XEROX CORP
Form S-4/A
November 24, 2009
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As filed with the U.S. Securities and Exchange Commission on November 24, 2009

Registration No. 333-162639

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

AMENDMENT NO. 1

TO

FORM S-4

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

XEROX CORPORATION

(Exact name of registrant as specified in its charter)

New York	3577	16-0468020
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

45 Glover Avenue

P.O. Box 4505

Norwalk, Connecticut 06856-4505

(203) 968-3000

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Don H. Liu

Senior Vice President, General Counsel and Secretary

Xerox Corporation

45 Glover Avenue

P.O. Box 4505

Norwalk, Connecticut 06856-4505

(203) 968-3000

(Name, address, including zip code, and telephone number, including area code, of agent for service)

With copies to:

Mario Ponce, Esq. **Simpson Thacher & Bartlett LLP** **425 Lexington Avenue** **New York, New York** **10017-3954** **(212) 455-2000**	**Tas Panos, Esq.** **General Counsel** **Affiliated Computer Services, Inc.** **2828 North Haskell Avenue** **Dallas, Texas** **75204** **(214) 841-6111**	**James C. Woolery, Esq.** **Minh Van Ngo, Esq.** **Cravath, Swaine & Moore LLP** **Worldwide Plaza** **825 Eighth Avenue** **New York, New York** **10019-7475** **(212) 474-1000**	**David C. Chapin, Esq.** **Ropes & Gray LLP** **One International Place** **Boston, Massachusetts** **02110-2624** **(617) 951-7000**

Approximate date of commencement of the proposed sale of the securities to the public: As soon as practicable after this Registration Statement becomes effective and upon completion of the merger described in the enclosed joint proxy statement/prospectus.

If the securities being registered on this Form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box. ¨

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act of 1933, as amended, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

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

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

Large accelerated filer x	Accelerated filer ¨	Non accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

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Information contained herein is subject to completion or amendment. A registration statement relating to these securities has been filed with the Securities and Exchange Commission. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This document shall not constitute an offer to sell or the solicitation of any offer to buy nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any such jurisdiction.

PRELIMINARY   SUBJECT TO COMPLETION   DATED NOVEMBER 24, 2009

Xerox Corporation | **Affiliated Computer Services, Inc.**

MERGER PROPOSAL   YOUR VOTE IS VERY IMPORTANT

[ ], 2009

Dear Stockholders:

Xerox Corporation and Affiliated Computer Services, Inc. have entered into a merger agreement pursuant to which Xerox will acquire ACS. In the proposed merger, each outstanding share of ACS Class A common stock will be converted into the right to receive 4.935 shares of Xerox common stock and $18.60 in cash. Each share of ACS Class B common stock will be converted into the right to receive 4.935 shares of Xerox common stock, $18.60 in cash and a fraction of a share of a new series of preferred stock to be issued by Xerox and designated as Xerox Corporation Series A Convertible Perpetual Preferred Stock. Upon completion of the merger, Xerox and ACS expect that former ACS stockholders will own approximately 36% of the outstanding shares of Xerox common stock and former Xerox stockholders will own approximately 64% of the outstanding shares of Xerox common stock, based on the number of shares of Xerox common stock issued and outstanding as of September 27, 2009, the date of the execution of the merger agreement.

The board of directors of Xerox has determined that the merger agreement and the merger are advisable and in the best interests of Xerox and its stockholders and has approved the merger agreement and the merger. The board of directors of ACS (other than Mr. Darwin Deason, who was recused from the meeting), acting upon the unanimous recommendation of the strategic transaction committee of the ACS board of directors, has determined that the merger agreement and the merger are advisable and in the best interests of ACS and its stockholders and has approved the merger agreement and the merger.

THE BOARD OF DIRECTORS OF XEROX UNANIMOUSLY RECOMMENDS THAT XEROX STOCKHOLDERS VOTE FOR THE PROPOSAL TO ISSUE SHARES OF XEROX COMMON STOCK REQUIRED TO BE ISSUED PURSUANT TO THE MERGER AGREEMENT. THE BOARD OF DIRECTORS OF ACS (OTHER THAN MR. DARWIN DEASON, WHO WAS RECUSED FROM THE MEETING), ACTING UPON THE UNANIMOUS RECOMMENDATION OF THE STRATEGIC TRANSACTION COMMITTEE OF THE ACS BOARD OF DIRECTORS, UNANIMOUSLY RECOMMENDS THAT ACS STOCKHOLDERS VOTE FOR THE PROPOSAL TO ADOPT THE MERGER AGREEMENT.

We cannot complete the merger unless the issuance of shares of Xerox common stock required to be issued pursuant to the merger agreement is approved by the affirmative vote of holders of a majority in voting power of the shares of Xerox common stock represented (whether in person or by proxy) at the Xerox special meeting (provided that at least a majority in voting power of the shares of Xerox common stock outstanding are represented in person or by proxy at such meeting or any adjournment or postponement thereof) or any adjournment or postponement thereof and the merger agreement is adopted by the affirmative vote of holders of a majority in voting power of the outstanding shares of ACS Class A common stock and ACS Class B common stock, voting together as a single class. **We urge you to read carefully the accompanying joint proxy statement/prospectus, which includes important information about Xerox, ACS and the proposed merger. In particular, please see the section entitled Risk Factors beginning on page 26 of the accompanying joint proxy statement/prospectus which contains a description of the risks that you should consider in evaluating the proposed merger.**

Shares of Xerox common stock are listed on the New York Stock Exchange and the Chicago Stock Exchange under the symbol XRX. Shares of ACS Class A common stock are listed on the New York Stock Exchange under the symbol ACS. On [ ], 2009, the most recent practicable trading day prior to the printing of the accompanying joint proxy statement/prospectus, the last sales price of Xerox common stock was $[ ] per share and the last sales price of ACS Class A common stock was $[ ] per share. You should obtain current market quotations for both Xerox common stock and ACS Class A common stock.

On [ ], each company is holding a special meeting of stockholders in order to obtain the stockholder approvals necessary to complete the merger as more fully described in the accompanying joint proxy statement/prospectus. **Whether or not you expect to attend the special meeting in person, we urge you to submit your proxy as promptly as possible. You have a choice of submitting your proxy over the Internet, by telephone or by marking, signing and dating the enclosed proxy card and returning it in the postage-paid envelope provided. Please refer to the instructions on the enclosed proxy card.**

Ursula M. Burns	Lynn R. Blodgett
Chief Executive Officer of Xerox Corporation	President and CEO of Affiliated Computer Services, Inc.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved the securities to be issued in connection with the merger or determined if the accompanying joint proxy statement/prospectus is accurate or complete. Any representation to the contrary is a criminal offense.

The accompanying joint proxy statement/prospectus is dated [ ], 2009, and is first being mailed or otherwise delivered to stockholders of Xerox and stockholders of ACS on or about [ ], 2009.

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ADDITIONAL INFORMATION

The accompanying joint proxy statement/prospectus incorporates by reference important business and financial information about Xerox and ACS from documents that are not included in or delivered with the joint proxy statement/prospectus. This information is available to you without charge upon your written or oral request. You can obtain the documents incorporated by reference in the joint proxy statement/prospectus by requesting them in writing or by telephone from the appropriate company at the following addresses and telephone numbers:

Xerox Corporation	Affiliated Computer Services, Inc.
45 Glover Avenue	2828 North Haskell
P.O. Box 4505	Dallas, Texas 75204
Norwalk, Connecticut 06856-4505	Attention: Investor Relations
Attention: Investor Relations	(214) 841-8281
(203) 968-3000	*www.acs-inc.com (Investor Relations tab)*
www.xerox.com (Investor Relations tab)	

In addition, if you have questions about the merger or the special meetings, or if you need to obtain copies of the accompanying joint proxy statement/prospectus, proxy cards, election forms or other documents incorporated by reference in the joint proxy statement/prospectus, you may contact the appropriate contact listed below. You will not be charged for any of the documents you request.

If you are a Xerox stockholder:	If you are an ACS stockholder:
Innisfree M&A Incorporated	MacKenzie Partners Inc.
501 Madison Avenue, 20th Floor	105 Madison Avenue
New York, NY 10022	New York, NY 10016
(877) 456-3442 (toll free)	(800) 322-2885 (toll free)
(212) 750-5833 (banks and brokers collect)	(212) 929-5500 (collect)
	E-mail: acsproxy@mackenziepartners.com

If you would like to request documents, please do so by [ ], 2009, in order to receive them before the special meetings.

For a more detailed description of the information incorporated by reference in the accompanying joint proxy statement/prospectus and how you may obtain it, see Where You Can Find More Information beginning on page 177 of the accompanying joint proxy statement/prospectus.

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Xerox Corporation

45 Glover Avenue

P.O. Box 4505

Norwalk, CT 06856-4505

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS

[ ], 2009

Dear Stockholders:

You are cordially invited to attend a special meeting of stockholders of Xerox Corporation (Xerox) to be held on [ ], at [ ], local time, at [ ], unless the special meeting is adjourned or postponed. The purposes of the special meeting are to consider and vote upon the following matters:

1. a proposal to approve the issuance of shares of Xerox common stock required to be issued to Affiliated Computer Services, Inc. (ACS) stockholders pursuant to the Agreement and Plan of Merger (the merger agreement), dated as of September 27, 2009, among Xerox, Boulder Acquisition Corp. (a wholly-owned subsidiary of Xerox established for the purpose of effecting the merger) and ACS, which provides for the merger of ACS with and into Boulder Acquisition Corp. (the merger); and

2. a proposal to approve the adjournment of the special meeting, if necessary or appropriate, including to solicit additional proxies.

The accompanying joint proxy statement/prospectus describes the merger agreement and the proposed merger in detail. **THE XEROX BOARD OF DIRECTORS HAS DETERMINED THAT THE MERGER AGREEMENT AND MERGER ARE ADVISABLE AND IN THE BEST INTERESTS OF XEROX AND ITS STOCKHOLDERS AND UNANIMOUSLY RECOMMENDS THAT XEROX STOCKHOLDERS VOTE FOR THE PROPOSAL TO APPROVE THE ISSUANCE OF SHARES OF XEROX COMMON STOCK REQUIRED TO BE ISSUED PURSUANT TO THE MERGER AGREEMENT AND FOR THE PROPOSAL TO APPROVE THE ADJOURNMENT OF THE SPECIAL MEETING, IF NECESSARY OR APPROPRIATE, INCLUDING TO SOLICIT ADDITIONAL PROXIES.** We cannot complete the merger unless the issuance of shares of Xerox common stock required to be issued pursuant to the merger agreement is approved by the affirmative vote of holders of a majority in voting power of the shares of Xerox common stock represented (whether in person or by proxy) at the Xerox special meeting or any adjournment or postponement thereof (provided that at least a majority in voting power of the shares of Xerox common stock outstanding are represented in person or by proxy at such meeting or any adjournment or postponement thereof).

Stockholders of record of Xerox common stock as of the close of business on [ ], 2009, are entitled to receive notice of the special meeting and to vote at it or at any adjournment or postponement thereof. Stockholders who hold shares in street name may vote through their brokers, banks or other nominees. If you wish to attend the special meeting and your shares are held in the name of a broker, trust, bank or other nominee, you must bring with you a proxy or letter from the broker, trustee, bank or nominee to confirm your beneficial ownership of the shares. A list of stockholders eligible to vote at the special meeting will be available for inspection at the special meeting.

For the Board of Directors,

Anne M. Mulcahy

Chairman of the Board

Your vote is very important. Please return your proxy as soon as possible, whether or not you expect to attend the special meeting in person. You may submit your proxy over the Internet, by telephone or by marking, signing and dating the enclosed proxy card and

returning it in the postage-paid envelope provided. You may revoke your proxy at any time before the special meeting. If you attend the special meeting and vote in person, your proxy will not be used.

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AFFILIATED COMPUTER SERVICES, INC.

2828 North Haskell Avenue

Dallas, Texas 75204

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS

[ ], 2009

To the stockholders of Affiliated Computer Services, Inc:

A special meeting of the stockholders of Affiliated Computer Services, Inc. (ACS) will be held at [ ] on [ ], at [ ], central standard time, unless the special meeting is adjourned or postponed. At the special meeting, ACS stockholders will be asked to:

- consider and act on a proposal to adopt the Agreement and Plan of Merger (the merger agreement), dated as of September 27, 2009, among Xerox, Boulder Acquisition Corp. (a wholly-owned subsidiary of Xerox established for the purpose of effecting the merger) and ACS, which provides for the merger of ACS with and into Boulder Acquisition Corp. (the merger) and pursuant to which ACS stockholders will have the right to receive, for each share of ACS Class A common stock held immediately prior to the merger (i) 4.935 shares of Xerox common stock and (ii) $18.60 in cash, and for each share of ACS Class B common stock held immediately prior to the merger (i) 4.935 shares of Xerox common stock, (ii) $18.60 in cash and (iii) a fraction of a share of a new series of preferred stock to be issued by Xerox and designated as Xerox Corporation Series A Convertible Perpetual Preferred Stock; and

- approve the adjournment of the ACS special meeting (if necessary or appropriate, including to solicit additional proxies if there are not sufficient votes to adopt the merger agreement).

The accompanying joint proxy statement/prospectus describes the merger agreement and the proposed merger in detail.

Please note that only stockholders of record as of the close of business on [ ], 2009 will be eligible to vote at the special meeting. Stockholders who hold shares in street name may vote through their brokers, banks or other nominees. If you wish to attend the special meeting and your shares are held in the name of a broker, trust, bank or other nominee, you must bring with you a proxy or letter from the broker, trustee, bank or nominee to confirm your beneficial ownership of the shares. Your vote is important. You may submit a proxy over the Internet, by telephone or by mail. In order to complete the merger, the affirmative vote of holders of a majority in voting power of the outstanding shares of ACS Class A common stock and ACS Class B common stock, voting together as a single class, entitled to vote on such proposal at such meeting at which a quorum is present must vote to adopt the merger agreement.

Under Delaware law, holders of record of ACS common stock who do not vote in favor of adoption of the merger agreement and who properly demand appraisal of their shares will have the right to seek appraisal of the fair value of their shares of ACS common stock if the merger is completed. To exercise your appraisal rights, you must strictly follow the procedures prescribed by Delaware law, including, among other things, submitting a written demand for appraisal to ACS before the vote is taken on the merger proposal. These procedures are summarized in the accompanying joint proxy statement/prospectus in the section entitled The Merger Appraisal Rights beginning on page 128 (the text of the applicable provisions of Delaware law is included as Annex G to the accompanying joint proxy statement/prospectus).

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For more information about the transactions contemplated by the merger agreement and the ACS special meeting, please review carefully the accompanying joint proxy statement/prospectus, the annexes thereto and the information incorporated thereto.

THE ACS BOARD OF DIRECTORS (OTHER THAN MR. DARWIN DEASON, WHO WAS RECUSED FROM THE MEETING), ACTING UPON THE UNANIMOUS RECOMMENDATION OF THE STRATEGIC TRANSACTION COMMITTEE OF THE ACS BOARD OF DIRECTORS, UNANIMOUSLY RECOMMENDS THAT ACS STOCKHOLDERS VOTE FOR THE PROPOSAL TO ADOPT THE MERGER AGREEMENT AND FOR THE PROPOSAL TO APPROVE THE ADJOURNMENT OF THE ACS SPECIAL MEETING, IF NECESSARY OR APPROPRIATE, INCLUDING TO SOLICIT ADDITIONAL PROXIES IF THERE ARE NOT SUFFICIENT VOTES TO ADOPT THE MERGER AGREEMENT.

Very truly yours,

Lynn R. Blodgett

President and CEO

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JOINT PROXY STATEMENT/PROSPECTUS

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QUESTIONS AND ANSWERS ABOUT THE MERGER AND THE SPECIAL MEETINGS

The following questions and answers are intended to address briefly some commonly asked questions regarding the merger and the special meetings. These questions and answers may not address all questions that may be important to you as a stockholder. To better understand these matters, and for a description of the legal terms governing the merger, you should carefully read this entire joint proxy statement/prospectus, including the annexes, as well as the documents that have been incorporated by reference in this joint proxy statement/prospectus. See Where You Can Find More Information beginning on page 177. All references in this joint proxy statement/prospectus to Xerox refer to Xerox Corporation, a New York corporation; all references in this joint proxy statement/prospectus to ACS refer to Affiliated Computer Services, Inc., a Delaware corporation; all references in this joint proxy statement/prospectus to Merger Sub refer to Boulder Acquisition Corp., a Delaware corporation and a direct wholly-owned subsidiary of Xerox; unless otherwise indicated or as the context requires, all references in this joint proxy statement/prospectus to we refer to Xerox and ACS; and all references to the merger agreement refer to the Agreement and Plan of Merger, dated September 27, 2009, among Xerox, Merger Sub and ACS, a copy of which is attached as Annex A to this joint proxy statement/prospectus.

About the Merger

Q: ***Why am I receiving this joint proxy statement/prospectus?***

A: Xerox and ACS have entered into the merger agreement, pursuant to which ACS will be merged with and into Boulder Acquisition Corp., with Boulder Acquisition Corp. continuing as the surviving corporation in the merger.

Xerox is holding a special meeting of stockholders in order to obtain the stockholder approval necessary to issue shares of Xerox common stock required to be issued pursuant to the merger agreement, as described in this joint proxy statement/prospectus. ACS is holding a special meeting of stockholders in order to obtain the stockholder approval necessary to adopt the merger agreement, as described in this joint proxy statement/prospectus.

We will be unable to complete the merger unless both the Xerox and ACS stockholder approvals are obtained at the respective special meetings.

We have included in this joint proxy statement/prospectus important information about the merger, the merger agreement (a copy of which is attached as Annex A) and the Xerox and ACS special meetings. You should read this information carefully and in its entirety. The enclosed voting materials allow you to vote your shares without attending the applicable special meeting. Your vote is very important and we encourage you to submit your proxy as soon as possible.

Q: ***What will I receive in the merger?***

A: If the merger is completed, holders of ACS Class A common stock will receive for each share of ACS Class A common stock held immediately prior to the merger (other than shares owned directly or indirectly by Xerox or ACS (which will be cancelled) and other than those shares with respect to which appraisal rights are properly exercised and not withdrawn, if any, which we collectively refer to in this joint proxy statement/prospectus as the excluded shares) (i) 4.935 shares of Xerox common stock and (ii) $18.60 in cash.

If the merger is completed, holders of ACS Class B common stock (which, together with the ACS Class A common stock, we refer to in this joint proxy statement/prospectus as the ACS common stock) will receive for each share of ACS Class B common stock held immediately prior to the merger (other than excluded shares) (i) 4.935 shares of Xerox common stock, (ii) $18.60 in cash and (iii) a fraction of a share of a new series of preferred stock to be issued by Xerox and designated as Xerox Corporation Series A Convertible Perpetual Preferred Stock, which we refer to in this joint proxy statement/prospectus as the

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Xerox Convertible Preferred Stock. As of the date of the execution of the merger agreement, Mr. Darwin Deason, Chairman of the ACS board of directors, whom we refer to in this joint proxy statement/prospectus as Mr. Deason, was the sole holder of ACS Class B common stock. The Xerox Convertible Preferred Stock will rank senior to the Xerox common stock with respect to dividend rights and rights on liquidation, winding-up and dissolution of Xerox. A description of additional terms of the Xerox Convertible Preferred Stock is set forth under the section entitled Description of Xerox Convertible Preferred Stock beginning on page 162.

ACS stockholders will not receive any fractional shares of Xerox common stock in the merger. Instead, the total number of shares of Xerox common stock that each ACS stockholder would have been entitled to receive will be rounded down to the nearest whole number, and Xerox will pay cash for the remaining fractional share of Xerox common stock that an ACS stockholder would otherwise have been entitled to receive. The amount of cash payable for such fractional share of Xerox common stock will be determined by multiplying the fraction (after taking into account all shares of ACS common stock that are converted by such ACS stockholder) by the per share closing price of Xerox common stock on the last trading day immediately prior to the completion of the merger.

Xerox stockholders will not receive any merger consideration and will continue to hold their shares of Xerox common stock.

Q: ***How do I calculate the value of the merger consideration?***

A: Because Xerox will issue a fixed number of shares of Xerox common stock in exchange for each share of ACS common stock, the value of the merger consideration that ACS stockholders will receive in the merger for each share of ACS common stock will depend on the price per share of Xerox common stock at the time the merger is completed. That price will not be known at the time of the meeting and may be less than the current price or the price at the time of the meeting.

Based on the closing price of $9.02 per share of Xerox common stock on the New York Stock Exchange, which we refer to in this joint proxy statement/prospectus as the NYSE, on September 25, 2009, the last trading day before the public announcement of the merger, the merger consideration for ACS Class A common stock represented approximately $63.11 per share of ACS Class A common stock, a 33.6% premium over the closing price of $47.25 per share of ACS Class A common stock on the NYSE on September 25, 2009. Based on the closing price of $[ ] per share of Xerox common stock on the NYSE on [ ], the latest practicable date before the printing of this joint proxy statement/prospectus, the merger consideration for ACS Class A common stock represented approximately $[ ] per share of ACS Class A common stock. Former ACS stockholders are currently expected to own approximately 36% of the shares of Xerox common stock outstanding immediately after the merger, based on the number of shares of Xerox common stock issued and outstanding as of September 27, 2009, the date of the execution of the merger agreement.

Q: ***What conditions must be satisfied to complete the merger?***

A: Xerox and ACS are not required to complete the merger unless a number of conditions are satisfied or waived. These conditions include receipt of both Xerox and ACS stockholder approvals, expiration of the waiting period under the Hart-Scott-Rodino Antitrust Improvement Act of 1976, as amended, and the rules and regulations promulgated thereunder, which we refer to in this joint proxy statement/prospectus as the HSR Act, receipt of other regulatory consents and receipt of legal opinions that the merger will be treated for U.S. federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended, which we refer to in this joint proxy statement/prospectus as the Code. In addition, Xerox is not required to complete the merger if the lenders providing Xerox with debt financing in connection with the merger have declined to provide such financing for certain reasons. For a more complete summary of the conditions that must be satisfied or waived prior to completion of the merger, see The Merger Agreement Conditions to the Merger beginning on page 148.

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Q: ***What constitutes a quorum?***

A: *Xerox:* Holders of a majority in voting power of the Xerox common stock issued and outstanding and entitled to vote thereat, represented (whether in person or by proxy) at the Xerox special meeting, will constitute a quorum to conduct business at the Xerox special meeting. In the absence of a quorum, the stockholders entitled to vote thereat and represented (whether in person or by proxy) at the Xerox special meeting will have the power to adjourn the meeting.

ACS: Holders of a majority in voting power of the ACS common stock issued and outstanding and entitled to vote thereat, represented (whether in person or by proxy) at the ACS special meeting, will constitute a quorum to conduct business at the ACS special meeting. In the absence of a quorum, the stockholders entitled to vote thereat and represented (whether in person or by proxy) at the ACS special meeting will have the power to adjourn the meeting.

Q: ***What vote is required to approve each proposal?***

A: *Proposal to Issue Shares of Xerox Common Stock:* The affirmative vote of holders of a majority in voting power of the shares of Xerox common stock represented (whether in person or by proxy) at the Xerox special meeting or any adjournment or postponement thereof is required to approve the issuance of shares of Xerox common stock required to be issued pursuant to the merger agreement (provided that at least a majority in voting power of the shares of Xerox common stock outstanding are represented (whether in person or by proxy) at such meeting or any adjournment or postponement thereof). **Because the vote required to approve this proposal is based upon the total number of Xerox shares represented at the Xerox special meeting, the abstention from voting by a stockholder will have the same effect as a vote against such proposal.**

Proposal to Adopt the Merger Agreement: The affirmative vote of holders of a majority in voting power of the outstanding shares of ACS common stock, voting together as a single class, is required to adopt the merger agreement. **Because the vote required to approve this proposal is based upon the voting power of the total number of outstanding shares of ACS common stock, the failure to submit a proxy card (or the failure to submit a proxy by telephone or over the Internet or to vote in person at the ACS special meeting) or the abstention from voting by a stockholder will have the same effect as a vote against such proposal.** A broker non-vote will also have the same effect as a vote against such proposal. See The ACS Special Meeting Quorum beginning on page 56.

Proposal to Adjourn the Xerox Special Meeting: Assuming a quorum of stockholders is represented (whether in person or by proxy) at the Xerox special meeting, the affirmative vote of holders of a majority of the votes cast in favor of or against such proposal by holders of shares of Xerox common stock is required to adjourn the Xerox special meeting, if necessary or appropriate, including to solicit additional proxies. In the absence of a quorum, the stockholders entitled to vote thereat and represented (whether in person or by proxy) at the Xerox special meeting will have the power to adjourn the meeting.

Proposal to Adjourn the ACS Special Meeting: Assuming a quorum of stockholders is represented (whether in person or by proxy) at the ACS special meeting, the affirmative vote of holders of a majority in voting power of the shares of ACS common stock represented (whether in person or by proxy) at such meeting and entitled to vote thereon and which has actually been voted, is required to adjourn the ACS special meeting, if necessary or appropriate, including to solicit additional proxies if there are not sufficient votes to adopt the merger agreement. In the absence of a quorum, the stockholders entitled to vote thereat and represented (whether in person or by proxy) at the ACS special meeting will have the power to adjourn the meeting.

Q: ***When do you expect the merger to be completed?***

A: Xerox and ACS are working to complete the merger as quickly as possible, and we anticipate that it will be completed in the first calendar quarter of 2010. However, the merger is subject to various regulatory approvals and other conditions, and it is possible that factors outside the control of both companies could result in the merger being completed at a later time, or not at all. We expect that the stockholder approvals will be the last closing condition (other than those closing conditions that by their terms are to be satisfied at the closing) to be satisfied and if so, pursuant to the merger agreement, unless Xerox and ACS otherwise agree, the merger would be completed no later than three business days after the stockholder approvals are obtained.

Q: ***What are the material U.S. federal income tax consequences of the merger to U.S. holders of shares of ACS Class A common stock?***

A: The merger is intended to qualify for U.S. federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Code. Therefore, for U.S. federal income tax purposes, as a result of the merger, a U.S. holder of shares of ACS Class A common stock generally will only recognize gain (but not loss) in an amount not to exceed the cash received as part of the merger consideration and will recognize gain or loss with respect to any cash received in lieu of fractional shares of Xerox common stock. See The Merger Material U.S. Federal Income Tax Consequences beginning on page 125.

Q: ***Are ACS stockholders entitled to appraisal rights?***

A: Yes. Under Delaware law, holders of shares of ACS common stock that meet certain requirements will have the right to dissent from the merger and obtain payment in cash for the fair value of their shares of ACS common stock, as determined by the Delaware Chancery Court, rather than the merger consideration. To exercise appraisal rights, ACS stockholders must strictly follow the procedures prescribed by Delaware law. These procedures are summarized under the section entitled The Merger Appraisal Rights beginning on page 128. In addition, the text of the applicable appraisal rights provisions of Delaware law is included as Annex G to this joint proxy statement/prospectus.

Q: ***What are the recommendations of the Xerox and ACS boards of directors?***

A: Each board of directors has approved the merger agreement and the merger and determined that the merger agreement and the merger are advisable and in the best interests of its stockholders.

THE XEROX BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT XEROX STOCKHOLDERS VOTE FOR THE PROPOSAL TO APPROVE THE ISSUANCE OF SHARES OF XEROX COMMON STOCK REQUIRED TO BE ISSUED PURSUANT TO THE MERGER AGREEMENT. See The Merger Recommendation of the Xerox Board of Directors; Xerox s Reasons for the Merger beginning on page 103.

THE ACS BOARD OF DIRECTORS (OTHER THAN MR. DEASON, WHO WAS RECUSED FROM THE MEETING), ACTING UPON THE UNANIMOUS RECOMMENDATION OF THE STRATEGIC TRANSACTION COMMITTEE OF THE ACS BOARD OF DIRECTORS, WHICH WE REFER TO IN THIS JOINT PROXY STATEMENT/PROSPECTUS AS THE STRATEGIC TRANSACTION COMMITTEE, UNANIMOUSLY RECOMMENDS THAT ACS STOCKHOLDERS VOTE FOR THE PROPOSAL TO ADOPT THE MERGER AGREEMENT. See The Merger Recommendation of the ACS Board of Directors; ACS s Reasons for the Merger beginning on page 73.

Q: ***If the merger is completed, when can I expect to receive the merger consideration for my shares of ACS common stock?***

A: *Certificated Shares:* As soon as reasonably practicable after the effective time of the merger and in no event later than three business days after the effective time, Xerox will cause an exchange agent to mail to each holder of certificated shares of ACS common stock a form of letter of transmittal and instructions for use in effecting the exchange of ACS common stock for the merger consideration. After receiving the proper documentation from a holder of ACS common stock, the exchange agent will deliver to such holder the cash, Xerox common stock and, if applicable, Xerox Convertible Preferred Stock to which such holder is entitled under the merger agreement. More information on the documentation a holder of ACS common

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stock is required to deliver to the exchange agent may be found under the section entitled The Merger Manner and Procedure for Exchanging Shares of ACS Common Stock; No Fractional Shares beginning on page 123.

Book-Entry Shares: Each holder of record of one or more book-entry shares of ACS common stock whose shares were converted into the right to receive the merger consideration will automatically, upon the effective time of the merger, be entitled to receive, and Xerox will cause the exchange agent to deliver to such holder as promptly as practicable after the effective time, the cash, Xerox common stock and, if applicable, Xerox Convertible Preferred Stock to which such holder is entitled under the merger agreement. Holders of book-entry shares will not be required to deliver a certificate or an executed letter of transmittal to the exchange agent to receive the merger consideration.

Q: ***What happens if I sell my shares of ACS common stock before the ACS special meeting?***

A: The record date of the ACS special meeting, which we refer to in this joint proxy statement/prospectus as the ACS record date, is earlier than the date of the ACS special meeting and the date that the merger is expected to be completed. If you transfer your shares after the ACS record date but before the ACS special meeting, you will retain your right to vote at the ACS special meeting, but will have transferred the right to receive the merger consideration in the merger. In order to receive the merger consideration, you must hold your shares through completion of the merger.

About the Special Meeting

Q: ***When and where will the Xerox and ACS special meetings be held?***

A: *Xerox:* The Xerox special meeting will be held at [ ], on [ ], at [ ], local time.

ACS: The ACS special meeting will be held at [ ] on [ ], at [ ], central standard time.

Q: ***Who is entitled to vote at the Xerox and ACS special meetings?***

A: Xerox has fixed [ ], 2009 as the record date for the Xerox special meeting, which we refer to in this joint proxy statement/prospectus as the Xerox record date. If you were a Xerox stockholder at the close of business on the Xerox record date, you are entitled to vote on matters that come before the Xerox special meeting. However, a Xerox stockholder may only vote his or her shares if he or she is present in person or is represented by proxy at the Xerox special meeting.

ACS has fixed [ ], 2009 as the ACS record date. If you were an ACS stockholder at the close of business on the ACS record date, you are entitled to vote on matters that come before the ACS special meeting. However, an ACS stockholder may only vote his or her shares if he or she is present in person or is represented by proxy at the ACS special meeting.

Q: ***How many votes do I have?***

A: You are entitled to one vote for each Xerox common share that you owned as of the Xerox record date. As of the close of business on the Xerox record date, there were [ ] outstanding shares of Xerox common stock.

You are entitled to one vote for each share of ACS Class A common stock that you owned as of the ACS record date. As of the close of business on the ACS record date, there were [ ] outstanding shares of ACS Class A common stock. The holders of ACS Class B common stock are entitled to ten votes for each share of ACS Class B common stock that such holders owned as of the ACS record date. As of the close of business on the ACS record date, there were [ ] outstanding shares of ACS Class B common stock. As of the date of the execution of the merger agreement, Mr. Deason was the sole holder of ACS Class B common stock. See The ACS Special Meeting Voting by ACS s Directors and Executive Officers beginning on page 56.

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Q: ***What if I hold shares in both Xerox and ACS?***

A: If you are a stockholder of both Xerox and ACS, you will receive two separate packages of proxy materials. A vote as an ACS stockholder for the proposal to adopt the merger agreement will not constitute a vote as a Xerox stockholder for the proposal to issue shares of Xerox common stock required to be issued pursuant to the merger agreement, or vice versa. **THEREFORE, PLEASE MARK, SIGN, DATE AND RETURN ALL PROXY CARDS THAT YOU RECEIVE, WHETHER FROM XEROX OR ACS, OR SUBMIT A PROXY AS BOTH A XEROX AND ACS STOCKHOLDER OVER THE INTERNET OR BY TELEPHONE.**

Q: ***My shares are held in street name by my broker. Will my broker automatically vote my shares for me?***

A: No. If your shares are held in a stock brokerage account or by a bank or other nominee, you are considered the beneficial holder of the shares held for you in what is known as street name. If this is the case, this joint proxy statement/prospectus has been forwarded to you by your brokerage firm, bank or other nominee, or their agent. As the beneficial holder, you have the right to direct your broker, bank or other nominee as to how to vote your shares. If you do not provide voting instructions to your broker, your shares will not be voted on any proposal on which your broker does not have discretionary authority to vote. This is called a broker non-vote.

We believe that under the current rules of the NYSE, (i) broker non-votes will not be counted for purposes of determining the presence or absence of a quorum at the Xerox special meeting or the ACS special meeting and (ii) brokers do not have discretionary authority to vote on either of the Xerox proposals or on either of the ACS proposals. **A broker non-vote will have the same effect as a vote against adoption of the merger agreement but will have no effect on the other proposals.**

Q: ***How are my employee plan shares voted?***

A: *Employees of Xerox:* Beneficial owners of shares of Xerox common stock held in their accounts in the Xerox Employee Stock Ownership Plan, which we refer to in this joint proxy statement/prospectus as the ESOP, can instruct State Street Bank and Trust Company, as the ESOP trustee, which we refer to in this joint proxy statement/prospectus as the ESOP Trustee, by telephone, over the Internet or by sending a completed proxy card by mail, how to vote. No matter which method is used, your voting instructions are confidential and will not be disclosed to Xerox. By providing your voting instruction in one of these ways, you instruct the ESOP Trustee to vote the shares allocated to your ESOP account. You also authorize the ESOP Trustee to vote a proportion of the shares of Xerox common stock held in the ESOP trust for which no instructions have been received. To allow sufficient time for voting by the ESOP Trustee, you must provide voting instructions to the trustees no later than [ ], central standard time, on [ ]. For more information about the voting of plan shares by the trustees of the Xerox employee benefit plans, see The Xerox Special Meeting ESOP Voting Instruction beginning on page 52.

Employees of ACS: In certain cases, the proxy card, or a proxy submitted by telephone or over the Internet, will also serve as voting instructions to the plan administrator or trustee for shares held on behalf of a participant under certain employee benefit plans, described under the section entitled The ACS Special Meeting How to Vote beginning on page 57. To ensure that all shares are voted, please sign and return every proxy card received or submit a proxy by telephone or over the Internet for each proxy card. If you are a registered stockholder of ACS and/or you own shares of ACS common stock through an ACS employee benefit plan, and the accounts are in the same name, you will receive a proxy card representing your combined directly-owned and plan-owned shares that will serve as voting instructions to the designated ACS proxy, if applicable, and also to the trustees of those plans. To allow sufficient time for voting by the trustees of the plans, participants in ACS employee benefit plans must provide voting instructions to the trustees no later than [ ] on [ ]. For more information about the voting of plan shares by the trustees of the ACS employee benefit plans, see The ACS Special Meeting How to Vote beginning on page 57.

Q: ***What do I need to do now?***

A: Read and consider the information contained in this joint proxy statement/prospectus carefully, and then please vote your shares as soon as possible so that your shares may be represented at your special meeting.

