Emdeon Inc. (EM/NYSE)

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Caught in the Middle – Initiating Coverage at Sell

Initiating Coverage at Sell
Target Price: $13

Investment Summary

Emdeon is the leading processor of medical claims in the industry, a quintessential middleman, connecting payors and providers. We believe the company's core clearinghouse business is a melting platform from which cross selling revenue cycle management products is a challenging endeavor. While investors may be focusing on the potential benefit from healthcare reform, we view the benefit as a potential one-time boost to the growth rate in claims that will revert back to the low-single digits after the anniversary of enrollment. Further, maintaining share of claims processed will be increasingly more difficult as providers bypass clearinghouses and submit their claims directly to the payors, in our opinion. We believe the multiple afforded the shares is more commensurate with a company capable of delivering double-digit top-line growth. We apply a 13x multiple to our 2010 cash EPS estimate, which we believe may prove overly generous, to arrive at a fair value of $13 per share.

- **Potential for Disintermediation –** We believe the company's core clearinghouse model faces serious challenges over the next few years from its channel partners as well as Health Information Exchanges (HIEs) being created by the stimulus package. We understand practice management vendors have begun building direct connections to payors into their practice management systems. We would also not ignore the potential threat that HIEs pose to the clearinghouse business, given their federal backing in the stimulus package. We believe HIEs are more likely to capture financial transactions than clearinghouses will process clinical data exchange.
- **Melting Platform –** We would not be so brazen as to think the clearinghouse model will be eliminated overnight, given the complexity of the transaction process. However, with the threat from upstarts like athenahealth, which processes 50% of its claims directly with payors, and the resulting competitive response from legacy practice management systems, we believe the erosion of the company's transaction processing business has already begun and will continue. Even more alarming, in our view, is that the company relies upon its network of clearinghouse customers to cross-sell additional solutions and services. As a middleman, we believe Emdeon is already at a disadvantage selling RCM and payor solutions. An erosion of the claims processing business would only weaken its competitive standing, in our opinion.
- **Shining Light –** While shining may be a bit strong, we do acknowledge the glimmer of possibility arising from proposed healthcare reform legislation. We estimate that covering the 45 million uninsured would increase healthcare transactions by 2.3 billion (+18%). In relation to Emdeon, we estimate the company would capture an additional 700 million transactions, which we model would represent an incremental $0.12 to Emdeon's EPS. Since healthcare reform would result in a one-time increase and not a permanent boost to the company's growth rate, we apply a consistent 13x EPS multiple and derive $1.50 of value from healthcare reform.
- **Valuation –** On an EV/EBITDA basis, EM shares trade at 10x our 2010 adjusted EBITDA estimate of $267 million. Given our expectation for mid-single digit top-line growth and adjusted EBITDA growth below 10%, we believe a 7x-9x EV/EBITDA multiple is more appropriate. The mid-point of this range equates to a valuation of approximately $12.70 or 24% below the shares' current value.

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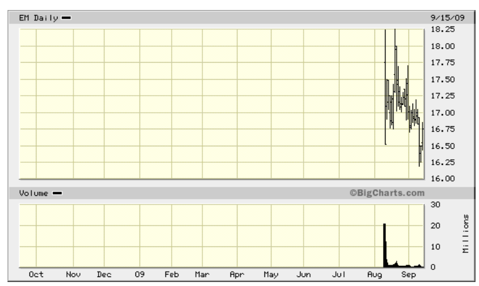
Price	$16.75
52-Week High/Low	$18.25 - 16.19
Shares Outstanding (mm)	115.00
Market Cap. (mm)	$1,926.25
Average Daily Volume (mm)	1.95

EPS	**FY08A**	**FY09E**	**FY10E**
Mar	NA	$0.23A	NA
Jun	NA	$0.26A	NA
Sep	NA	$0.21	NA
Dec	NA	$0.22	NA
FY	**$0.84**	**$0.92**	**$1.01**
Consensus	NA	NA	NA
P/E	19.9x	18.2x	16.6x
FY Rev. (mm)	$853.60	$914.88	$974.36



Source: BigCharts.com

Investment Thesis

Emdeon is a leading provider of software and services to connect health care providers and payors. The company reports revenue in three segments. However, in all practical purposes, nearly all of the various product offerings stem from the company's core clearinghouse operations. The company has completed a litany of acquisitions over its substantial history. Claims management represented only 22% of the company's total revenue in 2008. However, the majority of services and other product lines are either directly dependent upon the clearinghouse network or indirectly reliant upon the claims processing customer base to cross-sell revenue cycle management solutions. We believe the clearinghouse business is in danger of being phased out over the next five years, either through direct connections established between payors and providers or through health information exchanges (HIEs). As part of the American Recovery and Reinvestment Act (stimulus package) signed into law this past February, federal funding was set aside to promote the development of HIEs on a regional level that will eventually be connected for a national health information network (NHIN) to transfer clinical data on a patient level among clinical settings. These networks can also be utilized to transfer claims data and administrative requests between providers and payors. The erosion of the claims portion of the business would also threaten a majority of the company's other lines of business, in our opinion. Given the risk of disintermediation of the clearinghouse model, we are initiating coverage of Emdeon with a Sell rating and place a $13 target price on the shares.

Stimulus Package

Bull Case – The potential benefit from the American Recovery and Reinvestment Act (ARRA) is not obvious, as the stimulus package dedicated money for clinical HCIT adoption. The requirement within the ARRA for providers to exchange clinical data opens the door for clearinghouses to expand beyond being the gatekeepers of financial transactions. With a network in place, connecting payors and providers, clearinghouses could position themselves to capture the exchange of clinical data. Navinet, one of Emdeon's many competitors, has tried to lay claim to the clinical data exchange market. Navinet recently sent a letter to all of the governors in an attempt to circumvent the creation of health information exchanges (HIEs). Rather than build an HIE, the letter makes the case for states to utilize the Navinet network to transmit medical data. Navinet would offer the network for free to states and would instead charge the providers for accessing the network.

