MedQuist Holdings Inc.
Form 10-Q
November 10, 2011
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q
(Mark One)

þ	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended September 30, 2011.
OR	
o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the transition period from _____________ to _____________

Commission file number: 1-35069
MEDQUIST HOLDINGS INC.
(Exact name of Registrant as Specified in its Charter)

Delaware	98-0676666
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
9009 Carothers Parkway Franklin, TN	37067
(Address of Principal Executive Offices)	(Zip Code)

(615) 261-1740
(Registrant’s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o	Non-accelerated filer þ (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

The number of registrant's shares of common stock outstanding as of November 3, 2011 was 56,183,420.

MEDQUIST HOLDINGS INC.
INDEX

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
MedQuist Holdings Inc. and Subsidiaries
Consolidated Statements of Operations
(In thousands, except per share amounts)
Unaudited

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Net revenues	$108,034	$113,200	$327,709	$306,792
Cost of revenues	62,068	69,936	193,542	194,886
Gross profit	45,966	43,264	134,167	111,906
Operating costs and expenses:				
Selling, general and administrative	15,469	15,565	46,365	45,664
Research and development	2,181	3,351	7,073	8,944
Depreciation and amortization	9,219	9,125	26,516	23,745
Cost (benefit) of legal proceedings, settlements and accommodations	44	633	(6,888)	2,785
Acquisition and restructuring	6,251	1,797	17,520	8,808
Total operating costs and expenses	33,164	30,471	90,586	89,946
Operating income	12,802	12,793	43,581	21,960
Equity in income of affiliated company	—	70	—	616
Other (expense) income	(4,033)	482	(2,560)	560
Interest expense, net	(7,081)	(4,663)	(21,079)	(11,969)
Income from continuing operations before income taxes and noncontrolling interests	1,688	8,682	19,942	11,167
Income tax (benefit) provision	(19,226)	229	(17,196)	(153)
Net income from continuing operations	$20,914	$8,453	$37,138	$11,320
Income from discontinued operations, net of tax	—	155	—	338
Net income	20,914	8,608	37,138	11,658
Less: Net income attributable to noncontrolling interests	(361)	(2,737)	(2,138)	(5,234)
Net income attributable to MedQuist Holdings Inc.	$20,553	$5,871	$35,000	$6,424
Net income per common share from continuing operations			—	
Basic	$0.40	$0.15	$0.60	$0.11
Diluted	$0.39	$0.11	$0.59	$0.11
Net income per common share from discontinued operations				
Basic	$—	$—	$—	$0.01
Diluted	$—	$—	$—	$0.01
Net income per common share attributable to MedQuist Holdings Inc.				
Basic	$0.40	$0.15	$0.60	$0.12
Diluted	$0.39	$0.11	$0.59	$0.12
Weighted average shares outstanding:				
Basic	51,195	35,158	47,136	35,083
Diluted	52,509	49,121	48,415	35,893

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

MedQuist Holdings Inc. and Subsidiaries
Consolidated Balance Sheets
(In thousands except par value)
Unaudited

	September 30, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$37,453	$66,779
Accounts receivable, net of allowance of $1,720 and $1,466, respectively	70,483	82,038
Other current assets	28,645	23,706
Total current assets	136,581	172,523
Property and equipment, net	23,857	23,018
Goodwill	152,841	90,268
Other intangible assets, net	163,274	107,962
Deferred income taxes	6,703	6,896
Other assets	26,209	14,212
Total assets	$509,465	$414,879
Liabilities and Equity		
Current liabilities:		
Current portion of long-term debt	$16,883	$27,817
Accounts payable	13,238	11,358
Accrued expenses	35,543	36,917
Accrued compensation	13,108	16,911
Deferred acquisition payments	16,127	—
Deferred revenue	8,352	10,570
Total current liabilities	103,251	103,573
Long-term debt	279,505	266,677
Deferred income taxes	15,560	4,221
Deferred acquisition payments, non-current	10,290	3,537
Other non-current liabilities	2,607	2,360
Total liabilities	411,213	380,368
Commitments and Contingencies (Note 12)		
Total Equity		—
Preferred stock - $0.10 par value; authorized 25,000 shares; none issued or outstanding	—	—
Common stock - $0.10 par value; authorized 300,000 shares; 55,035 and 35,158 shares issued and outstanding, respectively	5,505	3,516
Additional paid-in-capital	167,075	148,265
Treasury stock, at cost (20 shares)	(250)	—
Accumulated deficit	(72,179)	(107,179)
Accumulated other comprehensive loss	(1,933)	(663)
Total MedQuist Holdings Inc. stockholders' equity	98,218	43,939
Noncontrolling interests	34	(9,428)
Total equity	98,252	34,511
Total liabilities and equity	$509,465	$414,879

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

MedQuist Holdings Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(In thousands)
Unaudited

	Nine months ended September 30, 2011	2010
Operating activities:		
Net income	$37,138	$11,658
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	26,516	24,377
Equity in income of affiliated company	—	(616)
Deferred income taxes	(19,228)	1,169
Share based compensation	3,517	486
Provision for doubtful accounts	299	1,571
Non-cash interest expense	2,463	3,328
Other	3,085	(1,106)
Changes in operating assets and liabilities:		
Accounts receivable	15,795	(1,267)
Other current assets	(2,098)	(4,532)
Other non-current assets	(11,989)	(1,391)
Accounts payable	(1,386)	2,114
Accrued expenses and other current liabilities	(4,863)	(9,058)
Accrued compensation	(4,277)	2,535
Deferred revenue	(2,545)	286
Other non-current liabilities	1,093	(898)
Net cash provided by operating activities	43,520	28,656
Investing activities:		
Purchase of property and equipment	(8,651)	(4,345)
Purchases of capitalized intangible assets	(8,356)	(5,275)
Payments for acquisitions and interests in affiliates, net of cash acquired	(56,605)	(97,710)
Net cash used in investing activities	(73,612)	(107,330)
Financing activities:		
Proceeds from debt	30,352	110,095
Repayment of debt	(27,379)	(29,866)
Debt issuance costs	—	(7,031)
Related party payments	(5,597)	—
Treasury stock transactions	(250)	—
Net proceeds from issuance of common stock	4,979	—
Net cash provided by financing activities	2,105	73,198
Effect of exchange rate changes	(1,339)	(132)
Net decrease in cash and cash equivalents	(29,326)	(5,608)
Cash and cash equivalents — beginning of period	66,779	29,633
Cash and cash equivalents — end of period	$37,453	$24,025

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

Table of Contents

MedQuist Holdings Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(In thousands, except for per share amounts)
Unaudited
1. Basis of Presentation

The consolidated financial statements and footnotes thereto are unaudited. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") have been omitted pursuant to such rules and regulations although we believe that the disclosures are adequate to make the information presented not misleading. The consolidated financial statements include the accounts of MedQuist Holdings Inc. and its subsidiaries (the "Company"). All significant inter-company accounts and transactions have been eliminated in consolidation.

These statements reflect all normal recurring adjustments that, in the opinion of management, are necessary for the fair presentation of our results of operations, financial position and cash flows. Interim results are not necessarily indicative of results for a full year. The information in this Form 10-Q should be read in conjunction with our 2010 Annual Report on Form 10-K for the year ended December 31, 2010 (the "2010 Form 10-K") filed with the Securities and Exchange Commission ("SEC") on March 16, 2011.

