Kingsley Scott Allen
Form 4
March 05, 2013

FORM 4

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

OMB APPROVAL

OMB Number:	3235-0287
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STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
Kingsley Scott Allen

(Last) (First) (Middle)

8365 GLEN EAGLE DRIVE

(Street)

MANLIUS, NY 13104

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
COMMUNITY BANK SYSTEM INC [CBU]

3. Date of Earliest Transaction (Month/Day/Year)
03/01/2013

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
Chief Financial Officer

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	03/01/2013		F (1)		151	D	$ 28.87	19,942	D	
Common Stock								2,848.8768 (2)	I	By 401(k) Plan

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Kingsley Scott Allen 8365 GLEN EAGLE DRIVE MANLIUS, NY 13104			Chief Financial Officer	

Signatures

/s/ Danielle M. Cima, pursuant to a Confirming Statement executed by Scott A. Kingsley	03/05/2013
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Payment of tax liability associated with vesting of restricted stock grant.

(2) The number of shares reported herein were acquired pursuant to Community Bank System, Inc.'s 401(K) Plan and are based on a current plan statement.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. 3)

Inventory
27,553 (23,766)
Prepaid expenses and other assets
(89,095) 174,287
Other assets
12,339 (14,706)
Accounts payable and accrued expenses
(39,844) (479,198)
Deferred revenues and other liabilities

45,014
Net cash provided by (used in) operating activities
57,173 (951,095)
Investing activities

Sale (purchase) of property and equipment
(11,743) 12,051
Net cash provided by (used in) investing activities
(11,743) 12,051
Financing activities

Net repayments of capital lease obligations
(22,010) (76,073)
Net borrowings (repayments) on line of credit
(163,991) 595,786
Net repayments of notes payable
(5,495)
Net borrowings (repayments) of other obligations
(22,561) 118,066
Net cash provided by (used in) financing activities
(214,057) 637,779
Net decrease in cash and cash equivalents
(168,627) (301,265)
Cash and cash equivalents, beginning of quarter
497,550 612,348
Cash and cash equivalents, end of quarter
$ 328,923 $ 311,083
Supplemental cash flow information

Cash paid during the quarter for

Income taxes
$ $
Interest
$ 93,194 $ 62,882

Beginning in the fourth quarter of 2005, the Company separately disclosed the operating, investing and financing components of the cash flows attributable to its discontinued operations, which in prior periods were reported on a combined basis as a single amount.

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

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Orion HealthCorp, Inc.

Consolidated Condensed Statements of Cash Flows

	For the Six Months Ended June 30, 2006	2005 Revised
Operating activities		
Net income (loss)	$ 291,027	$ (10,028,418)
Adjustments to reconcile net loss to net cash used in operating activities:		
Charge for impairment of intangible assets		6,362,849
Minority interest in earnings of partnerships		1,660
Provision for doubtful accounts	299,146	636,835
Depreciation and amortization	818,828	1,727,201
Gain on forgiveness of debt	(665,463)	
Stock option compensation expense	97,712	
Conversion of notes payable to common stock		57,886
Impact of discontinued operations	230,744	272,210
Changes in operating assets and liabilities:		
Accounts receivable	169,295	(897,899)
Inventory	35,957	(25,238)
Prepaid expenses and other assets	(85,912)	(82,691)
Other assets	12,942	(8,594)
Accounts payable and accrued expenses	(628,424)	149,951
Deferred revenues and other liabilities		29,018
Net cash provided by (used in) operating activities	575,852	(1,805,230)
Investing activities		
Sale (purchase) of property and equipment	(13,010)	32,195
Impact of discontinued operations	430,244	
Net cash provided by investing activities	417,234	32,195
Financing activities		
Net repayments of capital lease obligations	(45,700)	(125,650)
Net borrowings (repayments) on line of credit	(418,221)	364,514
Net borrowings of notes payable		1,402,460
Net repayments of notes payable	(325,189)	
Net borrowings (repayments) of other obligations	126,140	(259,052)
Impact of discontinued operations	(300,000)	
Net cash provided by (used in) financing activities	(962,970)	1,382,272
Net increase (decrease) in cash and cash equivalents	30,116	(390,763)
Cash and cash equivalents, beginning of period	298,807	701,846

Cash and cash equivalents, end of period	$	328,923	$	311,083
Supplemental cash flow information				
Cash paid during the period for				
Income taxes	$		$	
Interest	$	177,581	$	119,179

Beginning in the fourth quarter of 2005, the Company separately disclosed the operating, investing and financing components of the cash flows attributable to its discontinued operations, which in prior periods were reported on a combined basis as a single amount.

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

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Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements
June 30, 2006 and 2005

Note 1. General

Orion HealthCorp, Inc. (formerly SurgiCare, Inc. SurgiCare) and its subsidiaries (Orion or the Company) maintain their accounts on the accrual method of accounting in accordance with accounting principles generally accepted in the United States of America (GAAP). Accounting principles followed by the Company and its subsidiaries and the methods of applying those principles, which materially affect the determination of financial position, results of operations and cash flows are summarized below.

The unaudited consolidated condensed financial statements include the accounts of the Company and all of its majority-owned subsidiaries. Orion s results for the three months and six months ended June 30, 2006 and 2005 include the results of IPS, MBS and the Company s ambulatory surgery and diagnostic center business. The descriptions of the business and results of operations of MBS set forth in these notes include the business and results of operations of DCPS. All material intercompany balances and transactions have been eliminated in consolidation.

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

The accompanying unaudited consolidated condensed financial statements should be read in conjunction with the financial statements and related notes therein included in the Company s Annual Report on Form 10-KSB for the year ended December 31, 2005.

Description of Business

Orion is a healthcare services organization providing outsourced business services to physicians. The Company serves the physician market through two subsidiaries, Medical Billing Services, Inc. (MBS), which provides billing, collection and practice management services, primarily to hospital-based physicians; and Integrated Physician Solutions, Inc. (IPS), which provides business and management services to general and subspecialty pediatric physician practices.

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

In April 2005, the Company initiated a strategic plan designed to accelerate the Company s growth and enhance its future earnings potential. The plan focuses on the Company s strengths, which include providing billing, collections and complementary business management services to physician practices. As part of this strategic plan, the Company began to divest certain non-strategic assets. In addition, the Company ceased investment in business lines that did not complement the Company s strategic plan and redirected financial resources and Company personnel to areas that management believes enhance long-term growth potential. Beginning in the third quarter of 2005, the Company successfully completed the consolidation of corporate

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Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

functions into its Roswell, Georgia facility. Consistent with its strategic plan, the Company also completed a series of transactions involving the divestiture of non-strategic assets in 2005.

Medical Billing Services

MBS is based in Houston, Texas and was incorporated in Texas on October 16, 1985. DCPS is based in Houston, Texas and was organized as a Texas limited liability company on September 16, 1998. DCPS reorganized as a Texas limited partnership on August 31, 2003. MBS (which includes the operations of DCPS) offers its clients a complete outsourcing service, which includes practice management and billing and collection services, allowing them to avoid the infrastructure investment in their own back-office operations. These services help clients to be financially successful by improving cash flows and reducing administrative costs and burdens.

MBS provides services to approximately 58 customers throughout Texas. These customers include anesthesiologists, pathologists, and radiologists, imaging centers, comprehensive breast centers, hospital labs, cardio-thoracic surgeons and ambulatory surgery centers (ASCs.)

Integrated Physician Solutions

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

As of June 30, 2006, IPS managed nine practice sites, representing five medical groups in Illinois and Ohio. IPS provides human resources management, accounting, group purchasing, public relations, marketing, information technology, and general day-to-day business operations management services to these medical groups. The physicians, who are all employed by separate corporations, provide all clinical and patient care related services.

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

On April 1, 2005, IPS entered into a Mutual Release and Settlement Agreement (the CARDC Settlement) with Bradley E. Chipps, M.D. (Dr. Chipps) and Capital Allergy and Respiratory Disease Center, a medical corporation (CARDC) to settle disputes as to the existence and enforceability of certain contractual obligations. As part of the CARDC Settlement, Dr. Chipps, CARDC, and IPS agreed that CARDC would purchase the assets owned by IPS and used in connection with CARDC in exchange for termination of the MSA between IPS and CARDC. Additionally, among other provisions, after April 1, 2005, Dr. Chipps, CARDC and IPS have been released from any further obligation to each other.

On June 7, 2005, InPhySys, Inc. (formerly known as IntegriMED, Inc.) (IntegriMED), a wholly owned subsidiary of IPS, executed an Asset Purchase Agreement (the IntegriMED Agreement) with eClinicalWeb, LLC (eClinicalWeb) to sell substantially all of the assets of IntegriMED. The IntegriMED Agreement was deemed to be effective as of midnight on June 6, 2005. As consideration for the purchase of the acquired assets, eClinicalWeb issued to IntegriMED the following: (i) a two percent (2%) ownership interest in eClinicalWeb; and (ii) $69,034 for the payoff of certain leases and purchase of certain software. Also eClinicalWeb agreed to sublease certain office space from IPS that was occupied by employees of IntegriMED.

