MEDCOM USA INC
Form 10QSB
November 12, 2004

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U.S. Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-QSB

(Mark One)
[X] Quarterly Report Pursuant to Section 13 or 15(D) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2004.

[ ] Transition Report Pursuant to Section 13 or 15(D) of the Securities Exchange Act

For the transition period from N/A to N/A

Commission File No. 0-25474

MEDCOM USA, INCORPORATED
(Name of small business issuer as specified in its charter)

DELAWARE	65-0287558
State of Incorporation	IRS Employer Identification No.

7975 NORTH HAYDEN ROAD, SUITE D-333
SCOTTSDALE, AZ 85258
(Address of principal executive offices)

(480) 675-8865
(Issuer's telephone number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

The number of shares of the issuer's common equity outstanding as of October 27, 2004 was 50,957,995 shares of common stock.

Transitional Small Business Disclosure Format (check one):

Yes No X

MEDCOM USA, INC.
INDEX TO FORM 10-QSB FILING
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2004

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

MEDCOM USA, INC.
BALANCE SHEET (UNAUDITED)
AS OF SEPTEMBER 30, 2004

ASSETS:
CURRENT ASSETS

Cash	$ 81,194
Accounts receivable, net of allowance of $35,257.	476,337
Accounts receivable - affiliate	784,630
Inventories	609,634

Prepaid expenses and other current assets	71,574
Total current assets	2,023,369
PROCESSING TERMINALS, net	3,835,580
PROPERTY AND EQUIPMENT, net	390,429
GOODWILL, net of accumulated amortization of $322,575	436,423
OTHER ASSETS	87,657
TOTAL ASSETS	$ 6,773,458
LIABILITIES AND STOCKHOLDERS' EQUITY:	
CURRENT LIABILITIES:	
Accounts payable	$ 357,812
Accrued expenses and other liabilities	606,133
Dividend payable	23,750
Notes payable - current	109,437
Deferred revenue - current portion	1,411,447
Reserve for sales returns	40,270
Capital lease obligations - current portion	1,605,973
Total current liabilities	4,154,822
CAPITAL LEASE OBLIGATIONS - long-term portion	3,494,814
DEFERRED REVENUE	1,685,460
Total liabilities	9,335,096
STOCKHOLDERS' EQUITY:	
Convertible preferred stock, Series A $.001par value, 52,900 shares designated, 4,250 issued and outstanding	4
Convertible preferred stock, Series D $.01par value, 50,000 shares designated, 2,850 issued and outstanding	29
Common stock, $.0001 par value, 80,000,000 shares authorized, 51,924,665 issued and 51,737,678 outstanding	5,194
Subscriptions receivable	(500,000)
Treasury stock	(37,397)
Paid in capital	72,672,929
Accumulated deficit	(74,702,397)
Total stockholders' equity	(2,561,638)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 6,773,458

See the accompanying notes to these unaudited financial statements.

MEDCOM USA, INC.
STATEMENT OF OPERATIONS (UNAUDITED)
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003.

	Three Months Ended 2004	2003
REVENUES:		
Terminal sales	$ 156,366	$ 88,626
Service	428,703	314,437
Equipment lease	286,403	235,115
	871,472	638,178
COST OF SALES AND SERVICE:	179,850	28,233
GROSS PROFIT	691,622	609,945
OPERATING EXPENSES:		
General and administrative	933,075	797,255
Sales and marketing	292,299	261,553
Professional and consulting fees	110,400	30,000
Royalties	26,621	34,353
Depreciation and amortization	362,389	382,632
Total operating expenses	1,724,784	1,505,793
OPERATING LOSS	(1,033,162)	(895,848)
OTHER (INCOME) AND EXPENSES		
Interest expense	200,102	220,928
Other income	(9,402)	(202,984)
Loss on disposal of assets	25,016	-
Total other expense	215,716	17,944
NET LOSS	(1,248,878)	(913,792)
Preferred stock dividend	-	-
TOTAL NET LOSS AVAILABLE TO COMMON SHAREHOLDERS	$(1,248,878)	$ (913,792)
NET LOSS PER SHARE:		
Basic:	$ (0.03)	$ (0.02)
Diluted:	$ (0.03)	$ (0.02)
Weighted Average Common Shares Outstanding		
Basic	49,812,487	37,392,878
Diluted	49,812,487	37,392,878

See the accompanying notes to these unaudited financial statements.

