FORM 10-K/A

Annual report pursuant to section 13 and 15(d) [amend]

Filing Date: **1999-03-26** | Period of Report: **1998-12-31**
SEC Accession No. 0000950116-99-000523

(HTML Version on secdatabase.com)

FILER

MEDQUIST INC

CIK:**884497**| IRS No.: **222531298** | State of Incorp.:**NJ** | Fiscal Year End: **1231**
Type: **10-K/A** | Act: **34** | File No.: **000-19941** | Film No.: **99573286**
SIC: **7374** Computer processing & data preparation

Mailing Address
5 GREENTREE CENTRE
SUITE 311
ATTN BRUCE VAN FOSSEN
MARLTON NJ 08053

Business Address
FIVE GREENTREE CENTRE
STE 311
STATE HIGHWAY 73 N
MARLTON NJ 08053
6095968877

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-K/A

AMENDMENT NO. 1

TO

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934 (the "Act")

MEDQUIST INC.
(Exact name of registrant as specified in its charter)

For the fiscal year ended December 31, 1998   Commission file number 0-19941

New Jersey	22-2531298
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Five Greentree Centre, Suite 311, Marlton, NJ 08053
(Address of principal executive offices) (Zip Code)

(Registrant's telephone number, including area code) (609) 596-8877

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Title of Class
Common Stock (no par value)

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 report(s), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of Registrant's knowledge, in definite proxy or information statements incorporated by reference in Part III of this Form 10-K. [ ]

The aggregate market value of the Registrant's voting stock held by non-affiliates was approximately $ million on March 23, 1999, based on the closing price of Registrant's Common Stock as reported on the Nasdaq National Market as of such date.

The number of shares of the Registrant's Common Stock, no par value, outstanding as of March 22, 1999 was 33,727,120.

DOCUMENTS INCORPORATED BY REFERENCE

The following document is incorporated by reference.

Part III - Proxy Statement to be filed with the Commission in connection with the 1999 Annual Meeting.

PART I

Item 1. BUSINESS

MedQuist is the leading national provider of medical transcription services, a key component in the provision of healthcare services. Transcription is the process by which dictation is converted into an electronic medical report. The timely production of accurate reports is necessary for patient care and for healthcare providers to receive reimbursement. Through our approximately 6,000 transcriptionists, proprietary software, sophisticated digital dictation equipment and ability to interface with healthcare providers' computer systems, we provide customized solutions to shorten our customers' billing cycles and reduce their overhead and other administrative costs. We serve approximately 2,300 clients nationwide through our 77 client service centers.

As a result of internal growth and acquisitions, our revenue has increased from $61.5 million in 1996 (before restatements for acquisitions accounted for as pooling of interests) to $271.7 million in 1998. Our experienced management team and operating structure have enabled us to improve our operating margins. Our growth has enabled us to take advantage of efficiencies such as a larger network of transcriptionists and increased negotiating power with our vendors, including telecommunication providers.

Recent Developments

On December 10, 1998, MedQuist acquired The MRC Group, Inc. in a pooling of interests transaction issuing approximately 8.61 million shares of common stock. MRC, now a subsidiary of MedQuist, serves approximately 500 clients and employs approximately 2,400 experienced medical transcriptionists. For the year ended December 31, 1997, MRC had revenue of approximately $108.0 million.

We believe that the MRC acquisition will enable us to better utilize key resources. In addition to the reduction of corporate overhead costs by combining accounting, legal and human resources, the addition of transcriptionists will permit a more efficient workflow and faster customer service. In 1997, MRC's operating income, before its restructuring charge, was 1.1% of total revenue while MedQuist's operating income, before restating for the pooling of interests acquisitions, was 14.1% of total revenue. We believe that, over time, the operating margins of the combined company will continue to improve and achieve levels comparable to MedQuist's historical performance as a stand-alone company.

History

MedQuist was incorporated in New Jersey in 1984 and reorganized in 1987 as a group of out-patient healthcare businesses affiliated with a non-profit healthcare provider. In May 1994, we acquired our first medical transcription business, Transcriptions, Ltd. By the end of 1995, we had divested all of our non-medical transcription businesses, and through December 31, 1998, we had acquired MRC and 17 other medical transcription companies.

Industry Overview

Medical transcription is the process by which free-form dictated patient information is recorded and converted into a useable format, electronically routed to the appropriate location and added to a patient's medical record. Physicians and other healthcare providers use this information for delivery of patient care. Administrative personnel use the information for billing and other administrative purposes. Accurate and prompt transcribed records are required for reimbursement and to avoid healthcare fraud and abuse penalties. We expect that, as the percentage of medical records that are stored electronically continues to grow, the information management uses for such records will increase.

The majority of dictated reports are generated within the medical records departments of hospitals. Historically, transcription services were performed by hospital employees and were costly and difficult to manage. Examples of these reports include patient histories, discharge summaries, operative reports and consultation reports. Increasingly, other hospital departments, such as radiology, emergency, oncology, pediatrics and cardiology, are dictating reports to improve delivery of care and administrative functions. Health maintenance organizations, out-patient clinics and physician practice groups are also expanding their use of transcribed medical reports.

We believe the market for outsourced transcription services will expand due in part to the following trends:

Consolidation. As healthcare providers consolidate and increase in size, their information management needs become more complex and they increasingly require larger and more sophisticated vendors.

Connectivity. The exchange of patient information and the delivery of patient care must be coordinated among many entities, including physicians, hospitals and managed care companies. Increasingly, healthcare organizations are centralizing patient data into an accessible system creating economies of scale to reduce overall healthcare costs and to improve the efficient delivery of patient care. Accurate medical transcription and distribution and storage of transcribed records are critical to such coordination.

Cost Containment. Outsourcing services in the healthcare industry continues to increase as a means to reduce administrative burdens and fixed costs. Hospitals and other healthcare organizations increasingly are outsourcing their electronic transcription of dictated patient records as their information needs and volume of dictated reports expand. Outsourcing transcription services permits providers:

- to reduce overhead and other administrative costs;
- to improve the quality of reports;

- o to access leading technologies without development and investment risk; and

- o to obtain the expertise to implement and manage a system tailored to the providers' specific requirements.

Compliance. Government agencies are increasingly focused on fraud and abuse in the healthcare industry. For example, under Medicare, providers must submit detailed documentation in order to receive reimbursement. In many instances, providers have been fined and penalized for failing to substantiate claims for reimbursement in an audit. As a result, Medicare, the insurance industry and, in some cases healthcare accreditation organizations, are requiring transcribed reports:

- o to support claims for reimbursement;

- o to facilitate communication between various parts of a healthcare network;

- o to improve the quality and efficiency of patient care; and

- o to retain and provide reliable information in the event of malpractice litigation.

Strategy

Our objective is to maintain our position as the leading national provider of medical transcription services and to enhance that position as the information needs of healthcare providers continue to expand and evolve.

The key elements of our strategy include the following:

Expand Existing Client Relationships. We provide most of our transcription services to hospital medical records departments. We seek to increase our share of transcription services through our close and continuing client relationships as these departments outsource more of their transcription requirements and as the volume of patient records continues to grow. In addition, we will continue to penetrate the direct care departments at hospitals such as radiology, emergency, oncology, pathology, pediatrics and cardiology, within our existing client base. Historically, these departments have not dictated their patient data or outsourced the transcription of their patient data to the same extent as medical records departments.

Extend Current Client Base. We will continue to extend our base of traditional hospital clients and to pursue additional clients such as health maintenance organizations, out-patient clinics and physician practice groups which we believe will represent a growing percentage of the available market. Based upon input from new clients, we believe that references from our existing client base represent a key component of our sales and marketing efforts.

Capitalize on Operating Expertise. Our experienced management team and our operating structure have enabled us to consistently improve our operating margins by spreading the fixed portion of our overhead over a growing revenue base. We will focus on continuing to grow our revenue to take advantage of efficiencies such as

a larger network of transcriptionists and increased negotiating power with our vendors, including telecommunication providers.

Pursue Strategic Relationships. We have initiated relationships with developers and end-users of emerging technologies to create enhanced services for our clients. We will continue to incorporate advances in technology to improve the efficiency of our operations, reduce our costs, expand the breadth and functionality of our services and enhance our competitive position.

Pursue Strategic Acquisitions. The medical transcription industry is highly fragmented with approximately 1,500 providers of outsourced medical transcription services. Most of these are small companies that lack the financial resources or the technological capabilities necessary to provide transcription services nationwide. We will continue to pursue acquisitions that will expand our client base, network of qualified transcriptionists and geographic presence.

MedQuist Services

Through our approximately 6,000 transcriptionists, proprietary software, sophisticated digital dictation equipment and ability to interface with healthcare providers' computer systems, we provide customized solutions to shorten our customers' billing cycles and reduce their overhead and other administrative costs. In addition to hospital medical records departments, our target markets include patient care departments, such as radiology, emergency rooms, oncology, pathology, pediatrics and cardiology departments, health maintenance organizations, physician practice groups and out-patient clinics.

We record and store free-form medical dictation, transcribe the dictation into reports, and electronically receive, review and distribute final reports to a client. Authorized individuals at multiple locations can access this electronic information when needed for administrative, billing and patient care purposes.

We have designed our system to enable clients and individual healthcare providers to review the status of particular patient data and transcribed reports at any point in time and to advise us whether the production of a particular report requires acceleration. In addition, our system permits us to monitor our on-time performance, especially with respect to critical reports requiring turnaround times of less than 24 hours.

We serve approximately 2,300 clients through 77 client service centers nationwide. Each client service center is run by a manager who is supported by three additional levels of operating management. Due to the large number of trained transcriptionists and our ability to allocate work among them efficiently, we believe that we are able to reduce the production turnaround times for transcribed medical reports. An in-house staff or small transcription company generally cannot achieve these efficiencies to the extent that we can. Our system provides editing and electronic review capabilities, such as specific reference to pages or clauses to alert clients to potential deficiencies, that increase accuracy and reliability.

Our system provides flexibility to address individual client needs. We are capable of modifying the system to interface with existing client systems. Our technical staff works closely with our clients, both before and after installation, to develop system modifications and refinements.

Medical Transcriptionist Recruitment

One of the most significant challenges to our continued growth is the successful recruitment and retention of qualified transcriptionists. To address this challenge, we have enhanced our recruitment process, increased training and formed strategic relationships with various schools across the country.

We have hired a Director of National Recruitment and at least two recruiters in each of our three regional groups. In addition, each client service center has at least one person designated to monitor and manage recruitment efforts.

Currently, we are experimenting with software that monitors transcriptionist quality and should allow us to implement an accelerated training program so that less experienced transcriptionists can be hired and trained efficiently. In addition, we have established a "Partners in Education" program with adult education programs, vocational technology schools, and colleges offering medical transcription training programs.

Sales and Marketing Efforts

Our existing client base is a key component of our marketing and sales strategy. Based on input from new clients, we believe that new clients have utilized our services in large part due to recommendations and references by our existing national client base. All office managers and operational vice presidents, as well as our senior management, including Mr. Cohen, have sales responsibilities.

We utilize a consultative sales and marketing approach by establishing a working relationship with our clients through a series of direct meetings with the chief financial officer, health information manager, chief information officer and other key individuals at the client's organization. In this manner, we obtain information concerning the particular needs of a client and educate the client as to how our services can be customized to meet those needs. As part of our marketing efforts, we also advertise in national healthcare trade publications (including those sponsored by the American Health Information Management Association) and participate in industry conventions.

Business Partners and Relationships

We are always evaluating emerging technologies and apply them as appropriate to make our services more reliable, efficient and cost-effective, and to assist our clients in meeting their transcription and document management needs. We have initiated relationships with developers and end-users of emerging technologies, such as voice-recognition, data mining and outcomes analysis and Internet based telecommunications to create value added services for our clients and to participate in the development of the computer based patient record. Our Senior Vice President-New Business Development oversees our strategic partnerships and manages our research and development department that integrates these partnerships into useable product and service offerings. Some of our current business partners and relationships in exploring these emerging technologies are described below.