On October 31, 2005, IPS executed a Mutual Release and Settlement Agreement (the Sutter Settlement) with John Ivan Sutter, M.D., PA (Dr. Sutter) to settle disputes that had arisen between IPS and Dr. Sutter and to

Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

avoid the risk and expense of litigation. As part of the Sutter Settlement, Dr. Sutter and IPS agreed that Dr. Sutter would purchase the assets owned by IPS and used in connection with Dr. Sutter s practice, in exchange for termination of the related MSA. Additionally, among other provisions, after October 31, 2005, Dr. Sutter and IPS have been released from any further obligation to each other.

Ambulatory Surgery Center Business

As of June 30, 2006, the Company no longer has ownership or management interests in surgery and diagnostic centers.

On March 1, 2005, the Company closed its wholly owned subsidiary, Bellaire SurgiCare, Inc. (Bellaire SurgiCare), and consolidated its operations with the operations of SurgiCare Memorial Village, L.P. (Memorial Village).

In April 2005, due to unsatisfactory financial performance of the Company s surgery centers and in accordance with its strategic plan, the Company began the process of divesting its surgery center ownership interests.

On September 30, 2005, Orion executed purchase agreements to sell its 51% ownership interest in Tuscarawas Ambulatory Surgery Center, L.L.C. (TASC) and its 41% ownership interest in Tuscarawas Open MRI, L. P., (TOM) both located in Dover, Ohio, to Union Hospital (Union). Additionally, as part of the transactions, TASC, as the sole member of TASC Anesthesia, L.L.C. (TASC Anesthesia), executed an Asset Purchase Agreement to sell certain assets of TASC Anesthesia to Union. The limited partners of TASC and TOM also sold a certain number of their units to Union such that at the closing of these transactions, Union owned 70% of the ownership interests in TASC and TOM.

As consideration for the purchase of the 70% ownership interests in TASC and TOM, Union Hospital paid purchase prices of $950,000 and $2,188,237, respectively. Orion s portion of the total proceeds for TASC, TASC Anesthesia and TOM, after closing costs of $82,632, was cash in the amount of $1,223,159 and a note due on or before March 30, 2006 in the amount of $530,547. The March 30, 2006 note was not fully paid by Union and the remaining balance of $261,357 was written off against the gain on disposition for the quarter ended December 31, 2005. As a result of these transactions, Orion no longer has an ownership interest in TASC, TOM or TASC Anesthesia.

Additionally, as part of the TASC and TOM transactions, Orion executed two-year management services agreements (the TASC MSA and the TOM MSA) with terms substantially the same as those of the management services agreements under which Orion performed management services to TASC and TOM prior to the transactions.

On January 12, 2006, the Company was notified by Union that it was exercising its option to terminate the TOM MSA as of March 12, 2006. Management fee revenue related to TOM was $0 and $11,728 for the three months ended June 30, 2006 and 2005, respectively. For the six months ended June 30, 2006 and 2005, management fee revenue related to TOM was $7,217 and $17,351, respectively.

On February 3, 2006, the Company was notified by Union that it was exercising its option to terminate the TASC MSA as of April 3, 2006. Management fee revenue related to TASC was $968 and $26,014 for the three months ended June 30, 2006 and 2005, respectively. For the six months ended June 30, 2006 and 2005, management fee revenue related to TASC was $22,525 and $52,038, respectively.

On February 8, 2006, Memorial Village executed an Asset Purchase Agreement (the Memorial Agreement) for the sale of substantially all of its assets to First Surgical Memorial Village, L.P. (First Surgical). Memorial Village is approximately 49% owned by Town & Country SurgiCare, Inc., a wholly owned subsidiary of Orion. The Memorial Agreement was deemed to be effective as of January 31, 2006.

Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

The property sold by Memorial Village to First Surgical (hereinafter collectively referred to as the Memorial Acquired Assets) included the equipment, inventory, goodwill, contracts, leasehold improvements, equipment leases, books and records, permits and licenses and other personal property owned by Memorial Village and used in the operation of Memorial Village s business. The Memorial Acquired Assets did not include any of the following: accounts receivable, cash and cash equivalents, marketable securities, insurance policies, prepaid expenses, deposits with utility and/or service providers, shares of corporations, real estate owned by Memorial Village, or liabilities, other than those expressly assumed by the First Surgical in the Agreement.

As consideration for the Memorial Acquired Assets, Memorial Village received a total purchase price of $1,100,000, of which Orion received approximately $815,000 after payment of certain legal and other post-closing expenses. The proceeds received by Orion consisted of the following amounts:

i. Approximately $677,000 representing the principal amount of a note payable owed to Orion from Memorial Village;

ii. Approximately $99,000 representing Orion s pro-rata share of the net proceeds after payment of certain legal and other post-closing expenses; and

iii. A reserve fund of approximately $39,000, pending approval of the assumption of certain capital leases by First Surgical.

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

The property sold by San Jacinto to Methodist (hereinafter collectively referred to as the San Jacinto Acquired Assets), included the leasehold title to real property, together with all improvements, buildings and fixtures, all major, minor or other equipment, all computer equipment and hardware, furniture and furnishings, inventory and supplies, current financial, patient, credentialing and personnel records, interest in all commitments, contracts, leases and agreements outstanding in respect to San Jacinto, to the extent assignable, all licenses and permits held by San Jacinto, all patents and patent applications and all logos, names, trade names, trademarks and service marks, all computer software, programs and similar systems owned by or licensed to San Jacinto, goodwill and all interests in property, real, personal and mixed, tangible and intangible acquired by San Jacinto prior to March 1, 2006. The San Jacinto Acquired Assets did not include any of the following: restricted and unrestricted cash and cash equivalents, marketable securities, certificates of deposit, bank accounts, temporary investments, accounts receivable, notes receivable intercompany accounts of San Jacinto, and all commitments, contracts, leases and agreements other than those expressly assumed by Methodist in the San Jacinto Agreement.

As consideration for the San Jacinto Acquired Assets, San Jacinto received a total purchase price of $5,500,000, of which Orion received a net amount of approximately $598,000. The proceeds received by Orion consisted of the following amounts:

i. Approximately $450,000 representing Orion s pro-rata share of the net proceeds; and

ii. Approximately $148,000 representing the principal and interest amounts of a note payable owed to Orion from San Jacinto.

As part of the closing of the Agreement, Orion was obligated to make payments, totaling $607,000, from its portion of the proceeds as follows:

i. Approximately $357,000 representing distributions due to the limited partners of San Jacinto for cash collections previously received by Orion, and payment of accounts payable and other expenses; and

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Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

ii. Approximately $250,000 to CIT, which represents repayment of the obligations related to San Jacinto under the Loan and Security Agreement.

Note 2. Going Concern

The accompanying unaudited consolidated condensed financial statements have been prepared in conformity with GAAP, which contemplate the continuation of the Company as a going concern. The Company incurred substantial operating losses during 2005, and has used substantial amounts of working capital in its operations. Additionally, as described more fully below, the Company received notification from CIT Healthcare, LLC (formerly known as Healthcare Business Credit Corporation) (CIT) in December 2005 that certain events of default under the Loan and Security Agreement had occurred as a result of the Company being out of compliance with two financial covenants relating to its debt service coverage ratio and its minimum operating income level. These conditions raise substantial doubt about the Company s ability to continue as a going concern.

The Company has financed its growth and operations primarily through the issuance of equity securities, secured and/or convertible debt, most recently by completing a series of acquisitions and restructuring transactions (the Restructuring), which occurred in December 2004, and borrowing from related parties. In connection with the closing of these transactions, the Company entered into a new secured two-year revolving credit facility pursuant to a Loan and Security Agreement (the Loan and Security Agreement), dated December 15, 2004, by and among Orion, certain of its affiliates and subsidiaries, and CIT. Under this facility, initially up to $4,000,000 of loans could be made available to Orion, subject to a borrowing base, which is determined based on a percentage of eligible outstanding accounts receivable less than 180 days old. As discussed below, the amount available under this credit facility has been reduced. Orion borrowed $1,600,000 under this facility concurrently with the closing of the Restructuring. The interest rate under this facility is the prime rate plus 6%. Upon an event of default, CIT can accelerate the loans or call the Guaranties described below. (See Note 10. Long-Term Debt and Lines of Credit, for additional discussion regarding the Company s defaults under the Loan and Security Agreement.) In connection with entering into this new facility, Orion also restructured its previously-existing debt facilities, which resulted in a decrease in aggregate debt owed to DVI Business Credit Corporation and DVI Financial Services, Inc. (collectively, DVI) from approximately $10.1 million to a combined principal amount of approximately $6.5 million, of which approximately $2.0 million was paid at the Closing.

Pursuant to a Guaranty Agreement (the Brantley IV Guaranty), dated as of December 15, 2004, provided by Brantley Partners IV, L.P. (Brantley IV) to CIT, Brantley IV agreed to provide a deficiency guaranty in the initial amount of $3,272,727. As discussed below, the amount of this Brantley IV Guaranty has been reduced. Pursuant to a Guaranty Agreement (the Brantley Capital Guaranty and collectively with the Brantley IV Guaranty, the Guaranties), dated as of December 15, 2004, provided by Brantley Capital Corporation (Brantley Capital) to CIT, Brantley Capital agreed to provide a deficiency guarantee in the initial amount of $727,273. As discussed below, the amount of this Brantley Capital Guaranty has been reduced. In consideration for the Guaranties, Orion issued warrants to purchase 20,455 shares of Class A Common Stock, at an exercise price of $0.01 per share, to Brantley IV, and issued warrants to purchase 4,545 shares of Class A Common Stock, at an exercise price of $0.01 per share, to Brantley Capital. None of these warrants, which expire on December 15, 2009, have been exercised as of June 30, 2006.

