

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

ORION HEALTHCORP INC
Form 10QSB
August 09, 2007

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007

Commission File No. 001-16587

ORION HEALTHCORP, INC.
(NAME OF SMALL BUSINESS ISSUER IN ITS CHARTER)

Delaware
(STATE OR OTHER JURISDICTION
OF INCORPORATION OR ORGANIZATION)

58-1597246
(IRS EMPLOYER IDENTIFICATION NO.)

1805 Old Alabama Road
Suite 350, Roswell GA
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

30076
(ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER: (678) 832-1800

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
Class A Common Stock, \$0.001 par value per share	The American Stock Exchange

Indicate by check mark whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes No

As of August 9, 2007, 105,504,032 shares of the registrant's Class A Common Stock, par value \$0.001, were outstanding and 24,658,955 shares of the registrant's Class D Common Stock, par value \$0.001, were outstanding.

Transitional Small Business Disclosure Format Yes No

ORION HEALTHCORP, INC.
Quarterly Report on Form 10-QSB
For the Quarterly Period Ended June 30, 2007

TABLE OF CONTENTS

Item Number -----	Page Number -----
----------------------	----------------------

PART I - FINANCIAL INFORMATION

1. Financial Statements	3
2. Management's Discussion and Analysis or Plan of Operation	3

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

3. Controls and Procedures	23
PART II - OTHER INFORMATION	
1. Legal Proceedings	23
4. Submission of Matters to a Vote of Security Holders	23
5. Other Information	24
6. Exhibits	24
SIGNATURES	
UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS	F-1
INDEX OF EXHIBITS	

2

The following text is qualified in its entirety by reference to the more detailed information and unaudited consolidated condensed financial statements, including the notes thereto, appearing elsewhere in this Quarterly Report on Form 10-QSB. Unless otherwise indicated, the terms "we," "us" and "our" refer to Orion HealthCorp, Inc. ("Orion" or the "Company") and its consolidated subsidiaries.

NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Quarterly Report on Form 10-QSB constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, (the "Exchange Act," and collectively, with the Securities Act, the "Acts") as amended by the Private Securities Litigation Reform Act of 1995 (the "Reform Act"). Any statements other than statements of historical fact included in this Quarterly Report on Form 10-QSB, including without limitation, statements under the caption "Management's Discussion and Analysis or Plan of Operation" regarding our financial position, business strategy and plans and objectives for future performance are deemed to be forward-looking statements. Forward-looking statements include statements preceded by, followed by or including the words "may," "will," "would," "could," "should," "estimates," "predicts," "potential," "continue," "strategy," "believes," "anticipates," "plans," "expects," "intends" and similar expressions. In particular, these include statements relating to our future actions, future performance or results of current, anticipated services, expenses and financial results and any statements that are not statements of historical facts. From time to time, we may also provide oral or written forward-looking statements in other materials we release to the public. The forward-looking statements in this report are based on current beliefs, estimates and assumptions concerning our operations, future results, and prospects described herein. As actual operations and results may materially differ from those assumed in forward-looking statements, there is no assurance that forward-looking statements will prove to be accurate. Any number of factors could affect future operations, including, without limitation, changes in federal or state healthcare laws and regulations and third party payer requirements, changes in costs of supplies, the loss of major customers, increases in labor and employee benefit costs, increases in interest rates on our indebtedness as well as general market conditions, competition and pricing, and our ability to successfully implement our business strategies and integrate acquisitions, including the expense and impact of any potential acquisitions and the ability to obtain necessary approvals and financing. You are also advised to consult the risk factors set forth in Item 6. Management's Discussion and Analysis or Plan of Operations of our Annual Report on Form 10-KSB filed with the Securities and Exchange Commission ("SEC") on April 2, 2007.

We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information or future events. You are advised, however, to consult any further disclosures we make on related subjects

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

in the quarterly, periodic and annual reports we file with the SEC. Other factors in addition to those described herein could also adversely affect operating or financial performance. Forward-looking statements are subject to the safe harbors created in the Reform Act.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Our unaudited consolidated condensed financial statements and related notes thereto are included as a separate section of this report, commencing on page F-1.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following discussion 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. This discussion should be read in conjunction with our unaudited consolidated condensed financial statements and related notes thereto, which are included elsewhere in this Quarterly Report on Form 10-QSB.

Overview

We are a healthcare services organization providing outsourced business services to physicians, serving the physician market through two operating segments - Revenue Cycle Management and Practice Management - via five operating subsidiaries: Medical Billing Services, Inc. ("MBS"), Rand Medical Billing, Inc. ("Rand"), On Line Alternatives, Inc. ("OLA") and On Line Payroll Services, Inc. ("OLP") (collectively with OLA, "On Line"), and Integrated Physician Solutions, Inc. ("IPS"). Our mission is to provide superior billing, collections, practice management, business and financial management services for physicians, resulting in optimal profitability for our clients and increased enterprise value for our stakeholders. We believe our core competency is our long-term experience and success in working with and creating value for physicians.

3

Revenue Cycle Management Segment ("RCM")

Our RCM segment includes three business units: MBS, Rand and On Line. We offer 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, allowing them to avoid the infrastructure investment in their own back-office operations. In addition, we provide these services to other specialties including plastic surgery, family practice, internal medicine, orthopedics, neurologists, emergency medicine and ambulatory surgery centers. These services help clients to be financially successful by improving cash flows and reducing administrative costs and burdens. MBS currently provides services to approximately 56 clients. Rand currently provides services to approximately 54 clients. On Line currently provides services to approximately 20 billing clients and 43 transcription clients and provides payroll processing services to over 200 clients.

Billing and Collection Services. We offer billing and collection services to our clients. These include coding, reimbursement services, charge entry, claim submission, collection activities, and financial reporting services, including:

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

- o Current Procedural Terminology ("CPT") and International Classification of Diseases ("ICD-9") utilization reviews;
- o Charge ticket (superbill) evaluations;
- o Fee schedule analyses;
- o Reimbursement audits; and
- o Training seminars.
- o Patient refund processing

Managed Care Contract Management Services. We offer consulting services to assist clients in interacting with managed care organizations. Some of the managed care consulting services are:

- o Establishing the actual ownership of the managed care organization and determining that the entity is financially sound;
- o Negotiating the type of reimbursement offered;
- o Assuring that there are no "withholds" beyond the discount agreed upon;
- o Determining patient responsibility for non-covered services, as well as co-pays and deductibles;
- o Tracking managed care payments to verify the accuracy of the reimbursement rate;
- o Evaluating the appeals process in case of disputes concerning payment issues, utilization review, and medical necessity; and
- o Confirming the length of the contract, the renewal process, and the termination options.

Practice Consulting Services. We offer a wide range of management consulting services to medical practices. These management services help create a more efficient medical practice, providing assistance with the business aspects associated with operating a medical practice. Our management consulting services include the following:

- o Accounting and bookkeeping services;
- o Evaluation of staffing needs;
- o Provision of temporary staff services;
- o Quality assurance program development;
- o Physician credentialing assistance;
- o Fee schedule review, specific to locality;
- o Formulation of scheduling systems; and
- o Training and continuing education programs.
- o Payroll processing

See Note 5 in our Notes to Unaudited Consolidated Condensed Financial Statements included in Part I, Item 1. Financial Statements for financial information regarding our RCM segment.

Practice Management ("PM") Segment

IPS, a Delaware corporation, was founded in 1996 to provide physician practice management services to general and subspecialty pediatric practices. IPS commenced its business activities upon consummation of the combination of several medical group businesses effective January 1, 1999.

IPS serves the general and subspecialty pediatric physician market, providing accounting and bookkeeping, human resource management, group purchasing, accounts receivable management, quality assurance services, physician credentialing, fee schedule review, training and continuing education and billing and reimbursement analysis. As of June 30, 2007, IPS managed six practice sites, representing three medical groups in Illinois and Ohio. The physicians, who are all employed by unrelated corporations, provide all clinical and patient care related services.

IPS was party to a management services agreement ("the Illinois MSA") with Pediatric Specialists of the Northwest, M.D.S.C. ("PSNW"). IPS and PSNW were in arbitration regarding claims relating to the Illinois MSA. In connection therewith, on February 9, 2007, IPS and PSNW entered into a settlement agreement ("the PSNW Settlement") to settle disputes that had arisen between IPS and PSNW and to avoid the risk and expense of further litigation. As part of the PSNW Settlement, PSNW and IPS agreed that PSNW would purchase the assets owned by IPS and used in connection with PSNW's practice, in exchange for a negotiated cash consideration and termination of the Illinois MSA. The transaction contemplated by the PSNW Settlement was consummated on May 31, 2007. Among other provisions, after May 31, 2007, PSNW and IPS have been released from any further obligation to each other from any previous agreement. The operations of PSNW are reflected on our consolidated condensed statements of operations as 'income from operations of discontinued components' for the three months and six months ended June 30, 2007 and 2006, respectively. (See "Results of Operations - Discontinued Operations.")

The operations of Dayton Infant Care Specialists, Corp. ("Dayton ICS") are also reflected in our consolidated condensed statements of operations as 'income from operations of discontinued components' for the three months and six months ended June 30, 2007 and 2006, respectively. (See "Results of Operations - Discontinued Operations.")

There is a standard forty-year management service agreement ("MSA") between IPS and each of the various affiliated medical groups whereby a management fee is paid to IPS. IPS owns all of the assets used in the operation of the medical groups. IPS manages the day-to-day business operations of each medical group and provides the assets for the physicians to use in their practice for a fixed fee or percentage of the net operating income of the medical group. All revenues are collected by IPS, the fixed fee or percentage payment to IPS is taken from the net operating income of the medical group and the remainder of the net operating income of the medical group is paid to the physicians and treated as an expense on IPS's financial statements as "physician group distribution."

See Note 5 in our Notes to Unaudited Consolidated Condensed Financial Statements included in Part I, Item 1. Financial Statements for financial information regarding the continuing operations of our PM segment.

Company History and Strategic Focus

Orion was incorporated in Delaware on February 24, 1984 as Technical Coatings, Incorporated. On December 15, 2004, we completed a series of transactions to acquire IPS (the "IPS Merger") and to acquire Dennis Cain Physician Solutions, Ltd. ("DCPS") and MBS (the "DCPS/MBS Merger") (collectively, the "2004 Mergers"). As a result of these transactions, IPS and MBS became our wholly owned subsidiaries. On December 15, 2004, and simultaneous with the consummation of the 2004 Mergers, we changed our name from SurgiCare, Inc. to Orion HealthCorp, Inc. and consummated restructuring transactions, which included issuances of new equity securities for cash, contribution of outstanding debt, and the restructuring of our debt facilities. We also created Class B Common Stock and Class C Common Stock, which were issued in connection with the equity investments and acquisitions.

In 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. As part of this plan, we

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

completed a series of transactions involving the divestiture of non-strategic assets in 2005 and early 2006. In addition, we redirected financial resources and company personnel to areas that management believed would enhance long-term growth potential. We believe that we are 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. A key component of this strategy includes acquiring financially successful billing companies focused on providing services to hospital-based physicians and increasing sales and marketing efforts in existing markets.

On December 1, 2006 we completed the acquisition of Rand and the On Line businesses. We acquired 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 was paid through a combination of cash, the issuance of an unsecured subordinated promissory note and the issuance of shares of our Class A Common Stock. We acquired 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 was paid through a combination of cash and the issuance of unsecured subordinated promissory notes.

These acquisitions were financed in part through the proceeds of a private placement that was also completed on December 1, 2006 (the "Private Placement"). The Private Placement consisted of our issuance of (i) shares of a newly created class of our common stock, Class D Common Stock, par value \$0.001 per share (the "Class D Common Stock"), which is convertible into our Class A Common Stock, to each of Phoenix Life Insurance Company ("Phoenix") and Brantley Partners IV, L.P. ("Brantley IV") for an aggregate purchase price of \$4,650,000 and (ii) senior unsecured subordinated promissory notes due 2011 in the original principal amount of \$3,350,000, bearing interest at an aggregate rate of 14% per annum, together with warrants to purchase shares of our Class A Common Stock, to Phoenix for an aggregate purchase price of \$3,350,000.

5

Our senior unsecured subordinated promissory notes 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 are 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 notes subject to certain prepayment penalties and we are required to prepay outstanding principal (together with accrued interest) on the notes upon the occurrence of certain specified circumstances.

As a condition to the Private Placement, on December 1, 2006, we refinanced our existing loan facility with CIT Healthcare, LLC ("CIT") into a four year \$16,500,000 senior secured credit facility with Wells Fargo Foothill, Inc. ("Wells Fargo") consisting of a \$2,000,000 revolving loan commitment, a \$4,500,000 term loan and a \$10,000,000 acquisition facility commitment. Amounts borrowed under this facility are secured by substantially all of our assets and a pledge of the capital stock of our operating subsidiaries. Under the terms of the credit agreement (the "Credit Agreement") relating to this facility, amounts borrowed bear interest at either a fluctuating rate based on the prime rate or LIBOR rate, at our election. Currently, our interest rate on the revolving loan commitment and the term loan is the prime rate plus 1.75%. In addition to refinancing our existing loan facility, a portion of the proceeds from this

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

facility were used to fund our acquisitions of Rand and On Line and to finance our ongoing working capital, capital expenditure and general corporate needs. Upon repayment of the CIT loan facility, two of our stockholders, Brantley IV and Brantley Capital Corporation ("Brantley Capital") were released from guarantees that they had provided on our behalf in connection with the loan facility.

Also on December 1, 2006 in connection with the consummation of the Private Placement and the execution of the Credit Agreement, the following actions were taken:

- o We amended our certificate of incorporation to create the Class D Common Stock and eliminate both the Class B Common Stock and Class C Common Stock;
- o We purchased and retired all 1,722,983 shares of our Class B Common Stock owned by Brantley Capital for an aggregate purchase price of \$482,435;
- o Brantley IV converted the entire unpaid principal balance, and accrued but unpaid interest, of two convertible subordinated promissory notes in the original aggregate amount of \$1,250,000 (the "Brantley IV Notes") into 1,383,825 shares of our Class A Common Stock;
- o All of our remaining holders of Class B Common Stock and Class C Common Stock converted their shares into 87,761,969 shares of our Class A Common Stock;
- o We extended the maturity date and increased the interest rate on certain unsecured subordinated promissory notes totaling in the aggregate \$1,714,336 (the "DCPS/MBS Notes") issued to certain of the former equity holders of the businesses we acquired in 2004 as part of the DCPS/MBS Merger, including two of our executive officers, Dennis Cain, CEO of MBS, and Tommy Smith, President and COO of MBS; and
- o We restructured certain unsecured notes issued to DVI Financial Services, Inc. ("DVI") and serviced by U.S. Bank Portfolio Services ("USBPS") to reduce the outstanding balance from \$3,750,000 to \$2,750,000.

