

MModal Inc.  
Form 10-Q  
August 08, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10-Q  
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
For the quarterly period ended June 30, 2012.

OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 1-35069

MMODAL INC.  
(Exact name of Registrant as Specified in its Charter)  
Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization)

98-0676666  
(I.R.S. Employer  
Identification No.)

9009 Carothers Parkway  
Franklin, TN  
(Address of Principal Executive Offices)  
(615) 261-1740  
(Registrant's Telephone Number, Including Area Code)

37067  
(Zip Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

The number of registrant's shares of common stock outstanding as of August 1, 2012 was 57,103,043.

MMODAL INC.  
INDEX

	Page
<u>PART I. FINANCIAL INFORMATION</u>	<u>1</u>
<u>Item 1. Financial Statements</u>	<u>1</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>20</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>34</u>
<u>Item 4. Controls and Procedures</u>	<u>34</u>
<u>PART II. OTHER INFORMATION</u>	<u>35</u>
<u>Item 1. Legal Proceedings</u>	<u>35</u>
<u>Item 1A. Risk Factors</u>	<u>36</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>38</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>38</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>38</u>
<u>Item 5. Other Information</u>	<u>38</u>
<u>Item 6. Exhibits</u>	<u>39</u>

---

MModal Inc. and Subsidiaries  
Consolidated Statements of Operations  
(in thousands, except per share amounts)  
Unaudited

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

	Three Months Ended		Six Months Ended	
	June 30, 2012	2011	June 30, 2012	2011
Net revenues	\$115,957	\$108,439	\$233,357	\$219,675
Cost of revenues	65,172	65,453	131,602	131,474
Gross Profit	50,785	42,986	101,755	88,201
Operating costs and expenses:				
Selling, general and administrative	23,589	14,222	45,784	30,896
Research and development	3,624	2,190	6,568	4,892
Depreciation and amortization	12,155	8,879	24,544	17,297
(Benefit) cost of legal proceedings, settlements and accommodations	(211 )	581	329	(6,932 )
Acquisition and restructuring	5,287	4,391	16,373	11,269
Total operating costs and expenses	44,444	30,263	93,598	57,422
Operating income	6,341	12,723	8,157	30,779
Other income	814	530	2,678	1,473
Gain on sale of investment	4,439	—	4,439	—
Interest expense, net	(7,712 )	(6,961 )	(15,510 )	(13,998 )
Income (loss) before income taxes	3,882	6,292	(236 )	18,254
Income tax provision (benefit)	836	886	(413 )	2,030
Net income	3,046	5,406	177	16,224
Less: Net income attributable to noncontrolling interests	—	(271 )	—	-(1,777 )
Net income attributable to MModal Inc.	\$3,046	\$5,135	\$177	\$14,447
Net income per common share				
Basic	\$0.06	\$0.11	\$—	\$0.17
Diluted	\$0.05	\$0.11	\$—	\$0.17
Weighted average common shares outstanding:				
Basic	55,280	49,168	55,134	45,128
Diluted	56,708	50,559	56,357	46,410

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

MModal Inc. and Subsidiaries  
 Consolidated Statements of Comprehensive Income (Loss)  
 (In thousands)  
 Unaudited

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Net income attributable to MModal Inc.	\$3,046	\$5,135	\$177	\$14,447
Foreign currency translation adjustments	(2,201	) 590	(1,127	) 524
Comprehensive income (loss)	\$845	\$5,725	\$(950	) \$14,971

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

MModal Inc. and Subsidiaries  
Consolidated Balance Sheets  
(In thousands except par value)  
Unaudited