Q: ***How do I vote?***

A: If you are entitled to vote at your company s special meeting, you can vote in person by completing a ballot at the special meeting, or you can vote by proxy before the special meeting. Even if you plan to attend your company s special meeting, we encourage you to vote your shares by proxy as soon as possible. After carefully reading and considering the information contained in this joint proxy statement/prospectus, please submit your proxy by telephone or over the Internet in accordance with the instructions set forth on the enclosed proxy card, or mark, sign and date the proxy card, and return it in the enclosed postage-paid envelope as soon as possible so that your shares may be voted at your company s special meeting. For detailed information, see The Xerox Special Meeting Proxies beginning on page 52 and The ACS Special Meeting How to Vote beginning on page 57. **YOUR VOTE IS VERY IMPORTANT.**

Q: ***Can I change my vote after I have submitted a proxy by telephone or over the Internet or submitted my completed proxy card?***

A Yes. You can change your vote by revoking your proxy at any time before it is voted at the Xerox or ACS special meeting.
You can revoke your proxy in one of four ways: (1) submit a proxy again by telephone or over the Internet prior to midnight on the night before the special meeting; (2) sign another proxy card with a later date and return it prior to midnight on the night before the special meeting; (3) attend the applicable special meeting and complete a ballot; or (4) send a written notice of revocation to the secretary of Xerox or ACS, as applicable, so that it is received prior to midnight on the night before the special meeting.

If you have instructed a broker to vote your shares, you must follow directions received from your broker to change your vote.

Q: ***Should ACS or Xerox stockholders send in their share certificates now for the exchange?***

A: No. ACS stockholders should keep any share certificates they hold at this time. After the merger is completed, ACS stockholders holding ACS share certificates will receive a letter of transmittal and instructions on how to obtain cash, shares of Xerox common stock and, if applicable, shares of Xerox Convertible Preferred Stock to which they are entitled in exchange for their shares of ACS common stock.
Xerox stockholders will continue to hold their shares of Xerox common stock after the merger. Xerox stockholders should keep any Xerox share certificates they hold both now and after the merger is completed.

Q: ***What should stockholders do if they receive more than one set of voting materials for a special meeting?***

A: You may receive more than one set of voting materials for a special meeting, including multiple copies of this joint proxy statement/prospectus and multiple proxy cards or voting instruction cards. Please complete, sign, date and return each proxy card and voting instruction card that you receive. For example, if you hold your shares in more than one brokerage account, you will receive a separate voting instruction card for each brokerage account in which you hold shares. If you are a holder of record and your shares are registered in more than one name, you will receive more than one proxy card.

Q: ***Who pays for this solicitation?***

A: The expense of filing, printing and mailing this joint proxy statement/prospectus and the accompanying material will be borne equally by Xerox and ACS. In addition, Xerox and ACS have engaged Innisfree M&A Incorporated and MacKenzie Partners Inc., respectively, to assist in the solicitation of proxies for

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their respective special meetings for a fee of approximately $100,000 (of which $25,000 is a success fee) and $50,000, respectively. Each party will bear the costs related to the solicitation of proxies in connection with its special meeting.

Q: ***Who should I call if I have questions about the proxy materials or voting procedures?***

A: If you have questions about the merger, or if you need assistance in submitting your proxy or voting your shares or need additional copies of this joint proxy statement/prospectus or the enclosed proxy card, you should contact the proxy solicitation agent for the company in which you hold shares. If you are a Xerox stockholder, you should contact Innisfree M&A Incorporated, the proxy solicitation agent for Xerox, by mail at 501 Madison Avenue, 20th Floor, New York, NY 10022, by telephone toll free at (877) 456-3442 (banks and brokers may call collect at (212) 750-5833). If you are an ACS stockholder, you should contact MacKenzie Partners Inc., the proxy solicitation agent for ACS, by mail at 105 Madison Avenue, New York, NY 10016, by telephone at (800) 322-2885 (toll free) or (212) 929-5500 (collect), or by e-mail at acsproxy@mackenziepartners.com. If your shares are held in a stock brokerage account or by a bank or other nominee, you should contact your broker, bank or other nominee for additional information.

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SUMMARY

The following summary highlights selected information from this joint proxy statement/prospectus and may not contain all of the information that may be important to you. Accordingly, stockholders are encouraged to carefully read this entire joint proxy statement/prospectus, its annexes and the documents referred to or incorporated by reference in this joint proxy statement/prospectus. Each item in this summary includes a page reference directing you to a more complete description of that item. Please see the section entitled Where You Can Find More Information beginning on page 177.

Information about the Companies (Page 50)

Xerox Corporation

Xerox Corporation is a New York corporation and was founded in 1906. Xerox is a $17.6 billion technology and services enterprise and a leader in the global document market. Xerox develops, manufactures, markets, services and finances a complete range of document equipment, software, solutions and services. Xerox operates in over 160 countries worldwide. Xerox sells its products and solutions directly to customers through its worldwide sales force and through a network of independent agents, dealers, value-added resellers, systems integrators and on the Web. Xerox s principal executive offices are located at 45 Glover Avenue, Norwalk, Connecticut 06856-4505 and its telephone number is (203) 968-3000.

Boulder Acquisition Corp.

Boulder Acquisition Corp. is a Delaware corporation and a direct wholly-owned subsidiary of Xerox. Boulder Acquisition Corp. was organized on September 21, 2009, solely for the purpose of effecting the merger with ACS. It has not carried on any activities other than in connection with the merger. Boulder Acquisition Corp. s principal executive offices are located at 45 Glover Avenue, Norwalk, Connecticut 06856-4505 and its telephone number is (203) 968-3000.

Affiliated Computer Services, Inc.

Affiliated Computer Services, Inc. is a Delaware corporation and was founded in 1988. ACS is a provider of business process outsourcing and information technology services. ACS provides non-core, mission critical services that its clients need to run their day-to-day business. ACS s services are focused on vertical markets and centered on its clients needs. The services ACS provides enable its clients to concentrate on their core operations, respond to rapidly changing technologies and reduce expenses associated with their business processes and information processing. ACS supports client operations in more than 100 countries. ACS s principal executive offices are located at 2828 North Haskell, Dallas, Texas 75204 and its telephone number is (214) 841-6111.

The Merger (Page 59)

On September 27, 2009, Xerox, Boulder Acquisition Corp. and ACS entered into the merger agreement, which is the legal document governing the proposed merger. Subject to the terms and conditions of the merger agreement, ACS will be merged with and into Boulder Acquisition Corp., with Boulder Acquisition Corp. continuing as the surviving corporation. Upon completion of the merger, ACS Class A common stock will no longer be publicly traded.

Merger Consideration (Pages 59 and 134)

As a result of the merger, each outstanding share of ACS Class A common stock, other than excluded shares, will be converted into the right to receive a combination of (i) 4.935 shares of Xerox common stock and (ii) $18.60 in cash, without interest, which we collectively refer to in this joint proxy statement/prospectus as the

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Class A merger consideration. As a result of the merger, each outstanding share of ACS Class B common stock, other than excluded shares, will be converted into the right to receive (i) 4.935 shares of Xerox common stock, (ii) $18.60 in cash, without interest, and (iii) a fraction of a share of Xerox Convertible Preferred Stock equal to (x) 300,000 divided by (y) the number of shares of ACS Class B common stock issued and outstanding as of the effective time of the merger, which we collectively refer to in this joint proxy statement/prospectus as the Class B merger consideration. The Xerox Convertible Preferred Stock will be issued pursuant to the authority granted to the Xerox board of directors in the certificate of incorporation of Xerox to create out of authorized and unissued shares of cumulative preferred stock a new series of preferred stock that will rank senior to the Xerox common stock with respect to dividend rights and rights on liquidation, winding-up and dissolution of Xerox. A description of the Xerox Convertible Preferred Stock to be issued in connection with the proposed transaction is set forth under the section entitled Description of Xerox Convertible Preferred Stock beginning on page 162.

Treatment of ACS Stock Options (Page 134)

Except for ACS stock options granted in August 2009 which will continue to vest and become exercisable in accordance with their terms without regard to any provisions relating to a change of control, as of the effective time of the merger, each outstanding ACS stock option to acquire shares of ACS common stock will, whether or not exercisable or vested at the effective time, become fully vested and exercisable and be converted into options to purchase Xerox common stock under the same terms and conditions (adjusted for the merger) as are in effect immediately prior to the effective time with respect to such ACS stock option and be exercisable for that number of whole shares of Xerox common stock equal to the product of the number of shares of ACS common stock that were subject to such ACS stock option immediately prior to the effective time of the merger multiplied by the Option Exchange Ratio, rounded down to the nearest whole number of shares of Xerox common stock. For purposes of this joint proxy statement/prospectus, Option Exchange Ratio means the number equal to the sum of (i) 4.935 plus (ii) the number obtained by dividing (1) $18.60 by (2) the per share closing price of Xerox common stock on the NYSE on the last trading day immediately prior to the date of closing, as such price is reported on the screen entitled Comp/CLOSE/PRICE on Bloomberg. The per share exercise price for the shares of Xerox common stock issuable upon exercise of the assumed ACS stock options will be equal to the quotient determined by dividing the exercise price per share of ACS Class A common stock subject to the ACS stock option, as in effect immediately prior to the effective time of the merger, by the Option Exchange Ratio, rounded up to the nearest whole cent.

Total Xerox Shares to be Issued

Based on the number of shares of ACS common stock outstanding as of [ ], the latest practicable date before the printing of this joint proxy statement/prospectus, the total number of shares of Xerox common stock and Xerox Convertible Preferred Stock to be issued pursuant to the merger to ACS stockholders (assuming no ACS stock options are exercised between [ ] and the effective time of the merger) will be approximately [ ] and 300,000, respectively.

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Comparative Per Share Market Price and Dividend Information (Page 24)

Xerox common stock is listed on the NYSE under the symbol XRX. ACS Class A common stock is listed on the NYSE under the symbol ACS. The following table shows the closing prices of Xerox common stock and ACS Class A common stock as reported on the NYSE on September 25, 2009, the last trading day before the merger agreement was announced, and on [ ], 2009, the last full trading day before the date of this joint proxy statement/prospectus. This table also shows the equivalent value of the merger consideration per share of ACS Class A common stock, which was calculated by adding (i) the cash portion of the merger consideration, or $18.60, and (ii) the closing price of Xerox common stock as of the specified date multiplied by the exchange ratio of 4.935.

	ACS Class A Common Stock	Xerox Common Stock	Equivalent Value Per Share of ACS Class A Common Stock
September 25, 2009	$ 47.25	$ 9.02	$ 63.11
[ ], 2009			

The market prices of Xerox common stock and ACS Class A common stock will fluctuate prior to the merger. You should obtain current market quotations for the shares.

Xerox currently pays a quarterly dividend on its common stock and last paid a dividend on October 30, 2009, of $0.0425 per share. Under the terms of the merger agreement, during the period before the effective time of the merger, Xerox is prohibited from paying any dividends other than its regular quarterly dividends at the current rate, which is not to exceed $0.0425 per share. On October 15, 2009, the Xerox board of directors declared a quarterly dividend on its common stock, which we refer to in this joint proxy statement/prospectus as the January dividend, in the amount of $0.0425 per share payable on January 29, 2010 to holders of record on December 31, 2009. If the merger is completed on or before December 31, 2009, holders of ACS common stock whose shares were converted into the right to receive shares of Xerox common stock, as part of the merger consideration, will be entitled to receive the January dividend on such shares of Xerox common stock for which they were also the holder of record on December 31, 2009. If the merger is completed after December 31, 2009, holders of ACS common stock will not be entitled to receive the January dividend on any Xerox common stock which they receive as part of the merger consideration.

ACS currently does not pay a quarterly dividend on its common stock. Under the terms of the merger agreement, during the period before the effective time of the merger, ACS is prohibited from paying any dividends on its common stock.

ACS Special Meeting (Page 55)

When and Where

The ACS special meeting will be held at [ ] on [ ], at [ ], central standard time, unless the special meeting is adjourned or postponed.

Purposes of the Special Meeting

At the special meeting, ACS stockholders will be asked to consider and act on a proposal to adopt the merger agreement and approve the adjournment of the ACS special meeting (if necessary or appropriate, including to solicit additional proxies if there are not sufficient votes to adopt the merger agreement).

Record Date; Voting Power

Holders of ACS common stock as of the close of business on the ACS record date are entitled to vote at the special meeting or any adjournment or postponement thereof. Each outstanding share of ACS Class A common stock entitles its holder to cast one vote and each outstanding share of ACS Class B common stock entitles its holder to cast ten votes. As of the ACS record date, there were [ ] shares of ACS Class A common stock par value $0.01 per share, outstanding and entitled to vote at the ACS special meeting and [ ] shares of ACS Class B common stock par value $0.01 per share, outstanding and entitled to vote at the ACS special meeting.

Vote Required

The affirmative vote of holders of a majority in voting power of the outstanding shares of ACS common stock, voting together as a single class, is required to adopt the merger agreement. Mr. Deason has entered into a voting agreement with Xerox pursuant to which Mr. Deason has agreed, subject to certain exceptions, to vote all of his beneficially owned shares of ACS common stock, or approximately 43.6 % of the total voting power of the outstanding shares of ACS common stock as of September 27, 2009 in favor of the proposal to adopt the merger agreement. Assuming a quorum of stockholders is represented (whether in person or by proxy) at the ACS special meeting, in order to approve the proposal to adjourn the meeting (if necessary or appropriate, including to solicit additional proxies if there are not sufficient votes to adopt the merger agreement), holders of a majority in voting power of the shares of ACS common stock represented (whether in person or by proxy) at such meeting and entitled to vote on the proposal and which has actually been voted must vote in favor of the proposal to adjourn the meeting. In the absence of a quorum, the stockholders entitled to vote thereat and represented (whether in person or by proxy) at the ACS special meeting will have the power to adjourn the meeting. As of the close of business on the ACS record date, directors and executive officers of ACS and their affiliates had the right to vote [ ] shares of ACS Class A common stock and [ ] shares of ACS Class B common stock, or [ ] % of the combined voting power of the outstanding shares of ACS common stock entitled to vote at the ACS special meeting.

Xerox Special Meeting (Page 51)

When and Where

The Xerox special meeting will be held on [ ], beginning at [ ], local time, at [ ].

Purposes of the Special Meeting

At the special meeting, Xerox stockholders will be asked to consider and vote upon a proposal to approve the issuance of shares of Xerox common stock required to be issued to ACS stockholders pursuant to the merger agreement. You will also be asked to consider and vote upon a proposal to approve the adjournment of the special meeting, if necessary or appropriate, including to solicit additional proxies.

Record Date; Voting Power

Holders of Xerox common stock as of the close of business on the Xerox record date are entitled to vote at the special meeting or any adjournment or postponement thereof. Each share of Xerox common stock is entitled to one vote. As of the Xerox record date, [ ] shares of Xerox common stock were outstanding.

Vote Required

Assuming a quorum of stockholders is represented (whether in person or by proxy) at the Xerox special meeting, the affirmative vote of holders of a majority in voting power of the shares of Xerox common stock represented (whether in person or by proxy) at such meeting or any adjournment or postponement thereof is required to approve the proposal to issue shares of Xerox common stock required to be issued pursuant to the merger agreement. Assuming a quorum of stockholders is represented (whether in person or by proxy) at the Xerox special meeting, the affirmative vote of holders of a majority of the votes cast in favor of or against such proposal by holders of shares of Xerox common stock is required to approve the proposal to adjourn the special meeting, if necessary or appropriate, including to solicit additional proxies. In the absence of a quorum, the stockholders entitled to vote thereat and represented (whether in person or by proxy) at the Xerox special meeting will have the power to adjourn the meeting. As of the close of business on the Xerox record date, directors and executive officers of Xerox and their affiliates had the right to vote [ ] shares of Xerox common stock, or [ ] % of the voting power of the outstanding shares of Xerox common stock.

Recommendation of the ACS Board of Directors (Page 73)

On September 27, 2009, the ACS board of directors (other than Mr. Deason, who was recused from the meeting), acting upon the unanimous recommendation of the Strategic Transaction Committee, unanimously:

- determined the merger agreement and the merger to be advisable and in the best interests of ACS and its stockholders;
- approved the merger agreement and the merger;
- directed that the proposal to adopt the merger agreement be submitted to the holders of ACS common stock for their approval in accordance with the terms of the merger agreement; and
- resolved to recommend that the stockholders of ACS adopt the merger agreement.

For more information about the Strategic Transaction Committee, see the section entitled The Merger Background of the Merger beginning on page 59.

THE ACS BOARD OF DIRECTORS (OTHER THAN MR. DEASON, WHO WAS RECUSED FROM THE MEETING), ACTING UPON THE UNANIMOUS RECOMMENDATION OF THE STRATEGIC TRANSACTION COMMITTEE, UNANIMOUSLY RECOMMENDS THAT ACS STOCKHOLDERS VOTE FOR THE PROPOSAL TO ADOPT THE MERGER AGREEMENT AND FOR THE PROPOSAL TO APPROVE THE ADJOURNMENT OF THE SPECIAL MEETING, IF NECESSARY OR APPROPRIATE, INCLUDING TO SOLICIT ADDITIONAL PROXIES IF THERE ARE NOT SUFFICIENT VOTES TO ADOPT THE MERGER AGREEMENT.

Opinion of Financial Advisor to ACS (Page 77)

In connection with the merger, the ACS board of directors received an opinion, dated September 27, 2009, from Citigroup Global Markets Inc., which we refer to in this joint proxy statement/prospectus as Citi, as to the fairness, from a financial point of view, of the Class A merger consideration to be received in the merger by holders of ACS Class A common stock (other than those holders who are also holders of ACS Class B common stock and their affiliates). The full text of Citi s written opinion, which sets forth, among other things, the procedures followed, assumptions made, matters considered and limitations on the scope of review undertaken in rendering its opinion is attached as Annex C to this joint proxy statement/prospectus. The opinion was directed to the ACS board of directors and addresses only the fairness, from a financial point of view, of the Class A merger consideration to be received in the merger by holders of ACS Class A common stock (other than those holders who are also holders of ACS Class B common stock and their affiliates). The opinion does not address any other aspect of the proposed merger and does not constitute a recommendation to any stockholder as to how such stockholder should vote or act with respect to any matters relating to the merger agreement.

Opinion of Financial Advisor to the Strategic Transaction Committee (Page 87)

In connection with the merger, the Strategic Transaction Committee received an opinion, dated September 27, 2009, from Evercore Group L.L.C., which we refer to in this joint proxy statement/prospectus as Evercore, as to the fairness, from a financial point of view, of the Class A merger consideration to be received in the merger by holders of ACS Class A common stock (other than those holders who also hold shares of ACS

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Class B common stock) entitled to receive such Class A merger consideration. The full text of Evercore s written opinion, which sets forth, among other things, the procedures followed, assumptions made, matters considered and limitations on the scope of review undertaken in rendering its opinion is attached as Annex D to this joint proxy statement/prospectus. The opinion was directed to the Strategic Transaction Committee and addresses only the fairness, from a financial point of view, of the Class A merger consideration to be received in the merger by holders of ACS Class A common stock (other than those holders who also hold shares of ACS Class B common stock) entitled to receive such Class A merger consideration. The opinion does not address any other aspect of the proposed merger and does not constitute a recommendation to any stockholder as to how such stockholder should vote or act with respect to any matters relating to the merger agreement.

Recommendation of the Xerox Board of Directors (Page 103)

On September 27, 2009, the Xerox board of directors unanimously:

- determined the merger agreement and the merger to be advisable and in the best interests of Xerox and its stockholders;
- approved the merger agreement and the merger;
- directed that the proposal to issue shares of Xerox common stock required to be issued pursuant to the merger agreement be submitted to the holders of Xerox common stock for their approval in accordance with the terms of the merger agreement; and
- resolved to recommend that the stockholders of Xerox approve the proposal to issue shares of Xerox common stock required to be issued pursuant to the merger agreement.

THE XEROX BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT XEROX STOCKHOLDERS VOTE FOR THE PROPOSAL TO APPROVE THE ISSUANCE OF SHARES OF XEROX COMMON STOCK REQUIRED TO BE ISSUED PURSUANT TO THE MERGER AGREEMENT AND FOR THE PROPOSAL TO APPROVE THE ADJOURNMENT OF THE SPECIAL MEETING, IF NECESSARY OR APPROPRIATE, INCLUDING TO SOLICIT ADDITIONAL PROXIES.

Opinions of Financial Advisors to Xerox (Page 105)

In connection with the merger, the Xerox board of directors received separate opinions, each dated September 27, 2009, from Blackstone Advisory Services L.P., which we refer to in this joint proxy statement/prospectus as Blackstone, and J.P. Morgan Securities Inc., which we refer to in this joint proxy statement/prospectus as J.P. Morgan, in each case, as to the fairness to Xerox, from a financial point of view and as of the date of such opinion, of the aggregate consideration to be paid by Xerox to the holders of ACS common stock. The Blackstone opinion and the J.P. Morgan opinion, the full texts of which describe the assumptions made, procedures followed, matters considered and limitations on the review undertaken, are attached as Annexes E and F, respectively, to this joint proxy statement/prospectus. Each opinion was directed to the Xerox board of directors and was limited to the fairness to Xerox, from a financial point of view, of the aggregate consideration to be paid by Xerox in the merger, and neither Blackstone nor J.P. Morgan expressed any opinion as to the fairness of the merger to the holders of any class of securities, creditors or other constituencies of Xerox or as to the underlying decision by Xerox to engage in the merger. Neither opinion constitutes a recommendation to any stockholder as to how such holder should vote with respect to the merger or other matter.

Interests of ACS s Directors and Executive Officers in the Transaction (Page 117)

Aside from their interests as ACS stockholders, ACS s directors and executive officers have financial interests in the merger that are different from those of other ACS stockholders. The members of the ACS board of directors and the Strategic Transaction Committee were aware of and considered these potential interests,

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among other matters, in evaluating and negotiating the merger agreement and the merger, and in recommending to the ACS stockholders that the merger agreement be adopted. See The Merger Interests of ACS s Directors and Executive Officers in the Transaction beginning on page 117 for additional information about these financial interests.

Governmental and Regulatory Approvals (Page 124)

Under the HSR Act, the merger may not be completed until notification and report forms have been filed with the Antitrust Division of the U.S. Department of Justice, which we refer to in this joint proxy statement/prospectus as the DOJ, and the U.S. Federal Trade Commission, which we refer to in this joint proxy statement/prospectus as the FTC, and the applicable waiting period has expired or been terminated. Xerox and ACS filed the required HSR notification and report forms on October 15, 2009, and the HSR waiting period expired on November 16, 2009. The merger is also subject to approval by the governmental authorities in the European Union. Xerox and ACS plan to file a formal notification of the merger with the European Commission at the appropriate time. The European Commission will have 25 business days after receipt of such formal notification, which period may be extended by the European Commission in certain circumstances, to issue its decision regarding the merger. Although not a condition to the completion of the merger, the Financial Services Authority, which we refer to in this joint proxy statement/prospectus as the FSA, in the United Kingdom also requires Xerox to receive prior approval for a change in control over two FSA-regulated subsidiaries of ACS. In addition, although not a condition to the completion of the merger, Xerox and ACS made the competition filing required under the laws of Brazil on October 19, 2009.

Financing (Page 158)

On September 27, 2009, Xerox entered into a debt commitment letter, which we refer to in this joint proxy statement/prospectus as the debt commitment letter, with JPMorgan Chase Bank, N.A. and J.P. Morgan Securities Inc., pursuant to which, subject to the conditions set forth in the debt commitment letter, JPMorgan Chase Bank, N.A. committed to provide to Xerox unsecured bridge financing of up to $3.0 billion, the proceeds of which would be used (i) first, to repay or redeem ACS s indebtedness outstanding on the closing date other than its 5.20% senior notes due 2015, 4.70% senior notes due 2010 and capitalized lease obligations and (ii) second, to fund, in part, the cash consideration for the merger and pay certain fees and expenses in connection with the merger. For a more complete description of Xerox s debt financing for the merger, see the section entitled Description of Debt Financing beginning on page 158.

No Solicitation (Page 141)

Subject to certain exceptions, each of Xerox and ACS has agreed not to solicit, knowingly initiate or knowingly encourage, or knowingly facilitate any takeover proposal from any third party relating to an acquisition, or enter into an agreement relating to an acquisition proposal by a third party. Notwithstanding these restrictions, the merger agreement provides that, under specific circumstances, each of Xerox and ACS may furnish information to, and participate in discussions and negotiations with, third parties in response to an unsolicited acquisition proposal that, in the good faith judgment of its board of directors, constitutes or could reasonably be expected to lead to a superior proposal (as defined in the merger agreement). For additional information on the Undertaking agreed to by ACS relating to its non-solicitation obligation under the merger agreement, see the section entitled The Merger Litigation Relating to the Merger beginning on page 132.

Restrictions on Recommendation Withdrawal (Page 141)

The merger agreement generally restricts the ability of each of the Xerox and ACS boards of directors from withdrawing its recommendation that its stockholders adopt the merger agreement or approve the issuance of shares of Xerox common stock required to be issued pursuant to the merger agreement, as applicable. However, each of the Xerox board of directors and the ACS board of directors may withdraw its recommendation in response to (i) an intervening event (as defined in the merger agreement) or (ii) a superior proposal if, in either case, such board of directors concludes in good faith that the failure to take such action would reasonably be expected to be inconsistent with its fiduciary duties after Xerox and ACS have negotiated for three business days to amend the merger agreement in such a manner such that the failure by such board of directors to change its recommendation would no longer reasonably be expected to be inconsistent with its fiduciary duties.

Conditions to Completion of the Merger (Page 148)

Each party s obligation to complete the merger is subject to the satisfaction or waiver of various conditions that include the following:

- adoption of the merger agreement by the ACS stockholders and the approval of the issuance of shares of Xerox common stock required to be issued pursuant to the merger agreement by the Xerox stockholders;
- approval for listing on the NYSE of shares of Xerox common stock (i) to be issued pursuant to the merger, (ii) to be reserved for issuance upon the exercise of Xerox stock options issued in exchange for ACS stock options and (iii) to be reserved for issuance upon the conversion of Xerox Convertible Preferred Stock;
- absence of any injunctions, orders or laws that would prohibit the merger;
- receipt of required regulatory approvals;
- effectiveness of the registration statement on Form S-4, of which this joint proxy statement/prospectus forms a part;
- the receipt by each party of a legal opinion of their respective tax counsel that the merger will constitute a reorganization within the meaning of Section 368(a) of the Code;
- the representations and warranties of the other party will be true and correct, subject to certain materiality thresholds;
- the other party will have performed in all material respects all of its obligations under the merger agreement; and
- in the case of Xerox, the financing sources not having declined to make the financing (or alternate financing, if applicable) available primarily by reason of the failure of either or both of the following conditions, which we refer to in this joint proxy statement/prospectus as the Specified Financing Conditions :
  - Xerox shall have received (i) from Standard & Poor s, within one week of the closing date, a reaffirmation of the corporate credit rating of Xerox after giving effect to the merger and the other transactions contemplated by the merger agreement, which shall be BBB- or higher (stable) on the closing date and (ii) from Moody s, within one week of the closing date, a reaffirmation of the corporate family rating of Xerox after giving effect to the merger and the other transactions contemplated by the merger agreement, which shall be Baa3 or higher (stable) on the closing date. In addition, the credit ratings (after giving effect to the merger and the other transactions contemplated by the merger agreement (including any issuance of notes (as defined in the debt commitment letter))), of each issue of notes outstanding on the closing date (for the avoidance of doubt, not including the outstanding 8% trust preferred securities) of Xerox or any of its subsidiaries shall be at least BBB- (stable) from Standard & Poor s and Baa3 (stable) from Moody s on the closing date; or

since June 30, 2009, and subject to specified exceptions, there has not been any event, occurrence, development or state of circumstances or facts or condition that has had or would reasonably be expected to have, individually or in the aggregate, a material adverse effect on Xerox or ACS.

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Closing (Page 134)

Under the terms of the merger agreement, the closing will occur on a date, which we refer to in this joint proxy statement/prospectus as the closing date, to be specified by the parties, which will be no later than the third business day after the satisfaction or waiver of all conditions to closing (other than those conditions that by their terms are to be satisfied at the closing).

Termination of the Merger Agreement (Page 150)

The merger agreement may be terminated at any time prior to the completion of the merger, whether before or after receipt of the Xerox and ACS stockholder approvals:

- by mutual written consent of Xerox, ACS and Boulder Acquisition Corp.; or
- by either Xerox or ACS if:
  - the merger has not been completed by June 27, 2010;
  - a required regulatory approval has been denied and such denial is final and non-appealable or a governmental entity has issued an order, decree or ruling or taken any other action permanently restraining, enjoining or otherwise prohibiting the merger, and such action has become final and non-appealable;
  - either of the required stockholder approvals has not been obtained at the applicable special meeting;
  - the other party has breached its respective representations, warranties or covenants under the merger agreement such that the applicable closing conditions would not be satisfied (and such breach is incapable of being cured prior to June 27, 2010); or
  - the other party, prior to obtaining its stockholder approval: (i) adversely modified its recommendation in favor of the merger, (ii) materially breached its obligations regarding non-solicitation of takeover proposals or its obligations regarding a special meeting, (iii) approved, recommended or entered into, an agreement with respect to a takeover proposal or (iv) publicly proposed or announced its intention to do any of the actions described in clause (i), (ii) or (iii).

For additional information on the November Stipulation agreed to by ACS and Xerox relating to the termination of the merger agreement in connection with a superior proposal (as defined in the merger agreement), see the section entitled The Merger Litigation Relating to the Merger beginning on page 132.

Termination Fees (Page 152)

The merger agreement contains certain termination rights and provides that ACS must pay Xerox a cash termination fee of $194 million if (i) the merger agreement is terminated under specified circumstances, including a change in the recommendation of the ACS board of directors or (ii) (A) a third-party takeover proposal for ACS is made known to ACS or its stockholders or publicly announced after the date of the merger agreement, (B) thereafter the merger agreement is terminated under specified circumstances, including a failure to complete the merger by June 27, 2010, a failure to obtain the ACS stockholder approval at the ACS special meeting or any adjournment or postponement thereof, a material breach by ACS of a covenant or agreement in the merger agreement, or a material breach by the ACS board of directors of its no shop obligations or its obligation to call a stockholder vote and (C) within 12 months after such termination ACS enters into a definitive agreement with respect to, or consummates, a takeover proposal with a third party.

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Xerox must pay ACS a cash termination fee of $235 million if (i) the merger agreement is terminated under specified circumstances, including a change in the recommendation of the Xerox board of directors or (ii) (A) a third-party takeover proposal for Xerox is made known to Xerox or its stockholders or publicly announced after the date of the merger agreement, (B) thereafter the merger agreement is terminated under specified circumstances, including a failure to complete the merger by June 27, 2010, a material breach by Xerox of a covenant or agreement in the merger agreement, or a material breach by the Xerox board of directors of its no shop obligations or its obligation to call a stockholder vote and (C) within 12 months after such termination Xerox enters into a definitive agreement with respect to, or consummates, a takeover proposal with a third party. In the event that the Xerox stockholder approval is not obtained at the Xerox special meeting or any adjournment or postponement thereof, Xerox must pay ACS a fee of $65 million, and the $235 million termination fee, if later payable by Xerox to ACS, will be reduced by the amount of any vote down fee previously paid.

Xerox is also obligated to pay ACS a cash termination fee of $323 million if the merger agreement is terminated because the merger is not completed by June 27, 2010 and on such date, all conditions to closing other than (i) the condition relating to Xerox s financing sources not declining to make the financing (or alternative financing, if applicable) available primarily by reason of the failure to satisfy either or both of the Specified Financing Conditions and (ii) the other conditions that, by their nature, cannot be satisfied until closing, but subject to the fulfillment or waiver of those conditions, have been satisfied or waived.

Material U.S. Federal Income Tax Consequences (Page 125)

The merger is intended to qualify for U.S. federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Code. Therefore, for U.S. federal income tax purposes, as a result of the merger, a U.S. holder of shares of ACS Class A common stock generally will only recognize gain (but not loss) in an amount not to exceed the cash received as part of the merger consideration and will recognize gain or loss with respect to any cash received in lieu of fractional shares of Xerox common stock.

Appraisal Rights (Page 128)

Under Delaware law, ACS stockholders of record who do not vote in favor of the merger and properly make a demand for appraisal will be entitled to exercise appraisal rights and obtain payment in cash for the judicially-determined fair value of their shares of ACS common stock in connection with the merger if the merger is completed. The relevant provisions of the General Corporation Law of the State of Delaware, which we refer to in this joint proxy statement/prospectus as the DGCL, are included as Annex G to this joint proxy statement/prospectus.

Listing of Xerox Common Stock on the NYSE (Page 132)

Xerox common stock received by ACS stockholders in the merger will be listed on the NYSE under the symbol XRX. After completion of the merger, it is expected that Xerox common stock will continue to be traded on the NYSE, but ACS common stock will no longer be listed or traded on the NYSE.

Differences Between Rights of Xerox and ACS Stockholders (Page 164)

As a result of the merger, the holders of ACS Class A common stock will become holders of Xerox common stock. Holders of ACS Class B common stock will become holders of Xerox common stock and Xerox Convertible Preferred Stock. Following the merger, ACS stockholders will have different rights as stockholders of Xerox than as stockholders of ACS due to differences between the laws of the jurisdictions of incorporation and the different provisions of the governing documents of Xerox and ACS. For additional information regarding the different rights as stockholders of Xerox than as stockholders of ACS, see Comparative Rights of Xerox and ACS Stockholders beginning on page 164.

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SELECTED CONSOLIDATED HISTORICAL FINANCIAL DATA OF XEROX

The selected historical financial data of Xerox for each of the years ended December 31, 2008, 2007, 2006, 2005 and 2004 and as of December 31, 2008, 2007, 2006, 2005 and 2004 are derived from Xerox s accounting records and reflect the adoption of ASC Topic 810-10-65, *Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB 51* (FAS 160) and Emerging Issues Task Force Topic D-98, *Classification and Measurement of Redeemable Securities* (EITF D-98). The selected financial data of Xerox as of and for the nine months ended September 30, 2009 and September 30, 2008 are derived from Xerox s unaudited condensed consolidated financial statements and related notes contained in its Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2009, which is incorporated by reference in this joint proxy statement/prospectus. The information set forth below is only a summary and is not necessarily indicative of the results of future operations of Xerox or the combined company, and you should read the following information together with Xerox s audited consolidated financial statements, the notes related thereto and the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations contained in Xerox s Annual Report on Form 10-K for the year ended December 31, 2008, and Xerox s unaudited condensed consolidated financial statements, the notes related thereto and the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations contained in Xerox s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2009, which are incorporated by reference in this joint proxy statement/prospectus. For more information, see the section entitled Where You Can Find More Information beginning on page 177.