As of June 30, 2007, Brantley IV and its affiliates, Brantley Venture Partners III, L.P. ("Brantley III") and Brantley Equity Partners, L.P. ("BEP"), owned 66,629,515 shares of our Class A Common Stock, warrants to purchase 20,455 shares of our Class A Common Stock and 8,749,952 shares of our Class D Common Stock which are currently convertible into 8,749,952 shares of our Class A Common Stock. As of June 30, 2007, this represented 55.1% of our voting power on an as-converted, fully-diluted basis. As of December 1, 2006, we qualified as a "controlled company" under the listing rules of the American Stock Exchange ("AMEX"). Two of our directors, Paul H. Cascio and Robert P. Pinkas, are affiliated with Brantley IV and its related entities. Messrs. Cascio and Pinkas serve as general partners of the general partner of Brantley III and Brantley IV and are limited partners in these funds. The advisor to Brantley III is Brantley Venture Management III, L.P. and the advisor to Brantley IV is Brantley Management IV, L.P. Messrs. Cascio and Pinkas also serve as advisors to BEP.

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 closing of the Private Placement, Phoenix did not own, of record, any shares of our capital stock. As part of the Private Placement, Phoenix received (i) 15,909,003 shares of Class D Common Stock, representing upon conversion 15,909,003 shares, or 11.7%, of our outstanding Class A Common Stock as of June 30, 2007, on an as-converted, fully-diluted basis taking into account the issuance of the shares of Class D Common Stock and (ii) warrants to purchase 1,421,629 shares of our Class A Common Stock representing 1.0% of the voting power as of June 30, 2007 on an as-converted, fully-diluted basis.

Financial Overview

As more fully described below, our results of operations for the three months and six months ended June 30, 2007 as compared to the same period in 2006 reflect several important factors, many related to the impact of the transactions which occurred as part of our strategic plan referred to above.

- o Changes in revenues, resulting from the reclassification of some of IPS's operations into discontinued operations as well as the inclusion of revenues for Rand and On Line in the first and second quarters of 2007 as compared to no revenue in the same period in 2006;
- o Inclusion of legal expenses in the first quarter of 2007 related to IPS's discontinued operations;
- o Inclusion of expenses for Rand and On Line for the three and six months ended June 30, 2007 as compared to no expenses in the first and second quarters of 2006; and
- o We closed the transaction contemplated by the PSNW Settlement effective May 31, 2007, and recorded a gain on disposition of discontinued components of \$999,725 in the second quarter of 2007.

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 included beginning on Page F-1 of this Quarterly Report on Form 10-QSB 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;

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

- (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 saleable 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 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, Rand and OLA's principal source of revenues is fees charged to clients based on a percentage of net collections of the client's accounts receivable. They recognize revenue and bill their clients when the clients receive payment on those accounts receivable. Our RCM businesses typically receive 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, Rand and OLA also earn fees from the various consulting services that they provide, including medical practice management services, managed care contracting, coding and reimbursement services and transcription services. OLP earns revenue based on a contracted rate per transaction and recognizes revenue when the service is provided.

7

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

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

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. 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 three months and six months ended June 30, 2007 and 2006.

Accounts Receivable and Allowance for Doubtful Accounts. MBS, Rand and On Line record uncollectible accounts receivable using the direct write-off method of accounting for bad debts. Historically, they have experienced minimal credit losses and have not written-off any material accounts during 2007 or 2006.

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.

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 -- Discontinued Operations" for additional discussion regarding the impairment testing of identifiable intangible assets.)

Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of FASB Statement No. 115," ("SFAS 159") which is effective for fiscal years beginning after November 15, 2007. SFAS 159 permits entities to measure eligible financial assets, financial liabilities and firm commitments at fair value, on an instrument-by-instrument basis, that are otherwise not permitted to be accounted for at fair value under other U.S. generally accepted accounting principles. The fair value measurement election is irrevocable and subsequent changes in fair value must be recorded in earnings. We do not expect the impact of SFAS 159 to be material to our consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements," ("SAB 108") which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

misstatement. SAB 108 is effective for fiscal years ending after November 15, 2006. The adoption of SAB 108 was not material to our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," ("SFAS 157") which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Earlier application is encouraged provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year. We do not expect the impact of SFAS 157 to be material to our consolidated financial statements.

8

In June 2006, the FASB issued Financial Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," ("FIN 48") which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN 48 provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, based on the technical merits. This interpretation also provides guidance on measurement, de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We adopted the provisions of FIN 48 effective January 1, 2007 and analyzed filing positions in our federal and state jurisdictions where we are required to file income tax returns, as well as for all open tax years in these jurisdictions. Our reserve for uncertain tax positions was insignificant upon adoption of FIN 48 and we did not record a cumulative effect adjustment to opening retained earnings related to the adoption of FIN 48. We believe our income tax filing positions and deductions will be sustained under audit and we believe we do not have significant uncertain tax positions that, in the event of adjustment, will result in a material effect on our results of operations or financial position.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections" ("SFAS 154"). SFAS 154 replaces Auditing Practices Board ("APB") Opinion No. 20, "Accounting Changes" ("APB 20") and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirements for the accounting and reporting of a change in accounting principle. SFAS 154 applies to all voluntary changes in accounting principle as well as to changes required by an accounting pronouncement that does not include specific transition provisions. Previously, most changes in accounting principles were required to be recognized by way of including the cumulative effect of the changes in accounting principles in the income statement of the period of change. SFAS 154 requires that such changes in accounting principles be retrospectively applied as of the beginning of the first period presented as if that accounting principle had always been used, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. However, SFAS 154 does not change the transition provisions of any existing accounting pronouncements. The adoption of SFAS 154 was not material to our consolidated financial statements.

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

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

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 APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related interpretive guidance ("APB 25").

The effect of SFAS 123(R) was 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 adopted the provisions of SFAS 123(R) beginning with the quarter ending March 31, 2006.

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 adopted the modified prospective transition method beginning in 2006.

Results of Operations

The acquisitions of Rand and On Line were accounted for using the purchase accounting method, meaning that the purchase price, comprised of the consideration paid to the stockholders of Rand and On Line at closing, the fair value of the liabilities assumed and the transaction costs associated with the acquisitions, was allocated to the fair value of the tangible and identifiable intangible assets of Rand and On Line, with any excess being considered goodwill. Our results for the three months and six months ended June 30, 2007 include the results of MBS, Rand, On Line and IPS. Our results for the three months and six months ended June 30, 2006 include the results of MBS and IPS. We did not acquire Rand and On Line until December 1, 2006.

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 three months and six months ended June 30, 2006 have been reclassified to reflect the operations, including IPS operations, discontinued in 2006 and our surgery and diagnostic center businesses, which were discontinued in 2005.

This discussion should be read in conjunction with our unaudited consolidated condensed financial statements and related notes thereto, which are included as a separate section of this Quarterly Report on Form 10-QSB beginning on page F-1.

The following table sets forth selected statements of operations data expressed as a percentage of our net operating revenues for the three months and six months ended June 30, 2007 and 2006, respectively. Our historical results and period-to-period comparisons are not necessarily indicative of the results for any future period.

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

	June 30,	
	2007	2006
	-----	-----
Net operating revenues	100.0%	100.0%
Total operating expenses	106.7%	109.4%
	-----	-----
Loss from continuing operations before other income (expenses)	(6.7%)	(9.4%)
Total other income (expenses), net	(4.4%)	(2.3%)
	-----	-----
Loss from continuing operations	(11.1%)	(11.7%)
Discontinued operations		
Income from operations of discontinued components	12.5%	2.6%
	-----	-----
Net income (loss)	1.4%	(9.1%)
	=====	=====

Three Months Ended June 30, 2007 and 2006 - Continuing Operations

Net Operating Revenues.

	Three months ended
	2007

RCM Segment	\$ 4,975,098
PM Segment	3,114,229
Other	71,825

Total consolidated net operating revenues	\$8,161,152
	=====

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, Rand and On Line, and other revenue. Our results for the three months ended June 30, 2007 include the results of MBS, Rand, On Line and IPS. Our results for the three months ended June 30, 2006 include the results of MBS and IPS. We did not acquire Rand and On Line until December 1, 2006.

For the three months ended June 30, 2007, consolidated net operating revenues increased \$2,898,418 or 55.1%, to \$8,161,152, as compared with \$5,262,734 for the three months ended June 30, 2006.

Net operating revenues for our RCM segment, which included MBS, Rand and On Line in the second quarter of 2007 and MBS in the second quarter of 2006, totaled \$4,975,098 for the three months ended June 30, 2007, an increase of \$2,613,336, or 110.7%, over the same period in 2006. Net operating revenues for Rand and On Line totaled \$1,658,288 and \$610,640, respectively, in the second quarter of 2007. MBS's net operating revenues increased 14.6% in the second quarter of 2007, increasing from \$2,361,762 for the three months ended June 30, 2006 to \$2,706,170 for the same period in 2007.

The following table illustrates, by customer category, the contribution of existing, new and lost customers to MBS's net operating revenues for the three months ended June 30, 2007 and 2006, respectively:

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

	Three months ended June 30, 2007	2006
	-----	-----
MBS net operating revenues:		
Existing customers	\$ 2,318,939	\$ 2,235
New customers in 2006	360,519	15
New customers in 2007	25,812	
Customers lost in 2006	572	41
Customers lost in 2007	328	69
	-----	-----
Total consolidated net operating revenues	\$ 2,706,170	\$ 2,361
	=====	=====

Net operating revenues for our PM segment, which consists of net patient service revenue from IPS's affiliated medical groups, increased \$314,453, or 11.2%, from \$2,799,776 for the three months ended June 30, 2006 to \$3,114,229 for the three months ended June 30, 2007. IPS's clinic-based affiliated pediatric groups experienced increases in patient volume in the second quarter of 2007, with total procedures and immunizations increasing 8,395 and 4,827, respectively, to 78,499 and 16,891 for the three months ended June 30, 2007. These increases can be generally explained by the release of a new vaccine for adolescent females to prevent cervical cancer, which has increased patient demand.

10

Other revenue totaled \$101,196 for the second quarter of 2006, decreasing \$29,371, or 29.0%, to \$101,196 for the three months ended June 30, 2007. This represents revenue from our vaccine program, which is a group purchasing alliance for vaccines and medical supplies. The vaccine program, which had 507 enrolled participants at the end of the first quarter of 2007, added a net of approximately six members during the quarter ended June 30, 2007.

Operating Expenses.

	Three months ended June 30, 2007	2006
	-----	-----
Salaries and benefits	\$ 4,326,747	\$ 2,5
Physician group distribution	959,296	1,0
Facility rent and related costs	467,827	3
Depreciation and amortization	708,505	4
Professional and consulting fees	314,222	3
Insurance	147,337	1
Provision for doubtful accounts	57,645	
Other	1,726,337	9
	-----	-----
Total consolidated operating expenses	\$8,707,916	\$ 5,7
	=====	=====

Our expenses for the three months ended June 30, 2007 include the results of MBS, Rand, On Line and IPS. Our expenses for the three months ended June 30, 2006 include the results of MBS and IPS. We did not acquire Rand and On Line until December 1, 2006.

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

Consolidated operating expenses totaled \$8,707,916 for the three months ended June 30, 2007, an increase of \$2,949,507 over the same period in 2006.

Salaries and Benefits. Consolidated salaries and benefits increased \$1,789,393 to \$4,326,747 for the three months ended June 30, 2007, as compared to \$2,537,354 in the second quarter of 2006. Salaries and benefits for Rand and On Line totaled \$1,129,280 and \$362,134, respectively, for the three months ended June 30, 2007.

MBS's salaries and benefits totaled \$1,641,311 for the three months ended June 30, 2007 as compared to \$1,471,325 for the same three months in 2006, an increase of \$169,986. Staffing levels increased quarter over quarter, with salaries, including bonuses and overtime, increasing \$156,325 and temporary help increasing \$17,501 in the second quarter of 2007 as compared to the second quarter of 2006.

Clinical salaries and benefits include wages for the nurse practitioners, nursing staff and medical assistants employed by the affiliated medical groups and may fluctuate indirectly to increases and decreases in productivity and patient volume. Clinical salaries, bonuses, overtime and health insurance collectively totaled \$326,051 for the three months ended June 30, 2007, an increase of \$20,563 over the same period in 2006. These expenses represented approximately 10.5% and 10.9% of net operating revenues for the quarters ended June 30, 2007 and 2006, respectively.

Administrative salaries and benefits, excluding MBS, Rand and On Line, 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 \$104,260, or 14.1%, from \$737,041 for the three months ended June 30, 2006 to \$841,301 for the same period in 2007. The additional expense can be explained generally by the \$49,751 increase in stock option compensation expense in the second quarter of 2007, compared to the same period in 2006, as a result of options granted to employees and directors in December 2006. Additionally, the second quarter of 2007 included a full quarter of salary expense for the Director of Practice Operations, a position which was vacant during much of the second quarter of 2006.

Physician Group Distribution. Physician group distribution decreased \$98,517, or 9.3%, for the three months ended June 30, 2007 to \$959,296, as compared with \$1,057,813 for the three months ended June 30, 2006. 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 quarter ended June 30, 2007, management fee revenue totaled \$180,908 and represented approximately 15.9% of net operating income as compared to management fee revenue totaling \$178,085 and representing approximately 14.4% of net operating income for the same period in 2006. Physician group distributions represented 30.8% of net operating revenues in the second quarter of 2007, compared to 37.8% of net operating revenues for the same period in 2006. The decrease in physician group distribution for the three months ended June 30, 2007 was directly related to the increase in vaccine expenses, which was primarily the result of increased immunization volume during the second quarter.

Facility Rent and Related Costs. Facility rent and related costs increased \$141,771, or 43.5%, from \$326,057 for the three months ended June 30,

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

2006 to \$467,827 for the three months ended June 30, 2007. Rent and related expenses for Rand and On Line totaled \$73,828 and \$32,771, respectively, for the second quarter of 2007.

MBS's facility rent and related costs totaled \$139,935 for the three months ended June 30, 2007 as compared to \$127,442 for the same period in 2006. This increase can be explained generally by increases in base rent at all of MBS's operating locations.

Facility rent and related costs associated with IPS's affiliated medical groups and Orion's corporate office totaled \$221,294 for the three months ended June 30, 2007 compared to \$198,615 for the same period in 2006.

Depreciation and Amortization. Consolidated depreciation and amortization expense totaled \$705,648 for the three months ended June 30, 2007, an increase of \$301,925 over the three months ended June 30, 2006.