WebMD is an Internet-based healthcare network that connects physicians, hospitals, third-party payers, and consumers to a virtual marketplace of medical information, tools, and services. WebMD provides its subscribers with access to our medical transcription services on its website.

Lernout & Hauspie Speech Products, N.V. is a global leader in advanced speech and

language solutions for vertical markets, computers, automobiles, telecommunications, embedded products, consumer goods and the Internet.Lernout & Hauspie is making the speech user interface the keystone of simple, convenient interaction between humans and technology, and is using advanced translation technology to break doen language barriers. With Lernout & Hauspie, we have developed a clinical workstation that integrates voice recognition, structured input and free-form dictation.

Synthesys Technologies, Inc. develops innovative clinical data repository solutions for the healthcare industry. We have a co-marketing agreement with Synthesys to sell Synthesys' data mining and outcomes analysis software to our customer base. The software includes a search engine that provides for analysis of transcribed clinical data.

MasterChart is a provider of solution-based technology to leading healthcare system providers. Through an agreement with MasterChart, we offer the Physassist Portable Dictation, a hand-held digital recorder; Respond, an Internet document management system; and MasterChart Integration Engine, a message translation control and monitoring middleware. MasterChart also provides product development and software design services to MedQuist.

Item 2. PROPERTIES

The Company does not own any real property. The Company leases office and other space for 77 service centers nationally. The Company's typical service center ranges in size from 1,000 to 7,000 square feet and is leased for a term ranging from three to five years. The Company's executive offices comprise 14,000 square feet and has 5 years remaining on its lease. The Company believes that there is adequate office space available to it should it need to move or expand and that minimal leasehold improvements are required in order to open a new location.

Item 3. LEGAL PROCEEDINGS

Although the Company from time to time in the course of the operation of its business is subject to various legal proceedings, the Company is not currently a party to any material pending legal proceeding nor, to the knowledge of the Company, is any material legal proceeding currently threatened.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On December 10, 1998, the Company held a Special Meeting of its shareholders at which the acquisition by merger of The MRC Group, Inc. was approved. The number of votes cast for, against, as well as abstentions and broker non-votes as to such matter is as follows:

15,302,593	shares voted for the proposal;
20,646	shares voted against the proposal;
47,952	shares abstained; and
0	broker non-votes.

PART II

Item 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS

The common stock is traded on the Nasdaq National Market under the symbol "MEDQ". The following table sets forth the high and low reported prices for the Common Stock for the last two fiscal years and for the first quarter of 1999. The bid quotations for the Nasdaq National Market reflect inter-dealer prices, do not include retail mark-ups, mark-downs or commissions and may not necessarily reflect actual transactions.

	High	Low
1997		
First Quarter	$ 9.33	$ 7.17
Second Quarter	10.42	6.33
Third Quarter	12.00	9.33
Fourth Quarter	17.56	10.81
1998		
First Quarter	$ 19.56	$ 15.00
Second Quarter	29.38	17.63
Third Quarter	33.00	20.50
Fourth Quarter	40.00	21.75
1999		
First Quarter (through March 22)	$ 39.00	$ 29.25

The above noted bid quotations reflect a three for two stock split effected on September 9, 1997 and a two for one stock split effected on June 15, 1998.

On March 22, 1999 the closing sale price for the Common Stock, as reported on the Nasdaq National Market, was $30.06 per share.

We have never declared or paid any cash dividends on our capital stock. We expect to retain any future earnings to fund operations and the continued development of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future. In addition, our agreements with our senior lender restrict the payment of dividends.

Item 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following financial information is derived from MedQuist's audited financial statements for the years ended December 31, 1996, 1997 and 1998 included in this Form 10-K, from its audited financial statements for the year ended December 31, 1995, and from its unaudited financial statements for the year ended December 31, 1994. The Company's financial statements have been restated to reflect MedQuist's 1998 acquisitions accounted for as pooling of interests. This information is only a summary and you should read it in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations", MedQuist's financial statements and related notes and other information that MedQuist has filed with the SEC.

<TABLE>
<CAPTION>

	Year Ended December 31, (In thousands, except per share data)				
	1994	1995	1996	1997	1998
<S>	<C>	<C>	<C>	<C>	<C>

Statement of Operations Data:

Revenue	$59,228	$109,657	$152,109	$ 216,158	$271,655
Costs and expenses:					
Cost of revenue	46,873	86,265	118,978	169,235	209,587
Selling, general and administrative	6,184	9,144	11,908	14,362	16,061
Depreciation	2,581	5,752	7,372	10,339	12,697
Amortization of intangible assets	264	896	3,150	5,652	3,757
Transaction costs and restructuring charges	--	347	644	2,075	18,221
Total operating expenses	55,902	102,404	142,052	201,663	260,323
Operating income	3,326	7,253	10,057	14,495	11,332
Interest expense (income), net	2,648	4,252	2,049	469	(325)
Income from continuing operations before income taxes	678	3,001	8,008	14,026	11,657
Income tax provision (benefit)	(529)	640	2,720	5,293	8,472
Income from continuing operations	1,207	2,361	5,288	8,733	3,185
Discontinued operations	1,612	(1,729)	--	--	--
Extraordinary item	--	(545)	--	--	--
Net income	2,819	87	5,288	8,733	3,185
Inducement of warrant exercise	--	--	(707)	--	--
Net income available to common shareholders	$ 2,819	$ 87	$ 4,581	$ 8,733	$ 3,185
Basic income per share:					
Continuing operations	$ 0.12	$ 0.23	$ 0.22	$ 0.28	$ 0.10
Discontinued operations	0.17	(0.17)	--	--	--
Extraordinary item	--	(0.05)	--	--	--
Inducement of warrant exercise	--	--	(0.03)	--	--
	$ 0.29	$ 0.01	$ 0.19	$ 0.28	$ 0.10
Diluted income per share:					
Continuing operations	$ 0.12	$ 0.22	$ 0.20	$ 0.26	$ 0.09
Discontinued operations	0.17	(0.16)	--	--	--
Extraordinary item	--	(0.05)	--	--	--
Inducement of warrant exercise	--	--	(0.03)	--	--
	$ 0.29	$ 0.01	$ 0.17	$ 0.26	$ 0.09

Balance Sheet Data:

	As of December 31, (In thousands)				
	1994	1995	1996	1997	1998
Working capital	$ 6,453	$ 13,142	$ 33,483	$ 36,608	$ 41,852
Total assets	85,811	91,191	158,551	173,773	187,311
Long-term debt, net of current portion	39,577	23,342	9,964	7,589	215
Shareholders' equity	12,096	30,572	120,710	131,373	151,186

</TABLE>

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We are the leading national provider of medical transcription services. Our fees are based primarily on contracted rates with our customers. We recognize revenue when we render services and deliver reports to our customers. Cost of revenue consists of all direct costs associated with providing transcription related services, including payroll, telecommunications, repairs and maintenance, rent and other direct costs. Most of our cost of revenue is variable. Selling, general and administrative expenses include costs associated with our senior executive management, marketing, accounting, legal and other administrative functions. Selling, general and administrative expenses are mostly fixed, but include certain variable components.

From 1995 through 1998, we completed 18 acquisitions. Five acquisitions completed in 1998, including the acquisition of MRC, were accounted for as pooling of interests. Four of these acquisitions were material and, accordingly, we restated our financial statements.

On December 10, 1998, MedQuist acquired MRC through the issuance of approximately 8.61 million shares of the Company's common stock. We believe that the MRC acquisition will better enable us to better utilize crucial resources and reduce corporate overhead by combining accounting, legal and human resources. Further, the additional transcriptionists should permit a more efficient workflow and faster customer service. In 1997, MRC's revenue and operating income, before its restructuring charge, were $108.0 million and $1.2 million, or 1.1% of its revenue. MedQuist's operating income, before restating for its pooling of interests acquisitions, was 14.1% of revenue in 1997. We believe that, over time, the operating margins of the combined company will continue to improve and achieve levels comparable to MedQuist's historical performance as a stand-alone company.

Results of Operations

The following table sets forth, for the periods indicated, certain financial data as a percentage of revenue, as restated for our acquisitions accounted for as a pooling of interests:

<TABLE>
<CAPTION>

	Year Ended December 31,		
	1996	1997	1998
<S>	<C>	<C>	<C>
Revenue	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of revenue	78.2	78.3	77.2
Selling, general and administrative	7.8	6.6	5.9
Depreciation	4.9	4.8	4.7
Amortization of intangible assets	2.1	2.6	1.4
Transaction costs and restructuring charges	0.4	1.0	6.7
Operating income	6.6	6.7	4.1
Interest income (expense), net	(1.4)	(0.2)	0.1
Income before income taxes	5.2	6.5	4.2
Income tax provision	1.8	2.5	3.1
Net income	3.4%	4.0%	1.1%

</TABLE>

Year Ended December 31, 1998 Compared to
Year Ended December 31, 1997

Revenue. Revenue increased 25.7% from $216.2 million in 1997 to $271.7 million in 1998. The $55.5 million increase as compared to 1997 was composed of $43.5 million from internally generated growth and $12.0 million from acquisitions accounted for as purchase transactions.

Cost of Revenue. Cost of revenue increased 23.9% from $169.2 million in 1997 to $209.6 million in 1998 and was directly related to the increase in revenue. As a percentage of revenue, cost of revenue decreased from 78.3% in 1997 to 77.2% in 1998 due primarily to the improved direct margins of MRC's business in 1998 versus 1997.

Selling, General and Administrative. Selling, general and administrative expenses increased 11.8% from $14.4 million in 1997 to $16.1 million in 1998. The increase was due primarily to increased administrative costs to support the increase in revenue, in addition to increased technology development costs. This increase was partially offset by decreased marketing costs at MRC. As a percentage of revenue, selling, general and administrative expenses decreased from 6.6% in 1997 to 5.9% in 1998. The percentage decrease was due primarily to our ability to spread the fixed portion of our overhead over a larger revenue base.

Depreciation. Depreciation increased 23.3% from $10.3 million in 1997 to $12.7 million in 1998. The increase in depreciation was a result of increased capital expenditures to support the growth in revenue. As a percentage of revenue, depreciation remained relatively constant at 4.7% in 1998 compared to 4.8% in 1997.

Amortization. Amortization of intangible assets was $5.7 million in 1997 compared to $3.8 million in 1998. The amount in 1997 includes amortization of noncompete agreements from prior business acquisitions that were fully amortized in late 1997.

Interest. We had interest expense of $469,000 in 1997 and interest income of $325,000 in 1998. We repaid a significant portion of our debt in 1997 and invested our excess cash in 1998.

Transaction Costs and Restructuring Charges. In 1998, we (1) incurred

$11.0 million of transaction costs associated with pooling of interests business combinations, (2) incurred $682,000 of transaction costs related to MRC's terminated initial public offering and (3) recorded a $6.5 million restructuring charge associated with the MRC acquisition.

As of December 31, 1998, $10.5 million of transaction costs associated with the pooling of interests acquisitions had been paid, with $500,000 included in accrued expenses for payments scheduled to be made in 1999.

In June 1998, MRC filed a registration statement for an initial public offering that was terminated in September 1998 upon signing the merger agreement with the Company. All transaction costs related to MRC's terminated initial public offering were paid in 1998.

In December 1998, our board of directors approved a restructuring plan associated with the MRC acquisition. When the board approved the plan, we recorded a $6.5 million charge, of which $3.8 million related to non-cancelable lease obligations on duplicate facilities, $1.6 million related to employee severance and $1.1 million related to contract cancellations and other exit costs. We expect to complete the restructuring in 1999. As of December 31, 1998, $567,000 of the employee severance and $410,000 in other restructuring costs had been paid. At December 31, 1998, $5.6 million was included in accrued expenses related to the restructuring.