U.S. Initial Public Offering

On January 27, 2011, we changed our name from CBaySystems Holdings Limited to MedQuist Holdings Inc. and re-domiciled from a British Virgin Islands company to a Delaware corporation and authorized 300.0 million shares of common stock at $0.10 par value per share and 25.0 million shares of preferred stock at $0.10 par value per share. In connection with our re-domiciliation, we adjusted the number of our shares outstanding through a reverse share split pursuant to which every 4.5 shares of our common stock outstanding prior to our re-domiciliation was converted into one share of our common stock upon our re-domiciliation. All shares of common stock and per share data included in the consolidated financial statements reflect the reverse stock split. Our re-domiciliation and reverse share split resulted in no change to our common stockholders' relative ownership interests in us.

In February 2011, we completed our U.S. initial public offering of common stock ("IPO") selling 3.0 million shares of our common stock and 1.5 million shares of our common stock owned by selling shareholders at an offer price of $8.00 per share, resulting in gross proceeds to us of $24.0 million and net proceeds to us after underwriting fees of $22.3 million. Our common stock is listed on The NASDAQ Global Market under the symbol “MEDH.”

Private Exchange

Certain of MedQuist Inc.'s noncontrolling stockholders entered into an exchange agreement with us (the "Exchange Agreement") whereby we issued 4.8 million shares of our common stock in exchange for their 4.8 million shares of MedQuist Inc. common stock. We refer to this transaction as the Private Exchange. The Private Exchange was completed on February 11, 2011 and increased our ownership in MedQuist Inc. from 69.5% to 82.2%.

Public Exchange Offer

In addition to the Private Exchange referred to above, in February 2011, we commenced our public exchange offer (the "Public Exchange Offer"), to those noncontrolling MedQuist Inc. stockholders who did not participate in the Private Exchange to exchange shares of our common stock for shares of MedQuist Inc. common stock. The Public Exchange Offer expired on March 11, 2011. We accepted for, and consummated the exchange of, all MedQuist Inc. shares of common stock that were validly tendered in the Public Exchange Offer. As a result of the Public Exchange

Offer, we increased our ownership in MedQuist Inc. from 82.2% to approximately 97%. We issued 5.4 million shares of our common stock in exchange for 5.4 million shares of MedQuist Inc. common stock.

Table of Contents
MedQuist Holdings Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(In thousands, except for per share amounts)
Unaudited

Short Form Merger

In accordance with the terms of the stipulation of settlement entered into in connection with the settlement of certain MedQuist Inc. shareholder litigation, on October 18, 2011, we completed a short-form merger (the "Short Form Merger") with MedQuist Inc., resulting in MedQuist Inc. becoming our indirect wholly-owned subsidiary and MedQuist Inc. common stock no longer trading on the OTCQB or on any other market. As a result of the Short Form Merger, the remaining approximately 3% issued and outstanding shares of MedQuist Inc. not held by us were canceled and converted in the Short Form Merger to the right to receive one share of our common stock. In the Short Form Merger, we issued an additional 1.2 million shares of our common stock. We now own 100% of MedQuist Inc. The Short Form Merger will result in a reclassification from noncontrolling interest to common stock and additional paid-in-capital in the fourth quarter of 2011.

Business Segment and Reporting Unit

We currently operate in one business segment and have one reporting unit, which is clinical documentation solutions for the healthcare industry. The Patient Financial Services ("PFS") business was sold on December 31, 2010 and results of the PFS business have been accounted for as discontinued operations for all periods presented.

2. Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board ("FASB") issued an Accounting Standards Update ("ASU") that substantially converged the requirements for fair value measurement and disclosure between the FASB and the International Accounting Standards Board ("IASB"). This ASU is largely consistent with existing fair value measurement principles under U.S. GAAP. This ASU is effective for the Company in its first quarter beginning January 1, 2012 and is not expected to have a material impact on the Company’s financial statements.

In June 2011, the FASB issued an ASU that addressed the presentation of comprehensive income in the financial statements. This accounting update allows an entity the option to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In addition, this ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders’ equity and does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This ASU is effective for the Company in its first quarter beginning January 1, 2012 and is not expected to have a material impact on the Company’s financial statements other than modifying the presentation of comprehensive income.

In September 2011, the FASB issued an ASU that allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under this new ASU, if a Company chooses the qualitative method, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This ASU is effective for annual and interim impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The Company does not expect this ASU to have a material impact on the Company's financial statements.

3. Acquisitions

Multimodal Technologies, Inc.

On August 18, 2011, we completed the acquisition and merger ("Merger") of 100% of the shares of MultiModal Technologies, Inc. ("M*Modal"). The Merger provides us ownership of speech and natural language understanding technologies, and is expected to facilitate consolidation to a single back-end speech recognition platform, provide a broader product offering to local and regional transcription partners and leverage M*Modal's cloud based services to enhance gross margins.

(In thousands, except for per share amounts)

Pursuant to the Merger Agreement, on the closing date of the Merger, we paid an aggregate of approximately $49.0 million in cash to M*Modal's shareholders and optionholders, with funding provided by our available cash and availability under our revolving credit facility. Additionally, we issued an aggregate of 4,134,896 shares of our common stock to M*Modal's shareholders who are "accredited investors" within the meaning of Regulation D promulgated under the Securities Act of 1933. We are also obligated to pay approximately $28.8 million of additional cash consideration in three installments of approximately $16.3 million, $4.8 million and $7.7 million, respectively, following the first, second and third anniversaries of the closing date of the Merger. The recipients of our common stock as Merger consideration have registration rights and are subject to restrictions on trading as set forth in a Stockholders Agreement entered into as of the closing date of the Merger. Certain shareholders of M*Modal also entered into restrictive covenant agreements as of the closing of the Merger, which prohibit them from, among other things, competing against us for five years after the closing of the Merger.

Acquisition and direct integration costs are included in the line item acquisition and restructuring on the accompanying Consolidated Statements of Operations.

The following table summarizes the consideration paid for M*Modal and the amounts of the assets acquired and liabilities assumed recognized at the acquisition date:

Initial cash consideration	$48,955
First deferred cash payment (present value)	15,127
Second deferred cash payment (present value)	4,134
Third deferred cash payment (present value)	6,156
MedQuist Holdings Inc. common stock	23,530
Total consideration transferred	$97,902

The deferred cash payments were discounted using our incremental borrowing rate under our revolving loan facility at 7.75%. The fair value of the unregistered common stock transferred was measured using the closing stock price on August 18, 2011 and then discounted for the restrictions on the ability to sell or otherwise transfer the shares until such time as they are registered and able to be sold.

The deferred cash payments are included in the deferred acquisition payments, current, and deferred acquisition payments, non-current, line items in the accompanying Consolidated Balance Sheets.

(In thousands, except for per share amounts)

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of the acquisition. The fair value of the goodwill and identifiable intangible assets is preliminary pending receipt of the final valuations for those assets.