In the second quarter of 2007, depreciation expense related to our fixed assets totaled \$71,890 as compared to \$51,989 for the same period in 2006. Following is a table that illustrates, by business unit, the depreciation expense for our fixed assets for the three months ended June 30, 2007 and 2006:

	Three months ended June 30, 2007	2006
	-----	-----
Depreciation expense:		
Rand	\$ 12,805	
On Line	10,217	
MBS	16,802	
IPS	15,810	
Orion	16,256	
	-----	-----
Total consolidated depreciation expense	\$ 71,890	
	=====	=====

Amortization expense related to our intangible assets totaled \$636,615 for the three months ended June 30, 2007 as compared to \$351,734 for the same period in 2006. Following is a table that illustrates, by business unit, the amortization expense related to our intangible assets in the second quarter of 2007 and 2006:

	Three months ended June 30, 2007	2006
	-----	-----
Amortization expense:		
Rand	\$ 131,914	
On Line	92,444	
MBS	265,523	
IPS	40,700	
Orion	106,034	
	-----	-----
Total consolidated depreciation expense	\$ 636,615	\$
	=====	=====

Rand. Effective December 1, 2006, we purchased Rand for a combination of cash, notes and stock. Since the consideration for this purchase transaction

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

exceeded the fair value of the net assets of Rand at the time of the purchase, a portion of the purchase price was allocated to intangible assets and goodwill. The amortization expense related to the intangible assets recorded as a result of the acquisition of Rand totaled \$131,914 for the three months ended June 30, 2007.

On Line. Effective December 1, 2006, we purchased On Line for a combination of cash and notes. Since the consideration for this purchase transaction exceeded the fair value of the net assets of On Line at the time of the purchase, a portion of the purchase price was allocated to intangible assets and goodwill. The amortization expense related to the intangible assets recorded as a result of the acquisition of On Line totaled \$92,444 for the three months ended June 30, 2007.

MBS. 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 \$265,523 for the three months ended June 30, 2007 and 2006, respectively.

12

IPS. Amortization expense related to the MSAs for IPS's affiliated medical groups totaled \$40,700 and \$86,211 for the three months ended June 30, 2007 and 2006, respectively. The decrease is directly related to IPS operations discontinued in 2006, which resulted in the impairment of the intangible assets related to those operations at December 31, 2006.

Orion. There were significant costs associated with the acquisitions of Rand and On Line as well as the Private Placement, the Credit Agreement and the restructured USBPS loan.

Those costs that were specifically related to a particular component of the transactions were allocated directly to that component. In cases where it was not possible to specifically allocate certain costs to each identifiable component, we allocated the costs on a pro-rata basis based on each component's transaction value relative to the value of all of the transactions in the aggregate. With respect to the costs that we determined to be allocable to the equity portion of the Private Placement, we determined that, since the proceeds from the Private Placement were used to acquire Rand and On Line, those costs were to be further allocated to Rand and On Line on a pro-rata basis based on each company's acquisition consideration relative to the total aggregate acquisition consideration.

Amortization expense related to the transaction costs described above totaled \$106,034 for the three months ended June 30, 2007.

Professional and Consulting Fees. For the three months ended June 30, 2007, professional and consulting fees totaled \$314,222, a decrease of \$13,351, or 4.1%, from the same period in 2006. Professional and consulting fees for Rand and On Line totaled \$18,490 and \$46,996, respectively, in the second quarter of 2007.

For the three months ended June 30, 2007, MBS recorded professional and consulting expenses totaling \$29,388 as compared with \$47,621 for the same period in 2006, a decrease of \$18,232. This change is primarily the result of a decrease in contract labor used in early 2006 as a result of staffing shortages.

IPS's and Orion's professional and consulting fees, which include the

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

costs of corporate accounting, financial reporting and compliance, and legal fees, decreased from \$279,952 for the three months ended June 30, 2006 to \$219,348 for the three months ended June 30, 2007. This decrease can be explained generally by a \$30,000 decrease in consulting fees related to a business development consultant who was utilized in the first quarter of 2006, as well as decreases in legal, accounting and purchased services totaling approximately \$25,000 in the aggregate.

Insurance. Consolidated insurance expense, which includes the costs of professional liability insurance for affiliated physicians, property and casualty insurance and general liability insurance and directors' and officers' liability insurance, increased from \$105,936 for the three months ended June 30, 2006 to \$147,337 for the three months ended June 30, 2007. Approximately \$22,000 of the increase relates to workers' compensation and errors and omissions insurance for Rand, which was not included in the second quarter 2006 expense totals.

Provision for Doubtful Accounts. The consolidated provision for doubtful accounts, or bad debt expense, increased \$10,352, or 21.9%, for the three months ended June 30, 2007 to \$57,645. The entire provision for doubtful accounts for the three months ended June 30, 2007 related to IPS's affiliated medical groups and accounted for 0.9% of IPS's net operating revenues as compared to 0.8% of IPS's net operating revenues for the same period in 2006. The total collection rate, after contractual allowances, for IPS's affiliated medical groups was 67.6% in the second quarter of 2007, compared to 64.0% for the same period in 2006.

Other. Other expenses include general and administrative expenses such as office supplies, telephone and data communications, printing and postage, and board of directors' compensation and meeting expenses, as well as some direct clinical expenses, including vaccine costs, 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. Consolidated other expenses totaled \$1,726,337 for the three months ended June 30, 2007, an increase of \$773,677 over the same period in 2006.

13

Following is a table illustrating the composition of other expenses for the three months ended June 30, 2007 and 2006:

	Three months ended June 30, 2007

Vaccine costs	\$716,755
Medical supplies	63,441
Other direct clinical expenses	29,426
Travel	66,539
Office supplies and printing	127,048
Telephone and data communications	91,166
Postage and courier	395,275
Board of directors' compensation and meeting expenses	14,799
Bank charges	44,638
Taxes and licenses	22,836
Other general and administrative expenses	154,414

Total consolidated other expenses	\$1,726,337

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

Other expenses for Rand and On Line totaled \$233,664 and \$76,063 for the second quarter of 2007. More than 75% of Rand's and 45% of On Line's other expenses in the second three months of 2007 related to postage, courier and office supplies.

MBS's other expenses totaled \$269,923 for the three months ended June 30, 2006 as compared to \$322,055 for the three months ended June 30, 2007. The increase can be explained generally by an aggregate increase of approximately \$32,000 in postage and courier expenses in the second quarter of 2007 as compared to the same three-month period in 2006.

For the three months ended June 30, 2007, IPS's direct clinical expenses, other than salaries and benefits, totaled \$809,622, an increase of \$374,815 over direct clinical expenses in the same period in 2006, which totaled \$434,807. Vaccine expenses increased approximately \$375,000 in the second quarter of 2007 when compared with the three months ended June 30, 2006. In addition to price increases for certain vaccines that took effect in late 2006, vaccine purchases increased in the second quarter of 2007 as a result of increased patient volume as well as the continued impact of the release of a new vaccine for adolescent females to prevent cervical cancer.

General and administrative expenses other than those incurred by our RCM segment totaled \$284,953 for the three months ended June 30, 2007, an increase of \$32,624 over the same period in 2006, largely as a result of strategic planning meeting expenses incurred in the second quarter.

Other Income (Expenses).

	Three months ended June 30 2007	2006
	-----	-----
Interest expense	\$ (353,845)	
Other expense, net	(3,1485)	
	-----	-----
Total other income (expenses), net	\$ (356,990)	
	=====	=====

Other expenses, net, totaled \$356,990 for the three months ended June 30, 2007 as compared with other expenses, net, of \$123,447 for the three months ended June 30, 2006.

Interest Expense. Consolidated interest expense totaled \$353,845 for the three months ended June 30, 2007, an increase of \$165,721 over the same period in 2006. Interest expense activity in the second quarter of 2007, including increases over 2006, can be explained generally by the following:

- o 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. These notes, in addition to the \$1,000,000 in notes payable issued as a result of the DCPS/MBS Merger, represented the retroactive purchase price increase owed 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. On December 1, 2006, we executed the DCPS/MBS Notes, which extended the maturity of the amounts outstanding to the former equity owners of MBS and DCPS from December 15, 2007 to a quarterly principal

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

payment amortization schedule that begins on December 15, 2007 and extends to December 15, 2008, and increased the annual interest rate from 8% to 9%. Interest expense related to these notes totaled \$38,573 and \$31,429 for the three months ended June 30, 2007 and 2006, respectively.

14

- o Loan Facilities with Wells Fargo. On December 1, 2006, we entered into the Credit Agreement with Wells Fargo, which provides for a four year \$16.5 million senior secured credit facility consisting of a \$2 million revolving loan commitment, a \$4.5 million term loan and a \$10 million acquisition facility commitment. (See Part I, Item 2. Management's Discussion and Analysis or Plan of Operation - Company History and Recent Developments.) As of June 30, 2007, we had amounts outstanding under the revolving loan commitment and term loan of \$1,732,368 and \$4,316,250, respectively. Interest expense related to these loan facilities totaled approximately \$164,000 in the second quarter of 2007.
- o Phoenix Subordinated Debt. On December 1, 2006 we closed the Private Placement with Phoenix and Brantley IV. (See Part I, Item 2. Management's Discussion and Analysis or Plan of Operation - Company History and Recent Developments.) As part of the Private Placement, we issued a senior unsecured subordinated promissory note to Phoenix in the amount of \$3.35 million, bearing 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. We accrued interest expense of approximately \$117,000 on this note in the second quarter of 2007, in addition to approximately \$14,000 in additional interest expense related to the amortization of the debt discount that was applied to the warrants issued in conjunction with the subordinated note to Phoenix.
- o Brantley Debt. In March and April 2005, we borrowed an aggregate of \$1,250,000 from Brantley IV. We converted the Brantley IV Notes to Class A Common Stock on December 1, 2006. (See Part I, Item 2. Management's Discussion and Analysis or Plan of Operation - Company History and Recent Developments.) Interest expense related to these notes totaled approximately \$28,000 for the three months ended June 30, 2006.
- o CIT Line of Credit. In conjunction with the 2004 Mergers, we also entered into a new secured two-year revolving credit facility with CIT. On December 1, 2006, in conjunction with the new loan facilities under the Credit Agreement with Wells Fargo, we paid CIT a total of \$1,027,321, which represented full payment of all obligations under the loan and security agreement with CIT, plus expenses. We no longer have any amounts due to CIT. Interest expense related to the CIT credit facility totaled approximately \$51,000 in the second quarter of 2006.

Six Months Ended June 30, 2007 and 2006 - Continuing Operations

Net Operating Revenues.

Six months ended June 30
2007 2

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

RCM Segment	\$ 9,719,651
PM Segment	6,539,522
Other	186,759

Total consolidated net operating revenues	\$16,445,932
	=====

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, Rand and On Line, and other revenue. Our results for the six months ended June 30, 2007 include the results of MBS, Rand, On Line and IPS. Our results for the six months ended June 30, 2006 include the results of MBS and IPS. We did not acquire Rand and On Line until December 1, 2006.

For the six months ended June 30, 2007, consolidated net operating revenues increased \$5,574,176 or 51.3%, to \$16,445,932, as compared with \$10,871,756 for the six months ended June 30, 2006.

Net operating revenues for our RCM segment, which included MBS, Rand and On Line in the first half of 2007 and MBS in the first half of 2006, totaled \$9,719,651 for the six months ended June 30, 2007, an increase of \$4,963,599, or 104.4%, over the same period in 2006. Net operating revenues for Rand and On Line totaled \$3,263,907 and \$1,232,910, respectively, for the first six months of 2007. MBS's net operating revenues increased 9.8% in the first half of 2007, increasing from \$4,756,052 for the six months ended June 30, 2006 to \$5,222,834 for the same period in 2007.

The following table illustrates, by customer category, the contribution of existing, new and lost customers to MBS's net operating revenues for the six months ended June 30, 2007 and 2006, respectively:

15

	Six months ended June 2007	2006
	-----	-----
MBS net operating revenues:		
Existing customers	\$ 4,585,822	\$
New customers in 2006	603,998	
New customers in 2007	25,812	
Customers lost in 2006	2,817	
Customers lost in 2007	4,386	
	-----	-----
Total consolidated net operating revenues	\$ 5,222,835	\$
	=====	=====

Net operating revenues for our PM segment, which consists of net patient service revenue from IPS's affiliated medical groups, increased \$604,463, or 10.2%, from \$5,935,059 for the six months ended June 30, 2006 to \$6,539,522 for the six months ended June 30, 2007. IPS's clinic-based affiliated pediatric groups experienced increases in patient volume in the first half of

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

2007, with total procedures and immunizations increasing 15,506 and 7,845, respectively, to 166,072 and 32,279 for the six months ended June 30, 2007. These increases can be generally explained by the release of a new vaccine for adolescent females to prevent cervical cancer, which has increased patient demand for certain immunizations.

Other revenue totaled \$186,759 for the first half of 2006, decreasing \$6,114, or 3.3%, to \$180,645 for the six months ended June 30, 2007. This represents revenue from our vaccine program, which is a group purchasing alliance for vaccines and medical supplies. The vaccine program, which had 493 enrolled participants at the end of 2006, added a net of approximately twenty members during the six months ended June 30, 2007.

Operating Expenses.

	Six months ended June 30 2007	2006
	-----	-----
Salaries and benefits	\$ 8,422,244	\$ 5,052,577
Physician group distribution	2,371,495	2,160,017
Facility rent and related costs	930,790	722,457
Depreciation and amortization	1,417,249	1,160,017
Professional and consulting fees	667,252	552,577
Insurance	272,541	246,635
Provision for doubtful accounts	118,167	118,167
Other	3,268,572	2,922,367
	-----	-----
Total consolidated operating expenses	\$17,468,310	\$ 11,435,700
	=====	=====

Our expenses for the six months ended June 30, 2007 include the results of MBS, Rand, On Line and IPS. Our expenses for the six months ended June 30, 2006 include the results of MBS and IPS. We did not acquire Rand and On Line until December 1, 2006.

Consolidated operating expenses totaled \$17,468,310 for the six months ended June 30, 2007, an increase of \$5,623,127 over the same period in 2006.

Salaries and Benefits. Consolidated salaries and benefits increased \$3,369,667 to \$8,422,244 for the six months ended June 30, 2007, as compared to \$5,052,577 in the first half of 2006. Salaries and benefits for Rand and On Line totaled \$2,160,017 and \$722,457, respectively, for the six months ended June 30, 2007.

MBS's salaries and benefits totaled \$3,243,933 for the six months ended June 30, 2007 as compared to \$2,922,367 for the same six months in 2006, an increase of \$321,566. Staffing levels increased year-over-year, with salaries, including bonuses and overtime, increasing \$246,635 and temporary help increasing \$79,240 in the first half of 2007 as compared to the same period in 2006.