On March 16, 2005, Brantley IV loaned the Company an aggregate of $1,025,000 (the First Loan). On June 1, 2005, the Company executed a convertible subordinated promissory note in the principal amount of $1,025,000 (the First Note) payable to Brantley IV to evidence the terms of the First Loan. The material terms of the First Note are as follows: (i) the First Note is unsecured; (ii) the First Note is subordinate to the Company s outstanding loan from CIT and other indebtedness for monies borrowed, and ranks pari passu with general unsecured trade liabilities; (iii) principal and interest on the First Note is due in a lump sum on April 19, 2006 (the First Note Maturity Date); (iv) the interest on the First Note accrues from and after March 16, 2005, at a per annum rate equal to nine percent (9.0%) and is non-compounding; (v) if an event of default occurs and is

Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

continuing, Brantley IV, by notice to the Company, may declare the principal of the First Note to be due and immediately payable; and (vi) on or after the First Note Maturity Date, Brantley IV, at its option, may convert all or a portion of the outstanding principal and interest due of the First Note into shares of Class A Common Stock of the Company at a price per share equal to $1.042825 (the First Note Conversion Price). The number of shares of Class A Common Stock to be issued upon conversion of the First Note shall be equal to the number obtained by dividing (x) the aggregate amount of principal and interest to be converted by (y) the First Note Conversion Price (as defined above); provided, however, the number of shares to be issued upon conversion of the First Note shall not exceed the lesser of: (i) 1,159,830 shares of Class A Common Stock, or (ii) 16.3% of the then outstanding Class A Common Stock. As of June 30, 2006, if Brantley IV were to convert the First Note, the Company would have to issue 1,098,644 shares of Class A Common Stock. On May 9, 2006, Brantley IV and the Company executed an amendment to the First Note (the First and Second Note Amendment) extending the First Note Maturity Date to August 15, 2006. On August 8, 2006, Brantley IV and the Company executed a second amendment to the First Note (the First and Second Note Second Amendment) extending the First Note Maturity Date to October 15, 2006.

On April 19, 2005, Brantley IV loaned the Company an additional $225,000 (the Second Loan). On June 1, 2005, the Company executed a convertible subordinated promissory note in the principal amount of $225,000 (the Second Note) payable to Brantley IV to evidence the terms of the Second Loan. The material terms of the Second Note are as follows: (i) the Second Note is unsecured; (ii) the Second Note is subordinate to the Company s outstanding loan from CIT and other indebtedness for monies borrowed, and ranks pari passu with general unsecured trade liabilities; (iii) principal and interest on the Second Note is due in a lump sum on April 19, 2006 (the Second Note Maturity Date); (iv) the interest on the Second Note accrues from and after April 19, 2005, at a per annum rate equal to nine percent (9.0%) and is non-compounding; (v) if an event of default occurs and is continuing, Brantley IV, by notice to the Company, may declare the principal of the Second Note to be due and immediately payable; and (vi) on or after the Second Note Maturity Date, Brantley IV, at its option, may convert all or a portion of the outstanding principal and interest due of the Second Note into shares of Class A Common Stock of the Company at a price per share equal to $1.042825 (the Second Note Conversion Price). The number of shares of Class A Common Stock to be issued upon conversion of the Second Note shall be equal to the number obtained by dividing (x) the aggregate amount of principal and interest to be converted by (y) the Second Note Conversion Price (as defined above); provided, however, the number of shares to be issued upon conversion of the Second Note shall not exceed the lesser of: (i) 254,597 shares of Class A Common Stock, or (ii) 3.6% of the then outstanding Class A Common Stock. As of June 30, 2006, if Brantley IV were to convert the Second Note, the Company would have to issue 239,332 shares of Class A Common Stock. On May 9, 2006, Brantley IV and the Company executed the First and Second Note Amendment extending the Second Note Maturity Date to August 15, 2006. On August 8, 2006, Brantley IV and the Company executed the First and Second Note Second Amendment extending the Second Note Maturity Date to October 15, 2006.

Additionally, in connection with the First Loan and the Second Loan, the Company entered into a First Amendment to the Loan and Security Agreement (the First Amendment), dated March 22, 2005, with certain of the Company s affiliates and subsidiaries, and CIT, whereby its $4,000,000 secured two-year revolving credit facility has been reduced by the amount of the loans from Brantley IV to $2,750,000. As a result of the First Amendment, the Brantley IV Guaranty was amended by the Amended and Restated Guaranty Agreement, dated March 22, 2005, which reduced the deficiency guaranty provided by Brantley IV by the amount of the First Loan to $2,247,727. Also as a result of the First Amendment, the Brantley Capital Guaranty was amended by the Amended and Restated Guaranty Agreement, dated March 22, 2005, which reduced the deficiency guaranty provided by Brantley Capital by the amount of the Second Loan to $502,273. Paul H. Cascio, the Chairman of the board of directors of the Company, and

Michael J. Finn, a director of the Company, are affiliates of Brantley IV.

As part of the Loan and Security Agreement, the Company is required to comply with certain financial covenants, measured on a quarterly basis. The financial covenants include maintaining a required debt service coverage ratio and meeting a minimum operating income level for the surgery and diagnostic centers before corporate overhead allocations. As of and for the three months and six months ended June 30, 2006, the Company

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Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

was out of compliance with both of these financial covenants and has notified the lender as such. Under the terms of the Loan and Security Agreement, failure to meet the required financial covenants constitutes an event of default. Under an event of default, the lender may (i) accelerate and declare the obligations under the credit facility to be immediately due and payable; (ii) withhold or cease to make advances under the credit facility; (iii) terminate the credit facility; (iv) take possession of the collateral pledged as part of the Loan and Security Agreement; (v) reduce or modify the revolving loan commitment; and/or (vi) take necessary action under the Guaranties. The revolving credit facility is secured by the Company s assets. As of June 30, 2006, the outstanding principal under the revolving credit facility was $998,668. The full amount of the loan as of June 30, 2006 is recorded as a current liability. In December 2005, the Company received notification from CIT stating that (i) certain events of default under the Loan and Security Agreement had occurred as a result of the Company being out of compliance with two financial covenants relating to its debt service coverage ratio and its minimum operating income level, (ii) as a result of the events of default, CIT raised the interest rate for monies borrowed under the Loan and Security Agreement to the provided Default Rate of prime rate plus 6%, (iii) the amount available under the revolving credit facility was reduced from $2,750,000 to $2,300,000 and (iv) CIT reserved all additional rights and remedies available to it as a result of these events of default. The Company is currently in negotiations with CIT to obtain, among other provisions, a waiver of the events of default. In the event CIT declares the obligations under the Loan and Security Agreement to be immediately due and payable or exercises its other rights described above, the Company would not be able to meet its obligations to CIT or its other creditors. As a result, such action would have a material adverse effect on the Company s ability to continue as a going concern.

As of June 30, 2006, the Company s existing credit facility with CIT had limited availability to provide for working capital shortages. Although the Company believes that it will generate cash flows from operations in the future, there is substantial doubt as to whether it will be able to fund its operations solely from its cash flows. In April 2005, the Company initiated a strategic plan designed to accelerate the Company s growth and enhance its future earnings potential. The plan focuses on the Company s strengths, which include providing billing, collections and complementary business management services to physician practices. A fundamental component of the Company s plan is the selective consideration of accretive acquisition opportunities in these core business sectors. In addition, the Company ceased investment in business lines that did not complement the Company s strategic plans and redirected financial resources and Company personnel to areas that management believes enhance long-term growth potential. On June 7, 2005, as described in Note 1. General Description of Business Integrated Physician Solutions, IPS completed the sale of substantially all of the assets of IntegriMED, and on October 1, 2005, the Company completed the sale of its interests in TASC and TOM in Dover, Ohio. Beginning in the third quarter of 2005, the Company successfully completed the consolidation of corporate functions into its Roswell, Georgia facility. Additionally, consistent with its strategic plan, the Company sold its interest in Memorial Village effective January 31, 2006 and in San Jacinto effective March 1, 2006. (See Note 1. General Description of Business Ambulatory Surgery Center Business).

The Company intends to continue to manage its use of cash. However, the Company s business is still faced with many challenges. If cash flows from operations and borrowings are not sufficient to fund the Company s cash requirements, the Company may be required to further reduce its operations and/or seek additional public or private equity financing or financing from other sources or consider other strategic alternatives, including possible additional divestitures of specific assets or lines of business. Any acquisitions will require additional capital. There can be no assurances that additional financing will be available, or that, if available, the financing will be obtainable on terms acceptable to the Company or that any additional financing would not be substantially dilutive to the Company s existing stockholders.

