hospitals. So we're not going after the physician market, but it's just a natural progression as our hospitals buy clinics.
(Inaudible).

(Tom Galluci): Got it. Thank you.

Susan McGrogan: So we are excited about the 43 hospitals for sure.

(Tom Galluci): Sure, sure. All right. Thank you.

Larry Gerdes: Thanks (Tom).

Operator: Your next audio question comes from the line of (Ryan Daniels) with (William Blair).

(Ryan Daniels): Hey, good morning everyone. I just want to follow up with a quick question on some of the migration of (MDO) (psych) clients onto the BeyondText platform. It sounds like you've had a little more success this quarter. And I think, (Sue), you mentioned you know that can get up to 40 percent by year end. So, one, want to maybe discuss where you are today so we get a feel for how much improvement is left. And number two you know what's driving the better outlook? Are you incenting them to switch differently? Or just that a level of comfort they're getting with you as you're there to push that switch forward?

Susan McGrogan: (Inaudible) thanks. In Q2, we have one large hospital switch and then 20 small like private physician groups. So I don't think it was a very significant Q2.

(Ryan Daniels): OK.

Susan McGrogan: We definitely have a lot more traction going to the end of the year. Towards the end of the year, we estimate about 40 percent. But I mean the caveat is that, we don't want to risk. It's really the customer pace. The customers have to feel comfortable with us. And that we you know, that we can provide just as good service on our platform as on the existing platform.

And we have a very good customer relationship with all of our customers. And we don't want to kind of force them and put them on a schedule that may be too aggressive for them.

Lance Cornell: A good analogy might be (MDI) number one...

Susan McGrogan: Right.

Lance Cornell (Sue's) company, that we acquired back in the beginning of 2005, it was about three years, wouldn't you say?

Susan McGrogan: Yes.

Lance Cornell: ... before we migrated the bulk of those customers over to our BeyondText platform. We think we can do it more quickly than that, we took a pretty slow approach on that one.

Susan McGrogan: We did. But I think we can improve you know – we improve the margins with (inaudible) and my feeling is you know there's nothing worse than a lost customer. I mean the margin on zero revenue is zero. So...

(Ryan Daniels): Sure. And that makes sense. And then I guess, (Lance) a little bit of a follow-up to that, as we think of the gross margin profile obviously, a fantastic job this quarter, it seems like most of that should be reasonably sustainable if we think of the lease buyouts and taking the core business up to a higher speech rack and moving off fees. Do you view that as a sustainable gross margin looking forward if you don't do a deal? Or kind of how might we see that fluctuate into Q3 and Q4.

Lance Cornell: Yes. As we look forward, there are definitely some factors, some positive and negative factors. But the bulk of them are positive. Certainly, the things that we did in Q2 were not one time things, they were sustainable. And going forward there, we have a number of initiatives and you know (MDSI) is only one of those. We have others as well. Including offshore, for example, we hired a veteran Operations Manager in the industry to focus on our offshore relationships. And she's got a lot of experience in India. So we'll continue to drive those numbers up.

So we've got a lot of initiatives underway that would – that in our mind would lend ourselves towards the possibility of higher gross margins in the future. And the offsetting factor would be the fact - and we've discussed this before, you know, our – to the extent that we're selling large system deals or to the -- or just in general, you know, the new pricing on new sales is typically lower than pricing on historical sales. So, that would tend to bring margins down a

little bit. But net net of those two is that we're pretty confident we still have some room for improvement.

(Ryan Daniels): OK. And that kind of leads to my next question. Obviously, some good success partnering up as a preferred vendor or with the Health Trust and the GPO and I'm curious with those type of relationships, what the margin looks like. I assume to get into GPO there's a little bit of price concession there. Is that a fair assumption?

Lance Cornell: Yes, the GPO pricings are – is typically pretty low and that's one of the reasons that it took us awhile to get on the HPG contract as we worked through those negotiations. But it's you know it's within – obviously, we felt that it was acceptable and we could make decent money doing it.

(Ryan Daniels): OK. Just two more quick ones and then I'll hop off, first, just on the FAS 141R charges in the first two quarters. Do you see that spilling into Q3? I assume you know unless there is a deal done, those should kind of dissipate, we won't see any?

Lance Cornell: No. The only – there's not too much of an impact. We were constantly changing all the estimates that go into the various awards.

(Ryan Daniels): Fair enough.

Lance Cornell: And as does every company, but we don't really see any material impact going forward.