In 1997, MRC incurred a restructuring charge of $2.1 million related to the closure and consolidation of less profitable or redundant client service centers and other non-recurring acquisition and integration costs incurred in connection with MRC's acquisition of Medical Records Corp. As of December 31, 1998, $1.2 million related to closed facility leases remained in accrued expenses.

Year Ended December 31, 1997 Compared to
Year Ended December 31, 1996

Revenue. Revenue increased 42.1% from $152.1 million in 1996 to $216.2 million in 1997. The $64.1 million increase as compared to 1996 was composed of $53.1 million from internally generated growth and $11.0 million from acquisitions accounted for as purchase transactions.

Cost of Revenue. Cost of revenue increased 42.2% from $119.0 million in 1996 to $169.2 million in 1997. This increase was directly related to the increase in revenue. As a percentage of revenue, cost of revenue remained relatively constant at 78.2% in 1996 as compared to 78.3% in 1997.

Selling, General and Administrative. Selling, general and administrative expenses increased 21.0% from $11.9 million in 1996 to $14.4 million in 1997. The increase was due primarily to increased administrative costs to support the increase in revenue, in addition to increased marketing costs and technology development costs incurred by MRC. As a percentage of revenue, selling, general and administrative expenses decreased from 7.8% in 1996 to 6.6% in 1997. The percentage decrease was due primarily to our ability to spread the fixed portion of our overhead over a larger revenue base.

Depreciation. Depreciation increased 39.2% from $7.4 million in 1996 to $10.3 million in 1997. The increase in depreciation was a result of capital expenditures made to support the growth in revenue. As a percentage of revenue, depreciation remained relatively constant at 4.8% in 1997 compared to 4.9% in 1996.

Amortization. Amortization of intangible assets was $5.7 million in 1997 as compared to $3.2 million in 1996. The increase in 1997 was attributable to the acquisitions made in 1996 and 1997 accounted for as purchase transactions.

Interest. Interest expense decreased from $2.0 million in 1996 to $469,000 in 1997. The decrease in 1997 was primarily related to the payment of our senior term loans, reduced borrowings under our revolving credit facility and the payment of the cash portion of the deferred purchase price on May 30, 1996 for our 1994 acquisition of Transcriptions, Ltd. This deferred purchase price was paid using a portion of the proceeds from our 1996 common stock offering. In 1996 we recorded $640,000 of non-cash imputed interest expense associated with the Transcriptions, Ltd. deferred purchase price.

Restructuring Charges. MRC incurred restructuring charges of $2.1 million in 1997 and $644,000 in 1996. These charges were related to the closure and consolidation of less profitable or redundant facilities. In addition, the 1997 restructuring charge included other acquisition and integration costs incurred in connection with MRC's acquisition of Medical Records Corp.

Liquidity and Capital Resources

At December 31, 1998, we had working capital of $41.9 million, including

$15.9 million of cash and cash equivalents, and no outstanding bank debt. During 1998, our operating activities provided cash of $22.9 million and during 1997, our operating activities provided cash of $ 21.4 million. Our cash flow from operating activities is generated primarily from our net income before depreciation and amortization, partially offset by increases in accounts receivable. In 1998, the increase in operating cash flow was also affected by increased accrued expenses, primarily related to the restructuring charge.

During 1998, we used cash for investing activities of $15.9 million, consisting primarily of $14.0 million of capital expenditures. In addition, we generated $4.0 million in cash from sales of short-term investments and used $4.4 million for the acquisition of three transcription businesses accounted for under the purchase method. In addition, we paid $1.4 millon to a dissenting shareholder in connection with the Signal acquisition. During 1997, we used cash for investing activities of $18.4 million, consisting primarily of $13.7 million of capital expenditures. In addition, in 1997 we generated $1.0 million in cash from sales of short-term investments and used $5.6 million for the acquisition of eight transcription businesses accounted for under the purchase method.

During 1998, cash used in financing activities was $5.5 million, consisting primarily of $10.0 million of debt repayments and $1.0 million of distributions to former stockholders of acquired S-corporations, offset by $5.5 million in proceeds from the issuance of common stock, including option and warrant exercises and sales in connection with employee benefit plans. During 1997, cash used in financing activities was $3.5 million, consisting primarily of $3.8 million of debt repayments, and $1.1 million of shareholder distributions to former stockholders of acquired S-corporations, and $676,000 to purchase and retire common stock, offset by $2.0 million in proceeds from the issuance of common stock, including option and warrant exercises and sales in connection with employee benefit plans.

We have a borrowing facility with Chase Manhattan Bank. The Chase facility provides for a $10.0 million senior unsecured revolving credit facility expiring April 23, 2000. The Chase facility bears interest at resetting rates selected by the Company from various alternatives. The interest rate alternatives are either (1) the greater of (a) prime rate, (b) the federal funds rate plus 0.5%, and (c) the bank's certificate of deposit rate plus 1%, or (2) LIBOR plus 0.75%. The Chase facility also allows us to finance up to 100% of any acquisitions of companies that are in the business of providing transcriptions-related services. The financing of these acquisitions may be carved out of the Chase facility and amortized over five-year periods (20 consecutive quarters). Each acquisition term loan that is created would permanently reduce the remaining Chase facility commitment by a like amount.

We can use the Chase facility for working capital and general corporate purposes. If any amounts under the Chase facility are repaid, other

than acquisition term loans, we may reborrow such amounts. The Chase facility includes financial and other covenants applicable to us, including limitations on capital expenditures and dividends. As of March 22, we had no outstanding borrowings under the Chase facility.

We believe that cash flow generated from operations and borrowing capacity under the Chase facility will be sufficient to meet our current working capital and capital expenditure requirements. In 1999, we expect capital expenditures as a percentage of revenue to be consistent with prior years.

Year 2000 Compliance

We are aware of the issues associated with the programming code in existing computer systems as 2000 approaches. The Year 2000 problem is pervasive and complex as virtually every computer operation will be affected in some way by the rollover of the two digit year value to 00. The issue is whether computer systems will recognize date sensitive information when the year changes to 2000. Systems that do not properly recognize such information could generate erroneous data or cause a system to fail. We rely on our systems in operating and monitoring all aspects of our business. We also rely on the external systems of our customers, suppliers, telecommunication carriers, utilities and other organizations with which we do business.

We have approached the Year 2000 problem in the following manner:

o assessing, correcting and testing our internal systems;

o obtaining assurance or information on the state of Year 2000 readiness of our material clients and suppliers; and

- o developing contingency plans, when practical, to address expected Year 2000 failures.

A discussion of each of these areas follows.

Internal Systems. In 1998, we conducted an assessment of our internal systems. This assessment covered embedded computer chips, computer software, computer hardware, telephones, communications equipment, facsimile equipment, scanners, copiers and voice recording systems which we own and were able to identify as critical to our ability to provide services to our clients. The assessment identified a variety of software and hardware issues that we needed to address to be prepared for 2000. Some of these issues include the need to:

- o upgrade or modify the BIOS (programs which allow personal computers to run) on some of our PCs (or replace the PC);

- o modify some of our server operating systems;

- o reset the dates or modify some of our voice capture systems;

- o modify the date fields of some of our interfaces;

- o upgrade the version level of the transcription software of some of our users and clients;

- o accelerate the conversion of some clients from outdated software applications to compliant software applications; and

- o upgrade some of the financial systems.

June 30, 1999 is our internal target for rectifying Year 2000 issues for all mission critical applications. From July 1 to December 31, 1999, we plan to retest critical systems and evaluate non-critical applications for potential Year 2000 compliance issues.

Clients and Suppliers. We also have exposure to Year 2000 problems that may be experienced by others. These risks include the inability to exchange electronic data and the risk of disruptions and failures of persons with whom we do business or on whom we or our clients rely. Our business interacts with or depends on the systems of clients, suppliers, telecommunication carriers, utilities, vendors, financial institutions and others. If we are not able to exchange information electronically with our clients and transcriptionists our business may be materially impacted. For example, our business relies heavily on telephone services. If phone service is lost, we will be unable to provide services until phone service is restored or contingency plans can be put in place.

If our clients, suppliers, vendors and financial institutions are not Year 2000 compliant, there may be a material disruption to their businesses. These disruptions could negatively impact us in many ways, including:

o a client may be unable to pay us;

o a financial institution may be unable to process checks drawn on our bank accounts, accept deposits or process wire transfers;

o vendor deliveries of computer equipment and other supplies may be delayed or cease;

o voice and data connections we use to share information may be interrupted; and

o brokers who make a market in our stock may not be able to trade our stock.

This list is not comprehensive. Other interruptions to our normal business activities may occur, the nature and extent of which we cannot foresee. In an effort to minimize the exposure to such third party Year 2000 problems, we have initiated a process of obtaining written assurances from these third parties that they will be Year 2000 compliant. Based on the response we receive from the third parties, we are identifying the associated risks to our business and making necessary changes.

Contingency Plans. We are developing Year 2000 contingency plans where practical. These plans address alternatives to electronic processing of medical information, payroll, vendor payments, cash receipts from clients and communicating without e-mail. These plans include identifying alternative sources of goods and services and performing certain tasks manually. For example, these contingency plans include requiring physicians to dictate into hand held devices, delivering tapes from these devices to transcriptionists and printing paper copies of reports to be delivered to clients.

In some situations, however, it is impractical to have an effective contingency plan. For example, a failure of our primary banking institution may interrupt our cash receipts and our ability to pay our employees and vendors in a timely manner. Our contingency plan may call for paying employees in cash, but may not be practical due to the amount of cash involved, the number of locations and the number of individuals to be paid. The number of Year 2000 failures we suffer may exceed our ability to address them all at one time. In addition, significant Year 2000 failures by third parties, including clients, may jeopardize our financial strength. In severe circumstances, our ability to continue as a going concern may be threatened or we may fail. We believe, however, that we are taking reasonable and prudent steps to address the Year 2000 problem based on information currently available to us. We will continue to monitor this issue and plan to modify our approach if we believe the circumstances warrant such a change.

Based on the information available to date, we expect to incur approximately $200,000 in expense to correct operational problems such as BIOS fixes. We also believe we will incur approximately $1.2 million to replace and upgrade voice capture systems, which will be capitalized and depreciated over their estimated useful lives of five years.

Quantitative And Qualitative Disclosure About Market Risk

We generally do not use derivative financial instruments in our investment portfolio. We make investments in instruments that meet credit quality standards, as specified in our investment policy guidelines; the policy also limits the amount of credit exposure to any one issue, and type of instrument. We do not expect any material loss with respect to our investment portfolio.

The following table provides information about our investment portfolio at December 31, 1998. For investment securities, the table presents principal amounts and related weighted average interest rates (dollars in thousands).

Cash and cash equivalents	$15,936
Average interest rate	4.0%
Warrant investment	$ 900
Average interest rate	--
Total portfolio	$16,836
Weighted average interest rate ...	3.8%

The majority of our debt obligations were repaid in February 1999. Remaining obligations consist primarily of relatively insignificant capital lease obligations that mature through 2002.

Inflation

We believe that the effects of inflation and changing prices generally do not have a material adverse effect on our results of operations or financial condition.