	As of and for the Nine Months Ended September 30,		As of and for the Year Ended December 31,				
(in millions, except per share data)	**2009**	**2008**	**2008**	**2007(2)**	**2006**	**2005**	**2004**
Per Share Data							
Income from continuing operations(3)							
Basic	$ 0.35	$ 0.26	$ 0.26	$ 1.21	$ 1.25	$ 0.91	$ 0.84
Diluted	0.35	0.25	0.26	1.19	1.22	0.90	0.78
Earnings(3)							
Basic	$ 0.35	$ 0.26	$ 0.26	$ 1.21	$ 1.25	$ 0.96	$ 0.94
Diluted	0.35	0.25	0.26	1.19	1.22	0.94	0.86
Common stock dividends declared	$ 0.1275	$ 0.1275	$ 0.17	$ 0.0425			
Share Data							
Weighted average shares outstanding basic	870	891	885	935	944	957	834
Weighted average shares outstanding diluted	875	902	896	953	997	1,045	1,047
Operations							
Revenues	$ 10,960	$ 13,238	$ 17,608	$ 17,228	$ 15,895	$ 15,701	$ 15,722
Sales	4,651	6,179	8,325	8,192	7,464	7,400	7,259
Service, outsourcing and rentals	5,773	6,446	8,485	8,214	7,591	7,426	7,529
Finance income	536	613	798	822	840	875	934
Income from continuing operations(3)	325	256	265	1,165	1,232	948	784
Income from continuing operations Xerox	305	229	230	1,135	1,210	933	776
Net income(3)	325	256	265	1,165	1,232	993	867
Net Income Xerox	305	229	230	1,135	1,210	978	859
Financial Position							
Working capital	$ 3,010	$ 3,152	$ 2,700	$ 4,463	$ 4,056	$ 4,390	$ 4,628
Total Assets	21,753	23,625	22,447	23,543	21,709	21,953	24,884

(in millions, except per share data)	As of and for the Nine Months Ended September 30, 2009	2008	As of and for the Year Ended December 31, 2008	2007(2)	2006	2005	2004
Consolidated Capitalization							
Short-term debt and current portion of long-term debt	1,149	1,457	1,610	525	1,485	1,139	3,074
Long-term debt	6,297	6,783	6,774	6,939	5,660	6,139	7,050
Total Debt	7,446	8,240	8,384	7,464	7,145	7,278	10,124
Liabilities to subsidiary trusts issuing preferred securities(1)	649	637	648	632	624	724	717
Series C mandatory convertible preferred stock						889	889
Xerox Stockholders Equity(3)	6,898	7,502	6,238	8,588	7,080	6,319	6,244
Non-controlling interests	133	118	120	103	108	90	80
Total Consolidated Capitalization	**$ 15,126**	**$ 16,497**	**$ 15,390**	**$ 16,787**	**$ 14,957**	**$ 15,300**	**$ 18,054**
Selected Data and Ratios							
Gross margin	39.6%	39.3%	38.9%	40.3%	40.6%	41.2%	41.6%
Sales gross margin	33.3%	34.3%	33.7%	35.9%	35.7%	36.6%	37.4%
Service, outsourcing and rentals gross margin	42.6%	41.9%	41.9%	42.7%	43.0%	43.3%	43.0%
Finance gross margin	61.9%	61.8%	61.8%	61.6%	63.7%	62.7%	63.1%

(1) For 2005, the amount includes $98 reported in other current liabilities.

(2) 2007 results include the acquisition of Global Imaging Systems.

(3) Restated for non-controlling interests as required by ASC 810-10-65 (FAS 160 and EITF D-98), which Xerox adopted effective January 1, 2009. The adoption of ASC Topic 810-10-65 (FAS 160 and EITF D-98) did not change basic and diluted earnings per share as previously reported in Xerox s audited financial statements. The adoption of ASC Topic 810-10-65 increased income from continuing operations (Xerox and noncontrolling interests) by including the noncontrolling interests (previously minority interests) share of operating income from continuing operations of $35 million, $30 million, $22 million, $15 million and $8 million for the years ended 2008, 2007, 2006, 2005 and 2004, respectively. The adoption of ASC Topic 810-10-65 also served to increase total equity by $120 million, $103 million, $108 million, $90 million and $80 million as of December 31, 2008, 2007, 2006, 2005 and 2004, respectively, as the carrying value amounts due the holders of the noncontrolling interests were reclassified from liabilities into total equity.

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SELECTED CONSOLIDATED HISTORICAL FINANCIAL DATA OF ACS

The selected historical financial data of ACS for each of the years ended June 30, 2009, 2008 and 2007 and as of June 30, 2009 and 2008 have been derived from ACS s audited consolidated financial statements and related notes contained in its Annual Report on Form 10-K for the year ended June 30, 2009, which is incorporated by reference in this joint proxy statement/prospectus. The selected historical financial data for the years ended June 30, 2006 and 2005 and as of June 30, 2007, 2006 and 2005 have been derived from ACS s audited consolidated financial statements for such years, which have not been incorporated by reference in this joint proxy statement/prospectus. The selected financial data of ACS as of and for the three months ended September 30, 2009 and September 30, 2008 are derived from ACS s unaudited condensed consolidated financial statements and related notes contained in its Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2009, which is incorporated by reference in this joint proxy statement/prospectus. The information set forth below is only a summary and is not necessarily indicative of the results of future operations of ACS or the combined company, and you should read the following information together with ACS s audited consolidated financial statements, the notes related thereto and the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations contained in ACS s Annual Report on

Form 10-K for the year ended June 30, 2009 and its Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2009, which are incorporated by reference in this joint proxy statement/prospectus. For more information, see the section entitled Where You Can Find More Information beginning on page 177.

(in thousands, except per share data)	As of and for the Three Months Ended September 30, 2009	2008	As of and for the Fiscal Year Ended June 30, 2009	2008	2007	2006	2005
Results of Operations Data:							
Revenues	$ 1,676,996	$ 1,604,454	$ 6,523,164	$ 6,160,550	$ 5,772,479	$ 5,353,661	$ 4,351,159
Operating income	$ 130,310	$ 172,748	$ 685,943	$ 645,078	$ 536,955	$ 617,284	$ 647,484
Net income	$ 68,794	$ 83,635	$ 349,943	$ 329,010	$ 253,090	$ 358,806	$ 409,569
Earnings per share basic	$ 0.70	$ 0.86	$ 3.59	$ 3.36	$ 2.53	$ 2.91	$ 3.21
Earnings per share diluted	$ 0.70	$ 0.85	$ 3.57	$ 3.32	$ 2.49	$ 2.87	$ 3.14
Weighted average shares outstanding basic	97,642	97,307	97,510	98,013	100,181	123,197	127,560
Weighted average shares outstanding diluted	98,091	98,091	98,006	98,993	101,572	125,027	130,556
Balance Sheet Data:							
Working capital	$ 983,977	$ 1,125,615	$ 929,105	$ 1,017,977	$ 839,662	$ 704,158	$ 405,983
Total assets	$ 6,847,884	$ 6,445,893	$ 6,900,973	$ 6,469,399	$ 5,982,429	$ 5,502,437	$ 4,850,838
Total long-term debt (less current portion)	$ 2,030,287	$ 2,323,692	$ 2,041,529	$ 2,357,541	$ 2,342,272	$ 1,614,032	$ 750,355
Stockholders equity	$ 2,702,449	$ 2,367,245	$ 2,622,132	$ 2,308,374	$ 2,066,168	$ 2,456,218	$ 2,811,712

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COMPARATIVE PER SHARE DATA

The following tables set forth certain historical, pro forma and pro forma equivalent per share financial information for Xerox common stock and ACS Class A common stock. The pro forma and pro forma equivalent per share information gives effect to the merger as if the merger had occurred on September 30, 2009, in the case of book value per share data, and January 1, 2008, in the case of net income per share data.

The pro forma per share balance sheet information combines Xerox s September 30, 2009 unaudited consolidated balance sheet with ACS s September 30, 2009 unaudited consolidated balance sheet. The pro forma per share income statement information for the fiscal year ended December 31, 2008 combines Xerox s audited consolidated statement of income for the fiscal year ended December 31, 2008 with ACS s unaudited consolidated statement of income for the four fiscal quarters ended December 31, 2008, which includes the last two reported quarters of ACS s fiscal year ended June 30, 2008 and the first two reported quarters of ACS s fiscal year ended June 30, 2009. The pro forma per share income statement information for the nine months ended September 30, 2009 combines Xerox s unaudited consolidated statement of income for the nine months ended September 30, 2009 with ACS s unaudited consolidated statement of income for the three fiscal quarters ended September 30, 2009, which includes the last two reported quarters of ACS s fiscal year ended June 30, 2009 and the first reported quarter of ACS s fiscal year ending June 30, 2010. The ACS pro forma equivalent per share financial information is calculated by multiplying the unaudited Xerox pro forma combined per share amounts by the exchange ratio (4.935 shares of Xerox common stock for each share of ACS common stock). The exchange ratio does not include the $18.60 cash portion of the merger consideration.

The following information should be read in conjunction with the audited consolidated financial statements of Xerox and ACS, which are incorporated by reference in this joint proxy statement/prospectus, and the financial information contained in the section entitled Xerox and ACS Unaudited Pro Forma Condensed Combined Financial Information beginning on page 30. The unaudited pro forma information below is presented for informational purposes only and is not necessarily indicative of the operating results or financial position that would have occurred if the merger had been completed as of the periods presented, nor is it necessarily indicative of the future operating results or financial position of the combined company. In addition, the unaudited pro forma information does not purport to indicate balance sheet data or results of operations data as of any future date or for any future period.

	Nine Months Ended September 30, 2009		Year Ended December 31, 2008	
XEROX HISTORICAL DATA				
Historical diluted per common share				
Net income per share	$	0.35	$	0.26
Dividends declared per common share	$	0.1275	$	0.17
Book value per share	$	7.94	$	7.21

	Three Months Ended September 30, 2009		Year Ended June 30, 2009	
ACS HISTORICAL DATA				
Historical diluted per common share				
Net income per share	$	0.70	$	3.57
Dividends declared per common share				
Book value per share	$	27.68	$	26.85

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	Nine Months Ended September 30, 2009		Year Ended December 31, 2008	
XEROX PRO FORMA COMBINED DATA				
Unaudited diluted pro forma per common share				
Net income per share	$	0.28	$	0.23
Dividends declared per common share	$	0.1275	$	0.17
Book value per share(1)	$	7.97		N/A

	Nine Months Ended September 30, 2009		Year Ended December 31, 2008	
ACS PRO FORMA EQUIVALENT				
Unaudited diluted pro forma per common share				
Net income per share	$	1.38	$	1.14
Dividends declared per common share	$	0.63	$	0.84
Book value per share	$	39.33		N/A

(1) Amount is calculated by dividing Xerox stockholder s equity by common shares outstanding. Pro forma book value per share as of December 31, 2008 is not meaningful as purchase accounting adjustments were calculated as of September 30, 2009.

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COMPARATIVE PER SHARE MARKET PRICE DATA AND DIVIDEND INFORMATION

Xerox common stock is listed and traded on the NYSE under the symbol XRX. ACS Class A common stock is listed and traded on the NYSE under the symbol ACS. The following table sets forth, for the calendar quarters indicated, the high and low closing sales prices per share of Xerox common stock and the high and low closing sales prices of ACS Class A common stock, in each case as reported on the NYSE, as adjusted for all stock splits or stock dividends. In addition, the table also sets forth the quarterly cash dividends per share declared by Xerox and ACS with respect to their common stock. On the Xerox record date ([ ]), there were [ ] shares of Xerox common stock outstanding. On the ACS record date ([ ]), there were [ ] shares of ACS Class A common stock outstanding.

	Xerox Corporation			Affiliated Computer Services, Inc.		
	High	Low	Dividends Declared	High	Low	Dividends Declared
For the quarterly period ended:						
2007						
March 31, 2007	$ 18.09	$ 16.53		$ 59.95	$ 48.00	N/A
June 30, 2007	$ 19.40	$ 17.08		$ 61.45	$ 56.72	N/A
September 30, 2007	$ 19.90	$ 15.79		$ 58.09	$ 47.45	N/A
December 31, 2007	$ 17.68	$ 15.82	$ 0.043	$ 52.37	$ 40.39	N/A
2008						
March 31, 2008	$ 15.82	$ 13.10	$ 0.043	$ 52.77	$ 41.05	N/A
June 30, 2008	$ 15.36	$ 13.28	$ 0.043	$ 57.08	$ 49.95	N/A
September 30, 2008	$ 14.39	$ 11.05	$ 0.043	$ 53.62	$ 47.70	N/A
December 31, 2008	$ 11.30	$ 5.25	$ 0.043	$ 50.61	$ 35.72	N/A
2009						
March 31, 2009	$ 9.10	$ 4.17	$ 0.043	$ 48.83	$ 42.48	N/A
June 30, 2009	$ 7.25	$ 4.70	$ 0.043	$ 50.83	$ 43.70	N/A
September 30, 2009	$ 9.57	$ 6.05	$ 0.043	$ 55.32	$ 42.98	N/A
December 31, 2009 (through November 23, 2009)	$ 8.07	$ 7.25	$ 0.043	$ 55.94	$ 51.64	

These shares represent about 16.5% of our outstanding shares of Class B Common Stock (and about [11.5%] of our outstanding shares of Class A Common Stock on a fully-diluted basis assuming conversion as of the record date) and our purchase of these shares will assist us in satisfying the closing condition to the private placement that requires all holders of shares of our Class B Common Stock and Class C Common Stock to have converted or been acquired by us. Brantley Capital had previously informed us that they would not convert their shares as required in connection with the consummation of the private placement and our board of directors determined that the terms of this purchase were in the best interests of our stockholders and our ability to consummate the private placement. If Brantley Capital were to convert these shares to shares of Class A Common Stock, then, as of the record date, they would convert into [10,877,952] shares of Class A Common Stock. Our purchase and retirement of these shares would eliminate the dilution resulting from conversion of these shares and would have an accretive effect to all other stockholders.

Sources and Use of Proceeds

Some or all of the proceeds we receive upon consummation of the transactions set forth in the Private Placement Agreements, along with proceeds from senior bank financing and other funds available to us, will be used to finance a portion of the acquisitions of the Rand and On Line businesses, our purchase of certain shares of our Class B Common Stock from Brantley Capital and for general working capital purposes.

Below is a summary of the sources and uses of funds in connection with the transactions described in this Proxy Statement. Additional information regarding the sources and uses of funds can be found under the headings Private Placement Agreements and Acquisitions below.

Source	**Amount**
New senior secured revolver	$ 2,000,000
New senior secured term loan A	$ 4,500,000
New senior secured acquisition facility	$ 10,000,000
Issuance of Class D Common Stock to Brantley IV and Phoenix	$ 4,650,000

Issuance of senior unsecured subordinated promissory note to Phoenix	$	3,350,000
Unsecured subordinated promissory note to stockholders of Rand	$	1,365,333
Unsecured subordinated promissory note to stockholders of On Line	$	833,981
Issuance of Class A Common Stock to stockholders of Rand	$	600,000
Total	$	27,299,314

Use		Amount
Payoff of existing senior secured revolver	$	1,262,845
Acquisition of Rand	$	9,365,333
Acquisition of On Line	$	3,310,924
Acquisition of Class B Common Stock owned by Brantley Capital	$	482,435
Future acquisitions	$	10,000,000
Fees and expenses	$	1,080,000
Additional working capital	$	1,797,777
Total	$	27,299,314

New Senior Secured Credit Facility

We have entered into a non-binding letter of intent (a copy of which is attached as Annex O) with Wells Fargo Foothill, Inc. for the provision of a new senior secured credit facility in the aggregate principal amount of

$16,500,000, consisting of a $2,000,000 revolving loan commitment, a $4,500,000 term loan and a $10,000,000 acquisition facility commitment available for future acquisitions. We are currently negotiating the definitive terms of the documentation for this credit facility but anticipate that the substantive provisions of the relevant agreements will be as follows. The credit facility will have a maturity of four years and will be secured by a first priority security interest in substantially all of our assets, including the assets of the Rand and On Line businesses following consummation of those acquisitions. The loans under the credit facility will bear interest at floating rates of interest that would be in the range of the prime rate plus 1.75% or LIBOR plus 3.75%. Availability under the revolving loan will be dependent on our ability to meet a borrowing base formula determined based on certain multiples of our pro forma trailing twelve month earnings before interest, taxes, depreciation and amortization (EBITDA). The credit facility will be subject to certain mandatory prepayment obligations and certain prepayment penalties. In addition, we will be obligated to meet certain financial covenants including maintenance of minimum levels of EBITDA and minimum levels of customer turnover, maintenance of certain fixed charge coverage ratios and maximum leverage ratios, and limitations on annual capital expenditures. The obligations of this lender to consummate the credit facility will be subject to certain closing conditions, including negotiation of definitive documentation and diligence investigations. We anticipate that the closing of the credit facility will occur simultaneously with the closing of the private placement and the acquisitions of the Rand and On Line businesses. Our consummation of a credit facility of at least $6,500,000 with a senior lender is a condition to the obligations of Phoenix and Brantley IV to consummate the private placement and a portion of the funds available under such credit facility will be necessary to consummate the acquisitions of the Rand and On Line businesses. There is no guarantee that we will be able to consummate this credit facility on these terms or with this institutional lender. If we are unable to reach agreement on a credit facility with this lender, then we will seek to find another institutional lender to provide a credit facility on similar terms, but there is no guarantee that we will be able to find such a lender or be able to negotiate similar terms to such credit facility.

Necessity for Stockholder Approval

As a result of our Class A Common Stock being listed for trading on AMEX, issuances of our Common Stock are subject to the provisions of the AMEX Company Guide, including Sections 712 and 713. Pursuant to Section 712 of the AMEX Company Guide, prior to seeking to have any additional shares of our Class A Common Stock listed on AMEX which shares are to be used as consideration for the acquisition of another company, we must seek stockholder approval if, among other things, the present or potential issuance of our Class A Common Stock (or securities convertible into our Class A Common Stock) could result in an increase by 20% or more in the number of our outstanding shares of Class A Common Stock.

Similarly, pursuant to Section 713 of the AMEX Company Guide, prior to seeking to have any additional shares of our Class A Common Stock listed on AMEX in connection with any such transaction, we must seek stockholder approval if such shares are to be sold, issued or potentially issued both (i) at a price less than the greater of book or market value, and (ii) either (a) such shares together with shares sold by our officers, directors or principal stockholders equals 20% or more of the number of shares of our presently outstanding Class A Common Stock (on an as converted basis) or (b) such shares equal to 20% or more of the number of shares of our presently outstanding Class A Common Stock (on an as converted basis).

Pursuant to the terms of the Private Placement Agreements and as more fully described in this Proxy Statement under Proposals IV and V, we intend to issue (i) shares of our Class D Common Stock, representing upon conversion 19.375% of our outstanding Class A Common Stock as of the date of issuance of the Class D Common Stock, on a fully-diluted basis taking into account the issuance of the shares of Class D Common Stock but excluding certain of our outstanding options, warrants and convertible securities and certain shares of Class B Common Stock to be purchased by us from Brantley Capital and (ii) warrants to purchase shares of our Class A Common Stock equal to 1.117% of our outstanding Class A Common Stock on the date of issuance of the warrants, taking into account the issuance of the shares of Class D Common Stock described in this Proxy Statement but excluding certain of our outstanding options, warrants and convertible securities and certain shares of Class B Common Stock to be purchased by us from Brantley Capital. In addition, pursuant to the terms of the stock purchase agreement for the acquisition of Rand and as more fully described below, we have agreed to issue such number of shares of our Class A

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Common Stock having a value of $600,000 based on the average closing price per share of our Class A Common Stock for the twenty day period prior to the closing of the acquisition of Rand.

If we were to consummate the private placement and the Rand acquisition as of our record date, October 20, 2006, we would be obligated to issue [20,662,163] shares of Class D Common Stock (representing [18.4%] of our Class A Common Stock on an as converted basis) pursuant to the Private Placement Agreements, warrants to purchase [1,191,207] shares of our Class A Common Stock (representing [1.1%] of our Class A Common Stock on an as converted basis) pursuant to the Private Placement Agreements and the Warrant Certificate and [2,400,000] shares of our Class A Common Stock (representing [2.1%] of our Class A Common Stock on an as converted basis) in connection with the Rand acquisition. The closing price of our Class A Common Stock on the record date was [$0.25] per share. While none of these transactions individually would require issuances in excess of 20% of our outstanding Class A Common Stock (on an as converted basis), the combination of all three issuances will exceed 20% of our outstanding Class A Common Stock (on an as converted basis) and the issuance of the shares to Phoenix and Brantley IV and the warrants to Phoenix in the private placement, if consummated on October 20, 2006, would be at a price per share of $0. , representing a $0. per share discount from the closing price of [$0.25] for a share of our Class A Common Stock. In addition, since the price per share used in the calculation of the shares to be issued in the Rand acquisition is based on a twenty day average, it is possible that the shares issued in that transaction may be issued at a discount, at a premium or at market. If consummated on October 20, 2006, the shares in the Rand acquisition would have been issued at $. per share, representing a [discount] [premium] of $0. per share from the closing price of [$0.25] per share. Representatives of AMEX have advised us that they would aggregate these three transactions for purposes of determining whether stockholder approval is required under Sections 712 and 713 of the AMEX Company Guide. Therefore, our board of directors has decided to submit Proposals IV, V and VI to our stockholders for their consideration and approval prior to consummating these transactions.

PROPOSAL IV

APPROVAL TO ISSUE SHARES OF OUR CLASS D COMMON STOCK IN A PRIVATE PLACEMENT

As described above, as part of our financing, on September 8, 2006 we entered into a Stock Purchase Agreement with Phoenix and Brantley IV pursuant to which we agreed to issue, for an aggregate purchase price of $4,650,000, such number of shares of our Class D Common Stock representing upon conversion 19.375% of our outstanding Class A Common Stock as of the date of issuance of the Class D Common Stock, on a fully-diluted basis taking into account the issuance of the shares of Class D Common Stock but excluding certain of our outstanding options, warrants and convertible securities and certain shares of Class B Common Stock to be purchased by us from Brantley Capital. If we were to consummate the private placement as of our record date, October 20, 2006, we would be obligated to issue [20,662,163] shares of Class D Common Stock (representing [18.4%] of our Class A Common Stock on an as converted basis) pursuant to the Stock Purchase Agreement. Proposal IV seeks stockholder approval of the issuance of these shares of our Class D Common Stock to Phoenix and Brantley IV pursuant to the Stock Purchase Agreement. Reference is hereby made to the summary of terms of this transaction appearing above, the summary of the Stock Purchase Agreement appearing below, and the Stock Purchase Agreement attached hereto as Annex A.

Opinion of Financial Advisor

On July 21, 2006, our board of directors retained Valuation Research Corporation to provide an opinion to the board of directors and the special committee as to the fairness, from a financial point of view, to the stockholders other than Brantley IV and Phoenix of the price to be paid for the shares of Class D Common Stock to be issued to Brantley IV and Phoenix pursuant to the Stock Purchase Agreement. We paid Valuation Research Corporation approximately $88,000, plus reimbursement of reasonable out-of-pocket expenses, for its services with respect to providing the fairness opinion and related materials preparation. No portion of Valuation Research Corporation s fee is contingent upon the conclusions reached in its opinion, the closing of the private placement transaction or consummation of any acquisition transaction.

On August 25, 2006, Valuation Research Corporation made an oral presentation to the special committee consisting of a preliminary overview of the methodologies it was undertaking and the analysis it was performing with respect to its opinion. After discussion with the special committee and further analysis, Valuation Research Corporation presented its opinion both orally and in writing on September 8, 2006 stating that, as of such date, and subject to the assumptions, limitations and qualifications set forth in its written opinion, the price to be paid for the shares of Class D Common Stock to be issued to Brantley IV and Phoenix pursuant to the Stock Purchase Agreement is fair to the stockholders, other than Brantley IV and Phoenix, from a financial point of view.

In undertaking its analysis Valuation Research Corporation, among other things, (i) reviewed drafts of relevant transaction documents; (ii) reviewed historic and projected financial information from our management; (iii) conducted an in-person visit to our corporate headquarters and held telephonic discussions with certain members of our management team with respect to, among other subjects, our past, present, and future operating and financial conditions; (iv) reviewed public information regarding our industry, including with respect to certain publicly traded companies that Valuation Research Corporation deemed comparable to us and certain mergers and acquisitions involving businesses that Valuation Research Corporation deemed comparable to us; and (v) conducted such other reviews, analyses and inquiries and considered such other economic, industry, market, financial, other information and data as they deemed appropriate.

Overview of Opinion

Valuation Research Corporation s opinion is not intended to be, and does not constitute, a recommendation to any stockholder as to how such stockholder should vote with respect to the proposals set forth in this Proxy Statement. Valuation Research Corporation s opinion does not address the fairness of the consideration to be paid, or received, in connection with or the fairness of the acquisitions of Rand or On Line. In addition, the only opinion expressed by Valuation Research Corporation is that the price to be paid to us for the shares of Class D Common Stock to be issued to Brantley IV and Phoenix pursuant to the Stock Purchase Agreement is fair, from a financial point of view, to our stockholders, excluding Brantley IV and Phoenix. Valuation Research Corporation does not express any opinion with respect to the fairness of the purchase by us of shares of our Class B Common Stock from Brantley Capital.

Valuation Research Corporation presented its analysis, as described below, at the meeting of the special committee on September 8, 2006, in connection with the special committee s consideration of the approval of the terms of the Stock Purchase Agreement, including the issuance of the shares of Class D Common Stock. Valuation Research Corporation s opinion assumes that we are a going concern and gives effect to the consummation of the transactions described in this Proxy Statement. For purposes of conducting its analysis, Valuation Research Corporation s opinion assumes that the closing price of our Class A Common Stock at the time of consummation of the transactions described in this Proxy Statement is the same as it was on September 7, 2006, $0.23 per share. Based on this assumption Valuation Research Corporation calculated that 21,969,024 shares of Class D Common Stock would be sold to the investors for $4,650,000.

In undertaking its analysis, Valuation Research Corporation deemed that the $4,650,000 of consideration to be received by us in exchange for issuance of the Class D Common Stock consists of two components of value: (1) the value associated with the 9% per annum, non-compounding dividend on the shares of Class D Common Stock (the Dividend Preference) and (2) the residual equity value of the shares of Class D Common Stock (the Class D Common Equity or Class D Common Equity Value). Valuation Research Corporation used an internal rate of return analysis to allocate the $4,650,000 purchase price between the Class D Common Equity Value and the Dividend Preference value. Applying a 20.5% discount rate over five years, Valuation Research Corporation determined that the Dividend Preference had a value of $825,000, which resulted in a Class D Common Equity Value of $3,825,000. Valuation Research Corporation selected a 20.5% discount rate by adding a spread, determined through its professional judgment and experience, to the implied combined return of the 14% senior unsecured promissory note and warrant to purchase 1.117% of the outstanding Class A Common Stock issued to Phoenix. Valuation Research Corporation further determined, based on the Class D Common Equity Value and the number of shares of Class D Common Stock to be issued, that the investors would be paying a cash price of $0.17 per Class D Common Equity share.

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Valuation Research Corporation used several methodologies to assess the fairness, from a financial point of view, of the deemed $0.17 price per Class D Common Equity share. The following is a summary of the financial analyses performed by Valuation Research Corporation in connection with rendering its opinion. The full text of Valuation Research Corporation s opinion, dated September 8, 2006, which describes, among other things, the limitations on such opinion as well as the assumptions and qualifications made, general procedures followed, and matters considered by Valuation Research Corporation in its review, is attached as Annex E to this Proxy Statement. **The summary of Valuation Research Corporation s opinion contained in this Proxy Statement is qualified in its entirety by reference to the full text of the opinion. You are urged to carefully read Valuation Research Corporation s opinion in its entirety, especially with respect to the qualifications and limitations set forth in it.**

Valuation Research Corporation s analyses included a fundamental valuation of us using a market and acquisition multiples approach and a discounted cash flow approach.

Valuation Research Corporation performed each of the following analyses based upon its view that each is appropriate and reflective of generally accepted valuation methodologies in light of the industries in which we operate, our trading volume relative to total shares outstanding, the accessibility of information regarding comparable publicly-traded companies and the availability of projections from our management. Further, Valuation Research Corporation did not rely exclusively on any one methodology but rather it considered all of the following methodologies in arriving at its conclusions.

No company, transaction or business used in the market and acquisition multiples approach as a comparison is identical to us. Accordingly, an analysis of the results of the foregoing is not entirely mathematical; rather it involves complex considerations and judgments concerning differences in the financial and operating characteristics and other factors that could affect the acquisitions, public trading and other values of the comparable companies, selected transactions or the business segment, company or transactions to which they are being compared. The analyses were prepared solely for purposes of Valuation Research Corporation s opinion to our special committee as to the fairness, from a financial point of view, of the price to be paid for the Class D Common Stock.

Market and Acquisition Multiples Approach

The purpose of the market and acquisition multiples approach is to determine a range of values for shares of our Class A Common Stock on a fully diluted basis, which range is then compared to the $0.17 per share price deemed to be paid for the Class D Common Equity on a fully converted basis.

This approach to valuation involves the analysis of certain other publicly-traded companies and companies that have been acquired in recent change-of-control transactions that Valuation Research Corporation selected because they have certain business operations, financial characteristics and fundamental economic and industry drivers that provide a reasonable basis for comparison to us for valuation purposes. The analysis involves comparing financial and operating data, such as earnings and cash flow, to aggregate market value of equity and/or enterprise value (or aggregate value of equity plus debt, preferred stock and minority interest, net of cash) to generate valuation metrics, or multiples. The associated multiples, are derived from publicly-traded stock prices and acquisitions of controlling interests in companies. The multiples exhibited from the publicly-traded stock prices and from the selected change-of-control transactions are then used as a basis for selecting an appropriate range of multiples for us to generate a range of per share values for Class A Common Stock on a fully diluted basis, which range is then compared to the $0.17 per share price deemed to be paid for the Class D Common Equity. Multiples are generally regarded as an expression of what investors believe to be an appropriate rate of return for a particular security given the inherent risks of ownership of such security.

Accordingly, in connection with this analysis, Valuation Research Corporation reviewed certain financial information of publicly-traded companies engaged in the healthcare industry. The publicly-traded companies selected by Valuation Research Corporation for analysis included Triad Hospitals Inc., Universal Health Services Inc., Lifepoint Hospitals, Inc., Per-Se Technologies Inc., Alliance Imaging Inc., AmSurg Corp, Symbion Inc., Eresearchtechnology Inc., U.S. Physical Therapy Inc., Sunlink Health Systems, Inc., Propspect Medical Holdings,

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Inc., UCI Medical Affiliates Inc., and Emergent Group Inc. Valuation Research Corporation noted that no single publicly-traded company used in this analysis is directly comparable to us.

Valuation Research Corporation calculated and considered certain financial ratios of the selected publicly-traded companies based on publicly available information, including, among others, the multiples of enterprise value (EV), the equity value of the comparable company plus all interest-bearing debt, preferred securities, and minority interests, less cash and cash equivalents to EBITDA for, the latest twelve month period ended June 30, 2006 (LTM), as projected for the fiscal year ending December 31, 2006 (current fiscal year, or CFY), and as projected for the fiscal year ending December 31, 2007 (next fiscal year, or NFY). Enterprise value to EBITDA multiples are commonly used by investment bankers, institutional research analysts and other financial professionals to determine the value of companies in connection with the market and acquisition multiples approach. Valuation Research Corporation noted that mean and median the multiples for the selected publicly-traded company group as of September 7, 2006 were as follows:

		EV/EBITDA	
Company	**LTM**	**CFY**	**NFY**
Triad Hospitals Inc.	7.2x	7.3x	6.6x
Universal Health Services, Inc.	8.4x	8.3x	7.7x
Lifepoint Hospitals, Inc.	9.0x	8.2x	7.5x
Per-Se Technologies Inc.	10.8x	10.3x	8.9x
Alliance Imaging Inc.	5.8x	6.5x	5.9x
AmSurg Corp	5.2x	5.1x	4.8x
Symbion Inc.	7.5x	7.5x	6.3x
Eresearchtechnology Inc.	11.6x	11.6x	7.8x
U.S. Physical Therapy Inc.	6.1x	6.4x	5.2x
Sunlink Health Systems, Inc.	6.6x	n/a	n/a
Prospect Medical Holdings, Inc.	4.0x	n/a	n/a
UCI Medical Affiliates Inc.	4.6x	n/a	n/a
Emergent Group Inc.	6.5x	n/a	n/a
Median	6.6x	7.5x	6.6x
Mean	7.2x	7.9x	6.7x

Accordingly, in connection with this analysis, Valuation Research Corporation reviewed certain publicly available financial information regarding transactions of companies engaged in lines of business in industries similar to us. Valuation Research Corporation identified announced change-of-control acquisitions of the following companies: HCA Inc., Beverly Enterprises Inc., Occupational Health & Rehabilitation Inc., NDC Health Corp, Select Medical Corp, US Oncology, Inc., Prime Medical Services, Inc., Landacorp Inc., Comprehensive Medical Imaging Inc., and Pro Vantage Health Services Inc.

This analysis resulted in indicated mean and median EV/ LTM EBITDA multiples of 7.5x and 7.1x, respectively. Enterprise value to EBITDA multiples are commonly used by investment bankers, institutional research analysts and other financial professionals to determine the value of companies in connection with change-of-control transactions.

To account for differences between us and certain publicly traded companies and companies that have been acquired in recent change of control transactions, Valuation Research Corporation, based on its professional judgment and experience, selected EV/LTM, EV/CFY and EV/NFY multiples that were lower than the median and mean multiples observed for certain publicly traded companies and companies that have been acquired in recent change of control transactions to reflect the inherent differences in companies. The use of EV/LTM, EV/CFY and EV/NFY multiples that are lower than the median and mean multiples observed for certain publicly traded companies and companies that have been acquired in recent change of control transactions result in a lower implied value of the Class A Common Stock on a fully-diluted basis than if the median and mean observed multiples were applied. Valuation Research Corporation derived enterprise value indications for us by applying multiples of 6.0x to

7.0x to our LTM, CFY, and NFY proforma EBITDA, which were adjusted for nonrecurring expenses such as professional fees, loss on sale of property, discontinued operations and consummation of the acquisitions of Rand and Online. In deriving our adjusted LTM, CFY and NFY EBITDA, Valuation Research Corporation assumed that we would not undertake any future acquisitions (other than the acquisitions of Rand and On Line) because our current financial position makes our ability to consummate future acquisitions speculative. Valuation Research Corporation subtracted all interest-bearing debt and Dividend Preference value and added cash and cash equivalents to the derived enterprise value to calculate the equity value. The equity value was divided by the proforma fully-diluted shares of Class A Common Stock outstanding assuming consummation of the transactions described in this Proxy Statement to determine the indications of equity value per share of Class A Common Stock. Using these assumptions, this approach yielded an implied price for our Class A Common Stock in the range of $0.03 to $0.07 per share on a fully diluted basis. The multiples selected were based on the mean and median multiples exhibited by the comparable publicly-traded companies and change-of-control transactions. Valuation Research Corporation noted that the $0.17 per share price deemed to be paid for the Class D Common Equity is above the range of values resulting from this analysis.

Valuation Research Corporation noted that the accuracy of this valuation methodology is dependent on the extent to which the selected publicly-traded companies are comparable to the company being analyzed and on the extent to which the selected change-of-control transaction target companies are comparable to the company being analyzed. In our case, Valuation Research Corporation observed that several of the publicly-traded companies and change-in-control target companies used in the analysis were of a different size than us, operated in channels different from us or operated in different economic environments than we do.

Discounted Cash Flow Approach

The purpose of the discounted cash flow approach is to determine a range of values for shares of our Class A Common Stock on a fully diluted basis, which range is then compared to the $0.17 per share deemed price to be paid for the Class D Common Equity. The discounted cash flow approach is another commonly used method of determining the value of a company. The approach involves calculating the present value of the estimated future debt free cash flows projected to be generated by the business and theoretically available (though not necessarily paid) to the capital providers of the company. The discounted cash flow approach involves calculating the present value of (i) the estimated debt free cash flows generated by a company and (ii) the value of the company at the end of the projection period, or terminal value. The present value of such amounts is determined by discounting the cash flows to present value using a discount rate that is intended to reflect all risks of ownership and the associated risks of realizing the stream of projected future cash flows. The discount rate can also be interpreted as the weighted average cost of capital or the rate of return that would be required by investors providing capital to a company to compensate them for the time value of their money and the risk inherent in the particular investment.