(Ryan Daniels): OK. And then last question maybe for Larry, just your thoughts on the sales infrastructure today and maybe you know, what you're looking at investing in there, I know you talked a lot about attacking some of the bigger health systems and you know having some staff there to assist with that, but just any color on what that looks like going forward would be great. Thanks.

Larry Gerdes: I'll let Sue add because she's been driving sales pretty hard. But one thing I would say is that I'm practically excited about. As we get further along with our three initiatives I mentioned earlier, I think the clinical data world is going to add a new dimension to Transcend and I'm already seeing, we've got sales

folks in for training today and tomorrow, and just starting to talk about clinical data and how it drives the hospital's decisions is to me very fulfilling.

The other thing I would suggest is that I'm very excited about what the platform solution can provide to the market because now we can go after that large market that remains that's an old technology but still has an in-house staff. So, I think those two things are going to play a meaningful role in where Transcend's position in the future.

More to the point of your question, I want Sue to respond to because she's been working very hard in the sales world and we've seen results already in the last two months.

(Ryan Daniels): OK. Great.

Susan McGrogan: (Inaudible) you know we've – as we've said, I mean we're not satisfied with where our sales have been, we want you know we want to improve. And I believe that this business is all about relationships, and really, we want to leverage our existing relationships which we can do with the HPG because we do have a lot of relationships within HCA even that we have not tapped because we weren't on the list.

I (inaudible) the sales teams in today and tomorrow, and we really have a lot of momentum and I feel really good about where we're going.

(Ryan Daniels): Maybe one – I'm sorry, one quick follow-up, Larry, on something that you said. If we think about the platform technology and that being on track to launch at the start of 2011, when would you actually start selling that product or you know going out to customers? I mean, should we think of that as something that might be able to start generating revenue in the first half of 2011 or will you start selling it in the first half of 2011 and maybe back half, and into 2012 is where we will see some of the uplift?

Susan McGrogan: We're actually, Ryan, we're actually doing it now. I was just – before this call, I was just on call with a customer that wants a platform. So, I mean we're launching the platform. We're talking about it now to not only customers, but MTSOs and we're already seeing a high demand for it.

Lance Cornell: Yes. We're at sort of that awkward point where you're – we're roughly five months out from general availability. So, we're certainly talking about it. You can get it into the pipeline, certainly by the time you get to Q4 that there's no problem selling it. But...

Larry Gerdes: Well, and we want actually three pilots this fall.

Lance Cornell: Yeah.

Larry Gerdes: One, we want a transcription company and we've got the verbal decision from five million dollar transcription company to come on. So, we can make sure the platform meets their needs.

(Ryan Daniels): Right.

Larry Gerdes: Two, we'll take one of our existing customers and move them seamlessly onto it to test it. And then three, like Sue and Lance both said, we're already talking to people who want platform solutions. So, we'd like to have one of those by October and November to be beta. So, I think you'll see contributions by the second quarter.

(Ryan Daniels): OK. Perfect. Thanks for all the color and nice quarter, guys.

Lance Cornell: Thanks.

Operator: Your next audio question comes from the line of (Brad Hoover) with Sidoti & Company.

(Brad Hoover): Hi. Good morning.

Larry Gerdes: Good morning.

Susan McGrogan: Good morning.

(Brad Hoover): Just to go back to the gross margin. Sue, if you can just maybe elaborate on some of the types of things that HR did in conjunction with operational

managers to reduce cost and kind of how they helped you know increase transcription productivity?

Susan McGrogan: Well, we've constantly looked at transcription productivity because we they want our transcriptionists to be proficient on editing, that's the happier they'll be. So we've looked at the regional ops with HR and we looked at people that were not eligible for benefits and probably haven't been for awhile and we took them off. We gave them some time to raise their productivity and if they didn't, we took them off benefits and what we found was that, it was just general housekeeping with regards to combination between HR staff and our original operation managers. So you know we have a very strong new VP of HR and she's made a lot of changes you know with her doing all the things for MLS retention. And you know, but there are some people that were draining in terms of our benefits.

Lance Cornell: You, in this industry, you're constantly managing a lot of full-time, part-time and people shifting back and forth from period to period. And I think we've just done a better job of focusing on that and making sure that we're managing low producers and moving them up appropriately you know whenever they can.

Susan McGrogan: One of the things that I'm most excited about is our volume through the editor. I mean, we really – it was irrelatively easy change in working with our partners, MultiModal and also with our customers to standardize, standardizing a few things and it just jumped and we'll continue to see an improvement on the volumes in the editing. It went from 67 to 72 and you know I really think we're going to see a significant increase as we go forward.