Forward-Looking Statements

Some of the information in this Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act. These statements include forward-looking language such as "will likely result," "may," "are expected to," "is anticipated," "estimated," "projected," "intends to" or other similar words. Our actual results are likely to differ, and could differ materially, from the results expressed in, or implied by, these forward-looking statements. There are many factors that could cause these forward-looking statements to be incorrect, including but not limited to the following risks: risks associated with (1) our ability to recruit and retain qualified transcriptionists; (2) acquisitions; (3) dependence on our senior management team; (4) the impact of new services or products on the demand for our services; (5) our dependence on a single line of business; (6) our ability to expand our customer base; (7) our ability to maintain our current growth rate in revenue and earnings; (8) the volatility of our stock price; (9) our ability to compete with others; (10) changes in law relating to the classification of our transcriptionists; (11) potential infringement on the proprietary rights of others; (12) our failure to comply with confidentiality requirements; (13) our customers' and suppliers' failure to be Year 2000 compliant; and (14) our various anti-takeover protections. When considering these forward-looking statements, you should keep in mind these risk factors and the other cautionary statements in this prospectus, and should recognize that those forward-looking statements speak only as of the date made. MedQuist does not undertake any obligation to update any forward-looking statement included in this Form 10-K.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Index to Consolidated Financial Statements. The information called for by this Item is set forth on Pages F-1 through F-21.

MEDQUIST INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To MedQuist Inc.:

We have audited the accompanying consolidated balance sheets of MedQuist Inc. (a New Jersey corporation) and Subsidiaries as of December 31, 1997 and 1998, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of MedQuist Inc. and Subsidiaries as of December 31, 1997 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

/s/ Arthur Andersen LLP

Philadelphia, Pa.,
February 1, 1999

MEDQUIST INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands)

<TABLE>
<CAPTION>

	December 31, 1997	December 31, 1998
<S>	<C>	<C>
ASSETS		
Current assets:		
Cash and cash equivalents	$ 14,489	$ 15,936
Short-term investments	4,003	--
Accounts receivable, net of allowance of $1,298 and $2,274	41,819	52,477
Deferred income taxes	3,177	6,438
Prepaid expenses and other	307	233
Total current assets	63,795	75,084
Property and equipment, net	25,442	27,022
Intangible assets, net	82,382	82,216
Other	2,154	2,989
	$ 173,773	$ 187,311
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 6,792	$ 2,372
Accounts payable	5,777	5,010
Accrued expenses	14,618	25,850
Total current liabilities	27,187	33,232
Long-term debt	7,589	215
Other long-term liabilities	1,130	697
Deferred income taxes	6,494	1,981
Commitments and contingencies (Note 10)		
Shareholders' equity:		
Common stock, no par value, 60,000 shares authorized, 32,138 and 33,258 shares issued and outstanding	--	--
Additional paid-in capital	119,008	136,603
Retained earnings	12,365	14,536
Unrealized gain on marketable securities	--	585
Deferred compensation	--	(538)
Total shareholders' equity	131,373	151,186
	$ 173,773	$ 187,311

</TABLE>

The accompanying notes are an integral part of these statements.

MEDQUIST INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

<TABLE>
<CAPTION>

	Year Ended December 31, 1996	1997	1998
Revenue	$ 152,109	$ 216,158	$ 271,655
Costs and expenses:			
Cost of revenue	118,978	169,235	209,587
Selling, general and administrative	11,908	14,362	16,061
Depreciation	7,372	10,339	12,697
Amortization of intangible assets	3,150	5,652	3,757
Transaction costs and restructuring charges	644	2,075	18,221
Total operating expenses	142,052	201,663	260,323
Operating income	10,057	14,495	11,332
Interest expense (income), net	2,049	469	(325)
Income before income taxes	8,008	14,026	11,657
Income tax provision	2,720	5,293	8,472
Net income	5,288	8,733	3,185
Inducement of warrant exercise	(707)	--	--
Net income available to common shareholders	$ 4,581	$ 8,733	$ 3,185
Basic income per share:			
Net income	$ 0.22	$ 0.28	$ 0.10
Inducement of warrant exercise	(0.03)	--	--
Net income available to common shareholders	$ 0.19	$ 0.28	$ 0.10
Diluted income per share:			
Net income	$ 0.20	$ 0.26	$ 0.09
Inducement of warrant exercise	(0.03)	--	--
Net income available to common shareholders	$ 0.17	$ 0.26	$ 0.09

</TABLE>

The accompanying notes are an integral part of these statements.

MEDQUIST INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(in thousands)

<TABLE>
<CAPTION>

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Unrealized Gain on Marketable Securities	Deferred Compensation	Total
BALANCE, DECEMBER 31, 1995	13,182	$ --	$ 29,493	$ 1,079	$ --	$ --	$ 30,572
Net income	--	--	--	5,288	--	--	5,288
Exercise of common stock options, including tax benefit	98	--	336	--	--	--	336
Issuance of common stock in connection with business acquisitions	4,773	--	10,751	--	--	--	10,751
Sale of common stock, net of expenses	10,395	--	68,714	--	--	--	68,714
Distributions	--	--	--	(928)	--	--	(928)
Exercise of warrants, including inducement charge	3,016	--	6,980	(707)	--	--	6,273
Purchase and retirement of common stock, at cost	(36)	--	(296)	--	--	--	(296)
BALANCE, DECEMBER 31, 1996	31,428	--	115,978	4,732	--	--	120,710
Net income	--	--	--	8,733	--	--	8,733

Exercise of common stock options and warrants, including tax benefit	759	--	3,455	--	--	--	3,455
Issuance of common stock, net of expenses	33	--	251	--	--	--	251
Distributions	--	--	--	(1,100)	--	--	(1,100)
Purchase and retirement of common stock, at cost	(82)	--	(676)	--	--	--	(676)
BALANCE, DECEMBER 31, 1997	32,138	--	119,008	12,365	--	--	131,373
Comprehensive income:							
Net income	--	--	--	3,185	--	--	3,185
Unrealized gain on available for sale securities, net of tax	--	--	--	--	585	--	585
Total comprehensive income	--	--	--	3,185	585	--	3,770
Exercise of common stock options and warrants, including tax benefit	917	--	9,662	--	--	--	9,662
Issuance of common stock, net of expenses	203	--	1,701	--	--	--	1,701
Distributions	--	--	--	(1,014)	--	--	(1,014)
Grant of common stock options below fair value	--	--	1,078	--	--	(1,078)	--
Amortization of deferred compensation	--	--	--	--	--	540	540
Cash paid to dissenting stockholders in pooling of interests transaction	--	--	(1,438)	--	--	--	(1,438)
Transaction costs paid by acquired company stockholder	--	--	1,540	--	--	--	1,540
Income tax asset recognized in pooling of interests transaction ..	--	--	5,052	--	--	--	5,052
BALANCE, DECEMBER 31, 1998	33,258	$ --	$ 136,603	$ 14,536	$ 585	$ (538)	$ 151,186

</TABLE>

The accompanying notes are an integral part of these statements.

MEDQUIST INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

<TABLE>
<CAPTION>

	Year Ended December 31,		
	1996	1997	1998
<S>	<C>	<C>	<C>
OPERATING ACTIVITIES:			
Net income	$ 5,288	$ 8,733	$ 3,185
Adjustments to reconcile net income to net cash provided by operating activities--			
Depreciation and amortization	10,522	15,991	16,454
Amortization of debt discounts	704	--	--
Amortization of deferred compensation	--	--	540
Deferred income tax provision (benefit)	1,105	(200)	(3,213)
Loss on disposal of property and equipment	--	223	--
Transaction costs paid by acquired company stockholder	--	--	1,540
Changes in assets and liabilities, excluding effects of acquisitions and divestitures--			
Accounts receivable, net	(5,571)	(7,230)	(10,345)
Prepaid expenses and other	1,403	631	97
Other assets	182	(362)	65
Accounts payable	(1,983)	543	(767)
Accrued expenses	(832)	3,175	15,729
Other long-term liabilities	(79)	(87)	(433)
Net cash provided by operating activities	10,739	21,417	22,852
INVESTING ACTIVITIES:			
Purchases of property and equipment	(6,553)	(13,716)	(14,027)
Acquisitions, net of cash acquired	(26,205)	(5,628)	(5,839)
Sale (purchase) of short-term investments	(5,893)	973	4,003

Net cash used in investing activities	(38,651)	(18,371)	(15,863)
FINANCING ACTIVITIES:			
Repayments of long-term debt and subordinated payable	(38,728)	(3,757)	(10,006)
Proceeds from issuance of long-term debt	7,121	--	--
Distributions	(928)	(1,100)	(1,014)
Proceeds from exercise of common stock options and warrants	226	1,785	5,065
Net proceeds from issuance of common stock	68,714	251	413
Purchase and retirement of common stock	(296)	(676)	--
Net cash provided by (used in) financing activities	36,109	(3,497)	(5,542)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	8,197	(451)	1,447
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	6,743	14,940	14,489
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 14,940	$ 14,489	$ 15,936

</TABLE>

The accompanying notes are an integral part of these statements.

MEDQUIST INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except per share amounts)

1. BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Background and Basis of Presentation

MedQuist Inc. (the "Company" or "MedQuist") is the leading national provider of medical transcription services. MedQuist was incorporated in New Jersey in 1984 and reorganized in 1987. From 1995 through 1998, the Company completed 18 acquisitions, of which 13 were accounted for as purchase transactions and five were accounted for as pooling of interests (see Note 2). The pooling of interests transactions, all of which occurred in 1998, include the acquisitions of Digital Dictation, Inc. ("DDI"), Signal Transcriptions Network, Inc. ("Signal"), Transcriptions Ltd. of Florida, Inc. ("TLF") and The MRC Group, Inc. ("MRC") which required restatement of the Company's financial statements. Accordingly, the accompanying financial statements have been restated to reflect these 1998 acquisitions accounted for under the pooling of interests method.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of MedQuist and its subsidiaries. All material intercompany balances and transactions have been eliminated.

Common Stock Splits

On September 9, 1997, the Company effected a three-for-two stock split for all shares of common stock. Further, on June 15, 1998, the Company effected a two-for-one stock split for all shares of common stock. All share data in the accompanying financial statements has been retroactively adjusted to reflect both stock splits.

Use of Estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported assets and liabilities and contingency disclosures at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

Fees for transcription-related services are based primarily on contracted rates, and revenue is recognized upon the rendering of services and delivery of reports.

(in thousands, except per share amounts)

Pro Forma Presentation for Income Taxes

Prior to their mergers with the Company, Signal and TLF were taxed as "S" Corporations. Accordingly, no tax provision is included in the accompanying financial statements related to their income prior to their respective acquisition dates. The following pro forma presentation sets forth the Company's income tax provision, net income and net income per share as if Signal and TLF had been taxed as "C" Corporations for all periods presented.

	Year Ended December 31, 1996	1997	1998
Income before income taxes, as reported	$ 8,008	$ 14,026	$ 11,657
Pro forma income tax provision	3,357	5,975	8,766
Pro forma net income	$ 4,651	$ 8,051	$ 2,891
Pro forma net income per share:			
Basic	$ 0.19	$ 0.25	$ 0.09
Diluted	$ 0.18	$ 0.24	$ 0.08

Cash and Cash Equivalents

Cash and cash equivalents include cash and highly liquid investments purchased with an original maturity of three months or less, consisting primarily of cash on deposit with banks. At December 31, 1997, cash and cash equivalents included a restricted certificate of deposit of $1,339 which was used to repay a note payable in January 1998.

Investments

Short-term investments held by the Company at December 31, 1997 consisted primarily of investments in high-quality, fixed-income bonds with varying maturities and rates. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities," the Company classified their investments as held-to-maturity since the Company had both the intent and ability to hold to maturity. Accordingly, such investments were carried at amortized cost.

Included in other assets at December 31, 1998, is a warrant to purchase common stock in Learnout and Hauspie, Inc. ("L&H"). The warrant has been classified as available-for-sale. Pursuant to SFAS No. 115, available-for-sale securities are carried at fair value, with unrealized gains and losses, net of tax, reported as a separate component of shareholders' equity. The unrealized gain, net of taxes, at December 31, 1998 was $585.