Current Assets	$7,442	
Property and equipment	1,990	
Current liabilities	(3,590	)
Non-current liabilities	(77	)
Trademarks and trade name	6,670	
Developed technology	17,490	
Non-competition agreements	4,520	
Customer relationships	35,310	
Deferred income taxes	(24,822	)
Goodwill	52,969	
Purchase price allocated	$97,902	

The total amount assigned to identified intangible assets and the related amortization period is shown below:

	Fair Value	Amortization Period
Developed technology	$17,490	9 years
Customer relationships	35,310	10 years
Trademarks and trade names	6,670	20 years
Non-competition agreements	4,520	5 years
Goodwill	52,969	indefinite

Goodwill was recognized in connection with the Merger due to the anticipated cost savings, revenue generation and gross margin enhancement we expect to result from consolidating our multiple speech recognition platforms to a single back-end platform. No part of the goodwill is expected to be deductible for tax purposes. The amounts of the identified intangible assets other than goodwill were valued at fair value. The analyses included a combination of cost approach and income approach. We used discount rates from 15% to 17%.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. There is a hierarchy of valuation techniques based on the nature of the inputs used to develop the fair value measures. This is an exit price concept for the valuation of the asset or liability. In addition, market participants are assumed to be unrelated buyers and sellers in the principal or the most advantageous market for the asset or liability. Fair value measurements for an asset assume the highest and best use by these market participants. Many of these fair value measurements can be highly subjective and it is also possible that other professionals, applying reasonable judgment to the same facts and circumstances, could develop and support a range of alternative estimated amounts.

Total acquisition-related transaction costs incurred by the Company are expensed in the periods in which the costs are incurred. Acquisition-related transaction costs (such as advisory, legal, valuation and other professional fees) are not included as components of consideration transferred, but are accounted for as expenses in the periods in which the costs are incurred. Acquisition-related transaction costs incurred to acquire the business, and incremental direct integration costs have been included in the line item acquisition and restructuring related charges on the Company's Consolidated Statements of Operations.

(In thousands, except for per share amounts)

M*Modal contributed revenue of $2,490 and net income attributable to MedQuist Holdings Inc. of $537 for the period from August 18, 2011 to September 30, 2011.

Other Acquisitions

During the three and nine months ended September 30, 2011, we acquired two businesses other than M*Modal for a total cash consideration of $10.7 million, including $1.0 million in deferred acquisition payments that will be paid within one year of each respective acquisition. Subsequent to September 30, 2011, we acquired two additional businesses for a total cash consideration of $6.8 million. None of the acquisitions were individually material and were not material in the aggregate. Accordingly, impacts related to these acquisitions are excluded from pro forma information presented below.

Spheris

On April 22, 2010, we completed the acquisition of substantially all of the assets of Spheris Inc. ("Spheris") and certain of its affiliates including Spheris India Private Limited (SIPL). This acquisition provided substantial incremental volume growth and also provided opportunities for operating efficiencies and operating margin expansion. Costs incurred for the acquisition and direct integration costs are included in the line item Acquisition and restructuring on the accompanying Consolidated Statements of Operations. The acquisition was funded from the proceeds of credit facilities entered into in connection with the acquisition. The acquired Spheris business contributed net revenues of $58.2 million for the period April 22, 2010 through September 30, 2010.

Pro Forma Information
The revenues and earnings of the combined entities had the acquisitions of both M*Modal and Spheris (described below) occurred at the beginning of each period is presented below:

	Pro forma for the three months ended September 30,		Pro forma for the nine months ended September 30,	
	2011	2010	2011	2010
Net revenues	$110,184	$116,460	$338,186	$359,031
Net income attributable to MedQuist Holdings Inc.	$23,776	$5,828	$38,743	$9,729
Net income per share attributable to MedQuist Holdings Inc., from continuing operations (Basic)	$0.43	$0.13	$0.63	$0.19
Net income per share attributable to MedQuist Holdings Inc., from continuing operations (Diluted)	$0.42	$0.10	$0.61	$0.18
Net income per share attributable to MedQuist Holdings Inc., discontinued operations (Basic)	$—	$—	$—	$0.01
Net income per share attributable to MedQuist Holdings Inc., discontinued operations (Diluted)	$—	$—	$—	$0.01
Net income per share attributable to MedQuist Holdings Inc., (Basic)	$0.43	$0.13	$0.63	$0.20
	$0.42	$0.10	$0.61	$0.19

Net income per share attributable to MedQuist Holdings Inc., (Diluted)

These amounts have been calculated after applying our accounting policies and adjusting the results of M*Modal to reflect the additional amortization of intangible assets that would have been recorded as expense assuming the fair value adjustments to intangible assets had been applied from the beginning of the annual period being reported on, and excluding acquisition costs.

In addition, the 2010 pro forma amounts have been calculated after applying our accounting policies and adjusting the results of Spheris to reflect the additional amortization of intangible assets that would have been recorded as expense assuming the fair value adjustments to intangible assets had been applied from the beginning of the annual period being reported on, and the additional interest expense assuming the acquisition related debt had been incurred at the beginning of the period being reported on, excluding

8

(In thousands, except for per share amounts)

the acquisition costs, and including the related tax effects. Impacts of integration-related charges have been excluded from the amounts above. Additionally, the pro forma revenue amounts reflect only recognized revenues of the acquired business, but do not reflect the impacts of losses known at the time of close of the transaction that impacted the actual results in subsequent periods.

4. Debt

Debt consisted of the following:

	September 30, 2011	December 31, 2010
Senior Secured Credit Facility consisting of:		
Term loan	$175,000	$200,000
Revolving credit facility	25,000	—
Senior Subordinated Notes	85,000	85,000
All other	11,388	9,494
	296,388	294,494
Less: Current maturities	(16,883)	(27,817)
Total long-term debt	$279,505	$266,677

In January 2011, we made an optional prepayment of $20.0 million in addition to the $5.0 million due under the Senior Secured Credit Facility. No additional principal payments are required in 2011 under the Senior Secured Credit Facility. In January 2011, as required under our Senior Secured Credit Facility, we entered into Interest Rate Cap Contracts (for $60.0 million notional amounts which will amortize over time) to limit the risk of increase for fluctuation in interest rates. The interest rates on the term loan and the Senior Subordinated Notes were 7.25% and 13.0%, respectively, on September 30, 2011.

In September 2011, we amended the Senior Secured Credit Facility to, among other things, (i) permit repurchases of our outstanding common stock in an aggregate amount not to exceed $25.0 million and (ii) add an accordion feature that will allow for additional borrowing capacity of up to $50.0 million in the form of additional revolving credit commitments or incremental term loans, upon the satisfaction of certain conditions. As of September 30, 2011, the Company had not met these conditions; thus, there were no available borrowings under the accordion or the revolving credit facility.

As of September 30, 2011, we were in compliance with the covenants of the Senior Secured Credit Facility and the Senior Subordinated Notes.

5. Transfers From Noncontrolling Interests

On February 11, 2011, the Private Exchange was completed which increased our ownership interest in MedQuist Inc. to 82.2%.

Upon expiration of the Public Exchange Offer on March 11, 2011, we increased our ownership in MedQuist Inc. to approximately 97%. These exchanges resulted in the reclassification of $7.4 million from noncontrolling interest to common stock and additional paid-in-capital.