Clinical salaries and benefits include wages for the nurse practitioners, nursing staff and medical assistants employed by the affiliated medical groups and may fluctuate indirectly to increases and/or decreases in productivity and patient volume. Clinical salaries, bonuses, overtime and health insurance collectively totaled \$647,535 for the six months ended June 30, 2007, an increase of \$35,830 over the same period in 2006. These expenses represented approximately 9.9% and 10.3% of net operating revenues for the six-month periods

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

ended June 30, 2007 and 2006, respectively.

16

Administrative salaries and benefits, excluding MBS, Rand and On Line, 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 \$126,406, or 8.6%, from \$1,466,001 for the six months ended June 30, 2006 to \$1,592,407 for the same period in 2007. The additional expense can be explained generally by the \$94,636 increase in stock option compensation expense in the first half of 2007, compared to the same period in 2006, as a result of options granted to employees and directors in December 2006. Additionally, the first half of 2007 included a full five months of salary expense for the Director of Practice Operations, a position which was vacant during much of the second quarter of 2006.

Physician Group Distribution. Physician group distribution increased \$6,580, or 0.3%, for the six months ended June 30, 2007 to \$2,371,495, as compared with \$2,364,915 for the six months ended June 30, 2006. 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, 2007, management fee revenue totaled \$404,984 and represented approximately 14.6% of net operating income as compared to management fee revenue totaling \$395,054 and representing approximately 14.3% of net operating income for the same period in 2006. Physician group distributions represented 36.3% of net operating revenues in the first half of 2007, compared to 39.8% of net operating revenues for the same period in 2006. Physician group distribution for the six months ended June 30, 2007 remained relatively flat despite increased revenues largely due to increases in vaccine expenses as a result of increased immunization volume during the first half of 2007.

Facility Rent and Related Costs. Facility rent and related costs increased \$264,170, or 39.6%, from \$666,621 for the six months ended June 30, 2006 to \$930,790 for the six months ended June 30, 2007. Rent and related expenses for Rand and On Line totaled \$141,260 and \$63,726, respectively, for the first half of 2007.

MBS's facility rent and related costs totaled \$286,623 for the six months ended June 30, 2007 as compared to \$256,895 for the same period in 2006. This increase can be explained generally by increases in base rent at all of MBS's operating locations.

Facility rent and related costs associated with IPS's affiliated medical groups and Orion's corporate office totaled \$439,181 for the six months ended June 30, 2007 compared to \$409,726 for the same period in 2006.

Depreciation and Amortization. Consolidated depreciation and amortization expense totaled \$1,414,392 for the six months ended June 30, 2007, an increase of \$606,023 over the six months ended June 30, 2006.

In the first six months of 2007, depreciation expense related to our fixed assets totaled \$146,875 as compared to \$104,900 for the same period in 2006. Following is a table that illustrates, by business unit, the depreciation expense for our fixed assets for the six months ended June 30, 2007 and 2006:

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

	Six months ended June 30 2007	2006
Depreciation expense:		
Rand	\$ 25,285	
On Line	20,684	
MBS	34,216	
IPS	31,831	
Orion	34,860	
	-----	-----
Total consolidated depreciation expense	\$ 146,876	
	=====	=====

Amortization expense related to our intangible assets totaled \$1,267,516 for the six months ended June 30, 2007 as compared to \$703,468 for the same period in 2006. Following is a table that illustrates, by business unit, the amortization expense related to our intangible assets for the first six months of 2007 and 2006:

	Six months ended Jun 2007	2006
Amortization expense:		
Rand	\$ 263,828	
On Line	184,887	
MBS	531,046	
IPS	81,400	
Orion	209,212	
	-----	-----
Total consolidated depreciation expense	\$ 1,270,373	
	=====	=====

17

Rand. Effective December 1, 2006, we purchased Rand for a combination of cash, notes and stock. Since the consideration for this purchase transaction exceeded the fair value of the net assets of Rand at the time of the purchase, a portion of the purchase price was allocated to intangible assets and goodwill. The amortization expense related to the intangible assets recorded as a result of the acquisition of Rand totaled \$263,828 for the six months ended June 30, 2007.

On Line. Effective December 1, 2006, we purchased On Line for a combination of cash and notes. Since the consideration for this purchase transaction exceeded the fair value of the net assets of On Line at the time of the purchase, a portion of the purchase price was allocated to intangible assets and goodwill. The amortization expense related to the intangible assets recorded as a result of the acquisition of On Line totaled \$184,887 for the six months ended June 30, 2007.

MBS. 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, 2007 and 2006, respectively.

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

IPS. Amortization expense related to the MSAs for IPS's affiliated medical groups totaled \$81,400 and \$172,422 for the six months ended June 30, 2007 and 2006, respectively. The decrease is directly related to IPS operations discontinued in 2006, which resulted in the impairment of the intangible assets related to those operations at December 31, 2006.

Orion. There were significant costs associated with the acquisitions of Rand and On Line as well as the Private Placement, the Credit Agreement and the restructured USBPS loan.

Those costs that were specifically related to a particular component of the transactions were allocated directly to that component. In cases where it was not possible to specifically allocate certain costs to each identifiable component, we allocated the costs on a pro-rata basis based on each component's transaction value relative to the value of all of the transactions in the aggregate. With respect to the costs that we determined to be allocable to the equity portion of the Private Placement, we determined that, since the proceeds from the Private Placement were used to acquire Rand and On Line, those costs were to be further allocated to Rand and On Line on a pro-rata basis based on each company's acquisition consideration relative to the total aggregate acquisition consideration.

Amortization expense related to the transaction costs described above totaled \$209,212 for the six months ended June 30, 2007.

Professional and Consulting Fees. For the six months ended June 30, 2007, professional and consulting fees totaled \$687,252, an increase of \$17,711, or 2.7%, over the same period in 2006. Professional and consulting fees for Rand and On Line totaled \$29,312 and \$90,201 in the first six months of 2007.

For the six months ended June 30, 2007, MBS recorded professional and consulting expenses totaling \$63,993 as compared with \$88,476 for the same period in 2006, a decrease of \$24,483. This change is primarily the result of a decrease in contract labor used in early 2006 as a result of staffing shortages.

IPS's and Orion's professional and consulting fees, which include the costs of corporate accounting, financial reporting and compliance, and legal fees, decreased from \$561,065 for the six months ended June 30, 2006 to \$483,746 for the six months ended June 30, 2007. This decrease can be explained generally by a \$61,000 decrease in consulting fees related to a business development consultant who was utilized in the first half of 2006.

Insurance. Consolidated insurance expense, which includes the costs of professional liability insurance for affiliated physicians, property and casualty insurance and general liability insurance and directors' and officers' liability insurance, increased from \$233,130 for the six months ended June 30, 2006 to \$272,541 for the six months ended June 30, 2007. Approximately \$25,000 of the increase relates to workers' compensation and errors and omissions insurance for Rand, which was not included in 2006. Professional liability insurance and workers' compensation insurance also increased slightly on a year over year basis.

Provision for Doubtful Accounts. The consolidated provision for doubtful accounts, or bad debt expense, increased \$8,751, or 8.0%, for the six months ended June 30, 2007 to \$118,167. The entire provision for doubtful accounts for the six months ended June 30, 2007 related to IPS's affiliated medical groups and accounted for 1.8% of IPS's net operating revenues in the first half of 2007 and 2006. The total collection rate, after contractual allowances, for IPS's affiliated medical groups was 68.5% in the first six months of 2007, compared to 65.2% for the same period in 2006.

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

Other. Other expenses include general and administrative expenses such as office supplies, telephone and data communications, printing and postage, and board of directors' compensation and meeting expenses, as well as some direct clinical expenses, including vaccine costs, 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. Consolidated other expenses totaled \$3,268,572 for the six months ended June 30, 2007, an increase of \$1,307,956 over the same period in 2006.

18

Following is a table illustrating the composition of other expenses for the six months ended June 30, 2007 and 2006:

	Six months ended J 2007
Vaccine costs	\$1,271,511
Medical supplies	132,883
Other direct clinical expenses	58,699
Travel	114,639
Office supplies and printing	267,029
Telephone and data communications	186,176
Postage and courier	732,189
Board of directors' compensation and meeting expenses	29,598
Bank charges	98,777
Taxes and licenses	70,011
Other general and administrative expenses	307,060
Total consolidated other expenses	\$3,268,572

Other expenses for Rand and On Line totaled \$393,442 and \$176,953, respectively, for the first six months of 2007. Approximately 75% of Rand's and 54% of On Line's other expenses in the first six months of 2007 related to postage, courier and office supplies.

MBS's other expenses totaled \$556,621 for the six months ended June 30, 2006 as compared to \$629,194 for the six months ended June 30, 2007. The increase can be explained generally by an aggregate increase of approximately \$63,000 in postage and courier expenses in the first half of 2007 as compared to the same six-month period in 2006.

For the six months ended June 30, 2007, IPS's direct clinical expenses, other than salaries and benefits, totaled \$1,463,093, an increase of \$568,718 over direct clinical expenses in the same period in 2006, which totaled \$894,375. Vaccine expenses increased approximately \$555,000 in the first half of 2007 when compared with the six months ended June 30, 2006. In addition to price increases for certain vaccines that took effect in late 2006, vaccine purchases increased in the first six months of 2007 as a result of increased patient volume as well as the continued impact of the release of a new vaccine for adolescent females to prevent cervical cancer.

General and administrative expenses other than those incurred by our RCM segment totaled \$605,890 for the six months ended June 30, 2007, an increase of \$96,373 over the same period in 2006. This increase can be explained generally by the following: (i) franchise taxes for Illinois increased

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

approximately \$37,000 in the first half of 2007 as a result of changes in our corporate structure; (ii) business promotion expenses totaled approximately \$16,000 in the first six months of 2007 and related to printed marketing materials to be used at trade shows and in conjunction with other corporate presentations; and (iii) meeting expenses related to a strategic planning meeting totaled approximately \$37,000 for the six months ended June 30, 2007.

Other Income (Expenses).

	Six months ended June 2007	
Interest expense	\$(685,064)	
Gain on forgiveness of debt	--	
Other expense, net	(11,999)	
	-----	-----
Total other income (expenses), net	\$(697,063)	-----
	=====	=====

Other expenses, net, totaled \$697,063 for the six months ended June 30, 2007 as compared with other income, net, of \$422,605 for the six months ended June 30, 2006.

Interest Expense. Consolidated interest expense totaled \$685,064 for the six months ended June 30, 2007, an increase of \$366,929 over the same period in 2006. Interest expense activity in the first six months of 2007, including increases over 2006, can be explained generally by the following:

19

- o 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. These notes, in addition to the \$1,000,000 in notes payable issued as a result of the DCPS/MBS Merger, represented the retroactive purchase price increase owed 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. On December 1, 2006, we executed the DCPS/MBS Notes, which extended the maturity of the amounts outstanding to the former equity owners of MBS and DCPS from December 15, 2007 to a quarterly principal payment amortization schedule that begins on December 15, 2007 and extends to December 15, 2008, and increased the annual interest rate from 8% to 9%. Interest expense related to these notes totaled \$77,145 and \$51,541 for the six months ended June 30, 2007 and 2006, respectively.
- o Loan Facilities with Wells Fargo. On December 1, 2006, we entered into the Credit Agreement with Wells Fargo, which provides for a four year \$16.5 million senior secured credit facility consisting of a \$2 million revolving loan commitment, a \$4.5 million term loan and a \$10 million acquisition facility commitment. (See Part I, Item 2. Management's Discussion and Analysis or Plan of Operation - Company History and Recent Developments.) As of June 30, 2007, we had amounts outstanding under the revolving loan commitment and term loan of \$1,732,368 and \$4,316,250, respectively. Interest expense related to these loan facilities totaled approximately \$309,000 in the first half of 2007.

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

- o Phoenix Subordinated Debt. On December 1, 2006 we closed the Private Placement with Phoenix and Brantley IV. (See Part I, Item 2. Management's Discussion and Analysis or Plan of Operation - Company History and Recent Developments.) As part of the Private Placement, we issued a senior unsecured subordinated promissory note to Phoenix in the amount of \$3.35 million, bearing 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. We accrued interest expense of approximately \$235,000 on this note in the first half of 2007, in addition to approximately \$28,000 in additional interest expense related to the amortization of the debt discount that was applied to the warrants issued in conjunction with the subordinated note to Phoenix.
- o Brantley Debt. In March and April 2005, we borrowed an aggregate of \$1,250,000 from Brantley IV. We converted the Brantley IV Notes to Class A Common Stock on December 1, 2006. (See Part I, Item 2. Management's Discussion and Analysis or Plan of Operation - Company History and Recent Developments.) Interest expense related to these notes totaled approximately \$57,000 for the six months ended June 30, 2006.
- o CIT Line of Credit. In conjunction with the 2004 Mergers, we also entered into a new secured two-year revolving credit facility with CIT. On December 1, 2006, in conjunction with the new loan facilities under the Credit Agreement with Wells Fargo, we paid CIT a total of \$1,027,321, which represented full payment of all obligations under the loan and security agreement with CIT, plus expenses. We no longer have any amounts due to CIT. Interest expense related to the CIT credit facility totaled approximately \$115,000 in the first six months of 2006.

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. IPS and SurgiCare also 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 revolving lines of credit and, as part of that agreement we executed a new loan agreement with USBPS, 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 in the first quarter of 2006. Immediately prior to December 1, 2006, there was \$3,750,000 outstanding under term loan obligation. On December 1, 2006, we entered into a Restructured Loan Agreement with USBPS, as Servicer, which provides for the outstanding amount to be reduced to \$2,750,000 and for monthly principal payments, totaling, in the aggregate, \$570,000, until October 1, 2013, when the remaining amount becomes due. We recognized a gain on forgiveness of debt totaling \$340,701 in the fourth quarter of 2006 with respect to the Restructured Loan Agreement.

Three Months and Six Months Ended June 30, 2007 and 2006 - Discontinued Operations

Memorial Village. As a result of the uncertainty of future cash flows related to our surgery center business, we determined that the joint venture interest associated with Memorial Village was impaired and recorded a charge for impairment of intangible assets related to Memorial Village of \$3,229,462 for

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

the three months ended June 30, 2005. In November 2005, we decided that, as a result of ongoing losses at Memorial Village, we 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 an additional charge for impairment of intangible assets of \$1,348,085 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 Orion. 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. There were no operations for this component in our financial statements after March 31, 2006.