Property and Equipment

Property and equipment are recorded at cost. Depreciation and amortization have been provided using the straight-line method over the estimated useful lives of the assets, which range from two to seven years for furniture, equipment and software, and the lease term for leasehold improvements. Repairs and maintenance costs are charged to expense as incurred. Additions and betterments are capitalized. Gains or losses on disposals are charged to operations.

Intangible Assets

Intangible assets consist primarily of goodwill, customer lists, non-compete agreements and employee bases. The goodwill related to the May 1994 acquisition of Transcriptions, Ltd. (see Note 2) is being amortized over 40 years. All other goodwill is being amortized over 20-30 years. Customer lists and employee bases are being amortized over 10-20 years and five years, respectively. Non-compete agreements are amortized over their terms, ranging from 1.5 years to four years. Subsequent to its acquisitions, the Company continually evaluates whether later events and circumstances have occurred that indicate that the remaining estimated useful life of intangible assets may warrant revision or that the remaining balance may not be recoverable. When factors indicate that intangible assets should be evaluated for possible impairment, the Company uses an estimate of the related undiscounted cash flows

(in thousands, except per share amounts)

in measuring whether the intangible asset should be written down to fair value. Measurement of the amount of the impairment will be based on generally accepted valuation methodologies, as deemed appropriate. As of December 31, 1998, management believes that no revision to the remaining useful lives or write-down of intangible assets is required.

Transaction Costs and Restructuring Charges

During 1996, 1997 and 1998, the Company incurred certain charges resulting from restructurings and in 1998 incurred transaction costs associated with pooling of interests acquisitions and professional fees in connection with MRC's terminated initial public offering, as follows:

<TABLE>
<CAPTION>

	Year Ended December 31,		
	1996	1997	1998
<S>	<C>	<C>	<C>
Restructuring charges	$ 644	$ 2,075	$ 6,539
Transaction costs associated with pooling of interests	--	--	11,000
Terminated initial public offering costs	--	--	682
	$ 644	$ 2,075	$ 18,221

</TABLE>

In December 1998, the Company's board of directors approved management's restructuring plan associated with the MRC merger. Costs associated with the plan of approximately $6,539 have been recognized in 1998 in accordance with Emerging Issues Task Force ("EITF") 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity," as follows:

Non-cancelable leases	$ 3,835
Severance	1,618
Non-cancelable contracts and other exit costs	1,086
	$ 6,539

The plan relates primarily to the closure of several redundant customer service centers as well as certain corporate offices in order to improve operating efficiencies. The Company expects to complete the plan in 1999. The severance costs are attributable to 41 individuals from various levels of operational and senior management. As of December 31, 1998, $567 of severance had been paid and $410 of other restructuring costs had been paid. The consolidated balance sheet at December 31, 1998 reflects $5,562 in accrued expenses related to the 1998 restructuring charge.

In 1997, MRC approved a separate management plan to close and/or merge several redundant customer service centers in order to further reduce costs and improve operating efficiencies. The plan was completed during 1998 and included the cost of exiting certain facilities, primarily related to non-cancelable leases, the disposition of fixed assets and employee severance costs. Costs associated with the plan of approximately $2,075 were recognized in 1997 in accordance with EITF 94-3. Included in this amount is approximately $705 for the disposal of assets and approximately $800 in severance and employee contract buy outs. The balance is primarily related to non-cancelable lease costs. The severance costs are attributable to eight individuals from various levels of operational and senior management. At December 31, 1997 and 1998, approximately $1,773 and $1,213, respectively, related to MRC's restructuring charge is included in accrued expenses.

(in thousands, except per share amounts)

In 1996, MRC approved a separate management plan to close and/or merge several redundant customer service centers as well as certain corporate offices in order to reduce costs and improve operating efficiencies. The plan was essentially completed during 1997 and included the cost of exiting certain facilities, primarily related to non-cancelable leases, and employee severance costs. Costs associated with the plan of approximately $644 were recognized in 1996 in accordance with EITF 94-3.

In 1998, the Company incurred the following transaction costs associated with business combinations accounted for using the pooling of interests method:

Investment banker fees	$ 7,200
Accounting, legal and other professional fees	2,260
Broker fee paid by acquired company stockholder	1,540
	$ 11,000

At December 31, 1998, $500,000 of such costs are included in accrued expenses for payments scheduled to be made in 1999.

Advertising Costs

The Company charges advertising costs to expense as incurred. Advertising expense was $329, $678 and $650 for the years ended December 31, 1996, 1997 and 1998, respectively.

Research and Development Costs

Research and development costs are charged to expense as incurred. Total research and development costs were approximately $450, $550 and $813 for the years ended December 31, 1996, 1997 and 1998, respectively.

Statements of Cash Flow Information

For the years ended December 31, 1996, 1997 and 1998, the Company paid interest of $1,404, $1,027 and $695, respectively, and income taxes of $1,700, $3,162 and $6,705, respectively. Capital lease obligations of $191, $174 and $98 were incurred on equipment leases entered into in 1996, 1997 and 1998, respectively. In 1996, the Company exchanged $500 of debt for shares of capital stock. In 1998, convertible notes totaling $1,288 were converted into 172 shares of common stock.

The following table displays the net noncash financing activities resulting from the Company's business acquisitions (see Note 2):

<TABLE>
<CAPTION>

	Year Ended December 31,		
	1996	1997	1998
<S>	<C>	<C>	<C>
Noncash net assets acquired	$ 40,274	$ 8,965	$ 4,401
Less -- Seller notes and payables	(3,318)	(3,337)	--
Common stock issued	(10,751)	--	--

(in thousands, except per share amounts)

Cash paid to dissenting stockholder in pooling transaction	--	--	1,438
Net cash paid for business acquisitions	$ 26,205	$ 5,628	$ 5,839

</TABLE>

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Earnings Per Share

The Company follows SFAS No. 128, "Earnings per Share," which requires a dual presentation of "basic" and "diluted" earnings per share on the face of the income statement. Basic earnings per share is calculated by dividing net income by the weighted average number of shares of common stock outstanding for the period. Diluted earnings per share is calculated by dividing net income by the weighted average number of shares of common stock outstanding for the period, adjusted for the dilutive effect of common stock equivalents, which consists primarily of stock options, using the treasury stock method.

The table below sets forth the reconciliation of the numerators and denominators of the Company's basic and diluted income per share computations:

<TABLE>
<CAPTION>

	Year Ended December 31,								
	1996			1997			1998		
	Net Income	Shares	Per Share Amount	Income	Shares	Per Share Amount	Net Income	Shares	Per Share Amount
Basic	$ 5,288	24,138	$ 0.22	$ 8,733	31,726	$ 0.28	$ 3,185	33,087	$ 0.10
Effect of dilutive securities	--	1,906	(0.02)	--	1,632	(0.02)	--	1,818	(0.01)
Diluted	$ 5,288	26,044	$ 0.20	$ 8,733	33,358	$ 0.26	$ 3,185	34,905	$ 0.09

</TABLE>

For the years ended December 31, 1996, 1997 and 1998, 1,288, 1,961 and 654 common stock options and warrants were excluded from the diluted computation because their effect would be anti-dilutive.

Fair Value of Financial Instruments

Cash, accounts receivable, accounts payable and accrued expenses are reflected in the accompanying financial statements at fair value due to the short-term nature of those instruments. Available-for-sale investments are also reflected at fair value in accordance with SFAS No. 115. The carrying amount of long-term notes receivable and debt obligations approximate fair value at the balance sheet dates.

Comprehensive Income

In 1998, the Company adopted SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards for reporting and presentation of comprehensive income and its components in a full set of general-purpose financial statements that is presented with equal prominence as other financial statements. The Company's comprehensive income consists of net income and unrealized holding gains on available-for-sale securities. The adoption of SFAS

(in thousands, except per share amounts)

No. 130 had no impact on total shareholders' equity and is presented on the accompanying Consolidated Statements of Shareholders' Equity. During 1996 and 1997, there were no other comprehensive items. For the years ended December 31, 1998, the pre-tax unrealized gain on available-for-sale securities was $900 and the deferred tax recorded on the unrealized gain was $315.

Segment Reporting

In June 1997, the Financial Accounting Standards Board issued SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information." This statement establishes additional standards for segment reporting in the financial statements and is effective for fiscal years beginning after December 15, 1997. As the Company operates in one reportable segment, SFAS No. 131 had no effect on the Company's financial statements.

1. BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -- (Continued)

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

2. ACQUISITIONS

Effective May 1, 1994, the Company purchased substantially all of the assets of Transcriptions, Ltd. and Affiliates ("Transcriptions"), as well as assumed certain liabilities for $16,930 in cash, including acquisition costs of $322, plus the payment of Transcriptions' interest bearing debt of $5,816, plus a deferred purchase price based on future operating results. Effective December 29, 1995, the Company fixed the deferred purchase price by agreeing to pay the former owners of Transcriptions $18,375 in cash and issue 2,584 shares of common stock (valued at $4,550 for financial reporting purposes) on August 31, 1996. The total purchase price for the Transcriptions acquisition was $44,797. The acquisition has been accounted for using the purchase method with the purchase price allocated to the fair value of the acquired assets and liabilities.

In July 1996, MRC acquired all of the outstanding capital stock of Medical Records Corp. The former shareholders of Medical Records Corp. received total consideration of approximately $27,000, consisting of cash, notes and shares of common stock. The acquisition was accounted for as a purchase, and the results of Medical Records Corp. are included in the accompanying consolidated financial statements from the date of the acquisition. In connection with the acquisition, MRC assumed certain acquisition-related liabilities from Medical Records Corp. The cost of the acquisition has been allocated on the basis of the estimated fair market value of the assets acquired and liabilities assumed. The allocation resulted in goodwill and other intangible assets of approximately $33,015, which are being amortized over lives of 1.5 to 30 years.

The following unaudited pro forma summary presents the results of operations of the Company as if the payment of the Transcriptions deferred purchase price, which causes additional amortization and interest expense, and the Medical Records Corp. acquisition had occurred on January 1, 1996.

	Year Ended December 31, 1996
Revenue	$ 179,683
Net income	726
Net income per share	.03

On May 28, 1998, the Company completed the acquisition of approximately 94% of the outstanding capital stock of DDI and on July 31, 1998 acquired the remaining shares. The Company issued 912 shares in exchange for all DDI shares.

(in thousands, except per share amounts)

The acquisition was accounted for using the pooling of interests method of accounting. Accordingly, the Company's historical financial statements were retroactively restated to reflect the combination with DDI.

On August 18, 1998, the Company completed the acquisition of Signal, which was accounted for using the pooling of interests method of accounting. The Company issued 619 shares of its common stock and approximately $1,400 in cash to a dissenting Signal stockholder in exchange for all Signal capital stock. The Company's historical financial statements have been restated to reflect the combination with Signal. Signal and the Company elected to treat their merger as an asset purchase for income tax purposes. The Company recorded a deferred tax asset of $5,052 that was credited directly to shareholders' equity to reflect the tax effect of goodwill that was recorded for income tax purposes.

2. ACQUISITIONS -- (Continued)

On November 30, 1998, the Company completed the acquisition of TLF, which was accounted for using the pooling of interests method. The Company issued 800 shares of its common stock for all TLF capital stock. Accordingly, the Company's consolidated financial statements have been restated to reflect the combination with TLF.

On September 18, 1998 the Company signed a definitive merger agreement with MRC and on December 10, 1998, the merger was consummated. Pursuant to the agreement, each share of MRC common stock and each share of MRC preferred stock on an as-converted basis was exchanged for 0.5163 shares of the Company's Common stock. In total, the Company issued 8,662 shares of its common stock to the former MRC shareholders and options to purchase an aggregate of 1,543 shares to the former MRC option holders. The MRC merger was accounted for as a pooling of interests. Accordingly, the Company's consolidated financial statements have been restated to reflect the merger with MRC.