	June 30, 2012	December 31, 2011
Assets		
Current Assets:		
Cash and cash equivalents	\$9,043	\$29,557
Accounts receivable, net of allowance of \$1,849 and \$1,493, respectively	79,716	74,413
Other current assets	31,061	35,611
Total Current Assets	119,820	139,581
Property and equipment, net	22,511	24,367
Goodwill	164,410	161,866
Other intangible assets, net	160,787	173,294
Deferred income taxes	23,784	20,585
Other assets	10,480	12,102
Total Assets	\$501,792	\$531,795
Liabilities and Stockholders' Equity		
Current Liabilities:		
Current portion of long-term debt	\$27,774	\$22,712
Accounts payable	9,218	11,808
Accrued expenses	30,251	39,728
Accrued compensation	13,213	10,225
Deferred acquisition payments	20,231	22,323
Deferred revenue	11,689	7,186
Total Current Liabilities	112,376	113,982
Long-term debt	238,784	273,822
Deferred acquisition payments, non-current	15,908	15,161
Other non-current liabilities	4,681	3,779
Total Liabilities	371,749	406,744
Commitments and contingencies (Note 10)		
Stockholders' Equity:		
Preferred stock - \$0.10 par value; authorized 25,000 shares; none issued or outstanding	—	—
Common stock - \$0.10 par value; authorized 300,000 shares; 57,139 and 56,319 shares issued, respectively	5,705	5,632
Additional paid-in-capital	174,331	167,440
Accumulated deficit	(44,205)	(44,382)
Treasury stock, at cost (89 and - shares, respectively)	(1,022)	—
Accumulated other comprehensive loss	(4,766)	(3,639)
Total Stockholders' Equity	130,043	125,051
Total Liabilities and Stockholders' Equity	\$501,792	\$531,795

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

MModal Inc. and Subsidiaries  
Consolidated Statements of Cash Flows  
(In thousands)  
Unaudited

	Six months ended June 30,	
	2012	2011
Operating activities:		
Net income	\$177	\$16,224
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	24,544	17,297
Customer accommodation program reversal	—	(9,658)
Deferred income taxes	(1,419)	) 705
Share-based compensation	5,309	1,230
Provision for doubtful accounts	414	220
Non-cash interest expense	2,927	1,689
Other	1,192	42
Changes in operating assets and liabilities:		
Accounts receivable	(5,717)	) 6,206
Other current assets	4,550	(4,658)
Other non-current assets	(20)	) (5,024)
Accounts payable	(2,590)	) (665)
Accrued expenses	(10,483)	) 8,109
Accrued compensation	2,988	(7,141)
Deferred revenue	4,503	(2,017)
Other non-current liabilities	902	396
Net cash provided by operating activities	27,277	22,955
Investing activities:		
Purchase of property and equipment	(4,945)	) (5,368)
Capitalized software	(3,708)	) (5,564)
Payments for acquisitions, net of cash acquired	(3,068)	) —
Other	205	—
Net cash used in investing activities	(11,516)	) (10,932)
Financing activities:		
Proceeds from debt	26,633	2,113
Repayment of debt	(56,486)	) (27,092)
Deferred acquisition payments	(3,957)	) —
Net proceeds from issuance of common stock	—	6,781
Other	(1,336)	) —
Net cash used in financing activities	(35,146)	) (18,198)
Effect of exchange rate changes	(1,129)	) 197
Net decrease in cash and cash equivalents	(20,514)	) (5,978)
Cash and cash equivalents — beginning of period	29,557	66,779
Cash and cash equivalents — end of period	\$9,043	\$60,801

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

Table of Contents MModal Inc. and Subsidiaries  
Notes to Consolidated Financial Statements  
(Per share data in whole dollars)  
Unaudited

1. Basis of Presentation

The consolidated financial statements and footnotes thereto are unaudited. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") have been omitted pursuant to such rules and regulations although we believe that the disclosures are adequate to make the information presented not misleading. The consolidated financial statements include the accounts of MModal Inc. and its subsidiaries (referred to as "we," "us," "our," and the "Company"). All significant inter-company accounts and transactions have been eliminated in consolidation. Certain amounts for prior periods have been reclassified to conform to the current period presentation.

These statements reflect all normal recurring adjustments that, in the opinion of management, are necessary for the fair presentation of our results of operations, financial position and cash flows. Interim results are not necessarily indicative of results for a full year. The information in this Form 10-Q should be read in conjunction with our 2011 Annual Report on Form 10-K for the year ended December 31, 2011 (the "2011 Form 10-K") filed with the Securities and Exchange Commission ("SEC") on March 15, 2012.

Merger Agreement

On July 2, 2012, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Legend Parent, Inc., a Delaware corporation ("Parent"), and Legend Acquisition Sub, Inc., a Delaware corporation and a wholly-owned subsidiary of Parent ("Merger Sub"). Parent and Merger Sub are affiliates of One Equity Partners V, L.P., a Cayman Islands exempted limited partnership ("OEP").

Pursuant to the Merger Agreement, upon the terms and subject to the conditions thereof, Merger Sub commenced a tender offer on July 17, 2012 (the "Offer") to purchase all of the outstanding shares of common stock of the Company at a purchase price of \$14.00 per share, net to the seller thereof in cash (the "Offer Price"), without interest thereon and subject to any applicable withholding taxes. The transaction is expected to close during the third quarter of 2012.