Note 3. Revenue Recognition

MBS s principal source of revenues is fees charged to clients based on a percentage of net collections of the client s accounts receivable. MBS recognizes revenue and bills it clients when the clients receive payment on those accounts receivable. MBS typically receives payment from the client within 30 days of billing. The fees vary

Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

depending on specialty, size of practice, payer mix, and complexity of the billing. In addition to the collection fee revenue, MBS also earns fees from the various consulting services that MBS provides, including medical practice management services, managed care contracting, coding and reimbursement services.

IPS records revenue based on patient services provided by its affiliated medical groups. Net patient service revenue is impacted by billing rates, changes in Current Procedure Terminology code reimbursement and collection trends. IPS reviews billing rates at each of its affiliated medical groups on at least an annual basis and adjusts those rates based on each insurer s current reimbursement practices. Amounts collected by IPS for treatment by its affiliated medical groups of patients covered by Medicare, Medicaid and other contractual reimbursement programs, which may be based on cost of services provided or predetermined rates, are generally less than the established billing rates of IPS s affiliated medical groups. IPS estimates the amount of these contractual allowances and records a reserve against accounts receivable based on historical collection percentages for each of the affiliated medical groups, which include various payer categories. When payments are received, the contractual adjustment is written off against the established reserve for contractual allowances. The historical collection percentages are adjusted quarterly based on actual payments received, with any differences charged against net revenue for the quarter. Additionally, IPS tracks cash collection percentages for each medical group on a monthly basis, setting quarterly and annual goals for cash collections, bad debt write-offs and aging of accounts receivable.

As of June 30, 2006, the Company no longer has ownership or management interests in surgery and diagnostic centers. Orion s principal source of revenues from its surgery center business was a surgical facility fee charged to patients for surgical procedures performed in its ASCs and for diagnostic services performed at TOM. Orion depended upon third-party programs, including governmental and private health insurance programs to pay these fees on behalf of its patients. Patients were responsible for the co-payments and deductibles when applicable. The fees varied depending on the procedure, but usually included all charges for operating room usage, special equipment usage, supplies, recovery room usage, nursing staff and medications. Facility fees did not include the charges of the patient s surgeon, anesthesiologist or other attending physicians, which were billed directly to third-party payers by such physicians. In addition to the facility fee revenues, Orion also earned management fees from its operating facilities and development fees from centers that it developed. ASCs, such as those in which Orion owned an interest prior to June 30, 2006, depend upon third-party reimbursement programs, including governmental and private insurance programs, to pay for services rendered to patients. The Medicare program currently pays ASCs and physicians in accordance with fee schedules, which are prospectively determined. In addition to payment from governmental programs, ASCs derive a significant portion of their net revenues from private healthcare reimbursement plans. These plans include standard indemnity insurance programs as well as managed care structures such as preferred provider organizations, health maintenance organizations and other similar structures.

Note 4. Use of Estimates

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

Note 5. Segment Reporting

In accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, the Company has determined that it has two reportable segments IPS and MBS. The reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology, operational support and marketing strategies. The Company s reportable

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Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

segments consist of: (i) IPS, which includes the pediatric medical groups that provide patient care operating under the MSA; and (ii) MBS, which provides practice management, billing and collections, managed care consulting and coding and reimbursement services to hospital-based physicians and clinics. Management chose to aggregate the MSAs into a single operating segment consistent with the objective and basic principles of SFAS No. 131 based on similar economic characteristics, including the nature of the products and services, the type of customer for their services, the methods used to provide their services and in consideration of the regulatory environment under Medicare and the Health Insurance Portability and Accountability Act of 1996.

The following table summarizes key financial information, by reportable segment, as of and for the three months and six months ended June 30, 2006 and 2005, respectively:

	For the Three Months Ended June 30, 2006			For the Six Months Ended June 30, 2006		
	IPS	MBS	Total	IPS	MBS	Total
Net operating revenues	$ 4,468,756	$ 2,361,762	$ 6,830,518	$ 9,149,031	$ 4,756,052	$ 13,905,083
Income from continuing operations	229,831	149,321	379,152	488,092	338,890	826,982
Depreciation and amortization	107,883	282,773	390,656	216,488	565,883	782,371
Total assets	8,220,192	10,043,365	18,263,557	8,220,192	10,043,365	18,263,557

	For the Three Months Ended June 30, 2005			For the Six Months Ended June 30, 2005		
	IPS	MBS	Total	IPS	MBS	Total
Net operating revenues	$ 4,980,618	$ 2,653,017	$ 7,633,635	$ 10,045,992	$ 5,193,532	$ 15,239,524
Income from continuing operations	292,174	262,225	554,399	542,512	462,898	1,005,410
Depreciation and amortization	103,789	285,742	389,531	245,010	572,882	817,892
Total assets	9,799,965	10,474,085	20,274,050	9,799,965	10,474,085	20,274,050

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The following schedules provide a reconciliation of the key financial information by reportable segment to the consolidated totals found in Orion s consolidated balance sheets and statements of operations as of and for the three months and six months ended June 30, 2006 and 2005, respectively:

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Net operating revenues:				
Total net operating revenues for reportable segments	$ 6,830,518	$ 7,633,635	$ 13,905,083	$ 15,239,524
Corporate revenue	101,196	17,656	180,644	41,589
Total consolidated net operating revenues	$ 6,931,714	$ 7,651,291	$ 14,085,727	$ 15,281,113
Loss from continuing operations:				
Total income from continuing operations for reportable segments	$ 379,152	$ 554,399	$ 826,982	$ 1,005,410
Charge for impairment of intangible assets		(6,362,849)		(6,362,849)
Extraordinary gain			665,463	
Corporate overhead	(860,317)	(1,999,363)	(1,777,808)	(3,850,082)
Total consolidated loss from continuing operations	$ (481,165)	$ (7,807,813)	$ (285,363)	$ (9,207,521)
Depreciation and amortization (including charge for impairment of intangible assets):				
Total depreciation and amortization for reportable segments	$ 390,656	$ 389,531	$ 782,371	$ 817,892
Charge for impairment of intangible assets		6,362,849		6,362,849
Corporate depreciation and amortization	18,274	454,448	36,457	909,309
Total consolidated depreciation and amortization (including charge for impairment of intangible assets)	$ 408,930	$ 7,206,828	$ 818,828	$ 8,090,050
Total assets:				
Total assets for reportable segments	$ 18,263,557	$ 20,274,050	$ 18,263,557	$ 20,274,050
Corporate assets	1,474,068	785,171	1,474,068	785,171
Assets held for sale or related to discontinued operations(1)		13,253,261		13,253,261

Total consolidated assets	$ 19,737,625	$ 34,312,482	$ 19,737,625	$ 34,312,482

(1) The balance at June 30, 2005 includes $9,179,336 of intangible assets and goodwill that were impaired in 2005.

Note 6. Goodwill and Intangible Assets

Goodwill and intangible assets represent the excess of cost over the fair value of net assets of companies acquired in business combinations accounted for using the purchase method. In July 2001, the FASB issued SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 eliminates pooling-of-interest accounting and requires that all business combinations initiated after June 30, 2001, be accounted for using the purchase method. SFAS No. 142 eliminates the amortization of goodwill and certain other intangible assets and requires the Company to evaluate goodwill for impairment on an

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Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

annual basis by applying a fair value test. SFAS No. 142 also requires that an identifiable intangible asset that is determined to have an indefinite useful economic life not be amortized, but separately tested for impairment using a fair value-based approach at least annually.

The Company adopted SFAS No. 142 effective January 1, 2002. As a result, IPS determined that its long-term MSAs, executed as part of the medical group business combinations consummated in 1999, are an identifiable intangible asset in accordance with paragraph 39 of SFAS No. 141.

As part of the acquisition and restructuring transactions that closed on December 15, 2004, the Company recorded intangible assets and goodwill related to the 2004 Mergers. As of the Closing, the Company s management expected the case volumes at Bellaire SurgiCare to improve in 2005. However, by the end of February 2005, it was determined that the expected case volume increases were not going to be realized. On March 1, 2005, the Company closed Bellaire SurgiCare and consolidated its operations with the operations of Memorial Village. The Company tested the identifiable intangible assets and goodwill related to the surgery center business using the present value of cash flows method. As a result of the decision to close Bellaire SurgiCare and the resulting impairment of the joint venture interest and management contracts related to the surgery centers, the Company recorded a charge for impairment of intangible assets of $4,090,555 for the year ended December 31, 2004.

As a result of the CARDC Settlement described in Note 1. General Description of Business Integrated Physician Solutions, the Company recorded a charge for impairment of intangible assets related to CARDC of $704,927 for the year ended December 31, 2004.

On June 13, 2005, the Company announced that it had accepted an offer to purchase its interests in TASC and TOM in Dover, Ohio. In preparation for this pending transaction, the Company tested the identifiable intangible assets related to the surgery center business using the present value of cash flows method as of June 30, 2005. Based on the pending sales transaction involving TASC and TOM, as well as the uncertainty of future cash flows related to the Company s surgery center business, the Company determined that the joint venture interests associated with TASC, TOM and Memorial Village were impaired and recorded a charge for impairment of intangible assets of $6,362,849 for the quarter ended June 30, 2005. The sale of the Company s interests in TASC and TOM was completed effective as of October 1, 2005. (See Note 1. General Description of Business Ambulatory Surgery Center Business).