Sizing this market is nearly impossible as the required clinical transactions have yet to be defined. However, considering all of the permutations between labs, prescriptions, and notes, we would imagine the clinical exchange market would be at least as large as the financial transaction market, as there are generally only five financial or administrative transactions per patient visit (eligibility verification, claim submission, payment remittance). Further clouding our ability to size the clinical data exchange market is that we do not know how much would be charged for each clinical transaction.

Bear Case – What's good for the goose is good for the gander, and this gander has federal funding. Just as clearinghouse networks can be used to transmit medical data, HIEs have the ability to transmit claims data in addition to medical data. In fact, the initial mission of the Delaware Health Information Exchange (DHIE) was to act as a clearinghouse. After several years of trying to find a place in the market and as EMR adoption began to take hold, DHIE transitioned to a medical data exchange model to provide a network for community physicians to access clinical data. According to recent press reports, the DHIE intends to return to offering claims processing capabilities.

BlueCross Blue Shield (BCBS) of Arkansas invested $6 million in the Arkansas Regional Health Network to allow its provider network to utilize the Regional Health Information Organizations (RHIO) to submit all medical claims. BCBS of Arkansas would essentially act as its own clearinghouse, forwarding on claims for other payors. The initiative was fairly well received with over 6,000 physicians adopting the new model in the early months. Utilization, however, quickly declined because providers would have to enter in patient information twice, first into their practice management system and then again into the claims processing website established by BCBS of Arkansas. This double entry is the biggest impediment to direct claims processing, in our opinion. Workarounds have been developed to allow the batch claims file created by the practice management system to be submitted directly. However, glitches arise depending on the browser and version of the browser used by the practice. Given the lack of technical expertise generally found at small physician practices, physicians quickly abandoned the direct submission approach.

With the advent of HIPAA, which was intended to standardize medical claims and allow for electronic claims submission, many payors envisioned bypassing the traditional clearinghouses and building direct connections to providers. However, as BCBS of Arkansas learned, eliminating the middleman is not nearly as easy as initially thought. While the promise of direct connections has been slow to be realized, we believe there is little doubt that payors will continue to try and bypass clearinghouses and eliminate a layer of costs. Health Information Exchanges pose a viable competitor to clearinghouses, in our view. But, we believe direct connections to providers pose the greatest risk to Emdeon and the clearinghouse business model.

To this end, improving the functionality within the electronic data interchange component of practice management systems to allow direct connections between providers and payors is where we believe the market is headed. By embedding direct connectivity to payors within the practice management system, the issue of redundant data entry at the practice's end can be eliminated. Claims processing only represented 21% of Emdeon's revenue in 2008, but much of the company's other business lines are predicated on control of the claim. By building direct connections into the practice management system, all of the electronic transactions can be routed out of the clearinghouse channel to include submission, eligibility verification, status inquiries, payment and remittance.

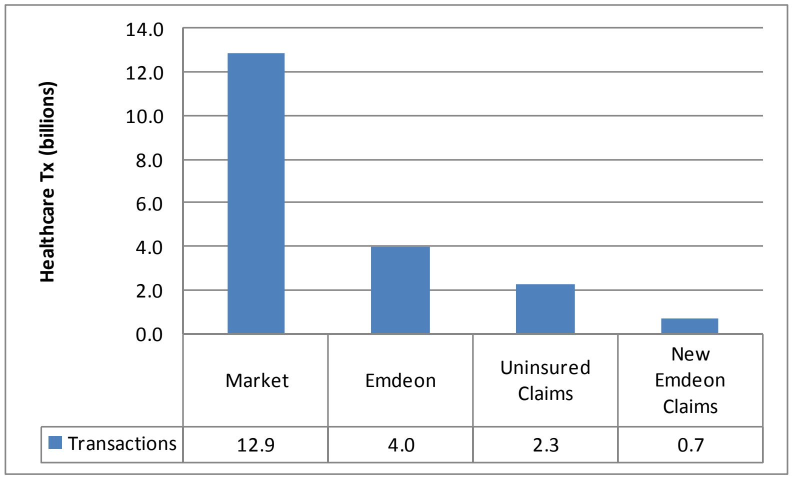
Our View – Last year, the loss of two contracts with channel partners contributed to the 6% y/y decline in claims management revenue. In response to requests from payors, Allscripts has begun building direct connectivity into its practice management system. Allscripts-Misys generally utilizes other clearinghouses, to include its own PayerPath clearinghouse, to route claims and, therefore, would not have a direct impact on Emdeon's revenue. However, we believe its competitors would likely have to respond in kind, posing a material threat to Emdeon's core business line. We believe these direct connections will be utilized to provide real-time claims adjudication (RTA). As claims are siphoned out of the clearinghouse channel, we believe the company's payment services revenue, which includes mail order services, could also be at risk of being lost. RTA allows providers to collect deductibles and co-payments upfront, minimizing the need for some of the company's mail order services.

One key channel partner that we believe is especially vulnerable is the relationship with the legacy Medical Manager customer base. Recall in 2006, Sage purchased the Practice Services division from Emdeon (also known as Healtheon), which included Medical Manager, Intergy PM, and Intergy EMR. Due to the company's historical relationship with the legacy practice management customers, we believe Emdeon's clearinghouse remains the default clearinghouse for this base. As Sage seeks to keep pace with its competitors, we would not be surprised to see Sage build its own direct-to-payor connections into the practice management systems. Further, we believe the Envoy EMR trails the leading EMR vendors, placing the legacy practice management base at further risk of erosion, as practices seek an EMR to capture the incentive payments from the stimulus package.