After the consummation of the Offer and subject to the satisfaction or waiver of certain conditions set forth in the Merger Agreement, Merger Sub will merge with and into the Company (the "Merger") with the Company being the surviving corporation. The Merger Agreement also provides that the Merger may be consummated regardless of whether the Offer is completed, but if the Offer is not completed, the Merger will only be able to be consummated after a majority of the stockholders of the Company have adopted the Merger Agreement at a meeting of stockholders. In the Merger, each share of Company common stock issued and outstanding, other than shares of Company common stock held by the Company as treasury stock, by Parent or Merger Sub or by stockholders who have properly demanded appraisal under Delaware law, will be converted into the right to receive an amount in cash equal to the Offer Price, without interest thereon and subject to any applicable withholding of taxes.

The Merger Agreement contains certain termination rights for both the Company and Parent, including, among others, if the Merger is not consummated on or before December 31, 2012. Upon termination of the Merger Agreement under specified circumstances, including a termination by the Company to enter into an agreement for an alternative transaction pursuant to a Superior Proposal (as defined in the Merger Agreement), the Company has agreed to pay Parent a termination fee of \$28.7 million. If the Merger Agreement is terminated by Parent or the Company following failure to obtain Company stockholder approval for the transaction, the Company will be required to reimburse Parent's expenses incurred in connection with the Merger Agreement and the transactions contemplated thereby up to a maximum amount of \$8.2 million.

The Merger Agreement also provides that Parent will pay, or cause to be paid, to the Company an amount equal to \$57.5 million if the Company terminates the Merger Agreement under certain circumstances, including as a result of (i) Parent's failure to consummate the Offer if all Offer conditions have been satisfied (other than those that by their nature will be satisfied by actions taken at the closing of the Merger), (ii) Parent's failure to consummate the Merger if all conditions to the obligations of Parent and Merger Sub to close the Merger have been satisfied (other than those that by their nature will be satisfied by actions taken at the closing of the Merger) and the Marketing Period (as defined in the Merger Agreement) has expired, or (iii) Parent's material uncured breach of the Merger Agreement that is the principal factor in the failure of the Offer or the Merger, as the case may be, to be consummated.



Table of Contents MModal Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Per share data in whole dollars)

Unaudited

On July 2, 2012, in connection with the Merger Agreement, investment funds affiliated with S.A.C. Private Capital Group LLC, collectively the Company's largest stockholder owning approximately 31% of the outstanding shares of Company common stock in the aggregate, entered into a support agreement with Parent and Merger Sub under which they agreed to tender all of their shares into the Offer and to support the Merger. The support agreement will terminate upon certain circumstances, including upon termination of the Merger Agreement.

U.S. Initial Public Offering

In February 2011, we completed our U.S. initial public offering of common stock selling 3 million shares of our common stock and 1.5 million shares of our common stock owned by selling stockholders at an offer price of \$8.00, resulting in gross proceeds to us of \$24.0 million and net proceeds to us after underwriting fees of \$22.3 million.

Change in Company Name and Ticker Symbol

Effective January 23, 2012, we changed our name from MedQuist Holdings, Inc. to MModal Inc. The name change was effected pursuant to Section 253 of the Delaware General Corporation Law ("DGCL") through the Company's merger with a newly formed wholly-owned subsidiary which, under the DGCL, does not require stockholder approval. Pursuant to Section 253 of the DGCL, such merger had the effect of amending the Company's Certificate of Incorporation to reflect the new legal name of the Company. The Company also amended the Company's By-laws, effective as of the same date, to reflect the name change.

On January 25, 2012, the Company's common stock, which trades on the NASDAQ Global Select Market, ceased trading under the ticker symbol "MEDH" and commenced trading under the ticker symbol "MODL."

Merger with MModal MQ Inc.

In October 2011, we completed the merger ("MModal MQ Merger") with MModal MQ Inc. (formerly MedQuist Inc.), resulting in MModal MQ Inc. becoming our indirect wholly-owned subsidiary and MModal MQ Inc. common stock no longer trading on the OTCQB or on any other market. As a result of the MModal MQ Merger, the remaining approximately 3% issued and outstanding shares of MModal MQ Inc. not held by us were canceled and converted to the right to receive one share of our common stock. The MModal MQ Merger resulted in a reclassification from noncontrolling interest to common stock and additional paid-in-capital.

