MEDCOM USA INC
Form 10QSB
May 15, 2006

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 March 31, 2006.

[ ] 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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12-b of the Exchange Act).

Yes No X

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PREVIOUS FIVE YEARS

The number of shares of the issuer's common equity outstanding as of May 12, 2006 was 65,557,072 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 AND NINE MONTHS ENDED MARCH 31, 2006

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

MEDCOM USA, INC.
BALANCE SHEET (UNAUDITED)
AS OF MARCH 31, 2006

ASSETS:	
CURRENT ASSETS	
Cash	$ 21,623
Licensing Contracts - ST	1,415,714
Prepaid expenses and other current assets	182,377
Total current assets	1,619,713
PROCESSING TERMINALS, net	1,430,942
PROPERTY AND EQUIPMENT, net	304,603
Licensing Contracts - LT	1,608,997
Other Assets	301,823
TOTAL ASSETS	$ 5,266,078
LIABILITIES AND STOCKHOLDERS' EQUITY:	
CURRENT LIABILITIES:	
Accounts payable	$ 375,610
Accrued expenses and other liabilities	142,528
Dividend payable	23,750
Notes from Affiliates	692,434
Deferred revenue - current portion	1,886,405
Licensing obligations - current portion	954,629
Total current liabilities	4,075,357
LICENSING OBLIGATIONS - long-term portion	2,932,482
DEFERRED REVENUE	3,440,204
Total liabilities	10,448,043
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, 65,557,072 issued and 60,743,480 outstanding	6,556
Treasury stock	(37,397)
Paid in capital	79,228,826
Accumulated deficit	(84,379,984)
Total stockholders' equity	(5,181,965)
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 5,266,078

See the accompanying notes to these unaudited financial statements.

MEDCOM USA, INC.
STATEMENT OF OPERATIONS (UNAUDITED)
FOR THE THREE AND NINE MONTHS ENDED MARCH 31, 2006 AND 2005

	Three Months Ended		Nine Months Ended	
	2006	2005	2006	2005
REVENUES:				
Terminal sales	$ 22,778	$ 35,844	$ 156,216	$ 395,431
Service	890,076	652,373	2,642,249	1,947,030
Licensing Fees	399,052	-	2,640,509	-
	1,311,907	688,217	5,438,974	2,342,461
COST OF DELIVERABLES:	370,809	183,774	2,676,198	399,563
GROSS PROFIT	941,097	504,443	2,762,777	1,942,898
OPERATING EXPENSES:				
General and administrative	1,118,451	1,225,013	4,094,904	3,145,621
Sales and marketing	341,165	266,149	627,357	605,559
Professional and consulting fees	-	601,330	-	1,231,238
Royalties	-	19,409	-	64,987
Depreciation and amortization	658,824	560,702	2,000,924	1,306,643
Total operating expenses	2,118,440	2,672,603	6,723,185	6,354,048
OPERATING LOSS	(1,177,343)	(2,168,160)	(3,960,408)	(4,411,150
OTHER (INCOME) AND EXPENSES				
Interest expense	111,651	202,292	377,042	643,810
Interest Income	(175,339)	(1,058)	(449,689)	(13,487
Gain on Extinguishment of Debt	(76,208)		(76,208)	
Loss on disposal of assets	-		-	25,016
Total other expense	(139,896)	201,234	(148,856)	655,339
NET LOSS	(1,037,447)	(2,369,394)	(3,811,552)	(5,066,489
NET LOSS PER SHARE:				
Basic:	$ (0.02)	$ (0.04)	$ (0.06)	$ (0.10
Diluted:	$ (0.02)	$ (0.04)	$ (0.06)	$ (0.10
Weighted Average Common Shares Outstanding				
Basic	64,150,290	53,306,354	60,743,480	53,305,292

Diluted	64,150,290	53,306,354	60,743,480	53,305,292

See the accompanying notes to these unaudited financial statements.