Healthcare Reform

Bull Case – While the prospects for material healthcare reform looked tenuous at best over the summer, President Obama seems to have stemmed the erosion of support with his recent address to Congress. At the very least, we believe the speech helped reunite the Democrats behind passing healthcare reform in some form and are likely to push forward with or without Republican support. As healthcare reform relates to Emdeon, bringing the ~45 million of uninsured into the fold would undoubtedly increase the number of medical claims processed. We estimate inclusion of the uninsured would provide a one-time increase in the number of medical transactions by 2.3 billion, an increase of 18%. We estimate Emdeon holds ~30% share of all medical transactions and, holding share constant, covering the uninsured could increase the company's revenue by a little more than $100 million due to healthcare reform. As it relates to the bottom line, we estimate healthcare reform could boost EPS by $0.12.

Exhibit 1: Healthcare Transactions and Healthcare Reform Estimates



Source: Company Reports and Brean Murray, Carret & Co. estimates

Bear Case –As skeptical as we are on viability of the clearinghouse model, even we cannot find the "bear" case of healthcare reform as it relates to the shares of EM. Assuming the uninsured gain access to affordable coverage all at once, medical transaction volume should spike by ~18%, by our estimate. However, we temper our enthusiasm about healthcare reform because the additional lives result in a one-time boost to the growth rate. We believe medical transaction growth will revert back to the low to mid-single digits once the anniversary of the reform date passes. We would look to the market's short-lived response to Medicare Part D as the closest precedent for what we can expect. In 2006, the relative P/E for U.S. Pharma traded at a premium to the S&P, reversing the discount seen in 2005, only to revert back to a discount in 2007. Placing a 13x multiple on the incremental $0.12 of EPS that we believe is possible would place a value of healthcare reform for EM shares at $1.50. Our estimate errs on the side of caution relative to our rating, in our opinion, because we believe the transaction share of clearinghouses is at jeopardy of being siphoned off.

Our View – Healthcare reform promises to provide coverage to the uninsured, which is a clear positive for the Clearinghouse industry and Emdeon in particular. We believe the value of the increased claims volume could represent as much as $1.50 in value to the shares of Emdeon. Because the effect is a one-time increase in the addressable population, we do not view the inclusion of the uninsured as a multiple expander. Rather, we believe the market should look past the temporary increase in claims volume growth and base the value of the shares on the long-term growth in claims, which we believe is in the low to mid-single digits. We would also note that the timing of reform legislation also plays a role in assessing the value for EM. As things currently stand, it is unclear what percentage of the 45 million of uninsured would receive coverage or the level of coverage. Finally, our $1.50 estimate for the value to the shares of EM is an undiscounted value, as if coverage enrollment occurs today. Therefore, our $0.12 EPS contribution for Emdeon may prove aggressive. While we see the value for Emdeon in healthcare reform, the current share price already more than accounts for the potential benefit, in our opinion.

Exhibit 2: Estimated EPS Benefit from Healthcare Reform

Healthcare Reform	
Total transactions (B)	12.9
Emdeon Transactions (B)	4.0
Market Share	31%
Insured (mm)	255
Tx per insured	50.5
Revenue/Tx	$0.16
Uninsured (mm)	45
Uninsured claims (B)	2.3
Market Opportunity ($mm)	$362
Emdeon share	$113
Operating margin	20%
Operating profit	23
Taxes	9
Net Income	14
EPS contribution	**$0.12**

Source: Company reports, Brean Murray, Carret & Co. estimates

Cross-selling Opportunity

Bull Case – Emdeon's vast network of providers could prove to be a fertile selling ground to cross-sell the company's RCM and payor solutions to streamline the administration of claims. Over the past 25 years, the company has built connections to 500,000 providers, 5,000 hospitals and over 1,200 payors. In terms of successes, the company has done an excellent job of selling additional services to the providers and payors that utilize its clearinghouse network, primarily outsourced mail and business process services. However, over the past few years the company has acquired or developed a litany of RCM solutions for providers and claims adjudication and data analytic tools for payors. Most recently, Emdeon acquired the Sentinel Group to provide fraud detection for its payor customers.

Bear Case – Despite having the broadest network of hospitals, physician practices and payors, cross-selling RCM solutions to providers and ancillary software modules to payors is not the foregone conclusion some might envision. As evidenced by the consistent desire to bypass clearinghouses, we believe the clearinghouse model does not endear itself to its customers, as payors and providers seemingly question the value proposition. Both providers and payors resent pay per click business models such as the clearinghouse, which generally charge per claim or administrative inquiry. We believe the lack of customer allegiance is the reason the company's cross-selling initiatives trail the respective growth rates in the markets it serves.

Our View – We believe the company's role as middleman, not truly aligned with the interest of either of its customer bases, places it at a disadvantage when competing with vendors focused on one side of the equation. The company's RCM business has been growing in the 6-7% range, materially below the low to mid-teen rate we believe the overall RCM market is growing. McKesson is one vendor who has been able to overcome that hurdle even despite operating its own clearinghouse network. However, McKesson's RelayHealth network goes beyond processing administrative claims into medical data exchange, even providing e-visits. McKesson was also well established selling HCIT systems to both payors and providers long before it acquired RelayHealth. We would also point out that McKesson smartly retained the RelayHealth brand and operates separate booths at tradeshows to avoid channel conflict.