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MEDCOM USA, INC.
STATEMENT OF CASH FLOWS (UNAUDITED)
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss)	$(1,248,878)	$ (913,792)
Adjustments to reconcile net income to net cash (used in) operating activities:		
Depreciation and amortization	362,389	382,632
Issuance of common stock as compensation for services	96,400	-
Loss on disposal of assets	25,016	-
Changes in assets and liabilities:		
Trade accounts receivable	(193,034)	7,679
Inventories	112,109	(42,176)
Prepaid and other current assets	17,649	(12,727)
Other assets	(70,000)	-
Accounts payable and accrued liabilities	35,115	(205,781)
Deferred revenue	(286,403)	(235,115)
Net cash (used) in operating activities:	(1,149,637)	(1,019,280)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property & equipment	(116,187)	(25,793)
Net repayments of advances to affiliate	635,599	107,674
Net cash provided by investing activities:	519,412	81,881
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal repayments on capital leases	(359,684)	(255,933)
Proceeds from sale of common stock	623,450	300,000
Proceeds from capital sale-leaseback transactions	361,032	874,868
Net cash provided by financing activities	624,798	918,935
INCREASE (DECREASE) IN CASH	(5,427)	(18,464)
CASH, BEGINNING OF PERIOD	86,621	54,460
CASH, END OF PERIOD	$ 81,194	$ 35,996
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$ 212,582	$ 167,698
Income taxes paid	-	-

SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:

Terminals capitalized under sales/leaseback transactions	$ 334,671	$ 1,034,862
Terminals returned and placed back into inventory at net capitalized cost	$ 55,625	$ 309,275

See the accompanying notes to these unaudited financial statements.

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MEDCOM USA, INC.
NOTES TO FINANCIAL STATEMENTS
INTERIM PERIODS ENDED SEPTEMBER 30, 2004

1. BASIS OF PRESENTATION

The accompanying unaudited financial statements represent the financial position of Medcom USA, Inc. ("Company") as of September 30, 2004 and includes results of operations of the Company for the three months ended September 30, 2004 and September 30, 2003 and cash flows for the three months ended September 30, 2004 and September 30,2003. These statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions for Form 10-QSB. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles ("GAAP") for complete financial statements. In the opinion of management, all adjustments to these unaudited financial statements necessary for a fair presentation of the results for the interim period presented have been made. The results for the three months ended September 30, 2004 may not necessarily be indicative of the results for the entire fiscal year. These financial statements should be read in conjunction with the Company's Form 10-KSB for the fiscal year ended June 30, 2004, including specifically the financial statements and notes to such financial statements contained therein.

Accounting Policies and Estimates

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires our management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. As such, in accordance with the use of accounting principles generally accepted in the United States of America, our actual realized results may differ from management's initial estimates as reported. A summary of significant accounting policies are detailed in notes to the financial statements which are an integral component of this filing.

Cash and Cash Equivalents

Cash and cash equivalents include all short-term liquid investments that are readily convertible to known amounts of cash and have original maturities of three months or less. At times cash deposits may exceed government insured limits.

Concentration of Credit Risk

The Company maintains its operating cash balances in banks in Islandia, New York, and in Scottsdale, Arizona. The Federal Depository Insurance Corporation (FDIC) insures accounts at each institution up to $100,000.

Inventories

Inventories are carried at the lower of cost or market on a first-in first-out basis. The Company purchases hardware from its supplier and records inventory at its original cost. Inventory terminals are sometimes returned by customers, and if these units have been sold and repurchased under sale-leaseback transactions, the Company records the returned inventory units at the amortized capitalized cost under the sale-leaseback arrangements. The capitalized costs under the sale-leaseback transactions are substantially greater than the original purchase price from the supplier. Management believes that all such units returned to-date are recorded at costs less than what they can be resold. Therefore, no impairment of carrying value is recorded.

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Property and Equipment

Property and equipment is stated at cost less accumulated depreciation. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets ranging from 3 to 5 years. The Company's leaseback transactions of processing terminals to healthcare providers are generally for a period of 48 to 60 months. Depreciation expense for the leased terminal assets are on the straight-line method over the term of the lease in amounts necessary to reduce the carrying amount of the terminal asset. Estimated and actual residual values are reviewed on a regular basis to determine that depreciation amounts are appropriate.

Assets Held under Capital Leases

Assets held under capital leases are recorded at the lower of the net present value of the minimum lease payments or the fair value of the leased asset at the inception of the lease. Amortization expense is computed using the straight-line method over the shorter of the estimated useful lives of the assets or the period of the related lease.

Amortization of Leasehold Improvements

Amortization of leasehold improvements is computed using the straight-line method over the shorter of the remaining lease term or the estimated useful lives of the improvements.

Revenue Recognition

The Company recognizes income on monthly service and transaction fees it charges to customers in the month in which the service is provided. Income on sale-leaseback transactions is deferred and recognized over the tem of the leaseback. Management has determined that the sale-leaseback transactions are capital leases.

Customers may return terminals under certain terms outlined in the rental agreements. Generally, customer returns do not affect previously recognized revenue in that rental/service and transaction fee income is recognized as the customer utilizes the terminal. When a customer terminates service, the billing process ceases and the terminals are returned and placed into inventory.

Income Taxes

Management evaluates the probability of the utilization of the deferred income tax assets. The Company has estimated a $23,652,000 deferred income tax asset at September 30, 2004. Of that amount, $20,281,000 related to net operating loss carry-forwards at September 30, 2004. Management determined that because the Company has not yet generated taxable income it was not appropriate to recognize a deferred income tax asset related to the net operating loss carry-forward. Therefore, a fully deferred income tax asset is offset by an equal valuation allowance. If the Company begins to generate taxable income, management may determine that some, if not all of the deferred income tax asset may be recognized. Recognition of the asset could increase after tax income in the future. Management is required to make judgments and estimates related to the timing and utilization of net operating loss carry-forwards, utilization of other deferred income tax assets, applicable tax rates and feasible tax planning strategies.

Fair Value of Financial Instruments

Financial instruments consist primarily of accounts receivable, and obligations under accounts payable, accrued expenses, capital lease obligations and notes payable. The carrying amounts of accounts receivable, accounts payable, accrued expenses and notes payable approximate fair value because of the short maturity of those instruments. The carrying value of the Company's capital lease arrangements approximates fair value because the instruments were valued at the cost of the equipment at the time the Company entered into the arrangements. The Company has applied certain assumptions in estimating these fair values. The use of different assumptions or methodologies may have a material effect on the estimates of fair values.

Net Loss Per Share

Net loss per share is calculated using the weighted average number of shares of common stock outstanding during the year. The Company has adopted the provisions of Statement of Financial Accounting Standards No. 128, Earnings Per Share.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. This may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Stock-Based Compensation

Statements of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, ("SFAS 123") established accounting and disclosure requirements using a fair-value based method of accounting for stock-based employee compensation. In accordance with SFAS 123, the Company has elected to continue accounting for stock based compensation using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees."

Intangible Assets

Goodwill was recognized in the Company's acquisition of Medcard. Since that time, the Company has divested of all other business segments. Management believes that there is no impairment of the carrying value of $436,000 at September 30, 2004. Management believes that there is sufficient evidence that the Company will generate operating income and operating cash flows. Also, management believes that there is substantial value in its proprietary software.

Research and Development Expenditures

Research and development costs are expensed as incurred.

Impairment of Assets

The Company performs an assessment of impairment of long-lived assets periodically whenever there is an indication that the carrying amount of the asset may not be recoverable. Recoverability of these assets is determined by comparing the forecasted undiscounted cash flows generated by those assets to the assets' net carrying value. The amount of impairment loss, if any, is measured as the difference between the net book value of the assets and the estimated fair value of the related assets.

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2. TERMINALS AND SALE-LEASEBACK TRANSACTIONS

The Company capitalizes the value of the point of sale terminals that are sold under capital sale-leaseback transactions. The terminals are purchased from third party vendors and are recorded as inventory at that time. The Company enters into sale and service agreements with its customers at which time the terminal is programmed with the Company's proprietary software and installed with the customer. Many of those terminals are the basis for the sale-leaseback transactions. The terminals are capitalized at the value determined by the lessor on the basis of the cash flow under the terms of the sale and service agreements with the customers.

Terminals	$6,219,177
Less accumulated amortization	(2,383,597)
Terminals, net	$3,835,580

During the three months ended September 30, 2004, the Company entered into capital lease obligations under sale-leaseback transactions totaling $369,500. The total gain realized on those transactions was $87,700 for the three months ended September 30, 2004.

3. SUBSCRIPTIONS RECEIVABLE

The Company is obligated to issue shares of its common stock for those that have subscribed for stock, however final payment has not been received. As of September 30, 2004, the amount of subscribed stock is $500,000 and is shown as "Subscriptions Receivable" in the Company's Balance Sheet.

4. COMMON STOCK TRANSACTIONS

During the three months ended September 30, 2004, the Company issued 2,245,000 shares of common stock for net cash proceeds of $623,450. Additionally, the Company granted 52,187 common shares as consideration for services.

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ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Except for historical information contained herein, the following discussion contains forward-looking statements that involve risks and uncertainties. Such forward-looking statements include, but are not limited to, statements regarding future events and plans and expectations. Actual results could differ materially from those discussed herein. Factors that could cause or contribute to such differences include, but are not limited to, those discussed elsewhere in this Form 10-QSB (incorporated herein Forward-Looking Statements).

OVERVIEW

MedCom USA, Inc.(the "Company") a Delaware corporation was formed in August 1991 under the name Sims Communications, Inc. The Company's primary business was providing telecommunications services. In 1996 the Company introduced four programs to broaden the Company's product and service mix: (a) cellular telephone activation, (b) sale of prepaid calling cards, (c) sale of long distance telephone service and (d) rental of cellular telephones using an overnight courier service. With the exception of the sale of prepaid calling cards, these four programs were discontinued in December 1997. During the fiscal year of 1998, the Company diversified its operations and moved into the area of medical information processing.

The Company changed its name to Medcom USA, Inc. in October 1999. During the fiscal years of 1999 and continuing through 2000, the Company directed its efforts in medical information processing. As of September 30, 2004, the Company currently operates the Medcard System (Medcard) that is deployed through a point-of-sale terminal or personal computer offering electronic transaction processing, as well as insurance eligibility verification. The Company has aggressively focused on its primary operations in Electronic Data Interchange (EDI) and core business in electronic Medical Transaction Processing.

MEDICAL TRANSACTION PROCESSING

MEDCARD SYSTEM

The Company provides innovative technology-based solutions for the healthcare industry that enable users to efficiently collect, use, analyze and disseminate data from payers, health care providers and patients. The Medcard System currently operates through a point-of-sale terminal or a personal computer. The point-of-sale terminals are purchased from Hypercom Corporation (Hypercom). The Medcard System also operates a PC version and an on-line version. The Company is in the process of assessing the feasibility of offering a service bundled package that would have the capability of processing unlimited claims and eligibility verification for monthly service fees.

FINANCIAL SERVICES

The Company's credit card center and check services, provides the healthcare industry an unprecedented combination of services designed to improve collection and approvals of credit/debit card payments along with the added benefit and convenience of personal check guarantee from financial institutions.

Flex-pay is an accounts receivable management program that allows a provider to swipe a patient's credit card and store the patient's signature in the terminals, and bill the patient's card at a later date when it is determined what services rendered were not covered by the patient's insurance. Also, an easy-pay option is offered which allows patient's the added benefit and convenience of a one-time payment option or a recurring installment payments that will be processed on a specified date determined by the provider and patient. These options insure providers that payments are timely processed with the features of electronic accounts receivable management. These services are

all deployed thorough point-of-sale terminals or a personal computer. Using the Medcard system, medical providers are relieved of the problems associated with billings and account management, and results in lower administrative documentation and costs.