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MEDCOM USA, INC.
STATEMENT OF CASH FLOWS (UNAUDITED)
FOR THE NINE MONTHS ENDED MARCH 31, 2006 AND 2005

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss)	$(3,811,552)	$(5,066,489)
Adjustments to reconcile net income to net cash (used in) operating activities:		
Depreciation and amortization	2,034,971	1,229,487
Issuance of common stock as compensation for services	2,011,552	136,478
Loss on disposal of assets	-	-
Changes in assets and liabilities:		
Licensing and Leasing Contracts	(922,306)	(126,358)
Inventories	-	696,049
Prepaid and other current assets	(133,435)	58,987
Other assets	(271,167)	(144,000)
Accounts payable and accrued liabilities	(829,171)	320,684
Deferred revenue	(1,529,514)	32,017
Net cash (used) in operating activities:	(3,450,621)	(2,863,145)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property & equipment	(88,334)	(396,164)
Net repayments of advances to affiliate	-	1,586,514
Net cash (used) and provided by investing activities:	(88,334)	1,190,350
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal repayments on capital leases	(769,072)	(1,040,060)
Net repayments of (advances) to Affiliate	(42,308)	
Proceeds from sale of common stock	1,830,698	3,478,583
Proceeds from licensing and leasing transaction	2,531,054	(734,424)
Net cash provided by financing activities	3,550,371	1,704,099
INCREASE (DECREASE) IN CASH	11,416	31,304
CASH, BEGINNING OF PERIOD	10,207	86,621
CASH, END OF PERIOD	$ 21,623	$ 117,925

SUPPLEMENTAL CASH FLOW INFORMATION:

Interest paid	$ 217,207	$ 643,810
Income taxes paid	-	-
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Terminals capitalized under sales/leaseback transactions	$ -	$ 1,848,904
Terminals returned and placed back into inventory at net capitalized cost	$ -	$ 776,984

See the accompanying notes to these unaudited financial statements

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MEDCOM USA, INC.
NOTES TO FINANCIAL STATEMENTS PERIODS ENDED MARCH 31, 2006 AND 2005

1. BASIS OF PRESENTATION

The accompanying unaudited financial statements represent the financial position of MedCom USA, Inc. ("Company") as of March 31, 2006 and includes results of operations of the Company for the three and nine months ended March 31, 2006 and 2005 and cash flows for the three and nine months ended March 31, 2006 and 2005. 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 and nine months ended March 31, 2006 and 2005 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, 2005, 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. The Company has entered into agreements with Tesia-PCI. The agreements entered into by and between the Company and Tesia-PCI represents of a major customer of the Company. The Company realized $1,156,000 from Tesia-PCI during the nine months presented.

Inventories

For the period ending March 31, 2005, inventories were 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 at times returned by customers, and if these units have been sold and repurchased, the Company recorded 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. Due to technological changes terminal are no longer considered an integral component in the

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generation of revenue. Accordingly effective July 1, 2005 terminals are expensed rather than capitalized as inventory terminals that have a nominal individual value. For the period beginning July 1, 2005 the Company adopted a new method of accounting and no longer carries inventory as its method of accounting. "See Revenue Recognition"

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.

Property & Equipment	953,985
Accumulated Depreciation	(649,382)
Net Property & Equipment	304,603

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. Effective July 1, 2005, the Company has adopted a new method of accounting and will discontinue the capitalization of terminal Assets. (See "Revenue Recognition")

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. All leasehold improvements have been fully amortized as of March 31, 2006.

Revenue Recognition

The Company recognized 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, prior to July 1, 2005, is deferred and recognized over the term of the leaseback. Management has determined that the sale-leaseback transactions are capital leases.

The terminals were 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 are as follows.

Terminal Assets	6,197,320
Accumulated Amortization	(4,766,378)
Net Terminal Assets	1,430,942

The Company has since upgraded its technology to address its core revenue model that is the sale of medical software. In recognition of the changes in technology and certain modifications to its licensing agreements the Company has adopted a new accounting method effective July 1, 2005, in accordance with SOP 97-2 and EITF

00-21, which they believe better matches revenue and expenses. SOP 97-2 applies to all entities that license, sell, lease, or market computer software. It also applies to "hosting" arrangements in which the customer has the option to take possession of the software. Hosting arrangements occur when end users do not take possession of the software but rather the software resides on the vendor's or a third party's hardware, and the customer accesses and uses the software on an as-needed basis over the Internet or some other connection. It does not, however, apply to revenue earned on products containing software incidental to the product as a whole or to hosting arrangements that do not give the customer the option of taking possession of the software.

SOP 97-2 provides that revenue should be recognized in accordance with contract accounting when the arrangement requires significant production, modification, or customization of the software. When the arrangement does not entail such requirements, revenue should be recognized when persuasive evidence of an agreement exists, delivery has occurred, the vendor's price is fixed or determinable, and collectibility is probable.