20

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., a wholly owned subsidiary of Orion, and was 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. As a result of the uncertainty of future cash flows related to the surgery center business, we determined that the joint venture interest associated with San Jacinto was impaired and recorded a charge for impairment of intangible assets related to San Jacinto of \$734,522 for the three months ended June 30, 2005. We also recorded an additional \$2,113,262 charge for impairment of intangible assets for the three months ended September 30, 2005 related to the management contracts with San Jacinto. 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 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.

Dayton ICS. IPS is party to a management services agreement ("the Dayton MSA") with Dayton ICS. The sole remaining shareholder of Dayton ICS has notified both IPS and the hospitals at which Dayton ICS has contracts that he intends to dissolve Dayton ICS, cease practicing at the hospitals and cease utilizing the services of IPS. IPS believes that the unilateral decision to dissolve Dayton ICS and terminate the business of Dayton ICS breaches the Dayton MSA and violates duties owed by Dayton ICS to IPS as a creditor of Dayton ICS. As a result of the pending litigation and the uncertainty of the outcome, the operations of Dayton ICS are now reflected in our consolidated statements of operations as 'income from operations of discontinued components' for the three months and six months ended June 30, 2007 and 2006, respectively. Additionally, we recorded a charge for impairment of intangible assets of \$1,845,669 for Dayton ICS for the quarter ended December 31, 2006.

PSNW. IPS was party to the Illinois MSA with PSNW. IPS and PSNW were in arbitration regarding claims relating to the Illinois MSA. In connection therewith, on February 9, 2007, IPS and PSNW entered into the PSNW Settlement to settle disputes that had arisen between IPS and PSNW and to avoid the risk and expense of further litigation. As part of the PSNW Settlement, PSNW and IPS

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

agreed that PSNW would purchase the assets owned by IPS and used in connection with PSNW's practice, in exchange for a negotiated cash consideration and termination of the Illinois MSA. The transaction contemplated by the PSNW Settlement was consummated on May 31, 2007. We recorded a gain on disposal of discontinued components totaling \$999,725 for the quarter ended June 30, 2007. PSNW and IPS have been released from any further obligation to each other from any previous agreement. As a result of the PSNW Settlement, the operations of PSNW are now reflected in our consolidated statements of operations as 'income from operations of discontinued components' for the three months and six months ended June 30, 2007 and 2006, respectively. Additionally, we recorded a charge for impairment of intangible assets of \$1,249,080 for PSNW for the quarter ended December 31, 2006.

Orion. Prior to the divestiture of our ambulatory surgery center businesses, we recorded management fee revenue, which was eliminated in the consolidation of our financial statements, from our surgery centers. 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 \$968 and \$61,038, respectively, for the three months and six months ended June 30, 2006.

The following table contains selected financial information regarding our discontinued operations for the three months and six months ended June 30, 2007 and 2006:

	Three months ended June 30, 2007	2006
	-----	-----
Net operating revenues from discontinued operations	\$641,552	\$1,669,948
Total expenses from discontinued operations	(621,552)	(1,531,023)
	-----	-----
Income from discontinued operations	20,000	138,925
Gain on disposal of discontinued operations	999,725	--
	-----	-----
Net income from discontinued operations	\$1,019,725	\$138,925
	=====	=====

Liquidity and Capital Resources

Net cash used by operating activities totaled \$419,905 for the six months ended June 30, 2007 as compared with cash provided by operating activities of \$575,852 for the six months ended June 30, 2006. Net cash used in operations increased in the first half of 2007 largely as a result of (i) increased interest expense in 2007 as a result of the Wells Fargo loan facilities and the subordinated debt with Phoenix; and (ii) increased legal expenses in the first quarter of 2007 related to operations we discontinued at the end of 2006. The net impact of discontinued operations on net cash used by operating activities in the first six months of 2007 was \$804,851.

For the six months ended June 30, 2007, net cash used in investing activities totaled \$89,309 compared to \$417,234 in net cash provided by investing activities for the same period in 2006. The net impact of discontinued operations on net cash provided by investing activities in the first six months of 2006 related to the transactions involving the sale of Memorial Village and San Jacinto.

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

Net cash provided by financing activities totaled \$142,315 for the six months ended June 30, 2007 as compared to \$962,970 in cash used in financing activities for the same period in 2006. The change in cash sources and uses related to financing activities from the first six months of 2006 to the first six months of 2007 can be explained generally by the following:

- o We borrowed an aggregate of approximately \$550,000 from Wells Fargo in the first six months of 2007 under the revolving loan commitment pursuant to the Credit Agreement;
- o We made aggregate principal payments of \$157,500 to Wells Fargo in the first half of 2007 pursuant to the amortization of our term loan commitment;
- o We repaid an aggregate of \$75,000 to the former shareholder of On Line as repayment for one of the notes issued on December 1, 2006 as consideration in connection with our acquisition of On Line;
- o We repaid approximately \$200,000 in satisfaction of a working capital note from the sellers of MBS in the first quarter of 2006; and
- o 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.

We have financed our growth and operations primarily through the issuance of equity securities, secured and/or convertible debt, most recently by completing a series of transactions, including the Private Placement, which occurred in December 2006 and is described under the caption "Company History and Recent Developments." As a condition to the Private Placement, on December 1, 2006, we refinanced our existing loan facility with CIT into a four year \$16,500,000 senior secured credit facility with Wells Fargo consisting of a \$2,000,000 revolving loan commitment, a \$4,500,000 term loan and a \$10,000,000 acquisition facility commitment. Amounts borrowed under this facility are secured by substantially all of our assets and a pledge of the capital stock of our operating subsidiaries. Under the terms of the Credit Agreement relating to this facility, amounts borrowed bear interest at either a fluctuating rate based on the prime rate or LIBOR rate, at our election. Currently, our interest rate on the revolving loan commitment and the term loan is the prime rate plus 1.75%. In addition to refinancing our existing loan facility, a portion of the proceeds from this facility were used to fund our acquisitions of Rand and On Line and to finance our ongoing working capital, capital expenditure and general corporate needs. Upon repayment of the CIT loan facility, two of our stockholders, Brantley IV and Brantley Capital were released from guarantees that they had provided on our behalf in connection with the loan facility.

The Credit Agreement contains certain financial covenants that require us to maintain minimum levels of trailing twelve month earnings before income taxes, depreciation and amortization ("EBITDA"), a minimum fixed charge coverage ratio, a maximum senior debt leverage ratio and a limitation on annual capital expenditures and other customary terms and conditions. As of June 30, 2007, we were in compliance with all of the financial covenants under the Credit Agreement.

As of June 30, 2007, our revolving loan commitment with Wells Fargo had limited availability to provide for working capital shortages. Although we believe we will generate cash flows from operations in the future, there is no guarantee that we will be able to fund our operations solely from our cash flows. In 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

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

management services to physician practices. As part of this plan, we completed a series of transactions involving the divestiture of non-strategic assets in 2005 and early 2006. In addition, we redirected financial resources and company personnel to areas that management believed would enhance long-term growth potential. A key component of our long-term strategic plan is the identification of potential acquisition targets that will increase our presence in the markets we serve and enhance stockholder value. On December 1, 2006 we completed the acquisition of Rand and On Line. (See "Company History and Recent Developments.") In addition to Rand and On Line, we have identified other potential acquisition opportunities to expand our business that are consistent with our strategic plan. We have a \$10 million acquisition facility commitment under the Credit Agreement that will enable us to finance some or all of the cash consideration for future acquisitions based on a formula tied to our pro forma trailing twelve month EBITDA, including the EBITDA of the potential acquisition target.

22

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. There can be no assurances that additional financing or strategic alternatives will be available, or that, if available, the financing or strategic alternatives will be obtainable on terms acceptable to us or that any additional financing would not be substantially dilutive to our existing stockholders.

ITEM 3. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. We maintain a set of disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed by us in our reports filed under the Exchange Act is recorded, processed, summarized and reported accurately and within the time periods specified in the SEC's rules and forms. As of the end of the period covered by this report, we evaluated, under the supervision and with the participation of our management, including our principal executive and principal financial officer, the design and effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15(c) of the Exchange Act. Based on that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information related to us (including our consolidated subsidiaries) required to be included in periodic filings.

Changes in Internal Controls. During the most recent fiscal quarter, there have been no changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

IPS was party to the Illinois MSA with PSNW. IPS and PSNW were in arbitration regarding claims relating to the Illinois MSA. In connection therewith, on February 9, 2007, IPS and PSNW entered into the PSNW Settlement to settle disputes that had arisen between IPS and PSNW and to avoid the risk and expense of further litigation. As part of the PSNW Settlement, PSNW and IPS

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

agreed that PSNW would purchase the assets owned by IPS and used in connection with PSNW's practice, in exchange for a negotiated cash consideration and termination of the Illinois MSA. Additionally, among other provisions, after May 31, 2007, which was the closing date of the transaction contemplated by the PSNW Settlement, PSNW and IPS have been released from any further obligation to each other from any previous agreement.

In addition, we are involved in various other legal proceedings and claims arising in the ordinary course of business. Our management believes that the disposition of these additional matters, individually or in the aggregate, is not expected to have a materially adverse effect on our financial condition. However, depending on the amount and timing of such disposition, an unfavorable resolution of some or all of these matters could materially affect our future results of operations or cash flows in a particular period.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

We held our Annual Meeting of Stockholders (the "Annual Meeting") on May 9, 2007. At the Annual Meeting, the stockholders voted on and approved each of the following proposals:

Proposal One: To elect five directors of the Company to serve until the 2008 annual meeting of stockholders or until their respective successors are elected and qualified.

The following list indicates the number of votes received by each of the nominees for election to our board of directors in Proposal One:

	For ---	Withheld -----
Terrence L. Bauer	127,588,486	12,157
Paul H. Cascio	127,578,706	21,937
Michael J. Finn	127,566,093	34,550
David Crane	127,573,343	27,300
Joseph M. Valley, Jr.	127,588,486	12,157

Proposal Two: To ratify the the appointment of UHY, L.L.P. as our independent public auditors. Proposal Two was approved by holders of 97.9% of the outstanding shares of our common stock (including Class A and Class D Common Stock) entitled to vote at the Annual Meeting. Specifically, a total of 127,400,898 shares were voted in favor of this proposal, 6,454 shares were voted against this proposal, and 193,291 shares abstained from voting on this proposal.

ITEM 5. OTHER INFORMATION

On May 21, 2007, the Compensation Committee of our Board of Directors awarded Terrence L. Bauer, President and Chief Executive Officer, and Stephen H. Murdock, Chief Financial Officer, cash bonuses of \$100,000 and \$20,000, respectively, as a result of their efforts in connection with consummating the Rand and On Line acquisitions, the debt and equity issuances and the credit facility refinancing that were consummated in December 2006. The bonuses were to be payable within ninety days after the grant date.

ITEM 6. EXHIBITS

The following documents are filed as exhibits to this Quarterly Report

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

on Form 10-QSB pursuant to Item 601 of Regulation S-B. Since our incorporation, we have operated under various names including: Technical Coatings, Inc., SurgiCare, Inc. and Orion HealthCorp, Inc. Exhibits listed below refer to these names collectively as "the Company."

24

Exhibit No. -----	Description -----
24.1	Power of Attorney (See Signatures on page 26)
31.1	Rule 13a-14(a)/15d-14(a) Certification
31.2	Rule 13a-14(a)/15d-14(a) Certification
32.1	Section 1350 Certification
32.2	Section 1350 Certification

25

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ORION HEALTHCORP, INC.

By: /s/ Terrence L. Bauer

Dated: August 9, 2007

Terrence L. Bauer
President, Chief Executive Officer and
Director
(Duly Authorized Representative)

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears on the signature page to this report constitutes and appoints Terrence L. Bauer and Stephen H. Murdock, and each of them, his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Report, and to file the same, with all exhibits hereto, and other documents in connection herewith with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or any of them, or their or his substitutes, may lawfully do or cause to be done by virtue hereof.

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on August 9, 2007.

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

By: /s/ Terrence L. Bauer

Terrence L. Bauer
President, Chief Executive Officer and
Director (Principal Executive Officer)

By: /s/ Robert P. Pinkas

Robert P. Pinkas
Director

By: /s/ Paul H. Cascio

Paul H. Cascio
Director

By: /s/ Joseph M. Valley, Jr.

Joseph M. Valley, Jr.
Director

By: /s/ David Crane

David Crane
Director

By: /s/ Stephen H. Murdock

Stephen H. Murdock
Chief Financial Officer (Principal
and Financial Officer)

26

ORION HEALTHCORP, INC.

INDEX TO UNAUDITED CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Consolidated Condensed Balance Sheets as of June 30, 2007 (unaudited) and December 31, 2006
Consolidated Condensed Statements of Operations for the Three Months Ended June 30, 2007 and 2006
Consolidated Condensed Statements of Operations for the Six Months Ended June 30, 2007 and 2006
Consolidated Condensed Statements of Cash Flows for the Three Months Ended June 30, 2007 and 2006
Consolidated Condensed Statements of Cash Flows for the Six Months Ended June 30, 2007 and 2006
Notes to Unaudited Consolidated Condensed Financial Statements

F-1

Orion HealthCorp, Inc.
Consolidated Condensed Balance Sheets

Current assets
Cash and cash equivalents
Accounts receivable, net
Inventory

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

Prepaid expenses and other current assets	
Assets held for sale	
Total current assets	--
Property and equipment, net	--
Other long-term assets	
Intangible assets, excluding goodwill, net	1
Goodwill	
Other assets, net	
Total other long-term assets	2
Total assets	\$2
Current liabilities	
Accounts payable and accrued expenses	\$
Current portion of capital lease obligations	
Current portion of long-term debt	
Current portion of long-term debt held by related parties	
Liabilities held for sale	
Total current liabilities	--
Long-term liabilities	
Capital lease obligations, net of current portion	
Long-term debt, net of current portion	
Long-term debt, net of current portion, held by related parties	
Total long-term liabilities	1
Commitments and contingencies	
Stockholders' equity	
Preferred stock, par value \$0.001; 20,000,000 shares authorized; no shares issued and outstanding	
Common Stock, Class A, par value \$0.001; 300,000,000 shares authorized at June 30, 2007 and December 31, 2006, respectively; 105,504,032 and 105,374,487 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively	
Common Stock, Class D, par value \$0.001; 50,000,000 shares authorized at June 30, 2007 and December 31, 2006, respectively; 24,658,955 shares issued and outstanding at June 30, 2007 and December 31, 2006	
Additional paid-in capital	6
Accumulated deficit	(5
Treasury stock - at cost; 9,140 shares	--
Total stockholders' equity	--
Total liabilities and stockholders' equity	\$2