PATIENT ELIGIBILITY

The Medcard System is also an electronic processing system that consolidates insurance eligibility verification, processes medical claims, and monitors referrals. The Medcard System allows a patient's primary care physician to request approval from the patient's insurance carrier or managed care plan for a referral to a secondary physician or specialist. The secondary physician or specialist can use the Medcard system to verify referrals are approved by the patient's insurance carrier. The Medcard system's referral capabilities reduce documentation and administrative costs which results in increased productivity and greater patient information for the specialist, as well as a written record of the referral authorization.

The Medcard System can record and track encounters between patients and health care providers for performance evaluation and maintenance of records. After examining a patient the physician enters a patient's name, procedure code and diagnostic code at a nearby terminal. This information is then uploaded to Medcom's computer network, processed and transmitted back to the provider formatted in both summary and/or detailed reports, and as a result healthcare providers' reimbursements are accelerated and account receivables are reduced. The average time it takes the healthcare providers to collect payments from insurance carriers and plans decreases from an average of 89 days to 7 to 21 days. Health care providers will benefit from a 100% paperless claim processing system.

TECHNICAL SUPPORT ASSISTANCE

The Company offers multiple training options for its products and services and is easily accessed at www.Medcard.com. The online E-learning tools enable health care professionals and health providers an opportunity to familiarize themselves with the Health Insurance Portability and Accountability Act (HIPAA) and also the mandates and compliance issues. Onsite training and teleconferencing, and technical support assistance are also features offered to health care providers. Also, a 24-hour terminal replacement program and system upgrades are offered.

MARKETING STRATEGY

Medcard's marketing plan is built around a strategy of expanding its sales capacity by using experienced external Independent Sales Organizations (ISO) and putting less reliance on an internal sales force. Medcom has set-up these Independent Sales Organizations (ISOs) to market and distribute the Medcard System throughout the U.S. Currently, there are 16 active ISOs promoting the Medcard system, with an average ISO that contains approximately 10-20 sales people, some selling the Medcard System exclusively. Financial service companies comprise an important sales channel that views the healthcare industry as an important growth opportunity. Only 6% of all healthcare payments are made with a credit card today, although according to a recent survey 55% of all consumers would prefer to pay doctor and hospital visits by credit/debit card.

SERVICE AGREEMENTS

During December 1998, the Company entered into a service agreement with WebMD Envoy. This agreement encompasses the process of Electronic Data Interchange (EDI) and related services. The services provided are complimentary to the Company's core business, and accomplishes transaction processing services

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that allows healthcare providers and payers to process medical transactions quickly and accurately, and results in reduced administrative costs and an increase in healthcare reimbursements to healthcare providers.

During January 2002, the Company has entered into a service agreement with MedUnite. This alliance will encompass the utilization of proprietary technologies and will enhance the existing network of healthcare constituents. Strategically both companies share the same vision of transforming the healthcare transactions systems affecting how healthcare providers, health plans, and other groups transacting business with one another by significantly reducing claim and payment processing time, and reducing healthcare administrative costs.

During February 2004, the Company entered into a service agreement with CDS Capital. This agreement will enable eligible healthcare providers utilizing the Medcom terminals to finance their accounts receivables. Health care providers using the Medcom terminal to secure patient eligibility and process claims will now be able to receive regular payments for a large percentage of claims processed from the previous week. This financial management service will decrease the time and costs associated with accounts receivable collections.

PROCESSING TERMINAL LEASING AGREEMENTS

The Company has entered into leasing agreements with LADCO Financial Group for the purpose of leasing processing terminals. The Company has pledged and granted for collateral in connection with the lease agreements one million restricted common shares. These common shares would be surrendered upon default of the leasing agreements. This pledge and granting of security interest was executed on January 2002.