Business Segment and Reporting Unit

We operate in one reportable operating segment, MModal Inc., which is clinical documentation solutions for the healthcare industry.

2. Summary of Significant Accounting Policies

Critical Accounting Policies

There have been no material changes in our critical accounting policies, judgments or estimates as disclosed in our 2011 Form 10-K.

## Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-04, Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs ("ASU 2011-04"), which clarifies the wording and disclosures required in Accounting Standards Codification ("ASC") Topic 820, Fair Value Measurement ("ASC 820"), to converge with those used in International Financial Reporting Standards ("IFRS"). The update explains how to measure and disclose fair value under ASC 820. However, the FASB does not expect the changes in this update to alter the current application of the requirements in ASC 820. We adopted this new accounting guidance for the quarterly period ended March 31, 2012. The adoption of this guidance did not have an impact on our financial statements.

Table of Contents MModal Inc. and Subsidiaries  
Notes to Consolidated Financial Statements  
(Per share data in whole dollars)  
Unaudited

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220) - Presentation of Comprehensive Income ("ASU 2011-05"). ASU 2011-05 changes the presentation of comprehensive income in the financial statements for all periods reported and eliminates the option under the current guidance that allows for presentation of other comprehensive income as part of the Statement of Stockholders' Equity. The update allows two options for the proper presentation of comprehensive income: 1) a single Statement of Comprehensive Income, which includes all components of net income and other comprehensive income; or 2) a Statement of Income followed immediately by a Statement of Comprehensive Income, which includes the summarized net income and all components of other comprehensive income. Additionally, the update requires the presentation of reclassification adjustments out of accumulated other comprehensive income on the face of the Statement of Income and the Statement of Comprehensive Income. The provisions of ASU 2011-05 are effective for public entities retrospectively for annual periods, and interim periods within those years, beginning after December 15, 2011, with early adoption permitted. We adopted this new accounting guidance for the quarterly period ended March 31, 2012. The adoption of this guidance did not have a material impact on our financial statements.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles - Goodwill and Other (Topic 350) - Testing Goodwill for Impairment ("ASU 2011-08"), which allows companies to assess qualitative factors prior to the use of the two-step quantitative method to determine if goodwill has been impaired. If the qualitative factors reviewed do not indicate that it is more likely than not that the fair value of a reporting unit does not exceed the carrying value, ASU 2011-08 deems any further impairment testing to be unnecessary. In the event that the qualitative review indicates otherwise, the company is required to perform further quantitative impairment testing as prescribed by Topic 350. Other indefinite-lived intangible assets are not affected by the provisions of this update. We adopted this new accounting guidance for the quarterly period ended March 31, 2012. The adoption of this guidance did not have an impact on our financial statements.

In December 2011, the FASB issued ASU No. 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 ("ASU 2011-12"). ASU No. 2011-12 defers the effective date of the requirement to present separate line items on the income statement for reclassification adjustments of items out of accumulated other comprehensive income into net income for all periods presented. The ASU does not change the other requirements of FASB ASU No. 2011-05, Presentation of Comprehensive Income. Entities are still required to present reclassification adjustments within other comprehensive income either on the face of the statement that reports other comprehensive income or in the notes to the financial statements. The requirement to present comprehensive income in either a single continuous statement or two consecutive condensed statements remains for both annual and interim reporting. The deferral of the requirement for the presentation of reclassification adjustments is intended to be temporary until the FASB reconsiders the operational concerns and needs of financial statement users. ASU 2011-12 is effective at the same time as ASU 2011-05, which is effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2011. We adopted this new accounting guidance for the quarterly period ended March 31, 2012. The adoption of this guidance did not have a material impact on our financial statements.

### 3. Acquisitions

Multimodal Technologies, Inc.

On August 18, 2011, we completed the acquisition and merger ("MultiModal Merger") of 100% of the shares of MultiModal Technologies, Inc. ("MultiModal"). The MultiModal Merger provided us ownership of speech and natural language understanding technologies, and facilitated consolidation to a single back-end speech recognition platform, provided a broader product offering to local and regional transcription partners and leveraged MultiModal's cloud-based services to enhance gross margins. The acquisition was funded by our available cash and availability under our revolving credit facility.

Table of Contents MModal Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(Per share data in whole dollars)

Unaudited

The following unaudited pro forma summary presents the consolidated information of MModal Inc. as if the business combination had occurred at the beginning of the first quarter of 2011: