



**HEALTHCARE CAPITAL RESOURCES, INC.  
PRIVATE PLACEMENT MEMORANDUM**

**OCTOBER 1999**

**[CONFIDENTIAL COMPANY NAME]**

## **CONFIDENTIAL MEMORANDUM**

### **Regarding the Proposed Issuance of \$25,000,000 New Series D Convertible Preferred Stock**

**October 1999**

[CONFIDENTIAL COMPANY NAME] (“COMPANY NAME”), is furnishing this private placement memorandum (the “Memorandum”) solely for the consideration of prospective investors who have the knowledge and experience in financial and business matters and the capability to conduct their own due diligence investigation and evaluation in connection with the investment described herein.

This Memorandum is based on information supplied by Healthcare Capital Resources, Inc. (“HCR” or the “Company”) and is being furnished through COMPANY NAME as exclusive agent, solely for use by prospective investors in connection with their consideration of the proposed transaction. Neither COMPANY NAME nor any of its affiliates, employees or representatives makes any representation or warranty, expressed or implied, as to the accuracy or completeness of the information contained herein or any other information (whether communicated in written or oral form) transmitted or made available to prospective investors, and COMPANY NAME and its affiliates, employees and representatives expressly disclaim any and all liability relating to or resulting from the use of this Memorandum or such other information by a prospective investor or any of its affiliates or representatives.

Each recipient of this Memorandum agrees by accepting this Memorandum that the information contained herein and in all related and ancillary documents is not to be used for any purpose other than in connection with its consideration of the proposed transaction, that such information is of a confidential nature and that recipients will treat it in a confidential manner, and that it will not, directly or indirectly, disclose or permit its affiliates or representatives to disclose any of such information to any other person or reproduce this Memorandum, in whole or in part, without the prior written consent of the Company. Each recipient of this Memorandum further agrees that these confidentiality and other obligations shall apply to any non-public information relating to the Company or the proposed transaction which is provided to such recipient subsequent to the delivery of this Memorandum.

No person has been authorized to provide any information with respect to the Company or the proposed transaction except the information contained herein. Prospective investors should not rely on any information not contained in this Memorandum. This Memorandum presents information with respect to the Company as of the date hereof. Neither COMPANY NAME nor the Company intends to update or otherwise revise this Memorandum following its distribution, and recipients of this Memorandum should not expect COMPANY NAME or the Company to do so. Prospective investors are urged to conduct an independent investigation and evaluation of the Company and the proposed transaction.

The financial projections presented in this Memorandum represent the subjective views of the management of the Company and management's current estimates of future performance based on assumptions which management believes are reasonable, but which may or may not prove to be correct. There can be no assurance that management's views are accurate or that management's projections will be realized. Industry experts may disagree with these assumptions and with management's view of the market and the prospects for the Company.

The Securities offered in this Memorandum (the "Securities") are being sold as a private placement pursuant to Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act") and, accordingly, are not being registered under the Securities Act. Therefore, no resale of the Securities may be made unless the Securities are subsequently registered under the Securities Act or an exemption from the registration requirements of the Securities Act is available, including without limitation the exemption provided by Rule 144A of the Securities Act relating to resales of the Securities to "qualified institutional buyers" (as such term is defined therein). Each prospective investor should proceed on the assumption that it must bear the economic risk of an investment in the Securities for an indefinite period.

The Securities described herein are being offered to a limited number of institutional and other accredited investors. An offeree may not solicit, directly or indirectly (whether through an agent or otherwise), the participation of any other person or entity in this offering without the prior written approval of COMPANY NAME.

Inquiries relating to the information contained in this Memorandum should be directed to one of the COMPANY NAME representatives listed below:

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Prospective investors who do not wish to pursue a strategic investment are requested to return this Memorandum at their earliest convenience:

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New York, New York 10285,  
Attention: Frank Blanco, 16<sup>th</sup> Floor.

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## I. EXECUTIVE SUMMARY

### *The Offering*

Healthcare Capital Resources, Inc. hereby offers (the “Offering”) \$25,000,000 of New Series D Convertible Preferred Stock (the “Preferred Shares”) which have not been registered under the Securities Act, in a private placement to accredited investors (the “Investors”). The terms of the Offering will be substantially the same as those incorporated in the attached Principal Terms of New Series D Preferred Stock under Section X. The proceeds from the Offering will be used by the Company to finance anticipated growth, make strategic acquisitions, enhance the Company’s marketing activities, continue the development of technology-based service offerings, and for general corporate purposes.

### *Company Overview*

The Company is a leading provider of asset-based financing to healthcare service providers. HCR focuses primarily on clients operating in certain sub-markets of the healthcare industry, including hospitals, physician services, home healthcare providers, and long-term care providers (collectively, the “Providers”). The Company targets Providers with financing needs of \$1 million to \$20 million, a segment of the market that the Company believes is underserved by banks, finance companies, and other financial institutions.

Management believes that HCR has a competitive advantage in its target markets as a result of a number of factors, including strong healthcare specific asset-based lending experience, detailed knowledge of the healthcare market, an experienced management team, thorough and proven underwriting credit review standards, proprietary and third-party technology and specialized information systems, and effective risk management procedures. Furthermore, the Company’s flexibility in structuring transactions, regarding both transaction size and terms, provides an additional advantage over its competitors.

The Company believes that tremendous market opportunities also exist for an outsourcing receivables service, which can be accessed on-line via the Internet, providing financial back-office services to Providers. To take advantage of these opportunities, the Company is developing a line of e-business services, e-HealthContinuum.com, which will complement its traditional accounts receivable finance products. This new service will allow the Company to act as an intermediary between Providers and government programs, commercial insurers, and managed care plans, (collectively known as “Third Party Payors” or “Payors”) and is expected to greatly expand HCR’s growth opportunities and effectively leverage its technological infrastructure. e-HealthContinuum.com will also allow Providers to realize significant cost savings by further utilization of back office outsourcing services.

The Company is well positioned to capitalize on the rapid growth forecasted for the healthcare financing industry which is expected to continue to exhibit above average growth as a result of fundamental shifts in the way healthcare is financed. In addition, the e-commerce services will complement the core finance function by helping generate lending opportunities as well as generating substantial transaction based fees. The healthcare industry constitutes one of the

largest segments of the U.S. economy, and is projected to account for more than \$1.2 trillion in expenditures in 1999, representing approximately 14% of GDP.

The Company estimates that its target market generated an aggregate of approximately \$375 billion of receivables in 1998. HCR believes that only a handful of financial institutions service this segment. Several factors have created a unique opportunity for the Company to provide working capital to this market: (1) third-party healthcare receivables are very different from traditional commercial receivables; (2) the government, which had historically been the source of working capital, has been phasing out its advance payment programs as a part of cost containment measures; (3) banks that served the hospital market withdrew from all but the strongest credits, (4) a high level of sophistication is necessary to structure programs for third-party healthcare receivables; and (5) companies with the sophistication to design third-party accounts receivable finance programs generally do not service small to middle market Providers.

Since its inception, HCR has advanced approximately \$937 million to its clients and executed over 5,000 transactions. As of June 30, 1999, the Company had 31 Providers with committed credit lines of \$100 million and amounts outstanding of \$60 million. These Providers are located in 18 different states, and no single client represents more than 10% of the portfolio. HCR's Payors are predominantly highly rated insurance companies and government entities. The Company currently has approximately \$47 million in business leads outstanding with 10 potential clients.

The Company funds its operations through equity and debt financing. Dresdner Kleinwort Benson Private Equity Partners LP ("DKBPEP LP"), Atlantic Medical Capital LP ("AMC") and Sinclair Medical Partners ("SMP"), an affiliate of AMC and other investors have previously provided approximately \$15 million of equity capital to the Company. COMPANY NAME, a subsidiary of COMPANY NAME, currently provides the Company with two debt facilities, a warehouse line of \$75 million that allows the Company to purchase or finance receivables and a warehouse line of \$25 million to finance term loans and receivables.

The Company maintains its headquarters at 875 Avenue of the Americas, 20<sup>th</sup> Floor, New York, New York, 10001.

### ***Background***

HCR began operations in 1995 providing financing to its clients by acquiring their accounts receivable. However, because the Company did not have adequate sources of liquidity and experienced difficulty offering flexible financing options to its clients, the Company did not achieve its loan portfolio growth targets. In May 1998, the Company was restructured and a new management team was installed. The new management team began a number of strategic initiatives and developed new product offerings, which resulted in significant portfolio growth and improvement in loan portfolio quality. Since restructuring, the Company has added a number of experienced employees and has further broadened its product offerings. The Company has not yet achieved profitability, but expects to be at or near breakeven in fiscal 2000, as the financed receivables portfolio grows, amortization of previous expenditures is completed, and new businesses are successfully implemented.

## ***The Products***

HCR currently provides financing to its clients through (1) revolving lines of credit secured by accounts receivable and advances against accounts receivable (the “Accounts Receivable Program” or “AR Program”), (2) purchase of accounts receivable (the “Purchase Program”), and (3) term loans secured by real estate, accounts receivable and other assets (the “Secured Term Loan Program” or “ST Program”, together, the “Financing Programs” and all programs collectively, the “HCR Programs”), which are executed in conjunction with the receivables facility. In addition, HCR expects to launch an equipment leasing product and a stand-alone term loan product in the current fiscal year.

## ***Company Strategy***

The Company’s objective is to be a leading healthcare service and finance company in its targeted small to middle market segment of the healthcare services industry. HCR’s growth strategy is focused on the following key elements:

- Target sub-markets within the healthcare industry that have favorable characteristics for working capital financing such as hospitals, physician services, home healthcare providers, and long-term care providers
- Focus on Providers with financing needs of \$1 million to \$20 million, a segment of the market which has consistently been underserved by commercial banks, diversified finance companies and traditional asset-based lenders
- Take advantage of the Company’s significant infrastructure investment in its origination, underwriting and servicing capabilities by expanding product lines to include stand alone term loans, equipment leasing and financing, and real estate financing
- Offer clients parallel services including billing and collection, client monitoring, claims verification and other technology-based products including financial and patient accounting consulting services
- Take advantage of consolidation in the healthcare finance industry by identifying and acquiring portfolios of loans secured by accounts receivables and/or acquiring companies engaged in similar lines of business
- Strengthen the Company’s competitive advantage by continuing to develop and enhance its information management systems, and servicing and risk management capabilities
- Expand the Company’s marketing reach by introducing regionally deployed account representatives and product managers

## Summary Historical, Estimated and Projected Financial Data

**Table 1: Summary Financial Information**

(\$ in 000's)

	Nine months ending June 30,		Fiscal Year Ended September 30,			
	1998A	1999A	1998A	1999E	2000P	2001P
<b>Selected Income Statement Data:</b>						
<b>Revenues:</b>						
Purchase Discounts	\$2,478	\$1,571	\$2,925	\$1,894	\$1,847	\$1,901
Interest Income	470	2,194	591	3,371	11,473	34,950
Fee Income	162	626	403	825	2,329	5,964
Total Revenues	3,110	4,391	3,919	6,090	15,649	42,815
<b>Expenses:</b>						
Interest Expense	1,756	2,290	2,195	3,210	7,541	20,924
Operating Expenses	3,012	3,467	4,921	4,983	5,951	6,006
Provision for Losses	430	0	1,118	1,190	2,458	4,808
Total Expenses	5,198	5,757	8,234	9,382	15,950	31,739
<b>Net Income / Loss</b>	<b>(2,088)</b>	<b>(1,366)</b>	<b>(4,315)</b>	<b>(3,293)</b>	<b>(301)</b>	<b>11,076</b>
Preferred Dividends	(204)	(263)	(292)	(642)	(992)	(1,342)
Net income / loss to common shareholders	(2,292)	(1,629)	(4,606)	(3,934)	(1,292)	9,735
<b>Other Data:</b>						
Number of clients financed	19	31	26	-	-	-
Allowance for loan losses to receivables	2.52%	1.66%	3.86%	3.60%	2.31%	1.99%
Return on average earning assets	-16.43%	-4.84%	-25.08%	-9.09%	-0.99%	2.88%
<b>Selected Balance Sheet Items</b>						
Total Assets	\$34,765	\$75,034	\$35,811	\$65,520	\$206,434	\$479,786
Gross Financed Receivables	15,528	59,999	25,791	60,729	201,397	475,397
Allowance for Loan Losses	392	995	995	2,185	4,643	9,451
Notes Payable (Warehousing Line)	17,000	59,741	23,012	57,065	100,000	-
Total Debt	19,500	59,801	23,472	57,065	170,578	402,656
Stockholders Equity	8,547	5,201	6,874	3,187	27,536	63,262

## II. THE OFFERING

### *Terms of the Offering*

<b>New Series D Preferred Stock</b>	
Issuer:	Healthcare Capital Resources
Amount of Financing:	\$25.0 million
Investment Form:	New Series D Convertible Preferred Stock
Liquidation Preference:	Parri Passu
Redemption:	Optional After Five Years
Anti-Dilution Protection:	To Be Determined

See Section X for more detailed terms of the New Series D Preferred Stock offering.

### *Use of Proceeds*

The proceeds to be received by the Company from the Offering are expected to be approximately \$22.5 million, net of fees and expenses. The Company intends to use the net proceeds from the Offering to finance anticipated growth of the HCR Programs, make strategic acquisitions of either healthcare finance companies or portfolios of companies in complementary or similar lines of business, enhance the Company's marketing activities through the introduction of regionally deployed sales representatives and product line managers, promote the introduction of new financial products, continue the development of additional technology based service offerings, and for general corporate purposes.

## Capitalization

The following table sets forth the capitalization of the Company as of June 30, 1999 on a historical basis and on a pro-forma as adjusted basis, giving effect to the Offering. The capitalization information set forth in the table below is qualified by the detailed information contained within, and should be read in conjunction with, the audited financial statements of the Company, along with the notes thereto, and the unaudited interim financial statements of the Company, along with the notes thereto, all appearing elsewhere in this Memorandum.

**Table 2: Capitalization**

	As of 6/30/99	Pro Forma As Adjusted
Cash and cash equivalents (1)	\$4,778,546	\$27,278,546
Long-term debt:		
Notes payable	59,741,178	59,741,178
Loan payable to affiliate	60,000	60,000
Total long-term debt	<u>59,801,178</u>	<u>59,801,178</u>
Stockholders' equity:		
Series C Convertible Preferred Stock(2)	1,000	1,000
New Series D Convertible Preferred Stock(3)	-	22,500,000
Common stock (4)	17,324	17,324
Additional paid-in capital	15,388,918	15,388,918
Accumulated deficit	<u>(10,206,628)</u>	<u>(10,206,628)</u>
Total stockholders' equity	<u>5,200,614</u>	<u>27,700,614</u>
<b>Total capitalization</b>	<b><u>\$65,001,792</u></b>	<b><u>\$87,501,792</u></b>

(1) Includes cash restricted for purchase of receivables.

(2) Consists of 100,000 shares of issued and outstanding (240,000 authorized) Preferred Stock at \$0.01 par value per share. The purchase price for the Series (C-1 and C-2) Preferred Shares is \$100 per share.

(3) Total capital (par value and additional paid in capital) for the Offering.

(4) Consists of 7,500,000 shares of authorized Common Stock at \$0.01 par value per share. Currently, there are 1,732,394 shares issued and outstanding. Excludes: (i) an aggregate of 170,000 shares of Common Stock issuable upon exercise of July 1996 Warrants, (ii) an aggregate of 123,072 shares of Common Stock issuable upon exercise of February 1996 Options, (iii) an aggregate of 1,428,571 shares of Common Stock issuable upon conversion of Series C-1 and C-2 Preferred Stock, (iv) an aggregate of 777,412 shares reserved for issuance under the Company's 1996 Equity Incentive Plan, pursuant to which the Company has granted options to purchase an aggregate of 147,510 shares, (v) an aggregate of 140,000 shares issuable upon exercise of Warrants granted to Atlantic Medical Capital, (vi) an aggregate of 48,000 shares of Common Stock issuable upon exercise of October 1997 Warrants, (vii) an aggregate of 50,000 shares of Common Stock issuable upon exercise of February 1998 Warrants, and (viii) an aggregate of 713,300 shares of Common Stock issuable upon exercise of May 1998 Warrants. See Section VII for Recent Transactions and Description of Capital Stock.

### **III. INVESTMENT MERITS**

#### ***Market Opportunity***

The healthcare industry constitutes one of the largest segments of the U.S. economy, projected to represent approximately 14% of GDP and more than \$1.2 trillion in expenditures in 1999. National health expenditures are projected to total \$2.2 trillion and reach 16% of the GDP by 2008. Growth in the healthcare industry is expected to average 1.8% greater than the growth rate of GDP through 2008. The Company's target markets of hospitals, physician services, home health care providers and long term care providers are projected to experience strong expenditure growth through 2008. Hospitals are projected to increase expenditures at a 6.4% annual rate, physician services at a 7.0% annual rate, home health care at a 8.6% annual rate, and long-term care facilities at a 6.6% annual rate. The Company is well positioned to capitalize on the projected growth in these markets.

As the population continues to age, the demand for healthcare products and services will grow. The need for flexible short-term working capital financing will increase as pressure is placed on Providers to reduce the costs of their products and services. Furthermore, spending in the healthcare industry is not highly correlated with overall economic performance. Demand for healthcare products and services is expected to continue to grow through economic upturns and downturns.

#### ***Attractive Sector of the Asset-Based Lending Industry***

The Company is well positioned to capitalize on a dynamic sector within a growing industry. The healthcare financing industry is expected to continue to exhibit above average growth as a result of fundamental shifts in the way healthcare is financed. Furthermore, in the asset-based lending market, margins in the healthcare financing sector are currently considerably higher than in other more mature and commoditized sub-markets. HCR's focus sub-markets are currently extremely fragmented but are expected to enter into a period of consolidation, restructuring, and high growth as a result of shifting demographic patterns. Expenditures of hospitals, physician services, home healthcare providers, and long-term care providers are expected to exceed \$765 billion in 1999. Many companies in these sub-markets will require more working capital financing, but will be unable to obtain it through traditional lending channels or through venture capital sources without materially diluting their ownership structure. HCR seeks to be one of the leading finance companies in the sector and has positioned itself to provide attractive alternative sources of capital.

#### ***Large and Under-Served Market***

The Company estimates that its target market generated an aggregate of approximately \$375 billion of receivables in 1998. HCR believes that only a handful of financial institutions service this segment. Several factors have created a unique opportunity for the Company to provide working capital to this market: (1) third-party healthcare receivables are very different from traditional commercial receivables; (2) the government, historically the source of working capital, has been phasing out and apparently will continue to phase out its advance payment

programs as a part of cost containment measures; (3) banks servicing the hospital market have withdrawn from all but the strongest credits, as the pressures from cost containment have reduced Provider cash flows; (4) a high level of sophistication is necessary to structure programs for third-party healthcare receivables; and (5) companies with the sophistication to design third-party accounts receivable finance programs generally do not service small to middle market Providers.

### ***Competition is Fragmented and Often Unfocused***

Working capital financing for middle market healthcare service providers is currently obtained from many different sources. However, most banks and financial institutions lack the healthcare expertise, flexibility, and responsiveness to effectively serve this segment of the market. Some larger banks and diversified finance companies have groups or divisions that provide working capital financing to healthcare companies, but they generally focus on Providers with borrowing needs exceeding \$25 million and often require collateral other than receivables to secure financing. Several smaller, independent healthcare finance companies raise and provide capital through securitization programs but these programs generally present borrowers with inflexible terms.

### ***Strong Relationships with Healthcare Providers***

The Company believes that it has formed strong relationships with Providers. With the introduction of the secured revolving line of credit and secured term loan products in May 1998, the Company has experienced strong demand from both new and existing clients. Since then, the Portfolio has grown 266% with new commitments totaling approximately \$74 million. Of the company's 47 different transactions outstanding during this period, 8 were additional deals executed for existing clients and 5 other deals were increased to include additional Provider sites or supply working capital during facility purchases.

### ***Competitive Advantages / Barriers to Entry***

The Company believes there are a number of barriers to entry in the healthcare financing business including: (1) specialized healthcare expertise; (2) origination capability; (3) access to capital; and (4) substantial investment in operating systems. Management's extensive experience in the industry has allowed HCR to turn these barriers into significant competitive advantages. The Company has developed strong alliances with both existing and potential clients. These relationships are critical in understanding and assessing the inherent risks in the healthcare financing industry and anticipating approaching trends. In addition, the Company has invested time and capital in the development of sophisticated information management systems, including the creation of a proprietary internet-based commerce hub that rationalizes and monitors payment flows on Provider claims. These systems will enable HCR to continue its expansion while effectively monitoring credit risks. The company believes that this investment in information systems, coupled with management's expertise, enhances the Company's competitive advantage and raises the barriers to entry.

### ***Experienced Management Team***

HCR's management team has over 80 years of combined experience in the healthcare and finance industry. The team includes Charles D. Van Sickle, William F. Reed, Suzanne B. Steinau, Frank G. Eng, Matthew R. Reder, James P. McAleer, and Ned Komar.

Mr. Van Sickle joined the company in November of 1998 as President and Chief Executive Officer. Prior to joining the Company, Mr. Van Sickle held the position of Group President at AT&T Capital Corporation, responsible for worldwide operations. Mr. Reed, Chief Operating and Financial Officer, joined HCR in August of 1996. Mr. Reed has held senior management positions with the Bank of America and Mitsui Nevitt, a partnership created to execute leveraged middle market transactions. Ms. Steinau joined the Company in March of 1998 as the Senior Vice President and Senior Managing Director of Underwriting. Ms. Steinau has over 20 years of experience in the healthcare finance industry, both at Chase Manhattan Bank where she was instrumental in developing their healthcare financing unit and at Daiwa Securities. Mr. Eng is the Company's Senior Vice President of Operations and Planning and is leading the development of HCR's technology platform. He has had over 20 years of experience in healthcare finance at Chase Manhattan Bank. Mr. Reder, Vice President and Controller, manages the Company's accounting and financial reporting. Prior to joining HCR, Mr. Reder worked as a public accountant at KPMG for over five years in their Financial Services Group. Mr. McAleer, [Vice-President and ]Assistant Treasurer, manages the Company's banking relationships and day-to-day liquidity. Mr. McAleer has had over 8 years of experience in corporate finance, liquidity management, and treasury management with Time Warner Inc. Ned Komar, Credit Manager, joined HCR in 1999 from Bank of Tokyo-Mitsubishi. Previously Mr. Komar held senior credit positions at NatWest Markets and Standard and Poor's. See Section VII for an organizational chart and more complete management biographies.

### ***Sophisticated Technology and Systems Infrastructure***

The Company employs advanced management information systems that enable it to monitor its clients' cash flow and collateral activity on a continuous basis. These systems allow the Company to mitigate its credit risk and efficiently provide its customers with a superior level of service. Additionally, these systems are now prepared to service a substantial increase in volume with only minimal investment in maintenance.

### ***e-HealthContinuum.com***

Management believes that entering the e-commerce marketplace will greatly expand HCR's growth opportunities and effectively leverage its technological infrastructure. The Company is currently developing e-HealthContinuum.com, a line of e-business services which will complement its traditional accounts receivable finance products. Utilizing web-based technology, HCR will offer a complete, end- to-end accounts receivable management solution to clients. Management believes that there is a demand among small and middle market healthcare providers for such online products tailored specifically to their needs.

### ***Prudent Credit Policies***

HCR has developed a proven credit culture through its extensive experience underwriting secured loans for small and middle market healthcare companies. Extensive due diligence is performed on potential clients. HCR's credit committee must unanimously approve each transaction prior to providing financing.

The HCR Programs are designed to minimize the Company's risk exposure. Prudent credit policies include: (1) financing only high quality third party receivables, (2) separating credit risk from third party adjudication risk and requiring Providers to absorb the latter, (3) requiring significant excess collateral to offset potential credit losses, and (4) following Payor and Provider concentration guidelines.

The Company has developed a system to review Provider billing and cash collections. This review takes place prior to providing funding to each Provider. HCR reviews the Provider's files and values the receivables based on historical collection data and Third Party Payor class. Whether the HCR Programs' financing facilities are structured as a loan or purchase, the Company may collateralize its financing with other receivables, assets, and personal guarantees.

The Company may advance up to 85% of its estimate of the net collectible value, determined through an analysis of collection rates on previous receivables of the clients' eligible receivables from Third Party Payors. However, the Company maintains a 100% security interest in all Provider receivables, as well as a security interest in additional Provider assets, and in certain transactions requires personal guarantees. Finally, the Company's cash management structure for Providers ensures that all cash from liquidated receivables flows through the Company's accounts, thus allowing the Company to withhold cash from Providers when deemed prudent. This is an important further level of control for the Company.

### ***Leverage of Equity Base***

Management believes that the design of the HCR Programs permits the Company to raise substantial amounts of debt with a limited amount of equity investment. The Company's capital structure should increase the returns to equity holders while the HCR Programs' design should minimize risk to the Company.

### ***Special Note Regarding Forward-Looking Statements***

Please refer to Section IV.

## IV. RISK FACTORS

### ***Risk Related to Lower Credit Grade Borrowers***

The Company focuses its marketing efforts on small and middle market Providers. Some of these Providers may be unable to obtain financing from more traditional credit sources, such as commercial banks. Advances made to these clients may entail a higher risk of loss than advances made to clients who are able to utilize traditional credit sources. While the Company employs underwriting criteria and monitoring procedures to mitigate these risks, no assurance can be given that such criteria or procedures will afford adequate protection against such risks. In the event that collections of amounts due under the HCR Programs are less than anticipated, the Company's results of operations and financial condition could be adversely affected. The Company routinely makes provisions for possible future losses in the ordinary course of its business and believes it currently maintains an appropriate level of reserves. As of June 30, 1999, the Company maintained reserves for possible loan losses of \$995,000 on a total finance portfolio of \$60 million, representing a reserve ratio of 1.66% of the total finance portfolio. Going forward, the Company intends to build reserves in order to maintain a 2.0% loan loss reserve ratio.

Since inception, the Company has recorded a single loss of \$188,000, related to an uncollectible receivable of the Purchase Program. This amount represented less than 0.3% of the portfolio as of June 30, 1999. During July 1999, the Company specifically provisioned \$900,000 for a second potential loss related to a Provider in the Purchase Program, who filed a Chapter 7 petition during the month. Management is uncertain of the financial effect regarding the resolution of this credit at this time. However, it is in the opinion of management, the Company has adequately reserved for the potential loss.

### ***Non-payment and Fraud***

The Company's ability to fully recover amounts due under the HCR Programs' existing securitized lending facility and revolver facility may be adversely affected by, among other things, the financial failure of the Company's clients or their Third Party Payors, fraud (e.g., the purchase of fraudulent receivables from a client), misrepresentation, conversion of account proceeds by clients (e.g., client misappropriation of account proceeds in violation of the terms of the HCR Programs), Third Party Payor disputes, and Third Party claims with respect to security interests. The Company establishes loss reserves to mitigate its exposure to such adverse occurrences. In evaluating the adequacy of the loss reserve, management considers, among other items, trends in past-due accounts, historical charge-off and recovery rates, credit risk indicators, economic conditions, on-going credit evaluations, overall portfolio size, average client balances, excess collateral, and underwriting policies. Many of these considerations involve significant estimation by management and are subject to changes which may be unforeseen and could result in immediately increased losses and material adjustments to the allowance. To date, the Company has financed \$937 million in receivables and believes that it has adequate reserves to cover any potential future losses. There is no assurance that the Company will not experience losses on financed receivables in the future. Such future losses could be significant and could vary from current reserve estimates.

### ***Medicare/Medicaid Restrictions on Assignability***

With certain limited exceptions, federal law prohibits payment of amounts owed to Providers under the Medicare and/or Medicaid programs to any entity other than the Provider. Except pursuant to a court order, the Company is unable to enforce collection directly against Third Party Payors in a government program. Accordingly, the Company is unable to collect receivables payable under government programs directly, and instead requires that Medicare and Medicaid proceeds be paid to a segregated lockbox account under the control of the client and the collected balances swept into the Company's accounts on a daily basis. The Company must closely monitor its clients' collection efforts to ensure compliance with the foregoing procedures. Although to date, the Company has been successful in monitoring the collection of government-based receivables from its clients in accordance with their contractual obligations, there can be no assurance that the Company will continue to be successful in monitoring such collection activities in the future.

### ***Dilution of Client Receivable/ Government's Right of Offset***

Dilution of accounts receivables occurs when such receivables are not fully collectible for reasons other than a Third Party Payor's financial inability to pay (such as disagreements as to appropriate reimbursement for services provided). Dilution with respect to any client's receivables increases the risk that the Company will be unable to collect amounts advanced by the Company to the client. The Company generally advances funds to its clients up to a specified percentage of the Company's estimate of the net collectible value of such client's receivables. The Company reviews collections by type of Third Party Payor and may contact such Third Party Payors prior to entering into a Financing Program or Purchase Program. Should dilution occur with respect to any client in an amount greater than the excess collateral then available with respect to such client's existing accounts receivable, the Company will typically rely upon other excess collateral, including new accounts receivable generated by such client, for the collection of the outstanding obligation to the Company. If no such new accounts receivable are forthcoming or the Company is unsuccessful in pursuing other rights, the Company may incur a loss. Some dilution occurs with respect to most, if not all, clients and may be more significant with respect to Medicare and Medicaid receivables as a result of the government's right of offset. The Company's historical dilution has not exceeded its excess collateral. Federal and state government agencies, in accordance with Medicare and Medicaid statutes and regulations, have broad rights to audit a Provider and offset any amounts it determines were overpaid to such Provider on any claims against payments due on other current, unrelated claims. This right of offset could create losses to the extent the Company has made advances against the accounts receivable for such unrelated claims. The Company monitors collections on a daily basis but may not be able to react quickly enough to dilution to cover resulting losses through collections on newer accounts receivable generated by the relevant client.

### ***Risk of Significant Capital Requirements / Need for Additional Financing***

Assuming no material new acquisitions are consummated, management anticipates that the net proceeds of the maximum Offering will be sufficient to fund the operations and capital requirements of the Company until January 2001, at which point the Company will require

additional equity to support their finance portfolio. If the Company fails to raise the maximum Offering, it may be obliged to raise additional funds in the future or curtail its anticipated growth. Management believes that the Company's future capital needs will be significant and intends to seek additional sources of financing.

There can be no assurance that the Company will be able to obtain any other additional financing, or, if such financing is available, that the Company will be able to obtain it on acceptable terms. In addition, while the Company expects to be able to renew its existing financing facilities and to have continued access to other sources of credit after the expiration of its current facilities, there is no assurance that such financing will be available, or, if available, that it will be on terms favorable to the Company. In the event that the Company fails to obtain additional financing when required, such failure could result in the modification, delay or abandonment of some or all of the Company's development and expansion plans. Any such modification, delay or abandonment is likely to have a material adverse effect on the Company's business, and may limit the Company's ability to make principal and interest payments on its indebtedness.

Furthermore, if less than all of the Preferred Shares offered are sold, it is likely that the Company will require additional financing in order to carry out its business plan, including offering new financial products and services on a commercial scale, as currently proposed. See section IX Projected Financial and Operating Data. If additional financing is required for these purposes, there can be no assurance that such financing will be available or, if available, that it will be obtained on terms favorable to the Company. Consequently, should less than the maximum number of Preferred Shares be sold, and should the Company be unable to secure needed substitute additional financing, the initial purchasers of Preferred Shares would be exposed to the risk of loss on their investment.

### ***Risk of Noncompliance with Loan Financial Covenants***

On July 29, 1999, the Company indicated to COMPANY NAME that based upon financial projections made by management of HCR for the fiscal year ending September 30, 1999, HCR will not be in compliance with certain financial covenants contained within the Loan and Security Agreement, dated May 21, 1998, and certain Guarantee, also dated May 21, 1998, both between the Company and COMPANY NAME SUBSIDIARY. The financial covenants that the Company does not expect to meet include a tangible net worth test, leverage ratio test and interest coverage test.

The Company has asked COMPANY NAME for a specific waiver of noncompliance with the respective covenants for a period of time to allow the Company to offer new capital.

Management expects that the Offering will provide enough additional capital to bring the Company within compliance for the tangible net worth test and leverage ratio test. If the Company is unable to obtain a waiver of non-compliance and remains in non-compliance, COMPANY NAME may require the Company to change the pace of asset origination, sell assets or raise additional capital to achieve compliance.

### ***Risk of Inability of the Company to Continue its Growth***

The Company's growth strategy is principally dependent upon its ability to increase its advances against accounts receivable while maintaining its underwriting standards. No assurance can be given that the rate of growth experienced by the Company to date will be sustainable or indicative of future results.

### ***Risk Associated With New Product Offerings***

The Company's projections are based upon the successful introduction and expansion of services not previously offered or offered on a limited basis to healthcare industry clients, such as equipment lease financing, secured term loans, and real estate lending. There is no assurance that the Company's ability to market these new products and services will be consistent with the Company's historical financial results. If the Company is unable to compete successfully, its financial position and results of operations could be adversely affected.

### ***Risk Associated with Inability to Compete Successfully***

The Company competes with numerous commercial banks, diversified finance companies, asset-based lenders and specialty healthcare finance companies. Many of these competitors have greater financial resources than the Company and significantly lower costs of funds. This disparity in costs of funds ranges from approximately 1% to 5% and reflects commercial banks' access to low cost sources of capital such as deposits, and other competitors' greater access to the capital markets. Competition can take many forms, including the pricing of financing, the timeliness and responsiveness in processing a prospective client's application, and customer service. Some of the Company's competitors target the same healthcare service Providers as HCR, and with the exception of most specialty healthcare finance companies, generally have operated in the markets serviced by HCR for a longer period of time than the Company. If HCR is unable to compete successfully, its financial position and results of operations could be adversely affected.

### ***No Public Market and Restricted Transferability***

There is currently no public market for any of the Company's securities, including the Preferred Shares offered herein. There can be no assurance that a market for the Company's securities will develop. The Preferred Shares offered herein and the Common Stock into which the Preferred Shares may be converted have not been registered under the Securities Act and accordingly are restricted securities which may not be offered for sale, transfer, pledge or otherwise disposed of without registration under the Securities Act or an exemption therefrom. Transfer of the Preferred Shares will be restricted in order to comply with the Securities Act.

### ***Risk of Government Regulation of Healthcare Providers***

The healthcare industry is subject to extensive federal, state and local statutes and regulations. Changes in applicable laws and regulations, or new interpretations of existing laws and regulations, could have a material impact on the Company's Providers with respect to licensure of facilities, eligibility for participation in federal and state programs, permissible activities, costs

of doing business, or levels of reimbursement from governmental, private and other sources. Thus, such regulatory changes could adversely affect HCR's results of operations. See Section VI for further details.

### ***Reliance on Reimbursements by Third Party Payors***

The Company's clients receive payment for services rendered to patients from Third Party Payors (including health maintenance organizations, managed care concerns and other insurers), other Providers, patients themselves, and from government programs. Clients rely on prompt payments from Third Party Payors to enable them to satisfy their obligations to the Company under the HCR Programs. The healthcare industry is experiencing a trend toward cost containment, as government and other Third Party Payors seek to impose lower reimbursement and utilization rates and negotiate reduced payment schedules with Providers. Such cost containment could adversely affect the ability of the Company's clients to make payments owed to the Company, which could have an adverse impact on the Company's business and financial performance.

### ***Risk of Reliance on Key Management***

The Company's success depends to a significant degree upon the continued contributions of members of its senior management. The future success of the Company also depends on its ability to identify, attract and retain additional qualified technical and managerial personnel, particularly with experience in healthcare financing. Although the Company has employment agreements, the loss of officers and key personnel could have a material adverse effect on the Company's business, financial condition, and results of operations. The Company is in the process of obtaining key man life insurance on selected officers.

### ***Risk of Adverse Effects of Healthcare Reform and Cost Containment***

The healthcare industry has undergone significant change primarily in response to governmental and private payor efforts to control the cost of providing healthcare services. Instead of reimbursing Providers on a cost plus basis, government programs such as Medicare, as well as traditional third party indemnity insurers, have established a reimbursement system based on prospectively determined prices rather than retrospectively determined costs. As a result, healthcare providers typically bear the cost risk of providing care as they receive specified reimbursement for each treatment regardless of actual cost.

The managed care segment of the industry is also focusing on cost containment. Health maintenance organizations and preferred provider organizations are able to limit expenses by giving physicians incentives to reduce hospital utilization and by negotiating discounted fixed rates for hospital services. HCR expects that both private third party and government payors will continue to undertake cost containment measures designed to limit payments made to healthcare providers. See Section VI for further details.

### ***Risk of Concentration of Client Base and Third Party Payor Base***

As of June 30, 1999, approximately 40% of the Company's financed receivables were concentrated in receivables due from five clients' or groups of affiliated clients; approximately 61% of the Company's financed receivables were concentrated in receivables due from ten clients or groups of affiliated clients. Adverse conditions affecting any of these clients could have a material adverse effect on the Company's ability to collect advances to such clients. The Company's client concentration has decreased as the number of its clients have increased over time. Over the last year HCR's top five clients share of total receivables has decreased from 64% to its current level of 40%. However, there can be no assurance that such concentration will continue to decrease in the future.

At June 30, 1999, approximately 62% of the accounts receivable that the Company had purchased or that were pledged to the Company were payable under government programs. Any reduction in the funding of government programs could have a material adverse effect on the Company and its ability to collect advances to clients.

### ***Risk of Control by Certain Stockholders***

The Company's executive officers, directors, and principal stockholders will beneficially own after the offering a significant portion of the Company's Common Stock and Series C Convertible Preferred Stock and will retain substantial influence on the operations of the Company. Since almost all such stockholders have agreed to act together, they may be able to effectively control all matters requiring approval of the Company's stockholders, including the election of a majority of directors and the approval of any business combinations. Control by these stockholders could limit the price that certain investors might be willing to pay in the future for shares of Common Stock.

### ***Risk of New Employees***

The Company believes that the successful achievement of its projections is dependent on the Company's ability to successfully attract and employ individuals with the proper background and experience. There can be no assurance that the Company will be successful in recruiting such individuals.

### ***Risk of Historical Profitability***

The Company has not yet achieved profitability, although losses are expected to decrease from fiscal 1998 to fiscal 1999. The Company expects to be at or near breakeven in fiscal 2000, as the financed receivable portfolio grows, amortization of previous expenditures is completed, and new businesses are successfully implemented. However, there can be no assurance that the Company will achieve profitability.

### ***Year 2000***

HCR has successfully tested all software presently in use that is significant to day to day operations, to ensure that its systems can effectively manage the Year 2000 transition. The

Company does not anticipate that the Year 2000 transition will have a material effect on its own operations. However, the Company is aware that some of its clients' and payors' systems may not be compliant. The failure by clients and payors to implement necessary software changes may disrupt clients' computerized billing and collection systems and adversely affect clients' cash flow and the collectability of HCR's financed receivables. The Company is unable to predict the effects that any such failure may have on the financial condition and results of operations of the Company. HCR has developed a contingency plan for any disruption in the computerized billing and collection systems of the Company's borrowers and their respective Third-Party Payors.

In addition, the Company may be subject to general economic disruptions stemming from problems related to Year 2000 computer issues. Such circumstances may unfavorably affect the manner in which the Company presently conducts its business and, in turn, may negatively affect the Company's operating results.

### ***General Economic Risks***

The Company's business could be affected by general economic conditions in the United States. Any substantial period of economic slowdown or recession could adversely affect the Company's business, financial condition, and results of operations. Although, the demand for healthcare services is unlikely to decrease as much as the demand for the products and services generated by other industries, the risks to which the Company's business is subject become more acute during an economic slowdown or recession because fewer accounts receivable may be generated by clients, resulting in decreased fees for the Company. In addition, the financial ability of certain Third Party Payors to pay on clients' outstanding accounts receivable could be impaired, possibly resulting in increased credit losses to the Company. Furthermore, to the extent that some HCR clients are relatively new to the marketplace, they could be more susceptible to any economic slowdowns or recessions.

### ***Forward-Looking Statements***

Certain statements contained in this Offering, including, without limitation, statements containing the words "believes," "anticipates," "expects" and words of similar import, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: the risk associated with new product offerings; the risk associated with the inability of the Company to compete successfully; failure to comply with government regulations; the inability of the Company to continue its growth; reliance on key management; the Company's significant capital requirements and need for additional financing; control by certain stockholders; and other factors referenced herein. Given these uncertainties, prospective investors are cautioned not to place undue reliance on such forward-looking statements. The Company disclaims any obligation to update any such factors or to publicly announce the result of any revisions to any of the forward-looking statements contained or incorporated by reference herein to reflect future events or developments.

## V. BUSINESS OVERVIEW

### *Business Overview*

HCR is a specialty finance company offering asset-based financing to healthcare service providers, with a primary focus on hospitals, physician services, home healthcare providers, and long-term care providers. The Company targets small and middle market healthcare service providers with financing needs in the \$1 million to \$20 million range with favorable characteristics for working capital financing. HCR currently provides financing to its clients through (1) revolving lines of credit to Providers secured by accounts receivable and advances against accounts receivable, (2) purchase of Providers' accounts receivables, and (3) term loans to providers secured by real estate, accounts receivable and other assets.

HCR and its subsidiaries have incurred losses and operating cash flow deficits since inception. The Company expects to be profitable in fiscal 2000, as the financed receivable portfolio grows, amortization of previous expenditures is completed, and new businesses are successfully implemented. However, there can be no assurance that the Company will ultimately be able to generate positive cash flows from operations, or that additional financing will be obtained on terms acceptable to the Company in the future.

### **Healthcare Providers**

As of June 30, 1999, the Company had 31 Providers with committed lines of \$100 million and amounts outstanding of approximately \$60 million, compared to June 30, 1998, when the Company had 19 Providers with committed lines of \$36 million and amounts outstanding of approximately \$16 million.

**Hospitals** - The Company markets to a variety of hospitals, including acute general care, psychiatric, rehabilitation and convalescent. The Company targets both for-profit and non-profit hospitals. The Company works with stand-alone hospitals as well as hospitals that are part of small private chains, or those that are under management by private multi-hospital management companies.

**Physician Services** - The Company markets to multi-physician groups that are not part of public chains. These generally include large multi-specialty group practices and faculty practice groups. Many medical practices are in the process of consolidating. Financing of accounts receivable is an important source of funds for working capital and acquisitions.

**Home Healthcare Providers** - The Company markets to both for-profit and non-profit home healthcare companies that are not part of a public chain. This segment of the industry has been experiencing ongoing consolidation; however, this segment still is quite fragmented. Historically, this segment has had the longest collection period for its accounts receivable. These Providers have a large and increasing need for working capital to finance their operations and growth.

**Long-Term Care Providers** - The Company markets to nursing homes, sub-acute facilities and step-down units. The Company targets all long-term care facilities that are not part of public

chains. Since long-term care facilities are typically reimbursed by Third-Party Payors once per month, the Company provides a financing alternative by smoothing a long-term care facility's cash flow through weekly payments.

### **Third Party Payors**

**Government Programs** - Medicare is a federal government program that pays for the healthcare needs of U.S. citizens ages 65 and older, as well as for long-term disability and catastrophic illness in younger people. In 1999 Medicare is projected to spend an estimated \$230 billion on healthcare services, according to the Healthcare Financing Review. Medicaid Programs are state government programs run under federal and state guidelines that pay for the healthcare needs of the poor. Funding for these government programs is provided by both the federal and state governments. Medicaid is expected to account for an estimated \$182 billion of healthcare services expenditures in 1999, according to the Healthcare Financing Review.

**Private Insurance Programs** - Private health insurance programs are projected to account for an estimated \$404 billion of healthcare services expenditures in 1999, according to the Healthcare Financing Review. Blue Cross/Blue Shield Plans are among the largest commercial healthcare insurance payors. Managed care programs provide a variety of alternatives to traditional insurance by offering discounts to enrollees and directing patients to doctors and facilities affiliated with such programs. Commercial insurance programs represent a wide variety of health plans, including traditional indemnity programs.

### ***Competitive Position***

The Company encounters significant competition in its healthcare finance business from numerous commercial banks, diversified finance companies, asset-based lenders, and specialty healthcare finance companies. Additionally, healthcare service Providers often seek alternative sources of financing such as venture capital firms, small business investment companies, suppliers, and individuals. As a result, the Company competes with a significant number of local and regional sources of financing and several large national competitors. Many of these competitors have greater financial and other resources than the Company and significantly lower costs of funds due to an expanded capital base. Competition can take many forms, including, among others, the pricing of financing, funding structure (e.g., securitization vs. portfolio lending), timeliness and responsiveness in processing a client's financing application, and customer service.

### ***Sales, Marketing and Origination***

#### **Target Markets**

HCR provides asset-based financing to healthcare service Providers, with a primary focus on clients operating in small to mid-size markets in the healthcare industry, including hospitals, physician services, home healthcare providers, and long-term care providers. The Company targets Providers with financing needs from \$1 million to \$20 million in healthcare sub-markets with favorable characteristics for working capital financing. The Company believes that its healthcare industry expertise and specialized information systems give it a competitive

advantage in its target markets over commercial banks, diversified finance companies and traditional asset-based lenders.

**Table 3: Target Markets**

<b>HCR's Target Market</b>	
<ul style="list-style-type: none"> <li>• Small to Mid-size Hospitals</li> </ul>	<ul style="list-style-type: none"> <li>• For profit and non-profit hospitals</li> <li>• Chain and private management company oriented</li> </ul>
<ul style="list-style-type: none"> <li>• Physician Services</li> </ul>	<ul style="list-style-type: none"> <li>• Large multi-physician/specialty groups</li> <li>• Non-chain involvement</li> </ul>
<ul style="list-style-type: none"> <li>• Home Healthcare Providers</li> </ul>	<ul style="list-style-type: none"> <li>• For profit and non-profit providers</li> <li>• Non-chain involvement</li> <li>• Fastest growing segment in healthcare</li> </ul>
<ul style="list-style-type: none"> <li>• Long-Term Care Providers</li> </ul>	<ul style="list-style-type: none"> <li>• Nursing homes, sub-acute and step-down units</li> <li>• Non-chain involvement</li> </ul>

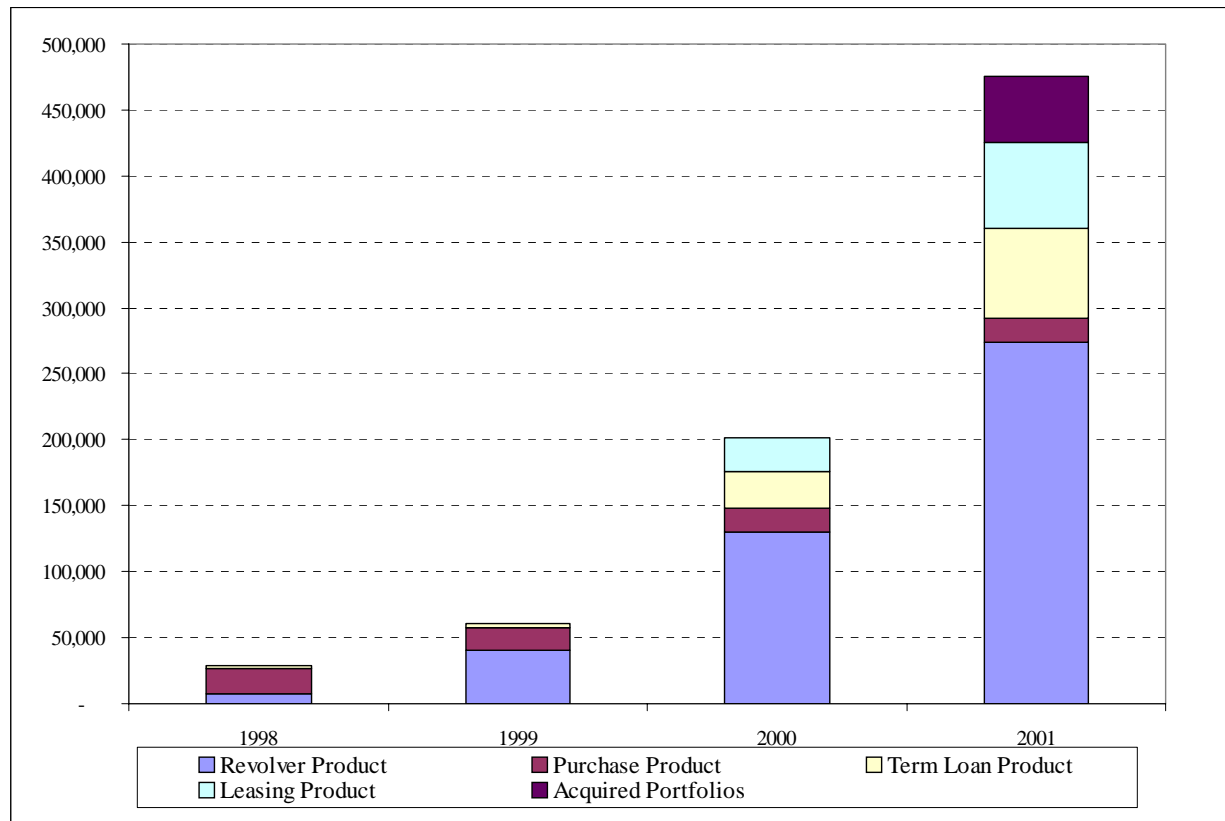
**Current and Future Product Offerings**

As indicated in Table 4, the Company currently offers a number of financial programs to its customer base.

**Table 4: Summary of Financial Products Offered**

<b>Product</b>	<b>Description</b>
Accounts Receivable (“AR”) Program	<ul style="list-style-type: none"> <li>• Working capital financing</li> <li>• Secured by first lien on accounts receivable</li> <li>• All collections flow through HCR managed bank accounts</li> <li>• Medicare, Medicaid, or highly rated insurance companies comprise collateral base</li> </ul>
Purchase Program	<ul style="list-style-type: none"> <li>• Factoring relationship (purchase of eligible accounts receivable)</li> <li>• Declining popularity; almost all new relationships are AR Program relationships</li> <li>• Working capital financing</li> <li>• All collections flow through HCR managed bank accounts</li> </ul>
Secured Term Loan (“ST”)	<ul style="list-style-type: none"> <li>• Currently offered in conjunction with other existing Financing Program clients</li> <li>• Cross-collateralization with Financing Program</li> <li>• First mortgage on healthcare facility or equipment</li> <li>• The Company plans to implement this product on a stand alone basis in the upcoming fiscal year</li> </ul>
Equipment Leasing Program	<ul style="list-style-type: none"> <li>• The Company plans to implement this product in the upcoming fiscal year</li> </ul>

**Figure 1: Earning Assets Growth by Product Line**



**Marketing**

HCR markets its services to selected small and mid-size healthcare Providers on a nationwide basis, primarily by telemarketing to prospective clients identified by the Company, advertising in industry specific periodicals, and participating in industry trade shows. The Company also focuses on developing referral relationships. The Company has and will continue to rely primarily on direct marketing efforts to generate new clients for its services. HCR currently employs 3 telemarketers and 1 salesperson. The Company expects to hire 1 telemarketer and 1 salesperson before the end of 1999 and 2 telemarketers and 1 salesperson in 2000

**New Clients** - For the 9 months ended June 30, 1999, the Company added 13 new Providers with committed lines of \$62 million.

**Direct Sales and Marketing** - Although the healthcare industry is large and diverse, the Company has been able to identify prospective clients through its specific industry expertise and thorough analyses of selective information on the healthcare industry.

**Broker Network** - A network of freelance brokers assist Providers in securing working capital. Brokers generally represent the Provider and may approach several capital sources in order to find the most suitable transaction for their client. The Company expects to maintain relationships with brokers as a source of transactions in the future.

**Direct Advertising** - The Company advertises in some of the industry's leading trade publications. Monthly advertisements appear in Modern Healthcare, HFMA (the trade journal of Healthcare Financial Management Association), and various home healthcare journals.

**Trade Shows** - The Company regularly participates in trade shows sponsored by a variety of professional organizations, including the American Hospital Association and the Medical Group Management Association, and is a member of or has applied for membership in a number of trade and finance associations.

**Telemarketing** - The Company utilizes telemarketing techniques to identify potential clients. Used in conjunction with direct marketing, telemarketing affords direct, personal access to decision makers and can be very effective in generating new business. Based on past success, the Company plans to increase its telemarketing staff and expand its effort.

**Referrals** - HCR's clients often assist the Company's marketing efforts by providing referrals and references. The Company also markets its services by developing referral relationships with professionals such as accountants, lawyers, venture capitalists, billing and collection agents, and investment bankers who focus on the healthcare industry and have pre-existing relationships with prospective clients.

## ***Operations***

**Underwriting and Due Diligence Reviews** - The Company follows formal written underwriting and credit policies. These policies require an initial due diligence review ("Initial Provider Review") of the prospective client, its principals, its financial condition and strategic position, including a review of all available financial statements and other financial information, legal documentation, and operational matters. The Initial Provider Review qualifies a Provider and determines the amount of cash flow that is likely to be realized from the financing of its receivables. HCR then issues a preliminary term sheet based on the results of the Initial Provider Review.

If the Provider agrees to the terms indicated in the preliminary term sheet, the Company conducts an intensive underwriting process including a detailed provider review ("Detailed Provider Review"). The Detailed Provider Review, performed at the Provider's expense, includes a detailed examination of its accounts receivable, accounts payable, billing and collection systems and procedures, management information systems, and other potential collateral. The Detailed Provider Review is conducted by an in-house field auditor or by third party consulting underwriters. The Company independently confirms certain matters with respect to the prospective client's business and the collectability of its accounts receivable and any other collateral by conducting public record searches, and by contacting Third Party Payors about the prospective client's receivables. The collateral analysis includes an intensive review of claims files, account records, historical collections, and medical records as well as real estate appraisals, and internal valuation models. The underwriting process also calls for a financial viability analysis of the potential customer and an analysis of the Provider's healthcare strategy. Based upon the results of the Detailed Provider Review and other findings, the Company issues a final term sheet establishing a valuation for the receivables and an overall funding limit for the Provider, including interest and fees to be collected from the fundings.

**Valuation of Receivables** - In order to estimate the net collectable value of a prospective client's accounts receivable, the Company conducts extensive due diligence to evaluate the receivables likely to be received within a defined collection period.

The valuation of healthcare receivables is unique and critical to the HCR Programs because Providers rarely collect the full amount. A number of explanations support the difference between the actual cash collected by a Provider and the amount charged by the Provider ("Gross Charges"). Third Party Payors may negotiate discounts from the Provider's Gross Charges. Additionally, bills may be rejected or changed by Third Party Payors as a result of errors in the preparation of the original bill. Due to the amount of detailed information required to adjudicate a claim, it is difficult to ensure that every bill is completed correctly. Finally, while not financed by the Company's Purchase or AR Programs, co-payments from the patients themselves may be required by Third Party Payors.

As part of the Detailed Provider Review, the Company determines how much cash has historically been collected from the Provider's receivables within 180 days of initial billing. The process begins by separating the Provider's receivables into distinct Third Party Payor classes for analysis. Next, the Company calculates a net value ("Net Value") for the receivables by deducting the contractual allowances and the patient co-payments from the Provider's Gross Charges. The Net Value is the payment the Provider actually expects to collect from Third-Party Payors. The Company then computes the Anticipated Liquidation Value ("ALV") of the receivables by measuring the historical collection rate of each class of receivables. The Company will then finance up to 85% of the product of the ALV and the Net Value.

**Receivables Financing Agreement** - If the Company and the Provider come to an agreement after the results of the Detailed Provider Review, they enter into either a Receivables Purchase Agreement or a Loan and Security Agreement (in either event, "Receivables Financing Agreement"). The Receivables Financing Agreement establishes the terms and conditions under which the Company will finance the Provider's receivables. The Provider represents in the Receivables Financing Agreement that the Provider will only finance those receivables which meet certain eligibility requirements ("Eligible Receivables"). The Receivables Financing Agreement also provides for the establishment of appropriate accounts with a lockbox agent at a financial institution, notification of Third Party Payors of new payment instructions, the perfection of first priority security interests (including UCC filings) in the classes of receivables to be obtained as collateral and other excess collateral.

**Funding Process** - The funding process begins when the Provider electronically transmits its receivables files to Accelerated Receivables Management ("ARM") in Illinois, HCR's master servicer (the "Master Servicer"), for review. Following the instructions provided by the Company, the Master Servicer screens the receivables to insure their eligibility for financing and calculates ALV's, discounts, and advances. The Master Servicer then electronically transmits lists of Eligible Receivables to the Company.

**Fees** - The Company charges a financing fee in either the form of a discount or an interest charge on the outstanding advances (the "Program Discount"). The size of the Program Discount depends on the financial strength of the Provider, the volume of its business, the Third Party Payor class financed, and the historical turnaround time for payment. In addition to the Program

Discount, the Company charges an up front fee to cover the cost of due diligence and a one time origination fee. The Company passes through to the Provider all lockbox fees, electronic interface costs, and other out-of-pocket expenses.

**Collection of Receivables** - An essential part of the collection process is the establishment of Provider lockboxes. Upon the signing of a Receivables Financing Agreement, two lockboxes, one for government payors and one for non-government payors, are established for each Provider at a bank. Third Party Payors are directed to send their payments, along with payment details, known as Explanation of Benefits ("EOB's"), to the lockbox. The funds in the lockbox are swept daily and remitted to the collateral agent ("Collateral Agent"). The Bank of New York presently serves as the Company's Collateral Agent. The Collateral Agent reviews the instructions provided by the Company in compliance with the terms and conditions of its financing documents. Federal law requires that government payors direct their payments only to accounts controlled by the Provider. Therefore, the lockbox established for government payors must be maintained under the control of the Provider. Payments made to these accounts are swept daily into accounts controlled by the Company. Non-government payors direct their payments into a lockbox controlled by the Company.

The bank forwards the EOB's to the Master Servicer or Provider for posting to the individual accounts. The Master Servicer or Provider, in turn, forwards this information to the Company. Providers are obligated to deposit all payments received directly from Third Party Payors into the lockbox. The Company monitors all cash deposits made by the Providers on a daily basis in order to ensure that all Third Party Payors are directing payments to the applicable lockbox.

**Monitoring of Receivables** - The Company monitors the collection of receivables to ensure complete and timely collections of outstanding balances. For each class of Eligible Receivables, expected liquidation patterns are developed and analyzed by the Company and its independent accountant. Receivables balances are compared regularly against expected balances for any deviations from historical collection patterns. The Company also completes a thorough audit of each Provider relationship on a quarterly basis to ensure the timely and correct receipt of payments.

**Servicing** - In order to maintain control over the performance of its receivables and cash flows, the Company has developed a number of information reporting procedures. These procedures are orchestrated by the Company with the assistance of the Master Servicer serving as the central processor of information supporting the HCR Programs. The Master Servicer's primary role is to act as the Company's data processor. This role includes setting up data interfaces with Providers, analyzing optimal receivables purchase mixes, monitoring account collections, and posting payments made to the Company's lockboxes. In addition, the Master Servicer serves as an alternative to the collection process by acting as a backup servicer in the event that the primary servicer, the Provider, does not fulfill its duties. The Master Servicer is contractually obligated to become the primary servicer within 48 hours of the occurrence of certain trigger events.

The Master Servicer collects collateral information from each of the Company's clients periodically (timing varies depending on the type of financing) and provides the Company with

collateral activity reports in a seamless electronic format. This information, in turn, is matched up against the clients' loan balances and cash activity to monitor the Company's position daily.

**Cash Management** - To monitor cash activity, the Company has licensed Chase Manhattan Bank's Chase Insight Global Treasury Workstation ("Insight"). Insight enables the Company to download its banking and cash activity, breakdown the data by client and upload the information to the general ledger. Furthermore, via interaction with e-HealthContinuum.com, Insight will be programmed to cue up daily client fundings for verification and release in a seamless electronic environment. In addition, Insight allows the Company to monitor balances and streamline cash flows to enhance yields on idle cash and improve operating performance by minimizing expenses. This multiple functionality permits the Company to support substantially larger portfolio volumes with minimal staffing requirements.

### ***Risk Management***

**Advance Rate** - The maximum amount the Company will advance to the Provider at the time of a funding is 85% of the ALV, which provides excess collateral of at least 17.6% over amounts advanced.

**Additional Collateral** - The clients of the Company are required to direct all payments to the Company for each class of receivables financed, regardless of whether or not the Company actually financed all of the receivables in such class. Thus, HCR receives additional cash on receivables not financed by the Company. The additional cash is used to offset the Provider's outstanding balance. If the collateral from Eligible Receivables is sufficient, the excess cash from such receivables is remitted to the Provider.

**Continuous Provider Reviews** - In the Purchase Program, the Company continually monitors each purchased batch of receivables to determine that collections are meeting anticipated liquidation amounts and timetables. The AR Program has similar stringent monitoring requirements in addition to the requirement for borrowing base certificates to be signed weekly by an officer of each Provider. HCR also makes use of an in-house credit department to daily monitor the financial position of each client.

**Clients** - The Company client base is diversified. As of June 30, 1999 the Company was servicing clients located in 18 states, in a number of different sub-markets of the healthcare industry.

**Table 5: Industry Group Breakdown***(as of 6/30/99)*

	<u>Number of Deals</u>	<u>Percentage of Deals</u>	<u>Financed Receivables</u>	<u>Percent of Portfolio</u>
Hospitals	5	13.2%	8,799,391	14.7%
Nursing Home	16	42.1%	31,554,805	52.6%
Home Health	10	26.3%	10,368,305	17.3%
Physician	4	10.5%	4,703,121	7.8%
Durable Medical	3	7.9%	4,573,516	7.6%
	<u>38</u>	<u>100.0%</u>	<u>59,999,138</u>	<u>100.0%</u>

**Table 6: Product Breakdown***As of 6/30/99*

	<u>Number of Deals</u>	<u>Percentage of Deals</u>	<u>Financed Receivables</u>	<u>Percent of Portfolio</u>
AR Program	19	50.0%	39,772,405	66.3%
Purchase Program	15	39.5%	15,256,733	25.4%
ST Program	4	10.5%	4,970,000	8.3%
	<u>38</u>	<u>100.0%</u>	<u>59,999,138</u>	<u>100.0%</u>

**Program Structural Enhancements**

**High Quality Third Party Payors** - The Company primarily purchases or finances receivables which are the obligations of the federal government, state governments, and commercial insurance carriers with investment grade ratings. Thus, risk of loss due to Third Party Payor default is substantially minimized.

**Separation of Collection Risk from Receivables Adjudication Risk** - The Company's clients represent and warrant in each Receivables Financing Agreement that receivables financed with the Company are in fact Eligible Receivables and indemnify the Company for any adjudication risk associated with receivables which are not Eligible Receivables. The Company monitors communications with Third Party Payors carefully in order to quickly identify all issues regarding payment of such receivables. If payment is denied, the Provider is obligated to replace or repurchase the rejected receivables.

**Concentration Limits** - The Company carefully monitors its portfolios on a daily basis to limit the concentration risk of Third Party Payors and Providers. Such diversification should protect the Company against any risk of concentration.

### ***e-HealthContinuum.com***

The Company is developing a line of e-business services, which will complement its traditional accounts receivable finance products. Management anticipates that entering the e-commerce marketplace will greatly expand HCR's growth opportunities and effectively leverage its technological infrastructure.

e-HealthContinuum.com is expected to be an independent Internet based business, offering a complete, seamless, end-to-end healthcare transaction solution for small and middle market healthcare providers. The Internet connectivity is expected to allow the Company to deliver a host of services and products to its current target market and expand its breadth to include other providers it does not currently serve. e-HealthContinuum.com is anticipated to deliver online patient eligibility verification, claims submission, screening and editing, collection monitoring and remittance processing, thus greatly streamlining the billing and collection process. e-HealthContinuum.com is expected to also provide a financial reporting system interface, as well as, short-term financing. Following the submission of the claim, for participating Payors, the claim will be adjudicated immediately and the payment amount will be advanced to the Provider by HCR. The remittance advice will be returned electronically, enabling accurate posting to the provider system. If desired, HCR expects to finance the lag between claim submission and funds being received from the payor whether or not that payor is participating in the e-HealthContinuum.com network. In addition, the Company is investigating a patient co-pay financing component with a major credit card issuer.

Clients will access e-HealthContinuum.com through the Internet using a browser. The application on the Web server is expected to walk Providers through a series of screens that will help the clients manage both the submission of the claim as well as the receipt of cash, whether directly from the payor or through an HCR financing program. For example, the application is anticipated to help ensure that all the necessary data is on the claim and that the procedure and diagnostic codes are consistent. This error checking will maximize the possibility that the claim is "clean" prior to submission, thus eliminating costly follow-up by both the Provider and payor.

e-HealthContinuum.com is anticipated to not only considerably reduce the length of clients' billing cycles, but is expected to also allow Providers to realize significant cost savings as the need for periodic recruiting and training of personnel, due to frequent changes in government regulation, is eliminated. Thus, the Company, through e-HealthContinuum.com, can offer an integrated solution to all major market segments of the healthcare industry from physician and dentist offices to pharmacists and major tertiary care systems.

### ***Funding Sources***

HCR has a revolving line of credit from COMPANY NAME for two loan facilities. The first facility is a warehouse line of approximately \$75 million that allows the Company to purchase or finance receivables. The second facility is a warehouse line of \$25 million for the financing of term loans and receivables. See COMPANY NAME Warehouse Facility in Section VII – Management and Organization. The Company anticipates expanding its debt financing with an additional line of credit from a new entity within the fiscal year ended September 30, 2000.

### ***Healthcare Capital Resources Limited***

In order to leverage its experiences in the healthcare lending sector and take advantage of opportunities abroad, the Company has invested in Healthcare Capital Resources Limited (“HCR-UK”), a United Kingdom based finance company that focuses on disclosed invoice discounting to nursing, residential and domiciliary healthcare providers. Currently, HCR-UK only finances receivables where the underlying obligors are U.K. local authorities. HCR-UK is a startup company that has been funded by HCR, SMT and COMPANY NAME. Pursuant to the transaction, HCR also granted HCR-UK the right to use the name “Healthcare Capital Resources” and similar identifying marks, product names and other intellectual property and agreed to provide managerial , operational, financial and strategic support services. (See Recent Transactions within Section VII - Management and Organization for more information on this investment).

### ***Litigation***

Except for pending legal action to enforce HCR’s rights under financing agreements with clients, where the Company believes the existing reserves are adequate to cover potential shortfalls as discussed under Management Discussion and Analysis in Section VIII – Historical Financial Information, to the best of management’s knowledge, there are no proceedings pending or threatened by or against HCR which could materially affect the assets of the Company or of any of its subsidiaries.

## VI. INDUSTRY OVERVIEW

According to Healthcare Financing Administration (“HCFA”) estimates, total domestic healthcare expenditures for 1999 are expected to exceed \$1.2 trillion, or 14% of gross domestic product, compared to expenditures of \$699.4 billion or 12% of gross domestic product (“GDP”) in 1990. The annual compound growth rate of healthcare expenditures from 1990 to 1999 was 7.0%. By the year 2008, according to the HCFA - Office of the Actuary, these expenditures are expected to grow to \$2.2 trillion or 16% of GDP.