Revenue and net income as previously reported for the years ended December 31, 1996, 1997 and 1998 and as restated for the pooling of interests transactions are as follows:

	Year Ended December 31, 1998	
	Revenue	Net Income
MedQuist, as previously reported	$164,779(a)	$ (305)(a)
DDI	6,165(b)	253(b)
Signal	5,281(b)	543(b)
TLF	3,688(c)	522(c)
MRC	91,742(c)	2,172(c)
Restated	$ 271,655	$3,185

(a) Includes (i) DDI and Signal amounts from July 1, 1998, (ii) TLF and MRC amounts from October 1, 1998 and (iii) $18,221 of pre-tax transaction and restructuring costs.
(b) Reflects amounts from January 1, 1998 to June 30, 1998.
(c) Reflects amounts from January 1, 1998 to September 30, 1998.

	Year Ended December 31, 1997	
	Revenue	Net Income
MedQuist, as previously reported	$ 84,495	$ 7,631
DDI	10,026	616
Signal	9,294	1,100
TLF	4,226	712
MRC	108,117	(1,326)

(in thousands, except per share amounts)

Restated	$ 216,158	$ 8,733

2. ACQUISITIONS -- (Continued)

	Year Ended December 31, 1996	
	Revenue	Net Income
MedQuist, as previously reported	$ 61,480	$ 3,477
DDI	6,937	440
Signal	8,058	842
TLF	3,934	882
MRC	71,700	(1,060)
Restated	$ 152,109	$ 4,581

Prior to their mergers with the Company, Signal and TLF were taxed as "S" Corporations. The above net income amounts do not include an aggregate "C" Corporation income tax provision for Signal and TLF of approximately $637, $682 and $294 for the years ended December 31, 1996, 1997 and 1998, respectively (see Note 1).

From 1996 through 1998, the Company completed several smaller acquisitions accounted for using the purchase method. Pro forma information is not presented as these acquisitions are not material to the Company. Certain of the acquisitions provide for additional consideration to be paid if net future billings to defined customers exceed specified contractual levels. These provisions expire in 2000 and 2001, and are generally payable on a quarterly basis. When the contingency is resolved and additional consideration is due, the Company will account for the payments as additional purchase price and amortize the additional amount paid over the remaining life of the asset.

3. PROPERTY AND EQUIPMENT

	December 31,	
	1997	1998
Furniture, equipment and software	$ 46,608	$ 52,571
Leasehold improvements	1,341	1,553
	47,949	54,124
Less -- Accumulated depreciation and amortization	(22,507)	(27,102)
	$ 25,442	$ 27,022

4. INTANGIBLE ASSETS

	December 31,	
	1997	1998
Goodwill	$ 64,600	$ 67,109
Customer lists	21,552	22,640
Non-compete agreements	3,405	3,405
Employee base	2,514	2,514
Other	137	150
	92,208	95,818
Less -- Accumulated amortization	(9,826)	(13,602)
	$ 82,382	$ 82,216

(in thousands, except per share amounts)

5. ACCRUED EXPENSES:

	December 31, 1997	December 31, 1998
Accrued payroll and related taxes	$ 7,175	$ 9,329
Restructuring charges	1,733	6,775
Other	5,710	9,746
	$ 14,618	$ 25,850

6. LONG-TERM DEBT

<TABLE>
<CAPTION>

<S>	<C> December 31, 1997	<C> December 31, 1998
Note payable to bank, repaid in 1998	$ 5,250	$ --
Note payable to former shareholders of Medical Records Corp., repaid in 1999	2,000	2,000
Promissory notes, repaid or converted into common stock in 1998	5,085	--
Capital lease obligations	1,786	468
Other	260	119
	14,381	2,587
Less -- current portion	(6,792)	(2,372)
	$ 7,589	$ 215

</TABLE>

On April 23, 1997, the Company amended its credit facility to provide for a $10 million unsecured senior revolving line of credit through April 23, 2000. The revolver bears interest at resetting rates selected by the Company from various alternatives. The interest rate alternatives are either (i) the greater of (a) prime rate, (b) the federal funds rate plus 0.5% (c) the bank's certificate of deposit rate plus 1%, or (ii) LIBOR plus 0.75%. The credit facility also allows for the Company to finance up to 100% of any acquisitions of companies that are in the business of providing transcriptions-related services. The financing of these acquisitions may be carved out of the revolver and amortized over 20 consecutive quarters. Each acquisition term loan that is created would permanently reduce the remaining borrowings under the revolver.

In addition to acquisitions, the revolver can be used for working capital and general corporate purposes. To the extent any amounts under the revolver are repaid, other than acquisition term loans, the Company may reborrow such amounts. The credit facility requires the Company to maintain certain financial and non-financial covenants, including limitations on capital expenditures and dividends.

For the year ended December 31, 1997 and 1998, the Company did not incur any interest expense on the revolving credit facility, as there were no borrowings on the credit facility. For the year ended December 31, 1996, the Company incurred interest expense of $49 on the revolving credit facility, at a weighted average interest rate of 9.78%. The highest outstanding borrowing under the revolver during 1996 was $2,534.

In connection with the acquisition of Medical Records Corp., MRC entered into a note agreement with a bank. The note was for $7,000 with an interest rate of LIBOR plus 1.65%, which totaled approximately 7.3% at December 31, 1997. The note was secured by substantially all of MRC's assets. The agreement required the payment of interest quarterly along with equal monthly principal payments of $117 through September 2001. The note was repaid in 1998.

MEDQUIST INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (Continued)

(in thousands, except per share amounts)

6. LONG-TERM DEBT -- (Continued)

Also, in connection with the acquisition of Medical Records Corp., MRC issued seven year, 8% unsecured notes to former shareholders of Medical Records Corp. for $2,000. The notes require the payment of interest quarterly, with annual principal payments of $500 beginning in July 2000. The Company repaid these notes in 1999.

In January 1998, subordinated convertible 6% promissory notes in the amount of $1,288 were converted into 172 shares of common stock at a conversion price of $7.48 per share.

Long-term debt maturities as of December 31, 1998, are as follows:

1999	$ 2,372
2000	138
2001	48
2002	29
	$ 2,587

7. SHAREHOLDERS' EQUITY

In May 1996, MedQuist consummated a secondary public offering of its common stock, selling 6,600 shares at a price of $5.67 per share. In June 1996, the underwriters exercised their overallotment option for an additional 922 shares. After deducting the underwriters' discount and offering expenses, the net proceeds to the Company were $39,442. In July 1996, MRC issued shares of preferred stock for total consideration, net of offering expenses, of $29,272. Such preferred stock was exchanged for MedQuist common in the merger (see Note 2).

In connection with the 1992 issuance of a senior subordinated note, the Company sold to the holder for $1,100, warrants to purchase 1,732 shares of Class A and 1,068 shares of Class B preferred stock at an exercise price of $2.50 per share. Each share of Class A and Class B preferred stock was convertible into one share of common stock. During 1994, the holder was issued additional warrants and all warrant exercise prices were reset at $2.43, in accordance with the antidilution provisions of the original warrant agreement. Simultaneous with the closing of the secondary public offering, the company and the holder agreed that the holder would exercise the warrants by tendering the $7,000 principal amount of the senior subordinated notes and simultaneously converting the shares of preferred stock received upon such exercise into 2,888 shares of common stock. As an inducement for the holder to exercise the warrants and convert the preferred stock, the Company issued the holder 128 additional shares of common stock. This inducement, valued at $707 or $0.03 per diluted share, has been recorded as a deduction from the net income available to common shareholders in 1996.

In connection with the Company's May 1994 credit agreement, the Company issued the agent bank warrants to purchase 226 shares of common stock at an exercise price of $2.25 per share. These warrants were exercised on June 12, 1997 by the agent bank for proceeds to the Company of $508.

In connection with the sale of equity securities to certain investors in 1992 and 1993, warrants to purchase common stock at $12.69 per share were issued by MRC. The warrants were fully vested and exercisable at the date of issuance and have terms which permit conversion into common stock at specified prices during periods ranging from four to five years. The fair value of the warrants at the date of grant was de minimis and therefore no compensation expense has been recorded in the accompanying financial statements. During 1998, 157 warrants were exercised and 37 were cancelled. At December 31, 1998, no warrants were outstanding.

(in thousands, except per share amounts)

8. STOCK OPTION PLANS

The Company has six stock option plans that provide for the granting of options to purchase shares of common stock to eligible employees (including officers) and nonemployee directors of the Company. Options granted may be at fair market value of the common stock or at a price determined by a committee of the Company's board of directors. The stock options vest and are exercisable over periods determined by the committee.

In February 1998, MRC granted 165 stock options to employees with exercise prices below the fair market value of MRC's common stock. Accordingly, MRC recorded deferred compensation totaling $1,078, of which $540 was amortized to expense in 1998.

Information with respect to the Company's common stock options is as follows:

	Shares	Option Price Per Share	Aggregate Proceeds
Outstanding, December 31, 1995	2,407	$1.14 - $8.31	$ 7,141
Granted	1,670	2.71 - 10.48	10,810
Exercised	(98)	2.17 - 5.13	(220)
Canceled	(156)	2.71 - 3.17	(271)
Outstanding, December 31, 1996	3,823	1.14 - 10.48	17,460
Granted	1,240	5.21 - 16.49	13,345
Exercised	(533)	1.56 - 10.42	(1,018)
Canceled	(193)	3.17 - 8.67	(412)
Outstanding, December 31, 1997	4,337	1.14 - 16.49	29,375
Granted	1,015	5.21 - 31.19	26,012
Exercised	(760)	1.14 - 16.49	(1,887)
Canceled	(159)	5.21 - 25.63	(391)
Outstanding, December 31, 1998	4,433	$ 1.34 - $31.19	$ 53,109

At December 31, 1998, there were 2,172 exercisable options with an aggregate exercise price of $16,204 and 273 additional options available for grant under the plans.

The options outstanding and exercisable by exercise price at December 31, 1998 are as follows:

Range Of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$0.00 - $3.11	463	5.9	$ 2.36	321	$ 2.20
3.12 - 6.23	845	7.0	4.56	488	4.42
6.24 - 9.35	833	5.9	8.12	650	8.17
9.36 - 12.47	935	7.4	10.48	567	10.48
12.48 - 15.59	524	9.0	14.34	144	14.26
15.60 - 18.71	11	8.8	15.90	2	15.94
18.72 - 21.83	52	9.4	21.43	--	--
21.84 - 24.95	116	9.6	23.11	--	--
24.96 - 28.06	43	9.6	25.63	--	--
28.07 - 31.18	611	9.7	31.13	--	--
	4,433	7.5	$ 12.00	2,172	$ 7.46

MEDQUIST INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (Continued)

(in thousands, except per share amounts)

8. STOCK OPTION PLANS -- (Continued)

The Company applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and the related interpretations in accounting for its stock option plans. Had compensation cost for the Company's common stock options been determined based upon the fair value of the options at the date of grant, as prescribed under SFAS No. 123, "Accounting for Stock-Based Compensation," the Company's net income and net income per share would have been the following pro forma amounts:

	Year Ended December 31,		
	1996	1997	1998
Net income:			
As reported	$ 5,288	$ 8,733	$ 3,185
Pro forma	4,454	7,613	1,705
Basic net income per share:			
As reported	.22	.28	.10
Pro forma	.18	.24	.05
Diluted net income per share:			
As reported	.20	.26	.09
Pro forma	.17	.23	.05

The fair value of the options granted is estimated using the Black-Scholes option pricing model with the following assumptions: dividend yield of 0.0%, volatility of 50.0%-55.0%, risk-free interest rates of 4.5% to 8.0%, and expected lives of five to ten years. The above pro forma amounts may not be indicative of future amounts because option grants prior to January 1, 1995 have not been included and because future option grants are expected.