In accordance with the terms of the stipulation of settlement entered into in connection with the settlement of certain MedQuist Inc. shareholder litigation, on October 18, 2011, we completed a Short Form Merger with MedQuist Inc., resulting in MedQuist Inc. becoming our indirect wholly-owned subsidiary and MedQuist Inc. common stock no longer trading on the OTCQB or on any other market. As a result of the Short Form Merger, the remaining approximately 3% issued and outstanding shares of MedQuist Inc. not held by us were canceled and converted in the Short Form Merger to the right to receive one share of our common stock. In the Short Form Merger, we issued an additional 1.2 million shares of our common stock. We now own 100% of MedQuist Inc. The Short Form Merger will result in a reclassification from noncontrolling interest to common stock and additional paid-in-capital in the fourth quarter of 2011.

MedQuist Holdings Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(In thousands, except for per share amounts)
Unaudited

6. Comprehensive Income

Comprehensive income was as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Net income attributable to MedQuist Holdings Inc.	$20,553	$5,871	$35,000	$6,424
Foreign currency translation adjustment	(1,794)	464	(1,270)	(211)
Comprehensive income	$18,759	$6,335	$33,730	$6,213

7. Net Income per Share

Basic net income per share is computed by dividing net income by the weighted average number of shares outstanding during each period. Diluted net income per share is computed by dividing net income by the weighted average shares outstanding, as adjusted for the dilutive effect of common stock equivalents, which consist of stock options and unvested restricted stock, using the treasury stock method.

The following table reflects the weighted average shares outstanding used to compute basic and diluted net income per share:

	For the three months ended September 30,		For the nine months ended September 30,	
	2011	2010	2011	2010
Net income attributable to MedQuist Holdings	$20,553	$5,871	$35,000	$6,424
Less: amount attributable to former principal shareholders	—	(688)	(6,619)	(2,063)
Net income available for common shareholders	$20,553	$5,183	$28,381	$4,361
Income from discontinued operations	$—	$155	$—	$338
Weighted average shares outstanding				
Basic	51,195	35,158	47,136	35,083
Effect of dilutive stock	1,283	13,963	1,314	810
Diluted	52,478	49,121	48,450	35,893
Net income per share from continuing operations				
Basic	$0.40	$0.15	$0.60	$0.11
Diluted	$0.39	$0.11	$0.59	$0.11
Net income per common share from discontinued operations				
Basic	$—	$—	$—	$0.01
Diluted	$—	$—	$—	$0.01
Net income per common share attributable to MedQuist Holdings				
Basic	$0.40	$0.15	$0.60	$0.12
Diluted	$0.39	$0.11	$0.59	$0.12

The computation of diluted net income per share does not assume conversion, exercise or issuance of shares that would have an anti-dilutive effect on diluted net income per share. Potentially dilutive shares having an anti-dilutive effect on net income per share and, therefore, excluded from the calculation of diluted net income per share, totaled 2,133 and 13,314 shares for the three months and nine months ended September 30, 2010, respectively.

10

The net income for the purpose of the basic income per share is adjusted for the amounts payable to former principal shareholders under a terminated management services agreement. Pursuant to an Agreement ("Agreement") entered into on August 19, 2008, the Company was obligated to pay S.A.C. PEI CB Investment II, LLC ("SAC CBI II") and Lehman Brothers Commercial Corporation Asia ("LBCCA"), an annual fixed amount of $1.9 million and $0.9 million, respectively, in cash or shares of the Company's common stock at the Company's election, in return for financial, managerial and operational advice. The payment provision of the Agreement had a five-year term that was scheduled to expire in August 18, 2013. The Agreement stipulated that the annual amount was payable regardless of whether any services were rendered by SAC CBI II or LBCCA. Under the Agreement, the Company was committed to pay for the remaining unexpired term at termination of the Agreement or upon a change in control, with the payment amount determined as follows: the sum of the present value (using the discount rate equal to the yield on U.S. Treasury securities of like maturity) of the annual amounts that would have been payable with respect to the period from the date of such change of control or termination, as applicable through scheduled expiration date. The change in control occurred and the Agreement terminated as a result of the consummation of our IPO and the Private Exchange. According to the terms of the Agreement, the Company recorded $6.6 million and $2.1 million of charges to additional paid-in-capital during the nine months ended September 30, 2011 and 2010, respectively. As a result of the termination of the Agreement, 770 thousand shares of common stock valued at $6.2 million were issued in March 2011 to satisfy the obligation to SAC CBI II. The termination of the Agreement related to LBCCA was settled and paid in July 2011 for $4.0 million.

The calculation of shares outstanding reflect the weighted average share counts during the applicable periods. However, they do not consider the additional shares of remaining noncontrolling shareholders of MedQuist Inc. A fully-diluted pro forma share count considering the additional shares would result in different per share amounts than reflected in the computations above.

Table of Contents
MedQuist Holdings Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(In thousands, except for per share amounts)
Unaudited

8. Equity

The following table is a roll forward of equity from January 1, 2011 to September 30, 2011.

Underwriter costs incurred for the IPO have been treated as a reduction of the proceeds and are included as a reduction of additional paid-in-capital. All other direct incremental costs incurred in connection with the IPO, Private Exchange, the Public Exchange Offer and the Short Form Merger also have been treated as a reduction of additional paid-in-capital.

	Common Stock								
	Shares	Amount	Additional paid-in-capital	Treasury stock	Accumulated deficit	Comprehensive income	Accumulated other comprehensive loss	Non-controlling interests	Total equity
Balance, January 1, 2011	35,158	$3,516	$ 148,265	$—	$ (107,179)	$ —	$ (663)	$ (9,428)	$34,511
Issuance of common stock at $8.00 per share	3,000	300	23,700	—	—	—	—	—	24,000
Common stock offering costs	—	—	(9,336)	—	—	—	—	—	(9,336)
Issuance of common stock under the Private Exchange and the Public Exchange Offer	10,240	1,024	(8,397)	—	—	—	—	7,373	—
Private Exchange and Public Exchange Offer costs	—	—	(13,056)	—	—	—	—	—	(13,056)
Shares issued to former principal shareholder to settle obligation	770	77	6,079	—	—	—	—	—	6,156
Accrued amounts due to former principal shareholders	—	—	(6,619)	—	—	—	—	—	(6,619)
Unregistered shares issued to acquire M*Modal	4,134	413	23,117	—	—	—	—	—	23,530
Restricted shares	1,753	175	(175)	—	—	—	—	—	—
Treasury stock transactions	(20)	—	—	(250)	—	—	—	—	(250)

Share based compensation		—	3,497	—	—	—	—	20	3,517
Components of comprehensive income:				—					—
Net income	—	—	—	—	35,000	35,000	—	2,138	37,138
Foreign currency translation adjustments	—	—	—	—	—	(1,270)	(1,270)	(69)	(1,339)
Total comprehensive income	—	—	—	—	—	$ 33,730	—	—	—
Balance September 30, 2011	55,035	$5,505	$ 167,075	$(250)	$(72,179)		$ (1,933)	$ 34	$98,252

Restricted stock awards

The Company has a stock incentive plan that provides for the grant of restricted stock to certain officers and employees. Restrictions on the awards to officers and employees typically vest quarterly over a three-year period from date of grant such that the officers or employees cannot sell or trade the restricted stock until it becomes vested. On July 11, 2011, the Company granted 0.9 million restricted shares to officers and employees with a grant date fair value of $13.20 per share. On August 18, 2011, the closing date of the Merger, the Company also granted 0.8 million restricted shares to certain of M*Modal's employees that became our employees with a grant date fair value of $7.35 per share. The Company recognizes compensation expense ratably over each quarterly service period at the market value of the Company's common stock on the grant date. The Company recorded share based compensation

12

(In thousands, except for per share amounts)

expense related to restricted stock awards of $2.2 million for the three months ended September 30, 2011. As of September 30, 2011, there was $15.6 million of total unrecognized compensation cost related to future service periods for nonvested restricted stock granted.