The Company has arranged its terms with this credit facility as an equipment lessor whereby the Company sells terminals to the lessor when it has obtained a service contract with a provider. Under these agreements, the Company is leasing back the processing terminals from the lessor and in turn leases them to the purchaser for a period of 48 to 60 months however; the customer may terminate the agreement after 12 months. The Company is accounting for the transactions as sale-leasebacks. The leases with the customers are inclusive with the monthly service contracts and are effectively accounted for as operating leases. Gains on terminal sales under sale-leaseback transactions are deferred and are being amortized to income in proportion to amortization of the assets, generally over the term of the lease with the credit facility generally for a period of 48 to 60 months. At September 30, 2004, the remaining deferred equipment gain of $3,096,907 is shown as "Deferred Revenue" in the Company's Balance Sheet. For the three months ended September 30, 2004, the total interest expense incurred by the Company under these leases was $202,835.

REVENUES

Revenues from the Medcard system are generated through the sale of terminals, and processing insurance eligibility/verification, insurance claims, and financial transaction processing. The Company receives a fixed amount per terminal, and also receives fees for each transaction processed through the Medcard System. Revenue sources include fees for financial transactions processed through the terminal, fees for collection of receivables if the Company provides billing services, fees associated with reimbursements made by insurance carriers for submitting claims that are processed electronically, fees for using the system's referral program and, fees for processing uploaded data. The Company also markets a complete billing service using the Medcard System for hospitals and large practice groups. The Company receives a percentage of the billing amount collected under these arrangements.

ADDITIONAL INFORMATION

Medcom files reports and other materials with the Securities and Exchange Commission. These documents may be inspected and copied at the Commission's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C., 20549. You can obtain information on the operation of the Public Reference Room by calling the Commission at 1-800-SEC-0330. You can also get copies of documents that the Company files with the Commission through the Commission's Internet site at www.sec.gov.

RESULTS OF OPERATIONS

Revenues for the quarter ended September 30, 2004 increased to $871,472 as compared to the quarter ended September 30, 2003 of $638,178. This increase in revenue is directly the result of changes in the Company's strategic direction in core operations. The Company continues to aggressively pursue and devote its resources and focus its direction in electronic transaction processing.

Cost of sales for the quarter ended September 30, 2004 increased to $179,850 as compared to quarter ended September 30, 2003 of $28,233. Overall margins have decreased; also an increase in the volume of sales has directly increased the volume of transaction processing and as a result has increased the total costs of processing transactions.

General and administrative expenses for quarter ended September 30, 2004 increased to $933,075 as compared to quarter ended September 30, 2003 of $797,255. This increase is attributed to the Company's hiring of additional employees as growth has occurred in the area of providing technical support for our products and services in relation to increases in sales.

Selling expenses for the quarter ended September 30, 2004 increased to $292,299 as compared to quarter ended September 30, 2003 of $261,553. This increase is primarily the result of marketing efforts and includes commissions paid to internal sales personnel to market the Company's products and services.

Interest expense for the quarter ended September 30, 2004 decreased to $200,102 as compared to September 30, 2004 of $220,928. This decrease is a result of payments made and interest income recognized from the note receivable made to the affiliate.

No tax benefit was recorded on the expected operating loss for the quarter ended September 30, 2004 as required by Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. For the quarter ended we do not expect to realize a deferred tax asset and it is uncertain, therefore we have provided a 100% valuation of the tax benefit and assets until we are certain to experience net profits in the future to fully realize the tax benefit and tax assets.

Net loss for the quarter ended September 30, 2004 was ($1,248,878) compared net loss for the quarter ended September 30, 2003 of ($913,792).

LIQUIDITY AND CAPITAL RESOURCES

Cash used in operating activities for the three months ended September 30, 2004, was ($1,149,637) as compared to cash used in operating activities for the three months ended September 30, 2003 of ($1,019,280). Overall sales have increased in the areas of direct sales along with sales-leaseback transactions.

Cash provided by investing activities for the three months ended September 30, 2004 was $519,412 as compared to cash used in investing activities for the three

months ended September 30, 2003 of $81,881. There has been terminal equipment that has been transacted as sales-leaseback transactions and terminal software upgrade expenses that have been incurred. Also, the Company has collected funds that were advanced from an affiliate to fund operations for deficiencies in operating cash requirements as of September 30, 2004.