In November 2005, the Company decided that, as a result of ongoing losses at Memorial Village, it would need to either find a buyer for the Company s equity interests in Memorial Village or close the facility. In preparation for this expected transaction, the Company once again tested the identifiable intangible assets related to the surgery center business using the present value of cash flows method at September 30, 2005. Based on the decision to sell or close Memorial Village, as well as the continuing uncertainty of cash flows related to the Company s surgery center segment, the Company determined that the joint venture interests for San Jacinto, as well as the management contracts associated with Memorial Village and San Jacinto, were impaired and recorded an additional charge for impairment of intangible assets totaling $3,461,351 for the quarter ended September 30, 2005.

As described in Note 1. General Description of Business Ambulatory Surgery Center Business, effective January 31, 2006 and March 1, 2006, respectively, the Company executed Asset Purchase Agreements to sell substantially all of the assets of Memorial Village and San Jacinto. Also in the first quarter of 2006, the Company was notified by Union that it was exercising its option to terminate the TASC MSA and TOM MSA. As a result of the sales of Memorial Village and San Jacinto, as well as the termination of the TASC MSA and TOM MSA, the Company no longer has an ownership or management interest in any ambulatory surgery centers and, as such, the Company tested the remaining identifiable intangible assets related to the surgery centers from the IPS Merger at December 31, 2005. Based on the terminations of the TASC MSA and TOM MSA, as well as the sales of Memorial Village and San Jacinto, the Company determined that the management contracts associated with TASC and TOM were impaired and recorded an additional charge for impairment of intangible assets of $1,163,830 for the quarter ended December 31, 2005.

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As a result of the Sutter Settlement, which is described in Note 1. General Description of Business Integrated Physician Solutions, the Company also recorded an additional $38,440 charge for impairment of intangible assets for the quarter ended December 31, 2005.

In order to determine whether the goodwill recorded as a result of the IPS Merger was impaired at December 31, 2005, the Company compared the fair value of each ASC s assets to its net carrying value. As each of the ASCs was sold between October 1, 2005 and March 1, 2006, the fair value of each ASC was best determined by the purchase price of the assets. Since TASC and TOM were sold effective October 1, 2005, the balance sheet at September 30, 2005 was used to determine the fair value of its assets. Since the Memorial Village and San Jacinto transactions took place after year-end, the December 31, 2005 balance sheets were used to determine the carrying value of the assets of those entities. The Company determined that the fair value of each ASC was greater than the carrying value in each case and concluded that there was no impairment of goodwill at December 31, 2005. As a result of the sale of all of the entities related to the Company s ambulatory surgery center business, the Company allocated the goodwill recorded as part of the IPS Merger to each of the surgery center reporting units and recorded a loss on the write-down of goodwill of $3,489,055 for the quarter ended December 31, 2005. The charge for the write-down of goodwill was included in discontinued operations in 2005.

Note 7. Earnings per Share

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2006	2005	2006	2005
Net income (loss)	$ (480,197)	$ (8,347,789)	$ 291,027	$ (10,028,418)
Weighted average number of shares of Class A Common Stock outstanding for basic net income (loss) per share	12,591,319	9,246,425	12,510,131	8,958,080
Dilutive stock options, warrants and restricted stock units(1)	(5)	(a)	2,612,347	(a)
Convertible notes payable(2)	(5)	(b)	1,687,200	(b)
Class B Common Stock(3)	(5)	(c)	57,623,732	(c)
Class C Common Stock(4)	(5)	(d)	14,885,754	(d)
Weighted average number of shares of Class A Common Stock outstanding for diluted net loss per	12,591,319	9,246,425	89,319,164	8,958,080

share									
Net income (loss) per share	Basic	$	(0.04)	$	(0.90)	$	0.03	$	(1.12)
Net income (loss) per share	Diluted	$	(0.04)	$	(0.90)	$	0.01	$	(1.12)

(1) 2,612,347 options, warrants and restricted stock units were outstanding as of June 30, 2006.

(2) $1,300,000 of notes were convertible into Class A Common Stock at June 30, 2006. Of the total, $50,000 was convertible into 349,224 shares of Class A Common Stock based on a conversion price equal to 75% of the

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average closing price for the 20 trading days immediately prior to June 30, 2006. The remaining $1,250,000 was convertible into 1,337,976 shares of Class A Common Stock at June 30, 2006.

(3) 10,448,470 shares of Class B Common Stock were outstanding at June 30, 2006. Holders of shares of Class B Common Stock have the option to convert their shares of Class B Common Stock into Class A Common Stock at any time based on a conversion factor in effect at the time of the transaction. The conversion factor is designed to yield one share of Class A Common Stock per share of Class B Common Stock converted, plus such additional shares of Class A Common Stock, or portions thereof, necessary to approximate the unpaid portion of the return of the original purchase price for the Class B Common Stock and a nine percent (9%) return on the original purchase price for the Class B Common Stock without compounding, from the date of issuance through the date of conversion. As of June 30, 2006, each share of Class B Common Stock was convertible into 5.515040151157 shares of Class A Common Stock.

(4) 1,437,572 shares of Class C Common Stock were outstanding at June 30, 2006. Holders of shares of Class C Common Stock have the option to convert their shares of Class C Common Stock into shares of Class A Common Stock at any time based on a conversion factor in effect at the time of the transaction. The conversion factor is designed initially to yield one share of Class A Common Stock per share of Class C Common Stock converted, with the number of shares of Class A Common Stock reducing to the extent that distributions are paid on the Class C Common Stock. The conversion factor is calculated as (x) the amount by which $3.30 exceeds the aggregate distributions made with respect to a share of Class C Common Stock divided by (y) $3.30. The initial conversion factor was one (one share of Class C Common Stock converts into one share of Class A Common Stock) and is subject to adjustment as discussed below. If the fair market value used in determining the conversion factor for the Class B Common Stock in connection with any conversion of Class B Common Stock is less than $3.30 (subject to adjustment to account for stock splits, stock dividends, combinations or other similar events affecting Class A Common Stock), holders of shares of Class C Common Stock have the option to convert their shares of Class C Common Stock (within 10 days of receipt of notice of the conversion of the Class B Common Stock) into a number of shares of Class A Common Stock equal to (x) the amount by which $3.30 exceeds the aggregate distributions made with respect to a share of Class C Common Stock divided by (y) the fair market value used in determining the conversion factor for the Class B Common Stock (the Anti-Dilution Option). The aggregate number of shares of Class C Common Stock so converted by any holder shall not exceed a number equal to (a) the number of shares of Class C Common Stock held by such holder immediately prior to such conversion plus the number of shares of Class C Common Stock previously converted in Class A Common Stock by such holder multiplied by (b) a fraction, the numerator of which is the number of shares of Class B Common Stock converted at the lower price and the denominator of which is the aggregate number of shares of Class B Common Stock issued at the closing of the 2004 Mergers. If all of the Class B Common Stock had been converted at June 30, 2006, the holders of Class C Common Stock would have been eligible to convert 1,308,142 shares of Class C Common Stock into 14,885,754 shares of Class A Common Stock under the anti-dilution provision.

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

The following potentially dilutive securities are not included in the calculation of weighted average number of shares of Class A Common Stock outstanding for diluted net loss per share for the three months and six months ended June 30, 2005, because the effect would be anti-dilutive due to the net loss for the periods:

a) 1,860,347 options and warrants were outstanding at June 30, 2005.

b) $1,300,000 of notes were convertible into Class A Common Stock at June 30, 2005. Of the total, $50,000 were convertible at a conversion price equal to the lower of $2.50 or 75% of the average closing price for the 20 trading days immediately prior to the conversion date. The remaining $1,250,000 was convertible into 1,228,598 shares of Class A Common Stock at June 30, 2005.

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Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

c) 10,685,381 shares of Class B Common Stock were outstanding at June 30, 2005. Holders of shares of Class B Common Stock have the option to convert their shares of Class B Common Stock into Class A Common Stock at any time based on a conversion factor in effect at the time of the transaction. The conversion factor is designed to yield one share of Class A Common Stock per share of Class B Common Stock converted, plus such additional shares of Class A Common Stock, or portions thereof, necessary to approximate the unpaid portion of the return of the original purchase price for the Class B Common Stock and a nine percent (9%) return on the original purchase price for the Class B Common Stock without compounding, from the date of issuance through the date of conversion.

d) 1,555,137 shares of Class C Common Stock were outstanding at June 30, 2005. The shares of Class C Common Stock are convertible into shares of Class C Common Stock based on the formula described in (4), above.

Note 8. Employee Stock-Based Compensation

At June 30, 2006, the Company had two stock-based employee compensation plans. Prior to January 1, 2006, the Company accounted for grants for these plans under Accounting Principals Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees (APB 25) and related interpretations, and applied SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, for disclosure purposes only. Under APB 25, stock-based compensation cost related to stock options was not recognized in net income since the options underlying those plans had exercise prices greater than or equal to the market value of the underlying stock on the date of the grant. The Company grants options at or above the market price of its common stock at the date of each grant.

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

On August 31, 2005, the Company granted 650,000 restricted stock units to certain officers of the Company under the Company s 2004 Incentive Plan, as amended. No restricted stock units have been granted in 2006.