The largest part of revenues stems from vendors' license fees associated with

software. The Company has recognized revenue from license fees when the software was shipped to the customer. The amount and timing of revenue recognition is complicated, however, by multiple-element arrangements that provide for multiple software deliverables [e.g., software products, upgrades or enhancements, postcontract customer support (PCS), or other services]. In hosting arrangements that are within the scope of SOP 97-2, multiple elements might include specified or unspecified upgrade rights, in addition to the software product and the hosting service. The software provider often charges a single fee that must be allocated to the products delivered in the present and in the future.

In an arrangement with multiple deliverables, EITF 00-21 requires that the delivered items be considered a separate unit of accounting if the delivered items have value to the customer on a stand-alone basis, if there is objective and reliable evidence of the fair value of the undelivered items, and if the arrangement includes a general right of return for the delivered item, or if delivery or performance of the undelivered items is considered probable and substantially in the control of the vendor. EITF 00-21 requires allocation of the vendor's fee to the various elements based on each element's stand-alone value.

In general, both SOP 97-2 and EITF 00-21 require allocating revenue to all of the elements of a multiple-deliverable arrangement using the relative fair value method, where objective and reliable evidence of fair value is present for all the products contained in the group.

Management has established Vendor-Specific Objective Evidence ("VSOE") for access fee, equipment, provider enrollment fee, EDI connectivity fee, Payer/Provider fee, benefit verification fee, referral transfer fee, service authorization fee, claim status, training, support, program upgrades, carrier editions, and customized reports. Revenue is accordingly allocated and recognized based on the value of deliverables. VSOE relates the method of accounting under SOP 97-2 and EITF 00-21.

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 March 31, 2006. Of that amount, $22,244,282 related to net operating loss carry-forwards at March 31, 2006. 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.

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If the Company begins to generate taxable income, management may determine that all of the deferred income tax asset may be recognized. Recognition of the asset could increase after tax income in the future. Federal Net operating loss carryforwards of $52,226,446 expire from 2011 to 2023. State net operating loss carryforwards of $29,603,000 expire from 2005 to 2008. During the year ended June 30, 2005, the Company reduced the state portion of the deferred income tax asset related to net operating loss carryforwards by $3,484,000 resulting from the expiration of such carryforwards. The future utilization of the net operating losses is uncertain. The valuation allowance on the deferred income tax asset was decreased by $1,648,702 in the year ended June 30, 2005, resulting primarily to the expiration of state net operating loss carryforwards.

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

During the period of quarter ended March 31, 2005, goodwill was recognized in the Company's acquisition of MedCom. Since that time, the Company has divested of all other business segments. Management had impaired the assets in total since there was not sufficient evidence that the Company will generate operating income and operating cash flows. The technology of the company has changed that the asset no longer has value.

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.

2. Common Stock Transactions

During the quarter ended March 31, 2006, the Company issued 1,584,788 shares of common stock for net cash proceeds of $590,949. Additionally, the Company granted 2,665,848 common shares as consideration for services and compensation.

There were no options granted in the end of the period of March 31, 2006 and all options previously granted have been fully vested and therefore there is no pro forma effects for the year ended Common stock warrants issued in the quarter ended March 31, 2006 consist of the following:

Number of Warrants	Exercise Price	Expiration of Warrants
628,991	$ 4.00	6/30/2006
678,400	$ 1.00	6/30/2007
390,400	$ 2.75	6/30/2007
94,400	$ 3.00	6/30/2008
148,999	$ 4.00	7/30/2008
20,000	$ 4.50	9/30/2008
1,961,190		

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

This portion of this Quarterly Report on Form 10-QSB, includes statements that constitute "forward-looking statements." These forward-looking statements are often characterized by the terms "may," "believes," "projects," "expects," or "anticipates," and do not reflect historical facts. Specific forward-looking statements contained in this portion of the Quarterly Report include, but are not limited to our ability to manage growth, involvement in litigation, competition in the health electronic transaction processing, ongoing contractual relationships, dependence upon key personnel, changes in customer demand for product and services, and the adoption of new, or changes in, accounting policies, practices and estimates and the application of such policies, practices, and estimates, and federal and state governmental regulation, specifically in the areas of electronic transaction processing in the health care industries.