The breakdown of estimated healthcare expenditures for 1999 is as follows:

**Table 7: Healthcare Industry Expenditures**  
*(\$ in billions)*

Healthcare Industry Segment	Estimated 1999 Expenditure
Acute Care Hospitals .....	\$ 401.3
Physician Services .....	241.5
Other Medical Non-Durables.....	132.6
Long-Term Care Nursing Homes .....	90.1
Other Professional Services .....	72.1
Insurance-net of healthcare costs .....	65.1
Dental Services .....	56.6
Home Healthcare .....	33.8
Government Public Health .....	46.2
Other Personal Care .....	36.0
Research .....	19.7
Construction.....	19.2
Vision Products and Other Medical Durables .....	14.3
Total.....	\$ 1,228.5

Source: HCFA - Office of the Actuary

The Company believes that there are several distinct trends that will continue to fuel the demand for both healthcare services in the United States and for the Company’s services. These include: (1) dramatic change driven by governmental and market forces which have put pressure on Providers to reduce healthcare delivery costs and increase efficiency, often resulting in greater short-term working capital requirements; (2) favorable demographic trends, including both the general increase in the U.S. population and the aging of the U.S. population, which should increase the size of the Company’s principal target markets; (3) growth, consolidation, and restructuring of healthcare sub-markets, including long-term care, home healthcare, and physician services; and (4) advances in medical technology, which have increased the demand for healthcare services.

### ***Healthcare Receivables Financing***

Businesses generally utilize working capital or accounts receivable financing to bridge the shortfall between the turnover of current assets and the maturity of current liabilities. A business will often experience this shortfall during periods of revenue growth because cash flow from new revenues lags behind cash outlays required to produce new revenues. For example, a growing labor intensive business will often need to fund payroll obligations before payments are received

on new services provided or products produced. Many of the Company's clients are labor intensive and growing and therefore require accounts receivable financing to fund their growth.

### ***Government Regulation***

The healthcare industry is subject to extensive federal, state and local statutes and regulations. These regulations include licensure requirements, reimbursement rules, and standards of services and care. Changes in applicable laws and regulations or new interpretations of existing laws and regulations could have a materially adverse effect on HCR's clients with respect to licensure of facilities, eligibility for participation in Federal and state programs, permissible activities, costs of doing business, or the levels of reimbursement from governmental, private and other sources.

Significant healthcare regulations which could potentially affect the Company's clients and therefore affect HCR are: (1) certification of need regulation, which many states require upon the provision of new health services, particularly for long-term care and home healthcare companies; (2) Medicare/Medicaid fraud and abuse of statutes, which prohibit, among other things, the offering, payment, solicitation, or receipt of remuneration, directly or indirectly, as an inducement to refer patients to facilities owned by physicians if such facilities receive reimbursement from Medicare or Medicaid; and (3) other prohibitions of physician self-referral that have been promulgated by the states.

### ***Adverse Effects of Healthcare Reform***

The healthcare industry has undergone significant change over the past 15 years, primarily in response to governmental and private payor efforts to control the cost of providing healthcare services. HCR's loans to clients are subject to the risk that one or more clients may fail to adapt sufficiently to current and future changes to healthcare regulations and payment levels.

In 1983, the Federal government acted to curtail increases in healthcare costs under Medicare. Instead of continuing to reimburse hospitals on a cost plus basis, the hospital's actual cost of care plus a specified return on investment, the Federal government established a new type of payment system based on prospectively determined prices rather than retrospectively determined costs, with payment for inpatient hospital services based on regional and national rates established under a system of diagnosis-related groups ("DRGs"). As a result, hospitals bear the cost risk of providing care as they receive specified reimbursement for each treatment regardless of actual cost.

Concurrent with the change in government reimbursement of healthcare costs, a "managed care" segment of the healthcare industry emerged based on the need for cost containment. The health maintenance organizations and preferred provider organizations, which constitute the managed care segment, are able to limit hospitalization costs by giving physicians incentives to reduce hospital utilization and by negotiating discounted fixed rates for hospital services. In addition, traditional third party indemnity insurers began to limit reimbursement to pre-determined amounts of "reasonable charges," regardless of actual cost, and to increase the co-payment required of patients. These changes have resulted in the earlier discharge of patients from acute care hospitals.

The Balanced Budget Act, (“BBA”), enacted in August 1997, made numerous changes to the Medicare and Medicaid programs significantly affecting the delivery of sub-acute care, skilled nursing facility care, and home healthcare. With respect to Medicare, the BBA provides, among other things, for a prospective payment system (“PPS”) for skilled nursing facilities to be implemented for cost reporting periods beginning on or after July 1, 1998, a PPS for home nursing to be implemented for cost reporting periods beginning on or after October 1, 1999 (subsequently extended to October 1, 2000), a reduction in current cost reimbursement for home nursing care pending implementation of a PPS, reductions in reimbursement for oxygen and oxygen equipment for home respiratory therapy, and a shift of the bulk of home health coverage from Part A to Part B of Medicare. As a result, like hospitals, skilled nursing facilities and providers of sub-acute care and home healthcare now bear the cost risk of providing care inasmuch as they receive specified reimbursement for each treatment regardless of actual cost. With respect to Medicaid, the BBA repealed the Boren Amendment, which required state Medicaid programs to reimburse nursing facilities for the costs that are incurred by efficiently and economically operated Providers in order to meet quality and safety standards. As a result, states now have considerable flexibility in establishing payment rates and certain states are expected to move towards a prospective payment system for skilled nursing facilities.

The Company expects that both private third party and governmental payors will continue to undertake cost containment measures designed to limit payments made to healthcare providers. Furthermore, government programs are subject to statutory and regulatory changes, retroactive rate adjustments, administrative rulings and government funding restrictions, all of which may materially increase or decrease the rate of program payments to Providers. There can be no assurance that payments under governmental and third party private payor programs will remain at levels comparable to present levels or will, in the future, be sufficient to cover the operating and fixed costs allocable to patients participating in such programs. Providers could be adversely affected by the continuing efforts of governmental and private third party payors to contain the amount of reimbursement for healthcare services. In an attempt to limit the Federal and state budget deficits, there have been, and will likely continue to be, a number of additional proposals to limit Medicare and Medicaid reimbursement for healthcare services. The Company cannot at this time predict whether this legislation or any other legislation will be adopted or, if adopted and implemented, what effect, if any, such legislation will have on Providers.

## VII. MANAGEMENT AND ORGANIZATION

### *Beneficial Ownership*

The following table sets forth certain information, as of June 30, 1999, regarding the beneficial ownership of the Company's Common Stock by the directors and executive officers of HCR, as well as each person known by the Company to own beneficially more than five percent of the outstanding shares of the Company's Common Stock.

**Table 8: Beneficial Ownership**

		<b>Beneficial Ownership Prior to Offering</b>	
		<u>Number</u>	<u>Percent</u>
Dr. Michael Sinclair	(1)	1,936,367	37.06%
Howard S. Weitzman	(2)	423,617	8.11%
H. Tomkins O'Connor	(3)	987,100	18.89%
Sinclair Medical Partners Limited	(1)	1,936,367	37.06%
Dresdner Kleinwort Benson Private Equity Partners II, L.P.	(4)	882,143	16.89%
Atlantic Medical Capital, L.P.	(3)	987,100	18.89%
Lehman Commercial Paper, Inc.	(5)	713,300	13.65%
Rianne Investments Limited	(6)	317,293	6.07%
Jeffrey Hyman	*	87,279	1.67%
Employee options authorized	(7)	777,412	14.88%
All executive officers and directors as a group (1)(2)(3)(4)		3,251,133	62.23%

(1) Includes 87,742 shares of Common Stock issuable upon exercise of July 1996 Warrants owned by Michael Sinclair, 111,461 shares of Common Stock issuable upon exercise of February 1996 Options owned by Sinclair Medical Partners Limited, 140,000 shares of Common Stock issuable upon exercise of the AMC Warrants, 250,000 shares of Common Stock owned by AMC, and 40,000 shares of Preferred C-1 stock owned by AMC convertible into 588,095 shares of Common Stock.

Dr. Sinclair is a director of Sinclair Medical Partners Limited and a director of Atlantic Medical Capital L.P.

(2) Includes 7,312 shares of Common Stock issuable upon exercise of July 1996 Warrants and 9,288 shares of Common Stock issuable upon exercise of February 1996 Options

(3) Includes 1,828 shares of Common Stock issuable upon exercise of July 1996 Warrants, 2,323 shares of Common Stock issuable upon exercise of February 1996 Options, 140,000 shares issuable upon exercise of the AMC Warrants, 250,000 shares of Common Stock owned by AMC, and 40,000 shares of Preferred C-1 stock owned by AMC convertible into 588,095 shares of Common Stock.

(4) Includes 60,000 shares of Preferred C-2 stock convertible into 882,143 shares of Non-Voting Common Stock.

(5) Includes 713,300 shares of Common Stock issuable upon exercise of May 1998 Warrants.

(6) Includes 73,118 shares of Common Stock issuable upon exercise of July 1996 Warrants and 50,000 shares of Common Stock issuable upon exercise of February 1998 Warrants.

(7) Includes 147,510 shares of Common Stock, of which Bill Reed owns 53,710, Suzanne Steinau owns 30,000, and Frank Eng owns 20,000, issuable upon exercise of 1996 Equity Incentive Plan Options and authorized and unissued options for 629,902 shares of Common Stock to be issued under the 1996 Equity Incentive Plan.

\* Individual owns 5.04% of Common Stock before full dilution.

**Table 9: Common Stock, Options and Warrants Outstanding**

	<u>Common</u>	<u>Conversion of Series C</u>	<u>Options &amp; Warrants</u>	<u>Total Fully Diluted Shares</u>	<u>% Ownership</u>
Sinclair Medical Partners Limited	759,069	-	111,461	870,530	16.95%
Howard S. Weitzman	407,017	-	16,600	423,617	8.25%
Rianne Investments Limited	194,175	-	123,118	317,293	6.18%
Jeffrey Hyman	87,279	-	-	87,279	1.70%
James Kardon	20,000	-	-	20,000	0.39%
George Siguler	10,000	-	-	10,000	0.19%
Atlantic Medical Capital, L.P.*	250,000	588,095	140,000	978,095	19.04%
Lehman Commercial Paper, Inc.	-	-	713,300	713,300	13.89%
Dresdner Kleinwort Benson Private Equity Partners II, L.P.	-	882,143	-	882,143	17.17%
H. Tomkins O'Connor	4,854	-	4,151	9,005	0.18%
Montrose Securities, Ltd.	-	-	32,000	32,000	0.62%
Raphel Zorn Hemsley Holdings PLC	-	-	16,000	16,000	0.31%
Employee options authorized	-	-	777,412	777,412	15.13%
<b>Total:</b>	<b><u>1,732,394</u></b>	<b><u>1,470,238</u></b>	<b><u>1,934,042</u></b>	<b><u>5,136,674</u></b>	<b><u>100.0%</u></b>
<i>% of Fully Diluted Shares:</i>	<i>33.7%</i>	<i>28.6%</i>	<i>37.7%</i>	<i>100.0%</i>	<i>-</i>

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\* Includes Atlantic Medical Management LLC

## ***Management and Directors***

The officers, senior management, and directors of HCR are named below.

**Table 10: Management and Directors**

<b>Name</b>	<b>Age</b>	<b>Position</b>
<b><i>Management:</i></b>		
Charles D. Van Sickle	57	President, Chief Executive Officer and Director of HCR
William F. Reed	47	Chief Financial Officer, Chief Operating Officer, Treasurer, Secretary and Director of HCR
Suzanne B. Steinau	51	Senior Vice President, Senior Managing Director of Underwriting
Frank G. Eng	62	Senior Vice President of Operations and Planning
Matthew R. Reder	27	Vice President and Controller
James P. McAleer	32	[Vice President,] Assistant Treasurer and Bank Relationship Manager
Ned Komar	39	Credit Manager
Robert A. Belmont	41	Assistant Treasurer, Managing Director of Cash Funding and Application
Vikram Pawar	35	Chief Information Officer
John A. Mertens	56	Director of Client Relations
Leslie Steinau	56	Assistant Secretary
G. Nicole Dina	26	Office Manager and Director of Personnel
<b><i>Directors:</i></b>		
Dr. Michael J. Sinclair	56	Chairman
Howard S. Weitzman	51	Vice Chairman
H. Tomkins O'Connor	48	Director of HCR
Charles D. Van Sickle	57	President, Chief Executive Officer and Director of HCR
William F. Reed	47	Chief Financial Officer, Chief Operating Officer, Treasurer, Secretary and Director of HCR

## ***Management***

**Charles D. Van Sickle** joined the Company in November 1998 and serves as President, Chief Executive Officer and Director of HCR. Prior to his employment at HCR, Mr. Van Sickle held the position of Group President at AT&T Capital Corporation responsible for worldwide operations. As a senior member of management he led the transition of AT&T Capital from a wholly-owned subsidiary of AT&T to an independent New York Stock Exchange listed company by July of 1993 and the subsequent private sale of the company to Nomura Securities in October 1996. Before joining AT&T Capital as one of its founding officers in 1986, Mr. Van Sickle had held various management positions with U.S. Leasing International since 1967.

**William F. Reed** serves as Chief Financial Officer, Chief Operating Officer, Treasurer, Secretary, and Director of HCR. Mr. Reed has over 20 years experience in the finance industry. Prior to joining HCR in August 1996, Mr. Reed started the investment advisory firm, the Cosel Reed Group. Cosel Reed focused on raising capital and general corporate finance work for middle market companies. Mr. Reed was a founder of Mitsui Nevitt Capital Corporation (“MNCC”). MNCC was a specialized finance company investing at all levels of the capital structure of middle market companies. In forming MNCC, Mr. Reed secured Mitsui and Co. as the primary investor and was responsible for the day to day management of the firm. MNCC became a major financing source in the leveraged buy-outs and leasing business. Over seven

years, the assets of MNCC grew to over \$1.5 billion. Prior to this, Mr. Reed worked for Bank of America and Chemical Bank as an investment banker specializing in tax sensitive equipment financing, both domestically and internationally.

**Suzanne B. Steinau** serves as Senior Vice President and Senior Managing Director of Underwriting. Prior to joining the Company in November 1997, Ms. Steinau has been involved in healthcare finance for the past 20 years. Recently, she served as an Advisory Principal to NP Capital, Inc., where she structured financial products and performed mergers and acquisitions work. Prior to her time at NP, Ms. Steinau was a Senior Vice President and Credit Officer at Daiwa Securities of America, Inc. where she developed the credit policy and directed operational planning for the securitization group. Ms. Steinau was a Vice President and Sales Executive for the Healthcare Financial Services Division of the Chase Manhattan Bank prior to joining Daiwa.

**Frank G. Eng** serves as Senior Vice President of Operations and Planning. Prior to joining HCR in March 1998, Mr. Eng spent eighteen years with Chase Manhattan Bank in capacities ranging from senior executive in charge of the Management Science Division to Business Manager of the Healthcare Financial Services Group. While in this position, Mr. Eng was responsible for securitizing healthcare receivables pools and managing payment flows. Prior to joining Chase, Mr. Eng served as a senior member of the New York City Health and Hospitals Corp and as the NYC Mayor's liaison to the healthcare industry. Mr. Eng also led the development of the first HMO in the NYC Metro Region while he was a member of the Healthcare Business Development Unit of the Equitable Life insurance Company.

**Matthew R. Reder** serves as Vice President and Controller, managing the Company's accounting and financial reporting. Prior to joining the Company in March 1999, Mr. Reder has over 5 years experience in public accounting with KPMG. Mr. Reder was a manager in KPMG's Financial Services audit practice, where he was responsible for the management of financial statement audits of several publicly traded financial institutions in the New York metropolitan area, with assets ranging from \$800 million to \$10 billion. Such activities also included quarterly reviews of client Forms 10-K, 10-Q, and other SEC filings, reviews of financial institution mergers and acquisitions, and various consulting engagements. Mr. Reder attended the AACSB accredited Sellinger Business School of Loyola College in Maryland, where he graduated cum laude with a Bachelor of Science degree in Accounting in December 1993. Mr. Reder is Certified Public Accountant in the State of New York.

**James P. McAleer** serves as [Vice President and] Assistant Treasurer, managing the Company's banking relationships and day to day liquidity. Prior to joining the Company in September 1998, Mr. McAleer has over 8 years experience in corporate finance, liquidity management, and treasury management with Time Warner Inc. Most recently, Mr. McAleer was a Manager in the Corporate Finance group at Time Warner, where he was responsible for an \$8 billion revolving credit facility, a \$1.5 billion commercial paper program and approximately \$2 billion of asset securitizations. In addition to day to day liquidity management, Mr. McAleer was involved with the analysis, negotiation, and execution of numerous financings including various public debt issues, asset securitizations, and revolving credit facilities. Prior to this, Mr. McAleer worked in the Cash Management Group at Time Warner for nearly 4 years, where he was responsible for treasury management systems, corporate banking, and cash management services. Mr. McAleer

attended New York University's Stern School of Business where he was a Stern Scholar and received his MBA in Finance in May 1998.