9. INCOME TAXES

The income tax provision consists of the following:

	Year Ended December 31,		
	1996	1997	1998
Current:			
State and local	$ 79	$ 1,176	$ 1,596
Federal	1,536	4,317	10,089
	1,615	5,493	11,685
Deferred	1,105	(200)	(3,213)
	$2,720	$ 5,293	$ 8,472

9. INCOME TAXES -- (Continued)

A reconciliation of the statutory federal income tax rate to the effective income tax rate is as follows:

(in thousands, except per share amounts)

	Year Ended December 31,		
	1996	1997	1998
Statutory federal income tax rate	34.0%	35.0%	35.0%
State income taxes, net of federal benefit	3.0	3.0	3.7
Non-deductible merger costs	--	--	30.8
Impact of Signal and TLF "S" Corporation status	(8.0)	(4.9)	(4.4)
Other	5.0	4.6	7.6
	34.0%	37.7%	72.7%

Signal and TLF were taxed as an "S" Corporation prior to their mergers with MedQuist. Accordingly, the former Signal and TLF shareholders were taxed individually on their companies' taxable income. Therefore, no tax provision is included in the accompanying financial statements related to Signal and TLF's net income prior to their mergers with the Company (see Note 1).

At December 31, 1997, the tax bases of Signal's net assets approximated their reported amount for financial statement purposes. However, Signal and the Company elected to treat their merger as an asset purchase for income tax purposes. Accordingly, the Company recorded a deferred tax asset and an increase in additional paid-in capital of $5,052, which represents the tax effect of goodwill that was recorded for income tax purposes.

The tax effected temporary differences that give rise to deferred income taxes are as follows:

	December 31,	
	1997	1998
Deferred tax asset:		
Restructuring accruals	$ 602	$ 2,722
Carryforwards	338	--
Accruals and reserves	2,237	3,716
	$ 3,177	$ 6,438
Deferred tax liability:		
Accumulated depreciation	$ (1,475)	$ (1,725)
Accumulated amortization	(3,518)	1,124
Deferred compensation	210	289
Marketable security	--	(315)
Other	(1,711)	(1,354)
	$ (6,494)	$ (1,981)

10. COMMITMENTS AND CONTINGENCIES

Rent expense for operating leases was $5,053, $4,599 and $5,618 for the years ended December 31, 1996, 1997 and 1998, respectively. Minimum annual rental commitments for noncancelable operating leases having terms in excess of one year as of December 31, 1998, are as follows:

10. COMMITMENTS AND CONTINGENCIES -- (Continued)

(in thousands, except per share amounts)

1999	$ 4,857
2000	3,590
2001	2,564
2002	1,616
2003	550
2004	29
	$ 13,206

The Company has an employment agreement, as amended, with a former Chief Executive Officer who is currently a director of the Company. The agreement entitles this individual to receive retirement benefits of $75 per year for life plus certain other benefits, as defined. Included in other long-term liabilities is $544 and $457at December 31, 1997 and 1998, respectively, related to these retirement benefits. The employment agreement also requires the Company to loan the former Chief Executive Officer's estate the necessary funds to exercise any options owned by the individual at the time of his death.

The Company has a severance plan for certain executive officers that provides for one-time payments in the event of a change in control, as defined. No liabilities are currently required to be recorded with respect to this plan.

In the normal course of business, the Company is a party to various claims and legal proceedings. Although the ultimate outcome of these matters is presently not determinable, management of the Company, after consultation with legal counsel, does not believe that the resolution of these matters will have a material effect upon the Company's financial position or results of operations.

11. EMPLOYEE BENEFIT PLANS

Savings Plan

The Company offers a savings plan under section 401(k) of the Internal Revenue Code. This savings plan allows eligible employees to contribute up to 15% of their compensation on a pre-tax basis. The Company matches 50% of participant's contribution, up to 5% of the participant's total compensation. Effective October 1, 1996, the Company's matching contribution is made in the form of the Company's common stock. The charge to operations for the Company's matching contributions was $63, $80 and $125 in 1996, 1997 and 1998, respectively. The Company issued approximately five thousand shares in both 1997 and 1998, in connection with the Company's matching contribution. The Company did not issue shares in 1996 in connection with the savings plan.

MRC has two defined contribution 401(k) plans, covering substantially all employees. Eligible employees of MRC may contribute certain amounts of their annual compensation. During 1996, 1997 and 1998, MRC made matching contributions to the plans of $171,000, $117,000 and $114,000, respectively.

Stock Purchase Plan

All full-time employees except those who own five percent or more of the voting stock of the Company are eligible to participate in the Company's Employee Stock Purchase Plan (SPP). The SPP provides that participants may authorize the Company to withhold up to 10% of their earnings for the purchase of the Company's common stock. The purchase price of the common stock is determined by the Compensation Committee but shall not be less than eighty-five percent of the fair market value of the common stock. Through the SPP, five and 15 shares of common stock have been purchased in 1997 and 1998, respectively. In connection with the SPP, the Company did not issue any shares in 1996.

12. QUARTERLY SUPPLEMENTAL FINANCIAL DATA (UNAUDITED)

<TABLE>
<CAPTION>

	Three Months Ended			
Year Ended December 31, 1997:	March 31	June 30	September 30	December 31

<S>	<C>	<C>	<C>	<C>
Revenue	$ 49,914	$ 52,999	$ 55,269	$ 57,976
Income before income taxes	3,283	4,557	4,632	1,554
Net income	2,058	2,931	2,910	834
Basic net income per share	0.07	0.10	0.10	0.02
Diluted net income per share	0.06	0.09	0.09	0.02

</TABLE>

<TABLE>
<CAPTION>

Year Ended December 31, 1998:	Three Months Ended			
	March 31	June 30	September 30	December 31
<S>	<C>	<C>	<C>	<C>
Revenue	$ 63,915	$ 66,870	$ 69,005	$ 71,865
Income before income taxes	6,214	6,327	6,155	(7,039)
Net income	4,004	3,969	3,776	(8,564)
Basic net income per share	0.12	0.12	0.12	(0.24)
Diluted net income per share	0.12	0.12	0.11	(0.24)

</TABLE>

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Medquist Inc.:

We have audited in accordance with generally accepted auditing standards, the consolidated financial statements of Medquist, Inc. and Subsidiaries included in this Registration Statement, and have issued our report thereon dated February 1, 1999. Our audits were made for the purpose of forming an opinion on those financial statements taken as a whole. The Schedule on page S-2 is the responsibility of the Company's management and is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to auditing procedures applied in the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

/s/ Arthur Andersen LLP

Philadelphia, Pa.
February 1, 1999

MEDQUIST INC. AND SUBSIDIARIES
SCHEDULE II
VALUATION AND QUALIFYING ACCOUNTS

<TABLE>
<CAPTION>

	Balance at beginning of period	Charged to costs and expenses	Charged to other Accounts	Write-offs	Balance at end of Period
<S>	<C>	<C>	<C>	<C>	<C>
Allowance for doubtful accounts:					
Year ended December 31, 1996	$ 1,040	$ 409	$ (208) (a)	$ 169	$ 1,072
Year ended December 31, 1997	1,072	812	20	606	1,298
Year ended December 31, 1998	1,298	1,217	--	241	2,274
Accrued restructuring costs:					
Year ended December 31, 1996	$ 347	$ 644	$ --	$ 121	$ 870
Year ended December 31, 1997	870	2,075	(289) (b)	923	1,733
Year ended December 31, 1998	1,733	6,539	--	1,497	6,775

</TABLE>

(a) Amount includes the addition of $64 relating to purchase accounting adjustment in connection with MRC's acquisition of Medical Records, Inc. offset by a write-off of $272 relating to MedQuist's discontinued operations.
(b) Reclassified to other long-term liabilities.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS AND FINANCIAL DISCLOSURE

Not applicable.

PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this item is incorporated by reference to the Company's Proxy Statement to be filed with the Commission in connection with the 1999 Annual Meeting.

Item 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated by reference to the Company's Proxy Statement to be filed with the Commission in connection with the 1999 Annual Meeting.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this item is incorporated by reference to the Company's Proxy Statement to be filed with the Commission in connection with the 1999 Annual Meeting.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is incorporated by reference to the Company's Proxy Statement to be filed with the Commission in connection with the 1999 Annual Meeting.

PART IV

Item 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

Exhibit No.	Description
3.1	Amended and Restated Certificate of Incorporation of the Company [incorporated by reference to Exhibit 1 of the Company's Current Report on Form 8-K filed August 15, 1997].
3.2	By-Laws of the Company [incorporated by reference to Exhibit 3.2 of the Company's 1993 Annual Report on Form 10-K (the "1993 10-K")].
3.3	Certificate of Designation of Terms of Preferred Stock [incorporated by reference to Exhibit 3.3 of the Company's 1992 Annual Report on Form 10-K (the "1992 10-K)].
4.1	Specimen Stock Certificate [incorporated by reference to Exhibit 4.1 of the Company's Registration Statement (No. 333-3050) on Form S-1 (the "1996 Registration Statement")].
*10.1	Agreement between the Company and Richard J. Censits, dated January 29, 1996 [incorporated by reference to Exhibit 10.1 of the 1996 Registration Statement].
*10.2	Incentive Stock Option Plan of the Company, dated January 1988 [incorporated by reference to Exhibit 10.2 of the Company's Registration Statement (No. 33-95968) on Form S-1 (the "1992 Registration Statement")].
*10.3	Stock Option Plan of the Company, dated January 1992, as amended

[incorporated by reference to Exhibit 10.3 of the 1996 Registration Statement].

*10.4 Nonstatutory Stock Option Plan for Non-Employee Directors of the Company, dated January 1992 [incorporated by reference to Exhibit 10.4 of the 1992 Registration Statement].

*10.5 Employment Agreement by and between the Company and John R. Emery, [incorporated by reference to Exhibit 10.5 of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1996 (the "1996 10-K")].

*10.6 Employment Agreement by and between the Company and David A. Cohen, dated May 1, 1994 ("Cohen Employment Agreement") [incorporated by reference to Exhibit 10.33 of the Company's Form 10-Q for the three-month period ended June 30, 1994 (the "6/30/94 10-Q")].

*10.7 Amendment to Cohen Employment Agreement, dated March 1, 1996 [incorporated by reference to Exhibit 10.7 of the 1996 Registration Statement].

*10.8 Employment Agreement by and between the Company and John A. Donohoe, dated May 27, 1994 ("Donohoe Employment Agreement") [incorporated by reference to Exhibit 10.8 of the 1996 Registration Statement].

Exhibit No.	Description

*10.9 Amendment to Donohoe Employment Agreement, dated March 1, 1996 [incorporated by reference to Exhibit 10.9 of the 1996 Registration Statement].

*10.10 Employment Agreement by and between the Company and Ronald F. Scarpone, dated May 27, 1994, as amended March 1, 1996 [incorporated by reference to Exhibit 10.10 of the 1996 Registration Statement].

*10.11 Employment Agreement by and between the Company and James R. Emshoff, dated August 25, 1996 [incorporated by reference to Exhibit 10.37 of the Company's Form 10-Q for the three-month period ended September 30, 1996 (the "9/30/95 10-Q")].

10.20 Asset Purchase Agreement among the Company, Transcriptions, Ltd. and its affiliates and subsidiaries, dated January 26, 1994 (the "Transcriptions Agreement") [incorporated by reference to Exhibit 10.30 of the 1993 10-K].

* Management contract or compensatory plan or arrangement.

Exhibit No.	Description

10.21 Amendment to the Transcriptions Agreement, dated September 30, 1996, [incorporated by reference to Exhibit 10.30.1 of the 9/30/95 10-Q].

10.22 Amendment to the Transcriptions Agreement, dated November 1, 1996 [incorporated by reference to Exhibit 10.30.2 of the 9/30/95 10-Q].

10.23 Registration Rights Agreement among the Company, David A. Cohen and Edward Forstein, dated September 30, 1996, [incorporated by reference to Exhibit 10.30.4 of the 9/30/95 10-Q].