Effective January 1, 2006, the company adopted SFAS No. 123 (revised 2004), Share Based Payment, (SFAS No. 123(R)) which revises SFAS No. 123 and supersedes APB 25. SFAS No. 123(R) requires that all share-based payments to employees be recognized in the financial statements based on their fair values at the date of grant. The calculated fair value is recognized as expense (net of any capitalization) over the requisite service period, net of estimated forfeitures, using the straight-line method under SFAS No. 123(R). The Company considers many factors when estimated expected forfeitures, including types of awards, employee class and historical experience. The statement was adopted using the modified prospective method of application which requires compensation expense to be recognized in the financial statements for all unvested stock options beginning in the quarter of adoption. No adjustments to prior periods have been made as a result of adopting SFAS No. 123(R). Under this transition method, compensation expense for share-based awards granted prior to January 1, 2006, but not yet vested as of January 1, 2006, will be recognized in the Company s financial statements over their remaining service period. The cost was based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123. As required by SFAS No. 123(R), compensation expense recognized in future periods for share-based compensation granted prior to adoption of the standard will be adjusted for the effects of estimated forfeitures.

For the three months and six months ended June 30, 2006, the impact of adopting SFAS No. 123(R) on the Company s consolidated condensed statements of operations was an increase in salaries and benefits expense of

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Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

$49,642 and $97,713, respectively, with a corresponding decrease in the Company s income from continuing operations, income before provision for income taxes and net income resulting from the recognition of compensation expense associated with employee stock options. There was no material impact on the Company s basic and diluted net income per share as a result of the adoption of SFAS No. 123(R).

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

The following table illustrates the pro forma net income and earnings per share that would have resulted in the three months and six months ended June 30, 2005 from recognizing compensation expense associated with accounting for employee stock-based awards under the provisions of SFAS No. 123(R). The reported and pro forma net income and earnings per share for the three months and six months ended June 30, 2006 are provided for comparative purposes only, since stock-based compensation expense is recognized in the financial statements under the provisions of SFAS No. 123(R).

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Net income (loss) as reported	$ (480,197)	$ (8,347,789)	$ 291,027	$ (10,028,418)
Add: Stock-based employee compensation included in net income (loss)	49,642		97,713	
Deduct: Total stock-based employee compensation (expense determined under the fair value-based method for all awards), net of tax effect	(49,642)	(42,775)	(97,713)	(69,137)
Net loss pro forma	$ (480,197)	$ (8,390,564)	$ 291,027	$ (10,097,555)
Net loss per share:				
Basic as reported	$ (0.04)	$ (0.90)	$ 0.03	$ (1.12)
Basic pro forma	$ (0.04)	$ (0.91)	$ 0.03	$ (1.13)
Diluted as reported	$ (0.04)	$ (0.90)	$ 0.01	$ (1.12)
Diluted pro forma	$ (0.04)	$ (0.91)	$ 0.00	$ (1.13)

Note 9. Discontinued Operations

Bellaire SurgiCare. As of the Closing, the Company s management expected the case volumes at Bellaire SurgiCare to improve in 2005. However, by the end of February 2005, it was determined that the expected case volume increases were not going to be realized. On March 1, 2005, the Company closed Bellaire SurgiCare and consolidated its operations with the operations of Memorial Village. The Company tested the identifiable intangible assets and goodwill related to the surgery center business using the present value of cash flows method. As a result of the decision to close Bellaire SurgiCare and the resulting impairment of the joint venture interest and management contracts related to the surgery centers, the Company recorded a charge for impairment of intangible assets of $4,090,555 for the year ended December 31, 2004. The Company also recorded a loss on disposal of this discontinued component (in addition to the charge for impairment of intangible assets) of $163,049 for the quarter ended March 31, 2005. The operations of this component are reflected in the Company s consolidated condensed statements of operations as loss from operations of discontinued components for the three months and six months ended June 30, 2005. There were no operations for this component after March 31, 2005.

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Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

The following table contains selected financial statement data related to Bellaire SurgiCare as of and for the three months and six months ended June 30, 2005:

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Income statement data:		
Net operating revenues	$	$ 161,679
Operating expenses		350,097
Net loss	$	$ (188,418)
Balance sheet data:		
Current assets	$	$
Other assets		
Total assets	$	$
Current liabilities	$	$
Other liabilities		
Total liabilities	$	$

CARDC. On April 1, 2005, IPS entered into the CARDC Settlement with Dr. Bradley E. Chipps, M.D. and CARDC to settle disputes as to the existence and enforceability of certain contractual obligations. As part of the CARDC Settlement, Dr. Chipps, CARDC, and IPS agreed that CARDC would purchase the assets owned by IPS and used in connection with CARDC, in exchange for termination of the MSA between IPS and CARDC. Additionally, among other provisions, after April 1, 2005, Dr. Chipps, CARDC and IPS have been released from any further obligation to each other arising from any previous agreement. As a result of the CARDC dispute, the Company recorded a charge for impairment of intangible assets related to CARDC of $704,927 for the year ended December 31, 2004. The Company also recorded a gain on disposal of this discontinued component (in addition to the charge for impairment of intangible assets) of $506,625 for the quarter ended March 31, 2005. For the quarter ended June 30, 2005, the Company reduced the gain on disposal of this discontinued component by $238,333 as the result of post-settlement adjustments related to the reconciliation of balance sheet accounts. The operations of this component are reflected in the Company s consolidated condensed statements of operations as loss from operations of discontinued components for the three months and six months ended June 30, 2005. There were no operations for this component in the Company s financial statements after March 31, 2005.

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Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

The following table contains selected financial statement data related to CARDC as of and for the three months and six months ended June 30, 2005:

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Income statement data:		
Net operating revenues	$	$ 848,373
Operating expenses		809,673
Net loss	$	$ 38,700
Balance sheet data:		
Current assets	$	$
Other assets		
Total assets	$	$
Current liabilities	$	$
Other liabilities		
Total liabilities	$	$

IntegriMED. On June 7, 2005, as described in Note 1. General Description of Business Integrated Physician Solutions, IPS executed an Asset Purchase Agreement with eClinicalWeb to sell substantially all of the assets of IntegriMED. As a result of this transaction, the Company recorded a loss on disposal of this discontinued component of $47,101 for the quarter ended June 30, 2005. The operations of this component are reflected in the Company s consolidated condensed statements of operations as loss from operations of discontinued components for the three months and six months ended June 30, 2005. There were no operations for this component in the Company s financial statements after June 30, 2005.

The following table contains selected financial statement data related to IntegriMED as of and for the three months and six months ended June 30, 2005:

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Income statement data:		

Net operating revenues	$	82,155	$	191,771
Operating expenses		392,931		899,667
Net loss	$	(310,776)	$	(707,896)
Balance sheet data:				
Current assets	$	(24,496)	$	(24,496)
Other assets				
Total assets	$	(24,496)	$	(24,496)
Current liabilities	$	17,022	$	17,022
Other liabilities				
Total liabilities	$	17,022	$	17,022

TASC and TOM. On June 13, 2005, the Company announced that it had accepted an offer to purchase its interests in TASC and TOM in Dover, Ohio. These transactions, which were consummated on September 30, 2005, were deemed to be effective as of October 1, 2005, and are described in greater detail in Note 1. General Description of Business Ambulatory Surgery Center Business. As a result of these transactions, as well as the

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Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

uncertainty of future cash flows related to the Company s surgery center business, the Company recorded a charge for impairment of intangible assets of $6,362,849 for the three months ended June 30, 2005. As a result of these transactions, the Company recorded a gain on disposal of this discontinued component (in addition to the charge for impairment of intangible assets) of $1,357,712 for the quarter ended December 31, 2005. The Company allocated the goodwill recorded as part of the IPS Merger to each of the surgery center reporting units and recorded a loss on the write-down of goodwill related to TASC and TOM totaling $789,173 for the quarter ended December 31, 2005, which reduced the gain on disposal. The operations of this component are reflected in the Company s consolidated condensed statements of operations as loss from operations of discontinued components for the three months and six months ended June 30, 2005. There were no operations for this component in the Company s financial statements after September 30, 2005.

The following table contains selected financial statement data related to TASC and TOM as of and for the three months and six months ended June 30 2005:

		Three Months Ended June 30, 2005		Six Months Ended June 30, 2005
Income statement data:				
Net operating revenues	$	873,959	$	1,670,801
Operating expenses		799,418		1,630,806
Net loss	$	74,541	$	39,995
Balance sheet data:				
Current assets	$	794,831	$	794,831
Other assets		1,487,732		1,487,732
Total assets	$	2,282,563	$	2,282,563
Current liabilities	$	709,779	$	709,779
Other liabilities		907,390		907,390
Total liabilities	$	1,617,169	$	1,617,169

Sutter. On October 31, 2005, IPS executed the Sutter Settlement with Dr. Sutter to settle disputes that had arisen between IPS and Dr. Sutter and to avoid the risk and expense of litigation. As part of the Sutter Settlement, Dr. Sutter and IPS agreed that Dr. Sutter would purchase the assets owned by IPS and used in connection with Dr. Sutter s practice, in exchange for termination of the MSA between IPS and Dr. Sutter. Additionally, among other provisions, after October 31, 2005, Dr. Sutter and IPS have been released from any further obligation to each other arising from any previous agreement. As a result of this transaction, the Company recorded a loss on disposal of this discontinued component (in addition to the charge for impairment of intangible assets) of $279 for the quarter ended December 31,

2005. The operations of this component are reflected in the Company s consolidated condensed statements of operations as loss from operations of discontinued components for the three months and six months ended June 30, 2005. There were no operations for this component in the Company s financial statements after October 31, 2005.