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

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

	----- (Unaudited)
Net operating revenues	\$ 8,161,152
Operating expenses	
Salaries and benefits	4,326,747
Physician group distribution	959,296
Facility rent and related costs	467,827
Depreciation and amortization	708,505
Professional and consulting fees	314,222
Insurance	147,337
Provision for doubtful accounts	57,645
Other expenses	1,726,337

Total operating expenses	8,707,916

Loss from continuing operations before other income (expenses)	(546,764)

Other income (expenses)	
Interest expense	(353,845)
Gain on forgiveness of debt	--
Other expense, net	(3,145)

Total other income (expenses), net	(356,990)

Loss from continuing operations	(903,754)
Discontinued operations	
Income from operations of discontinued components	1,019,725

Net income (loss)	\$ 115,971
	=====
Weighted average common shares outstanding	

Basic	105,502,884
Diluted	105,502,884
Income (loss) per share	

Basic	
Net loss per share from continuing operations	\$ (0.01)
Income per share from discontinued operations	\$ 0.01

Net income (loss) per share	\$ 0.00
	=====
Diluted	
Net loss per share from continuing operations	\$ (0.01)
Income per share from discontinued operations	\$ 0.01

Net income (loss) per share	\$ 0.00
	=====

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

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

Orion HealthCorp, Inc.
Consolidated Condensed Statements of Operations

	For the Six 2007
	(Unaudited)
Net operating revenues	\$ 16,445,
Operating expenses	
Salaries and benefits	8,422,
Physician group distribution	2,371,
Facility rent and related costs	930,
Depreciation and amortization	1,417,
Professional and consulting fees	667,
Insurance	272,
Provision for doubtful accounts	118,
Other expenses	3,268,
Total operating expenses	17,468,
Loss from continuing operations before other income (expenses)	(1,022,
Other income (expenses)	
Interest expense	(685,
Gain on forgiveness of debt	
Other expense, net	(11,
Total other income (expenses), net	(697,
Loss from continuing operations	(1,719,
Discontinued operations	
Income from operations of discontinued components	1,049,
Net income (loss)	\$ (669,
Weighted average common shares outstanding	
Basic	105,497,
Diluted	105,497,
Income (loss) per share	
Basic	
Net loss per share from continuing operations	\$ (0
Net income per share from discontinued operations	\$ 0
Net income (loss) per share	\$ (0
Diluted	
Net loss per share from continuing operations	\$ (0
Net income per share from discontinued operations	\$ 0
Net income (loss) per share	\$ (0

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

F-4

Orion HealthCorp, Inc.
Consolidated Condensed Statements of Cash Flows

	For the Three Months 2007
	----- (Unaudited)
Operating activities	
Net income (loss)	\$ 115,971
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:	
Provision for doubtful accounts	57,645
Depreciation and amortization	708,505
Stock option compensation expense	99,393
Issuance of stock	41
Impact of discontinued operations	(718,041)
Changes in operating assets and liabilities:	
Accounts receivable	29,362
Inventory	114,736
Prepaid expenses and other assets	58,459
Other assets	(140,691)
Accounts payable and accrued expenses	(152,427)

Net cash provided by operating activities	172,953

Investing activities	
Purchase of property and equipment	(46,128)
Impact of discontinued operations	1,550
Issuance of stock	5

Net cash used in investing activities	(44,573)

Financing activities	
Net repayments of capital lease obligations	(57,427)
Net borrowings (repayments) on line of credit	119,617
Net repayments of senior notes payable	(105,000)
Net borrowings from related parties	13,868
Net repayments of notes payable	(15,000)
Net repayments of other obligations	(56,584)

Net cash used in financing activities	(100,526)

Net increase (decrease) in cash and cash equivalents	27,854
Cash and cash equivalents, beginning of period	248,879

Cash and cash equivalents, end of period	\$ 276,733
	=====

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

Supplemental cash flow information

Cash paid during the period for

Income taxes	\$	--
Interest	\$	339,979

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

F-5

Orion HealthCorp, Inc.

Consolidated Condensed Statements of Cash Flows

	For the Six 2007
	----- (Unaudited)
Operating activities	
Net income (loss)	\$ (669,71
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:	
Provision for doubtful accounts	118,16
Depreciation and amortization	1,417,24
Gain on forgiveness of debt	-
Stock option compensation expense	192,34
Issuance of stock	4
Impact of discontinued operations	(804,85
Changes in operating assets and liabilities:	
Accounts receivable	149,36
Inventory	26,85
Prepaid expenses and other assets	(169,97
Other assets	(142,88
Accounts payable and accrued expenses	(536,50

Net cash used in operating activities	(419,90

Investing activities	
Sale (purchase) of property and equipment	(92,41
Impact of discontinued operations	3,10
Proceeds from equity transaction	-

Net cash provided by (used in) investing activities	(89,30

Financing activities	
Net repayment of capital lease obligations	(79,96
Net borrowings (repayments) on line of credit	549,96
Net repayments of senior notes payable	(157,50
Net repayments to related parties	(47,26
Net repayments of notes payable	(35,00
Net borrowings (repayments) of other obligations	(87,92
Impact of discontinued operations	-

Net cash provided by (used in) financing activities	142,31

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

Net increase (decrease) in cash and cash equivalents	(366,89
Cash and cash equivalents, beginning of period	643,63
Cash and cash equivalents, end of period	\$ 276,73
Supplemental cash flow information	
Cash paid during the period for	
Income taxes	\$ -
Interest	\$ 657,32

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

F-6

Orion HealthCorp, Inc.
Notes to Unaudited Consolidated Condensed Financial Statements
June 30, 2007 and 2006

Unless otherwise indicated, the terms "we," "us" and "our" refer to Orion HealthCorp, Inc. and its subsidiaries (formerly SurgiCare, Inc. "SurgiCare") ("Orion" or the "Company").

Note 1. General

We maintain our accounts on the accrual method of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Accounting principles followed by us and the methods of applying those principles, which materially affect the determination of financial position, results of operations and cash flows are summarized below.

Our unaudited consolidated condensed financial statements include the accounts of the Company and all of its majority-owned subsidiaries. Our results for the three months and six months ended June 30, 2007 include the results of Medical Billing Services, Inc. ("MBS"), Rand Medical Billing, Inc. ("Rand"), On Line Alternatives, Inc. ("OLA"), On Line Payroll Services, Inc. ("OLP") (collectively with OLA, "On Line"), and Integrated Physician Solutions, Inc. ("IPS"). Our results for the three months and six months ended June 30, 2006 include the results of MBS and IPS. We did not acquire Rand and On Line until December 1, 2006. All material intercompany balances and transactions have been eliminated in consolidation.

These financial statements have been prepared in accordance with GAAP for interim financial reporting and in accordance with the instructions to Form 10-QSB and Item 310(b) of Regulation S-B. Accordingly, they do not contain all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the accompanying unaudited consolidated condensed financial statements include adjustments consisting of only normal recurring adjustments necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods presented. The results of operations for any interim period are not necessarily indicative of results for the full year.

Certain reclassifications have been made in the 2006 financial statements to conform to the reporting format in 2007. Such reclassifications had no effect on previously reported earnings. In addition, the first and second quarter financial statements were restated to reflect operations discontinued subsequent to the first and second quarters of 2006.

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

The accompanying unaudited consolidated condensed financial statements should be read in conjunction with the financial statements and related notes therein included in our Annual Report on Form 10-KSB for the year ended December 31, 2006.

Description of Business

We are a healthcare services organization providing outsourced business services to physicians, serving the physician market through two operating segments - Revenue Cycle Management and Practice Management - via our operating subsidiaries: MBS, Rand, On Line, and IPS. Our mission is to provide superior billing, collections, practice, business and financial management services for physicians, resulting in optimal profitability for our clients and increased enterprise value for our stakeholders. We believe our core competency is our long-term experience and success in working with and creating value for physicians.

Orion was incorporated in Delaware on February 24, 1984 as Technical Coatings, Incorporated. On December 15, 2004, we completed a series of transactions to acquire IPS (the "IPS Merger") and to acquire Dennis Cain Physician Solutions, Ltd. ("DCPS") and MBS (the "DCPS/MBS Merger") (collectively, the "2004 Mergers"). As a result of these transactions, IPS and MBS became our wholly owned subsidiaries. On December 15, 2004, and simultaneous with the consummation of the 2004 Mergers, we changed our name from SurgiCare, Inc. to Orion HealthCorp, Inc. and consummated restructuring transactions, which included issuances of new equity securities for cash and contribution of outstanding debt, and the restructuring of our debt facilities. We also created Class B Common Stock and Class C Common Stock, which were issued in connection with the equity investments and acquisitions.

In 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. As part of this plan, we completed a series of transactions involving the divestiture of non-strategic assets in 2005 and early 2006. In addition, we redirected financial resources and company personnel to areas that management believed would enhance long-term growth potential. A key component of our long-term strategic plan was the identification of potential acquisition targets that would increase our presence in the markets we serve and enhance stockholder value.

On December 1, 2006 we completed the acquisition of Rand and On Line. We acquired 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 was paid through a combination of cash, the issuance of an unsecured subordinated promissory note and the issuance of shares of our Class A Common Stock. We acquired 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 was paid through a combination of cash and the issuance of unsecured subordinated promissory notes. (See Note 2. Acquisitions and Private Placement for additional information on the furtherance of our strategic plan in 2006.)

F-7

Revenue Cycle Management Segment ("RCM")

Our RCM segment includes three business units, MBS, Rand and On Line. We offer billing, collection, accounts receivable management, coding and

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

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, allowing them to avoid the infrastructure investment in their own back-office operations. In addition, we provide these services to other specialties including plastic surgery, family practice, internal medicine, orthopedics, neurologists, emergency medicine and ambulatory surgery centers. These services help clients to be financially successful by improving cash flows and reducing administrative costs and burdens. MBS currently provides services to approximately 56 clients. Rand currently provides services to approximately 54 clients. On Line currently provides services to approximately 20 billing clients and 43 transcription clients and provides payroll processing services to over 200 clients.

Billing and Collection Services. We offer billing and collection services to our clients. These include coding, reimbursement services, charge entry, claim submission, collection activities, and financial reporting services, including:

- o Current Procedural Terminology ("CPT") and International Classification of Diseases ("ICD-9") utilization reviews;
- o Charge ticket (superbill) evaluations;
- o Fee schedule analyses;
- o Reimbursement audits; and
- o Training seminars.
- o Patient refund processing

Managed Care Contract Management Services. We offer consulting services to assist clients with navigating and interacting with managed care organizations. Some of the managed care consulting services are:

- o Establishing the actual ownership of the managed care organization and determining that the entity is financially sound;
- o Negotiating the type of reimbursement offered;
- o Assuring that there are no "withholds" beyond the discount agreed upon;
- o Determining patient responsibility for non-covered services, as well as co-pays and deductibles;
- o Tracking managed care payments to verify the correctness of the reimbursement rate;
- o Evaluating the appeals process in case of disputes concerning payment issues, utilization review, and medical necessity; and
- o Confirming the length of the contract, the renewal process, and the termination options.

Practice Consulting Services. We offer a wide range of management consulting services to medical practices. These management services help create a more efficient medical practice, providing assistance with the business aspects associated with operating a medical practice. Our management consulting services include the following:

- o Accounting and bookkeeping services;
- o Evaluation of staffing needs;
- o Provision of temporary staff services;
- o Quality assurance program development;
- o Physician credentialing assistance;
- o Fee schedule review, specific to locality;
- o Formulation of scheduling systems; and
- o Training and continuing education programs.
- o Payroll processing

Practice Management ("PM") Segment

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

IPS, a Delaware corporation, was founded in 1996 to provide physician practice management services to general and subspecialty pediatric practices. IPS commenced its business activities upon consummation of several medical group business combinations effective January 1, 1999.

F-8

IPS serves the general and subspecialty pediatric physician market, providing accounting and bookkeeping, human resource management, group purchasing, accounts receivable management, quality assurance services, physician credentialing, fee schedule review, training and continuing education and billing and reimbursement analysis. As of June 30, 2007, IPS managed six practice sites, representing three medical groups in Illinois and Ohio. The physicians, who are all employed by separate corporations, provide all clinical and patient care related services.

There is a standard forty-year management service agreement ("MSA") between IPS and the various affiliated medical groups whereby a management fee is paid to IPS. IPS owns all of the assets used in the operation of the medical groups. IPS manages the day-to-day business operations of each medical group and provides the assets for the physicians to use in their practice for a fixed fee or percentage of the net operating income of the medical group. All revenues are collected by IPS, the fixed fee or percentage payment to IPS is taken from the net operating income of the medical group and the remainder of the net operating income of the medical group is paid to the physicians and treated as an expense on IPS's financial statements as "physician group distribution."

IPS is party to a management services agreement (the "Dayton MSA") with Dayton Infant Care Specialists, Corp. ("Dayton ICS"). The sole remaining shareholder of Dayton ICS has notified both IPS and the hospitals at which Dayton ICS has contracts that he intends to dissolve Dayton ICS, cease practicing at the hospitals and cease utilizing the services of IPS. IPS believes that the unilateral decision to dissolve Dayton ICS and terminate the business of Dayton ICS breaches the Dayton MSA and violates duties owed by Dayton ICS to IPS as a creditor of Dayton ICS. As a result of pending litigation and the uncertainty of the outcome, the operations of Dayton ICS are now reflected in our consolidated statements of operations as 'income from operations of discontinued components' for the three months and six months ended June 30, 2007 and 2006, respectively.

IPS was party to a management services agreement (the "Illinois MSA") with Pediatric Specialists of the Northwest, M.D.S.C. ("PSNW"). IPS and PSNW were in arbitration regarding claims relating to the Illinois MSA. In connection therewith, on February 9, 2007, IPS and PSNW entered into a settlement agreement (the "PSNW Settlement") to settle disputes that had arisen between IPS and PSNW and to avoid the risk and expense of further litigation. As part of the PSNW Settlement, PSNW and IPS agreed that PSNW would purchase the assets owned by IPS and used in connection with PSNW's practice, in exchange for a negotiated cash consideration and termination of the Illinois MSA. The transaction contemplated by the PSNW Settlement was consummated on May 31, 2007. Among other provisions, after May 31, 2007, PSNW and IPS have been released from any further obligation to each other from any previous agreement. The operations of PSNW are reflected on our consolidated condensed statements of operations as 'income from operations of discontinued components' for the three months and six months ended June 30, 2007 and 2006, respectively.

Ambulatory Surgery Center Business

As of June 30, 2007, we no longer have ownership or management interests in surgery and diagnostic centers.

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

On January 12, 2006, we were notified by Union Hospital ("Union") that it was exercising its option to terminate the management services agreement for Tuscarawas Open MRI, L.P. ("TOM") as of March 12, 2006. In 2005, management fee revenue related to TOM was \$38,837.