Valuation Research Corporation calculated a range of enterprise values for us as the sum of the present values of (i) our estimated future debt-free cash flows generated during the quarter ending September 30, 2006 through fiscal year ended 2011 and (ii) our terminal value at the end of the projection period. The estimated future debt-free cash flows were based on projections provided by our management. The range of our terminal values was calculated based on projected 2011 EBITDA and a range of EBITDA multiples of 5.5x to 6.5x. The representative EV/EBITDA multiple range was derived from a representative range of multiples observed with comparable public companies, acquisition transactions, and multiples paid by us in the transactions described in this Proxy Statement. Valuation Research Corporation used discount rates ranging from 16.0% to 18.0% for us based on our estimated weighted average cost of capital. The range of discount rates are based upon a range of implied weighted-average costs of capital observed with comparable publicly traded companies, certain published studies with respect to required rates of return, and Valuation Research Corporation s professional judgement and experience. In calculating our EBITDA for purposes of this analysis, Valuation Research Corporation assumed that we would not undertake any future acquisitions (other than the acquisitions of Rand and On Line) because our current financial position makes our ability to consummate future acquisitions speculative. Valuation Research Corporation subtracted all interest-bearing debt and Dividend Preference value and added cash and cash equivalents to the derived enterprise value to calculate the equity value. The equity value was divided by the pro forma fully-diluted shares of Class A Common Stock outstanding assuming consummation of the transactions described in this Proxy Statement to determine the indications of equity value per share of Class A Common Stock. Using these

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assumptions, this analysis indicated an implied price for our Class A Common Stock in the range of $0.05 to $0.09 per share on a fully diluted basis. Valuation Research Corporation noted that the $0.17 per share price deemed to be paid for the Class D Common Equity is above the range of values indicated by this analysis.

While the discounted cash flow approach is a widely accepted and practiced valuation methodology, it relies on a number of assumptions, including revenue growth rates, profit margins, working capital ratios, capital expenditures, terminal multiples and discount rates.

Conclusion

On September 8, 2006, Valuation Research Corporation delivered an oral opinion to the special committee, which was reconfirmed both orally and in writing on September 8, 2006, stating that, as of the date of the opinion, the price to be paid for the shares of Class D Common Stock to be issued to Brantley IV and Phoenix pursuant to the Stock Purchase Agreement is fair to our stockholders, excluding Brantley IV and Phoenix, from a financial point of view. This opinion was based upon and subject to the assumptions, qualifications and limitations made and matters considered by Valuation Research Corporation in its review as set forth in its written opinion.

As a matter of course, we do not publicly disclose forward-looking financial information. Nevertheless, in connection with its review, Valuation Research Corporation considered our financial projections. These financial projections were prepared by our management based on assumptions regarding our future performance. The financial projections were prepared under market conditions as they existed as of September 8, 2006. The financial projections do not take into account any circumstances or events occurring after the date they were prepared. In addition, factors such as industry performance, general business, economic, regulatory, market and financial conditions, as well as changes to our business, financial condition or results of operation, including without limitation such changes as may occur as a result of the risk factors we identified in this Proxy Statement and in our other filings with the SEC, may cause the financial projections or the underlying assumptions to be materially inaccurate. As a result, the financial projections are not necessarily indicative of future results.

Valuation Research Corporation s opinion is necessarily based on economic, financial, industry, market and other conditions as in effect on, and the information made available to it as of, the date the opinion is issued. Valuation Research Corporation has not undertaken, and is under no obligation, to update, revise, reaffirm or withdraw its opinion, or otherwise comment on or consider events occurring after the date on which the opinion was issued.

Controlled Company Status

AMEX has adopted minimum requirements for director independence and nominating and compensation committee membership. These requirements do not apply to any company who has a majority of the voting power of its equity securities controlled by a single owner or group. Prior to April 12, 2006, Brantley III, Brantley IV and Brantley Capital were affiliated entities that owned over a majority of the voting power of our issued and outstanding Common Stock. Until that time, we were considered a controlled company under the AMEX rules and, as such, were not required to comply with certain of AMEX s rules regarding director independence and nominating and compensation committee membership.

On April 12, 2006, Brantley IV and Brantley III filed with the SEC an amendment to their Schedule 13D relating to us indicating that Brantley Capital had terminated its investment advisory relationship with Brantley Capital Management on September 28, 2005, which resulted in Brantley Capital no longer being an affiliate of Brantley III or Brantley IV. Therefore, no individual or group now owns a majority of the voting power of our equity securities and we are no longer a controlled company under the listing rules of AMEX. The board of directors has since modified its nominating procedures and Compensation Committee membership to comply with the AMEX rules and we have one year from April 12, 2006 within which to establish a board of directors consisting of 50% directors who are independent for purposes of the corporate governance standards for small business issuers of AMEX. However, as a result of the issuance of the Class D Common Stock to Brantley IV in connection with the private placement, Brantley IV would own a majority of the voting power of our equity securities and we would once again become a controlled company under the listing rules of AMEX. As a controlled company, we would not need to comply with, and our stockholders would not have the protection provided by, certain AMEX requirements which mandate that (i) at least a majority of our directors must be independent; (ii) all board members must be nominated by a committee comprised solely of independent directors or by a majority of the independent directors, and (iii) compensation for our chief executive officer must be determined by a compensation committee comprised of independent directors.

Appraisal or Dissenters Rights

No appraisal rights are available under the Delaware General Corporation Law for our stockholders in connection with the private placement or the issuance of the shares of Class A Common stock as part of the Rand acquisition.

Consequences If This Proposal and Other Proposals Are Not Approved

If Proposal IV is not approved by our stockholders at the Special Meeting, then we will not be able to consummate the transactions contemplated by the Private Placement Agreements on the terms currently contemplated and in all likelihood will not be able to complete the Rand acquisition or the On Line acquisition. We could seek alternative financing for the Rand and On Line acquisitions; however, there is no assurance that such financing will be available or, if available, on terms acceptable to us. If Proposals IV and V are not approved, we will not consummate the purchase of shares of our Class B Common Stock from Brantley Capital.

If the amendments to our certificate of incorporation set forth in Proposals I, II and III are not approved by our stockholders at the Special Meeting, then we will not be able to consummate the transactions contemplated by the private placement. In addition, we may not be able to engage in discussions relating to any future transactions involving our Common Stock until our certificate of incorporation is amended to increase the number of authorized shares of our Common Stock.

Required Vote

The affirmative vote of a majority of the total number of shares of Common Stock represented in person or by proxy at the Special Meeting and entitled to vote is needed to approve this proposal. As such, abstentions and broker non-votes will have the same effect as a vote AGAINST this proposal. If our stockholders approve the issuance of the Class D Common Stock in connection with the Stock Purchase Agreement (as set forth in this Proposal IV), as well as Proposals V and VI regarding the issuance of the warrants to purchase shares of Class A Common Stock in the private placement and the issuance of shares of Class A Common Stock in connection with the Rand acquisition, subject to approval by the stockholders of Proposals I, II and III and the satisfaction of the other closing conditions contained therein, we will file our Second Amended and Restated Certificate of Incorporation with the Secretary of State of Delaware and immediately consummate the private placement and the Rand acquisition.

Recommendation

After careful consideration, the special committee of our board of directors has determined that the issuance of the shares of Class D Common Stock to Brantley IV and Phoenix pursuant to the Stock Purchase Agreement as part of the private placement that is the subject of Proposal IV is fair to and in the best interests of our stockholders. In addition, the special committee has determined that the terms of the Stock Purchase Agreement, as a whole, are in the best interests of our stockholders and approved the execution of this document. In reaching its decision relating to the issuance of the Class D Common Stock, the special committee considered, among other things, the opinion of Valuation Research Corporation that, as of the date of its opinion and based upon such other matters as Valuation Research Corporation considered relevant, the price to be paid to us in connection with the issuance of the Class D Common Stock is fair to our current stockholders, other than Brantley IV and Phoenix, from a financial point of view. Accordingly, the special committee has approved and declared advisable Proposal IV relating to the issuance to Brantley IV and Phoenix of the shares of Class D Common stock.

THE SPECIAL COMMITTEE RECOMMENDS THAT ALL STOCKHOLDERS VOTE, OR INSTRUCT THEIR VOTES TO BE CAST, FOR APPROVAL OF PROPOSAL IV, APPROVING THE ISSUANCE OF CLASS D COMMON STOCK PURSUANT TO THE STOCK PURCHASE AGREEMENT.

PROPOSAL V

APPROVAL TO ISSUE WARRANTS TO PURCHASE SHARES OF OUR CLASS A COMMON STOCK IN A PRIVATE PLACEMENT

As described above, as part of our financing, on September 8, 2006 we entered into a Note Purchase Agreement with Phoenix, pursuant to which we will, subject to stockholder approval and satisfaction of the other closing conditions set forth therein, issue, for an aggregate purchase price of $3,350,000, (i) our senior unsecured subordinated promissory notes due 2011 in the original principal amount of $3,350,000 and (ii) warrants to purchase shares of our Class A Common Stock equal to 1.117% of our outstanding Class A Common Stock on the date of issuance of the Warrant Certificate, on a fully-diluted basis taking into account the issuance of the shares of Class D Common Stock described above but excluding certain of our outstanding options, warrants and convertible securities and certain shares of Class B Common Stock to be purchased by us from Brantley Capital. If we were to consummate the private placement as of our record date, October 20, 2006, we would be obligated to issue warrants to purchase [1,191,207] shares of our Class A Common Stock (representing [1.1%] of our Class A Common Stock on an as converted basis) pursuant to the Note Purchase Agreement and the Warrant Certificate. Proposal V seeks stockholder approval of the issuance of these warrants to purchase shares of our Class A Common Stock to Phoenix pursuant to the Note Purchase Agreement, as well as approval to issue shares of Class A Common Stock upon exercise of the warrants. Reference is hereby made to the summary of terms of this transaction appearing above, the summary of the Note Purchase Agreement and the warrants appearing below, and the Note Purchase Agreement and the form of Warrant Certificate, attached hereto as Annexes B and N, respectively.

Appraisal or Dissenters Rights

No appraisal rights are available under the Delaware General Corporation Law for our stockholders in connection with the warrants to purchase shares of Class A Common Stock pursuant to the Note Purchase Agreement and the form of Warrant Certificate or the issuance of Class A Common Stock upon exercise of the warrants.

Consequences If This Proposal and Other Proposals Are Not Approved

If Proposal V is not approved by our stockholders at the Special Meeting, then we will not be able to consummate the transactions contemplated by the Private Placement Agreements on the terms currently contemplated and in all likelihood will not be able to complete the Rand acquisition or the On Line acquisition. We could seek alternative financing for the Rand and On Line acquisitions; however, there is no assurance that such financing will be available or, if available, on terms acceptable to us. If Proposals IV and V are not approved, we will not consummate the purchase of shares of our Class B Common Stock from Brantley Capital. If the amendments to our certificate of incorporation set forth in Proposals I, II and III are not approved by our stockholders at the Special Meeting, then we will not be able to consummate the transactions contemplated by the Private Placement Agreements. In addition, we may not be able to engage in discussions relating to any future transactions involving our Common Stock until our certificate of incorporation is amended to increase the number of authorized shares of our Common Stock.

Required Vote

The affirmative vote of a majority of the total number of shares of Common Stock represented in person or by proxy at the Special Meeting and entitled to vote is needed to approve this proposal. As such, abstentions and broker non-votes will have the same effect as a vote AGAINST this proposal. If our stockholders approve the issuance of the warrants to purchase shares of Class A Common Stock in connection with the Note Purchase Agreement and the

Warrant Certificate, as well as Proposals IV and VI regarding the issuance of shares of Class D Common Stock in the private placement and the issuance of share of Class A Common Stock in connection with the Rand acquisition, subject to approval by the stockholders of Proposals I, II and III and the satisfaction of the other closing conditions contained therein, we will file our Second Amended and Restated Certificate of Incorporation with the Secretary of State of Delaware and immediately consummate the private placement and the Rand acquisition.

Recommendation

After careful consideration, the special committee of our board of directors has determined that the issuance of the warrants to purchase shares of Class A Common Stock to Phoenix pursuant to the Note Purchase Agreement and the Warrant Certificate and as part of the private placement that is the subject of Proposal V is fair to and in the best interests of our stockholders. In addition, the special committee has determined that the terms of the Note Purchase Agreement and the Warrant Certificate, as a whole, are in the best interests of our stockholders and approved the execution of these documents. Accordingly, the special committee has approved and declared advisable Proposal V relating to the issuance to Phoenix of the warrants to purchase shares of Class A Common Stock.

THE SPECIAL COMMITTEE RECOMMENDS THAT ALL STOCKHOLDERS VOTE, OR INSTRUCT THEIR VOTES TO BE CAST, FOR APPROVAL OF PROPOSAL V, APPROVING THE ISSUANCE OF WARRANTS TO PURCHASE SHARES OF CLASS A COMMON STOCK PURSUANT TO THE NOTE PURCHASE AGREEMENT AND THE WARRANT.

SUMMARY OF PRIVATE PLACEMENT DOCUMENTS

The following summary of the material provisions of the Private Placement Agreements and the form of Warrant Certificate is qualified by reference to the complete text of the Private Placement Agreements and the form of Warrant Certificate, copies of which are attached as Annexes A, B and N to this Proxy Statement. All stockholders are encouraged to read the Private Placement Agreements in their entirety for a more complete description of their terms and conditions.

General

On September 8, 2006 we entered into a Stock Purchase Agreement with Phoenix and Brantley IV pursuant to which we agreed to issue, for an aggregate purchase price of $4,650,000, such number of shares of our Class D Common Stock representing upon conversion 19.375% of our outstanding Class A Common Stock as of the date of issuance of the Class D Common Stock, on a fully-diluted basis taking into account the issuance of the shares of Class D Common Stock but excluding certain of our outstanding options, warrants and convertible securities and certain shares of Class B Common Stock to be purchased by us from Brantley Capital.

On September 8, 2006 we also entered into a Note Purchase Agreement with Phoenix pursuant to which we agreed to issue, for an aggregate purchase price of $3,350,000, (i) our senior unsecured subordinated promissory notes due 2011 in the original principal amount of $3,350,000 and (ii) warrants to purchase shares of our Class A Common Stock equal to 1.117% of our outstanding Class A Common Stock on the date of issuance of the Warrant Certificate, on a fully-diluted basis taking into account the issuance of the shares of Class D Common Stock described above but excluding certain of our outstanding options, warrants and convertible securities and certain shares of Class B Common Stock to be purchased by us from Brantley Capital.

Investors

As of the record date, Brantley IV owns 7,863,996 shares of our Class B Common Stock, warrants to purchase 20,455 shares of our Class A Common Stock and notes which are currently convertible into [1,358,054] shares of our Class A Common Stock (at the closing price of our Class A Common Stock on the record date of [$0.25] per share). As of the record date, this represents [31.9%] of our voting power and [52.4%] of our voting power on an as converted basis (at the closing price of our Class A Common Stock on the record date of [$0.25] per share). As of the record date, Brantley IV and its affiliates own [44.8%] of our voting power and [60.5%] of our voting power on an as converted basis (at the closing price of our Class A Common Stock on the record date of [$0.25] per share). Brantley IV will purchase, for an aggregate purchase price of $1,650,000, such number of shares of Class D Common Stock representing upon conversion 6.875% of our outstanding Class A Common Stock as of the date of issuance of the Class D Common Stock, on a fully-diluted basis taking into account the issuance of the shares of Class D Common Stock but excluding certain of our outstanding options, warrants and convertible securities and certain shares of Class B Common Stock to be purchased by us from Brantley Capital.

Phoenix is a limited partner in Brantley IV and Brantley Partners V, L.P. and has also co-invested with Brantley IV and its affiliates in a number of transactions. Prior to the consummation of the private placement, Phoenix is not a record owner of any shares of our capital stock. Phoenix will purchase (i) for an aggregate purchase price of $3,000,000, such number of shares of Class D Common Stock, representing upon conversion 12.5% of our outstanding Class A Common Stock as of the date of issuance of the Class D Common Stock, on a fully-diluted basis taking into account the issuance of the shares of Class D Common Stock but excluding certain of our outstanding options, warrants and convertible securities and certain shares of Class B Common Stock to be purchased by us from Brantley Capital, and (ii) for an aggregate purchase price of $3,350,000, (A) our senior unsecured subordinated promissory notes due 2011 in the original principal amount of $3,350,000 and (B) warrants to purchase shares of our Class A Common Stock equal to 1.117% of our outstanding Class A Common Stock on the date of issuance of the Warrant Certificate, on a fully-diluted basis taking into account the issuance of the shares of Class D Common Stock described above but excluding certain of our outstanding options, warrants and convertible securities and certain shares of Class B Common Stock to be purchased by us from Brantley Capital.

Class D Common Stock

We will issue to Brantley IV and Phoenix on the closing date, for an aggregate purchase price of $4,650,000, such number of shares of our Class D Common Stock representing upon conversion 19.375% of our outstanding Class A Common Stock as of the date of issuance of the Class D Common Stock, on a fully-diluted basis taking into account the issuance of the shares of Class D Common Stock but excluding certain of our outstanding options, warrants and convertible securities and certain shares of Class B Common Stock to be purchased by us from Brantley Capital. The rights and preferences of the Class D Common Stock are set forth under Proposal III.

Registration Rights

In connection with the private placement, the parties will enter into a registration rights agreement, pursuant to which the holders of a majority of the shares of Class A Common Stock issuable upon either conversion of the Class D Common Stock or the exercise of the warrants will have the right to require us to register their shares of Class A Common Stock under the Securities Act. The agreement allows them one right to demand that we register their shares of Class A Common stock under the Securities Act on a registration statement filed with the SEC and unlimited rights to include (or piggy-back) the registration of their shares of Class A Common stock on certain registration statements that we may file with the SEC for other purposes.

The investors may not exercise their demand rights unless the securities to be registered have an anticipated net aggregate offering price of at least $10,000,000. The investors may not exercise their piggy-back registration rights unless the shares to be registered have an anticipated net aggregate offering price of at least $1,000,000. We will bear the cost of the registration, unless the registration request is withdrawn by the investors, in which case the investors requesting withdrawal shall bear the expenses.

Note and Warrants

We will issue to Phoenix on the closing date, for an aggregate purchase price of $3,350,000, (i) our senior unsecured subordinated promissory notes due 2011 in the original principal amount of $3,350,000 and (ii) warrants to purchase shares of our Class A Common Stock equal to 1.117% of our outstanding Class A Common Stock on the date of issuance of the Warrant Certificate, on a fully-diluted basis taking into account the issuance of the shares of Class D Common Stock described above but excluding certain of our outstanding options, warrants and convertible securities and certain shares of Class B Common Stock to be purchased by us from Brantley Capital.

Our senior unsecured subordinated promissory notes will bear interest at the combined rate of (i) 12% per annum payable in cash on a quarterly basis and (ii) 2% per annum payable in kind (meaning that the accrued interest will be capitalized as principal) on a quarterly basis, subject to our right to pay such amount in cash. The notes will be unsecured and subordinated to all of our other senior debt. Upon the occurrence and during the continuance of an event of default the interest rate on the cash portion of the interest shall increase from 12% per annum to 14% per annum, for a combined rate of default interest of 16% per annum. We may prepay outstanding principal (together with accrued interest) on the note subject to certain prepayment penalties and we are required to prepay outstanding principal (together with accrued interest) on the note upon certain specified circumstances.

The Warrant Certificate provide the holder with the right to purchase shares of our Class A Common Stock equal to 1.117% of our outstanding Class A Common Stock on the date of issuance of the Warrant Certificate, on a fully-diluted basis taking into account the issuance of the shares of Class D Common Stock described above but excluding certain of our outstanding options, warrants and convertible securities and certain shares of Class B Common Stock to be purchased by us from Brantley Capital. The warrants will be exercisable for five years from the date of issuance of the Warrant Certificate at $0.01 per share.

Closing the Private Placement

Subject to satisfaction of the conditions contained in the Private Placement Agreements, the closing of the transactions contemplated thereunder will take place on the third business day following the date our stockholders approve Proposals I, II, III, IV, V and VI, or at such other time as the parties may agree.

Representations and Warranties

The Private Placement Agreements contain a number of representations and warranties that the respective parties have made to each other. These representations and warranties relate to: (i) organization, power and authority; (ii) validity and binding effect of the agreements; (iii) financial statements; (iv) capitalization; (v) no material adverse change; (vi) conflicts; (vii) litigation; (viii) SEC filings; (ix) defaults; (x) compliance with law; (xi) intellectual property; (xii) taxes; (xiii) certain transactions; (xiv) environmental; (xv) title to properties; (xvi) insurance; (xvii) margin regulations; (xviii) subsidiaries; (xix) debt; (x) significant contracts; (xxi) ERISA; (xxii) registration rights; (xxiii) employees; and (xxiv) real property; (xxv) private offering status; (xxvi) fees and commissions; (xxvii) fairness opinion; (xxviii) special committee recommendations; (xxix) complete disclosure; (xxx) foreign assets control regulations, (xxxi) investment company status; and (xxxii) investment representations and warranties.

Stockholder Approval

The closing of the transactions contemplated under each of the Private Placement Agreements is subject to the approval of our stockholders of each of Proposals I, II, III, IV, V and VI at the Special Meeting.

Conditions to Closing

The obligations of Phoenix and Brantley IV to complete the private placement are subject to the satisfaction or waiver of many conditions in accordance with each of the Private Placement Agreements, including:

- receipt of approval from our stockholders of the amendments to our certificate of incorporation and parts of the private placement (Proposals I, II, III, IV, and V);
- the absence of any material adverse change in our business and operations, and the business and operations of the Rand and On Line businesses, since June 30, 2006;
- in the case of the Stock Purchase Agreement, the filing of our Second Amended and Restated Certificate of Incorporation with the Secretary of State of Delaware and its acceptance thereof and our reservation of a sufficient number of shares of Class A common Stock for issuance on conversion of the Class D Common Stock;

the conversion to Class A Common Stock by Brantley IV of the entire unpaid principal amount of, including accrued but unpaid interest on, our convertible subordinated promissory notes in the aggregate original principal amount of $1,250,000;

consummation, in the case of the Stock Purchase Agreement, of the transactions contemplated by the Note Purchase Agreement and, in the case of the Note Purchase Agreement, of the transactions contemplated by the Stock Purchase Agreement;

in the case of the Stock Purchase Agreement, consummation by each of Phoenix and Brantley IV of their respective obligations under the Stock Purchase Agreement;

consummation of the acquisitions of the Rand and On Line businesses;

the accuracy of our representations and warranties in the Private Placement Agreements as of the closing date taking into account in certain instances the inclusion of the Rand and On Line businesses as part of our business;

delivery of pro forma financial statements giving effect to the acquisitions of the Rand and On Line businesses, the consummation of the private placement, the conversion of the Brantley notes and the consummation of senior financing that are satisfactory to Phoenix and Brantley IV;

the performance and compliance with all of the covenants made, and obligations to be performed, by the other parties in the Private Placement Agreements prior to the closing;

the receipt of all requisite third-party consents;

consummation with one or more senior lenders for the provision of not less than $6,500,000 of senior secured financing and, in the case of the Note Purchase Agreement, execution of mutually acceptable intercreditor and subordination agreement(s) among Phoenix, our senior lender and certain of our existing debtholders; and

conversion of all shares of Class B Common Stock and Class C Common Stock by the holders thereof into shares of Class A Common Stock or our acquisition and retirement of all such shares, including our acquisition and retiring of the 1,722,983 shares of Class B Common Stock held by Brantley Capital.

Indemnification

The Private Placement Agreements both provide that we will indemnify Phoenix and Brantley IV and certain of their affiliates for all losses incurred by any of the indemnified parties for (i) any breach of our representations and warranties or (ii) any breach of our covenants, agreements and obligations, other than losses resulting from action on the part of the indemnified party caused by their gross negligence or willful misconduct.

Termination, Amendment and Waiver

Each of the Private Placement Agreements may be terminated at any time prior to the consummation of the transactions contemplated thereunder, whether before or after receipt of the approval of our stockholders, by mutual written consent of Phoenix, Brantley IV and us, as applicable.

In addition, each Private Placement Agreement may be terminated:

by any party thereto if a material breach by any other party of any representation, warranty or obligation contained in such Private Placement Agreement exists that may not be cured within 30 days after written notice of such breach;

by any party thereto if any condition to such party s obligations contained in such Private Placement Agreement has not been fulfilled or waived;

by any party thereto if the transactions contemplated by such Private Placement Agreement are illegal or otherwise prohibited by law;

by Phoenix or Brantley IV if the private placement has not been consummated prior to December 31, 2006; or

in the case of the Note Purchase Agreement, by Phoenix if it determines in its good faith discretion that, assuming consummation of the private placement and the acquisitions of the Rand and On Line businesses, we would not be creditworthy.

If permitted under applicable law, any of the parties to a Private Placement Agreement may waive any conditions for their own respective benefit and consummate the transactions contemplated thereby even though one or more of the conditions have not been met.

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Any purported amendment to the Private Placement Agreements shall be null and void unless it is in writing and signed by each of the respective parties to such agreement.

None of the rights and obligations of a party under the Private Placement Agreements may be assigned without the prior written consent of the other parties to such agreement, except that the investors may assign their rights to affiliates of such investors and we may assign our rights pursuant to a merger, recapitalization or other business combination transaction in which the surviving entity agrees in writing to assume our obligations under the Private Placement Agreements.

PROPOSAL VI

APPROVAL TO ISSUE SHARES OF OUR CLASS A COMMON STOCK AS PARTIAL CONSIDERATION IN THE RAND ACQUISITION

As described above, as part of our financing, on September 8, 2006 we entered into a stock purchase agreement with the stockholder of Rand, pursuant to which we will, subject to stockholder approval and satisfaction of the other closing conditions set forth therein, issue, as partial consideration for the purchase by us of the outstanding stock of Rand, such number of shares of our Class A Common Stock having a value of $600,000 based on the average closing price per share of our Class A Common Stock for the twenty day period prior to the closing of the acquisition of Rand. If we were to consummate the Rand acquisition as of our record date, October 20, 2006, we would be obligated to issue [2,400,000] shares of our Class A Common Stock (representing [2.1%] of our Class A Common Stock on an as converted basis) in connection with the Rand acquisition. Reference is hereby made to the summary of terms of this transaction appearing above, the summary of the Rand stock purchase agreement appearing below, and the Rand stock purchase agreement attached hereto as Annex C, the terms of which are incorporated herein by reference.

Appraisal or Dissenters Rights

No appraisal rights are available under the Delaware General Corporation Law for our stockholders in connection with the issuance of the shares of Class A Common Stock pursuant to the Rand stock purchase agreement.

Consequences If This Proposal and Other Proposals Are Not Approved

If Proposal VI is not approved by our stockholders at the Special Meeting, then we will not be able to consummate the Rand acquisition on the terms currently contemplated by the Rand stock purchase agreement and in all likelihood will not be able to complete the private placement. We could seek alternative terms for the Rand stock purchase agreement and alternative financing; however, there is no assurance that alternative terms can be obtained or that such financing will be available or, if available, on terms acceptable to us. If Proposal VI is not approved and we cannot complete the private placement, we will not consummate the purchase of shares of our Class B Common Stock from Brantley Capital. If the amendments to our certificate of incorporation set forth in Proposals I, II and III are not approved by our stockholders at the Special Meeting, then we will not be able to consummate the transactions contemplated by the Rand stock purchase agreement. In addition, we may not be able to engage in discussions relating to any future transactions involving our Common Stock until our certificate of incorporation is amended to increase the number of authorized shares of our Common Stock.

Required Vote

The affirmative vote of a majority of the total number of shares of Common Stock represented in person or by proxy at the Special Meeting and entitled to vote is needed to approve this proposal. As such, abstentions and broker non-votes will have the same effect as a vote AGAINST this proposal. If our stockholders approve the issuance of the shares of Class A Common Stock in connection with the Rand stock purchase agreement, as well as Proposals IV and V regarding the issuance of shares of Class D Common Stock and of warrants to purchase shares of Class A Common Stock in the private placement, subject to approval by the stockholders of Proposals I, II and III and the satisfaction of the other closing conditions contained therein, we will file our Second Amended and Restated

Certificate of Incorporation with the Secretary of State of Delaware and immediately consummate the private placement and the Rand acquisition.

Recommendation

After careful consideration, the board of directors has determined that the issuance of the shares of Class A Common Stock pursuant to the Rand stock purchase agreement that is the subject of Proposal VI is fair to and in the best interests of our stockholders. In addition, the board of directors has determined that the terms of the Rand stock purchase agreement, as a whole, are in the best interests of our stockholders and approved the execution of this document. Accordingly, the board of directors has approved and declared advisable Proposal VI relating to the issuance of shares of Class A Common Stock as partial consideration under the Rand stock purchase agreement.

THE BOARD OF DIRECTORS RECOMMENDS THAT ALL STOCKHOLDERS VOTE, OR INSTRUCT THEIR VOTES TO BE CAST, FOR APPROVAL OF PROPOSAL VI, APPROVING THE ISSUANCE OF SHARES OF CLASS A COMMON STOCK PURSUANT TO THE RAND STOCK PURCHASE AGREEMENT.

SUMMARY OF ACQUISITION DOCUMENTS

We have identified two acquisition opportunities to expand our medical billing services businesses. On September 8, 2006 we entered into a stock purchase agreement with Rand and its stockholder pursuant to which we will acquire all of the issued and outstanding capital stock of Rand. In addition, on September 8, 2006 we entered into a stock purchase agreement with On Line and their respective stockholders pursuant to which we have agreed to purchase all of the issued and outstanding capital stock of On Line. A copy of the stock purchase agreement with Rand is attached hereto as Annex C. A copy of the On Line stock purchase agreement is attached hereto as Annex L. The terms of these agreements are incorporated herein by reference.

The historical financial statements for each of these businesses are attached hereto as Annexes F, G and H, respectively. Additionally, pro forma financial information showing the effect of these acquisitions and the transactions contemplated by the Private Placement Agreements on us is attached hereto as Annex I, the terms of which are incorporated herein by reference.

Rand Acquisition

Rand Medical Billing, Inc. is a full service billing agency providing medical billing, exclusively for anatomic and clinical pathology practices located in Simi Valley, California.

On September 8, 2006 we entered into a stock purchase agreement with the stockholder of Rand to purchase all of the issued and outstanding capital stock of Rand for an aggregate purchase price of $9,365,333, subject to adjustments conditioned upon future revenue results.

The purchase price shall be paid as follows:

- at closing we will pay $6,800,000 in cash;
- at closing we will deliver an unsecured subordinated promissory note in the original principal amount of $1,365,333;
- at closing we will deliver $600,000 to the escrow agent for deposit in an interest bearing escrow account; and

at closing we will deliver to the escrow agent such number of shares of our Class A Common Stock having a value of $600,000 based on the average closing price per share of our Class A Common Stock for the twenty day period prior to the closing of the acquisition of Rand.

The purchase price shall be subject to adjustments conditioned upon future revenue results and claims, if any, for indemnification.

In the event that the gross revenue related to Rand for the period ending December 31, 2007 equals or exceeds the established 2007 minimum revenue target of $6,349,206 plus the amount of the aggregate losses (which arise

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under the indemnification obligations of the sellers) then we will release all the cash and shares held in escrow to the stockholder of Rand within 30 days of the final determination of the gross revenue for the period. If the gross revenue for the period is less than $6,349,206 then the release of the cash and shares held in escrow will be postponed.

If the release of the purchase price consideration held in escrow is postponed, then we will calculate the gross revenue for the period ending December 31, 2008. Based on this calculation:

If the 2008 gross revenue equals or exceeds the 2008 minimum revenue target amount of $9,600,000 then the cash and shares held in escrow shall be released to the Rand stockholder and we will proceed to pay the balance due on the promissory note in five equal monthly installments commencing March 1, 2009.

If the 2008 gross revenue is less than $9,600,000 but is equal or greater than $6,349,206 then the cash and shares held in escrow will be released to the Rand stockholder and payments under the promissory note will be adjusted downward based in part on the difference between the 2008 gross revenue and $6,349,206 divided by $3,250,794.

If the 2007 gross revenue was equal to or exceeded $6,349,206 but the 2008 gross revenue amount was less than $6,349,206, the promissory note will be cancelled and we will not owe the Rand stockholder any amounts under such note.

If the 2007 gross revenue was not equal to or greater than $6,349,206 and the release from escrow was otherwise postponed and the 2008 gross revenue is also less than $6,349,206, then the promissory note will be cancelled and the purchase price will be subject to a downward adjustment. The downward adjustment shall be calculated by multiplying $8,000,000 by the result of 2008 gross revenue divided by $6,349,206. Any purchase price shortfall will first be allocated out of the cash proceeds held in escrow and any remaining shortfall will cause the forfeiture of the shares. The shortfall will be capped at the amount held in escrow.

The stock purchase agreement with Rand contains customary representations and warranties and conditions to closing. In addition, the stockholder of Rand has agreed to a five-year non-compete and non-solicitation period. The indemnification provided by the Rand stockholder for breaches of representations is capped at the purchase price and we can not make claims until the aggregate amount of our losses exceeds $50,000.

The closing of the Rand acquisition is expected to occur shortly after the Special Meeting, subject to approval by our stockholders of Proposals I, II, III, IV, V and VI. No regulatory approval is required to consummate this acquisition.

On Line Acquisition

On Line consists of two related companies, OLA and OLP. OLA is an outsourcing company providing data entry, insurance filing, patient statements, payment posting, collection follow-up and patient refund processing to medical practices. Most of OLA s customers are hospital-based physician practices including radiology, neurology and emergency medicine. Customers also include some other specialties as plastic surgery, family practice, internal medicine and orthopaedics. All billing functions are the responsibility of OLA, and include credentialing and accounts payable processing. OLA also has a group of contract transcriptionists who work out of their homes and OLA offers these services to clients as well.

OLP provides payroll processing services to small businesses, a few of which are also customers of OLA. OLP provides payroll services including direct deposit, time clock interface and tax reporting to clients in Alabama, Florida, Georgia, Louisiana, Mississippi, Tennessee and Texas.

On September 8, 2006 we entered into a stock purchase agreement with the stockholders of OLA and OLP to purchase all of the issued and outstanding capital stock of both OLA and OLP for an aggregate purchase price of $3,310,924, subject to adjustments conditioned upon future revenue results. The purchase price is payable in a combination of cash and unsecured subordinated promissory notes. At the closing of the On Line acquisition, $2,476,943 of the purchase price will be paid in cash and the remainder in an unsecured subordinated promissory note. We have an option to pay up to $75,000 of the purchase price in the form of an additional unsecured promissory note in lieu of cash at the closing.

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Within 45 days following the end of the 12-month anniversary of the closing, we will deliver written notice to the former On Line stockholders detailing the revenue of the acquired businesses, determined on a cash basis in accordance with generally accepted accounting principles for such 12-month period. If the actual revenue exceeds $2,500,259 then the purchase price will be increased on a dollar-for-dollar basis by the lesser of (i) the amount of the excess or (ii) $500,052. If the actual revenue is less than $2,500,259 then the principal amount of the unsecured promissory note shall be reduced on a dollar-for-dollar basis. The downward adjustment of the purchase price will be capped at the value of the promissory note. In the event that we move the principal location of the business out of the greater Mobile, Alabama geographic region or the employment of William Suffich or Dorothy Matter is terminated by us without cause or by them for Good Reason, as defined in their respective employment agreements, there will be no downward adjustment in the purchase price.

The stock purchase agreement for the On Line acquisition contains customary representations and warranties and conditions to closing. The indemnification provided by the respective stockholders of OLA and OLP for breaches of representations and warranties is capped at $1,000,000 and we can not make claims until the aggregate amount of our losses exceeds $50,000.

The closing of the On Line acquisition is expected to occur shortly after the Special Meeting, subject to approval by our stockholders of Proposals I, II, III, IV, V and VI. No regulatory approval is required to consummate this acquisition.

PROPOSAL VII

APPROVAL OF THE AMENDMENT TO OUR 2004 INCENTIVE PLAN

On September 8, 2006, the board of directors voted to adopt an amendment to the our 2004 Incentive Plan to (i) to increase the number of shares of our Class A Common Stock available for grants under the 2004 Incentive Plan from 2,200,000 shares to such number of shares representing 10% of our outstanding Class A Common Stock as of the date of closing of the private placement, on a fully diluted basis taking into account the shares issued in the private placement and the Rand acquisition, and (ii) to increase the maximum number of shares that can be granted to a participant in any calendar year under the 2004 Incentive Plan from 1,000,000 shares to 3,000,000 shares. The board of directors unanimously (with the exception of Mr. Bauer who abstained) determined to recommend approval of the amendment by the stockholders. Section 711 of the AMEX Company Guide requires AMEX-listed companies to obtain stockholder approval with respect to certain amendments to option plans. Approval of this proposal is contingent upon approval of Proposals I, II, III, IV, V and VI and the filing of our Second Amended and Restated Certificate of Incorporation with the Secretary of State of Delaware.