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Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

The following table contains selected financial statement data related to Sutter as of and for the three months and six months ended June 30, 2005:

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Income statement data:		
Net operating revenues	$ 107,419	$ 216,319
Operating expenses	105,171	210,609
Net loss	$ 2,248	$ 5,710
Balance sheet data:		
Current assets	$ 113,819	$ 113,819
Other assets	15,033	15,033
Total assets	$ 128,852	$ 128,852
Current liabilities	$ 7,839	$ 7,839
Other liabilities		
Total liabilities	$ 7,839	$ 7,839

Memorial Village. In November 2005, the Company decided that, as a result of ongoing losses at Memorial Village, it would need to either find a buyer for the Company s equity interests in Memorial Village or close the facility. In preparation for this pending transaction, the Company tested the identifiable intangible assets and goodwill related to the surgery center business using the present value of cash flows method. As a result of the decision to sell or close Memorial Village, as well as the uncertainty of cash flows related to the Company s surgery center business, the Company recorded a charge for impairment of intangible assets of $3,461,351 for the three months ended September 30, 2005. As described in Note 1. General Description of Business Ambulatory Surgery Center Business, effective January 31, 2006, the Company executed an Asset Purchase Agreement to sell substantially all of the assets of Memorial Village. As a result of this transaction, the Company recorded a gain on the disposal of this discontinued component (in addition to the charge for impairment of intangible assets) of $574,321 for the quarter ended March 31, 2006. The Company allocated the goodwill recorded as part of the IPS Merger to each of the surgery center reporting units and recorded a loss on the write-down of goodwill related to Memorial Village totaling $2,005,383 for the quarter ended December 31, 2005. The operations of this component are reflected in the Company s consolidated statements of operations as loss from operations of discontinued components for the three months and six months ended June 30, 2006 and 2005, respectively.

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Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

The following table contains selected financial statement data related to Memorial Village as of and for the three months and six months ended June 30, 2006 and 2005, respectively:

	Three Months Ended		Six Months Ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
Income statement data:				
Net operating revenues	$	$ 684,676	$ 17,249	$ 1,268,852
Operating expenses		812,407	170,285	1,511,624
Net loss	$	$ (127,731)	$ (153,036)	$ (242,772)
Balance sheet data:				
Current assets	$	$ 861,111	$	$ 861,111
Other assets		767,497		767,497
Total assets	$	$ 1,628,608	$	$ 1,628,608
Current liabilities	$	$ 729,567	$	$ 729,567
Other liabilities		725,884		725,884
Total liabilities	$	$ 1,455,451	$	$ 1,455,451

San Jacinto. As described in Note 1. General Description of Business Ambulatory Surgery Center Business, effective March 1, 2006, the Company executed an Asset Purchase Agreements to sell substantially all of the assets of San Jacinto, which is 10% owned by Baytown SurgiCare, Inc., a wholly owned subsidiary of the Company and is not consolidated in the Company s financial statements. As a result of this transaction, the Company recorded a gain on disposal of this discontinued operation of $94,066 for the quarter ended March 31, 2006. The Company allocated the goodwill recorded as part of the IPS Merger to each of the surgery center reporting units and recorded a loss on the write-down of goodwill related to San Jacinto totaling $694,499 for the quarter ended December 31, 2005.

Orion. Prior to the divestiture of the Company s ambulatory surgery center business, the Company recorded management fee revenue, which was eliminated in the consolidation of the Company s financial statements, for Bellaire SurgiCare, TASC and TOM and Memorial Village. The management fee revenue for San Jacinto was not eliminated in consolidation. The management fee revenue associated with the discontinued operations in the surgery center business totaled $968 and $61,039, respectively, for the three months and six months ended June 30, 2006. For the three months and six months ended June 30, 2005, the Company generated management fee revenue of $112,155 and 218,407, respectively, and net minority interest losses totaling $3,318 and 42,765, respectively.

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Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

The following table summarizes the components of income (loss) from operations of discontinued components:

	Three Months Ended		Six Months Ended	
	June 30, 2006	**June 30, 2005**	**June 30, 2006**	**June 30, 2005**
Bellaire SurgiCare				
Net loss	$	$	$	(188,418)
Loss on disposal				(163,049)
CARDC				
Net income				38,700
Gain on disposal		(238,333)		268,292
IntegriMED				
Net loss		(310,776)		(707,896)
Loss on disposal		(47,101)		(47,101)
TASC and TOM				
Net income		74,541		39,995
Sutter				
Net income		2,248		5,710
Memorial Village				
Net loss		(127,731)	(153,036)	(242,772)
Gain on disposal			574,321	
San Jacinto				
Gain on disposal			94,066	
Orion				
Net income	968	107,176	61,039	175,642
Total income (loss) from operations of discontinued components, including net gain (loss) on disposal	$ 968	$ (539,976)	$ 576,390	$ (820,897)

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Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

Note 10. Long-Term Debt

Long-term debt is as follows:

	As of	
	June 30, 2006	December 31, 2005
Promissory note due to sellers of MBS, bearing interest at 8%, interest payable monthly or on demand, matures December 15, 2007	$ 1,714,336	$ 1,000,000
Working capital due to sellers of MBS, due on demand		199,697
Term loan with a financial institution, non-interest bearing, matures November 15, 2010, net of accretion of $654,418 and $641,467, respectively	3,095,725	3,108,677
Revolving line of credit with a financial institution, bearing interest at 6.5%, interest payable monthly or on demand(1)		778,005
$2,300,000 revolving line of credit, bearing interest at prime (8.25% at June 30, 2006) plus 6%, interest payable monthly, matures December 14, 2006(2)	998,668	1,703,277
Convertible notes, bearing interest at 18%, interest payable monthly, convertible on demand	50,000	50,000
Note payable due to a related party, bearing interest at 6%, interest payable monthly, due on demand		13,611
Insurance financing note payable, bearing interest at 5.25%, interest payable monthly	126,140	
Convertible promissory notes due to a related party, bearing interest at 9%, matures October 15, 2006	1,250,000	1,250,000
Total long-term debt	7,234,869	8,103,267
Less: current portion of long-term debt	(3,439,897)	(4,231,674)
Long-term debt, net of current portion	$ 3,794,972	$ 3,871,593

(1) As of March 13, 2006, the Company had retired approximately $778,000 of debt at a discounted price of $112,500.

(2) As part of the Loan and Security Agreement, the Company is required to comply with certain financial covenants, measured on a quarterly basis. The financial covenants include maintaining a required debt service coverage ratio and meeting a minimum operating income level for the surgery and diagnostic centers before corporate overhead allocations. At June 30, 2006, the Company was out of compliance with both of these

financial covenants and has notified the lender as such. Under the terms of the Loan and Security Agreement, failure to meet the required financial covenants constitutes an event of default. Under an event of default, the lender may (i) accelerate and declare the obligations under the credit facility to be immediately due and payable; (ii) withhold or cease to make advances under the credit facility; (iii) terminate the credit facility; (iv) take possession of the collateral pledged as part of the Loan and Security Agreement; (v) reduce or modify the revolving loan commitment; and/or (vi) take necessary action under the Guaranties. The full amount of the loan as of June 30, 2006 is recorded as a current liability. In December 2005, the Company received notification from CIT stating that (i) certain events of default under the Loan and Security Agreement had occurred as a result of the Company being out of compliance with two financial covenants relating to its debt service coverage ratio and its minimum operating income level, (ii) as a result of the events of default, CIT raised the interest rate for monies borrowed under the Loan and Security Agreement to the provided Default Rate of prime rate plus 6%, (iii) the amount available under the revolving credit facility was reduced to $2,300,000 and

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Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

(iv) CIT reserved all additional rights and remedies available to it as a result of these events of default. The Company is currently in negotiations with CIT to obtain, among other provisions, a waiver of the events of default. In the event CIT declares the obligations under the Loan and Security Agreement to be immediately due and payable or exercises its other rights described above, the Company would not be able to meet its obligations to CIT or its other creditors. As a result, such action would have a material adverse effect on the Company s ability to continue as a going concern.