On February 3, 2006, we were notified by Union that it was exercising its option to terminate the management services agreement for Tuscarawas Ambulatory Surgery Center, L.L.C. ("TASC") as of April 3, 2006. In 2005, management fee revenue related to TASC was \$95,846.

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, L.P. ("First Surgical"). Memorial Village was approximately 49% owned by Town & Country SurgiCare, Inc., a wholly owned subsidiary of Orion. The Memorial Agreement was deemed to be effective as of January 31, 2006.

On March 1, 2006, San Jacinto Surgery Center, Ltd. ("San Jacinto") executed an Asset Purchase Agreement (the "San Jacinto Agreement") for the sale of substantially all of its assets to San Jacinto Methodist Hospital ("Methodist"). San Jacinto was approximately 10% owned by Baytown SurgiCare, Inc., a wholly owned subsidiary of Orion.

Note 2. Acquisitions and Private Placement

On December 1, 2006 we completed the acquisitions of Rand and On Line.

Rand. We acquired 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 was paid through a combination of cash, the issuance of an unsecured subordinated promissory note and the issuance of shares of our Class A Common Stock. As of the closing of the Rand acquisition on December 1, 2006, \$7,200,000 of the purchase price was paid in cash, and both \$200,000 in cash and 3,314,917 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 Rand acquisition) were placed in escrow pending resolution of the purchase price adjustments and subject to claims, if any, for indemnification. The remainder of the purchase price was paid in a combination of cash and the issuance of an unsecured subordinated promissory note in the original principal amount of \$1,365,333.

F-9

The Rand stock purchase agreement includes contingent future payments (the "Rand Earn-out") to the seller based on post acquisition revenue targets for Rand in 2007 and 2008 of \$6,349,206 and \$9,600,000, respectively. The stock portion of the Rand Earn-out (3,314,917 shares) was placed into escrow at the closing of the acquisition, but the shares were considered issued and outstanding as of December 1, 2006. Therefore, the stock portion of the Rand Earn-out has been reflected in the purchase price we paid for Rand. The cash and promissory note portions of the contingent Rand Earn-out have not been reflected in the purchase price we paid for Rand on December 1, 2006, and were placed into escrow at December 1, 2006. If the revenue targets are achieved, then the cash and shares held in escrow will be released to the seller and the full amount of the promissory note will be outstanding. If the revenue targets are not achieved, then all or a portion of the shares held in the escrow will be forfeited, all or a portion of the cash will be returned to us and/or the amount of the promissory note will be reduced. The contingent Rand Earn-out, if realized, will be accounted for at the time as an addition to (earn-out) or

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

reduction in (reduction) the cost of the acquisition and goodwill and other identifiable intangible assets will be adjusted accordingly.

On Line. We acquired all of the issued and outstanding capital stock of On Line for an aggregate purchase price of \$3,310,924, subject to adjustments conditioned upon future revenue results. The purchase price was paid through a combination of cash and the issuance of unsecured subordinated promissory notes. As of the closing of the On Line acquisition on December 1, 2006, \$2,401,943 of the purchase price was paid in cash and the remainder through the issuance of unsecured promissory notes in the aggregate original principal amount of \$908,981. The On Line stock purchase agreement includes contingent future payments (the "On Line Earn-out") to the seller in the form of a promissory note and cash, and contingent return or adjustment of the promissory note based on a post acquisition revenue target for the twelve months after closing of \$2,500,259. The On Line Earn-out has not been reflected in the purchase price allocation. The On Line Earn-out, if realized, will be accounted for at the time as an addition to (earn-out) or reduction in (reduction) the cost of the acquisition and goodwill and other identifiable intangible assets will be adjusted accordingly.

Private Placement. These acquisitions were financed in part through the proceeds of the Private Placement, which consisted of our issuance of (i) shares of a newly created class of our common stock, Class D Common Stock, par value \$0.001 per share (the "Class D Common Stock"), which is convertible into our Class A Common Stock, to each of Phoenix Life Insurance Company ("Phoenix") and Brantley Partners IV, L.P. ("Brantley IV") for an aggregate purchase price of \$4,650,000 and (ii) senior unsecured subordinated promissory notes due 2011 in the original principal amount of \$3,350,000, bearing interest at an aggregate rate of 14% per annum, together with warrants to purchase shares of our Class A Common Stock, to Phoenix for an aggregate purchase price of \$3,350,000.

Our senior unsecured subordinated promissory notes 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 are 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.

As of June 30, 2007, Brantley IV and its affiliates, Brantley Venture Partners III, L.P. ("Brantley III") and Brantley Equity Partners, L.P. ("BEP"), owned 66,629,515 shares of our Class A Common Stock, warrants to purchase 20,455 shares of our Class A Common Stock and 8,749,952 shares of our Class D Common Stock which are currently convertible into 8,749,952 shares of our Class A Common Stock. As of June 30, 2007, this represented 55.1% of our voting power on an as-converted, fully-diluted basis. As of December 1, 2006, we qualified as a "controlled company" under the listing rules of the American Stock Exchange ("AMEX"). Two of our directors, Paul H. Cascio and Robert P. Pinkas, are affiliated with Brantley IV and its related entities. Messrs. Cascio and Pinkas serve as general partners of the general partner of Brantley III and Brantley IV and are limited partners in these funds. The advisor to Brantley III is Brantley Venture Management III, L.P. and the advisor to Brantley IV is Brantley Management IV, L.P. Messrs. Cascio and Pinkas also serve as advisors to BEP.

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

As a condition to the Private Placement, on December 1, 2006, we refinanced our existing loan facility with CIT Healthcare, LLC ("CIT") into a four year \$16,500,000 senior secured credit facility with Wells Fargo Foothill, Inc. ("Wells Fargo") consisting of a \$2,000,000 revolving loan commitment, a \$4,500,000 term loan and a \$10,000,000 acquisition facility commitment. Amounts borrowed under this facility are secured by substantially all of our assets and a pledge of the capital stock of our operating subsidiaries. Under the terms of the credit agreement (the "Credit Agreement") relating to this facility, amounts borrowed bear interest at either a fluctuating rate based on the prime rate or LIBOR rate, at our election. Currently, our interest rate on the revolving loan commitment and the term loan is the prime rate plus 1.75%. In addition to refinancing our existing loan facility, a portion of the proceeds from this facility were used to fund our acquisitions of Rand and On Line and to finance our ongoing working capital, capital expenditure and general corporate needs. Upon repayment of the CIT loan facility, two of our stockholders, Brantley IV and Brantley Capital Corporation ("Brantley Capital") were released from guarantees that they had provided on our behalf in connection with the loan facility.

The Credit Agreement contains certain financial covenants that require us to maintain minimum levels of trailing twelve month earnings before income taxes, depreciation and amortization ("EBITDA"), a minimum fixed charge coverage ratio, a maximum senior debt leverage ratio and a limitation on annual capital expenditures and other customary terms and conditions. As of June 30, 2007, we were in compliance with all of the financial covenants under the Credit Agreement.

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 closing of the Private Placement, Phoenix did not own, of record, any shares of our capital stock. As part of the Private Placement, Phoenix received (i) 15,909,003 shares of Class D Common Stock, representing upon conversion 15,909,003 shares, or 11.6%, of our outstanding Class A Common Stock as of December 31, 2006, on an as-converted, fully-diluted basis taking into account the issuance of the shares of Class D Common Stock and (ii) warrants to purchase 1,421,629 shares of our Class A Common Stock representing 1.0% of the voting power as of December 31, 2006 on an as-converted, fully-diluted basis.

Also on December 1, 2006 in connection with the consummation of the Private Placement and the execution of the Credit Agreement, the following actions were taken:

- o All of our remaining holders of Class B Common Stock and Class C Common Stock converted their shares into shares of our Class A Common Stock;
- o We purchased and retired all 1,722,983 shares of our Class B Common Stock owned by Brantley Capital for an aggregate purchase price of \$482,435;
- o We amended our certificate of incorporation to create the Class D Common Stock and eliminate the Class B Common Stock and Class C Common Stock;
- o Brantley IV converted the entire unpaid principal balance, and accrued but unpaid interest, of two convertible subordinated promissory notes in the original aggregate amount of \$1,250,000 into shares of our Class A Common Stock;
- o We extended the maturity date and increased the interest rate on certain unsecured subordinated promissory notes totaling in the aggregate \$1,714,336 (the "DCPS/MBS Notes") issued to certain of the former equity holders of the businesses we acquired in 2004 as part of the DCPS/MBS Merger, including two of our executive officers, Dennis

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

- o Cain, CEO of MBS, and Tommy Smith, President and COO of MBS; and We restructured certain unsecured notes issued to DVI Financial Services, Inc. ("DVI") and serviced by U.S. Bank Portfolio Services ("USBPS") to reduce the outstanding balance from \$3,750,000 to \$2,750,000.

As of June 30, 2007, our revolving loan commitment with Wells Fargo had limited availability to provide for working capital shortages. Although we believe we will generate cash flows from operations in the future, there is no guarantee that we will be able to fund our operations solely from our cash flows. In 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. As part of this plan, we completed a series of transactions involving the divestiture of non-strategic assets in 2005 and early 2006. In addition, we redirected financial resources and company personnel to areas that management believed would enhance long-term growth potential. A key component of our long-term strategic plan was the identification of potential acquisition targets that would increase our presence in the markets we serve and enhance stockholder value. On December 1, 2006 we completed the acquisition of Rand and On Line. In addition to Rand and On Line, we have identified other potential acquisition opportunities to expand our business that are consistent with our strategic plan. We have a \$10 million acquisition facility commitment under the Credit Agreement that will enable us to finance some or all of the cash consideration for future acquisitions based on a formula tied to our pro forma trailing twelve month EBITDA, including the EBITDA of the potential acquisition target.

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. There can be no assurances that additional financing or strategic alternatives will be available, or that, if available, the financing or strategic alternatives will be obtainable on terms acceptable to us or that any additional financing would not be substantially dilutive to our existing stockholders.

F-11

Note 3. Revenue Recognition

MBS, Rand and On Line's principal source of revenues is fees charged to clients based on a percentage of net collections of the client's accounts receivable. They recognize revenue and bill their clients when the clients receive payment on those accounts receivable.

Our RCM businesses typically receive 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, Rand and OLA also earn fees from the various consulting services that they provide, including medical practice management services, managed care contracting, coding and reimbursement services and transcription services. OLP earns revenue based on a contracted rate per transaction and recognizes revenue when the service is provided.

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

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

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. 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 three months ended June 30, 2007 and 2006.

Our principal source of revenues from our surgery center business was a surgical facility fee charged to patients for surgical procedures performed in its ASCs and for diagnostic services performed at TOM. We depended upon third-party programs, including governmental and private health insurance programs to pay these fees on behalf of its patients. Patients were responsible for the co-payments and deductibles when applicable. The fees varied depending on the procedure, but usually included all charges for operating room usage, special equipment usage, supplies, recovery room usage, nursing staff and medications. Facility fees did not include the charges of the patient's surgeon, anesthesiologist or other attending physicians, which were billed directly to third-party payers by such physicians. In addition to the facility fee revenues, we also earned management fees from its operating facilities and development fees from centers that it developed. As more fully described in Note 1. General under the caption "Description of Business," we no longer have ownership or management interests in surgery and diagnostic centers.

Note 4. Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. While management believes current estimates are reasonable and appropriate, results could differ from these estimates.

F-12

Note 5. Segment Reporting

The following table summarizes key financial information, by reportable segment, as of and for the three months and six months ended June 30, 2007 and 2006, respectively:

For the Three Months Ended June

RCM

PM

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

Net operating revenues	\$4,975,098	\$3,11
Income from continuing operations	293,181	18
Depreciation and amortization	529,705	5
Total assets	20,400,522	4,32

For the Three Months Ended June

	RCM	PM
Net operating revenues	\$2,361,762	\$2,79
Income from continuing operations	149,321	17
Depreciation and amortization	282,773	10
Total assets	10,043,365	8,22

For the Six Months Ended June 3

	RCM	PM
Net operating revenues	\$9,719,651	\$6,539
Income from continuing operations	586,179	404
Depreciation and amortization	1,059,947	113
Total assets	20,400,522	4,328

For the Six Months Ended June 3

	RCM	PM
Net operating revenues	\$4,756,052	\$5,935
Income from continuing operations	338,890	395
Depreciation and amortization	565,883	206
Total assets	10,043,365	8,220

F-13

The following schedules provide a reconciliation of the key financial information by reportable segment to the consolidated totals found in our consolidated balance sheets and statements of operations as of and for the three months and six months ended June 30, 2007 and 2006, respectively:

	Three Months Ended June 30, 2007	2006	Si
Net operating revenues:			
Total net operating revenues for reportable segments	\$8,089,327	\$5,161,538	\$1
Corporate revenue	71,825	101,196	
Total consolidated net operating revenues	\$8,161,152	\$5,262,734	\$1
Income (loss) from continuing operations:			
Total income from continuing operations for reportable segments	\$474,086	\$327,406	
Extraordinary gain	-	-	
Corporate overhead	(1,374,982)	(946,528)	(

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

Total consolidated income (loss) from continuing operations	\$ (900,896)	\$ (619,122)	\$ (
Depreciation and amortization:			
Total depreciation and amortization for reportable segments	\$586,215	\$385,449	\$
Corporate depreciation and amortization	122,290	18,274	
Total consolidated depreciation and amortization	\$708,505	\$403,723	\$
Total assets:			
Total assets for reportable segments	\$24,729,166	\$18,263,557	\$2
Corporate assets	4,065,936	1,474,068	
Assets related to discontinued operations(1)	175,004	-	
Total consolidated assets	\$28,970,106	\$19,737,625	\$2

Note 6. Goodwill and 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 Financial Accounting Standards Board ("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.

Note 7. Earnings per Share

Basic earnings per share are calculated on the basis of the weighted average number of shares of Class A Common Stock outstanding at year-end. Diluted earnings per share, in addition to the weighted average determined for basic loss per share, include common stock equivalents which would arise from the exercise of stock options and warrants using the treasury stock method, conversion of debt and conversion of Class B Common Stock, Class C Common Stock and Class D Common Stock.