**Ned Komar** serves as Credit Manager. Prior to joining the Company in August 1999, Mr. Komar was most recently employed by Bank of Tokyo-Mitsubishi, where he was responsible for sourcing and underwriting leveraged loans to large healthcare providers. Previously Mr. Komar held senior credit positions at NatWest Markets and Standard and Poor's where he covered the retailing and food manufacturing industries. In addition to his experience in the financial services industry, Mr. Komar has held marketing and operations positions at Unilever and Gillette. Mr. Komar has an MBA from New York University in Finance and Marketing.

**Robert A. Belmont** serves as Managing Director of Cash Funding and Application for HCR since September 1998. Mr. Belmont has worked with several corporations in the healthcare industry over the last 10 years and has held middle and senior level management positions with several companies. He has served as the CFO and Vice President of Finance at CHP the Medical Group and its subsidiary Managed Health Inc., as Assistant Controller at the Bronx Health Plan, and as Senior Finance Manager at Health First, the largest Medicaid HMO in New York. Mr. Belmont has a Masters of Public Administration from Baruch College.

**Vikram Pawar** has served as the Company's Chief Information Officer since June 1998. Mr. Pawar is responsible for ensuring the availability of MIS infrastructure to support a growing client base, addressing market and technology changes, and designing, developing, and implementing the Company's internet presence via a user friendly web page. Mr. Pawar had over 12 years experience as a technical officer at Chase Manhattan Bank. While there, he managed a team to service Chase's Health Care financing module which supported a portfolio comprised of large hospitals and nursing homes. In addition, Mr. Pawar was responsible for managing a MIS group, which serviced other asset-backed securities, such as mortgage backed securities, auto loans, and credit cards. Mr. Pawar has a Masters degree in Computer Science from the New York Institute of Technology.

**John A. Mertens** has served as Director of Client Relations since the Company's inception. Previously he was with Medimax, a healthcare financing company, as Director of Operations. Mr. Mertens also served as a partner in the Health Care Practice of KPMG after his firm, Ingram, Weitzman, Mertens and McCann, merged with KPMG. Mr. Mertens previously served as an assistant vice president for Blue Cross where his duties included the development of reimbursement methodologies, management of all Blue Cross and Medicare appeals of reimbursement rates, and supervision of the President's Cost Control Program.

**Leslie Steinau** has served as the Assistant Secretary and General Corporate Counsel for the Company for the past year. Mr. Steinau is a member of the law firm Parker, Duryee, Rosoff and Haft, P.C., located in New York City, where he has practiced since 1969. He is married to Suzanne Steinau.

**G. Nicole Dina** serves as the Company's Office Manager and Director of Personnel. Ms. Dina has over eight years of experience in personnel and executive committee management at major international companies, including Simint USA and Nautica Enterprises.

## *Directors*

**Dr. Michael J. Sinclair** has served as Chairman of the Board of Directors for the Company since 1995. Dr. Sinclair has been a director of AMC since 1993. Dr. Sinclair also serves as a director of Sinclair Montrose Trust Limited (“SMT”). Prior to organizing AMC, Dr. Sinclair was Chairman of Lifetime Corporation (parent of Kimberly Quality Care), a NYSE listed home healthcare company with over \$900 million in revenues, which he founded in 1981. Prior to his tenure at Lifetime Corporation, Dr. Sinclair served as the President of the International Division of Hospital Affiliates International, a subsidiary of the Insurance Company of North America. From 1971 to 1978 Dr. Sinclair built Allied Investments, Ltd., a company he founded, into one of the U.K.’s largest publicly listed healthcare services companies. Dr. Sinclair is a physician and currently serves on the Board of Overseers at the Tufts University School of Medicine.

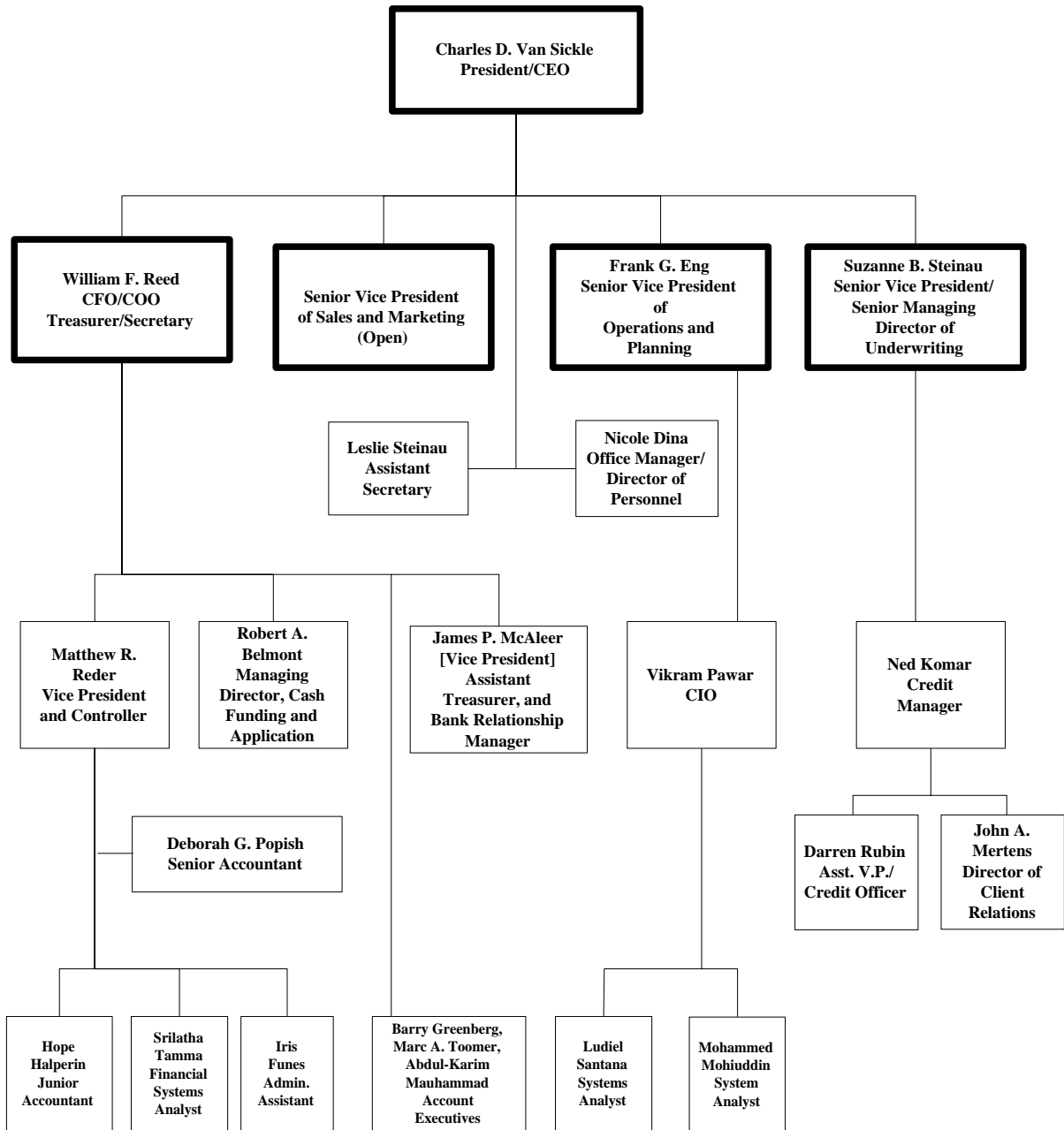
**Howard S. Weitzman** serves as Vice Chairman of the Board. Mr. Weitzman has over 25 years of experience in the healthcare industry and was recently promoted to the position of Vice Chairman of the Board. Prior to founding the Company, Mr. Weitzman served as the CEO of EPIC Healthcare Group from 1985 to 1990, a publicly traded (NASDAQ) mail order prescription drug service which he also founded. From 1982 to 1985, Mr. Weitzman was the partner in charge responsible for KPMG's New York healthcare practice where he led 100 healthcare professionals in four offices. Prior to that, Mr. Weitzman spent ten years as a co-founder and managing partner of the healthcare accounting firm of Ingram, Weitzman, Mertens and McCann, Inc., which eventually merged with KPMG in 1982.

**H. Tomkins O'Connor** serves as a Director of HCR. Mr. O'Connor has been a director of AMC since 1993. Prior to organizing AMC, he was at GE Capital, responsible for originating and structuring investments for the Corporate Finance Group's \$750 million healthcare portfolio, where he was employed since 1989.

**Charles D. Van Sickle** (See Management section, above)

**Bill Reed** (See Management section, above)

**Figure 2: Management and Employee Organizational Chart**



### ***AMC Consulting Agreement***

AMC, of which Dr. Michael J. Sinclair and H. Tomkins O'Connor are directors, entered into a Management Consulting Agreement with the Company as of April 1, 1998 pursuant to which the Company, commencing May 21, 1998 ("Cash Payment Commencement Date"), agreed to compensate AMC at the rate of \$8,333 per month for services relating to strategic planning, corporate development, and management of the Company.

### ***Equity Incentive Plan***

The 1996 Equity Incentive Plan (the "Plan") was adopted by the Company on December 19, 1996. It provides for the issuance by the Company of incentive stock options, non-qualified stock options, stock appreciation rights, restricted share grants, unrestricted stock grants and performance awards, loans to participants in connection with awards, supplemental grants and combinations thereof by the Company to employees, directors and consultants with exercise prices ranging between \$4.00 and \$6.00 per share. A total of 777,412 shares of Common Stock are reserved for issuance under the Plan.

### ***Recent Transactions***

#### **Series C Preferred Stock**

On May 21, 1998, the Company issued 100,000 Series C Preferred Shares for an aggregate amount of \$10,000,000. DKBPEP LP purchased 60,000 Preferred Series C Shares for \$6,000,000 and AMC purchased 40,000 Preferred Series C Shares for \$4,000,000.

On September 30, 1999, the Company re-classified the Series C Preferred Shares as 60,000 Series C-2 (non-voting) and 40,000 Series C-1 (voting), respectively, as a result of DKBPEP LP being a regulated entity under Regulation Y of the Board of Governors of the Federal Reserve System. DKBPEP LP has recently transferred its Series C-2 shares to a new entity, Dresdner Kleinwort Benson Private Equity Partners II LP. See Appendix six hereto for a summary of the rights, preferences, privileges, and restrictions applicable to the Series C-1 and C-2 Preferred Stock.

#### **COMPANY NAME Warehouse Facility**

On May, 21, 1998, the Company entered into a loan and security agreement (the "Loan and Security Agreement") with COMPANY NAME SUBSIDIARY. Under the terms of the Loan and Security Agreement, COMPANY NAME agreed to provide the Company with two debt facilities (together, the "COMPANY NAME FACILITY"), a warehouse line of \$75 million that allows the Company to purchase or finance receivables and a warehouse line of \$25 million to finance term loans and receivables. The interest rate applicable to the COMPANY NAME FACILITY is 150 basis points above the one month LIBOR rate published in the Wall Street Journal, adjusted on the first business day of each month. The expiration date for the COMPANY NAME FACILITY is May 21, 2001, but is subject to automatic renewal for one-year periods thereafter unless terminated by either party which requires six months prior written notice.

Pursuant to the Loan and Security Agreement, the Company granted to COMPANY NAME warrants to purchase 594,417 and 118,883 shares of Common Stock at \$0.01 and \$5.00 per share, respectively (the “COMPANY NAME WARRANTS”). The COMPANY NAME WARRANTS expire on May 20, 2005.

The COMPANY NAME FACILITY contain financial and operating covenants, including the requirement that the Company maintain an adjusted tangible net worth of at least \$8.9 million, a total debt to equity ratio of not more than 10.0 to 1, and a 1.25x interest coverage ratio. In addition, under the COMPANY NAME FACILITY, the Company may not incur annual capital expenditures greater than \$800,000 without COMPANY NAME’s consent.

As of September 30, 1999, the Company was not in compliance with all of the covenants under the COMPANY NAME FACILITY. On [ ] COMPANY NAME granted the Company has a specific waiver of noncompliance (the “Waiver”) with the respective covenants for a period of time to allow the Company to offer new capital. (See Appendix 5 for a copy of the Waiver). If the Company does not raise enough capital to bring it within compliance of all covenants, COMPANY NAME may require the Company to change the pace of asset origination, sell assets or raise additional capital to achieve compliance.

#### **Healthcare Capital Resources Limited**

In 1998, the Company purchased 190 Series A Ordinary Shares of HCR-UK (representing 19.2% ownership) for £[ ]. Other investors in the Series A Ordinary Shares include: SMT (260 shares or 26.3%), COMPANY NAME (450 shares or 45.5%) and management (90 shares or 9%). Furthermore, COMPANY NAME and SMT each purchased 80,000 Preference Shares for an aggregate investment of £[ ], which comprised the substantial majority of the economic investment in HCR-UK. The investment in the Preference Shares by SMT was funded by an a 3-year, unsecured, interest-free line of credit facility extended to SMT by HCR in the amount of £500,000, repayable on three months’ notice. In return for providing such facility, HCR received an irrevocable option to acquire, at cost, all of SMT’s ordinary and Preference shares in HCR-UK following a change in control or public listing of HCR-UK’s shares. Pursuant to the transaction, HCR also granted HCR-UK the right to use the name “Healthcare Capital Resources” and similar identifying marks, product names and other intellectual property and agreed to provide managerial, operational, financial and strategic support services.

#### **Advica**

On August 12, 1999 HCR loaned Advica, an affiliate of Dr. Sinclair, \$250,000. On September 15, 1999 HCR loaned Advica an additional \$250,000. The interest rate on these loans is prime plus 2 percent, default pricing is prime plus four percent. To date, both loans are outstanding.

#### **XCare**

On April 26, 1999 HCR loaned Xcare, an affiliate of Dr. Sinclair, \$150,000 at a 12% annual interest rate. As of August 31, 1999 the loan was repaid in full. HCR collected a total of \$5,917.81 in interest

### **1998 Stockholders Agreement**

Pursuant to the Stockholders Agreement dated May 21, 1998, with amendments dated March 24, 1999 and September 30, 1999, the stockholders agreed to (i) set the authorized number of directors on the Board of the Company at a minimum of not less than five or such greater number as determined by the Board (ii) grant the Preferred Series C-1 stockholders to right to elect two Board members (iii) elect Howard Weitzman as Vice Chairman of the Board, as long as he retains a 5% or greater interest in the Company on a fully diluted basis (iv) elect one representative designated by SMP (v) elect two officers of the Company as additional members of the Board (vi) grant the holder of the majority of the COMPANY NAME WARRANTS observer status at Board meetings (vii) restrict the transfer of Company securities, subject to certain rights of first refusal and co-sale, “tagalong” rights and (viii) certain preemptive rights. The 1998 Agreement terminates in the event of a “qualified” public offering.

### ***Dividend Policy***

The Company has never declared or paid a cash dividend on its common stock and it anticipates that all foreseeable future earnings will be retained by the Company to finance the operation and expansion of its business. The Company currently accrues a “paid in kind” dividend of 3.5% on Series C Preferred Stock.

### ***Description of Capital Stock***

The Company is currently authorized to issue 7,500,000 shares of Voting Common Stock, \$0.01 par value per share, of which 1,732,394 shares are issued and outstanding; 1,500,000 shares of Non-Voting Common Stock, \$0.01 par value per share, of which no shares are outstanding; 150,000 shares of Series C-1 Preferred Stock, \$0.01 par value per share, of which there are 40,000 shares issued and outstanding; 90,000 shares of Series C-2 Preferred Stock, \$0.01 par value per share, of which there are 60,000 shares issued and outstanding; and 1,260,000 shares of Serial Preferred Stock, \$0.01 par value per share (the “Serial Preferred Stock”), of which no shares are outstanding.

### **Common Stock**

The holders of Voting Common Stock are entitled to one vote per share on all matters to be voted on by the stockholders. The holders of Non-Voting Common Stock are not entitled to vote their shares except in very narrow circumstances where their rights are adversely affected. Subject to preferences that may be applicable to the outstanding shares of Preferred Stock, the holders of Common Stock (both voting and non-voting) are entitled to receive ratably such dividends as may be declared from time to time by the Board of Directors out of funds legally available therefor. In the event of a liquidation, dissolution, or winding up of the Company, the holders of Common Stock are entitled to share ratably in all assets remaining after payment of liabilities, subject to prior liquidation rights of the Preferred Stock then outstanding. The Common Stock has no preemptive rights or other subscription rights. There are no redemption or sinking fund provisions applicable to the Common Stock.