(Brad Hoover): OK. Thanks for the color. So, that's 60, so 72 from 67, that's...

Susan McGrogan: 67 percent volume to 72.

Lance Cornell: Of the BeyondText volume.

(Brad Hoover): Exactly. And that's more broad based, not just a couple large clients, is that accurate?

Susan McGrogan: Correct.

Larry Gerdes: That's right.

(Brad Hoover): And just turning to the new business sold in the quarter, was that below kind of your expectations and if so, kind of why - maybe why did we see the lower number in the quarter?

Susan McGrogan: Yes. It definitely was below expectations. I mean, we just have to do better. And I think there were some deals that dropped right after the quarter and there was you know we were just disappointed.

Larry Gerdes: Again, we had a strong Q1.

Susan McGrogan: We had a strong Q1, exactly.

(Brad Hoover): OK. And...

Susan McGrogan: But, yes, in a perfect world, I mean, I'm disappointed in it for sure..

Brad Hoover. OK. And the just on the G&A, the \$2.7 million, was there any cost in there from BeyondAlerts pilots or any with that development in there at all?

Lance Cornell: There's some cost that's getting capitalized related to the actual product itself and not too much cost in the SG&A section for - other than that. No, I'll take that back. There's probably-- probably about 50,000 or so of non-capitalized cost that's incremental.

(Brad Hoover): OK. So just minimal. OK. And then just lastly, I know you've been doing some rebranding on the marketing front and perhaps being a little more aggressive this year with marketing. I think you also hired a new marketing manager. Is that why we saw sales and marketing expense up in the quarter or kind of what specifically drove that up a little bit?

Susan McGrogan: Yes. We are doing some marketing and we've done some (inaudible), we sponsored some things that we haven't in the past. We were at HSMA in Las Vegas and we actually sponsored the welcome dinner which we haven't done.

You know, we don't normally do things like that, but we are doing a lot of branding and marketing to get our name out there.

Larry Gerdes: Yes. We had a website overhaul and collaterals overhaul, things like that.

(Brad Hoover): OK. Great. Thanks for answering my question.

Larry Gerdes: Thank you.

Lance Cornell: Thanks Brad.

Operator: The next audio question comes from the line of (Lenny Dunn) with Freedom Investors.

(Lenny Dunn): Good morning and good quarter, a little confusing because of various charges but you know after I had a change read it thoroughly, I think it was a very good quarter. It would appear to me that beyond the obvious potential revenue stream from these new initiatives, you also are going to be locking in clients because you're offering a full service period, not just transcription.

And you know if people buy more than one product from you, they're more likely to be permanent clients. So, I believe that that's something to look forward to. But going forward as you said to the previous caller, there is going to be no extraordinary. So, we'll be seeing clean things to look up to, that will be accurate.

Larry Gerdes: Yes. Lenny, let me just give you my color on it. I was extremely happy with two things for the quarter. One was this tremendous effort that Sue and Lance and our various teams did on the margin improvement. I think that was a great job. And then two, that carried on down the P&L.

So, from an internal standpoint, when we look at our plans and when we look where we wanted to be, for us to hit 21 cents outside of extraordinary items was tremendous, especially having picked up that delusion of the increased number of shares. So, I'm like you. I kind of look at run rates and where the structure of the company is and we were just tickled pink with where our margins at our 21 cents ended up. So, I think it portends great for our future.

And I think your comments about being a more fully serviced company, and competing on more fronts and deepening that relationship is significant.

Susan McGrogan: Yes. Anything we can do to increase our customer stickiness is a good thing.

(Lenny Dunn): No question about that. And it wouldn't be a leap of faith to assume we're going to see a much better third quarter because of the higher gross margins and no extraordinary expenses and more implementation of contracts that are already sold.

Larry Gerdes: Yes.

Susan McGrogan: Yes.

(Lenny Dunn): OK. Well, thank you again. And again, good quarter and really, Sue, just amazing work with getting that SG&A under control there. So, thank you.

Susan McGrogan: Thanks Lenny.

Larry Gerdes: Great. Lenny.

Operator: Your next audio question comes from the line of (Sasha Kostadinov) with Shaker Investment.

(Sasha Kostadinov): Yes. Hi, I echo the congratulations. And I apologize if you already answered this question. What accounted for the significant quarter-over-quarter change in your gross profit margin?