Share based compensation presented in the table above also reflects compensation expense related to the vesting of stock options of $1.3 million for the nine months ended September 30, 2011, including $0.8 million associated with the acceleration of stock option vesting and the extension of the stock option exercise period for terminated employees, as discussed under the 2011 Restructuring Plan in Note 9.

MedQuist Inc. Long Term Incentive Plan

The MedQuist Inc. Long Term Incentive Plan ("Plan") was terminated on July 11, 2011, which resulted in a reversal of $0.9 million related to amounts previously accrued under the Plan in the three months ended September 30, 2011.

9. Accrued Expenses

Accrued expenses consisted of the following:

	September 30, 2011	December 31, 2010
Customer accommodations	$729	$10,387
Accrued taxes	5,592	5,422
Accrued interest	5,573	5,593
Restructure liability	6,545	2,245
Other (no item exceeds 5% of current liabilities)	17,104	13,270
Total accrued expenses	$35,543	$36,917

Total restructuring charges, net of $0.6 million of reversals related to the 2010 restructuring plan, were $2.1 million and $0.9 million for the three months ended September 30, 2011 and 2010, and $9.5 million and $1.9 million for the nine months ended September 30, 2011 and 2010, respectively. The Company also incurred acquisition and integration related charges of $4.2 million and $0.9 million for the three months ended September 30, 2011 and 2010, and $8.0 million and $6.9 million for the nine months ended September 30, 2011 and 2010, respectively. Acquisition and integration-related charges represent amounts related to integration of the acquired Spheris business, as well as charges related to acquisitions made in 2011 including M*Modal.

2011 Restructuring Plan

On March 31, 2011, the board of directors adopted a restructuring plan to complete the integration of its acquired Spheris operations into MedQuist Inc. and to integrate MedQuist Inc. with MedQuist Holdings ("2011 Restructuring Plan"). We recorded a charge of $1.5 million in the nine months ended September 30, 2011 representing future lease payments on MedQuist Inc.'s former corporate headquarters in Mt. Laurel, New Jersey and former data center in Sterling, Virginia, net of estimated sublease rentals. The future minimum lease payments on the Mt. Laurel facility total $2.5 million. The commencement of the integration of MedQuist Inc. and MedQuist Holdings resulted in a charge of $5.9 million primarily consisting of severance costs of $4.3 million and non-cash stock compensation costs of approximately $0.8 million associated with the acceleration of stock option vesting and the extension of the stock option exercise period for terminated employees. In addition, in July 2011 we recorded $1.2 million in charges related to the separation of the Company's former Chairman and CEO.

The 2011 Restructuring Plan will be implemented throughout the remainder of 2011 and may result in additional charges, as management identifies opportunities for synergies from the integration of MedQuist Inc. into MedQuist Holdings Inc., including elimination of redundant functions. Also, the Company has completed several acquisitions in 2011, including M*Modal, and may complete additional acquisitions in the fourth quarter of 2011, which will likely result in additional charges to the 2011 Restructuring Plan.
We expect the majority of the remaining balance to be paid in 2011 and 2012.

Table of Contents
MedQuist Holdings Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(In thousands, except for per share amounts)
Unaudited

The table below reflects the financial statement activity related to the 2011 Restructuring Plan:

	Nine Months ended September 30, 2011
Beginning balance	$—
Charge	10,121
Non-cash use for share based compensation	(836)
Cash paid	(3,301)
Ending balance	$5,984

2010 Restructuring Plan

Management's 2010 cost reduction initiatives, including process improvement, combined with the acquisition of Spheris, resulted in a restructuring plan ("2010 Restructuring Plan") involving staff reductions and other actions designed to maximize operating efficiencies.

The table below reflects the financial statement activity related to the 2010 Restructuring Plan. We expect the remaining balance to be paid in 2011.
:

	Nine Months ended September 30, 2011
Beginning balance	$2,071
Charge	—
Cash paid	(904)
Other	(607)
Ending balance	$561

The $0.6 million other adjustment represents a reduction in previously accrued employee severance costs related to certain employee positions that were ultimately not terminated.

10. Cost (Benefit) of Legal Proceedings, Settlements and Accommodations

The following is a summary of the amounts recorded as Cost (benefit) of legal proceedings, settlements and accommodations in the accompanying Consolidated Statements of Operations:

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Legal fees and settlements	$44	$633	$2,770	$2,785
Accommodation reversal	—	—	(9,658)	—
Total	$44	$633	$(6,888)	$2,785

The amounts included in legal fees and settlements for the nine months ended September 30, 2011 include the settlement with the former chief financial officer of MedQuist Inc. of indemnification claims with the former chief financial officer which will reduce legal fees MedQuist Inc. would otherwise be required to pay pursuant to the indemnification obligations under the MedQuist Inc. bylaws, and the legal fees incurred in connection with the settlement of Shareholder Litigation. See Note 12, Commitments and Contingencies.

In November 2003, one of MedQuist Inc.'s employees raised allegations that it had engaged in improper billing practices. In response, the MedQuist Inc. board of directors undertook an independent review of these allegations ("Review"). In response to our customers' concern over the public disclosure of certain findings from the Review, MedQuist Inc. made the decision in the fourth quarter of 2005 to take action to try to avoid litigation and preserve and solidify its customer business relationships by offering a financial accommodation to certain of its customers.

In connection with the decision to offer financial accommodations to certain of its customers ("Accommodation Customers"), MedQuist Inc. analyzed its historical billing information and the available report-level data to develop individualized accommodation offers to be made to Accommodation Customers ("Accommodation Analysis"). Based on the Accommodation Analysis, the MedQuist Inc. board of directors authorized management to make cash or credit accommodation offers to Accommodation Customers in the aggregate amount of $75.8 million ("Customer Accommodation Program"). By accepting the
accommodation offer, the customer agreed, among other things, to release MedQuist Inc. from any and all claims and liability regarding the billing related issues. On March 31, 2011, the MedQuist Inc. board of directors terminated the Customer Accommodation Program. As a result, any amounts that had not been offered to customers were reversed.

11. Income Taxes

Our consolidated income tax expense normally consists principally of an increase in deferred tax liabilities related to indefinite lived assets amortization deductions for income tax purposes during the applicable period as well as state and foreign income taxes. We recorded a valuation allowance to reduce our net deferred tax assets to an amount that is more likely than not to be realized in future years.

We regularly assess the future realizability of deferred tax assets and whether the valuation allowance against the majority of domestic net deferred tax assets is still warranted. To the extent sufficient positive evidence, including past results and future projections, exists to recognize all or part of these benefits, the valuation allowance will be adjusted accordingly. It is reasonably possible that some or all of the valuation allowance could be further adjusted within the next year.