Forward-looking statements involve risks, uncertainties and other factors, which may cause our actual results, performance or achievements to be materially different from those expressed or implied by such forward-looking statements. Factors and risks that could affect our results and achievements and cause them to materially differ from those contained in the forward-looking statements include those identified in the section titled "Risk Factors" in the Company's Annual Report on Form 10-KSB for the year ended June 30, 2005, as well as other factors that we are currently unable to identify or quantify, but that may exist in the future.

In addition, the foregoing factors may affect generally our business, results of

operations and financial position. Forward-looking statements speak only as of the date the statement was made. We do not undertake and specifically decline any obligation to update any 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 March 31, 2006, the Company currently operates the MedCom System (MedCom) 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

MEDCOM SYSTEM

The Company provides innovative technology-based solutions for the healthcare industries that enable users to efficiently collect, use, analyze and disseminate data from payers, health care providers and patients. The MedCom 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 MedCom 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.

The Company has developed a "portal" system that encourages customers to process their medical claims through an online portal. Many customers purchase the terminal for the front office and the portal system for the back office to take advantage of the ease of both products.

FINANCIAL SERVICES

The Company's credit card center and check services, provides the healthcare industry a 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 MedCom system, medical providers are relieved of many of the problems associated with billings and account management, and results in lower administrative documentation and costs.

PATIENT ELIGIBILITY

The MedCom System is also an electronic processing system that consolidates insurance eligibility verification, processes medical claims, and monitors referrals. The MedCom 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 MedCom system to verify referrals are approved by the patient's insurance carrier. The MedCom 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 MedCom 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 7-21 days. Health care providers will benefit from a 100% paperless claim processing system.

As of June 30, 2005 the MedCom system was able to retrieve on-line eligibility and authorization information from approximately 450 medical insurance companies and plans. Included in this group is the newly activated Medicare Part A & B eligibility for all 50 states. This gives us access to over 42 million lives. The system also electronically processes and submits claims for its healthcare providers to over 1,700 companies. These insurance providers include CIGNA, Prudential, Oxford Health Plan, United Health Plans, Blue Cross, Medicaid, Aetna, Blue Cross/Blue Shield, and Prudential.

PATENT

The Company has the ability to market and sell licensing opportunities for the MedCom proprietary patented technology for Activating Phone card and Gift Card at retail. The patent covers the technology and process for taking a card with magnetic strip or other data capture mechanism and activating the card by downloading a determined monetary value onto the card for use at a later date for different types of transactions. This process can be utilized for prepaid phone cards, gift cards, and affinity cards. New View Technologies, which was acquired by MedCom USA, developed the patent and all patents were assigned.

COMPETITION

Competing health insurance claims processing and/or benefit verification systems include WebMD (HLTH), NDCHealth (NDC), and Per-se Technologies (PSTI). There are similar companies that compete with the Company with respect to its financial transaction processing services performed by the MedCom system. These companies compete with the Company directly or to some degree. Many of these competitors are better capitalized than the Company, and maintain a significant market share

in their respective industries.

TECHNICAL SUPPORT ASSISTANCE

The Company offers multiple training options for its products and services and is easily accessed at www.MedComUSA.com. 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

MedCom has broadened marketing strategy to reduce cost and increase efficiency. The Company has employed telesales strategy where as there is less dependence on individual sales personnel. The Company just completed its final phase of its portal software development which has broadened the sales model to both a terminal and portal sale. The company has entered into telesales agreements which have implemented the new marketing strategy. The completion of the portal will increase sales to hospitals which results in multiple sales. In addition, the portal has become popular for individual doctors, dentist, and other healthcare professionals which often results in a single or possibly multiple sales. The Company has focused its sales to hospitals as a growing revenue source.

In the past the Company built its marketing 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 MedCom System throughout the U.S. In addition to regional ISOs which represent approximately 100+ sales people, the Company has signed an agreement with Abanoc International and is in the midst of training 200+ sales people in 15 cities around the country. Initial sales have already begun to result from this relationship. 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.

MedCom has been expanding its position with Hospitals. Working closely with Hospital consultants and targeted seminars. The Company, with its new Online portal product and Medicare access, is becoming an increasingly valuable tool for the outpatient and faculty practice areas of hospitals. While the ISO groups focus on individual doctors, dentists and clinics, our hospital team is focusing on multiple unit sales opportunities with hospitals around the country.

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 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 2005, 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

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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.

During June 2005, the Company entered into a service agreement with Tesia-PCI. This agreement to replace and service and support at a minimum of 1,500 POS terminals inclusive of eligibly, claims processing, credit card processing for Tesia's dental providers.