Description of 2004 Incentive Plan

The following is a summary of the material features of the existing 2004 Incentive Plan and identifies, where applicable, the effect of these amendments. It may not contain all of the information important to you. We urge you to read the entire 2004 Incentive Plan, which was filed as Exhibit 10.19 to our Annual Report on Form 10-KSB for the year ending December 31, 2004 filed with the SEC on April 28, 2005. The 2004 Incentive Plan currently provides for issuance of up to 2,200,000 shares of Class A Common Stock, of which there are 476,000 shares left for issuance pursuant to future grants. If the amendment to the 2004 Incentive Plan is approved, this number will be increased to such number of shares representing 10% of our outstanding Class A Common Stock as of the date of closing of the private placement, on a fully diluted basis taking into account the shares issued in the private placement and the Rand acquisition. If this increase were to have been implemented on our record date, October 20, 2006, assuming that the private placement and the Rand acquisition had been consummated as of such date, this would have resulted in an increase of [9,052,840] shares for an aggregate total of [9,528,840] shares available for grants under the 2004

Incentive Plan.

Currently, there are no specific grants proposed to be made under the 2004 Incentive Plan.

The purpose of the 2004 Incentive Plan is to advance the interests of the Company and its affiliates by providing for the grant to participants of stock-based and other incentive awards, all as more fully described below.

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The amendment to the 2004 Incentive Plan will become effective on the date of its approval by the stockholders. The plan will terminate when there are no remaining shares available for awards unless terminated as to future grants earlier by the Administrator (as defined below). No incentive stock options (ISOs) may be granted under the 2004 Incentive Plan after September 7, 2014, although ISOs granted before such date may extend beyond that date. A maximum of 2,200,000 shares of Class A Common Stock may be delivered in satisfaction of awards made under the 2004 Incentive Plan (which will increase to 10% of our outstanding Class A Common Stock as of the date of closing of the private placement, on a fully diluted basis taking into account the shares issued in the private placement and the Rand acquisition if the amendment is approved). For purposes of the preceding sentence, shares that have been forfeited in accordance with the terms of the applicable award and shares held back in satisfaction of the exercise price or tax withholding requirements from shares that would otherwise have been delivered pursuant to an award shall not be considered to have been delivered under the 2004 Incentive Plan. Also, the number of shares delivered under an award shall be determined net of any previously acquired shares tendered by the participant in payment of the exercise price or of withholding taxes.

The maximum number of shares of Class A Common Stock for which stock options may be granted to any person in any calendar year and the maximum number of shares of Class A Common Stock subject to stock appreciation rights, or SARs , granted to any person in any calendar year is 1,000,000 shares. The maximum benefit that may be paid to any person under other awards in any calendar year is, to the extent paid in shares, 1,000,000 shares (which will increase to 3,000,000 if the amendment is approved), and, to the extent paid in cash, $1,000,000. However, stock options and SARs that are granted with an exercise price that is less than the fair market value of the underlying shares on the date of the grant will be subject to both of the limits imposed by the two preceding sentences. These limitations will be construed in a manner consistent with Section 162(m) of the Internal Revenue Code of 1984, as amended (the Internal Revenue Code).

In the event of a stock dividend, stock split or other change in our capital structure, the Administrator will make appropriate adjustments to the limits described above and will also make appropriate adjustments to the number and kind of shares of stock or securities subject to awards, any exercise prices relating to awards and any other provisions of awards affected by the change. The Administrator may also make similar adjustments to take into account other distributions to stockholders or any other event, if the Administrator determines that adjustments are appropriate to avoid distortion in the operation of the 2004 Incentive Plan and to preserve the value of awards.

Administration

The board of directors or a committee appointed by the board of directors administers the 2004 Incentive Plan. In the case of awards granted to persons who are or are reasonably expected to become our officers, such committee shall be comprised solely of two or more directors, all of whom are outside directors within the meaning of Section 162(m) of the Internal Revenue Code and non-employee directors within the meaning of Rule 16b-3 under the Exchange Act. The term Administrator is used in this Proxy Statement to refer to the person (the board of directors or committee, and their delegates) charged with administering the 2004 Incentive Plan. The Administrator has full authority to determine who will receive awards and to determine the types of awards to be granted as well as the amounts, terms, and conditions of any awards. Awards may be in the form of options, SARs, restricted or unrestricted stock or restricted stock units, Deferred Stock (hereafter defined) or performance awards. The Administrator has the right to determine any questions that may arise regarding the interpretation and application of the provisions of the 2004 Incentive Plan and to make, administer, and interpret such rules and regulations as it deems necessary or advisable. Determinations of the Administrator made under the 2004 Incentive Plan are conclusive and bind all parties.

Eligibility

Participation is limited to those key employees and directors, as well as consultants and advisors, who in the Administrator s opinion are in a position to make a significant contribution to our success and the success of our affiliates and who are selected by the Administrator to receive an award. The group of persons from which the Administrator will select participants currently consists of approximately 25 individuals.

Stock Options

The Administrator may from time to time award options to any participant subject to the limitations described above. Stock options give the holder the right to purchase shares of our Class A Common Stock within a specified period of time at a specified price. Two types of stock options may be granted under the 2004 Incentive Plan: ISOs , which are subject to special tax treatment as described below, and nonstatutory options (NSOs). Eligibility for ISOs is limited to our employees and employees of our subsidiaries.

The exercise price of an ISO cannot be less than the fair market value of the Class A Common Stock at the time of grant. In addition, the expiration date of an ISO cannot be more than ten years after the date of the original grant. In the case of NSOs, the exercise price and the expiration date are determined in the discretion of the Administrator. The Administrator also determines all other terms and conditions related to the exercise of an option, including the consideration to be paid, if any, for the grant of the option, the time at which options may be exercised and conditions related to the exercise of options. Unless the Administrator determines otherwise, and in all events in the case of any stock option intended to qualify as an ISO and any stock option or SAR (other than a Performance Award subject to Section 6(a)(7) of the 2004 Incentive Plan) intended to qualify as performance-based for purposes of Section 162(m) of the Internal Revenue Code, the exercise price of an award requiring exercise will not be less than the fair market value of the stock subject to the award determined as of the date of grant.

The closing price of our Class A Common Stock as reported on AMEX on our record date, October 20, 2006, was [$0.25] per share.

Stock Appreciation Rights

The Administrator may grant SARs under the 2004 Incentive Plan. An SAR entitles the holder upon exercise to receive an amount in cash or Class A Common Stock or a combination thereof (as determined by the Administrator) computed by reference to appreciation in the value of a share of Class A Common Stock.

Stock Awards; Deferred Stock

The 2004 Incentive Plan provides for awards of nontransferable shares of restricted Class A Common Stock, restricted stock units, which entitle the holder to receive such number of shares specified in the award or a cash payment for such shares equal to the fair market value on a specified date, as well as unrestricted shares of Class A Common Stock. Awards of restricted stock, restricted stock units and unrestricted stock may be made in exchange for past services or other lawful consideration. Generally, awards of restricted stock or restricted stock units are subject to the requirement that the shares be forfeited or resold to us unless specified conditions are met. Subject to these restrictions, conditions and forfeiture provisions, any recipient of an award of restricted stock will have all the rights of one of our stockholders, including the right to vote the shares and to receive dividends. Other awards under the 2004 Incentive Plan may also be settled with restricted stock. The 2004 Incentive Plan also provides for deferred grants (Deferred Stock) entitling the recipient to receive shares of Class A Common Stock in the future on such conditions as the Administrator may specify.

Performance Awards

The Administrator may also make awards subject to the satisfaction of specified performance criteria. Performance Awards may consist of Class A Common Stock or cash or a combination of the two. The performance criteria used in connection with a particular Performance Award will be determined by the Administrator. In the case of Performance Awards intended to qualify for exemption under Section 162(m) of the Internal Revenue Code, the Administrator will use objectively determinable measures of performance in accordance with Section 162(m) of the Internal Revenue

Code that are based on any or any combination of the following (determined either on a consolidated basis or, as the context permits, on a divisional, subsidiary, line of business, project or geographical basis or in combinations thereof): sales; revenues; assets; expenses; earnings before or after deduction for all or any portion of interest, taxes, depreciation, or amortization, whether or not on a continuing operations or an aggregate or per share basis; return on equity, investment, capital or assets (in each case before or after deduction for all or any portion of interest, taxes, depreciation or amortization, whether or not on a continuing operations or an aggregate or per share basis); one or more operating ratios; one or more financial coverage ratios; book value per share;

borrowing levels, leverage ratios (including, without limitation, debt as a percentage of capitalization) or credit rating; market share; capital expenditures; cash flow; stock price; stockholder return; sales of particular products or services; customer acquisition or retention; acquisitions and divestitures (in whole or in part); joint ventures and strategic alliances; spin-offs, split-ups and the like; reorganizations; or recapitalizations, restructurings, financings (issuance of debt or equity) or refinancings. The Administrator will determine whether the performance targets or goals that have been chosen for a particular Performance Award have been met.

General Provisions Applicable to All Awards

Neither ISOs nor, except as the Administrator otherwise expressly provides, other awards may be transferred other than by will or by the laws of descent and distribution. During a recipient s lifetime an ISO and, except as the Administrator may provide, other non-transferable awards requiring exercise may be exercised only by the recipient. Shares delivered under the 2004 Incentive Plan may consist of either authorized but unissued or treasury shares. The number of shares delivered upon exercise of a stock option is determined net of any shares transferred by the optionee to us (including through the holding back of shares that would otherwise have been deliverable upon exercise) in payment of the exercise price or tax withholding.

Mergers and Similar Transactions

In the event of a consolidation or merger in which we are not the surviving corporation or which results in the acquisition of substantially all of our stock by a person or entity or by a group of persons or entities acting together, or in the event of a sale of substantially all of our assets or our dissolution or liquidation, the following rules will apply except as otherwise provided in an Award:

> If there is no assumption or substitution of stock options, existing stock options will become fully exercisable prior to the completion of the transaction on a basis that gives the holder of the stock option a reasonable opportunity to exercise the stock option and participate in the transaction as a stockholder.
>
> Existing stock options, unless assumed or exercised, will terminate upon completion of the transaction.
>
> Awards of Deferred Stock will be accelerated by the Administrator so that the stock is delivered prior to the completion of the transaction on a basis that gives the holder of the award a reasonable opportunity following issuance of the stock to participate as a stockholder in the transaction.

If there is a surviving or acquiring entity, the Administrator may arrange to have that entity (or an affiliate) assume outstanding awards or grant substitute awards. In the case of shares of restricted stock, the Administrator may require that any amounts delivered, exchanged or otherwise paid in respect of those shares in connection with the transaction be placed in escrow or otherwise made subject to restrictions determined by the Administrator.

Amendment

The Administrator may at any time or times amend the 2004 Incentive Plan or any outstanding Award for any purpose which may at the time be permitted by law, and may at any time terminate the 2004 Incentive Plan as to any future grants of awards. The Administrator may not, however, alter the terms of an Award so as to affect adversely the participant s rights under the Award without the participant s consent, unless the Administrator expressly reserved the right to do so at the time of the Award.

New 2004 Incentive Plan Benefits

The future benefits or amounts that would be received under the 2004 Incentive Plan by executive officers, non-executive directors and non-executive officer employees are discretionary and are therefore not determinable at this time. In addition, the benefits or amounts which have been received by or allocated to the named executive officers and directors for the last completed fiscal year have been identified in this Proxy Statement in the section entitled Director and Executive Officer Compensation. In addition to those options reported in Director and Executive Officer Compensation for the last completed fiscal year, we granted options to purchase 10,000 shares at an exercise price of $0.47 per share on May 12, 2006 to each of David Crane and Joseph M. Valley, Jr., two of our directors.

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Equity Compensation Plan Information

The following table gives information about our Class A Common Stock that may be issued upon the exercise of options, warrants and rights under all of our existing equity compensation plans as of October 20, 2006.

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans approved by security holders	1,727,615	$ 0.54	612,385
Equity compensation plans not approved by security holders	884,732	$ 4.31	
Total	2,612,347	$ 1.82	612,385

Federal Tax Effects

The following discussion summarizes certain federal income tax consequences of the issuance and receipt of options under the 2004 Incentive Plan under the law as in effect on the date of this Proxy Statement. The summary does not purport to cover federal employment tax or other federal tax consequences that may be associated with the 2004 Incentive Plan, nor does it cover state, local or non-U.S. taxes.

ISOs

In general, an optionee realizes no taxable income upon the grant or exercise of an ISO. However, the exercise of an ISO may result in an alternative minimum tax liability to the optionee. With certain exceptions, a disposition of shares purchased under an ISO within two years from the date of grant or within one year after exercise produces ordinary income to the optionee (and a deduction to us) equal to the value of the shares at the time of exercise less the exercise price. Any additional gain recognized in the disposition is treated as a capital gain for which we are not entitled to a deduction. If the optionee does not dispose of the shares until after the expiration of these one-and two-year holding periods, any gain or loss recognized upon a subsequent sale is treated as a long-term capital gain or loss for which we are not entitled to a deduction.

NSOs

In general, in the case of an NSO with an exercise price that is equal to or greater than the fair market value of our Class A Common Stock on the date of grant, the optionee has no taxable income at the time of grant but realizes income in connection with exercise of the option in an amount equal to the excess (at the time of exercise) of the fair market value of the shares acquired upon exercise over the exercise price; a corresponding deduction is available to us; and upon a subsequent sale or exchange of the shares, any recognized gain or loss after the date of exercise is treated as capital gain or loss for which we are not entitled to a deduction. Differing and adverse tax consequences would result if the exercise price of an NSO is less than the fair market value of a share of Class A Common Stock on the date of grant. We do not currently intend to grant any NSOs with an exercise price that is less than the fair market value of our Class A Common Stock on the date of grant.

In general, an ISO that is exercised by the optionee more than three months after termination of employment is treated as an NSO. ISOs are also treated as NSOs to the extent they first become exercisable by an individual in any calendar year for shares having a fair market value (determined as of the date of grant) in excess of $100,000.

The Administrator may award stock options that are exercisable for restricted stock. Under Section 83 of the Internal Revenue Code, an optionee who exercises an NSO for restricted stock will generally have income only when the stock vests. The income will equal the fair market value of the stock at that time less the exercise price. However, the optionee may make a so-called 83 (b) election in connection with the exercise to recognize taxable income at that time. Assuming no other applicable limitations, the amount and timing of the deduction available to us will correspond to the income recognized by the optionee. The application of Section 83 of the Internal Revenue Code to ISOs exercisable for restricted stock is less clear.

Under the so-called golden parachute provisions of the Internal Revenue Code, the accelerated vesting of awards in connection with our change in control may be required to be valued and taken into account in determining whether participants have received compensatory payments, contingent on the change in control, in excess of certain limits. If these limits are exceeded, a substantial portion of amounts payable to the participant, including income recognized by reason of the grant, vesting or exercise of awards under the 2004 Incentive Plan, may be subject to an additional 20% federal tax and may be nondeductible to us.

Stockholder Approval of the Amendment to the 2004 Incentive Plan

The affirmative vote of the holders of a majority of the outstanding shares of our Common Stock properly cast in person or by proxy at the Special Meeting, voting together as a single class, is required to approve the amendment to the 2004 Incentive Plan.

THE BOARD OF DIRECTORS RECOMMENDS THAT ALL STOCKHOLDERS VOTE, OR INSTRUCT THEIR VOTES TO BE CAST, FOR THE AMENDMENT TO THE 2004 INCENTIVE PLAN.

UNAUDITED PRO FORMA FINANCIAL INFORMATION

Pro forma financial information for the year ended December 31, 2005 and the six month period ended June 30, 2006, which reflects our proposed acquisition of the Rand and On Line businesses and the closing of the transactions contemplated under the Private Placement Agreements is set forth in Annex I attached hereto, which includes the unaudited pro forma combined financial statements and related notes thereto. Our historical financial statements for the years ended December 31, 2004 and December 31, 2005 and for the six month period ended June 30, 2006 are attached as Annexes J and K, respectively.

MANAGEMENT S DISCUSSION AND ANALYSIS

The following Management s Discussion and Analysis of Financial Condition and Results of Operations highlights the principal factors that have affected our financial condition and results of operations as well as our liquidity and capital resources for the periods described. All significant intercompany balances and transactions have been eliminated in consolidation.

The discussion that follows should be read in conjunction with our financial statements attached hereto as Annexes J and K.

Overview

We are a healthcare services organization providing outsourced business services to physicians, serving the physician market through two subsidiaries, MBS and IPS. MBS provides billing, collection, accounts receivable management, coding and reimbursement services, reimbursement analysis, practice consulting, managed care contract management and accounting and bookkeeping services, primarily to hospital-based physicians such as pathologists, anesthesiologists and radiologists. MBS currently provides services to approximately 58 clients, representing 337 physicians. IPS serves the general and subspecialty pediatric physician market, providing accounting and bookkeeping, human resource management, accounts receivable management, quality assurance services, physician credentialing, fee schedule review, training and continuing education and billing and reimbursement analysis. IPS currently provides services to five pediatric groups in Illinois and Ohio, representing 37 physicians. We believe our core competency is our long-term experience and success in working with and creating value for physicians.

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Strategic Focus

In 2005, we initiated a strategic plan designed to accelerate our growth and enhance our future earnings potential. As part of this plan, we began to divest certain non-strategic assets and ceased investing in business lines that did not complement our plan, and redirected financial resources and company personnel to areas that management believes enhances long-term growth potential.

More specifically, we have taken the following actions since the first quarter of 2005:

In March 2005, we closed Bellaire SurgiCare, Inc. (Bellaire SurgiCare), one of our ASCs in Houston, Texas, because of declining case load volume and unsatisfactory financial performance and combined the operations of Bellaire SurgiCare with SurgiCare Memorial Village, L.P. (Memorial Village);

In June 2005, we sold IntegriMED, a wholly-owned subsidiary of IPS, to eClinicalWeb;

In August 2005, we closed the SurgiCare corporate headquarters in Houston, Texas and transitioned all corporate functions to our offices in Roswell, Georgia;

In October 2005, we sold our interests in Tuscarawas Ambulatory Surgery Center, LLC (TASC), TASC Anesthesia and Tuscarawas Open MRI, L.P. (TOM) in Dover, Ohio to Union Hospital (Union);

In January 2006, we sold substantially all of the assets of Memorial Village in Houston, Texas to First Surgical Memorial Village, L.P.;

In early 2006, we were notified by Union that it was exercising its option to terminate the management services agreements of TOM and TASC as of March 12, 2006 and April 3, 2006, respectively; and

In March 2006, we sold substantially all of the assets of San Jacinto Surgery Center, Ltd. (San Jacinto) in Baytown, Texas to San Jacinto Methodist Hospital (Methodist).

With the completion of these activities, we no longer have any ownership or management interests in ASCs.

Additionally, we believe that we are now positioned to focus on our physician services business and the physician billing and collections market, leveraging our existing presence to expand into additional geographic regions and increase the range of services we provide to physicians. Part of this strategy will include acquiring financially successful billing companies focused on providing services to hospital-based physicians and increasing sales and marketing efforts in existing markets.

Financial Overview

As more fully described below, our results of operations for the six months ended June 30, 2006 as compared to the same period in 2005 and the year ended December 31, 2005 as compared to the same period in 2004 reflect several important factors, many relating to the impact of transactions which occurred as part of our strategic plan referred to above.

Significant changes in revenues, resulting from increased patient volume and rate increases in IPS s operations and from inclusion of a full year of revenues for MBS in 2005 as compared to two weeks of revenue in 2004;

Inclusion of expenses in 2005 relating to the separation agreement for our former president, Professional and consulting fees incurred in connection with our merger with IPS (the IPS Merger) and the merger of MBS and Dennis Cain Physician Solutions, Ltd. (DCPS) (the DCPS/MBS Merger and, together with the IPS Merger, the 2004 Mergers) in December 2004 and significant 2005 transactions,

Inclusion of a full year of operating expenses for MBS in 2005 as compared to two weeks of operating expenses in 2004;

Significant charges for impairment of intangible assets and goodwill in 2005 as a result of the significant 2005 transactions.

Sale of substantially all of the assets of Memorial Village, which resulted in a gain on disposition of discontinued components of $574,321 recorded in the first quarter of 2006;

Sale of substantially all of the assets of San Jacinto, which resulted in a gain on disposition of discontinued components of $94,066 recorded in the first quarter of 2006; and

Payment of $112,500 in satisfaction of a $778,000 debt, which resulted in a gain on forgiveness of debt totaling $665,463 recorded in the first quarter of 2006.

Critical Accounting Policies and Estimates

The preparation of our financial statements is in conformity with accounting principles generally accepted in the United States, which require management to make estimates and assumptions that affect the amounts reported in the financial statements and footnotes. Our management bases these estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments that are not readily apparent from other sources. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Changes in the facts or circumstances underlying these estimates could result in material changes and actual results could differ from these estimates. We believe the following critical accounting policies affect the most significant areas involving management s judgments and estimates. In addition, please refer to Note 1. General of our unaudited consolidated condensed financial statements for the six months ended June 30, 2006 and 2005 and Note 1, Organization and Accounting Policies, of our consolidated financial statements for the year ended December 31, 2005 and 2004 included in Annex J of this Proxy Statement for further discussion of our accounting policies.

Consolidation of Physician Practice Management Companies. In March 1998, the Emerging Issues Task Force (EITF) of the Financial Accounting Standards Board (FASB) issued its Consensus on Issue 97-2 (EITF 97-2). EITF 97-2 addresses the ability of physician practice management (PPM) companies to consolidate the results of medical groups with which it has an existing contractual relationship. Specifically, EITF 97-2 provides guidance for consolidation where PPM companies can establish a controlling financial interest in a physician practice through contractual management arrangements. A controlling financial interest exists, if, for a requisite period of time, the PPM has control over the physician practice and has a financial interest that meets six specific requirements. The six requirements for a controlling financial interest include:

(a) the contractual arrangement between the PPM and physician practice (1) has a term that is either the entire remaining legal life of the physician practice or a period of 10 years or more, and (2) is not terminable by the physician practice except in the case of gross negligence, fraud, or other illegal acts by the PPM or bankruptcy of the PPM;

(b) the PPM has exclusive authority over all decision making related to (1) ongoing, major, or central operations of the physician practice, except the dispensing of medical services, and (2) total practice compensation of the licensed medical professionals as well as the ability to establish and implement guidelines for the selection, hiring, and firing of them;

(c) the PPM must have a significant financial interest in the physician practice that (1) is unilaterally salable or transferable by the PPM and (2) provides the PPM with the right to receive income, both as ongoing fees and as proceeds from the sale of its interest in the physician practice, in an amount that fluctuates based upon the performance of the operations of the physician practice and the change in fair value thereof.

IPS is a PPM company. IPS s management services agreements (MSA or, collectively, MSAs) governing the contractual relationship with its affiliated medical groups are for forty year terms; are not terminable by the physician practice other than for bankruptcy or fraud; provide IPS with decision making authority other than related to the practice of medicine; provide for employment and non-compete agreements with the physicians governing compensation; provide IPS the right to assign, transfer or sell its interest in the physician practice and assign the rights of the MSAs; provide IPS with the right to receive a management fee based on results of operations and the right to the proceeds from a sale of the practice to an outside party or, at the end of the MSA term, to the physician group. Based on this analysis, IPS has determined that its contracts meet the criteria of EITF 97-2 for consolidating the results of operations of the affiliated medical groups and has adopted EITF 97-2 in its statement of operations. EITF 97-2 also has addressed the accounting method for future combinations with individual physician practices. IPS believes that, based on the criteria set forth in EITF 97-2, any future acquisitions of individual physician practices would be accounted for under the purchase method of accounting.

Revenue Recognition. MBS s principal source of revenues is fees charged to clients based on a percentage of net collections of the client s accounts receivable. MBS recognizes revenue and bills its clients when the clients receive payment on those accounts receivable. MBS typically receives payment from the client within 30 days of billing. The fees vary depending on specialty, size of practice, payer mix, and complexity of the billing. In addition to the collection fee revenue, MBS also earns fees from the various consulting services that MBS provides, including medical practice management services, managed care contracting, coding and reimbursement services.

IPS records revenue based on patient services provided by its affiliated medical groups. Net patient service revenue is impacted by billing rates, changes in current procedural terminology code reimbursement and collection trends. IPS reviews billing rates at each of its affiliated medical groups on at least an annual basis and adjusts those rates based on each insurer s current reimbursement practices. Amounts collected by IPS for treatment by its affiliated medical groups of patients covered by Medicare, Medicaid and other contractual reimbursement programs, which may be based on cost of services provided or predetermined rates, are generally less than the established billing rates of IPS s affiliated medical groups. IPS estimates the amount of these contractual allowances and records a reserve against accounts receivable based on historical collection percentages for each of the affiliated medical groups, which include various payer categories. When payments are received, the contractual adjustment is written off against the established reserve for contractual allowances. The historical collection percentages are adjusted quarterly based on actual payments received, with any differences charged against net revenue for the quarter. Additionally, IPS tracks cash collection percentages for each medical group on a monthly basis, setting quarterly and annual goals for cash collections, bad debt write-offs and aging of accounts receivable. For the twelve months ended December 31, 2005 and 2004, IPS s net fee-for-service revenue, less bad debt expense, totaled $17,207,226 and $14,875,133, respectively. Cash collections related to dates of service in 2005 and 2004 totaled $17,025,718 and $15,143,913, respectively. The variance between cash collections and net fee-for-service revenue for the twelve months ended December 31, 2005 was $181,508, or 1.1% of net fee-for-service revenue. For the year ended December 31, 2004, the variance between cash collections and net fee-for-service revenue was $268,780, or 1.8% of net fee-for-service revenue. IPS is not aware of any material claims, disputes or unsettled matters with third party payers and there have been no material settlements with third party payers for the six months ended June 30, 2006 and 2005 or the twelve months ended December 31, 2005 and 2004.

Accounts Receivable and Allowance for Doubtful Accounts. MBS records uncollectible accounts receivable using the direct write-off method of accounting for bad debts. Historically, MBS has experienced minimal credit losses and has not written-off any material accounts for the six months ended June 30, 2006 and 2005 or the twelve months ended December 31, 2005 or 2004.

IPS s affiliated medical groups grant credit without collateral to its patients, most of which are insured under third-party payer arrangements. The provision for bad debts that relates to patient service revenues is based on an evaluation of potentially uncollectible accounts. The provision for bad debts includes a reserve for 100% of the accounts receivable older than 180 days. Establishing an allowance for bad debt is subjective in nature. IPS uses historical collection percentages to determine the estimated allowance for bad debts, and adjusts the percentage on a quarterly basis.

The following table summarizes IPS s aging of accounts receivable, by major payer classification, as of December 31, 2005 and 2004, respectively:

	December 31, 2005				
	0-30	**31-60**	**61-90**	**90+**	**Total**
Commercial, HMO/PPO	$ 1,101,815	$ 398,426	$ 196,531	$ 156,116	$ 1,852,888
Medicaid	177,722	120,316	88,698	39,338	426,074
Medicaid Pending	62,121	92,482	60,072	23,904	238,579
Other	219,895	136,683	36,311	123,239	516,128
Self Pay	277,107	114,847	93,829	362,344	848,127
Total	$ 1,838,660	$ 862,754	$ 475,441	$ 704,941	$ 3,881,796

	December 31, 2004				
	0-30	**31-60**	**61-90**	**90+**	**Total**
Commercial, HMO/PPO	$ 1,068,012	$ 321,465	$ 122,486	$ 178,954	$ 1,690,917
Medicaid	211,992	161,333	60,791	126,504	560,620
Medicaid Pending	101,291	40,644	4,188	460	146,583
Other	39,462	20,894	15,538	34,049	109,943
Self Pay	130,917	117,962	124,083	419,249	792,211
Total	$ 1,551,674	$ 662,298	$ 327,086	$ 759,216	$ 3,300,274

The following schedule provides a reconciliation of IPS s aging of accounts receivable to the Company s consolidated accounts receivable as of December 31, 2005 and 2004, respectively:

	December 31,	
	2005	**2004**
IPS gross accounts receivable	$ 3,881,795	$ 3,300,274
Non-trade accounts receivable	300,272	308,738
MBS accounts receivable, net	856,823	737,129
SurgiCare accounts receivable, net	167,349	1,538,458(1)
Accounts receivable related to discontinued operations		652,973(1)
Contractual allowance and bad debt reserve	(2,407,935)	(2,068,332)
Consolidated net accounts receivable	$ 2,798,304	$ 4,469,240

(1) Relates to operations discontinued in 2005. See the *Discontinued Operations* section below.

IPS s affiliated medical groups follow a written policy regarding the write-off of accounts receivable older than 90 days. The billing department of each affiliated medical group complies with government and third party payer regulations regarding the collection of balance due amounts. Accounts receivable eligible for adjustment are reviewed monthly by the practice administrators, with accounts considered for assignment to a collection agency the latter of 180 days after the date of patient liability has been determined or as soon as the internal collection effort has been exhausted. All collection attempts and contacts are documented in the patient s account record for future reference. Once maximum collection efforts are exhausted, both internally and through external collection agencies, adjustments and write-offs are reviewed in the following manner:

Accounts showing a balance less than $9.99 may be written off at the discretion of the billing staff;

Accounts showing a balance greater than $10.00 but less than $500.00 will be evaluated by the billing staff, practice administrator and Director of Operations; and

Accounts showing a balance of greater than $500.00 will be evaluated by the billing staff, practice administrator, Director of Operations and managing affiliated physician partners.

IPS s days sales outstanding totaled 53.9 and 53.7, respectively, for the twelve months ended December 31, 2005 and 2004.

Investment in Limited Partnerships. At December 31, 2005, we owned a 10% general partnership interest in San Jacinto. The investment is accounted for using the equity method. Under the equity method, the investment is initially recorded at cost and is subsequently increased to reflect our share of the income of the investee and reduced to reflect the share of the losses of the investee or distributions from the investee. Effective March 1, 2006, we sold our interest in San Jacinto. (See Results of Operations Discontinued Operations .)

The general partnership interest was accounted for as an investment in limited partnership due to the interpretation of SFAS 94/Accounting Research Bulletin (ARB) 51 and the interpretations of such by Issue 96-16 and Statement of Position SOP 78-9. Under those interpretations, we could not consolidate our interest in an entity in which it held a minority general partnership interest due to management restrictions, shared operating decision-making, and capital expenditure and debt approval by limited partners and the general form versus substance analysis.

Goodwill and Other Intangible Assets. Goodwill and intangible assets represent the excess of cost over the fair value of net assets of companies acquired in business combinations accounted for using the purchase method. In July 2001, the FASB issued SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 eliminates pooling-of-interest accounting and requires that all business combinations initiated after June 30, 2001, be accounted for using the purchase method. SFAS No. 142 eliminates the amortization of goodwill and certain other intangible assets and requires us to evaluate goodwill for impairment on an annual basis by applying a fair value test. SFAS No. 142 also requires that an identifiable intangible asset that is determined to have an indefinite useful economic life not be amortized, but separately tested for impairment using a fair value-based approach at least annually. We evaluate our goodwill and other intangible assets in the fourth quarter of each fiscal year, unless circumstances require testing at other times. (See Results of Operations Charge for Impairment of Intangible Assets for additional discussion regarding the impairment testing of identifiable intangible assets.)

Recent Accounting Pronouncements

In November 2004, the EITF reached a consensus in applying the conditions in Paragraph 42 of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (EITF 03-13). Evaluation of whether operations and cash flows have been eliminated depends on whether (1) continuing operations and cash flows are expected to be generated, and (2) the cash flows, based on their nature and significance are considered direct or indirect. This consensus should be applied to a component that is either disposed of or classified as held-for-sale in fiscal periods beginning after December 15, 2004. The adoption of EITF 03-13 did not have a material impact on our consolidated financial position, results of operations or cash flows.

In December 2004, the FASB published SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123(R)). SFAS 123(R) requires that the compensation cost relating to share-based payment transactions, including grants of employee stock options, be recognized in the financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. SFAS 123(R) covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. SFAS 123(R) is a replacement of SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes Auditing Practices Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and its related interpretive guidance (APB 25).

The effect of SFAS 123(R) will be to require entities to measure the cost of employee services received in exchange for stock options based on the grant-date fair value of the award, and to recognize the cost over the period the employee is required to provide services for the award. SFAS 123(R) permits entities to use any option-pricing model that meets the fair value objective in SFAS 123(R). We were required to begin to apply SFAS 123(R) for the quarter ending March 31, 2006.

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SFAS 123(R) allows two methods for determining the effects of the transition: the modified prospective transition method and the modified retrospective method of transition. We have adopted the modified prospective transition method beginning in 2006.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48), which provides criteria for the recognition, measurement, presentation and disclosure of uncertain tax positions. A tax benefit from an uncertain position may be recognized only if it is more likely than not that the position is sustainable based on its technical merits. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. We do not expect FIN 48 will have a material effect on our consolidated financial condition or results of operations.

Results of Operations

The IPS Merger was treated as a reverse acquisition, meaning that the purchase price, comprised of the fair value of the outstanding shares of the Company prior to the transaction, plus applicable transaction costs, were allocated to the fair value of our tangible and intangible assets and liabilities prior to the transaction, with any excess being considered goodwill. IPS was treated as the continuing reporting entity, and, thus, IPS s historical results became those of the combined company. Our results for the six months ended June 30, 2006 and 2005 include the results of IPS, MBS and our ambulatory surgery and diagnostic center business. Our results for fiscal 2005 include the results of IPS, MBS (which includes DCPS) and our ambulatory surgery and diagnostic center business for the twelve months ended December 31, 2005. Our results for fiscal 2004 include the results of IPS for the twelve months ended December 31, 2004 and the results of MBS (which includes DCPS) and our ambulatory surgery and diagnostic center business commencing on December 15, 2004. The descriptions of the business and results of operations of MBS set forth in this report include the business and results of operations of DCPS. This discussion should be read in conjunction with our unaudited consolidated condensed financial statements for the six months ended June 30, 2006 and 2005 and consolidated financial statements for the years ended December 31, 2005 and 2004 and related notes thereto, which are included as Annex J of this Proxy Statement.

Pursuant to paragraph 43 of SFAS 144, which states that, in a period in which a component of an entity either has been disposed of or is classified as held for sale, the income statement of a business enterprise for current and prior periods shall report the results of operations of the component, including any gain or loss recognized, in discontinued operations. As such, our financial results for the six months ended June 30, 2005 and the twelve months ended December 31, 2004 have been reclassified to reflect the operations, including our surgery and diagnostic center businesses, which were discontinued in 2005.

Six Months Ended June 30, 2006 as Compared to Six Months Ended June 30, 2005

The following table sets forth, for the periods indicated, the consolidated statements of operations of the Company.