The Company recorded an income tax benefit of $17.2 million for the nine months ended September 30, 2011, compared to a $0.2 income tax benefit for the same period in 2010. During the three month period ended September 30, 2011, we completed our acquisitions of M*Modal and other entities, which resulted in the recording of additional deferred tax liabilities in purchase accounting. These deferred tax liabilities provide a source of positive evidence for releasing the valuation allowance against certain domestic deferred tax assets resulting in a non-cash tax benefit of $20.9 million, which is considered a discrete event in the three months ended September 30, 2011. The tax benefit for the nine months ended September 30, 2010 includes the reversal of approximately $0.5 million from our accrual for various state uncertain tax positions as a result of filing voluntary disclosure agreements with state jurisdictions.

In January 2011, we re-domiciled from a British Virgin Island company to a Delaware corporation. Accordingly, domestic income taxes now refers to income taxes recorded on operations in the United States.

SIPL has received notifications of tax assessments resulting from transfer pricing audits for fiscal tax periods ended March 31, 2007, 2005 and 2004. Total assessments and demands related to these notifications amount to 204.5 million Rupees (approximately $4.3 million), including penalties and interest. The Company has filed appeals with India authorities under the India Income Tax Act. Pending resolution of the Company's appeal process, the Company has been required to make advance tax payments aggregating to $1.2 million, which is included other current assets in the accompanying Consolidated Balance Sheets. At the time of acquisition of SIPL, the Company evaluated and recorded a liability of $4.8 million related to transfer pricing exposures as a part of the purchase price allocation. The Company believes this liability remains adequate to cover all such transfer pricing exposures.

12. Commitments and Contingencies

Shareholder Settlement

On February 8, 2011 and February 10, 2011, two of MedQuist Inc.'s minority shareholders filed class action complaints in the Superior Court of New Jersey, Burlington County, Chancery Division, (the "Court") against MedQuist Inc., the individual members on MedQuist Inc.'s board of directors and us, in a matter entitled in Re: MedQuist Shareholder Litigation (the "Shareholder

15

Litigation"). Plaintiffs alleged that the defendants breached certain fiduciary duties they owed to minority shareholders of MedQuist Inc. in connection with the structuring and disclosure of the Public Exchange Offer.

On March 4, 2011, the parties to the Shareholder Litigation entered into a memorandum of understanding (the "MOU") that outlined the material terms of a proposed settlement of the Shareholder Litigation. Under the terms of the MOU, we agreed to extend the expiration of the Public Exchange Offer and further agreed that if, as a result of the Public Exchange Offer, we obtained ownership of at least 90% of the outstanding common stock of MedQuist Inc., we would conduct the Short Form Merger under applicable law to acquire the remaining shares of MedQuist Inc. common stock that we do not currently own at the same exchange ratio applicable under the Public Exchange Offer. MedQuist Inc. agreed to make certain supplemental disclosures concerning the Public Exchange Offer, which were contained in an amendment to Schedule 14D-9 that MedQuist Inc. filed with the SEC on March 7, 2011. We also agreed to use our best efforts to finalize a stipulation of settlement (the "Stipulation of Settlement") and present it to the Court for preliminary approval within thirty days of the date of the MOU.

On April 1, 2011, the parties executed the Stipulation of Settlement that memorialized the terms of the settlement outlined in the MOU. On this same date, plaintiffs' counsel filed with the Clerk of the Court a Motion for Preliminary Approval of the Proposed Stipulation of Settlement. The Motion asked the Court to, among other things, (a) hold a hearing to address preliminary approval of the Stipulation of Settlement, (b) certify a class, for purposes of effectuating the Stipulation of Settlement only, of all MedQuist Inc.'s shareholders (except the named defendants and their families and affiliates) as of and including the date of the closing of the Short Form Merger contemplated under the Stipulation of Settlement, and (c) schedule a final hearing within 60 days to determine whether the Stipulation of Settlement is reasonable and fair and should receive final approval.

The Court held a preliminary approval hearing on April 19, 2011 and entered an Order preliminarily approving the settlement and setting a final approval hearing for June 17, 2011 (the "Preliminary Approval Order"). The Preliminary Approval Order also required MedQuist Inc. to provide mail and publication notice of the proposed settlement to all shareholders of recorded and established deadlines for objections to the settlement and for filing briefs in support and in opposition to the settlement.

On June 17, 2011, following mail and publication notice to MedQuist Inc.'s shareholders, the Court held a fairness hearing on the settlement. On this date, the Court entered an Order and Final Judgment (the "Final Judgment") that, among other things, (a) certified the settlement class consisting of all MedQuist Inc.'s shareholders (except the named defendants and their families and affiliates) as of and including the date of the closing of the Short Form Merger contemplated under the Stipulation of Settlement (the "Settlement Class"), (b) found the terms set forth in the Stipulation of Settlement to be fair and reasonable and in the best interests of the Settlement Class, and (c) approved the application for attorney's fees and costs and awarded plaintiffs' counsel $400 which was recorded in Cost (benefit) of legal proceedings, settlements and accommodations for the nine months ended September 30, 2011, and in accrued expenses as of September 30, 2011. The final judgment also dismissed the case with prejudice.

Agreement with Nuance Communications, Inc.

On June 30, 2011, MedQuist Inc. and Nuance Communications, Inc., ("Nuance"), entered into an agreement whereby MedQuist Inc. agreed to pay Nuance an agreed upon amount in full satisfaction of MedQuist Inc.'s license fee obligations with respect to certain products through June 30, 2015. MedQuist Inc. also agreed to pay Nuance for one year of maintenance services to be provided by Nuance to MedQuist with respect to the licensed products. The maintenance services will automatically renew for successive one-year terms unless canceled in writing by MedQuist Inc. prior the annual renewal date or the underlying agreement expires. The installments due under the agreement were paid during the second and third quarters of 2011, and are classified in both other current assets and other assets in the accompanying Consolidated Balance Sheets. The related expense is being recorded over the contractual period. As a result of the Merger with M*Modal, MedQuist Inc. expects to transition its back-end speech recognition to the M*Modal platform. The transition period is currently under evaluation and when the transition plans are finalized, we will reassess the useful life to prospectively record the expense over the new useful life. Any unamortized pre-paid license fees to Nuance will be recognized as restructuring expense over the remaining useful life.

13. Fair Value Measurements

Fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, FASB ASC 820, Fair Value Measurements and Disclosures ("ASC 820") establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained

from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).
Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for are typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

Derivative Financial Instruments
The Company uses interest rate cap contracts to manage its interest rate risk. As of September 30, 2011, the Company has interest rate cap contracts for $60.0 million in notional amounts, which amortize over time and expire in January 2013, to the limit the risk of increase of fluctuation in interest rates. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The fair values of interest rate caps are determined using the market standard methodology of discounting the future expected cash receipts that would occur if variable interest rates rise above the strike rate of the caps. The variable interest rates used in the calculation of projected receipts on the cap are based on an expectation of future interest rates derived from observable market interest rate curves and volatilities. To comply with the provisions of ASC 820, the Company incorporates credit valuation adjustments to appropriately reflect the respective counterparty's nonperformance risk in the fair value measurements.

The Company also uses foreign exchange forward contracts to manage its foreign exchange risk. As of September 30, 2011, the Company has foreign exchange forward cover contracts for $41.0 million of notional amounts, which expire through June 2012, to limit the risk of fluctuation in foreign exchange rates. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including foreign exchange forward rates and implied volatilities. To comply with the provisions of FASB ASC 820, the Company incorporates credit valuation adjustments to appropriately reflect the respective counterparty's nonperformance risk in the fair value measurements.