Valuation

On an EV/EBITDA basis, EM shares trade at 10x our 2010 adjusted EBITDA estimate of $267 million, adjusting the economic value for the tax receivable liability. Given our expectation for mid-single digit top-line growth and adjusted EBITDA growth of approximately 10%, we believe a 7x-9x EV/EBITDA multiple is more appropriate. The mid-point of this valuation range equates to a valuation of approximately $12.70 or 24% below the shares current value. In relation to our 2010 cash EPS estimate of $1.01, the shares currently carry an EPS multiple of 17x. We would be hard pressed to argue against assigning an EPS multiple in line with its cash EPS growth rate, which we estimate to be ~10%.

While an EPS multiple of 10x may seem fairly draconian, we believe it may prove fair, given our estimate for a three-year top-line CAGR of 6.8% from 2006A-2009E, which includes acquisitions. We believe sustaining even this level of top-line growth may be challenging if payors continue to bypass clearinghouses. The shares have benefitted from being characterized as a healthcare IT company, in our opinion. However, only the company's RCM business clearly falls into the traditional healthcare IT universe and that business accounts for less than 20% of the company's revenue. Further, as we discussed above, the growth rate of Emdeon's RCM business is materially below that of the industry, in our estimation. Our fair value estimate of $12.70, based on an EV/EBITDA multiple, results in a P/E multiple of 13x our 2010 cash EPS estimate of $1.01.

In valuing the shares, we also need to incorporate an estimate for the option value of healthcare reform. Applying a consistent 13x EPS multiple, we estimate that healthcare reform could be worth an additional $1.50 of value for EM shares. We believe this estimate is the upper bound of value because it assumes full coverage for 45 million of the uninsured and is an undiscounted value as if coverage were to occur today. Therefore, including the potential benefit for healthcare reform, we would place an upper value for EM shares at $14, which would still represent a 16% decline in EM shares from the current value.

Risks to Our Rating

We attempted to cover the major risks to our Sell rating above by presenting the "bull" case to each of the major catalysts we outline in the Investment Thesis. However, for the sake of regulatory i dotting and t crossing, we will provide recap. The biggest risk to our Sell rating is the proposed healthcare reform legislation, in our opinion. We estimate healthcare reform would add an additional 2.3 billion administrative transactions. Based on our estimate that Emdeon holds a ~30% share of the transaction processing market, we assign an incremental 700 million transactions to Emdeon.

Other risks to our Sell rating covered above include the potential effect of the stimulus package and cross-selling additional RCM and payment solutions to the company's customer base. While we believe the requirement in the ARRA to share clinical data will increase competition and potentially disintermediate the clearinghouse model, clearinghouse networks could be utilized to exchange clinical data and meet the ARRA requirement.

One risk we did not cover in our investment thesis is for the company to expand its product suite through acquisition. The company has been fairly acquisitive of late, even closing two acquisitions since the end of 2Q09. However, we do not view any of the four acquisitions the company has completed since going private in 2006 as transformative. Rather, the acquisitions have either been for additional scale (IXT Solutions and GE's bulk mail and print business) or tangential product offerings (The Sentinel Group and eRx). We believe the company's position as a middleman places it at a disadvantage when cross-selling into both the provider and payor markets.

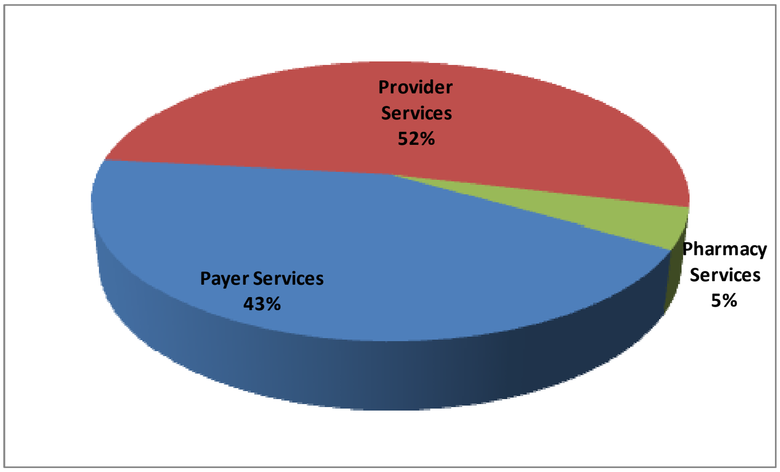
Finally, we note that, due to the quiet period following the company's recent IPO, we have not discussed our views or our estimates with company management. Our Sell rating is based on the belief that there are more attractive investment opportunities, given the low growth profile and risk of disintermediation. We would caution investors from shorting the shares at this time as the quiet period ends early next week. Potential positive comments from the syndicate could provide support for EM in the near-term.

Company Description

Emdeon is a leading provider of revenue and payment cycle solutions for healthcare providers and payors. The company operates in three segments comprised of Payer Services, Provider services and Pharmacy Services. For the payor segment, which accounted for 52% of the company's revenue in 2008, the company reports claims management (48% of Payer Services revenue) and payment services (52% of Payer services revenue) revenue. The company's clearinghouse network reaches 1,200 payors. In 2008, the company's top 10 payor customers accounted for 16% of total revenue. Provider Services represents 43% of the company's total revenue and is comprised of patient statements (60% of Provider Services revenue), revenue cycle management (33% of Provider Services revenue), and dental (7% of Provider

Services revenue). Emdeon had contractual or submitter relationships with 260,000 physicians, 2,700 hospitals and 81,000 dentists. The top 10 providers accounted for 13% of total revenue, with no provider representing more than 6% of total revenue. The company's final segment is Pharmacy services, which comprises 5% of total revenue.