	For the Six Months Ended June 30, 2006 (Unaudited)	For the Six Months Ended June 30, 2005 (Unaudited)
Net operating revenues	$ 14,085,728	$ 15,281,113
Operating expenses		
Salaries and benefits	5,535,247	6,205,856
Physician group distribution	4,023,346	4,603,758
Facility rent and related costs	792,276	858,099
Depreciation and amortization	818,828	1,727,201
Professional and consulting fees	707,112	931,640
Insurance	339,360	441,272
Provision for doubtful accounts	299,146	636,835
Other expenses	2,272,944	2,550,096
Charge for impairment of intangible assets and goodwill		6,362,849
Total operating expenses	14,788,259	24,317,606
Loss from continuing operations before other income (expenses)	(702,531)	(9,036,493)
Other income (expenses)		
Interest expense	(234,144)	(150,391)
Gain on forgiveness of debt	665,463	
Other expense, net	(14,151)	(18,977)
Total other income (expenses), net	417,168	(169,368)
Minority interest earnings in partnership		(1,660)
Loss from continuing operations	(285,363)	(9,207,521)
Discontinued operations Income (loss) from operations of discontinued components	576,390	(820,897)
Net income (loss)	$ 291,027	$ (10,028,418)

Net Operating Revenues. Our net operating revenues consist of patient service revenue, net of contractual adjustments, related to the operations of IPS s affiliated medical groups, billing services revenue related to MBS and other revenue. For the six months ended June 30, 2006, consolidated net operating revenues decreased $1,195,385, or 7.8%, to $14,085,728, as compared to consolidated net operating revenues of $15,281,113 for the six months ended June 30, 2005.

MBS s net operating revenues totaled $4,756,052 for the six months ended June 30, 2006 as compared to net operating revenues totaling $5,193,532 for the same period in 2005, a decrease of $437,478, or 8.4%. The decrease in net operating revenues for MBS was primarily the result of the loss of two customers in August 2005, one of which retired from medical practice and one group which decided to bring their billing in-house, which accounted for approximately $486,000 in net operating revenues in the first six months of 2005. This decrease was partially offset in the first half of 2006 by the addition of three new customers accounting for approximately $258,525 in net operating revenues in the first six months of 2006.

IPS s net patient service revenue decreased $757,906, or 7.5%, from $10,087,581 for the six months ended June 30, 2005 to $9,329,675 for the six months ended June 30, 2006. The decrease in net patient service revenue for IPS s affiliated medical groups was primarily the result of decreases in patient volume as a consequence of a diminished cold and flu season in the first six months of 2006 as compared with the same period in 2005. All of IPS s four clinic-based affiliated pediatric groups experienced decreases in patient volume in the first six months of 2006, with total procedures and office visits for all clinic-based facilities decreasing 13,422 and 9,016, respectively, to 191,124 and 79,894 for the six months ended June 30, 2006.

Other revenue, which represents revenue from our vaccine program, a group purchasing alliance for vaccines and medical supplies, totaled $41,589 for the first six months of 2005, increasing $139,048, or 334.3%, to $180,637 for the six months ended June 30, 2006. The vaccine program, which had a total of 428 enrolled participants at December 31, 2005, added approximately 62 members during the first six months of 2006.

Operating Expenses

Salaries and Benefits. Consolidated salaries and benefits decreased $670,609 to $5,535,247 for the six months ended June 30, 2006, as compared to $6,205,856 for the same period in 2005.

MBS s salaries and benefits totaled $2,922,367 for the six months ended June 30, 2006 as compared to $3,100,956 for the six months ended June 30, 2005, a decrease of $178,588. This decrease is primarily the result of a reduction in health benefit costs related to the consolidation of MBS s benefit plans with the IPS benefit plans at the beginning of 2006, thereby allowing greater negotiating leverage with benefit providers.

Clinical salaries & benefits include wages for the nurse practitioners, nursing staff and medical assistants employed by the affiliated medical groups and fluctuate indirectly to increases and decreases in productivity and patient volume. Clinical salaries, bonuses, overtime and health insurance collectively totaled $865,670 for the first six months of 2006, an increase of $9,334 over the same period in 2005. There was one additional medical assistant on the payroll of one of IPS s affiliated medical groups in the first six months of 2006 as compared to the staffing levels for the first six months of 2005. These expenses represented approximately 9.5% and 8.5% of net operating revenues for the six months ended June 30, 2006 and 2005, respectively. The increase, as a % of net operating revenues, is related to the fixed nature of salaries and benefits needed to maintain minimum staffing levels.

In August 2005, we consolidated our corporate operations into the Roswell, Georgia office. Prior to the staff reductions resulting from this corporate consolidation, salaries and benefits related to corporate staff in Houston, Texas totaled $565,026 for the six months ended June 30, 2005.

Administrative salaries and benefits, excluding MBS and the former staff of our Houston, Texas office, represent the employee-related costs of all non-clinical practice personnel at IPS s affiliated medical groups as well as our corporate staff in Roswell, Georgia. These expenses increased $67,129, or 4.2%, from $1,605,306 for the six months ended June 30, 2005 to $1,672,435 for the same period in 2006. The additional expense can be attributed primarily to the adoption of SFAS 123(R) in the first quarter of 2006, which resulted in stock option compensation expense totaling approximately $98,000 for the first six months of 2006.

Physician Group Distribution. Physician group distribution decreased $580,412, or 12.6%, for the six months ended June 30, 2006 to $4,023,346, as compared with $4,603,758 for the six months ended June 30, 2005. Pursuant to the terms of the MSAs governing each of IPS s affiliated medical groups, the physicians of each medical group receive disbursements after the payment of all clinic facility expenses as well as a management fee to IPS. The management fee revenue and expense, which is eliminated in the consolidation of our financial statements, is either a fixed fee or is calculated based on a percentage of net operating income. For the six months ended June 30, 2006, management fee revenue totaled $660,513 and represented approximately 14.1% of net operating income as compared to management fee revenue totaling $751,853 and representing approximately 14.0% of net operating income for the same period in 2005. Physician group distribution represented 43.1% of net operating revenues in the first six months of 2006, compared to 45.6% of net operating revenues for the six months ended June 30, 2005. The decrease in physician group distribution for the six months ended June 30, 2006 was directly related to the decrease in net patient service revenue, which was primarily the result of decreased patient volume during the first half of 2006.

Facility Rent and Related Costs. Facility rent and related costs decreased $65,824, or 7.7%, from $858,099 for the six months ended June 30, 2005 to $792,276 for the six months ended June 30, 2006.

MBS s facility rent and related costs totaled $256,895 for the six months ended June 30, 2006 as compared to $242,777 for the same period in 2005. This increase can be explained generally by increases in utilities and off-site storage costs for the first half of 2006.

Facility rent and related costs associated with IPS s affiliated medical groups and our corporate office totaled $507,103 for the six months ended June 30, 2006 compared to $539,406 for the same period in 2005. Rent expense related to our corporate office in Roswell, Georgia decreased for the first half of 2006 due to approximately $54,000 in rent payments received for the sublease between eClinicalWeb and us as a result of the IntegriMED Agreement in June 2005.

In August 2005, we consolidated our corporate operations into the Roswell, Georgia office. Prior to this consolidation, facility-related costs such as utilities and personal property taxes associated with our former office in Houston, Texas totaled approximately $48,000 for the six months ended June 30, 2005.

Depreciation and Amortization. Consolidated depreciation and amortization expense totaled $818,828 for the six months ended June 30, 2006, a decrease of $908,373 from the six months ended June 30, 2005.

For the six months ended June 30, 2006, depreciation expense related to the fixed assets of MBS totaled $34,836 as compared to $41,836 for the same period in 2005. Deprecation expense related to the fixed assets of IPS and us totaled $80,523 and $58,816 for the six months ended June 30, 2006 and 2005, respectively. Depreciation expense associated with fixed assets related to our former Houston, Texas office, which was closed in August 2005, totaled $22,768 for the six months ended June 30, 2005.

As part of the DCPS/MBS Merger, we purchased MBS and DCPS for a combination of cash, notes and stock. Since the consideration for this purchase transaction exceeded the fair value of the net assets of MBS and DCPS at the time of the purchase, a portion of the purchase price was allocated to intangible assets. The amortization expense related to the intangible assets recorded as a result of the DCPS/MBS Merger totaled $531,046 for the six months ended June 30, 2006 and 2005, respectively.

Amortization expense related to the MSAs for IPS s affiliated medical groups totaled $172,422 and $209,341 for the six months ended June 30, 2006 and 2005, respectively. The decrease is directly related to the Sutter Settlement and the CARDC Settlement.

As part of the IPS Merger, the purchase price, comprised of the fair value of the outstanding shares of the Company prior to the transaction, plus applicable transaction costs, was allocated to the fair value of our tangible and intangible assets and liabilities prior to the transaction, with any excess being considered goodwill. Amortization expense for the intangible assets recorded as a result of the IPS Merger totaled $863,394 for the six months ended June 30, 2005. As a result of the dispositions related to our surgery and diagnostic center business, which was discontinued in 2005, and the uncertainty of future cash flows related to our surgery center business, we impaired substantially all of the intangible assets related to the IPS Merger in 2005. Therefore, there was no amortization expense related to the intangible assets in the first half of 2006. (See Discontinued Operations for additional discussion regarding the disposition of intangible assets and goodwill recorded as a result of the IPS Merger.)

Professional and Consulting Fees. For the six months ended June 30, 2006, professional and consulting fees totaled $707,112, a decrease of $224,528, or 24.1%, from the same period in 2005.

For the first six months of 2006, MBS recorded professional and consulting expenses totaling $88,476 as compared with $142,261 for the first six months of 2005, a decrease of $53,786. This change is primarily the result of a decrease in contract labor used in the first half of 2005 as a result of staffing shortages. This contract labor was not utilized in the first six months of 2006 because MBS s position inventory is fully staffed.

IPS s and our professional and consulting fees, which include the costs of corporate accounting, financial reporting and compliance, and legal fees, decreased from $653,835 for the six months ended June 30, 2005 to $618,636 for the six months ended June 30, 2006. The decrease is primarily the result of reduced legal fees and expenses related to the divestiture of our surgery and diagnostic business in 2005.

Insurance. Consolidated insurance expense, which includes the costs of professional liability for affiliated physicians, property and casualty and general liability insurance and directors and officers liability insurance, decreased from $441,272 for the six months ended June 30, 2005 to $339,360 for the six months ended June 30, 2006. Insurance expense related to the directors and officers liability policies in the first half of 2005 included approximately $75,000 of premiums for run-off policies related to SurgiCare and IPS. The run-off policies were expensed fully in 2005.

Provision for Doubtful Accounts. Our consolidated provision for doubtful accounts, or bad debt expense, decreased $337,689, or 53.0%, for the six months ended June 30, 2006 to $299,146. The entire provision for doubtful accounts for the six months ended June 30, 2006 related to IPS s affiliated medical groups and accounted for 3.2% of IPS s net operating revenues as compared to 6.3% of IPS s net operating revenues for the same period in 2005. The total collection rate, after contractual allowances, for IPS s affiliated medical groups was 70.6% for the six months ended June 30, 2006, compared to 63.8% for the same period in 2005.

Other Expenses. Consolidated other expenses totaled $2,272,944 for the six months ended June 30, 2006, a decrease of $277,151 from the same period in 2005. Other expenses include general and administrative expenses such as office supplies, telephone & data communications, printing & postage, transfer agent fees, and board of directors compensation and meeting expenses, as well as some direct clinical expenses, which are expenses that are directly related to the practice of medicine by the physicians that practice at the affiliated medical groups managed by IPS.

MBS s other expenses totaled $556,621 for the six months ended June 30, 2006 as compared to $662,957 for the six months ended June 30, 2005. Of the total decrease, approximately $90,000 and $19,000 related to decreases in office supplies and postage and courier expenses, respectively, in the first six months of 2006 as compared to the same period in 2005. These expense fluctuations are the direct result of the decrease in net operating revenues in the first half of 2006. Additionally, MBS renegotiated its long distance rates in the fall of 2005, which resulted in approximately $39,000 in cost savings in the first six months of 2006 as compared to the same period in 2005.

For the six months ended June 30, 2006, IPS s direct clinical expenses, other than salaries and benefits, totaled $1,146,920, an increase of $34,792 over direct clinical expenses in the first half of 2005, which totaled $1,112,128. Vaccine expenses accounted for approximately $43,000 of the total increase in direct clinical expenses in the first six months of 2006. IPS s affiliated medical groups began using two new vaccines in late 2005 Menactra and Decavac which replaced lower-priced vaccines previously utilized by the medical groups.

Our and IPS s general and administrative expenses totaled $334,778 for the six months ended June 30, 2006, a decrease of $200,472 from the same period in 2005. Of the total decrease, approximately $198,000 relates to cost efficiencies and expense reductions as a result of the consolidation of corporate functions into our Roswell, Georgia office in August 2005.

Charge for Impairment of Intangible Assets. On June 13, 2005, we announced that we had accepted an offer to purchase our interests in TASC and TOM. In preparation for this pending transaction, we tested the identifiable intangible assets and goodwill related to the surgery center business using the present value of cash flows method. Based on the pending sales transaction involving TASC and TOM, as well as the uncertainty of future cash flows related to our surgery center business, we recorded a charge for impairment of intangible assets of $6,362,849 for the six months ended June 30, 2005.

Other Income and Expenses.

Interest Expense. Consolidated interest expense totaled $234,144 for the six months ended June 30, 2006, an increase of $83,752 from the same period in 2005. Interest expense activity in the first half of 2006, including increases from the first six months of 2005, can be explained generally by the following:

> *Brantley Debt.* In March and April 2005, we borrowed an aggregate of $1,250,000 from Brantley Partners IV, L.P. (Brantley IV). (See Liquidity and Capital Resources.) Interest expense related to these notes totaled approximately $57,000 for the six months ended June 30, 2006.
>
> *MBS Notes.* On April 19, 2006, we executed subordinated promissory notes with the former equity owners of MBS and DCPS for an aggregate of $714,336. This represented the retroactive purchase price increase due to the former equity owners of MBS and DCPS based on the financial results of the newly formed MBS, as

required by the merger agreement governing the DCPS/MBS Merger. The notes bear interest at the rate of 8% per annum, payable monthly beginning on April 30, 2006, and will mature on December 15, 2007. Interest expense related to these notes totaled approximately $11,429 for the six months ended June 30, 2006.

Line of Credit. As part of the restructuring transactions, we also entered into a new secured two-year revolving credit facility pursuant to the Loan and Security Agreement (the Loan and Security Agreement), dated December 15, 2004, by and among us, certain of our affiliates and subsidiaries, and CIT Healthcare, LLC (formerly known as Healthcare Business Credit Corporation)(CIT) borrowing $1.6 million under this facility concurrently with the Closing. (See Liquidity and Capital Resources for additional discussion regarding the Loan and Security Agreement.) Interest expense related to this line of credit totaled $114,807 for the six months ended June 30, 2006, compared to $97,825 for the six months ended June 30, 2005. The increase in interest expense on the line of credit facility was a direct result of interest rate increases for the first six months of 2006 as compared to the same period in 2005. In December 2005, we received notification from CIT stating that certain events of default under the Loan and Security Agreement had occurred as a result of us being out of compliance with two financial covenants. As a result of the events of default, CIT raised the interest rate for monies borrowed under the Loan and Security Agreement to a default rate of prime rate plus 6% as compared to the stated interest rate of prime rate plus 3% as of the Closing. (See Liquidity and Capital Resources for additional discussion regarding our defaults under the Loan and Security Agreement.) The loan balance for this facility was $998,668 and $1,681,450 at June 30, 2006 and 2005, respectively. Additionally, the average prime rate for the first half of 2006 was 7.67% as compared to 5.67% for the same six-month period in 2005.

Gain on Forgiveness of Debt. On August 25, 2003, our lender, DVI, announced that it was seeking protection under Chapter 11 of the United States Bankruptcy laws. Both IPS and SurgiCare had loans outstanding to DVI in the form of term loans and revolving lines of credit. As part of the IPS Merger, we negotiated a discount on the term loans and a buy-out of the revolving lines of credit. As part of that agreement, we executed a new loan agreement with U.S. Bank Portfolio Services, as Servicer for payees, for payment of the revolving lines of credit and renegotiation of the term loans. In the first quarter of 2006, we negotiated an 85% discount on the revolving line of credit, which had a balance of $778,000 at December 31, 2005. As of March 13, 2006, we had made aggregate payments in the amount of $112,500 in satisfaction of the $778,000 debt, and recognized a gain on forgiveness of debt totaling $665,463 for the six months ended June 30, 2006.

Discontinued Operations.

Bellaire SurgiCare. As of the Closing, our management expected the case volumes at Bellaire SurgiCare to improve in 2005. However, by the end of February 2005, it was determined that the expected case volume increases were not going to be realized. On March 1, 2005, we closed Bellaire SurgiCare and consolidated its operations with the operations of Memorial Village. We tested the identifiable intangible assets and goodwill related to the surgery center business using the present value of cash flows method. As a result of the decision to close Bellaire SurgiCare and the resulting impairment of the joint venture interest and management contracts related to the surgery centers, we recorded a charge for impairment of intangible assets of $4,090,555 for the year ended December 31, 2004. We also recorded a loss on disposal of this discontinued component (in addition to the charge for impairment of intangible assets) of $163,049 for the quarter ended March 31, 2005. There were no operations for this component after March 31, 2005.

The following table contains selected financial statement data related to Bellaire SurgiCare as of and for the six months ended June 30, 2005:

	June 30, 2005
Income statement data:	
Net operating revenues	$ 161,679
Operating expenses	350,097
Net loss	$ (188,418)

Balance sheet data:	
Current assets	$
Other assets	
Total assets	$
Current liabilities	$
Other liabilities	
Total liabilities	$

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Capital Allergy and Respiratory Disease Center (CARDC). On April 1, 2005, IPS entered into a Mutual Release and Settlement Agreement (the CARDC Settlement) with Dr. Bradley E. Chipps, M.D. and CARDC to settle disputes as to the existence and enforceability of certain contractual obligations. As part of the CARDC Settlement, Dr. Chipps, CARDC, and IPS agreed that CARDC would purchase the assets owned by IPS and used in connection with CARDC, in exchange for termination of the MSA between IPS and CARDC. Additionally, among other provisions, after April 1, 2005, Dr. Chipps, CARDC and IPS have been released from any further obligation to each other arising from any previous agreement. As a result of the CARDC dispute, we recorded a charge for impairment of intangible assets related to CARDC of $704,927 for the year ended December 31, 2004. We also recorded a gain on disposal of this discontinued component (in addition to the charge for impairment of intangible assets) of $506,625 for the quarter ended March 31, 2005. For the quarter ended June 30, 2005, we reduced the gain on disposal of this discontinued component by $238,333 as the result of post-settlement adjustments related to the reconciliation of balance sheet accounts. There were no operations for this component in our financial statements after March 31, 2005.

The following table contains selected financial statement data related to CARDC as of and for the six months ended June 30, 2005:

		June 30, 2005
Income statement data:		
Net operating revenues	$	848,373
Operating expenses		809,673
Net loss	$	38,700
Balance sheet data:		
Current assets	$	
Other assets		
Total assets	$	
Current liabilities	$	
Other liabilities		
Total liabilities	$	

IntegriMED. On June 7, 2005, InPhySys, Inc. (formerly known as IntegriMED, Inc.) (IntegriMED), a wholly owned subsidiary of IPS, executed an Asset Purchase Agreement (the IntegriMED Agreement) with eClinicalWeb, LLC (eClinicalWeb) to sell substantially all of the assets of IntegriMED. As a result of this transaction, we recorded a loss on disposal of this discontinued component of $47,101 for the quarter ended June 30, 2005. The operations of this component are reflected in our consolidated condensed statements of operations as loss from operations of discontinued components for the six months ended June 30, 2005. There were no operations for this component in our financial statements after June 30, 2005.

The following table contains selected financial statement data related to IntegriMED as of and for the six months ended June 30, 2005:

		June 30, 2005
Income statement data:		
Net operating revenues	$	191,771
Operating expenses		899,667
Net loss	$	(707,896)
Balance sheet data:		
Current assets	$	(24,496)
Other assets		
Total assets	$	(24,496)
Current liabilities	$	17,022
Other liabilities		
Total liabilities		17,022

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TASC and TOM. On June 13, 2005, we announced that it had accepted an offer to purchase our interests in TASC and TOM in Dover, Ohio. On September 30, 2005, we executed purchase agreements to sell our 51% ownership interest in TASC and our 41% ownership interest in TOM to Union. Additionally, as part of the transactions, TASC, as the sole member of TASC Anesthesia, executed an Asset Purchase Agreement to sell certain assets of TASC Anesthesia to Union. The limited partners of TASC and TOM also sold a certain number of their units to Union such that at the closing of these transactions, Union owned 70% of the ownership interests in TASC and TOM. We no longer have an ownership interest in TASC, TOM or TASC Anesthesia. As a result of these transactions, as well as the uncertainty of future cash flows related to our surgery center business, we recorded a charge for impairment of intangible assets of $6,362,849 for the three months ended June 30, 2005. Also as a result of these transactions, we recorded a gain on disposal of this discontinued component (in addition to the charge for impairment of intangible assets) of $1,357,712 for the quarter ended December 31, 2005. We allocated the goodwill recorded as part of the IPS Merger to each of the surgery center reporting units and recorded a loss on the write-down of goodwill related to TASC and TOM totaling $789,173 for the quarter ended December 31, 2005, which reduced the gain on disposal. The operations of this component are reflected in our consolidated condensed statements of operations as loss from operations of discontinued components for the six months ended June 30, 2005. There were no operations for this component in our financial statements after September 30, 2005.

The following table contains selected financial statement data related to TASC and TOM as of and for the six months ended June 30, 2005:

	June 30, 2005
Income statement data:	
Net operating revenues	$ 1,670,801
Operating expenses	1,630,806
Net income (loss)	$ 39,995
Balance sheet data:	
Current assets	$ 794,831
Other assets	1,487,732
Total assets	$ 2,282,563
Current liabilities	$ 709,779
Other liabilities	907,390
Total liabilities	$ 1,617,169

Sutter. On October 31, 2005, IPS executed the Sutter Settlement with Dr. Sutter to settle disputes that had arisen between IPS and Dr. Sutter and to avoid the risk and expense of litigation. As part of the Sutter Settlement, Dr. Sutter and IPS agreed that Dr. Sutter would purchase the assets owned by IPS and used in connection with Dr. Sutter s practice, in exchange for termination of the related MSA. Additionally, among other provisions, after October 31, 2005, Dr. Sutter and IPS have been released from any further obligation to each other arising from any previous agreement. As a result of this transaction, we recorded a loss on disposal of this discontinued component (in addition to the charge for impairment of intangible assets) of $279 for the quarter ended December 31, 2005. The operations of this component are reflected in our consolidated condensed statements of operations as loss from operations of discontinued components for the six months ended June 30, 2005. There were no operations for this component in our financial statements after October 31, 2005.

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The following table contains selected financial statement data related to Sutter as of and for the six months ended June 30, 2005:

		June 30, 2005
Income statement data:		
Net operating revenues	$	216,319
Operating expenses		210,609
Net income	$	5,710
Balance sheet data:		
Current assets	$	113,819
Other assets		15,033
Total assets	$	128,852
Current liabilities	$	7,839
Other liabilities		
Total liabilities	$	7,839

Memorial Village. In November 2005, we decided that, as a result of ongoing losses at Memorial Village, it would need to either find a buyer for our equity interests in Memorial Village or close the facility. In preparation for this pending transaction, we tested the identifiable intangible assets and goodwill related to the surgery center business using the present value of cash flows method. As a result of the decision to sell or close Memorial Village, as well as the uncertainty of cash flows related to our surgery center business, we recorded a charge for impairment of intangible assets of $3,461,351 for the three months ended September 30, 2005. On February 8, 2006, Memorial Village executed an Asset Purchase Agreement (the Memorial Agreement) for the sale of substantially all of its assets to First Surgical. Memorial Village was approximately 49% owned by Town & Country SurgiCare, Inc., a wholly owned subsidiary of the Company. The Memorial Agreement was deemed to be effective as of January 31, 2006. As a result of this transaction, we recorded a gain on the disposal of this discontinued component (in addition to the charge for impairment of intangible assets) of $574,321 for the quarter ended March 31, 2006. We allocated the goodwill recorded as part of the IPS Merger to each of the surgery center reporting units and recorded a loss on the write-down of goodwill related to Memorial Village totaling $2,005,383 for the quarter ended December 31, 2005. The operations of this component are reflected in our consolidated statements of operations as loss from operations of discontinued components for the six months ended June 30, 2006 and 2005, respectively. There were no operations for this component in our financial statements after March 31, 2006.

The following table contains selected financial statement data related to Memorial Village as of and for the six months ended June 30, 2006 and 2005, respectively:

		June 30, 2006		June 30, 2005
Income statement data:				
Net operating revenues	$	17,249	$	1,268,852

Operating expenses		170,285		1,511,624
Net loss	$	(153,036)	$	(242,772)
Balance sheet data:				
Current assets	$		$	861,111
Other assets				767,497
Total assets	$		$	1,628,608
Current liabilities	$		$	729,567
Other liabilities				725,884
Total liabilities	$		$	1,455,451

San Jacinto. On March 1, 2006, San Jacinto executed an Asset Purchase Agreement for the sale of substantially all of its assets to Methodist. San Jacinto was approximately 10% owned by Baytown SurgiCare, Inc., our wholly owned subsidiary, and is not consolidated in our financial statements. As a result of this transaction, we recorded a gain on disposal of this discontinued operation of $94,066 for the quarter ended March 31, 2006. We

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allocated the goodwill recorded as part of the IPS Merger to each of the surgery center reporting units and recorded a loss on the write-down of goodwill related to San Jacinto totaling $694,499 for the quarter ended December 31, 2005. There were no operations for this component in our financial statements after March 31, 2006.

Orion. Prior to the divestiture of our ambulatory surgery center business, we recorded management fee revenue, which was eliminated in the consolidation of our financial statements, for Bellaire SurgiCare, TASC and TOM and Memorial Village. The management fee revenue for San Jacinto was not eliminated in consolidation. The management fee revenue associated with the discontinued operations in the surgery center business totaled $61,039 for the six months ended June 30, 2006. For the six months ended June 30, 2005, we generated management fee revenue of $218,407 and net minority interest losses totaling $42,765.

The following table summarizes the components of income (loss) from operations of discontinued components:

	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Bellaire SurgiCare		
Net loss	$	(188,418)
Loss on disposal		(163,049)
CARDC		
Net income		38,700
Gain on disposal		268,292
IntegriMED		
Net loss		(707,896)
Loss on disposal		(47,101)
TASC and TOM		
Net loss		39,995
Sutter		
Net income		5,710
Memorial Village		
Net loss	(153,036)	(242,772)
Gain on disposal	574,321	
San Jacinto		
Gain on disposal	94,066	
Orion		
Net income	61,039	175,642
Total income (loss) from operations of discontinued components, including net gain (loss) on disposal	$ 576,390	$ (820,897)

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Year Ended December 31, 2005 as Compared to Year Ended December 31, 2004

The following table sets forth, for the periods indicated, our consolidated statements of operations.

	For the Years Ended December 31, 2005	2004
Net operating revenues	$ 29,564,885	$ 17,582,937
Operating expenses		
Salaries and benefits	12,663,369	5,055,249
Physician group distribution	8,314,975	6,939,081
Facility rent and related costs	1,707,579	1,116,949
Depreciation and amortization	2,818,042	651,731
Professional and consulting fees	1,910,555	703,707
Insurance	898,495	534,650
Provision for doubtful accounts	1,176,405	1,065,137
Other expenses	5,024,169	3,115,015
Charge for impairment of intangible assets and goodwill	11,026,470	4,795,482
Total operating expenses	45,540,059	23,977,001
Loss from continuing operations before other income (expenses)	(15,975,174)	(6,394,064)
Other income (expenses)		
Interest expense	(342,678)	(969,047)
Gain on forgiveness of debt		2,427,938
Other expense, net	(24,066)	(21,978)
Total other income (expenses), net	(366,744)	1,436,913
Minority interest loss in partnership	(6,124)	
Loss from continuing operations	(16,348,042)	(4,957,152)
Discontinued operations		
Loss from operations of discontinued components, including net loss on disposal of $2,073,480 for the year ended December 31, 2005	(4,091,459)	(1,217,944)
Net loss	(20,439,501)	(6,175,095)
Preferred stock dividends		(606,100)
Net loss attributable to common stockholders	$ (20,439,501)	$ (6,781,195)

Net Operating Revenues. Our net operating revenues consist of patient service revenue, net of contractual adjustments, related to the operations of IPS s affiliated medical groups, billing services revenue related to MBS and other revenue. For the twelve months ended December 31, 2005, consolidated net operating revenue increased $11,981,948, or 68.1%, to $29,564,885, as compared with $17,582,937 for the twelve months ended December 31,

2004. Our results for fiscal 2005 include the results of IPS, MBS and our ambulatory surgery and diagnostic center business for the twelve months ended December 31, 2005. Our results for fiscal 2004 include the results of IPS for the twelve months ended December 31, 2004 and the results of MBS and our ambulatory surgery and diagnostic center business for the two weeks beginning December 15, 2004.

MBS s net operating revenues totaled $9,979,232 for the twelve months ended December 31, 2005. In 2004, MBS s net operating revenues, which totaled $426,359, represented operations beginning on December 15, 2004 after the DCPS/MBS Merger.

IPS s net patient service revenue increased $2,261,614, or 13.4%, from $16,928,348 for the year ended December 31, 2004 to $19,189,962 for the year ended December 31, 2005. The increase in net patient service revenue for IPS s affiliated medical groups was primarily the result of the following:

Increases in patient volume and productivity. Three of IPS s four clinic-based affiliated pediatric groups experienced increases in patient volume in 2005, with total procedures and office visits for all clinic-based facilities increasing 24,423 and 6,619, respectively, to 415,622 and 168,257 for the twelve months ended December 31, 2005. One medical group added two full-time equivalent (FTE) providers in July 2004 that have been considerably more productive than the physicians they replaced. Additionally, the increased usage of electronic medical records software in 2005 has improved overall productivity in another affiliated medical group, primarily in the area of patient scheduling. These productivity increases contributed to an average increase of 255 procedures per provider in 2005, as compared to the same period in 2004.

Rate increases. In addition to increases in production, several of the clinic-based affiliated medical groups increased their rates in 2005 for core procedure and visit current procedural terminology codes. These rate increases were the result of an analysis of the medical groups 2004 rates as compared to the reimbursement rates of key insurers that showed that, in many cases, the insurer s reimbursement rates were higher than the medical groups core charges.

Increases in other sources of patient revenue. In July 2005, physicians at one of IPS s affiliated medical groups began to provide services on a rotating basis to a clinic started by a local hospital for a flat fee of $14,000 per month.

Other revenue totaled $228,230 in 2004, increasing $167,460, or 73.4%, to $395,690 for the year ended December 31, 2005. For the twelve months ended December 31, 2005, revenue from our vaccine program, which is a group purchasing alliance for vaccines and medical supplies, totaled $319,799, an increase of $91,569 over 2004. The vaccine program, which had a total of 222 enrolled participants at the end of 2004, added approximately 204 members during the year ended December 31, 2005. Additionally, revenue related to a small number of former IntegriMED customers not fully transitioned to eClinicalWeb at the time of the IntegriMED Agreement totaled approximately $58,000 for the year ended December 31, 2005. This revenue is not expected to be recurring revenue and the final customer was transitioned from the Company in November 2005.

Operating Expenses.

Salaries and Benefits. Consolidated salaries and benefits increased $7,608,119 to $12,663,369 for the year ended December 31, 2005, as compared to $5,055,249 in 2004. MBS s salaries and benefits totaled $6,243,209 for the twelve months ended December 31, 2005. In 2004, MBS s salaries and benefits, which totaled $262,230, represented wages beginning on December 15, 2004 after the DCPS/MBS Merger.

In August 2005, we consolidated our corporate operations into the Roswell, Georgia office. Prior to the staff reductions resulting from this corporate consolidation, salaries and benefits related to corporate staff in Houston, Texas totaled $864,010 in 2005. In 2004, salaries and benefits for the Houston, Texas corporate employees totaled $45,865, which represented wages beginning on December 15, 2004 after the IPS Merger. Severance, retention costs and accrued vacation related to the corporate staff reductions at our Houston, Texas office totaled $143,250 for the year ended December 31, 2005. Additionally, effective November 8, 2005, Keith G. LeBlanc resigned his position as president and director of the Company to pursue other interests. Mr. LeBlanc will remain as a consultant to the Company for a period of twelve months. The Company and Mr. LeBlanc executed a Separation Agreement and General Release (the Separation Agreement) governing Mr. LeBlanc s separation benefits and consulting agreement. The Separation Agreement is incorporated by reference to Exhibit 10.8 of our Form 10-QSB for the quarter ended September 30, 2005, which was filed on November 14, 2005. Salaries and benefits expense in 2005 included an accrual of $484,520 for separation benefits related to the Separation Agreement.

Clinical salaries & benefits include wages for the nurse practitioners, nursing staff and medical assistants employed by the affiliated medical groups and are directly related to increases and decreases in productivity and patient volume. Clinical salaries, bonuses, overtime and health insurance collectively totaled $1,728,764 in 2005, an increase of $126,374 over the same period in 2004. These expenses represented approximately 9.0% and 9.5% of net operating revenue for the twelve months ended December 31, 2005 and 2004, respectively.

Administrative salaries and benefits, excluding MBS and the former staff of our Houston, Texas office, represent the employee-related costs of all non-clinical practice personnel at IPS s affiliated medical groups as well as our corporate staff in Roswell, Georgia. These expenses increased $127,033, or 5.1%, from $2,476,378 for the year ended December 31, 2004 to $2,603,411 for the same period in 2005. The additional salaries expense can be attributed primarily to: (i) the addition of one billing FTE and the promotion of several employees to supervisor at two of IPS s affiliated medical groups as the result of billing office reorganizations, which accounted for approximately $57,000 of the increase; and (ii) combined salary increases totaling approximately $62,000 for our Chief Executive Officer and Chief Financial Officer as a result of the IPS Merger on December 15, 2004.

Physician Group Distribution. Physician group distribution increased $1,375,894, or 19.8%, for the year ended December 31, 2005 to $8,314,975, as compared with $6,939,081 for the year ended December 31, 2004. Pursuant to the terms of the MSAs governing each of IPS s affiliated medical groups, the physicians of each medical group receive disbursements after the payment of all clinic facility expenses as well as a management fee to IPS. The management fee revenue and expense, which is eliminated in the consolidation of our financial statements, is either a fixed fee or is calculated based on a percentage of net operating income. For the twelve months ended December 31, 2005, management fee revenue totaled $1,450,784 and represented approximately 14.9% of net operating income as compared to management fee revenue totaling $1,246,470 and representing approximately 13.8% of net operating income in 2004. Physician group distributions represented 42.5% of net operating revenues in 2005, compared to 40.4% of net operating revenues for the same period in 2004. The increase in physician group distributions in 2005 was directly related to the increase in net patient service revenue, which was primarily the result of increased patient volume during the year.

Facility Rent and Related Costs. Facility rent and related costs increased 52.9% from $1,116,949 for the year ended December 31, 2004 to $1,707,579 for the year ended December 31, 2005. MBS s facility rent and related costs totaled $502,917 for the twelve months ended December 31, 2005. In 2004, MBS s rent expenses totaled $9,291, which represented expenses beginning on December 15, 2004 after the DCPS/MBS Merger. Facility rent and related costs associated with our former Houston, Texas office totaled $625,453 in 2005 as compared to $11,940 for the period beginning on December 15, 2004 after the IPS Merger.

Facility rent and related costs associated with IPS s affiliated medical groups and our corporate office totaled $1,082,126 for the year ended December 31, 2005 compared to $1,105,009 for the same period in 2004. One of IPS s affiliated medical groups refurbished its existing office space at two locations at a cost of approximately $36,000. Rent expense related to our corporate office in Roswell, Georgia decreased in 2005 due to approximately $63,000 in rent payments received for the sublease between eClinicalWeb and the Company as a result of the IntegriMED Agreement in June 2005.

Depreciation and Amortization. Consolidated depreciation and amortization expense totaled $2,818,042 for the year ended December 31, 2005, an increase of $2,166,312 over the year ended December 31, 2004.