Although the Company has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with these derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by its counterparties. For counterparties with publicly available credit information, the credit spreads over LIBOR used in the calculations represent implied credit default swap spreads obtained from a third party credit data provider. However, as of September 30, 2011, the

Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of the derivatives. As a result, the Company has determined that its valuations for the foreign currency exchange contracts in their entirety are classified in Level 2 of the fair value hierarchy.

The Company's assets (liabilities) measured at fair value on a recurring basis were as follows:

	Balance at September 30, 2011
Interest rate agreements	$4
Foreign currency derivatives	$(3,026)

17

Table of Contents
MedQuist Holdings Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(In thousands, except for per share amounts)
Unaudited

These contracts are not designated for hedge accounting treatment and therefore, the Company records the fair value of these agreements as an asset or liability and the change in fair value at each reporting period as an adjustment in the Consolidated Statements of Operations. The interest rate derivatives are classified in other assets, and gains and losses are recorded in Interest expense, net.

Foreign currency derivatives are classified in other current assets or liabilities. Prior to the current reporting period, the Company recorded gains and losses on the foreign currency derivatives in an allocation between cost of revenues and selling, general and administrative expense. For the three and nine months ended September 30, 2011, the Company reclassified gains and losses on the foreign currency derivatives to other income (expense) in the Consolidated Statements of Operations, as the Company believes that the foreign currency derivative impacts do not reflect the Company's ongoing operations and should be recorded separately from operating income on the Consolidated Statements of Operations. Other expense for the nine months ended September 30, 2011 includes the impact of $0.9 million of foreign currency derivative gains, which were recognized during the first half of the year and reclassified in conformity with this change.

For the three and nine months ended September 30, 2011, losses in fair value for the foreign currency derivative contracts of $4.1 million and $3.2 million, respectively, as offset by recognized gains from the settlement of such contracts of $0.1 million and $0.6 million, respectively, were classified in other expense in the Consolidated Statements of Operations.

14. Subsequent events

In accordance with the terms of the stipulation of settlement entered into in connection with the settlement of certain MedQuist Inc. shareholder litigation, on October 18, 2011, we completed the Short Form Merger with MedQuist Inc., resulting in MedQuist Inc. becoming our indirect wholly-owned subsidiary and MedQuist Inc. common stock no longer trading on the OTCQB or on any other market. As a result of the Short Form Merger, the remaining approximately 3% issued and outstanding shares of MedQuist Inc. not held by us were canceled and converted in the Short Form Merger to the right to receive one share of our common stock. In the Short Form Merger, we issued an additional 1.2 million shares of our common stock. We now own 100% of MedQuist Inc. The Short Form Merger will result in a reclassification from noncontrolling interest to common stock and additional paid-in-capital in the fourth quarter of 2011.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

This report contains forward-looking statements that are based on current expectations, estimates, forecasts and projections about us, the industry in which we operate and other matters, as well as management’s beliefs and assumptions and other statements regarding matters that are not historical facts. These statements include, in particular, statements about our plans, strategies and prospects. For example, when we use words such as "projects," "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," "should," "would," "could," "will," "opportunity," "potential" or "may," variations of such words or other words that convey uncertainty of future events or outcomes, we are making forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended ("Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended ("Exchange Act"). Our forward-looking statements are subject to risks and uncertainties. Actual events or results may differ materially from the results anticipated in these forward-looking statements as a result of a variety of factors. While it

is impossible
to identify all such factors, factors that could cause actual results to differ materially from those estimated by us include the risk
factors set forth in the in the 2010 Form 10-K as modified or supplemented with the risk factors listed under Item 1A of Part II of this Quarterly Report on Form 10-Q. These and other risks and uncertainties that could affect our actual results are discussed in this report and in our other filings with the SEC.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, events, levels of activity, performance, or achievements. We do not assume responsibility for the accuracy and completeness of the forward-looking statements other than as required by applicable law. We do not undertake any duty to update any of the forward-looking statements after the date of this report to conform them to actual results, except as required by the federal securities laws.

You should read this section in combination with the section entitled Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2010, included in the 2010 Form 10-K.

Table of Contents

Critical Accounting Policies

There have been no material changes in our critical accounting policies, judgments or estimates as disclosed in our 2010 Form 10-K except as discussed below.

Executive Overview

We are a leading provider of integrated clinical documentation solutions for the U.S. healthcare system. Our end-to-end solutions convert physicians' dictation of patient interactions, or the physician narrative, into a high quality and customized electronic record. These solutions integrate technologies and services for voice capture and transmission, automated speech recognition ("ASR"), medical transcription and editing, workflow automation, and document management and distribution to deliver a complete managed service for our customers. Our solutions enable hospitals, clinics, and physician practices to improve the quality of clinical data as well as accelerate and automate the documentation process, and we believe our solutions improve physician productivity and satisfaction, enhance revenue cycle performance, and facilitate the adoption and meaningful use of electronic health records.

On August 18, 2011, we completed the acquisition and merger ("Merger") of 100% of the shares of MultiModal Technologies, Inc. ("M*Modal"). The Merger provides us ownership of speech and natural language understanding technologies, and is expected to facilitate consolidation to a single back-end speech recognition platform, provide a broader product offering to local and regional transcription partners and leverage M*Modal's cloud based services to enhance gross margins.

We believe that there are significant opportunities available to create value through strategic acquisitions. We intend to seek appropriate opportunities to expand our customer base, enhance or expand our solutions, incorporate synergy opportunities and expand our value proposition to our customers.

Key Factors Affecting Our Performance

During the third quarter of 2011, we made three acquisitions, including the Merger with M*Modal, that we anticipate will increase volume and provide us ownership of speech and natural language understanding technologies, facilitate consolidation to a single back-end speech recognition platform, provide a broader product offering to local and regional transcription partners and leverage M*Modal's cloud based services to enhance gross margins. In 2010, we completed the acquisition of Spheris and in 2008 we completed the acquisition of MedQuist Inc., both of which materially impacted our financial results. In addition, our results have also been impacted by volume changes, pricing impacts as we move to ASR and offshore production, as well as operating improvements and selling, general and administrative expense savings resulting from leveraging our scalable platform.

Customer Accommodation Program

During the nine months ended September 30, 2011 we reversed $9.7 million of the Customer Accommodation Program ("Customer Accommodation Program") accrual as the MedQuist Inc. board of directors terminated the Customer Accommodation Program on March 31, 2011. We also recorded a charge for a settlement of our indemnification obligations with the former chief financial officer of MedQuist Inc., and fees in connection with the Shareholder Litigation.

Agreement with Nuance Communications, Inc.

On June 30, 2011, MedQuist Inc. and Nuance Communications, Inc., ("Nuance"), entered into an agreement whereby MedQuist Inc. agreed to pay Nuance an agreed upon amount in full satisfaction of MedQuist Inc.'s license fee obligations with respect to certain products through June 30, 2015. MedQuist Inc. also agreed to pay Nuance for one year of maintenance services to be provided by Nuance to MedQuist with respect to the licensed products. The maintenance services will automatically renew for successive one-year terms unless canceled in writing by MedQuist Inc. prior the annual renewal date or the underlying agreement expires. The installments due under the agreement were paid during the second and third quarters of 2011, and are classified in both other current assets and other assets in the accompanying Consolidated Balance Sheets. The related expense is being recorded over the contractual period. As a result of the Merger with M*Modal, MedQuist Inc. expects to transition its back-end speech recognition to the M*Modal platform. The transition period is currently under evaluation and when the transition plans are finalized, we will reassess the useful life to prospectively record the expense over the new useful life. Any unamortized pre-paid license fees to Nuance will be recognized as restructuring expense over the remaining useful life.