Exhibit 3: EM Revenue by Segment – 2008A



Source: Company Reports

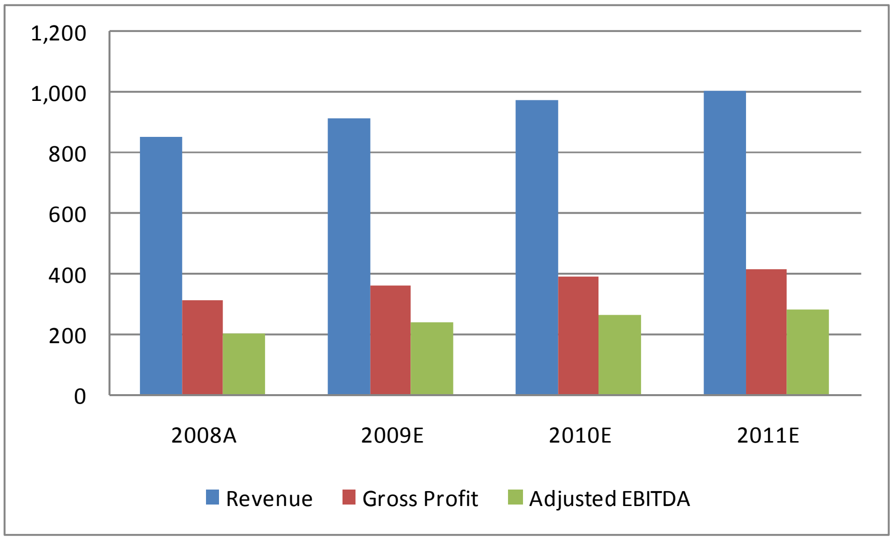
While we generally find little value in recounting a company's history, we believe Emdeon's past holds some relevant value in assessing the company. As part of Healtheon, the vision was to leverage the clearinghouse network to provide connectivity for patients, payors and providers. The company assembled a broad array of solutions, controlling a sizable practice management base, a web-based portal (WebMD), and the Emdeon clearinghouse. Healtheon abandoned its vision in 2006, divesting the legacy Medical Manager practice management business to Sage, the clearinghouse to General Atlantic LLC, and the ViPS government transaction processing. In 2006, General Atlantic LLC purchased 52% of the Emdeon Business Services unit from Healtheon for $1.2 billion. In conjunction with Hellman and Friedman LLC, General Atlantic purchased the remaining 48% of the Business services unit for $575 million.

Ironically, we would likely have a more positive view of the clearinghouse business had it been retained with the other Healtheon assets. We believe a clearinghouse with a strong practice management base provides a more defensible position should the industry transition to more direct connections between payors and providers, as is our view. If Emdeon had a practice management business we could envision the company acquiring an electronic medical record system to capitalize on the stimulus package. Cross-selling RCM solutions also becomes a much easier proposition when combined with a practice management system, in our opinion. With an established practice management customer base and acquiring a strong EMR product, we believe Emdeon could have become a company in the likeness of Allscripts. Recall, due to its merger with Misys Healthcare, Allscripts is also firmly entrenched in the clearinghouse business. However, since Practice Services and Business Services were broken apart, we are left to evaluate Emdeon in its current state, which is a transaction processor struggling to capture more of the payment cycle, in our opinion.

Financial Discussion

As a reminder, we have not met with or discussed our financial projections with management because the company is still operating under the quiet period following last month's initial public offering. We model revenue will increase by 7.2% y/y in FY09 to $915 million. We believe the eRx and The Sentinel Group acquisitions will contribute at least 150 bps to the revenue growth rate this year, with the eRx acquisition being the material contributor. The benefit from the eRx acquisition should carry over through the first half of 2010. As we look to 2010, we expect revenue growth to normalize somewhat in the 6.5% range. We do not begin to forecast claims erosion until 2011, when we expect claims management revenue to decline by 3% y/y, barring healthcare reform covering the uninsured. Overall, we look for revenue growth of only 3.5% y/y in 2011.

Exhibit 4: EM Revenue, Gross Profit and Adj. EBITDA 2008A-2011E



Source: Company Reports and Brean Murray, Carret & Co. estimates

Balance Sheet – As of June 30, 2009, Emdeon had $96.1 million of cash and cash equivalents. Primarily due to the recent IPO, we expect the company's cash balance to increase to $277 million at the end of 3Q09. However, as part of the IPO, the conversion of EBS units to class A shares creates a tax liability owed to General Atlantic and Hellman and Friedman. The net effect of the creation of the liability to the Tax Receivable Entity is estimated to be $150 million. Because the timing of the payment to the private equity firms is unclear, we have made the assumption the liability will be paid 4Q09, reducing the cash balance by $150 million. We estimate the company will end the year with $151 million of cash.

Income Statement Model ($ in millions)	2006	2007	2008A	Q1-09A	Q2-09A	Q3-09E	Q4-09E	2009E	2010E	2011E
				2009E						
Revenue										
Payer Services	339.3	366.7	372.2	95.5	99.1	100.3	101.3	396.2	416.8	424.9
Provider Services	381.2	408.4	444.8	114.6	115.3	116.8	118.4	465.1	485.8	507.5
Pharmacy Services	36.2	36.9	39.1	10.2	10.8	16.1	18.7	55.8	74.0	78.5
Eliminations	-5.6	-3.5	-2.5	-0.5	-0.6	-0.6	-0.6	-2.3	-2.3	-2.3
Total Revenue	751.1	808.5	853.6	219.9	224.5	232.6	237.8	914.9	974.4	1008.5
Cost of Services										
Payer Services	228.0	241.8	243.0	59.9	62.4	63.0	63.7	249.0	260.5	263.4
Provider Services	251.3	268.5	292.8	73.4	73.0	73.7	74.6	294.7	303.6	312.1
Pharmacy Services	7.0	6.8	6.6	1.7	2.1	3.7	4.5	12.0	15.2	15.3
Eliminations	-4.5	-2.5	-1.8	-0.4	-0.4	-0.4	-0.4	-1.8	-1.8	-1.8
Total Cost of Services	481.7	514.6	540.6	134.6	137.0	140.0	142.3	553.9	577.5	589.0
Gross Profit	269.4	294.0	313.0	85.3	87.5	92.7	95.5	361.0	396.8	419.5
Gross margin	35.9%	36.4%	36.7%	38.8%	39.0%	39.8%	40.1%	39.5%	40.7%	41.6%
R&D	24.6	28.5	29.6	7.2	7.2	7.8	8.1	30.3	32.5	33.3
% of revenue	3.3%	3.5%	3.5%	3.3%	3.2%	3.4%	3.4%	3.3%	3.3%	3.3%
SG&A	88.9	94.5	91.2	24.1	27.2	34.2	29.0	114.5	116.9	118.0
% of revenue	11.8%	11.7%	10.7%	10.9%	12.1%	14.7%	12.2%	12.5%	12.0%	11.7%
Depreciation & amortization	37.6	62.8	97.9	25.1	25.3	25.5	25.7	101.6	105.4	109.4
Other expense	4.2	0.0	3.1	0.1	0.2	0.2	0.2	0.7	0.8	0.8
Total operating expenses	155.2	185.8	221.8	56.5	59.9	67.7	63.0	247.1	255.7	261.5
Operating Income	114.1	108.1	91.3	28.8	27.7	25.0	32.4	113.9	141.1	157.9
Operating margin			10.7%	13.1%	12.3%	10.7%	13.6%	12.4%	14.5%	15.7%
EBITDA	151.7	170.9	189.1	53.9	52.9	50.5	58.2	215.5	246.6	267.4
Stock option compensation	6.5	4.5	4.1	2.6	6.4	11.6	5.0	25.5	20.0	20.0
Other adjustments	6.7	7.2	11.9	0.6	1.1	0.0	0.0	1.7	0.0	0.0
Adjusted EBITDA	164.8	182.7	205.2	57.0	60.4	62.1	63.2	242.7	266.6	287.4
Interest expense (net)	9.9	72.8	70.8	17.9	17.1	17.3	17.3	69.7	69.3	69.3
Pretax Income	104.2	35.4	20.5	10.9	10.5	7.6	15.1	44.1	71.8	88.6
Taxes	43.0	18.1	8.6	7.6	-4.0	3.4	6.8	13.9	28.7	35.4
Tax rate	41.3%	51.2%	41.8%	69.8%	-37.7%	45.0%	45.0%	31.4%	40.0%	40.0%
Net Income	61.2	17.3	11.9	3.3	14.5	4.2	8.3	30.3	43.1	53.2
Cash Net Income	111.9	91.8	84.0	24.5	27.1	24.6	25.2	101.3	118.3	130.8
GAAP EPS		$0.17	$0.12	$0.03	$0.14	$0.04	$0.07	$0.28	$0.37	$0.45
Cash EPS		$0.92	$0.84	$0.23	$0.26	$0.21	$0.22	$0.92	$1.01	$1.10
Fully Diluted shares	52.0	100.0	100.0	104.4	104.4	115.1	116.1	110.0	117.4	119.4
Growth										
Payer Services		8.1%	1.5%	3.7%	7.1%			6.5%	5.2%	1.9%
Provider Services		7.2%	8.9%	4.9%	4.2%			4.6%	4.4%	4.5%
Pharmacy Services		2.0%	5.8%	5.7%	8.4%			42.8%	32.7%	6.0%
Total Revenue Growth		7.6%	5.6%	4.5%	5.7%			7.2%	6.5%	3.5%
Gross Margin										
Payer Services	32.8%	34.1%	34.7%	37.3%	37.0%	37.2%	37.1%	37.2%	37.5%	38.0%
Provider Services	34.1%	34.3%	34.2%	35.9%	36.7%	36.9%	37.0%	36.6%	37.5%	38.5%
Pharmacy Services	80.6%	81.7%	83.1%	83.3%	80.7%	77.0%	76.0%	78.5%	79.5%	80.5%
EBITDA Margin	20.2%	21.1%	22.2%	24.5%	23.6%	21.7%	24.5%	23.6%	25.3%	26.5%
Adjusted EBITDA Margin	21.9%	22.6%	24.0%	25.9%	26.9%	26.7%	26.6%	26.5%	27.4%	28.5%