F-14

	For the Three Months Ended June 30,	
	2007	2006
Net income (loss)	\$115,971	\$(480,197)
Weighted average number of shares of Class A Common Stock outstanding for basic net income (loss) per share	105,502,884	12,591,319
Dilutive stock options, warrants and restricted stock units (1)	(a)	(5)

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

Convertible notes payable (2)	(b)	(5)
Class B Common Stock (3)	(c)	(5)
Class C Common Stock (4)	(d)	(5)
Class D Common Stock	(e)	--
Weighted average number of shares of Class A Common Stock outstanding		
for diluted net income (loss) per share	105,502,884	12,591,319
Net income (loss) per share - Basic	\$(0.00)	\$(0.04)
Net income (loss) per share - Diluted	\$(0.00)	\$(0.04)

The following potentially dilutive securities are not included in the June 30, 2007 calculation of weighted average number of shares of Class A Common Stock outstanding for diluted net income (loss) per share, because the effect would be anti-dilutive due to the net loss for the quarter:

- a) 7,113,361 options, warrants and restricted stock units were outstanding at June 30, 2007. (See Note 2. Acquisitions and Private Placement for information on warrants issued to Phoenix.)
- b) A \$50,000 note was convertible into 442,152 shares of our Class A Common Stock at June 30, 2007 based on 75% of the average closing price for the 20 trading days immediately prior to the conversion date.
- c) There were no shares of our Class B Common Stock outstanding at June 30, 2007. On December 1, 2006, we purchased all 1,722,983 shares of our Class B Common Stock owned by Brantley Capital and retired them in accordance with the terms of our Third Amended and Restated Certificate of Incorporation. Also on December 1, 2006, in connection with the Private Placement, all of the other holders of our Class B Common Stock converted those shares into 67,742,350 shares of our Class A Common Stock. (See Note 2. Acquisitions and Private Placement.)
- d) There were no shares of our Class C Common Stock outstanding at June 30, 2007. On December 1, 2006, in connection with the Private Placement, all of the holders of our Class C Common Stock converted those shares into 20,019,619 shares of our Class A Common Stock. (See Note 2. Acquisitions and Private Placement.)
- e) 24,658,955 shares of our Class D Common Stock were outstanding at June 30, 2007. On December 1, 2006, pursuant to the Stock Purchase Agreement, Phoenix and Brantley IV purchased an aggregate of 24,658,955 shares of our Class D Common Stock for a total purchase price of \$4,650,000. Each share of our Class D Common Stock is currently convertible into one share of our Class A Common Stock. (See Note 2. Acquisitions and Private Placement.)

The following potentially dilutive securities were included in the June 30, 2006 calculation of weighted average number of shares outstanding for diluted net income per share:

- (1) 2,510,347 options, warrants and restricted stock units were outstanding as of June 30, 2006.
- (2) \$1,300,000 of notes were convertible into Class A Common Stock at June 30, 2006. Of the total, \$50,000 was convertible into 242,494 shares of Class A Common Stock based on a conversion price equal to 75% of the average closing price for the 20 trading days immediately prior to June 30, 2006. The remaining \$1,250,000 was convertible into 1,310,706 shares of Class A Common Stock at June 30, 2006.
- (3) 10,448,470 shares of Class B Common Stock were outstanding at June 30, 2006. Each share of Class B Common Stock was convertible into 5.140508175 shares of Class A Common Stock as of June 30, 2006.
- (4) 1,437,572 shares of Class C Common Stock were outstanding at June 30, 2006. If all of the Class B Common Stock had been converted at June 30, 2006, the holders of Class C Common Stock would have been eligible

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

- to convert 1,308,142 shares of Class C Common Stock into 13,925,383 shares of Class A Common Stock under the anti-dilution provision.
- (5) The potentially dilutive securities listed in (1) -- (4), above, are not included in the calculation of weighted average number of shares of Class A Common Stock outstanding for diluted net loss per share for the three months ended June 30, 2006, because the effect would be anti-dilutive due to the net loss for the quarter:

F-15

Note 8. Employee Stock Based Compensation

At June 30, 2007, we had two stock-based employee compensation plans. Prior to January 1, 2006, we accounted for grants for these plans under Accounting Principals Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations, and applied SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," for disclosure purposes only. Under APB 25, stock-based compensation cost related to stock options was not recognized in net income since the options underlying those plans had exercise prices greater than or equal to the market value of the underlying stock on the date of the grant. Effective January 1, 2006, we adopted SFAS No. 123(R), which requires that all share-based payments to employees be recognized in the financial statements based on their fair values at the date of grant. The calculated fair value is recognized as expense (net of any capitalization) over the requisite service period, net of estimated forfeitures, using the straight-line method under SFAS No. 123(R). We consider many factors when estimating expected forfeitures, including types of awards, employee class and historical experience. The statement was adopted using the modified prospective method of application which requires compensation expense to be recognized in the financial statements for all unvested stock options beginning in the quarter of adoption. No adjustments to prior periods have been made as a result of adopting SFAS No. 123(R). Under this transition method, compensation expense for share-based awards granted prior to January 1, 2006, but not yet vested as of January 1, 2006, will be recognized in our financial statements over their remaining service period. The cost was based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123. As required by SFAS No. 123(R), compensation expense recognized in future periods for share-based compensation granted prior to adoption of the standard will be adjusted for the effects of estimated forfeitures.

On June 17, 2005, we granted 1,357,000 stock options to certain of our employees, officers, directors and former directors under our 2004 Incentive Plan, as amended. In the third quarter of 2005, stock options totaling 360,000 to certain employees were cancelled as a result of staff reductions related to the consolidation of corporate functions duplicated at our Houston, Texas and Roswell, Georgia facilities. On May 12, 2006, we granted 102,000 stock options to certain of our employees and directors under our 2004 Incentive Plan, as amended. On December 4, 2006, we granted 2,500,000 stock options to certain of our employees, officers and directors under our 2004 Incentive Plan, as amended.

In March 2007, we granted 420,000 stock options to certain of our employees under our 2004 Incentive Plan, as amended.

On August 31, 2005, we granted 650,000 restricted stock units to certain of our officers under our 2004 Incentive Plan, as amended.

For the six months ended June 30, 2007 and 2006, the impact of adopting SFAS No. 123(R) on our consolidated statements of operations was an increase in salaries and benefits expense of \$192,349 and \$97,713, respectively, with a corresponding decrease in our income from continuing operations, income before

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

provision for income taxes and net income resulting from the recognition of compensation expense associated with employee stock options. There was no material impact on our basic and diluted net income per share as a result of the adoption of SFAS No. 123(R).

The adoption of SFAS No. 123(R) has no effect on net cash flow. Since we are not presently a taxpayer and have provided a valuation allowance against deferred income tax assets net of liabilities, there is also no effect on our consolidated statement of cash flows. Had we been a taxpayer, we would have recognized cash flow resulting from tax deductions in excess of recognized compensation cost as a financing cash flow.

Note 9. Discontinued Operations

Memorial Village. As a result of the uncertainty of future cash flows related to our surgery center business as well as the transactions related to TASC and TOM, we determined that the joint venture interest associated with Memorial Village was impaired and recorded a charge for impairment of intangible assets related to Memorial Village of \$3,229,462 for the three months ended June 30, 2005. 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 an additional charge for impairment of intangible assets of \$1,348,085 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 Orion. 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. There were no operations for this component in our financial statements after March 31, 2006.

F-16

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., a wholly owned subsidiary of Orion, and was 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. As a result of the uncertainty of future cash flows related to the surgery center business, and in conjunction with the transactions related to TASC and TOM, we determined that the joint venture interest associated with San Jacinto was impaired and recorded a charge for impairment of intangible assets related to San Jacinto of \$734,522 for the three months ended June 30, 2005. We also recorded an additional \$2,113,262 charge for impairment of intangible assets for the three months ended September 30, 2005 related to the management contracts with San Jacinto. 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 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.

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

Dayton ICS. IPS is party to the Dayton MSA with Dayton ICS. The sole remaining shareholder of Dayton ICS has notified both IPS and the hospitals at which Dayton ICS has contracts that he intends to dissolve Dayton ICS, cease practicing at the hospitals and cease utilizing the services of IPS. IPS believes that the unilateral decision to dissolve Dayton ICS and terminate the business of Dayton ICS breaches the Dayton MSA and violates duties owed by Dayton ICS to IPS as a creditor of Dayton ICS. As a result of the pending litigation and the uncertainty of the outcome, the operations of Dayton ICS are now reflected in our consolidated statements of operations as 'income from operations of discontinued components' for the three months and six months ended June 30, 2007 and 2006, respectively. Additionally, we recorded a charge for impairment of intangible assets of \$1,845,669 for Dayton ICS for the quarter ended December 31, 2006.

PSNW. IPS was party to the Illinois MSA with PSNW. IPS and PSNW were in arbitration regarding claims relating to the Illinois MSA. In connection therewith, on February 9, 2007, IPS and PSNW entered into the PSNW Settlement to settle disputes that had arisen between IPS and PSNW and to avoid the risk and expense of further litigation. As part of the PSNW Settlement, PSNW and IPS agreed that PSNW would purchase the assets owned by IPS and used in connection with PSNW's practice, in exchange for a negotiated cash consideration and termination of the Illinois MSA. The transaction contemplated by the PSNW Settlement was consummated on May 31, 2007. We recorded a gain on disposal of discontinued components totaling \$999,725 for the quarter ended June 30, 2007. PSNW and IPS have been released from any further obligation to each other from any previous agreement. As a result of the PSNW Settlement, the operations of PSNW are now reflected in our consolidated statements of operations as 'income from operations of discontinued components' for the three months and six months ended June 30, 2007 and 2006, respectively. Additionally, we recorded a charge for impairment of intangible assets of \$1,249,080 for PSNW for the quarter ended December 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, from our surgery centers. 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 \$968 and \$61,038, respectively, for the three months and six months ended June 30, 2006.

The following table contains selected financial information regarding our discontinued operations for the three months and six months ended June 30, 2007 and 2006, respectively:

	Three months ended June 30, 2007	2006	Six
Net operating revenues from discontinued operations	\$641,552	\$1,669,948	\$1
Total expenses from discontinued operations	(621,552)	(1,531,023)	(1
Income from discontinued operations	20,000	138,925	
Gain on disposal of discontinued operations	999,725	--	
Net income from discontinued operations	\$1,019,725	\$138,925	\$1

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

Note 10. Long-Term Debt

Long-term debt is as follows:

	June 30, 2007

Long-term debt:	

\$4,500,000 senior note payable to a financial institution, bearing interest at the Prime Rate (8.25% at June 30, 2007) plus 1.75%, interest payable monthly, principal payments monthly based on schedule, matures December 1, 2010	\$4,316,250
\$2,000,000 senior revolving line of credit with a financial institution, bearing interest at the Prime Rate (8.25% at June 30, 2007) plus 1.75%, interest payable monthly, matures December 1, 2010	1,732,368
\$10,000,000 senior acquisition line of credit with a financial institution, bearing interest at the Prime Rate (8.25% at June 30, 2007) plus 1.75%, interest payable monthly, principal payments monthly based on schedule, matures December 1, 2010	--
Term loan payable to a financial institution, non-interest bearing, matures October 1, 2013	2,700,000
Convertible notes, bearing interest at 18%, interest payable monthly, convertible on demand	50,000
Insurance financing note payable, bearing interest at 5.25%, interest payable monthly	49,040

Total debt	8,847,658
Less: Current portion of long-term debt	(2,273,907)

Total long-term debt	\$6,573,751
	=====
Long-term debt held by related parties:	

Promissory notes payable to sellers of MBS, bearing interest at 9%, interest payable monthly, principal payments quarterly beginning on December 15, 2007 based on schedule, matures December 15, 2008	1,714,336
\$3,350,000 senior subordinated promissory note payable to a related party, bearing interest at 12% plus 2% PIK, interest payable quarterly, principal due on December 1, 2011	3,105,002
\$75,000 unsecured subordinated promissory note payable to the stockholders of OLA, bearing interest at 7%, interest payable monthly in arrears, principal payable February 1, 2007	--

Total debt held by related parties	\$4,819,338
Less: Current portion of long-term debt held by related parties	(850,000)

Total long-term debt held by related parties	\$3,969,338
	=====

Edgar Filing: ORION HEALTHCORP INC - Form 10QSB

Note 11. Litigation

IPS is party to the Dayton MSA with Dayton ICS. The sole remaining shareholder of Dayton ICS has notified both IPS and the hospitals at which Dayton ICS has contracts that he intends to dissolve Dayton ICS, cease practicing at the hospitals and cease utilizing the services of IPS. On November 28, 2006, we were named as a defendant in a suit entitled Dayton Infant Care Specialists, Corp. vs. Integrated Physician Solutions, Inc., et al. in the United States District Court of the Southern District of Ohio, Western Division, Case No. 3:06-cv-00374, in which Dayton ICS was seeking certain injunctive relief ordering that certain funds derived from accounts receivable and held in a lockbox be released to Dayton ICS. On November 29, 2006, the Court denied Dayton ICS's motion for a temporary restraining order. There is an arbitration clause in the Dayton MSA. IPS asserts that Dayton ICS waived arbitration and, therefore, has filed a counterclaim against Dayton ICS for breach of contract and other causes of action. Also on November 29, 2006, IPS filed a suit entitled Integrated Physician Solutions, Inc. vs. Don T. Granger, M.D., et al. in the United States District Court of the Southern District of Ohio, Western Division, Case No 3:06-cv-00377 against the shareholder of Dayton ICS and physicians who are under employment agreements with Dayton ICS stating various claims arising out of their involvement with the termination of the business. Certain of the employees have filed a motion to dismiss the counterclaim against them. Both cases are assigned to the same judge in the Western Division of the United States District Court of the Southern District of Ohio and may be consolidated. Trial dates have been scheduled for both cases in July 2008.

F-18

IPS was party to the Illinois MSA with PSNW. IPS and PSNW were in arbitration regarding claims relating to the Illinois MSA. In connection therewith, on February 9, 2007, IPS and PSNW entered into the PSNW Settlement to settle disputes that had arisen between IPS and PSNW and to avoid the risk and expense of further litigation. As part of the PSNW Settlement, PSNW and IPS agreed that PSNW would purchase the assets owned by IPS and used in connection with PSNW's practice, in exchange for a negotiated cash consideration and termination of the Illinois MSA. Additionally, among other provisions, after May 31, 2007, which was the closing date of the transaction contemplated by the PSNW Settlement, PSNW and IPS have been released from any further obligation to each other from any previous agreement.

In addition, we are involved in various other legal proceedings and claims arising in the ordinary course of business. Our management believes that the disposition of these additional matters, individually or in the aggregate, is not expected to have a materially adverse effect on our financial condition. However, depending on the amount and timing of such disposition, an unfavorable resolution of some or all of these matters could materially affect our future results of operations or cash flows in a particular period.

F-19

Exhibit Index

Exhibit No.	Description
24.1	Power of Attorney (See Signatures on page 26)
31.1	Rule 13a-14(a)/15d-14(a) Certification
31.2	Rule 13a-14(a)/15d-14(a) Certification
32.1	Section 1350 Certification
32.2	Section 1350 Certification