Table of Contents

Volume and Pricing Trends

Providing clinical documentation and technology services to our customers generates the vast majority of our revenue. We measure the volume associated with such services using the number of lines and line equivalents that are billed by the Company, as defined by a customer's contract, including volume transcribed or edited on the Company's transcription platforms, as well as ASR volume. Product sales and related maintenance contracts and implementation services make up the balance of our net revenues.

We base our pricing on various factors, principally market forces, the extent to which we can utilize our offshore production facilities, the extent to which customers utilize the ASR technology available in our solutions, the scope of services provided, and turnaround times requested. We work with our customers to evaluate how different solutions affect pricing and to determine what for them is an optimal mix of service level and price. Higher utilization of offshore production and ASR leads to lower costs for us, which permits us to offer better pricing to our customers while at the same time contributing to margin growth. We have successfully migrated a significant portion of our volume offshore and we will continue these efforts.

As technological advances and increased use of offshore resources have driven down industry costs, the average price per character has also declined as healthcare providers have sought to participate in the economic gains. We intend to monitor and adjust our pricing accordingly to remain competitive as these industry trends continue.

Operating Improvements

Cost of revenues on a per unit basis has declined versus the prior year period due to the increased percentage of volume produced offshore and the increased utilization of ASR technology, as well as a shift in other staffing offshore in order to further reduce operating costs. We have increased our offshore production volumes from 42% for the three months ended September 30, 2010 to 45% for the same period in 2011, and from 41% for the nine months ended September 30, 2010 to 43% for the same period in 2011, respectively. Our use of ASR technology has increased from 67% for the three months ended September 30, 2010 to 76% for the same period in 2011, and from 62% for the nine months ended September 30, 2010 to 74% for the same period in 2011, respectively. As we continue to increase the use of ASR technology and move volume offshore, we expect to continue to reduce costs.

Adjusted EBITDA

Adjusted EBITDA was $29.8 million, or 27.6% of net revenues, for the three months ended September 30, 2011, compared to $24.5 million, or 21.7% of net revenues, for the same period in 2010. This increase is primarily due to increased gross margins and also reflects the acquisition of M*Modal and the two additional acquisitions completed in the third quarter of 2011. Adjusted EBITDA was $84.0 million, or 25.6% of net revenues, for the first nine months of 2011, compared to $57.8 million, or 18.8% of net revenues, for the same period last year. This increase is primarily the result of the contribution from the integration of Spheris. Adjusted EBITDA is a non-GAAP financial measure. See section "Non-GAAP Financial Measure - Adjusted EBITDA" below for further discussion of this financial measure.

U.S. Initial Public Offering

On January 27, 2011, we changed our name from CBaySystems Holdings Limited to MedQuist Holdings Inc. and re-domiciled from a British Virgin Islands company to a Delaware corporation and authorized 300.0 million shares of common stock par value at $0.10 per share and 25.0 million shares of preferred stock at $0.10 par value per share. In connection with our re-domiciliation, we adjusted the number of our shares outstanding through a reverse share split pursuant to which every 4.5 shares of our common stock outstanding prior to our re-domiciliation was converted into one share of our common stock upon our re-domiciliation. Our re-domiciliation and reverse share split resulted in no change to our common stockholders' relative ownership interests in us.

In February 2011, we completed our U.S. initial public offering of common stock selling 3.0 million shares of our common stock and 1.5 million shares of our common stock owned by selling shareholders at an offer price of $8.00 per share, resulting in gross proceeds to us of $24.0 million and net proceeds to us after underwriting fees of $22.3 million. Our common stock is listed on The NASDAQ Global Market under the symbol “MEDH.”

Private Exchange

Certain of MedQuist Inc.'s noncontrolling stockholders entered into an exchange agreement with us, whereby we issued 4.8 million shares of our common stock in exchange for their 4.8 million shares of MedQuist Inc. common stock. We refer to this transaction as the Private Exchange. The Private Exchange was completed on February 11, 2011 and increased our ownership in MedQuist Inc. from 69.5% to 82.2%.

Table of Contents

Public Exchange Offer

In addition to the Private Exchange referred to above, in February 2011, we commenced our public exchange offer, (the "Public Exchange Offer") to those noncontrolling MedQuist Inc. stockholders who did not participate in the Private Exchange to exchange shares of our common stock for shares of MedQuist Inc. common stock. The Public Exchange Offer expired on March 11, 2011. We accepted for, and consummated the exchange of, all MedQuist Inc. shares of common stock that were validly tendered in the Public Exchange Offer. As a result of the Public Exchange Offer, we increased our ownership in MedQuist Inc. from 82.2% to approximately 97%. We issued 5.4 million shares of our common stock in exchange for 5.4 million shares of MedQuist Inc. common stock.

Short Form Merger

In accordance with the terms of the stipulation of settlement entered into in connection with the settlement of certain MedQuist Inc. shareholder litigation, on October 18, 2011, we completed a short-form merger (the "Short Form Merger") with MedQuist Inc., resulting in MedQuist Inc. becoming our indirect wholly-owned subsidiary and MedQuist Inc. common stock no longer trading on the OTCQB or on any other market. As a result of the Short Form Merger, the remaining approximately 3% issued and outstanding shares of MedQuist Inc. not held by us were canceled and converted in the Short Form Merger to the right to receive one share of our common stock. In the Short Form Merger, we issued an additional 1.2 million shares of our common stock. We now own 100% of MedQuist Inc. The Short Form Merger will result in a reclassification from noncontrolling interest to common stock and additional paid-in-capital in the fourth quarter of 2011.

Table of Contents

Consolidated Results of Operations

The following tables set forth our consolidated results of operations for the three months ended September 30, 2011 and 2010:

MedQuist Holdings Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
(In thousands, except per share amounts)
Unaudited

	Three Months Ended September 30,					
	2011		2010			Change in
($ in thousands)	Amount	% of Net Revenues	Amount	% of Net Revenues	$ Change	% of Net Revenues
Net revenues	$108,034	100.0 %	$113,200	100.0 %	$(5,166)	—
Cost of revenues	62,068	57.5 %	69,936	61.8 %	(7,868)	(4.3)%
Gross profit	45,966	42.5 %	43,264	38.2 %	2,702	4.3 %
Operating costs and expenses:						
Selling, general and administrative	15,469	14.3 %	15,565	13.8 %	(96)	0.6 %
Research and development	2,181	2.0 %	3,351	3.0 %	(1,170)	(0.9)%
Depreciation and amortization	9,219	8.5 %	9,125	8.1 %	94	0.5 %
Cost of legal proceedings, settlements and accommodations	44	— %	633	0.6 %	(589)	(0.5)%
Acquisition and restructuring	6,251	5.8 %	1,797	1.6 %	4,454	4.2 %
Total operating costs and expenses	33,164	30.7 %	30,471	26.9 %	2,693	3.8 %
Operating income	12,802					