Larry Gerdes: It was a series – it wasn't any one thing. It was a series of numerous initiatives from increasing the percentage of our volume that was going through speech recognition, increasing offshore volumes, working on productivity and cost issues within our operation infrastructure and a little bit of progress on the MDSI conversion front. Just – it was no single thing. It was a half dozen different initiatives that all worked together to drive the results.

Susan McGrogan: (inaudible) It's just a blocking and tackling of transcription really. I mean, it's not – there wasn't anything, it's just blocking and tackling.

(Sasha Kostadinov): OK. So, as a run rate, is this 36 percent level a fair level for me to expect going forward?

Larry Gerdes: Yes. We still have some room for improvement from some of the same initiatives that drove the improvement in Q2. And as we told everybody, pricing is definitely competitive in the industry and new sales could be at lower prices especially for large system sales and that sort of thing which could drive the margins the other way and our anticipation is that the net result of those two can still be positive.

(Sasha Kostadinov): OK. Thank you very much. Keep up the good work.

Larry Gerdes: Thank you.

Susan McGrogan: Sure.

Operator: Your next audio question comes from the line of (Stephanie Haggerty) of Register Financial.

(Stephanie Haggerty): Good morning guys.

Larry Gerdes: Good morning, Stephanie. Good morning.

(Stephanie Haggerty): I see you've been hard at work. I just wanted to ask if there has been you know any big changes in the market place since the MedQuist-Spheris combination and by asking that, I mean are there sales folks available? Are there accounts available who are just – just can't figure out what this new animal is? And have you picked up any salespeople? How many do you have right now?

Larry Gerdes: Sue, do you want to answer that?

Susan McGrogan: Sure. In terms of the you know what the market is looking like, I think everyone is just – is relatively status quo. And in terms of MedQuist, I think they've done a very good job of staying close to Spheris customers and keeping great people on board. You know, we met a lot of them through the due diligence and – but we are seeing some people, I mean we've had some

folks contact us, sales and otherwise. And we're seeing some RFPs, but no real – I mean nothing that would unusual or out of the ordinary. In terms of sales, we have five sales team members and we're looking for – to replace (Leo's) position which we have not done yet.

(Stephanie Haggerty): OK. Keep it up, guys.

Larry Gerdes: Thank you.

Lance Cornell: Thanks, Stephanie.

Operator: Your next audio question comes from the line of (Craig Hoagland) with Anderson, Hoagland & Associates.

(Craig Hoagland): You mentioned one of the factors in the uptick in gross margin sequentially was buying equipment that had previously been leased. I was just wondering how much of the 200 basis point improvement would be ascribed to that?

Lance Cornell: I was in the neighborhood of \$40,000 a month and it was bought out probably – we probably saw two months of that impact. I'm trying to remember the exact date. It wasn't a full impact to the quarter but it was the most of it.

(Craig Hoagland): About 80,000.

Lance Cornell: Yes, that sounds about right.

(Craig Hoagland): OK. And I guess the other – I just really have a comment which is I'm really pleased to hear that – how careful you're being with your acquisition review. You know, the company seems to – there are some risks on the balance sheet and that you've raised so much cash and how that cash is put to work and the returns on that investment are – to a large extent going to determine the path of the stock going forward. And I just really would encourage you to take your time and be careful and don't let the pressure on that cash lead to doing any deals.

Larry Gerdes: We agree with you. Thank you.

(Craig Hoagland): OK. Thanks.

Susan McGrogan: Thank you.

Operator: Once again, to ask an audio question, press star one. At this time you have no further audio question?

Larry Gerdes: OK. Thank you, (Janetta). Just in closing, again I'd like to recognize what our team did with this margin effort this last quarter. I think it's a tremendous indications of rising to the occasion and we're more excited than we've ever been about that area of our P&L and like was just commented, we are going to remain very cautious but active in the acquisition world. And we're going to focus very hard on taking advantage of these two new national contracts we've got as Sue continue to build the sales team. We are still focused on maintaining organic growth rates to 10 to 15 percent. We'd love to supplement that with well-chosen acquisitions.

But I in particularly excited about the fact that we continue to progress on our initiatives to position Transcend in the clinical data world in a way that we'll play a big role in a very fast changing market place. So, we appreciate all of your support. We look forward to the next quarter and the rest of the year with the momentum we're seeing in the company. Thank you and look forward to our next call.

Operator: We thank you for joining today's conference call. You may now disconnect.

END