Note 11. Litigation

On January 1, 1999, IPS acquired Children s Advanced Medical Institutes, Inc. (CAMI) in a merger transaction. On that same date, IPS began providing management services to the Children s Advanced Medical Institutes, P.A. (the P.A.), an entity owned by the physicians affiliated with CAMI. The parties rights and obligations were memorialized in a merger agreement, a management services agreement and certain other agreements. On February 7, 2000, the P.A., certain physicians affiliated with the P.A., and the former shareholders of CAMI filed suit against IPS in the U.S. District Court for the Northern District of Texas, Dallas Division, Civil Action File No. 3-00-CV-0536-L. On May 9, 2001, IPS (which was formerly known as Pediatric Physician Alliance, Inc.) filed suit against the P.A., certain physicians who were members of the P.A., and Patrick Solomon as Escrow Agent of CAMI. The case was filed in the U.S. District Court for the Northern District of Texas, Dallas Division, Civil Action File No. 3-01CV0877-L. In their complaint, the P.A., the former shareholders of CAMI and the physicians seek a claim against IPS for approximately $500,000 (which includes interest and attorneys fees). IPS asserted a claim against the physicians for over $5,000,000 due to the overpayments and their alleged breach of the agreements. An arbitration hearing was held on the claim filed by the former shareholders of CAMI in January 2004, and the Arbitrator issued an award against IPS. The U.S. District Court confirmed the award in the amount of $548,884 and judgment was entered. IPS has accrued approximately $540,000 for possible losses related to this claim. On June 1, 2005, IPS and the physicians executed a settlement agreement under which $300,000 of the judgment was paid to the physicians with the remaining amount of the judgment being returned to IPS. All claims asserted in the lawsuit and arbitration were dismissed with prejudice.

On October 5, 2004, Orion s predecessor, SurgiCare, was named as a defendant in a suit entitled Shirley Browne and Bellaire Anesthesia Management Consultants, Inc. (BAMC) v. SurgiCare, Inc., Bellaire SurgiCare, Inc., Sherman Nagler, Jeffrey Penso, and Michael Mineo, in the 152nd Judicial District Court of Harris County, Texas, Cause No. 2004-55688. The dispute arises out of the for cause termination of BAMC s exclusive contract to provide anesthesia services to Bellaire SurgiCare, Inc. Ms. Browne had filed a charge of discrimination with the EEOC on February 6, 2004, claiming that she was terminated in retaliation for having previously complained about discriminatory treatment and a hostile work environment. She claimed she had been discriminated against based on her sex, female, and retaliated against in violation of Title VII. The Company denied Ms. Browne s allegations of wrongdoing. The EEOC declined to institute an action and issued a right to sue letter, which prompted the lawsuit. The parties have reached a final settlement, which was accrued for as of September 30, 2005 and paid on December 27, 2005, on all matters for dismissal of all claims.

On July 12, 2005, Orion was named as a defendant in a suit entitled American International Industries, Inc. vs. Orion HealthCorp, Inc., previously known as SurgiCare, Inc., Keith G. LeBlanc, Paul Cascio, Brantley Capital Corporation, Brantley Venture Partners III, L.P., and Brantley Partners IV, L.P. in the 80th Judicial District Court of Harris County, Texas, Cause No. 2005-44326. This case involves allegations that the Company made material and intentional misrepresentations regarding the financial condition of the parties to the acquisition and restructuring transactions effected on December 15, 2004 for the purpose of inducing American International Industries, Inc. (AII) to convert its SurgiCare Class AA convertible preferred stock (Class AA Preferred Stock) into shares of Orion Class A Common Stock. AII asserts that the value of its Class A Common Stock of Orion has fallen as a direct result of the alleged material misrepresentations by the Company. AII is seeking actual damages of $3,800,000, punitive damages of $3,800,000, and rescission of the agreement to convert the Class AA Preferred Stock into

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Orion HealthCorp, Inc.

Notes to Unaudited Consolidated Condensed Financial Statements (Continued)

Class A Common Stock. The Company and the other defendants filed an Answer denying the allegations set forth in the Complaint.

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

Note 12. Subsequent Events

In connection with the DCPS/MBS Merger in December 2004, 75,758 shares of Orion s Class A Common Stock were reserved for issuance at the direction of the sellers of the MBS and DCPS equity. On July 14, 2006, 75,000 shares of Class A Common Stock were issued to certain employees and affiliates of MBS and DCPS.

On August 8, 2006, Brantley IV and the Company executed the First and Second Note Second Amendment, which extends the First Note Maturity Date and Second Note Maturity Date to October 15, 2006. (See Note 2. Going Concern).

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ORION HEALTHCORP, INC.
SPECIAL MEETING OF STOCKHOLDERS
SEPTEMBER _____, 2006

The undersigned hereby appoints each of Terrence L. Bauer and Stephen H. Murdock, or their designees, with full powers of substitution, to act as attorney and proxy for the undersigned, to vote all shares of Class A Common Stock, Class B Common Stock and Class C Common Stock which the undersigned is entitled to vote at the Special Meeting, to be held on __________, September ______, 2006, at 8:00 a.m. local time, at 1805 Old Alabama Road, Roswell, Georgia 30076, or at any and all adjournments or postponements thereof, in the following manner:

THE APPROVAL OF PROPOSALS II, III AND IV IS CONTINGENT ON THE APPROVAL OF PROPOSAL I. THE APPROVAL OF PROPOSAL III IS CONTINGENT ON THE APPROVAL OF PROPOSALS I AND II. THE APPROVAL OF PROPOSAL IV IS CONTINGENT ON THE APPROVAL OF PROPOSALS I, II AND III. THE APPROVAL OF PROPOSAL V IS CONTINGENT ON THE APPROVAL OF PROPOSALS I AND II.

The description of Proposals I through V below are qualified in their entirety by reference to the descriptions contained in the accompanying proxy statement. We advise you to read the proxy statement, including the sections describing each proposal to be voted upon, prior to executing and returning this proxy.

<u>Proposals to be Voted Upon by All Stockholders:</u>

	FOR	AGAINST	ABSTAIN
Proposal I Approval of an amendment to our certificate of incorporation to increase the aggregate number of shares of our authorized capital stock to 370,000,000 shares			

	FOR	AGAINST	ABSTAIN
Proposal II Approval of an amendment to our certificate of incorporation to increase the number of authorized shares of Class A Common Stock to 300,000,000 shares			

	FOR	AGAINST	ABSTAIN
Proposal III Approval of an amendment to our certificate of incorporation to create a new class of common stock, Class D Common Stock, and to authorize 50,000,000 shares of Class D Common Stock			

	FOR	AGAINST	ABSTAIN
Proposal IV Approval of the issuance of additional shares of our stock in the following three transactions: (i) shares of Class D Common Stock in a private placement, (ii) warrants to purchase shares of Class A Common Stock in a private placement and (iii) shares of Class A Common Stock in connection with an acquisition			

	FOR	AGAINST	ABSTAIN
Proposal V Approval of the amendment to our 2004 Incentive Plan			

<u>Proposals to be Voted Upon by Only Holders of Class B Common Stock:</u>

	FOR	AGAINST	ABSTAIN
Proposal III Approval of an amendment to our certificate of incorporation to create a new class of common stock, Class D Common Stock, and to authorize 50,000,000 shares of Class D Common Stock			

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Proposals to be Voted Upon by Only Holders of Class C Common Stock:

	FOR	AGAINST	ABSTAIN
Proposal III Approval of an amendment to our certificate of incorporation to create a new class of common stock, Class D Common Stock, and to authorize 50,000,000 shares of Class D Common Stock			

In their discretion, these attorneys and proxies are authorized to vote in their discretion upon any other business as may properly come before the Special Meeting and all adjournments or postponements thereof.

The board of directors and, in certain instances the special committee, recommends a vote FOR each of the above listed proposals.

THIS PROXY WILL BE VOTED AS DIRECTED, BUT IF NO INSTRUCTIONS ARE SPECIFIED, THIS SIGNED PROXY WILL BE VOTED FOR EACH OF THE PROPOSALS STATED. IF ANY OTHER BUSINESS IS PRESENTED AT THE MEETING, THIS PROXY WILL BE VOTED BY THOSE NAMED IN THIS PROXY IN THEIR BEST JUDGMENT.

THIS PROXY IS SOLICITED BY THE BOARD OF DIRECTORS.

Should the undersigned be present and elect to vote at the Special Meeting, or at any adjournment thereof, and after notification to our Corporate Secretary at the Special Meeting of the stockholder s decision to terminate this proxy, the power of said attorneys and proxies shall be deemed terminated and of no further force and effect. The undersigned may also revoke this proxy by filing a subsequently dated proxy or by written notification to our Corporate Secretary of his or her decision to terminate this proxy. Such subsequently dated proxy must be received by our Corporate Secretary prior to the date of the Special Meeting.

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The undersigned acknowledges receipt from us prior to the execution of this proxy of the Notice of Special Meeting of Stockholders and Proxy Statement dated September _______, 2006.

Dated: ____________________, 2006

SIGNATURE OF STOCKHOLDER SIGNATURE OF STOCKHOLDER

PRINT NAME OF STOCKHOLDER PRINT NAME OF STOCKHOLDER

Please sign exactly as your name appears on this proxy. When signing as attorney, executor, administrator, trustee, or guardian, please give your full title. If shares are held jointly, each holder should sign.

PLEASE COMPLETE, DATE, SIGN, AND MAIL THIS PROXY PROMPTLY IN THE ENCLOSED POSTAGE-PREPAID ENVELOPE.

IF YOUR ADDRESS HAS CHANGED, PLEASE CORRECT THE ADDRESS IN THE SPACE PROVIDED BELOW AND RETURN THIS PORTION WITH THE PROXY IN THE ENVELOPE PROVIDED.

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