Source: Company Reports and Brean Murray, Carret & Co. estimates

Balance Sheet ($ in millions)	2006	2007	2008A	Q1-09A	Q2-09A	Q3-09E	Q4-09E	2009E	2010E	2011E
				2009E						
Cash	29.3	33.7	71.5	78.4	96.1	277.0	150.6	150.6	270.5	390.7
Accounts receivable	121.1	123.1	144.1	145.4	148.4	150.0	155.0	155.0	162.7	170.8
Deferred income tax assets	2.5	3.5	2.3	3.0	3.8	4.0	4.0	4.0	4.2	4.4
Prepaid expenses	11.7	15.4	21.1	14.6	20.0	20.7	21.2	21.2	22.0	20.7
Other current assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Current Assets	**164.6**	**175.7**	**239.0**	**241.4**	**268.2**	**451.6**	**330.8**	**330.8**	**459.4**	**586.5**
PP&E	120.3	113.6	136.0	134.8	136.7	136.8	136.7	136.7	139.8	141.5
Goodwill	659.8	667.0	646.9	646.9	649.6	649.6	649.6	649.6	649.6	649.6
Intangible assets	413.9	398.6	971.0	955.8	940.6	924.0	907.3	907.3	838.7	767.6
Other Assets	20.9	2.4	7.3	7.3	8.3	8.4	8.6	8.6	9.0	9.3
Total Assets	**1,379.4**	**1,357.2**	**2,000.3**	**1,986.1**	**2,003.4**	**2,170.4**	**2,033.0**	**2,033.0**	**2,096.6**	**2,154.6**
Accounts payable	2.7	10.0	0.8	3.2	5.8	6.3	6.0	6.0	6.4	6.9
Accrued expenses	70.6	75.3	79.5	75.7	75.5	76.8	78.0	78.0	84.8	87.8
Deferred revenues	14.3	16.1	12.1	13.4	12.3	13.3	13.6	13.6	14.2	14.7
Current portion of LTD	7.6	7.2	17.2	1.6	3.4	3.4	3.4	3.4	3.4	3.4
Other current liabilities	30.7	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Current Liabilities	**125.8**	**109.4**	**109.6**	**94.0**	**97.0**	**99.7**	**101.0**	**101.0**	**108.9**	**112.8**
Long-term debt	917.5	864.7	808.0	798.5	797.8	797.8	797.8	797.8	797.8	797.8
Deferred Income tax liabilities	43.3	59.9	159.8	163.5	156.8	156.8	156.8	156.8	156.8	156.8
Income tax receivable	0.0			0.0	0.0	150.1	0.0	0.0	0.0	0.0
Other LT Liabilities	1.0	22.4	44.7	46.1	32.0	32.6	32.8	32.8	33.9	34.9
Commitments & contingencies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Liabilities	**1,087.6**	**1,056.3**	**1,122.1**	**1,102.1**	**1,083.5**	**1,237.0**	**1,088.4**	**1,088.4**	**1,097.4**	**1,102.2**
Preferred stock	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Class A par value	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Class B par value	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Additional paid-in capital	294.6	300.6	670.7	670.9	683.6	684.9	684.9	684.9	684.9	684.9
Accumulated other comprehensive loss	0.0	-14.5	-23.2	-21.3	-17.5	-14.5	-11.5	-11.5	0.0	0.0
Retained earnings	-2.8	14.9	24.1	25.3	37.8	33.2	41.5	41.5	84.6	137.7
Emdeon Total Equity	291.8	301.0	671.6	674.9	703.9	703.6	714.9	714.9	769.4	822.6
Noncontrolling interest	0.0	0.0	206.5	209.1	216.0	229.8	229.8	229.8	229.8	229.8
Total Equity	**291.8**	**301.0**	**878.2**	**884.0**	**919.9**	**933.3**	**944.6**	**944.6**	**999.2**	**1,052.3**
Total Liabilities and Equity	**1,379.4**	**1,357.2**	**2,000.3**	**1,986.1**	**2,003.4**	**2,170.4**	**2,033.0**	**2,033.0**	**2,096.6**	**2,154.6**

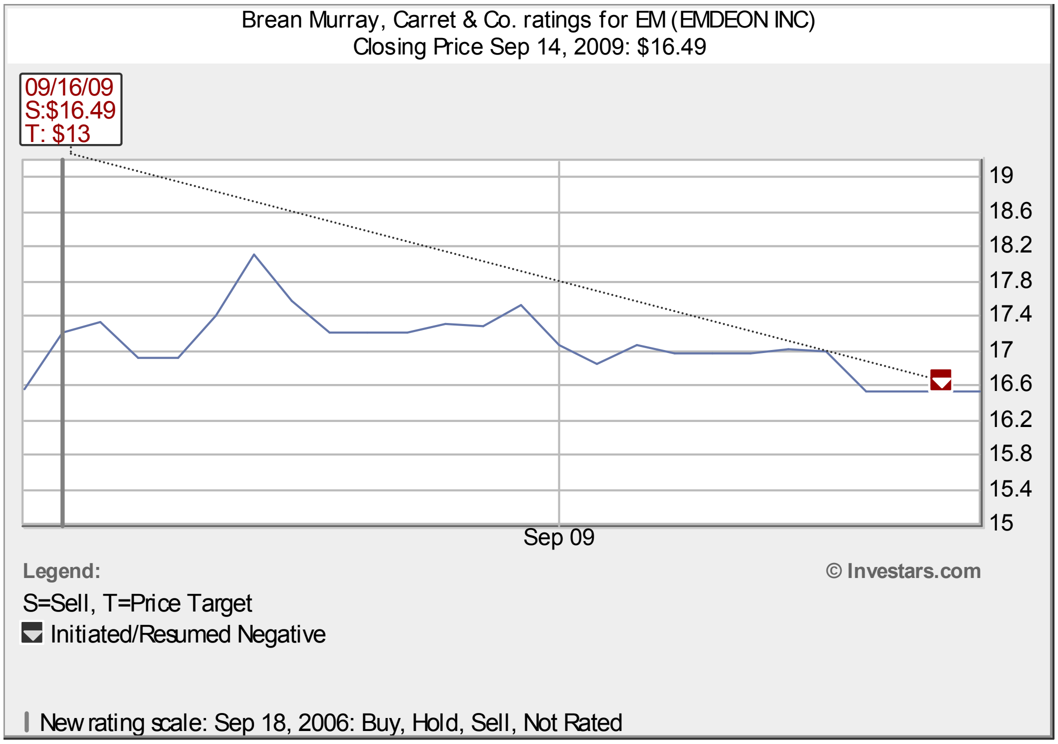
Source: Company Reports and Brean Murray, Carret & Co. estimates