For the twelve months ended December 31, 2005, depreciation expense related to the fixed assets of MBS totaled $86,081. In 2004, MBS s depreciation expenses totaled $1,692, which represented the expense beginning on December 15, 2004 after the DCPS/MBS Merger. Depreciation expense associated fixed assets related to our former Houston, Texas office totaled $46,454 in 2005 as compared to $20,764 for the period beginning on December 15, 2004 after the IPS Merger. Depreciation expense related to the fixed assets of IPS and us totaled $118,620 and $132,716 for the years ended December 31, 2005 and 2004, respectively.

Amortization expense related to the MSAs for IPS s affiliated medical groups totaled $386,125 and $358,116 for the years ended December 31, 2005 and 2004, respectively.

As part of the IPS Merger, the purchase price, comprised of the fair value of the outstanding shares of the Company prior to the transaction, plus applicable transaction costs, was allocated to the fair value of our tangible and intangible assets and liabilities prior to the transaction, with any excess being considered goodwill. The amortization expense related to the intangible assets recorded as a result of the IPS Merger totaled $1,118,670 and $94,089 for the years ended December 31, 2005 and 2004, respectively. (See Charge for Impairment of Intangible Assets and Discontinued Operations for additional discussion regarding the disposition of intangible assets and goodwill recorded as a result of the IPS Merger.)

As part of the DCPS/MBS Merger, we purchased MBS and DCPS for a combination of cash, notes and stock. Since the consideration for this purchase transaction exceeded the fair value of the net assets of MBS and DCPS at the time of the purchase, a portion of the purchase price was allocated to intangible assets. The amortization expense related to the intangible assets recorded as a result of the DCPS/MBS Merger totaled $1,062,093 and $44,254 for the years ended December 31, 2005 and 2004, respectively.

Professional and Consulting Fees. For the year ended December 31, 2005, professional and consulting fees totaled $1,910,555, an increase of $1,206,848, or 171.5%, over the same period in 2004. For the twelve months ended December 31, 2005, MBS recorded professional and consulting expenses totaling $275,176. In 2004, MBS s professional and consulting fees totaled $22,020 for the period beginning on December 15, 2004 after the DCPS/MBS Merger.

IPS s and our professional and consulting fees, which include the costs of corporate accounting, financial reporting and compliance, increased from $681,687 for the year ended December 31, 2004 to $1,635,379 for the year ended December 31, 2005. The increase is primarily the result of (i) approximately $345,000 in additional accounting and audit fees as a result of the expanded reporting requirements resulting from the IPS Merger and DCPS/MBS Merger (collectively, the 2004 Mergers); (ii) approximately $355,000 in additional legal fees resulting from the 2004 Mergers, including a $90,000 charge to legal fees recorded in the third quarter of 2005 related to a litigation settlement; (iii) approximately $91,000 in professional fees for investor relations and corporate communications; (iv) approximately $57,000 in costs associated with the small number of former IntegriMED customers not fully transitioned to eClinicalWeb at the time of the IntegriMED Agreement; and (v) approximately $20,000 in consulting fees incurred during the year related to accounting software upgrades in the corporate office.

Insurance. Consolidated insurance expense, which includes the costs of professional liability insurance for affiliated physicians, property and casualty and general liability insurance and directors and officers liability insurance, increased from $534,650 for the year ended December 31, 2004 to $898,495 for the year ended December 31, 2005. For the twelve months ended December 31, 2005, MBS s insurance expenses totaled $13,637. In 2004, MBS recorded insurance expense totaling $136 for the period beginning on December 15, 2004 after the DCPS/MBS Merger.

IPS s and our insurance expenses totaled $900,768 for the twelve months ended December 31, 2005, an increase of $366,255 over the same period in 2004. Directors and officers liability insurance increased approximately $240,000 from 2004 to 2005, and relates solely to the increase in premiums as a result of the 2004 Mergers. General liability insurance, which includes property & casualty insurance for the affiliated medical groups and the corporate office in Roswell, Georgia, increased from $20,050 for the year ended December 31, 2004 to $92,381 for the twelve months ended December 31, 2005. The expense for 2005 included insurance premiums totaling $86,379 related to our former office in Houston, Texas, while the 2004 expense only included $1,601 for the period beginning December 15, 2004 after the IPS Merger. Professional liability insurance for the affiliated medical groups increased $28,674 from $457,360 for the twelve months ended December 31, 2004 to $486,034 for the same period in 2005. This increase is primarily due to a combination of two factors at one of the affiliated medical groups: (i) the addition of a FTE provider in 2005 coupled with (ii) an approximately $2,500 per provider annual rate increase over 2004 premiums.

Provision for Doubtful Accounts. Our consolidated provision for doubtful accounts, or bad debt expense, increased $111,268, or 10.4%, for the year ended December 31, 2005 to $1,176,405. IPS s provision for doubtful accounts for the twelve months ended December 31, 2005 totaled $1,154,464 and accounted for 5.9% of net operating revenues as compared to 6.2% of net operating revenues for the same period in 2004. The total collection rate, after contractual allowances, for IPS s affiliated medical groups was 68.6% for the year ended December 31, 2005, compared to 67.1% for the same period in 2004.

Other Expenses. Consolidated other expenses totaled $5,024,169 for the year ended December 31, 2005, an increase of $1,909,154 over the same period in 2004. Other expenses include general and administrative expenses such as office supplies, telephone & data communications, printing & postage, transfer agent fees, and board of directors compensation and meeting expenses, as well as some direct clinical expenses, which are expenses that are directly related to the practice of medicine by the physicians that practice at the affiliated medical groups managed by IPS. MBS s other expenses totaled $1,240,494 for the twelve months ended December 31, 2005, and included approximately $641,000 in postage and courier fees, approximately $391,000 for office supplies & telephone expenses, and approximately $51,000 in travel expenses related to new business marketing. In 2004, MBS s other expenses totaled $118,783 for the period beginning on December 15, 2004 after the DCPS/MBS Merger.

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For the year ended December 31, 2005, IPS s direct clinical expenses, other than salaries and benefits, totaled $2,349,706, an increase of $377,721, or 19.2%, over 2004 direct clinical expenses, which totaled $1,971,985. Vaccine expenses accounted for $358,408 of the total increase in direct clinical expenses in 2005, increasing from $1,565,833 in 2004 to $1,924,241 in 2005, largely as a result of the increase in patient volume at IPS s affiliated medical groups during the year. Vaccine expenses represented approximately 10.0% of net operating revenue for the twelve months ended December 31, 2005 compared to approximately 9.2% of net operating revenue for the same period in 2004. Additionally, IPS s affiliated medical groups began using two new vaccines in 2005 Menactra and Decavac which replaced lower-priced vaccines previously utilized by the medical groups.

Our and IPS s general and administrative expenses totaled $1,192,545 for the twelve months ended December 31, 2005, an increase of $215,012 over 2004 totals. Of the total increase, approximately $109,000 and $16,000 relate to our board of directors fees and travel expenses and transfer agent fees, respectively, both of which were new costs for us in 2005. Additional printing costs associated with our SEC filings totaled approximately $65,000 for the twelve months ended December 31, 2005. Travel expenses related primarily to employee travel between Roswell, Georgia and Houston, Texas as part of the process of the consolidation of corporate functions totaled approximately $94,000 in 2005.

Charge for Impairment of Intangible Assets. For the twelve months ended December 31, 2005, we recorded a total charge for impairment of intangible assets of $11,026,470 as compared to $4,795,482 for the year ended December 31, 2004. As part of the IPS Merger, the purchase price, comprised of the fair value of the outstanding shares of the Company prior to the transaction, plus applicable transaction costs, was allocated to the fair value of our tangible and intangible assets and liabilities prior to the transaction, with any excess being considered goodwill.

As of the Closing, our management expected the case volumes at Bellaire SurgiCare to improve in 2005. However, by the end of February 2005, it was determined that the expected case volume increases were not going to be realized. On March 1, 2005, we closed Bellaire SurgiCare and consolidated its operations with the operations of Memorial Village. As a result of the decision to close Bellaire SurgiCare and the resulting impairment of the joint venture interest and management contracts related to the surgery centers, we recorded a charge for impairment of intangible assets of $4,090,555 for the year ended December 31, 2004.

As a result of the CARDC Settlement, we recorded a charge for impairment of intangible assets related to CARDC of $704,927 for the year ended December 31, 2004.

On June 13, 2005, we announced that we had accepted an offer to purchase our interests in TASC and TOM in Dover, Ohio. Based on the pending sales transaction involving TASC and TOM, as well as the uncertainty of future cash flows related to our surgery center business, we determined that the joint venture interests associated with TASC, TOM and Memorial Village were impaired and recorded a charge for impairment of intangible assets of $6,362,849 for the quarter ended June 30, 2005. The sale of our interests in TASC and TOM was completed effective as of October 1, 2005 and is described in greater detail under the caption Discontinued Operations .

In November 2005, we decided that, as a result of ongoing losses at Memorial Village, it would need to either find a buyer for our equity interests in Memorial Village or close the facility. Based on the decision to sell or close Memorial Village, as well as the continuing uncertainty of cash flows related to our surgery center segment, we determined that the joint venture interests for San Jacinto, as well as the management contracts associated with Memorial Village and San Jacinto, were impaired and recorded an additional charge for impairment of intangible assets totaling $3,461,351 for the quarter ended September 30, 2005.

Effective January 31, 2006 and March 1, 2006, respectively, we executed asset purchase agreements to sell substantially all of the assets of Memorial Village and San Jacinto. On January 12, 2006, we were notified by Union that it was exercising its option to terminate the TOM MSA as of March 12, 2006. Additionally, on February 3, 2006, we were notified by Union that it was exercising its option to terminate the TASC MSA as of April 3, 2006. As a result of the sales of Memorial Village and San Jacinto, as well as the termination of the TASC MSA and TOM MSA, we no longer have an ownership or management interest in any ambulatory surgery centers and, as such, we tested the remaining identifiable intangible assets related to the surgery centers from the IPS Merger at December 31, 2005. Based on the terminations of the TASC MSA and TOM MSA, as well as the sales of Memorial Village and San Jacinto, we determined that the management contracts associated with TASC and TOM were impaired and recorded an additional charge for impairment of intangible assets of $1,163,830 for the quarter ended December 31, 2005.

As a result of the Sutter Settlement, we also recorded an additional $38,440 charge for impairment of intangible assets for the quarter ended December 31, 2005.

Other Income and Expenses.

Interest Expense. Consolidated interest expense totaled $342,678 for the twelve months ended December 31, 2005, a decrease of $626,368 from the same period in 2004. Interest expense activity in 2005, including decreases from 2004, can be explained generally by the following:

> *Brantley Debt.* As part of the 2004 Mergers, we used $6,037,111 of proceeds to repay debt and accrued interest owed to an affiliate of Brantley IV. Additionally, Brantley Capital and Brantley III each held debt of IPS and were party to the Amended and Restated Debt Exchange Agreement, dated February 9, 2004, as amended by the First Amendment to Debt Exchange Agreement dated July 16, 2004 (the Debt Exchange Agreement) under which Brantley Capital and Brantley III received Class A Common Stock in exchange for the contribution of an aggregate of approximately $4,375,000 in debt, including accrued interest as of the Closing, to us. Brantley Capital also received Class A Common Stock equal to the amount of approximately $593,000 in accrued dividends owed to it by IPS in exchange for such indebtedness. Interest expense related to the Brantley Capital, Brantley III and Brantley IV subsidiary debt totaled approximately $566,000 in 2004. In March and April 2005, we borrowed an aggregate of $1,250,000 from Brantley IV. Interest expense related to these notes totaled approximately $89,000 for the twelve months ended December 31, 2005.
>
> *DVI Restructuring.* As described in Part I. Item 1. Description of Business Acquisitions and Restructuring Transactions New Line of Credit and Debt Restructuring, we restructured our previously-existing debt facilities, which resulted in a decrease in aggregate debt owed to DVI from approximately $10.1 million to a combined principal amount of approximately $6.5 million, of which approximately $2.0 million was paid at the Closing. Interest expense related to IPS s portion of the restructured debt totaled $207,428 in 2004.
>
> *New Line of Credit.* As part of the restructuring transactions, we also entered into the Loan and Security Agreement with CIT, borrowing $1.6 million under this facility concurrently with the Closing. Interest expense related to this line of credit totaled $208,211 for the year ended December 31, 2005, an increase of $42,510 over the interest expense for 2004 related to our previous revolving credit facility with DVI.

Gain on Forgiveness of Debt. On August 25, 2003, our lender, DVI, announced that it was seeking protection under Chapter 11 of the United States Bankruptcy laws. Both IPS and SurgiCare had loans outstanding to DVI in the form of term loans and revolving lines of credit. As part of the IPS Merger, we negotiated a discount on the term loans and a buy-out of the revolving lines of credit. As part of that agreement, we executed a new loan agreement with U.S. Bank Portfolio Services (USBPS), as Servicer for payees, for payment of the revolving lines of credit and renegotiation of the term loans. Additionally, as part of that transaction, we entered into a new secured two-year revolving line of credit with CIT, which was used to pay-off the DVI revolving lines of credit. The total gain on the cancellation of debt was $4,956,885 (net of accrued interest totaling $24,597 related to a 60-day extension of the original settlement agreement with USBPS) and was allocated based on the historical note balances of IPS and SurgiCare. The gain allocated to SurgiCare reduced the amount of debt assumed in the purchase price calculation, along with the resulting allocation of the fair value of our historical net assets to intangible assets and goodwill. The gain allocated to IPS (net of $12,093 in accrued interest) totaled $2,424,978 for the year ended December 31, 2004. The remaining $2,960 gain on forgiveness of debt recorded in 2004 relates to previously negotiated settlements by us with certain creditors.

Discontinued Operations.

Heart Center. On September 19, 2003, IPS entered into a Settlement Agreement (the Heart Center Settlement) with Dr. Jane Kao (Dr. Kao)and the Heart Center to settle disputes as to the existence and enforceability of certain contractual obligations. As part of the Heart Center Settlement, Dr. Kao, the Heart Center

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and IPS agreed that, until December 31, 2004, each party would conduct their operations under the terms established by the MSA between IPS and the Heart Center. Additionally, among other provisions, after December 31, 2004, Dr. Kao, the Heart Center and IPS were released from any further obligation to each other arising from any previous agreement, and Dr. Kao purchased the accounts receivable related to the Heart Center and IPS terminated its ownership and management agreement with the Heart Center. The operations of this component are reflected in our consolidated statements of operations as loss from operations of discontinued components for the year ended December 31, 2004. IPS recorded a loss on disposal of this discontinued component of $12,366 for the year ended December 31, 2004. There were no operations for this component in Company s financial statements in 2005.

The following table contains selected financial statement data related to the Heart Center as of and for the year ended December 31, 2004.

		2004
Income statement data:		
Net operating revenues	$	2,275,890
Operating expenses		2,130,379
Net income	$	145,511
Balance sheet data:		
Current assets	$	
Other assets		
Total assets	$	
Current liabilities	$	3,953
Other liabilities		
Total liabilities	$	3,953

Bellaire SurgiCare. As of the Closing, our management expected the case volumes at Bellaire SurgiCare to improve in 2005. However, by the end of February 2005, it was determined that the expected case volume increases were not going to be realized. On March 1, 2005, we closed Bellaire SurgiCare and consolidated its operations with the operations of Memorial Village. We tested the identifiable intangible assets and goodwill related to the surgery center business using the present value of cash flows method. As a result of the decision to close Bellaire SurgiCare and the resulting impairment of the joint venture interest and management contracts related to the surgery centers, we recorded a charge for impairment of intangible assets of $4,090,555 for the year ended December 31, 2004. We also recorded a loss on disposal of this discontinued component (in addition to the charge for impairment of intangible assets) of $163,049 for the quarter ended March 31, 2005. The operations of this component are reflected in our consolidated statements of operations as loss from operations of discontinued components for the twelve months ended December 31, 2005 and 2004, respectively. There were no operations for this component after March 31, 2005.

The following table contains selected financial statement data related to Bellaire SurgiCare as of and for the twelve months ended December 31, 2005 and 2004, respectively:

	2005	2004
Income statement data:		
Net operating revenues	$ 161,679	$ 23,123
Operating expenses	350,097	129,430
Net loss	$ (188,418)	$ (106,307)
Balance sheet data:		
Current assets	$	$ 284,192
Other assets		395,997
Total assets	$	$ 680,189
Current liabilities	$	$ 583,580
Other liabilities		39,689
Total liabilities	$	$ 623,269

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CARDC. On April 1, 2005, IPS entered into the CARDC Settlement with Dr. Bradley E. Chipps, M.D. and CARDC to settle disputes as to the existence and enforceability of certain contractual obligations. As part of the CARDC Settlement, Dr. Chipps, CARDC, and IPS agreed that CARDC would purchase the assets owned by IPS and used in connection with CARDC, in exchange for termination of the MSA between IPS and CARDC. Additionally, among other provisions, after April 1, 2005, Dr. Chipps, CARDC and IPS have been released from any further obligation to each other arising from any previous agreement. As a result of the CARDC dispute, we recorded a charge for impairment of intangible assets related to CARDC of $704,927 for the year ended December 31, 2004. We also recorded a gain on disposal of this discontinued component (in addition to the charge for impairment of intangible assets) of $506,625 for the quarter ended March 31, 2005. For the quarter ended June 30, 2005, we reduced the gain on disposal of this discontinued component by $238,333 as the result of post-settlement adjustments related to the reconciliation of balance sheet accounts. The operations of this component are reflected in our consolidated statements of operations as loss from operations of discontinued components for the twelve months ended December 31, 2005 and 2004, respectively. There were no operations for this component in our financial statements after March 31, 2005.

The following table contains selected financial statement data related to CARDC as of and for the twelve months ended December 31, 2005 and 2004, respectively:

	2005	2004
Income statement data:		
Net operating revenues	$ 848,373	$ 3,210,158
Operating expenses	809,673	3,056,258
Net income	$ 38,700	$ 153,900
Balance sheet data:		
Current assets	$	$ 237,367
Other assets		9,971
Total assets	$	$ 247,338
Current liabilities	$	$ 233,711
Other liabilities		
Total liabilities	$	$ 233,711

IntegriMED. On June 7, 2005, IPS executed an Asset Purchase Agreement with eClinicalWeb to sell substantially all of the assets of IntegriMED. As a result of this transaction, we recorded a loss on disposal of this discontinued component of $47,101 for the quarter ended June 30, 2005. The operations of this component are reflected in our consolidated statements of operations as loss from operations of discontinued components for the twelve months ended December 31, 2005 and 2004, respectively. There were no operations for this component in our financial statements after June 30, 2005.

The following table contains selected financial statement data related to IntegriMED as of and for the twelve months ended December 31, 2005 and 2004, respectively:

	2005	2004
Income statement data:		
Net operating revenues	$ 191,771	$ 258,673
Operating expenses	899,667	1,710,891
Net loss	$ (707,896)	$ (1,452,218)
Balance sheet data:		
Current assets	$	$ 443,120
Other assets		62,575
Total assets	$	$ 505,695
Current liabilities	$	$ 571,766
Other liabilities		
Total liabilities	$	$ 571,766

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TASC and TOM. On June 13, 2005, we announced that we had accepted an offer to purchase our interests in TASC and TOM in Dover, Ohio. These transactions, which were consummated on September 30, 2005, were deemed to be effective as of October 1, 2005. As a result of these transactions, as well as the uncertainty of future cash flows related to our surgery center business, we recorded a charge for impairment of intangible assets of $6,362,849 for the three months ended June 30, 2005. As a result of these transactions, we recorded a gain on disposal of this discontinued component (in addition to the charge for impairment of intangible assets) of $1,357,712 for the quarter ended December 31, 2005. We allocated the goodwill recorded as part of the IPS Merger to each of the surgery center reporting units and recorded a loss on the write-down of goodwill for the quarter ended December 31, 2005. The loss on write-down of goodwill related to TASC and TOM totaled $789,173 and reduced the gain on disposal. The operations of this component are reflected in our consolidated statements of operations as loss from operations of discontinued components for the twelve months ended December 31, 2005 and 2004, respectively. There were no operations for this component in our financial statements after September 30, 2005.

The following table contains selected financial statement data related to TASC and TOM as of and for the twelve months ended December 31, 2005 and 2004, respectively:

	2005	2004
Income statement data:		
Net operating revenues	$ 2,408,156	$ 177,761
Operating expenses	2,458,234	123,551
Net income (loss)	$ (50,078)	$ 54,210
Balance sheet data:		
Current assets	$	$ 772,035
Other assets		1,632,949
Total assets	$	$ 2,404,984
Current liabilities	$	$ 779,684
Other liabilities		724,563
Total liabilities	$	$ 1,504,247

Sutter. On October 31, 2005, IPS executed the Sutter Settlement with Dr. Sutter to settle disputes that had arisen between IPS and Dr. Sutter and to avoid the risk and expense of litigation. As part of the Sutter Settlement, Dr. Sutter and IPS agreed that Dr. Sutter would purchase the assets owned by IPS and used in connection with Dr. Sutter s practice, in exchange for termination of the MSA between IPS and Dr. Sutter. Additionally, among other provisions, after October 31, 2005, Dr. Sutter and IPS have been released from any further obligation to each other arising from any previous agreement. As a result of this transaction, we recorded a loss on disposal of this discontinued component (in addition to the charge for impairment of intangible assets) of $279 for the quarter ended December 31, 2005. The operations of this component are reflected in our consolidated statements of operations as loss from operations of discontinued components for the twelve months ended December 31, 2005 and 2004, respectively. There were no operations for this component in our financial statements after October 31, 2005.

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The following table contains selected financial statement data related to Sutter as of and for the twelve months ended December 31, 2005 and 2004, respectively:

	2005	2004
Income statement data:		
Net operating revenues	$ 356,351	$ 434,063
Operating expenses	347,643	421,352
Net income	$ 8,708	$ 12,711
Balance sheet data:		
Current assets	$	$ 112,920
Other assets		15,296
Total assets	$	$ 128,216
Current liabilities	$	$ 9,806
Other liabilities		
Total liabilities	$	$ 9,806

Memorial Village. In November 2005, we decided that, as a result of ongoing losses at Memorial Village, it would need to either find a buyer for our equity interests in Memorial Village or close the facility. In preparation for this pending transaction, we tested the identifiable intangible assets and goodwill related to the surgery center business using the present value of cash flows method. As a result of the decision to sell or close Memorial Village, as well as the uncertainty of cash flows related to our surgery center business, we recorded a charge for impairment of intangible assets of $3,461,351 for the three months ended September 30, 2005. Effective January 31, 2006, we executed an Asset Purchase Agreement to sell substantially all of the assets of Memorial Village. Pursuant to SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the assets and liabilities of Memorial Village have been reclassified as assets held for sale and liabilities held for sale on our consolidated balance sheet as of December 31, 2005. We allocated the goodwill recorded as part of the IPS Merger to each of the surgery center reporting units and recorded a loss on the write-down of goodwill for the quarter ended December 31, 2005. The loss on write-down of goodwill related to Memorial Village totaled $2,005,383. The operations of this component are reflected in our consolidated statements of operations as loss from operations of discontinued components for the twelve months ended December 31, 2005 and 2004, respectively.

The following table contains selected financial statement data related to Memorial Village as of and for the twelve months ended December 31, 2005 and 2004, respectively:

	2005	2004
Income statement data:		
Net operating revenues	$ 1,490,799	$ 112,994
Operating expenses	2,966,860	90,966

Net income (loss)	$ (1,476,061)	$ 22,028
Balance sheet data:		
Other current assets	$ 152,856	$ 243,321
Property and equipment, net	430,244	739,810
Total assets held for sale	$ 583,100	$ 983,131
Capital lease obligation	79,206	55,939
Total liabilities held for sale	$ 79,206	$ 55,939

San Jacinto. Effective March 1, 2006, we executed an Asset Purchase Agreement to sell substantially all of the assets of San Jacinto, which is 10% owned by Baytown SurgiCare, Inc., our wholly owned subsidiary and is not consolidated in our financial statements. We allocated the goodwill recorded as part of the IPS Merger to each of the surgery center reporting units and recorded a loss on the write-down of goodwill for the quarter ended December 31, 2005. The loss on write-down of goodwill related to San Jacinto totaled $694,499.

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Orion. Prior to the divestiture of our ambulatory surgery center business, we recorded management fee revenue, which was eliminated in the consolidation of our financial statements, for Bellaire SurgiCare, TASC and TOM and Memorial Village. The management fee revenue for San Jacinto was not eliminated in consolidation. The management fee revenue associated with the discontinued operations in the surgery center business totaled $407,595 for the year ended December 31, 2005. Additionally, we recorded equity in the earnings of San Jacinto in the amount of $43,273 for the twelve months ended December 31, 2005, while sustaining a minority interest loss in TOM of $93,802 for the same period. For the year ended December 31, 2004, we generated management fee revenue of $15,219, a minority interest loss in Memorial Village of $51,800 and equity in the earning of San Jacinto totaling $1,169. Pursuant to SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the long-term investment in San Jacinto and the distributions due to the limited partners of San Jacinto have been reclassified as assets and liabilities held for sale on our consolidated balance sheet as of December 31, 2005.

The following table summarizes the components of loss from operations of discontinued components:

	2005	2004
Heart Center		
Net income	$	$ 145,511
Loss on disposal		(12,366)
Bellaire SurgiCare		
Net loss	(188,418)	(106,308)
Loss on disposal	(163,049)	
CARDC		
Net income	38,700	153,900
Gain on disposal	268,292	
IntegriMED		
Net loss	(707,896)	(1,452,218)
Loss on disposal	(47,101)	
TASC and TOM		
Net income (loss)	(50,079)	54,210
Gain on disposal, net of loss on write-down of goodwill	568,539	
Sutter		
Net income	8,708	12,711
Loss on disposal	(279)	
Memorial Village		
Net income (loss)	(1,476,061)	22,028
Loss on write-down of goodwill	(2,005,383)	
San Jacinto		
Loss on write-down of goodwill	(694,499)	
Orion		
Net income (loss)	357,066	(35,412)
Total loss from operations of discontinued components, including net loss on disposal	$ (4,091,459)	$ (1,217,943)

Preferred Stock Dividends. Prior to the IPS Merger, holders of IPS s Series A-2 preferred stock were entitled to receive, when, as and if declared by the board of directors, cumulative dividends payable at the annual rate of $0.40

for each share. Dividends were accrued, even if not declared, and were to be declared and paid in cash in equal installments on the first day of January, April, July and October immediately following the issue date, or continue to be accrued until such time as the preferred stockholders demanded payment. Preferred stock dividends in the amount of $606,100 were accrued for the twelve months ended December 31, 2004. No cash payments of dividends were made in 2005 or 2004. The Series A-2 redeemable convertible preferred stock, along with the other three series of redeemable convertible preferred stock held by IPS stockholders prior to the IPS Merger, including any accrued and unpaid dividends therein, were exchanged for shares of our Class A Common Stock as a part of the IPS Merger.

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Liquidity and Capital Resources

For the six months ended June 30, 2006, net cash provided by operating activities totaled $575,852 as compared to net cash used in operating activities totaling $1,805,230 for the same period in 2005. The net impact of discontinued operations on net cash provided by operating activities in the first six months of 2006 totaled $230,744.

Net cash used in operating activities totaled $3,309,084 for the year ended December 31, 2005 compared to net cash used in operating activities of $2,820,499 for the same period in 2004. Net cash used in operations increased over 2004 primarily as a result of the growth in operating expenses related to the IPS Merger and the DCPS/MBS Merger. The net impact of discontinued operations on net cash used in operating activities in 2005 totaled $3,352,219.

For the six months ended June 30, 2006, net cash provided by investing activities totaled $417,234 as compared to $32,195 in net cash provided by investing activities in the six months ended June 30, 2005. The net impact of discontinued operations on net cash provided by investing activities totaled $430,244 in the first six months of 2006.

For the year ended December 31, 2005, net cash provided by investing activities totaled $1,947,564 compared to $1,716,708 in net cash provided by investing activities for the same period in 2004, which included $2,090,677 in net proceeds related to the 2004 Mergers. In 2005, we received proceeds from the sale of TASC and TOM in the fourth quarter of 2005, in addition to the sales of CARDC, IntegriMED and Sutter in the first, second and fourth quarters of 2005, respectively.

Net cash used in financing activities totaled $962,970 for the six months ended June 30, 2006 as compared to $1,382,272 in net cash provided by financing activities for the six months ended June 30, 2005. The change in cash uses related to financing activities from 2005 to 2006 can be explained generally by the following:

- Net repayments on the CIT revolving credit facility totaled $718,221 in the first six months of 2006, including approximately $300,000 in repayments related to discontinued operations;
- As discussed below, in March and April of 2005, we borrowed an aggregate of $1,250,000 from Brantley IV.
- We made aggregate payments in the amount of $112,500 in the first quarter of 2006 in satisfaction of a $778,000 debt, and recognized a gain on forgiveness of debt totaling $665,463 for the six months ended June 30, 2006; and
- We repaid approximately $200,000 in satisfaction of a working capital note from the sellers of MBS in the first quarter of 2006.

Net cash provided by financing activities totaled $958,482 for the year ended December 31, 2005 compared to net cash provided by financing activities totaling $1,756,105 for the year ended December 31, 2004. The following financing activities occurred in 2005:

- Net repayments of capital lease obligations totaled $492,819, including approximately $635,000 in repayments related to discontinued operations;
- Net borrowings on the CIT revolving credit facility totaled $386,340; and
- In March and April 2005, we borrowed an aggregate of $1,250,000 from Brantley IV.

Our financial statements have been prepared in conformity with GAAP, which contemplate the continuation of the Company as a going concern. We incurred substantial operating losses during 2005, and has used substantial amounts of working capital in our operations. Additionally, as described more fully below, we received notification from CIT in December 2005 that certain events of default under the Loan and Security Agreement had occurred as a result of us being out of compliance with two financial covenants relating to our debt service coverage ratio and our minimum operating income level. These conditions raise substantial doubt about our ability to continue as a going concern.

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We have financed our growth and operations primarily through the issuance of equity securities, secured and/or convertible debt, most recently by completing the 2004 Mergers and restructuring transactions in December 2004 and borrowing from related parties. On December 15, 2004, we also entered into a new secured two-year revolving credit facility pursuant to the Loan and Security Agreement. Under this facility, initially up to $4,000,000 of loans could be made available to us, subject to a borrowing base. As discussed below, the amount available under this credit facility has been reduced. We borrowed $1,600,000 under this facility concurrently with the Closing. The interest rate under this facility is the prime rate plus 6%. Upon an event of default, CIT can accelerate the loans or call the Guaranties described below. In connection with entering into this new facility, we also restructured our previously-existing debt facilities, which resulted in a decrease in aggregate debt owed to DVI from approximately $10.1 million to a combined principal amount of approximately $6.5 million, of which approximately $2.0 million was paid at the Closing.

Pursuant to a Guaranty Agreement (the Brantley IV Guaranty), dated as of December 15, 2004, provided by Brantley IV to CIT, Brantley IV agreed to provide a deficiency guaranty in the initial amount of $3,272,727. As discussed below, the amount of this Brantley IV Guaranty has been reduced. Pursuant to a Guaranty Agreement (the Brantley Capital Guaranty and collectively with the Brantley IV Guaranty, the Guaranties), dated as of December 15, 2004, provided by Brantley Capital Corporation (Brantley Capital) to CIT, Brantley Capital agreed to provide a deficiency guarantee in the initial amount of $727,273. As discussed below, the amount of this Brantley Capital Guaranty has been reduced. In consideration for the Guaranties, we issued warrants to purchase 20,455 shares of Class A Common Stock, at an exercise price of $0.01 per share, to Brantley IV, and issued warrants to purchase 4,545 shares of Class A Common Stock, at an exercise price of $0.01 per share, to Brantley Capital. None of these warrants, which expire on December 15, 2009, have been exercised as of June 30, 2006.

On March 16, 2005, Brantley IV loaned us an aggregate of $1,025,000 (the First Loan). On June 1, 2005, we executed a convertible subordinated promissory note in the principal amount of $1,025,000 (the First Note) payable to Brantley IV to evidence the terms of the First Loan. The material terms of the First Note are as follows: (i) the First Note is unsecured; (ii) the First Note is subordinate to our outstanding loan from CIT and other indebtedness for monies borrowed, and ranks pari passu with general unsecured trade liabilities; (iii) principal and interest on the First Note is due in a lump sum on April 19, 2006 (the First Note Maturity Date); (iv) the interest on the First Note accrues from and after March 16, 2005, at a per annum rate equal to nine percent (9.0%) and is non-compounding; (v) if an event of default occurs and is continuing, Brantley IV, by notice to us, may declare the principal of the First Note to be due and immediately payable; and (vi) on or after the First Note Maturity Date, Brantley IV, at its option, may convert all or a portion of the outstanding principal and interest due of the First Note into shares of our Class A Common Stock at a price per share equal to $1.042825 (the First Note Conversion Price). The number of shares of Class A Common Stock to be issued upon conversion of the First Note shall be equal to the number obtained by dividing (x) the aggregate amount of principal and interest to be converted by (y) the First Note Conversion Price (as defined above); provided, however, the number of shares to be issued upon conversion of the First Note shall not exceed the lesser of: (i) 1,159,830 shares of Class A Common Stock, or (ii) 16.3% of the then outstanding Class A Common Stock. As of June 30, 2006, if Brantley IV were to convert the First Note, we would have to issue 1,098,644 shares of Class A Common Stock. On May 9, 2006, we and Brantley IV executed an amendment to the First Note (the First and Second Note Amendment) extending the First Note Maturity Date to August 15, 2006. On August 8, 2006, we and Brantley IV executed a second amendment to the First Note (the First and Second Note Second Amendment) extending the First Note Maturity Date to October 15, 2006 and as of October 15, 2006 we and Brantley IV executed a third amendment to the First Note (the First and Second Note Third Amendment) further extending the First Note Maturity Date to November 30, 2006.

On April 19, 2005, Brantley IV loaned us an additional $225,000 (the Second Loan). On June 1, 2005, we executed a convertible subordinated promissory note in the principal amount of $225,000 (the Second Note) payable to Brantley IV to evidence the terms of the Second Loan. The material terms of the Second Note are as follows: (i) the

Second Note is unsecured; (ii) the Second Note is subordinate to our outstanding loan from CIT and other indebtedness for monies borrowed, and ranks pari passu with general unsecured trade liabilities; (iii) principal and interest on the Second Note is due in a lump sum on April 19, 2006 (the Second Note Maturity Date); (iv) the interest on the Second Note accrues from and after April 19, 2005, at a per annum rate equal to nine percent (9.0%) and is non-compounding; (v) if an event of default occurs and is continuing, Brantley IV, by notice to us, may declare the principal of the Second Note to be due and immediately payable; and (vi) on or after the Second

Note Maturity Date, Brantley IV, at its option, may convert all or a portion of the outstanding principal and interest due of the Second Note into shares of our Class A Common Stock at a price per share equal to $1.042825 (the Second Note Conversion Price). The number of shares of Class A Common Stock to be issued upon conversion of the Second Note shall be equal to the number obtained by dividing (x) the aggregate amount of principal and interest to be converted by (y) the Second Note Conversion Price (as defined above); provided, however, the number of shares to be issued upon conversion of the Second Note shall not exceed the lesser of: (i) 254,597 shares of Class A Common Stock, or (ii) 3.6% of the then outstanding Class A Common Stock. As of June 30, 2006, if Brantley IV were to convert the Second Note, we would have to issue 239,332 shares of Class A Common Stock. On May 9, 2006, we and Brantley IV executed the First and Second Note Amendment extending the Second Note Maturity Date to August 15, 2006. On August 8, 2006, we and Brantley IV executed the First and Second Note Second Amendment extending the Second Note Maturity Date to October 15, 2006 and as of October 15, 2006 we executed the First and Second Note Third Amendment further extending the Second Note Maturity Date to November 30, 2006.