## **Preferred Stock**

Upon the consummation of the Offering, there will be 2,500,000 shares of New Series D Preferred Stock, \$0.01 par value per share, outstanding (the “Series D”). See Section X Principal Terms of Series D Preferred Stock for a description of the terms thereof. In addition, the Board of Directors, subject to the rights of the Series C and Series D stockholders and COMPANY NAME, has the authority to issue the remaining authorized Serial Preferred Stock in one or more series and to fix the rights, preferences, privileges and restrictions granted to or imposed upon any wholly unissued shares of Serial Preferred Stock and to fix the number of shares constituting any series in the designations of such series, without any further vote or action by the stockholders. The Board of Directors, without Common stockholder approval, can issue Serial Preferred Stock with voting and conversion rights which could adversely affect the voting power of the holders of Common Stock. The issuance of Serial Preferred Stock may have the effect of delaying, deferring or preventing a change in control of the Company. The Company does not currently intend to issue Serial Preferred Stock other than the Series D Preferred Stock. The holders of Series C Preferred Stock have the right to approve the issuance of any class or series of stock having rights or preferences prior to or *parri passu* with the Series C.

## ***Change in Control Provisions***

Certain provisions of the Company's Certificate of Incorporation and Bylaws may have the effect of preventing, discouraging, or delaying any change in the control of the Company and may maintain the incumbency of the Board of Directors and Management. The authorization of Serial Preferred Stock makes it possible for the Board of Directors to issue Serial Preferred Stock with voting or other rights or preferences that could impede the success of any attempt to effect a change in control of the Company.

## ***Indemnification of Directors and Officers and Limitation of Director Liability***

The Company's Certificate of Incorporation contains provisions that eliminate the personal liability of its directors to the fullest extent permitted by Delaware corporate law for monetary damages resulting from breaches of their fiduciary duty. The Certificate of Incorporation also contains provisions requiring the indemnification of the Company's directors and officers to the fullest extent permitted by Delaware corporate law against all losses or liabilities which they may sustain or incur in connection with the execution of the duties of their offices or otherwise in relation thereto. The Company believes that these provisions are necessary to attract and retain qualified persons as directors and officers.

## VIII. HISTORICAL FINANCIAL INFORMATION

The following tables set forth certain consolidated financial data of the Company for the periods indicated. This financial data should be read in conjunction with the Company's consolidated financial statements and notes thereto (for the fiscal years ended 1998, 1997 and 1996) located in Appendix 1 and Appendix 2

COMPANY NAME has not independently verified the information herein and makes no representations as to the accuracy or completeness of the data herein. Furthermore, the operating results and forward looking statements discussed below are not necessarily indicative of the results to be expected for any future fiscal year.

**Table 11: Historical Income Statements**

*(\$ in 000's)*

	<b>Fiscal Year Ended September 30,</b>			<b>Nine Months Ended</b>	
	<b>June 30,</b>				
	<b>1996A</b>	<b>1997A</b>	<b>1998A</b>	<b>1998A</b>	<b>1999A</b>
Revenues:					
Purchase discounts	\$1,554	\$3,735	\$2,674	\$2,234	\$1,571
Discounts on deferred purchase obligations	263	503	252	244	-
Origination fees	331	371	109	90	125
Interest income	309	516	591	470	2,194
Unused commitment line and other fees	6	95	294	72	501
<b>Total Revenues</b>	<b>2,464</b>	<b>5,221</b>	<b>3,919</b>	<b>3,110</b>	<b>4,391</b>
Expenses:					
Selling	\$1,130	\$726	\$1,286	\$649	\$687
General and administrative	1,378	1,758	2,977	1,917	2,258
Interest expense	1,080	2,461	2,195	1,756	2,290
Depreciation and amortization	561	302	658	447	523
Provision for losses on accounts receivable	-	252	1,118	430	-
Charge for conversion of nonvoting to voting common stock	-	485	-	-	-
<b>Total Expenses</b>	<b>4,148</b>	<b>5,984</b>	<b>8,234</b>	<b>5,198</b>	<b>5,757</b>
<b>Net loss before preferred dividends</b>	<b>(1,684)</b>	<b>(763)</b>	<b>(4,315)</b>	<b>(2,088)</b>	<b>(1,366)</b>
Preferred dividends	-	-	(292)	(204)	(263)
Net loss applicable to common shareholders	(1,684)	(763)	(4,606)	(2,292)	(1,629)

**Table 12: Historical Balance Sheets**

(\$ in 000's)

	<u>As of September 30,</u>		<u>As of June 30,</u>
	<u>1997A</u>	<u>1998A</u>	<u>1999A</u>
<b>Assets</b>			
Cash and cash equivalents - unrestricted	\$135	\$2,027	\$665
Cash and cash equivalents - restricted	10,205	3,454	4,113
Accounts receivable purchased, net of allowance for uncollectible accounts	25,403	18,241	22,076
Revolver loans receivable - secured	-	7,696	39,759
Term loans receivable - secured	350	1,950	4,970
Accrued interest income	180	89	675
Capitalized financing fees, net of accumulated amortization	366	1,477	1,061
Loan receivable	75	500	1,217
Furniture, fixtures and equipment, net of accumulated depreciation	84	313	419
Prepaid expenses	80	64	78
<b>Total Assets</b>	<b><u>\$36,879</u></b>	<b><u>\$35,811</u></b>	<b><u>\$75,034</u></b>
<b>Liabilities and Shareholders' Equity</b>			
Liabilities:			
Accounts payable and accrued expenses	\$646	\$2,199	\$1,218
Deferred purchase obligations and other amounts do to providers	7,019	3,091	8,433
Deferred income	109	58	2
Amounts held in escrow for providers	11	-	-
Loan payable to affiliate	500	460	60
Dividends payable	-	117	379
Notes payable	27,500	23,012	59,741
<b>Total Liabilities</b>	<b><u>35,784</u></b>	<b><u>28,937</u></b>	<b><u>69,833</u></b>
Shareholders' Equity:			
Convertible preferred stock, Series C - \$.01 par value; authorized 150,000 shares in 1998, issued and outstanding 100,000 shares in 1998 (liquidation preference of \$10,000,000)	-	1	1
Common Stock - \$.01 par value; authorized 6,000,000 shares; issued and outstanding 1, 732,395 shares in 1998 and 1,722,395 shares in 1997	17	17	17
Additional paid-in-capital	5,049	15,434	15,389
Accumulated deficit	(3,972)	(8,578)	(10,207)
<b>Total Shareholders' Equity</b>	<b><u>1,095</u></b>	<b><u>6,874</u></b>	<b><u>5,201</u></b>
<b>Total Liabilities and Shareholders' equity</b>	<b><u>\$36,879</u></b>	<b><u>\$35,811</u></b>	<b><u>\$75,034</u></b>

**Management Discussion and Analysis****Overview**

HCR is a specialty finance company offering asset-based financing to healthcare providers in target markets where growth, consolidation or restructuring appear likely in the near to medium

term. HCR focuses primarily on small and middle market hospitals, physician services, home healthcare providers, and long-term care providers with financing needs ranging from \$1 million to \$20 million. The Company had 31 clients as of June 30, 1999. The average amount outstanding per client or affiliated client group at June 30, 1999 was approximately \$1.9 million. For the nine month period ending June 30, 1999, the Company's net loss to common shareholders was \$1,628,676, compared to the nine month period ending June 30, 1998, when the net loss was \$2,292,183.

The Company currently provides financing to its clients through (1) revolving lines of credit secured by, and advances against, accounts receivables (the "Accounts Receivable Program"), (2) purchases of accounts receivables (the "Purchase Program"), and (3) term loans secured by first or second liens on real estate, accounts receivables or other assets (the "Secured Term Loan Program" or "ST Program"). Loans generally have terms of three years. ST Program Loans are currently made in conjunction with financing provided under the Accounts Receivable Program, but will be offered as a stand alone product in the next fiscal year. Since inception, the Company has recorded a single loss of \$188,000, related to an uncollectible receivable of the Purchase Program. This amount represented less than 0.3% of the portfolio as of June 30, 1999. However, during July, 1999, the Company specifically provided \$900,000 for possible future losses for a Provider in the Purchase Program, who filed a Chapter 7 petition during the month. Management is uncertain of the financial effect regarding the resolution of this credit at this time. The Company added \$688,000 to its provision for loan losses in the quarter ending September 30, 1998.

### **Financial Information**

The following discussion should be read in conjunction with the consolidated financial statements, including the notes thereto, of the Company.

### **Results Of Operations**

The following discussion compares the financial results of the nine month period ending June 30, 1999 with the corresponding nine month period ending June 30, 1998.

Total fee and interest income increased to \$4.4 million for the nine month period ended June 30, 1999 from \$3.1 million for the nine month period ended June 30, 1998, an increase of 41.2%. This growth resulted principally from an increase of \$26.3 million in average financed receivables outstanding under the Accounts Receivable and ST Programs.

Fee income increased to \$626,000 for the nine month period ended June 30, 1999 from \$161,000 for the nine month period ended June 30, 1998. This increase was attributable to the growth of the financed receivables portfolio mentioned above, as well as to a focus placed by management on other fee income such as collateral management fees, advanced funding fees, and unused line of credit fees in 1999. These fees are recurring in nature, and driven by the volume of outstanding loans.

Interest earned from the Accounts Receivable and ST Programs accounted for the majority of growth in total fee and interest income. Interest income increased to \$2.2 million for the nine month period ended June 30, 1999 from \$470,000 for the nine month period ended June 30,

1998. The overall yields on financed receivables were 13.0% and 22.3% for the nine month periods ended June 30, 1999 and 1998, respectively. This decrease was a result of the Company's focus on the higher dollar volume, lower risk, and therefore lower yield, Accounts Receivable Program as opposed to the Purchase Program.

The Company increased its net client base from 19 clients at June 30, 1998 to 31 clients at June 30, 1999. This net increase resulted from the addition of 18 new clients, replacing 6 clients who had generally maintained smaller average balances. Additionally, existing clients increased their average borrowings with HCR in the nine month period ended June 30, 1999.

Interest expense increased to \$2.3 million for the nine month period ended June 30, 1999 from \$1.8 million for the nine month period ended June 30, 1998. The Company's average cost of borrowed funds decreased to 8.3% for the nine months ended June 30, 1999 from 9.0% for the same period in 1998. This reduction resulted from the utilization of a lower cost credit facility for borrowings related to financed receivables during the nine month 1999 period. The overall increase in interest expense resulted from the higher average borrowed balance required to support the Company's growth.

Net fee and interest income increased 55.2% to \$2.1 million for the nine month period ended June 30, 1999 from \$1.4 million for the nine month period ended June 30, 1998. The lowered yield on financed receivables was offset by the lowered average cost of funds.

The Company's provision for losses on receivables increased to \$995,000 for the nine month period ended June 30, 1999 from \$392,000 for the nine month period ended June 30, 1998. This increase was attributable to the volume growth of the Company's financed receivables and a higher average client balance. The Company experienced only minimal credit losses in the nine month periods ended June 30, 1999 and 1998, respectively.

As a result of HCR's growth, operating expenses increased to \$3.5 million for the nine month period ended June 30, 1999 from \$3.0 million for the nine month period ended June 30, 1998, a 15.1% increase. This increase was comprised of a 20.9% increase in compensation and benefits, a 483.2% increase in consulting fees, and a 277.9% increase in data processing fees.

Direct expenses incurred by the Company as a result of processing financed receivables are expensed as incurred. Beginning in fiscal 1998, origination fees received by the Company are netted against any brokers' fees incurred by HCR, capitalized, and amortized over the life of the transaction.

The net loss to common shareholders decreased by 28.9% to \$1.6 million for the nine month period ended June 30, 1999 from \$2.3 million for the nine month period ended June 30, 1998. The improved results are primarily attributable to the overall growth in the Company's financed receivables as discussed above.

### **Liquidity and Capital Resources**

The most significant sources of operating cash flow are HCR's interest income, purchase discounts, and various fees from financed receivables. The most significant operating uses of

cash include cash payments for compensation and employee benefits, rent expense, and other administrative expenses.

The Company's financing has been obtained from both debt and equity sources. HCR has a \$75 million revolving line of credit and a \$25 million with COMPANY NAME SUBSIDIARY. As of June 30, 1999, \$59.7 million was outstanding under the COMPANY NAME FACILITY. The interest rate applicable to the COMPANY NAME FACILITY is 150 basis points above the one month LIBOR rate published in the Wall Street Journal, adjusted on the first business day of each month. In May 1998, 100,000 shares of Series C Preferred Stock were sold to private investors raising \$9.8 million, net of expenses.

The COMPANY NAME FACILITY contains financial and operating covenants, including the requirement that the Company maintain an adjusted tangible net worth of at least \$8.9 million, a total debt to equity ratio of not more than 10.0 to 1, and a 1.25x interest coverage ratio. In addition, under the COMPANY NAME FACILITY the Company may not incur annual capital expenditures greater than \$800,000 without COMPANY NAME's consent. As of June 30, 1999, the Company was not in compliance with all of its covenants under the COMPANY NAME FACILITY. On TBD COMPANY NAME granted the Company has a specific waiver of noncompliance (the "Waiver") with the respective covenants for a period of time to allow the Company to offer new capital. The expiration date for the COMPANY NAME FACILITY is May 21, 2001, but is subject to automatic renewal for one- year periods thereafter unless terminated by either party which requires six months prior written notice.

The COMPANY NAME FACILITY requires the Company to transfer advances and related receivables under its financed receivables programs which meet certain criteria to a special purpose subsidiary of HCR. The special purpose subsidiary pledges the financed receivables to COMPANY NAME SUBSIDIARY. COMPANY NAME then lends against such pledged assets through the issuance of commercial paper. The COMPANY NAME FACILITY generally require the maintenance of a minimum overcollateralization percentage of 1.25x.

### **Interest Rate Sensitivity**

HCR's interest rate sensitivity is the difference between the yield on the Company's portfolio and HCR's cost of funds resulting from movements in interest rates. To the extent that interest income and interest expense do not respond equally to changes in interest rates, or that interest rates do not change uniformly, HCR's earnings are affected.

The interest rate charged by HCR on revolving lines of credit secured by accounts receivables adjusts based upon changes in the prime rate and LIBOR. The interest rate charged by the Company on term loans also generally adjusts based on the prime rate or LIBOR. Fees charged by HCR on advances against accounts receivables are determined at the time of the advance.

As mentioned above, the interest rate HCR pays under the COMPANY NAME FACILITY adjusts based upon LIBOR. Because the Company funds most of its financed receivables activity through the COMPANY NAME FACILITY, HCR is exposed to a certain amount of interest rate risk. Interest income from advances to Providers fluctuates with changes in the prime rate as well as with changes in LIBOR whereas interest expense is dependent solely on LIBOR movements.

## **Inflation**

Inflation has not had a significant effect upon the Company's operating results to date.

## **Year 2000**

HCR has successfully tested all software presently in use, significant to day to day operations, to ensure that its systems can effectively manage the Year 2000 transition. The Company does not anticipate that the Year 2000 transition will have a material effect on its own operations. However, the Company is aware that some of its clients' and payors' systems may not be compliant. The failure by clients and payors to implement necessary software changes may disrupt clients' computerized billing and collection systems and adversely affect clients' cash flow and the collectibility of HCR's financed receivables. The Company is unable to predict the effects that any such failure may have on the financial condition and results of operations of the Company. HCR has developed a contingency plan for any disruption in the computerized billing and collection systems of the Company's borrowers and their respective Third-Party Payors.

In addition, the Company may be subject to general economic disruptions stemming from problems related to Year 2000 computer issues. Such circumstances may unfavorably affect the manner in which the Company presently conducts its business and, in turn, may negatively affect the Company's operating results.

## IX. PROJECTED FINANCIAL AND OPERATING DATA

Management has prepared the following projections of the Company's operating performance for the fiscal years ending September 30, 1999, 2000, and 2001. The projections are based on estimates and assumptions that may or may not be realized and are subject to significant uncertainties and contingencies. The actual results achieved, therefore, may materially vary from the projections. COMPANY NAME has not independently verified the information contained herein and make no assurances as to the accuracy or completeness of the data. A discussion of the assumptions underlying these projections follows the financial statements. Risks related to the Company and its prospects which may affect the projections include those under the heading "Risk Factors."