Statement of Cash Flow				2009E						
($ in millions)	**2006**	**2007**	**2008A**	**Q1-09A**	**Q2-09A**	**Q3-09E**	**Q4-09E**	**2009E**	**2010E**	**2011E**
Operating Activities										
Net Income	61.2	17.3	11.9	3.3	14.5	4.2	8.3	30.3	43.1	53.2
Depreciation and amortization	37.6	62.8	97.9	25.1	25.3	25.5	25.7	101.6	105.4	109.4
Equity compensation expense	6.5	6.6	4.1	2.6	6.4	0.0	0.0	8.9	0.0	0.0
Deferred income tax	39.4	13.8	-4.1	2.7	-8.2	0.0	0.0	-5.6	0.0	0.0
Amortization of debt	0.3	2.4	19.7	2.8	3.0	3.0	3.0	11.8	11.5	0.0
Loss on disposal of assets	0.0	0.0	3.3	0.0	0.3	0.0	0.0	0.3	0.0	0.0
Other	0.0	0.0	-12.7	2.0	2.0	0.6	0.1	4.6	0.7	0.6
Change in operating assets & liabilities										
Accounts receivable	-12.1	0.4	-19.4	-1.2	-2.8	-1.6	-5.0	-10.6	-7.7	-8.0
Prepaid expenses	15.1	-3.1	-12.0	6.5	-6.4	-0.7	-0.5	-1.1	-0.8	1.3
Accounts payable	2.7	6.0	-9.2	2.4	2.6	0.5	-0.3	5.2	0.4	0.4
Accrued expenses	-10.9	-0.6	3.1	-5.8	-0.4	1.3	1.2	-3.7	6.8	3.0
Deferred revenues	-2.3	1.7	-0.8	1.3	-1.1	0.9	0.3	1.5	0.7	0.5
Other	10.0	-9.2	1.6	0.0	0.0	-0.2	-0.1	-0.2	-0.2	-0.1
Cash flow from operations	**147.4**	**98.0**	**83.3**	**41.7**	**35.1**	**33.6**	**32.7**	**143.0**	**159.9**	**160.2**
Investing Activities										
Purchase of PP&E	-25.3	-28.2	-28.0	-7.1	-11.4	-9.0	-9.0	-36.4	-40.0	-40.0
Acquisitions	-1236.8	-22.0	-327.3	0.0	-4.1	0.0	0.0	-4.1	0.0	0.0
Cash flow from investing	**-1262.1**	**-50.2**	**-355.3**	**-7.1**	**-15.5**	**-9.0**	**-9.0**	**-40.6**	**-40.0**	**-40.0**
Financing Activities										
Change in debt	828.9	-48.1	2.5	-27.9	-1.9	0.0	0.0	-29.8	0.0	0.0
Capital contributions	320.0	3.4	307.6	0.2	0.0	1.3	0.0	1.5	0.0	0.0
Other			-0.3	0.0	0.0	155.1	-150.1	5.0	0.0	0.0
Cash flow from financing	**1149.0**	**-44.7**	**309.7**	**-27.7**	**-1.8**	**156.4**	**-150.1**	**-23.4**	**0.0**	**0.0**
Beginning cash	6.9	30.5	33.7	71.5	78.4	96.1	277.0	71.5	150.6	270.5
Net change in cash	34.3	3.2	37.8	6.9	17.7	180.9	-126.4	79.1	119.9	120.2
Cash Balance Adj for divestiture	-10.7									
Ending cash	30.5	33.7	71.5	78.4	96.1	277.0	150.6	150.6	270.5	390.7

Source: Company Reports and Brean Murray, Carret & Co. estimates

Important Disclosures

Ratings and Target Price History



All prices are as of the market close on 9/15/2009.

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Buy - Expected to appreciate by at least 10% within the next 12 months.
Hold - Fully valued, not expected to appreciate or decline materially within the next 12 months.
Sell - Expected to decline by at least 10% within the next 12 months.

	# of Securities	% of Total Securities	# of IB-Related Securities in Past 12 mos.	% of Total Securities
BUY	95	56.21%	8	8.42%
HOLD	59	34.91%	1	1.69%
SELL	9	5.33%	0	0%
NOT RATED	6	3.55%	0	0%
TOTAL	**169**			

Note : Stock price volatility may cause temporary non-alignment of some ratings with some target prices.

Valuation Methodology and Risks

Emdeon Inc. (EM): On an EV/EBITDA basis, EM shares trade at 10x our 2010 adjusted EBITDA estimate of $267 million. Given our expectation for mid-single digit top-line growth and adjusted EBITDA growth below 10%, we believe a 7x-9x EV/EBITDA multiple is more appropriate. The mid-point of this range equates to a valuation of approximately $12.70 or 24% below the shares' current value. Our fair value estimate of $12.70, based on an EV/EBITDA multiple, results in a P/E multiple of 13x our 2010 cash EPS estimate of $1.01. Risks to the achievement of our target price include (1) the proposed healthcare reform legislation; (2) the potential effect of the stimulus package and cross-selling additional RCM and payment solutions to the company's customer base as clearinghouse networks could be utilized to exchange clinical data and meet the ARRA requirement; (3) the company could expand its product suite through acquisition.

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I, Bret Jones, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about any and all of the subject securities or issuers referred to in this document. The analyst and associate analyst further certify that they have not received and will not be receiving direct or indirect compensation in exchange for expressing the recommendation contained in this publication.

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