PROCESSING TERMINAL LEASING AGREEMENTS

The Company has entered into leasing agreements for the purpose of leasing contracts. 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 arranged its terms with this credit facility as an equipment lessor whereby the Company sold terminals to the lessor when it has obtained a service contract with a provider. Under these agreements, the Company leased back the processing terminals from the lessor and in turn leased them to the purchaser for a period of 48 to 60 months however; the customer could terminate the agreement after 12 months. The Company accounted 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.

REVENUES

For the nine months period ending March 31, 2006 and 2005 the Company licensed 2066 and 821 units respectively. During the prior periods very few customers terminated there agreements prior to the expiration of the underlying lease. Additionally, Effective July 1, 2005 the Company modified the licensing agreement to make them noncancellable for the term of the underlying licensing agreement. Accordingly, management believes that application of a new method of accounting and revenue recognition more appropriately accomplishes the matching of revenues and cost of licenses entered into after July 1, 2005.

Revenues from the MedCom system are generated through the sale of the portal software, software terminals, and processing insurance benefit eligibility/verification, insurance claims, and financial transaction processing. The Company receives a fixed amount per software portal and software terminal, and also receives fees for each transaction processed through the MedCom System. Revenue sources include fees for financial transactions processed

through the software portal and software 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 MedCom System for hospitals and large practice groups. The Company receives a percentage of the billing amount collected under these arrangements.

Due to changes in technology and certain modification to the licenses agreements, the Company has adopted a new method of accounting and revenue recognition in accordance with SOP 97-2 and EITF 00-21 (See "Revenue Recognition")

ADDITIONAL INFORMATION

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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 March 31, 2006 increased to $1,311,907 as compared to the quarter ended March 31, 2005 of $688,217. 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. The increase in income relates to the implementation of the change in accounting method as discussed above and a direct increase in the number of units and portals licensed. The prior accounting method was in accordance of SAFS 13 implementation of the sale lease back method. The company adopted an accounting method in accordance with SOP 97-2 and EITF 00-21 which applies to entities that sell computer software. In addition, the company has changed its marketing strategy in which we should see the results of those efforts in the fourth quarter.

Cost of deliverables for the quarter ended March 31, 2006 increased to $370,809 as compared to quarter ended March 31, 2005 of $183,774. 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. The company adopted a method of accounting that provided a better matching of income and expenses and is in accordance to SOP 97-2 and EITF 00-21. In the past, the company generated revenues through licenses utilized the use of the medical terminal and related software. However while the development of proprietary software, the software can be utilized through a portal system which rendered the medical terminals sales no longer the core revenue model for the Company.

General and administrative expenses for quarter ended March 31, 2006 decreased to $1,118,451 as compared to quarter ended March 31, 2005 of $1,225,013. This decrease is attributed to the Company's change in marketing strategy to telesales rather than individual sales personal. The telesales personal still will require technical support for our products and services in relation to increases in sales. The Company issued stock for services in the amount of $506,705 which increased the overall General and Administrative expenses. The

services rendered for the stock included software development, royalties expenses, legal and professional, and consulting services by vendors. In March 31, 2005, royalties were separately stated wherein management changed revenue recognition the royalties for March 31, 2006 were included as cost of deliverables. Vendors that will accept stock for services reduces the burden of cash flow maintained. The Company also combined professional fees with general and administrative expenses to better report financial position.

Selling expenses for the quarter ended March 31, 2006 increased to $341,165 as compared to quarter ended March 31, 2005 of $266,149. This increase is primarily the result of the increase in marketing efforts and includes commissions paid to external sales personnel to market the Company's products and services. The Company has begun a campaign to increase internal sales force through telesales model which will maintain the integrity of the product proprietary technology. The Company's increases in General and Administrative costs reflect this new corporate campaign.

Interest expense for the quarter ended March 31, 2006 decreased to $111,651 as compared to March 31, 2005 of $202,292. This decrease is a result of payments made and interest income recognized from the note receivable made to the affiliate. Further the Company has been accelerating payments to Ladco one of its financing arrangements. The payments to Ladco represent a high interest rate and it has been a Company initiative to reduce the Ladco debt.