**Table 13: Projected Summary Income Statement**

	<b>Fiscal Year Ended/Ending September 30,</b>			
	<b>1998A</b>	<b>1999E</b>	<b>2000P</b>	<b>2001P</b>
<i>(\$ in 000's)</i>				
Revenues:				
Purchase Discounts	\$2,674	\$1,894	\$1,847	\$1,901
Discounts on deferred purchase obligations	252	-	-	-
Origination Fees	109	196	544	1,304
Interest Income	591	3,371	11,473	34,950
Unused commitment line and other fees	294	629	1,785	4,660
<b>Total Revenues</b>	<b>3,919</b>	<b>6,090</b>	<b>15,649</b>	<b>42,815</b>
Expenses:				
Selling	1,286	980	1,756	2,263
General & Administrative	2,977	3,303	2,839	1,686
Interest Expense	2,195	3,210	7,541	20,924
Depreciation and Amortization	658	701	1,356	2,057
Provision for Losses on accounts receivable	1,118	1,190	2,458	4,808
<b>Total Expenses</b>	<b>8,234</b>	<b>9,382</b>	<b>15,950</b>	<b>31,739</b>
<b>Net Income/(Loss)</b>	<b>(\$4,315)</b>	<b>(\$3,293)</b>	<b>(\$301)</b>	<b>\$11,076</b>
Preferred Dividends	(292)	(642)	(992)	(1,342)
Net Income/(Loss) applicable to common shareholders	(4,606)	(3,934)	(1,292)	9,735

**Table 14: Projected Summary Balance Sheet**

(\$ in 000's)

	<b>Fiscal Year Ended/Ending September 30,</b>			
	<b>1998A</b>	<b>1999E</b>	<b>2000P</b>	<b>2001P</b>
<b>Assets</b>				
Cash and cash equivalents - unrestricted	\$2,027	\$750	\$750	\$750
Cash and cash equivalents - restricted	3,454	2,607	2,000	2,000
Accounts receivable purchased	18,241	15,894	16,652	16,652
Revolver loans receivable - secured	7,696	40,322	129,294	271,005
Term loans receivable - secured	1,950	3,298	28,067	67,461
Leasing Product	-	-	24,781	64,188
Acquired Portfolios	-	-	-	49,750
Specific Reserves for Non-performing Assets	-	(970)	(2,040)	(3,109)
Accrued Interest Income	89	952	2,226	4,823
Capitalized financing fees	1,477	923	2,244	2,963
Loan Receivable	500	1,261	1,346	1,346
Furniture, fixtures and equipment	313	408	386	340
Inv in e-HealthContinuum.com	-	13	662	662
Goodwill	-	-	-	933
Prepaid expenses	64	63	64	23
<b>Total Assets</b>	<b>\$35,811</b>	<b>\$65,520</b>	<b>\$206,434</b>	<b>\$479,786</b>
<b>Liabilities &amp; Stockholders' Equity</b>				
<b>Liabilities:</b>				
Accounts payable and accrued expenses	\$2,199	\$1,635	\$3,176	\$6,717
Deferred purchase obligations and other amounts due to provide	3,091	3,162	4,241	5,780
Deferred income	58	5	86	204
Amounts held in escrow for providers	-	-	-	-
Loan payable to affiliate	460	-	-	-
Dividends payable	117	467	817	1,167
Notes payable	23,012	57,065	170,578	402,656
<b>Total Liabilities</b>	<b>28,937</b>	<b>62,334</b>	<b>178,898</b>	<b>416,524</b>
<b>Total Stockholders' equity:</b>	<b>6,874</b>	<b>3,187</b>	<b>27,536</b>	<b>63,262</b>
<b>Total Liabilities &amp; Stockholders' Equity</b>	<b>\$35,811</b>	<b>\$65,520</b>	<b>\$206,434</b>	<b>\$479,786</b>

## *Assumptions underlying Projected Financial and Operating Data*

**Forecast Assumptions** - The Company's Earning Asset Portfolio (the "Portfolio") is the key driver of both revenues and direct expenses. Operating expenses reflect both the forecasted size of the Portfolio as well as management's estimates based upon historical results and current market conditions.

Management has based the Portfolio projections based upon numerous factors including, but not exclusively to, the overwhelming size of the industry and its fragmented nature, management's knowledge and experience and the addition of new sales and underwriting personnel.

**Portfolio Composition** - The Company's Portfolio will be divided into the following product lines:

- Revolver Product (or "AR Program")
- Purchase Product (or "Purchase Program")
- Term Loan Product (or "ST Program")
- Equipment Leasing Product

The Company also plans to acquire portfolios in similar lines of business.

**Revolver Product** - The AR Program has become, and will continue to be, HCR's primary product line. The AR Program has grown from \$8 million in outstanding client balances in September 1998 to \$41 million as of September 30, 1999. Management expects to originate \$90 million in new loans, net of repayments, in fiscal 2000. Furthermore, management expects that HCR will originate \$12 million in new loans, net of repayments, per month in fiscal 2001, resulting in \$144 million increase in the revolver portfolio.

**Purchase Product** - Due to its complicated and expensive legal and operating structure, the Purchase Program is no longer HCR's principal product line. While management does not plan to emphasize this product in marketing and sales initiatives, HCR will maintain the Purchase Program in order to meet the specific needs of selected customers. The Purchase Program is projected to increase moderately from \$14.4 million as of September 31, 1999 to \$15.0 million as of October 31, 1999, net of DPO, and remains constant going forward.

**Term Loan Product** - HCR traditionally has not had a stand alone term loan product. Previously, term loans were done to accommodate the particular needs of individual clients with established Purchase or Revolver relationships with the Company. Going forward, HCR expects to aggressively market term loans as an separate line of business and expects to hire an underwriter specializing in real estate and term loan transactions to assist in this effort. Based upon market research and Provider feedback, management believes the Company will be able to originate \$25 million and \$40 million in term loans during fiscal 2000 and 2001, respectively.

**Equipment Leasing Product** - HCR plans to hire an underwriter specializing in equipment leasing and aggressively launch this new product line. Based upon management's extensive experience and thorough market research, management expects to originate \$25 million and \$40 million in equipment leasing loans in fiscal 2000 and 2001, respectively.

**Acquired Portfolios** - The Company foresees numerous opportunities to purchase portfolios of companies engaged in similar lines of business as HCR. The Company plans to capitalize on these opportunities to seamlessly add new assets to its already existing infrastructure. This strategy will leverage HCR's investments in technological infrastructure and back office operations. Management expects to finalize a portfolio purchase of \$50 million by January 2000.

#### **Other Balance Sheet Assumptions – Assets**

**Bad Debt Reserves** - The Company estimates that both general and specific bad debt reserves will total approximately 2% of the Portfolio.

**Fixed Assets** - The Company has made significant investments in hardware, systems and internally generated software. These investments have created the infrastructure necessary to support HCR's forecasted growth. The Company believes that its technological sophistication will allow HCR to expand its Provider base and product offerings with minimal maintenance expenditures. Fixed assets are assumed to have a useful life of five years and are depreciated on a straight-line basis accordingly.

**Capitalized Financing Fees** - The Company is currently capitalizing all up front financing costs related to the COMPANY NAME Warehouse Facility on a straight line basis over the three year term of the financing. Going forward, the Company has assumed this will continue to be the case for up front costs of equity and debt financings. The projections assume all inclusive costs of 8% of equity funds raised and 1% costs for debt financings. New issuances of debt are forecasted to be completed in \$100 million tranches.

**Loan to SMT (HCR Ltd.)** - The Company has agreed to lend Sinclair Montrose Trust Ltd. ("SMT") funds periodically to facilitate SMT's investment in HCR Ltd. (UK). HCR expects to receive no interest or principal payments over the next three years.

**Loans – Advica** - The Company has advanced \$500,000 to one related entity. The Company has forecasted no interest or principal payments over the two year term of the forecast.

**Goodwill** - The Company has assumed it will be necessary to pay a premium of 2% over book value to acquire a portfolio in a similar line of business in January 2000. The premium is recorded as goodwill and amortized on a straight-line basis over 10 years.

#### **Other Balance Sheet Assumptions – Liabilities and Equity**

**Accounts Payable and Accrued Expenses** - For cash flow purposes, it was assumed that cash expenditures for expenses would grow proportionately with the size of the company relative to the Portfolio (i.e. A/P turnover remains consistent with its current level).

**Accrued Taxes Payable** - Income taxes will not begin accruing until the Company has fully utilized its prior period Net Operating Losses (NOLs). The Company does not expect to incur any tax liability over the two year term of the forecast.

**Dividends Payable** - Dividends on the Series C Preferred Stock will continue to accrue but will not be paid in cash for the term of the forecast.

**Deferred Purchase Obligations** - Deferred Purchase Obligations, represent the Company's interest in the over-collateralization of the receivables financed under the Company's Purchase Program. Based upon the Company's advance rate, DPO's should be approximately 15% of the Gross Purchased Product. The forecast utilizes the 15% ratio.

**Due to Providers** - Funds due to Providers are collected on behalf of clients who have already repaid their loans to HCR. However, the Company often holds these funds as a reserve against unanticipated expenditures on behalf of the provider. This amount is usually immaterial and is forecasted to be zero.

**Deferred Income** - Deferred income represents fees that have been collected, but not yet recorded as income. This income is usually immaterial, but may increase slightly as the Portfolio grows.

**Deferred Purchase Discounts** - The Company's Purchase Program generates income by charging a discount on each batch of accounts receivables purchased. Income is not recognized until the receivables are collected, or is recognized gradually over the life of the receivables. Since the Company tracks these receivables on a batch basis, it can be difficult to match income with specific receivables. However, on average these receivables turnover in 60 days or less. Therefore, the Company no longer feels it is necessary to amortize this income given its short-term nature.

**Deferred Origination Fees** - Origination fee income is amortized on a straight-line basis over the life of the loan. The average life of future loans is projected to be three years.

**COMPANY NAME Warehouse Facility** - This facility totals \$100 million and matures in May 2001. The interest payable on this facility is 150 basis points above LIBOR. There is an unused facility cost of 50 basis points. The up-front costs of this line are amortized over the three year life of the line.

**Other Debt Funding** - The forecast assumes additional debt financing will be completed in \$100 million increments. The cost of these funds is expected to be 175 basis points above LIBOR. The up-front costs are expected to total 0% of the commitment, and will be amortized over three years.

**Newly Paid-in-Capital** - Newly Paid-in-Capital represents the gross proceeds of the private placement of equity. Newly Paid-in-Capital is assumed to be \$25 million

### **Income Statement Assumptions**

**Revenues** - Revenues are broken down into three sections: (1) the "Current Earning Asset Portfolio", (2) the "Forecasted Earning Asset Portfolio" and (3) other Income. The Current Portfolio assumes that yields will remain consistent with their current levels. The Forecasted Portfolio assumes higher yields, as management feels HCR will be able to price new transactions more aggressively. However, the yields on the Revolver and Term Loan products in the Forecasted Portfolio are projected to be reduced by 25 basis points annually. Other income is forecasted to be a percentage of the portfolio. Advanced funding fees and expense reimbursements are based upon the Company's historical experience. Due diligence fee income

has been set to reflect the Company's intention to make the due diligence function a profit center, to mirror the competition.

**Direct Expenses** - All direct expenses, except interest expense and commitment fees, have been forecasted as percentage of the Portfolio based on the Company's historical experience. Interest expense and commitment fees are based on the applicable interest rates and unused facility fees stated previously.

**Operating Expenses** - All operating expenses, except salaries, taxes and benefits, are based upon the Company's experience and historical costs with minimal increases to reflect inflation. These expenses do not grow with the size of the Portfolio, as the Company believes it will be able to pass on a substantial amount of the incremental costs to the customer. Salaries are based on management's opinion of what will be necessary to support the Portfolio growth (see salary assumptions page of forecast for details). Taxes and benefits are a percentage of salaries based on Company history.

## **X. PRINCIPAL TERMS OF NEW SERIES D PREFERRED STOCK**

### **Healthcare Capital Resources, Inc. \$25,000,000 New Series D Convertible Preferred Stock October 1999**

<b>Issuer:</b>	Healthcare Capital Resources, Inc. ("HCR" or the "Company")
<b>Type of Security:</b>	New Series D Convertible Preferred Stock (the "Preferred Stock")
<b>Gross Proceeds:</b>	\$25 million
<b>Use of Proceeds:</b>	To finance anticipated growth, make strategic acquisitions, enhance the Company's marketing activities, continue the development of additional technology-based service offerings, and for general corporate purposes.
<b>Issue Price:</b>	To be determined
<b>Number of Shares:</b>	To be determined
<b>Proposed Capitalization:</b>	Please refer to Section II of the Private Placement Memorandum
<b>Purchasers:</b>	The Series D Purchasers are collectively referred to as the "Purchasers"
<b>Convertibility:</b>	<p>The Purchasers will have the right to convert, at any time, all or any portion of such Preferred Stock into shares of Voting Common Stock at the Conversion Rate, as defined below. If the Company conducts a Qualified Initial Public Offering ("IPO") of its shares of Voting Common Stock, the Company may, at its option, force the conversion of all the issued and outstanding Preferred Stock into shares of Voting Common Stock at the applicable conversion price.</p> <p>For purposes of this transaction, a Qualified IPO shall be defined as a public offering (as defined by the Securities Act) of the Company's Voting Common Stock on a firm commitment basis by an underwriter reasonably acceptable to the Purchasers. The Qualified IPO must result in at least \$25 million in gross proceeds to the Company. The offering price of the Company's Common Stock in the Qualified IPO must be in excess of 2.0x the then applicable Conversion Price of the Preferred Stock.</p>
<b>Conversion Rate:</b>	The Conversion Rate of the Preferred Stock shall be equal to \$[ ] (the original cost) plus all accumulated and unpaid dividends divided by the Conversion Price. The Conversion Price will be \$[ ] per share subject to possible adjustment due to stock dividends, splits, sales of Common Stock at less than the applicable Conversion Price and other standard anti-dilution provisions.
<b>Dividend:</b>	To be determined
<b>Liquidation Value:</b>	Original issue price plus any accumulated and unpaid dividends or, if greater, the amount otherwise payable on an "as if" converted basis.

**Liquidation Preference:** In the event of a liquidation of the Company, proceeds available to the shareholders will be distributed first to all of the Preferred Shareholders, parri passu, to the extent of the aggregate liquidation preference of the outstanding Preferred Shares, and then to the Common Shareholders on a share for share basis.

**Sale of the Business:** If, prior to a Qualified IPO, a majority or more of the Company's business is sold (whether by stock or assets), the holders of the Preferred Stock shall be entitled to receive as a liquidation preference, an amount equal to the Liquidation Value as provided above.

**Optional Redemption:** Subject to applicable Delaware law, each holder of Preferred Stock has the option to require the Company to redeem all or any portion of its Preferred Stock five years from the closing of the Preferred Stock or sooner, upon the occurrence of certain specified loan defaults by the Company. The redemption price is the greater of the Liquidation Value or the fair value of the shares calculated on an as-converted basis.

**Voting:** The Preferred Stock shall be entitled to the number of votes per share equal to the number of shares of Common Stock then issuable upon conversion of such Preferred Stock on all matters to be voted on by the stockholders. In addition, until more than two thirds of the Preferred Stock has been converted into Common Stock or redeemed, the holders of the Preferred Stock, voting separately as one class, shall have the right to elect one Director to the Board.

**Protective Provisions:** Until more than two-thirds of the Preferred Stock has been converted into Common Stock or redeemed, the holders of the Preferred Stock will vote as a single class on:

1. any matter which amends or repeals any provision of the Company's Articles of Incorporation or By-laws if such action would adversely affect the rights, preferences or privileges of the Preferred Stock;
2. any matter which creates any new class or series of shares or any term debt having rights or privileges senior to or parri passu with the Preferred Stock;
3. any matter which results in the redemption of any shares of any series of preferred stock or common stock;
4. the declaration or payment of any dividend or other distribution; and
5. a sale or merger of the Company for less than 2.0x times the then applicable Conversion Price of the Preferred Stock or for a consideration payable in securities;

**Registration Rights:** Registrable Stock means Common Stock issued or, if applicable, Common Stock issuable upon conversion of Preferred Stock or the exercise of warrants issued to COMPANY NAME in connection with the loan Facility.

Holders of Registrable Stock shall be entitled during the 18 month period after the earlier of (i) November [ ], 2002 or (ii) the initial public offering of the Company's Common Stock, to require the Company, on demand, to effect one public registration of the Company's Common Stock and listing

thereof on the New York Stock Exchange, NASDAQ or any other stock exchange mutually agreed upon by the Company and such holders.

The holders of Registrable Stock shall also have certain “piggyback” registration rights.

The Company, including the fees and expenses of one counsel for the holders of the Registrable Stock, will pay all expenses in connection with the registration (other than underwriting discounts and selling commissions).

**Board of Directors:**

The Board shall consist of a minimum of not less than six directors or such greater number as established from time to time by resolution of the Board. Currently, the Board consists of five directors. The holders of the new Series D Preferred Stock shall have the right to elect one director to the Board.

**Rights of First Offer, Tag-Along Rights, Preemptive Rights:**

The Purchasers will be granted customary rights of first offer, tag-along rights and preemptive rights.

**Restrictions on Stock Transfers:**

So long as the Preferred Stock is unregistered, any transfer by a Purchaser, except in certain conditions, is subject to a right of first offer on the part of the other principal stockholders and certain other restrictions prohibiting transfers to competitors of the Company.

**Information Rights:**

The Company shall furnish the Purchasers with information and materials related to the operation and management of the Company, including but not limited to: (i) quarterly management accounts, (ii) annual audited financial statements and (iii) any other information that the Purchasers may from time to time reasonably request.

## **XI. APPENDICES**

**Appendix 1 – Financial Statements for the Fiscal Years Ended September 31, 1998 and 1997**

**Appendix 2 – Financial Statements for the Fiscal Years Ended September 31, 1997 and 1996**

**Appendix 3 – Financial Statements for the Nine-Month Periods Ended June 30, 1998 and 1997**

**Appendix 4 – Selected Company Press Releases and Marketing Materials**

**Appendix 5 – Waiver of Noncompliance on COMPANY NAME FACILITY**

**Appendix 6 – Principal Terms of Series C Preferred Stock**