Additionally, in connection with the First Loan and the Second Loan, we entered into a First Amendment to the Loan and Security Agreement (the First Amendment), dated March 22, 2005, with certain of our affiliates and subsidiaries, and CIT, whereby our $4,000,000 secured two-year revolving credit facility has been reduced by the amount of the loans from Brantley IV to $2,750,000. As a result of the First Amendment, the Brantley IV Guaranty was amended by the Amended and Restated Guaranty Agreement, dated March 22, 2005, which reduced the deficiency guaranty provided by Brantley IV by the amount of the First Loan to $2,247,727. Also as a result of the First Amendment, the Brantley Capital Guaranty was amended by the Amended and Restated Guaranty Agreement, dated March 22, 2005, which reduced the deficiency guaranty provided by Brantley Capital by the amount of the Second Loan to $502,273. Paul H. Cascio, our Chairman of the board of directors, and Michael J. Finn, one of our directors, are affiliates of Brantley IV.

As part of the Loan and Security Agreement, we are required to comply with certain financial covenants, measured on a quarterly basis. The financial covenants include maintaining a required debt service coverage ratio and meeting a minimum operating income level for the surgery and diagnostic centers before corporate overhead allocations. As of and for the three months and six months ended June 30, 2006, we were out of compliance with both of these financial covenants and has notified the lender as such. Under the terms of the Loan and Security Agreement, failure to meet the required financial covenants constitutes an event of default. Under an event of default, the lender may (i) accelerate and declare the obligations under the credit facility to be immediately due and payable; (ii) withhold or cease to make advances under the credit facility; (iii) terminate the credit facility; (iv) take possession of the collateral pledged as part of the Loan and Security Agreement; (v) reduce or modify the revolving loan commitment; and/or (vi) take necessary action under the Guaranties. The revolving credit facility is secured by our assets. As of June 30, 2006, the outstanding principal under the revolving credit facility was $998,668. The full amount of the loan as of June 30, 2006 is recorded as a current liability. In December 2005, we received notification from CIT stating that (i) certain events of default under the Loan and Security Agreement had occurred as a result of us being out of compliance with two financial covenants relating to our debt service coverage ratio and our minimum operating income level, (ii) as a result of the events of default, CIT raised the interest rate for monies borrowed under the Loan and Security Agreement to the provided Default Rate of prime rate plus 6%, (iii) the amount available under the revolving credit facility was reduced to $2,300,000 and (iv) CIT reserved all additional rights and remedies available to it as a result of these events of default. We are currently in negotiations with CIT to obtain, among other provisions, a waiver of the events of default. In the event CIT declares the obligations under the Loan and Security Agreement to be immediately due and payable or exercises its other rights described above, we would not be able to meet our obligations to CIT or our other creditors. As a result, such action would have a material adverse effect on our ability to continue as a going concern.

As of June 30, 2006, our existing credit facility with CIT had limited availability to provide for working capital shortages. Although we believe that we will generate cash flows from operations in the future, there is substantial doubt as to whether we will be able to fund our operations solely from our cash flows. In April 2005, we initiated a strategic plan designed to accelerate our growth and enhance our future earnings potential. The plan focuses on our strengths, which include providing billing, collections and complementary business management services to physician practices. A fundamental component of our plan is the selective consideration of accretive acquisition opportunities in these core business sectors. In addition, we ceased investment in business lines that did not complement our strategic plans and redirected financial resources and our personnel to areas that management believes enhances long-term growth potential. On June 7, 2005, as described in Discontinued Operations, IPS completed the sale of substantially all of the assets of IntegriMED, and on October 1, 2005, we completed the sale of our interests in TASC and TOM in Dover, Ohio. Beginning in the third quarter of 2005, we successfully completed the consolidation of corporate functions into our Roswell, Georgia facility. Additionally, consistent with our strategic plan, we sold our interest in Memorial Village effective January 31, 2006 and in San Jacinto effective March 1, 2006. These transactions are described in greater detail under the caption Discontinued Operations.

We intend to continue to manage our use of cash. However, our business is still faced with many challenges. If cash flows from operations and borrowings are not sufficient to fund our cash requirements, we may be required to further reduce our operations and/or seek additional public or private equity financing or financing from other sources or consider other strategic alternatives, including possible additional divestitures of specific assets or lines of business. Any acquisitions will require additional capital. There can be no assurances that additional financing will be available, or that, if available, the financing will be obtainable on terms acceptable to us or that any additional financing would not be substantially dilutive to our existing stockholders.

DIRECTOR AND EXECUTIVE OFFICER COMPENSATION

Director Compensation

Our current directors who are not our employees or affiliates receive compensation of up to $5,000 per meeting for meetings held in person and up to $500 per meeting for meetings held telephonically. Additionally, the members of the Audit Committee receive compensation of up to $1,000 per Audit Committee meeting. The Chairman of the Audit Committee receives compensation of up to $2,500 per quarter.

In addition, we granted the following stock options during the year ended December 31, 2005 to our directors who are not our employees as compensation for service.

Name	Number of Securities Underlying Options/ SARs Granted ($)	Percent of Total Options/SARS Granted to Employees in Fiscal Year (%)	Exercise or Base Price ($/sh)	Expiration Date
Joseph M. Valley, Jr.	20,000(1)	1.9	0.84	6/17/2015
Michael J. Finn	17,000(2)	1.6	0.84	6/17/2015
David Crane	10,000(3)	0.9	0.84	6/17/2015
Gerald M. McIntosh	10,000(4)	0.9	0.84	6/17/2015
Robert P. Pinkas	17,000(5)	1.6	0.84	6/17/2015

(1) Mr. Valley was granted 20,000 options to acquire Class A Common Stock on June 17, 2005 pursuant to a Stock Option Agreement (Incentive Stock Option). The options were issued in accordance with the 2004 Incentive

Plan, and vested fully on the first anniversary of the date of the grant.

(2) Mr. Finn was granted 17,000 options to acquire Class A Common Stock on June 17, 2005 pursuant to a Stock Option Agreement (Incentive Stock Option). The options were issued in accordance with the 2004 Incentive Plan, and vested fully on the first anniversary of the date of the grant.

(3) Mr. Crane was granted 10,000 options to acquire Class A Common Stock on June 17, 2005 pursuant to a Stock Option Agreement (Incentive Stock Option). The options were issued in accordance with the 2004 Incentive Plan, and vested fully on the first anniversary of the date of the grant.

(4) Mr. McIntosh was granted 10,000 options to acquire Class A Common Stock on June 17, 2005 pursuant to a Stock Option Agreement (Incentive Stock Option). The options were issued in accordance with the 2004 Incentive Plan. The options were cancelled in connection with Mr. McIntosh s resignation from our board of directors on November 3, 2005.

(5) Mr. Pinkas was granted 17,000 options to acquire Class A Common Stock on June 17, 2005 pursuant to a Stock Option Agreement (Incentive Stock Option). The options were issued in accordance with the 2004 Incentive

Plan as compensation for Mr. Pinkas service as a director of IPS prior to our acquisition of IPS on December 15, 2004, and vested fully on the first anniversary of the date of the grant.

Executive Officer Compensation

Summary Compensation Table. The following table presents the total compensation paid during each of our last three fiscal years to each of our Chief Executive Officer, the other most highly compensated executive officers who were serving as executive officers on December 31, 2005 and whose salary and bonus exceeded $100,000, and one individual for whom disclosure would have been provided but for the fact that the individual was not serving as an executive officer on December 31, 2005 (collectively, the Named Executive Officers). All amounts include aggregate compensation paid by us and our subsidiaries.

					Long-Term Compensation		
		Annual Compensation			Awards		Payouts
Name and Principal Position	Year	Salary ($)	Bonus ($)	Other Annual Compensation ($)	Restricted Stock Award(s) ($)	Securities Underlying Options/SARs (#)	All Other Compensation ($)
Terrence L. Bauer(1)	2005	240,000		6,000(3)	(2)	300,000	
Chief Executive Officer	2004	12,000	25,000	300(3)			
and President	2003						
Stephen H. Murdock(4)	2005	189,423		6,000(5)	(6)	200,000	
Chief Financial Officer	2004	7,308	15,000	231(5)			
and Corporate Secretary	2003						
Dennis M. Cain(7)	2005	175,000		25,000(8)		150,000	
Chief Executive Officer of	2004	6,731		962(8)			
MBS	2003						
Tommy M. Smith(9)	2005	175,000		25,000(10)		150,000	
President and Chief Operating	2004	6,731		962(10)			
Officer of MBS	2003						
Keith G. LeBlanc(11)	2005	212,390		4,000(12)	(13)		125,000(14)
Former President	2004	199,615	100,000	16,191(15)			
	2003	188,942		28,828(16)			

(1) Mr. Bauer joined us as Chief Executive Officer on December 15, 2004, and was named President in November 2005.

(2) Mr. Bauer was granted an aggregate of 300,000 restricted stock units for Class A Common Stock under the 2004 Incentive Plan on August 31, 2005 pursuant to a Restricted Stock Unit Award Agreement. The restricted stock units vest in equal parts on each of December 23, 2005, December 23, 2006 and December 23, 2007. Mr. Bauer elected to defer the vesting of such restricted stock units until January 1, 2008, January 1, 2009 and January 1, 2010, respectively, pursuant to the Restricted Stock Unit Deferral Plan adopted by us on August 31, 2005 (the Deferral Plan). Until the Class A Common Stock underlying the restricted stock units is issued to Mr. Bauer, dividends will not be paid with respect to the restricted stock units; however, Mr. Bauer is entitled to receive in cash a dividend equivalent, which shall equal the value of all cash or stock dividends or other distributions that would have been paid on the Class A Common Stock underlying the restricted stock units.

(3) Includes $6,000 auto allowance paid in 2005 and $300 auto allowance paid in December 2004.

(4) Mr. Murdock joined us as Chief Financial Officer and Corporate Secretary on December 15, 2004.

(5) Includes $6,000 auto allowance paid in 2005 and $231 auto allowance paid in December 2004.

(6) Mr. Murdock was granted an aggregate of 100,000 restricted stock units for Class A Common Stock under the 2004 Incentive Plan on August 31, 2005 pursuant to a Restricted Stock Unit Award Agreement. The restricted stock units vest in equal parts on each of December 23, 2005, December 23, 2006 and December 23, 2007. Mr. Murdock elected to defer the vesting of such restricted stock units until January 1, 2008, January 1, 2009 and January 1, 2010, respectively, pursuant to the Deferral Plan. Until the Class A Common Stock underlying the restricted stock units is issued to Mr. Murdock, dividends will not be paid with respect to the restricted

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stock units; however, Mr. Murdock is entitled to receive in cash a dividend equivalent, which shall equal the value of all cash or stock dividends or other distributions that would have been paid on the Class A Common Stock underlying the restricted stock units.

(7) Mr. Cain joined us as Chief Executive Officer of MBS on December 15, 2004 in connection with our acquisition of DCPS.

(8) Includes $25,000 personal expense allowance paid in 2005 and $962 personal expense allowance paid in December 2004.

(9) Mr. Smith joined us as President and Chief Operating Officer of MBS on December 15, 2004 in connection with our acquisition of MBS.

(10) Includes $25,000 personal expense allowance paid in 2005 and $962 personal expense allowance paid in December 2004.

(11) Mr. LeBlanc joined us as our President and Chief Executive Officer on November 10, 2002, resigned as our Chief Executive Officer on December 15, 2004 and resigned as our President and a director effective November 8, 2005.

(12) Includes $4,000 auto allowance paid in 2005.

(13) Mr. LeBlanc was granted an aggregate of 250,000 restricted stock units for Class A Common Stock under the 2004 Incentive Plan on August 31, 2005 pursuant to a Restricted Stock Unit Award Agreement. Pursuant to the terms of the Separation Agreement and General Release, dated November 8, 2005, between Mr. LeBlanc and us (the Separation Agreement) the restricted stock units vest in equal parts on each of January 1, 2006 and January 1, 2007. Until the Class A Common Stock underlying the restricted stock units is issued to Mr. LeBlanc, dividends will not be paid with respect to the restricted stock units; however, Mr. LeBlanc is entitled to receive in cash a dividend equivalent, which shall equal the value of all cash or stock dividends or other distributions that would have been paid on the Class A Common Stock underlying the restricted stock units.

(14) Pursuant to the terms of the Separation Agreement, Mr. LeBlanc received a lump sum payment of $125,000 upon termination.

(15) Includes vacation payout for unused vacation time.

(16) Includes $11,120 for living expenses, $11,372 for moving expenses and $6,336 for auto allowance.

Option Grants in Last Fiscal Year. The following table sets forth all information concerning individual grants of stock options to any of the Named Executive Officers during the year ended December 31, 2005.

Name	Number of Securities Underlying Options/ SARs Granted ($)	Percent of Total Options/SARS Granted to Employees in Fiscal Year (%)	Exercise or Base Price ($/sh)	Expiration Date

Terrence L. Bauer	300,000(1)	28.4	0.84	6/17/2015
Stephen H. Murdock	200,000(2)	18.9	0.84	6/17/2015
Dennis M. Cain	150,000(3)	14.2	0.84	6/17/2015
Tommy M. Smith	150,000(4)	14.2	0.84	6/17/2015

(1) Mr. Bauer was granted 300,000 options to acquire Class A Common Stock on June 17, 2005 pursuant to a Stock Option Agreement (Incentive Stock Option). The options were issued in accordance with the 2004 Incentive Plan, and vest in 1/4 increments on an annual basis commencing on the first anniversary of the date of grant.

(2) Mr. Murdock was granted 200,000 options to acquire Class A Common Stock on June 17, 2005 pursuant to a Stock Option Agreement (Incentive Stock Option). The options were issued in accordance with the 2004 Incentive Plan, and vest in 1/4 increments on an annual basis commencing on the first anniversary of the date of grant.

(3) Mr. Cain was granted 150,000 options to acquire Class A Common Stock on June 17, 2005 pursuant to a Stock Option Agreement (Incentive Stock Option). The options were issued in accordance with the 2004 Incentive Plan, and vest in 1/4 increments on an annual basis commencing on the first anniversary of the date of grant.

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(4) Mr. Smith was granted 150,000 options to acquire Class A Common Stock on June 17, 2005 pursuant to a Stock Option Agreement (Incentive Stock Option). The options were issued in accordance with the 2004 Incentive Plan, and vest in 1/4 increments on an annual basis commencing on the first anniversary of the date of grant.

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year End Values. The following table sets forth all information concerning option exercises during the fiscal year ended December 31, 2005 and option holdings as of December 31, 2005 with respect to our Named Executive Officers. No stock appreciation rights were outstanding at the end of the fiscal year. No shares were acquired on exercise of options by our Named Executive Officers during 2005.

			Number of Securities Underlying Unexercised Options at Fiscal Year-End (#)		Value of Unexercised In-the-Money Options at Fiscal Year-End ($)(1)	
Name	**Shares Acquired on Exercise (#)**	**Value Realized ($)**	**Exercisable**	**Unexercisable**	**Exercisable**	**Unexercisable**
Terrence L. Bauer				300,000		
Stephen H. Murdock				200,000		
Dennis M. Cain				150,000		
Tommy M. Smith				150,000		
Keith G. LeBlanc			328,462(2)			

(1) The values of the unexercised options and warrants above are based on the difference between the exercise price of the options and warrants, as applicable, and the fair market value of our Class A Common Stock at the end of the fiscal year ended December 31, 2005, which was $0.34 per share.

(2) Consists of the following:

Warrants for 4,000 shares of our Class A Common Stock were issued to Mr. LeBlanc in January 2003, have an exercise price of $4.50 per share and expire on January 31, 2008.

Warrants for 324,462 shares of our Class A Common Stock were issued to Mr. LeBlanc in November 2002, with an original exercise price of $3.20 per share, vesting through November 2006, and an original expiration date of November 12, 2012. Pursuant to the terms of the Separation Agreement, the vesting of these warrants was accelerated and 100% of these warrants were fully vested at December 31, 2005.

Employment and Other Agreements

Employment Agreements. Effective December 15, 2004, we entered into an employment agreement with Terrence L. Bauer for the position of our Chief Executive Officer. In November 2005, Mr. Bauer was named our President. The initial term of the agreement is five years, with automatic renewal at the end of the initial term and each successive renewal term thereafter for successive two-year terms. The agreement provides for a base salary of $240,000 for each of the five years in the initial term. The board of directors will review the base salary annually, and may, in its reasonable discretion, adjust the base salary. Mr. Bauer s base salary for 2006 is $260,000. In addition, we may pay an annual bonus to Mr. Bauer upon the attainment of objectives determined by the board of directors. Mr. Bauer s employment agreement includes post-employment restrictive covenants not to disclose our confidential information, or engage in activity that interferes with our business. If Mr. Bauer is terminated without cause, the agreement provides for, among other things, a continuation of base salary through and until the end of the non-competition period, which for purposes of the employment agreement shall mean the period during the term of employment and thereafter until the second anniversary of the date of termination of Mr. Bauer s employment with us. All equity incentives, including warrants, would also vest at that time.

Effective December 15, 2004, we entered into an employment agreement with Keith G. LeBlanc, for the position of President. On November 8, 2005, we entered into the Separation Agreement with Mr. LeBlanc terminating his employment effective as of October 31, 2005. Pursuant to the terms of the Separation Agreement, Mr. LeBlanc resigned his positions as President and a director and received a lump sum payment of $125,000. Mr. LeBlanc was retained by us as a consultant, on an independent contractor basis, to assist with certain transition matters in exchange for a payment of $215,000 to be paid in equal incremental payments through October 31, 2006. In addition, Mr. LeBlanc was entitled to receive an aggregate lump sum payment totaling $125,000 at the time of the closing of the sales by our Memorial Village and San Jacinto ambulatory surgery centers, assuming the terms of the sales were substantially the same as those set forth in the letters of intent for those sales. In lieu of this lump sum

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payment, Mr. LeBlanc will receive payments totaling $125,000 in equal incremental payments commencing on November 1, 2006 and continuing through October 31, 2007. The vesting of the restricted stock units granted to Mr. LeBlanc in August, 2005 was accelerated to vest in equal parts on each of January 1, 2006 and January 1, 2007. Likewise, warrants previously issued to Mr. LeBlanc were modified to vest in full and be exercisable until November 2013 at a price of $0.34 per share. In exchange for these benefits, the Separation Agreement included a general release of all claims by Mr. LeBlanc against us arising from his employment and a restriction on his ability to engage in certain activities competitive with us prior to November 1, 2007.

Effective December 15, 2004, we entered into an employment agreement with Stephen H. Murdock, for the position of Chief Financial Officer. The initial term of the agreement is five years, with automatic renewal at the end of the initial term and each successive renewal term thereafter for successive two-year terms. The agreement provides for a base salary of $175,000 for each of the five years in the initial term. The board of directors will review the base salary annually, and may, in its reasonable discretion, adjust the base salary. Mr. Murdock s base salary for 2006 is $205,000. In addition, we may pay an annual bonus to Mr. Murdock upon the attainment of objectives determined by the board of directors. Mr. Murdock s employment agreement includes post-employment restrictive covenants not to disclose our confidential information, or engage in an activity that interferes with our business. If Mr. Murdock is terminated without cause, the agreement provides for, among other things, a continuation of base salary through and until the end of the non-competition period, which for purposes of the employment agreement shall mean the period during the term of employment and thereafter until the second anniversary of the date of termination of Mr. Murdock s employment with us. All equity incentives, including warrants, would also vest at that time.

Effective December 15, 2004, we and MBS entered into an employment agreement with Dennis M. Cain, for the position of Chief Executive Officer of MBS. The initial term of the agreement is five years, with automatic renewal at the end of the initial term and each successive renewal term thereafter for successive two-year terms. The agreement provides for a base salary of $175,000 for each of the five years in the initial term. The board of directors will review the base salary annually, and may, in its reasonable discretion, adjust the base salary. Mr. Cain s base salary for 2006 is $190,000. In addition, we may pay an annual bonus to Mr. Cain upon the attainment of objectives determined by the board of directors. Mr. Cain s employment agreement includes post-employment restrictive covenants not to disclose our confidential information, or engage in an activity that interferes with our business. If Mr. Cain is terminated without cause, the agreement provides for, among other things, a continuation of base salary through and until the end of the non-competition period, which for purposes of the employment agreement shall mean the period during the term of employment and thereafter until the second anniversary of the date of termination of Mr. Cain s employment with us. All equity incentives, including warrants, would also vest at that time.

Effective December 15, 2004, we and MBS entered into an employment agreement with Tommy M. Smith, for the position of President and Chief Operating Officer of MBS. The initial term of the agreement is five years, with automatic renewal at the end of the initial term and each successive renewal term thereafter for successive two-year terms. The agreement provides for a base salary of $175,000 for each of the five years in the initial term. The board of directors will review the base salary annually, and may, in its reasonable discretion, adjust the base salary. Mr. Smith s base salary for 2006 is $190,000. In addition, we may pay an annual bonus to Mr. Smith upon the attainment of objectives determined by the board of directors. Mr. Smith s employment agreement includes post-employment restrictive covenants not to disclose our confidential information, or engage in an activity that interferes with our business. If Mr. Smith is terminated without cause, the agreement provides for, among other things, a continuation of base salary through and until the end of the non-competition period, which for purposes of the employment agreement shall mean the period during the term of employment and thereafter until the second anniversary of the date of termination of Mr. Smith s employment with us. All equity incentives, including warrants, would also vest at that time.

Other Stock Option Plans

SurgiCare, Inc. 2001 Stock Option Plan. In October 2001, our board of directors adopted the SurgiCare, Inc. 2001 Stock Option Plan (the 2001 Plan), which was approved by our stockholders at the annual meeting of stockholders held on November 13, 2001. Initially 140,000 shares of stock (adjusted for stock splits) were reserved for issuance pursuant to the 2001 Plan. Options to acquire approximately 3,615 shares of our Class A Common Stock were outstanding under the 2001 Plan at December 31, 2005. The purposes of the 2001 Plan are to advance the best interest of our stockholders and to attract, retain and motivate key employees and persons affiliated with us, and provide such persons with additional incentive to further the business, promote long-term financial success and increase stockholder value by increasing their proprietary interest in our success. The 2001 Plan permits us to grant stock option grants, stock appreciation rights, restricted stock awards and performance stock awards to our key employees, officers, directors, and consultants. Incentive stock options granted pursuant to the 2001 Plan cannot be granted at an exercise price which is less than 100% of the fair market value of the Common Stock on the date of the grant.

Limitation of Liability and Indemnification of Officers and Directors

Our certificate of incorporation and bylaws provide that we will indemnify our directors and officers to the fullest extent permitted by Delaware law. We believe that the provisions in our certificate of incorporation and bylaws are necessary to attract and retain qualified persons as directors and officers.

MARKET PRICE INFORMATION AND DIVIDENDS

Market Information

Our Class A Common Stock is currently traded on AMEX under the symbol ONH. From July 2001 to December 15, 2004, our common stock was traded on AMEX under the symbol SRG.

On December 15, 2004, we completed a one-for-ten reverse stock split and reclassified our outstanding common stock as Class A Common Stock. No fractional shares of common stock were issued as a result of the reverse stock split and reclassification. In lieu of receiving fractional shares, stockholders received a cash payment in U.S. dollars equal to such fraction multiplied by the closing price of the common stock reported on AMEX on the effective date of the reverse stock split. In addition, each option and warrant to purchase common stock outstanding on the effective date of the reverse stock split was adjusted so that the number of shares of common stock to be issued upon their exercise was divided by ten and the exercise price of each option and warrant was multiplied by ten and the options and warrants became exercisable for Class A Common Stock. The number of shares of Class A Common Stock reserved under our stock option plans and for issuance pursuant to warrants to purchase our Class A Common Stock were similarly adjusted. If the adjustments to the options and warrants described above resulted in any right to acquire a fractional share of Common Stock, such fractional share was disregarded and the number of shares of Class A Common Stock reserved for issuance under the plans and warrants and the number of shares of common stock subject to any such options and warrants became the next lower number of Class A Common Stock, rounding all fractions downward.

On October 20, 2006, the last sale price of our common stock as reported on AMEX was [$0.25] per share. The following table sets forth for the periods indicated the high and low per share closing prices for our common stock for the periods prior to December 15, 2004 and the Class A Common Stock for periods after December 15, 2004, in each as reported by AMEX. Prices prior to December 15, 2004 are restated to reflect a one-for-ten reverse stock split of our common stock on December 15, 2004.

Fiscal Year 2006	**High**	**Low**
Quarter ended March 31, 2006	$ 0.44	$ 0.31

Quarter ended June 30, 2006	$ 0.60	$ 0.25
Quarter ended September 30, 2006	$ 0.31	$ 0.23

Fiscal Year 2005	**High**	**Low**
Quarter ended March 31, 2005	$ 2.70	$ 0.90
Quarter ended June 30, 2005	$ 1.40	$ 0.62
Quarter ended September 30, 2005	$ 0.88	$ 0.37
Quarter ended December 31, 2005	$ 0.49	$ 0.25

Fiscal Year 2004	High	Low
Quarter ended March 31, 2004	$ 6.70	$ 3.50
Quarter ended June 30, 2004	$ 5.20	$ 3.10
Quarter ended September 30, 2004	$ 4.30	$ 2.60
Quarter ended December 31, 2004	$ 4.30	$ 2.60

Holders

As of October 20, 2006, there were approximately (i) [477] holders of record of our Class A Common Stock and [12,788,776] shares of Class A Common Stock issued and outstanding; (ii) [4] holders of record of our Class B Common Stock and [10,448,470] shares of Class B Common Stock outstanding; and (iii) [6] holders of record of our Class C Common Stock and [1,437,572] shares of Class C Common Stock outstanding.

Dividends

We have not paid dividends on shares of our Common Stock within the last three years, and do not expect to declare or pay any cash dividends on our Common Stock in the foreseeable future. Our existing senior credit facility does not allow the payment of dividends without the prior written consent of our lender. We anticipate that our new senior credit facility will have a similar restriction on the payment of dividends.

Subject to the terms of any preferred stock that our board of directors may designate and authorize in the future, our certificate of incorporation currently provides that all dividends and other distributions to be paid to our stockholders will be made to the holders of our Class A Common Stock, Class B Common Stock and Class C Common Stock in the following order and priority (If Proposals I through VI described above is approved by our stockholders at the Special Meeting, the following description will change in the manner set forth under Proposal IV above):

> First, the holders of the shares of Class B Common Stock (other than shares concurrently being converted into Class A Common Stock), as a single and separate class, shall be entitled to receive all distributions until there has been paid with respect to each such share from amounts then and previously distributed an amount equal to $1.15, plus an amount equal to nine percent (9%) per annum on such amount, without compounding, from the date the Class B Common Stock was first issued.
>
> Second, the holders of the shares of Class C Common Stock (other than shares concurrently being converted into Class A Common Stock), as a single and separate class, shall be entitled to receive all distributions until there has been paid with respect to each such share from amounts then and previously distributed an amount equal to $3.30. After the full required distributions have been made to the holders of shares of Class C Common Stock (other than shares concurrently being converted into Class A Common Stock) as described in the previous sentence, each share of Class C Common Stock then outstanding shall be retired and shall not be reissued, and the holder thereof shall surrender the certificates evidencing the shares to us.
>
> Third, after the full distributions have been made to the holders of the shares of Class B Common Stock and Class C Common Stock as described above, all holders of the shares of Class A Common Stock and Class B Common Stock, as a single class, shall thereafter be entitled to receive all remaining distributions pro rata based on the number of outstanding shares of Class A Common Stock or Class B Common Stock held by each holder, provided that for purposes of such remaining distributions, each share of Class B Common Stock shall be deemed to have been converted into one share of Class A Common Stock (subject to adjustment to account for stock splits, stock dividends, combinations or other similar events affecting Class A Common Stock).

VOTING SECURITIES AND PRINCIPAL HOLDERS THEREOF

The board of directors has set October 20, 2006, as the record date for the determination of stockholders entitled to notice of and to vote at the Special Meeting. Stockholders of record as of the close of business on the record date are entitled to one vote for each share of Common Stock (regardless of class) then held. As of the record date, we had [24,674,818] shares of Common Stock issued and outstanding, including [12,788,776] shares of

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Class A Common Stock, [10,448,470] shares of Class B Common Stock, and [1,437,572] shares of Class C Common Stock. Our certificate of incorporation provides that all holders of all classes of Common Stock shall vote together as a single class with respect to Proposals I and II. For Proposal III, the affirmative vote of each of the following will be required to approve such proposal: (i) the holders of a majority of the votes attributable to the then outstanding shares of Common Stock voting together as a single class, (ii) the holders of a majority of the votes attributable to the then outstanding shares of Class B Common Stock voting separately as a class and (iii) the holders of a majority of the votes attributable to the then outstanding shares of Class C Common Stock voting separately as a class. For Proposals IV, V, VI and VII, the affirmative vote of the holders of a majority of the total number of shares of Common Stock represented in person or by proxy at the Special Meeting and entitled to vote will be required to approve each of these proposals.

The following table sets forth certain information with respect to Common Stock beneficially owned as of October 20, 2006, by (i) each person known to us to be the beneficial owner of more than 5% of the issued and outstanding Common Stock, (ii) each of the members or nominees of the board of directors, (iii) each of our named executive officers, and (iv) all directors and executive officers as a group. Beneficial ownership has been determined in accordance with Rule 13d-3 under the Exchange Act. Under this rule, certain shares may be deemed beneficially owned by more than one person (if, for example, persons share the power to vote or the power to dispose of the shares). In addition, shares are deemed beneficially owned by a person if the person has the right to acquire shares (for example, upon the exercise of an option or warrant) within sixty days of the date as of which the information is provided. In computing the percentage ownership of any person, the amount of shares is deemed to include the amount of shares beneficially owned by such person by reason of such acquisition rights. As a result, the percentage of outstanding shares of any person as shown in the following table does not necessarily reflect the person s actual voting power at any particular date. The information in the table is based on information provided to us by the person or group, including filings made by such person with the SEC. Other than as noted below, management knows of no person or group that owns more than 5% of the outstanding shares of Common Stock at the record date.

	Class A Common Stock Beneficially Owned		**Class B Common Stock Beneficially Owned**		**Class C Common Stock Beneficially Owned**	
Name of Beneficial Owner	**Number of Class A Shares(1)**	**Percentage of Class(1)**	**Number of Class B Shares(2)**	**Percentage of Class(2)**	**Number of Class C Shares(3)**	**Percentage of Class(3)**
Robert P. Pinkas(4)	50,142,477(5)	52.28%	7,863,996(6)	75.26%		
Pinkas Family Partners, L.P.(4)	50,142,477(7)	52.28%	7,863,996(8)	75.26%		
Brantley Venture Partners III, L.P.(4)	2,321,649	2.27%				
Brantley Venture Management III, L.P.(4)	2,321,649(9)	2.27%				
Brantley Capital Corporation (10)	12,512,234(11)	12.26%	1,722,983	16.49%		
Brantley Partners IV, L.P.(4)	51,027,384(12)	49.99%	7,863,996	75.26%		
Brantley Management IV, L.P.(4)	51,027,384(13)	49.99%	7,863,996(14)	75.26%		
Terrence L. Bauer	88,461(15)	*				
Paul H. Cascio(4)						

Michael J. Finn(4)	17,000(16)	*				
David Crane	12,272(17)	*				
Joseph M. Valley, Jr.	20,000(18)	*				
Crossroads 1999 Direct/ Co-investment Portfolio A, L.P.	2,948,585(19)	2.89%	467,033	4.47%		
Crossroads Cornerstone Direct/ Co-investment Fund V, L.P.	2,490,387(20)	2.44%	394,348	3.78%		
D/V Cain Family, L.P.	10,019,641(21)	9.82%			718,789	50.00%
Dennis M. Cain	10,019,641(22)	9.82%			718,789	50.00%
Tommy M. Smith	8,099,233(23)	7.93%			580,780	40.40%
Stephen H. Murdock	50,000(24)	*				
Keith G. LeBlanc	461,462(25)	*				
All directors and executive officers as a group (9 persons)	18,768,069(26)	18.39%			1,299,569	90.40%

* Indicates beneficial ownership of less than 1%.

(1) For purposes of calculating the number of shares of Class A Common Stock and the percentage beneficially owned, the number of shares of Class A Common Stock for each person or group deemed outstanding includes: (i) [12,788,776] shares of Class A Common Stock outstanding as of October 20, 2006, (ii) any shares of Class A Common Stock issuable by us pursuant to options and warrants held by the respective person or group which may be exercised within 60 days following October 20, 2006 (Presently Exercisable Options), (iii) any shares of Class Common Stock issuable by us upon conversion of convertible debt of the Company as of October 20, 2006; and (iv) shares of Class A Common Stock issuable by us upon conversion of shares of Class B Common Stock and Class C Common Stock, which are convertible into [65,965,799] shares and [18,975,950] shares of Class A Common Stock, respectively, as of October 20, 2006. The shares of Class B Common Stock and the shares of Class C Common Stock are convertible at the option of the holder into shares of Class A Common Stock at a variable rate determined pursuant to a formula as described under Proposal III above. As of October 20, 2006, each share of Class B Common Stock was convertible into [6.313441095890] shares of Class A Common Stock and each share of Class C Common Stock was convertible into [13.2] shares of Class A Common Stock (assuming simultaneous conversion of all shares of Class B Common Stock).

(2) For purposes of calculating the number of shares of Class B Common Stock and the percentage beneficially owned, the number of shares of Class B Common Stock outstanding as of October 20, 2006 was [10,448,470].

(3) For purposes of calculating the number of shares of Class C Common Stock and the percentage beneficially owned, the number of shares of Class C Common Stock outstanding as of October 20, 2006, was [1,437,572].

(4) The business address of Robert P. Pinkas (Mr. Pinkas), Pinkas Family Partners, L.P. (Pinkas Partners), Brantley III, Brantley Venture Management III, L.P. (Brantley Management III), Brantley IV, Brantley Management IV, L.P. (Brantley Management IV), Paul H. Cascio, and Michael J. Finn is 3201 Enterprise Parkway, Suite 350, Beachwood, OH 44122. Mr. Cascio and Mr. Finn each serve as general partner of Brantley Management III, which is the sole general partner of Brantley III, and Brantley Management IV, which is the sole general partner of Brantley IV. These relationships do not provide either Messr. Cascio or Finn with shared voting or dispositive power with respect to the shares held by Brantley III and Brantley IV and therefore neither Mr. Cascio nor Mr. Finn is deemed to beneficially own the shares held by Brantley III or Brantley IV. Pursuant to a Stockholders Agreement, dated as of December 15, 2004 (the Stockholders Agreement), as amended from time to time, each of Brantley III, Brantley IV and Brantley Capital have agreed to cast all votes necessary to elect as members of our board of directors one director as shall have been nominated by each of Brantley III, Brantley IV and Brantley Capital. Brantley III and Brantley IV disclaim that they are part of a group by virtue of the Stockholders Agreement for purposes of Section 13(d)(3) of the Exchange Act, and each disclaims beneficial ownership of all of our securities held by any other party to the Stockholders Agreement.

(5) The shares consist of (a) 2,321,649 shares of Class A Common Stock owned by Brantley III; (b) [49,648,876] shares of Class A Common Stock issuable upon conversion of 7,863,996 shares of Class B Common Stock owned by Brantley IV; (c) 20,455 shares of Class A Common Stock issuable upon exercise of warrants to purchase Class A Common Stock owned by Brantley IV; (d) [1,358,054] shares of Class A Common Stock issuable upon conversion of $1,250,000 of our convertible debt held by Brantley IV; and (e) 17,000 shares of Class A Common Stock issuable upon exercise of options to purchase Class A Common Stock. Mr. Pinkas is the sole general partner of Pinkas Partners. Pinkas Partners is a general partner of, and holds a majority of the general partnership interests of, Brantley Management III, which is the sole general partner of Brantley III; and is a general partner of and holds a majority of the general partnership interests of Brantley Management IV, which is the sole general partner of Brantley IV. Due to Mr. Pinkas relationships with Brantley III and Brantley IV, he

may be deemed to share voting and dispositive power with respect to the shares held by Brantley III and Brantley IV. Mr. Pinkas disclaims beneficial ownership of any shares except to the extent of a pecuniary interest therein.