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Gain on Extinguishment of Debt for the quarter ended March 31, 2006 increased to $76,208 as compared March 31, 2005 of $0. The company extinguished debt that was beyond the statute of limitation and was a matter of law that the debt was extinguished. The company applied FAS 140, Paragraph 16: A debtor shall derecognize a liability if and only if it has been extinguished. A liability has been extinguished if either, (a) the debtor pays the creditor and is relieved of its obligation for the liability, or (b) the debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor.

The company has been legally released from the obligations which were past the statute of limitation and there has been no attempt at collection, and has accordingly removed the obligations.

Interest Income for the quarter ended March 31, 2006 increased to $175,339 as compared to March 31, 2005 of $1,058. The increase in interest income is a result of the implementation of the new accounting method that better considers interest earned on the licensing contracts in accordance with SOP 97-2 and EITF 00-21.

Depreciation and Amortization for the quarter ended March 31, 2006 increased to $658,824 as compared to March 31, 2005 of $560,702. This increase is a result of accelerated depreciation of terminal assets. The accelerated retirement of those assets is a result of the change in accounting method that better reflects the change in company revenue generation model.

No tax benefit was recorded on the expected operating loss for the quarter ended March 31, 2006 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 March 31, 2006 was ($1,037,447) compared net loss for the quarter ended March 31, 2005 of ($3,811,552).

LIQUIDITY AND CAPITAL RESOURCES

Cash used in operating activities for the nine months ended March 31, 2006, was ($2,863,145) as compared to cash used in operating activities for the nine months ended March 31, 2005 of ($3,450,621). Overall sales have increased in the areas of direct sales along with sales-leaseback transactions. The increase in cash used in operating activities was a result in the change in accounting method to better match income and expenses and further related to the decrease in accounts payables and decrease in deferred revenue.

Cash used for investing activities for the nine months ended March 31, 2005 was $88,334 as compared to cash provided in investing activities for nine months ended March 31, 2005 of $1,190,350. There has been terminal equipment that has been transacted as sales-leaseback transactions and terminal software upgrade expenses that have been incurred. The cash provided during the nine month period primarily was related to advances from affiliates.

Cash provided by financing activities was $3,550,371 for the nine months ended March 31, 2006 compared to cash provided by financing activities for the nine months ended March 31, 2005 of $1,704,099. 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 increased proceeds from capital leases by $2,531,054, collected $1,830,698 in proceeds from the sale of common stock and repaid capital leases facilities by $769,072. The Company repaid its affiliate $42,308.

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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 enters into an agreement with the Company to lease a terminal licensing software and subscribe to the transaction processing and insurance verification service. At that time, the Company sells the terminal software and licensing rights associated with the service contract to the lessor. The leasing transactions provide for funding to the Company to cover its cost of the software terminal and portal, implementation through the internet the software portal and software terminal with the customer and a profit margin. The source of funds for the repayments is the payments from the health care provider customer. The Sources of Capital come from Ladco and Leeco who are our main provider of financing for the Company and the company had started to receiving financing through Abanco.

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

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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, 2005. No material developments occurred in any of these proceedings during the quarter ended March 31, 2006. 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

Disclosure controls and procedures are designed with an objective of ensuring that information required to be disclosed in our periodic reports filed with the Securities and Exchange Commission, such as this Quarterly Report on Form 10-QSB, is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission. Disclosure controls are also designed with an objective of ensuring that such information is accumulated and communicated to our management, including our chief executive officer, in order to allow timely consideration regarding required disclosures.

The evaluation of our disclosure controls by our principal executive officer included a review of the controls' objectives and design, the operation of the controls, and the effect of the controls on the information presented in this

Quarterly Report. Our management, including our chief executive officer, does not expect that disclosure controls can or will prevent or detect all errors and all fraud, if any. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Also, projections of any evaluation of the disclosure controls and procedures to future periods are subject to the risk that the disclosure controls and procedures may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on their review and evaluation as of the end of the period covered by this Form 10-Q, and subject to the inherent limitations all as described above, our principal executive officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective as of the end of the period covered by this report. They are not aware of any significant changes in our disclosure controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses. During the period covered by this Form 10-Q, there have not been any changes in our internal control over financial reporting that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 6: EXHIBITS AND REPORTS ON FORM 8-K

REPORTS ON FORM 8-K

Changes in Registrant's Certifying Accountant.

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.

Registrant — Medcom USA Incorporated

Date: May 12, 2006 — By: /s/ William P. Williams

William P. Williams
Chairman, President Chief Executive Officer (Principle Executive Officer, Principle Financial Officer)

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