Cash provided by financing activities was $624,798 for the three months ended September 30, 2004 compared to cash provided by financing activities for the three months ended September 30, 2003 of $918,935. The Company has increased the amount of transacted sales in connection with its terminal equipment though direct sales, and as a result has decreased sales and the related financing through its credit facility.

The Company has advanced funds to an affiliated entity that is controlled by the Company's chairman and chief executive officer. As of September 30, 2004 the Company maintains an account receivable from this entity for the amount of $784,630 including accrued interest.

SOURCES OF CAPITAL

The Company has secured an arrangement with a third party leasing company to provide funds upon the execution of a rental and service agreement with a customer. Generally, the health care provider customer will enter into an agreement with the Company to rent a terminal and subscribe to the transaction processing and insurance verification service. At that time, the Company will sell the terminal associated with the service contract to the lessor and then leaseback that terminal. The leasing transactions provide for funding to the Company to cover its cost of the terminal, placement of the terminal with the customer and a profit margin. The Company is generally required to pay the lease rentals to the lessor from 48 to 60 months. The source of funds for those repayments is the rental payments from the health care provider customer.

OTHER CONSIDERATIONS

There are numerous factors that affect our business and the results of its operations. Sources of these factors include general economic and business conditions, federal and state regulation of business activities, the level of demand for the Company's product or services, the level and intensity of competition in the medical transaction processing industry and the pricing pressures that may result, the Company's ability to develop new services based on new or evolving technology and the market's acceptance of those new services, the Company's ability to timely and effectively manage periodic product transitions, the services, customer and geographic sales mix of any particular period, and the ability to continue to improve infrastructure including personnel and systems, to keep pace with the growth in its overall business activities.

FORWARD-LOOKING STATEMENTS

Except for historical information contained herein, this Form 10-QSB contains express or implied forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Exchange Act. The Company intends that such forward-looking statements be subject to the safe harbors created thereby. The Company may make written or oral forward-looking statements from time to time in filings with the SEC, in press releases, or otherwise. The words "believes," "expects," "anticipates," "intends," "forecasts," "project," "plans," "estimates" and similar expressions identify forward-looking statements. Such statements reflect the current views with respect to future events and financial performance or operations and are only as of the date the statements are made. Forward-looking statements involve risks and uncertainties and readers are cautioned not to place undue reliance on forward-looking statements. The Company's actual results may differ materially from such statements. Factors that cause or contribute to such differences include, but are not limited to, those discussed elsewhere in this Form 10-QSB, as well as those discussed in Form 10-KSB which is incorporated by reference in this Form 10-QSB.

Management believes that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, there can be no assurance that the results contemplated in such forward-looking statements will be realized. The inclusion of such forward-looking information should not be regarded, as a representation that the future events, plans, or expectations contemplated will be achieved. The Company undertakes no obligation to publicly update, review, or revise any forward-looking statements to reflect any change in expectations or any change in events, conditions, or circumstances on which any such statements are based. Our filings with the Securities Exchange Commission, including the Form 10-KSB, and may be accessed at the SEC's web site, www.sec.gov.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Medcom is involved in various legal proceedings and claims as described in our Form 10-KSB for the year ended June 30, 2004. No material developments occurred in any of these proceedings during the quarter ended September 30, 2004. The costs and results associated with these legal proceedings could be significant and could affect the results of future operations.

ITEM 3. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company maintains controls and procedures designed to ensure that information required to be disclosed in this report is recorded, processed, accumulated, and reported to its management, including the chief executive officer, to allow timely decisions regarding the required disclosure. Within the 90 days prior to the filing date of this report, Medcom's management, with the participation of its chief executive officer performed an evaluation of the effectiveness of the design and operation of these disclosure controls and procedures. Management has concluded that such disclosure controls and procedures are effective at ensuring that required information is disclosed in the Company's reports.

CHANGES IN INTERNAL CONTROLS

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the evaluation date.

ITEM 6: EXHIBITS AND REPORTS ON FORM 8-K

NO REPORTS ON FORM 8-K

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SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, there unto duly authorized.

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