10.24 Amended and Restated Credit Agreement among the Company, Transcriptions, Ltd., the Guarantors named therein, the Lenders named therein and Chemical Bank as agent, dated December 29, 1996 [incorporated by reference to Exhibit 10.24 of the 1996 Registration Statement].

10.28 Form of Employee Stock Purchase Plan [incorporated by reference to Exhibit 10.33 of the 1996 Registration Statement].

22.1 Subsidiaries [incorporated by reference to Exhibit 22.1 of the 1996 Registration Statement].

23.1 Consent of Arthur Andersen LLP, filed herewith.

24.1 Powers of Attorney (included on signature page)

Item 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K - Continued

Exhibit No.	Description
27.1	Financial Data Schedule, Restated 1998
27.2	Financial Data Schedule, Restated 1997

(b) Financial Statements and Financial Statement Schedule

1. The consolidated financial statements of the Company and its subsidiaries filed as part of this Report are listed on the attached Index to Consolidated Financial Statements. See page F-1.

2. The Schedule to the consolidated financial statements of the Company and its subsidiaries filed as part of this Report is listed in the attached Index to Consolidated Financial Statements. See page F-1.

(c) Reports on Form 8-K

During the fourth quarter of 1998, the Company filed the following Reports on Form 8-K:

Current Report on Form 8-K, dated December 15, 1998, regarding the completion of the acquisition of The MRC Group, Inc.

SIGNATURES

Pursuant to the requirements of the Section 13 or 15(d) Securities Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereto duly authorized, in the City of Marlton, State of New Jersey, on March 26, 1999.

MedQuist Inc.

By /s/David A. Cohen

David A. Cohen, President, Chief Executive Officer, Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons as of March 26, 1999.

Each person below, in so signing, also makes, constitutes and appoints David A. Cohen his true and lawful attorney-in-fact, with full power and substitution and resubstitution, in his name, place and stead to execute and cause to be filed with the Securities and Exchange Commission any or all amendments to this Report.

<TABLE>
<CAPTION>

Signatures	Title
<S>	<C>
/s/ David A. Cohen David A. Cohen	Chairman and Chief Executive Officer (principal executive officer)
/s/ John R. Emery John R. Emery	Senior Vice President, Treasurer and Chief Financial Officer (principal financial officer and principal accounting officer)
Bruce K. Anderson	Director
William T. Carson, Jr.	Director
John T. Casey	Director
Richard J. Censits	Director
James R. Emshoff	Director
Terrence J. Mulligan	Director
A. Fred Ruttenberg	Director
R. Timothy Stack	Director
By: /s/ David A. Cohen David A. Cohen Attorney-in-fact	
Edward L. Samek	Director
Richard H. Stowe	Director
John H. Underwood	Director

</TABLE>

Exhibit 23.1

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

To MedQuist Inc.:

As independent public accounts, we hereby consent to the incorporation of our report included in this Form 10-K into the Company's previously filed Form S-8 Registration Statements File Nos. 333-09541, 333-09543, 333-66447, Form S-4 Registration Statements File Nos. 333-57265, 333-066447, Form S-3 Registration Statement Nos. 333-58113, 333-69687.

/s/ Arthur Andersen LLP

Philadelphia, PA
March 26, 1999

```
<TABLE> <S> <C>

<ARTICLE> 5

<S>                                <C>
<PERIOD-TYPE>                      3-MOS
<FISCAL-YEAR-END>                            MAR-31-1998
<PERIOD-END>                                 MAR-31-1998
<CASH>                                            18,158
<SECURITIES>                                       2,977
<RECEIVABLES>                                     42,585
<ALLOWANCES>                                       1,339
<INVENTORY>                                            0
<CURRENT-ASSETS>                                  65,318
<PP&E>                                            51,519
<DEPRECIATION>                                    25,411
<TOTAL-ASSETS>                                   177,195
<CURRENT-LIABILITIES>                             28,024
<BONDS>                                                0
<PREFERRED-MANDATORY>                                  0
<PREFERRED>                                            0
<COMMON>                                               0
<OTHER-SE>                                       136,573
<TOTAL-LIABILITY-AND-EQUITY>                     177,195
<SALES>                                                0
<TOTAL-REVENUES>                                  63,915
<CGS>                                                  0
<TOTAL-COSTS>                                     49,740
<OTHER-EXPENSES>                                   7,896
<LOSS-PROVISION>                                       0
<INTEREST-EXPENSE>                                    65
<INCOME-PRETAX>                                    6,214
<INCOME-TAX>                                       2,210
<INCOME-CONTINUING>                                4,004
<DISCONTINUED>                                         0
<EXTRAORDINARY>                                        0
<CHANGES>                                              0
<NET-INCOME>                                       4,004
<EPS-PRIMARY>                                       0.12
<EPS-DILUTED>                                       0.12


</TABLE>
```

```
<TABLE> <S> <C>

<ARTICLE> 5

<S>                                <C>
<PERIOD-TYPE>                      6-MOS
<FISCAL-YEAR-END>                            JUN-30-1998
<PERIOD-END>                                 JUN-30-1998
<CASH>                                            20,127
<SECURITIES>                                       1,991
<RECEIVABLES>                                     45,317
<ALLOWANCES>                                       1,509
<INVENTORY>                                            0
<CURRENT-ASSETS>                                  69,254
<PP&E>                                            54,137
<DEPRECIATION>                                    27,968
<TOTAL-ASSETS>                                   182,038
<CURRENT-LIABILITIES>                             25,451
<BONDS>                                                0
<PREFERRED-MANDATORY>                                  0
<PREFERRED>                                            0
<COMMON>                                               0
<OTHER-SE>                                       143,933
<TOTAL-LIABILITY-AND-EQUITY>                     182,038
<SALES>                                                0
<TOTAL-REVENUES>                                 130,785
<CGS>                                                  0
<TOTAL-COSTS>                                    101,435
<OTHER-EXPENSES>                                  16,815
<LOSS-PROVISION>                                       0
<INTEREST-EXPENSE>                                   128
<INCOME-PRETAX>                                   12,541
<INCOME-TAX>                                       4,568
<INCOME-CONTINUING>                                7,973
<DISCONTINUED>                                         0
<EXTRAORDINARY>                                        0
<CHANGES>                                              0
<NET-INCOME>                                       7,973
<EPS-PRIMARY>                                       0.24
<EPS-DILUTED>                                       0.23


</TABLE>
```

<TABLE> <S> <C>

<ARTICLE> 5

<S>	<C>	
<PERIOD-TYPE>	9-MOS	
<FISCAL-YEAR-END>		SEP-30-1998
<PERIOD-END>		SEP-30-1998
<CASH>		25,207
<SECURITIES>		0
<RECEIVABLES>		49,313
<ALLOWANCES>		1,819
<INVENTORY>		0
<CURRENT-ASSETS>		76,367
<PP&E>		58,449
<DEPRECIATION>		31,265
<TOTAL-ASSETS>		190,799
<CURRENT-LIABILITIES>		30,653
<BONDS>		0
<PREFERRED-MANDATORY>		0
<PREFERRED>		0
<COMMON>		0
<OTHER-SE>		151,282
<TOTAL-LIABILITY-AND-EQUITY>		190,799
<SALES>		0
<TOTAL-REVENUES>		199,790
<CGS>		0
<TOTAL-COSTS>		154,029
<OTHER-EXPENSES>		27,276
<LOSS-PROVISION>		0
<INTEREST-EXPENSE>		157
<INCOME-PRETAX>		18,696
<INCOME-TAX>		6,948
<INCOME-CONTINUING>		11,749
<DISCONTINUED>		0
<EXTRAORDINARY>		0
<CHANGES>		0
<NET-INCOME>		11,749
<EPS-PRIMARY>		0.36
<EPS-DILUTED>		0.34

</TABLE>

```
<TABLE> <S> <C>

<ARTICLE> 5

<S>                              <C>
<PERIOD-TYPE>                    12-MOS
<FISCAL-YEAR-END>                           DEC-31-1998
<PERIOD-END>                                DEC-31-1998
<CASH>                                           15,936
<SECURITIES>                                          0
<RECEIVABLES>                                    54,751
<ALLOWANCES>                                      2,274
<INVENTORY>                                           0
<CURRENT-ASSETS>                                 75,084
<PP&E>                                           54,124
<DEPRECIATION>                                   27,102
<TOTAL-ASSETS>                                  187,311
<CURRENT-LIABILITIES>                            33,232
<BONDS>                                               0
<PREFERRED-MANDATORY>                                 0
<PREFERRED>                                           0
<COMMON>                                              0
<OTHER-SE>                                      151,186
<TOTAL-LIABILITY-AND-EQUITY>                    187,311
<SALES>                                               0
<TOTAL-REVENUES>                                271,655
<CGS>                                                 0
<TOTAL-COSTS>                                   209,587
<OTHER-EXPENSES>                                 50,736
<LOSS-PROVISION>                                      0
<INTEREST-EXPENSE>                                  233
<INCOME-PRETAX>                                  11,657
<INCOME-TAX>                                      8,472
<INCOME-CONTINUING>                               3,185
<DISCONTINUED>                                        0
<EXTRAORDINARY>                                       0
<CHANGES>                                             0
<NET-INCOME>                                      3,185
<EPS-PRIMARY>                                      0.10
<EPS-DILUTED>                                      0.09


</TABLE>
```

<TABLE> <S> <C>

<ARTICLE> 5

<S>	<C>
<PERIOD-TYPE>	3-MOS
<FISCAL-YEAR-END>	MAR-31-1997
<PERIOD-END>	MAR-31-1997
<CASH>	15,238
<SECURITIES>	1,995
<RECEIVABLES>	35,842
<ALLOWANCES>	733
<INVENTORY>	0
<CURRENT-ASSETS>	54,105
<PP&E>	40,419
<DEPRECIATION>	18,324
<TOTAL-ASSETS>	158,817
<CURRENT-LIABILITIES>	21,854
<BONDS>	0
<PREFERRED-MANDATORY>	0
<PREFERRED>	0
<COMMON>	0
<OTHER-SE>	121,702
<TOTAL-LIABILITY-AND-EQUITY>	158,817
<SALES>	0
<TOTAL-REVENUES>	49,914
<CGS>	0
<TOTAL-COSTS>	39,228
<OTHER-EXPENSES>	7,265
<LOSS-PROVISION>	0
<INTEREST-EXPENSE>	138
<INCOME-PRETAX>	3,283
<INCOME-TAX>	1,225
<INCOME-CONTINUING>	2,058
<DISCONTINUED>	0
<EXTRAORDINARY>	0
<CHANGES>	0
<NET-INCOME>	2,058
<EPS-PRIMARY>	0.07
<EPS-DILUTED>	0.06

</TABLE>

<TABLE> <S> <C>

<ARTICLE> 5

<S>	<C>
<PERIOD-TYPE>	6-MOS
<FISCAL-YEAR-END>	JUN-30-1997
<PERIOD-END>	JUN-30-1997
<CASH>	10,861
<SECURITIES>	5,995
<RECEIVABLES>	38,469
<ALLOWANCES>	1,120
<INVENTORY>	0
<CURRENT-ASSETS>	56,080
<PP&E>	45,812
<DEPRECIATION>	21,572
<TOTAL-ASSETS>	163,109
<CURRENT-LIABILITIES>	23,575
<BONDS>	0
<PREFERRED-MANDATORY>	0
<PREFERRED>	0
<COMMON>	0
<OTHER-SE>	125,165
<TOTAL-LIABILITY-AND-EQUITY>	163,109
<SALES>	0
<TOTAL-REVENUES>	102,913
<CGS>	0
<TOTAL-COSTS>	80,502
<OTHER-EXPENSES>	14,309
<LOSS-PROVISION>	0
<INTEREST-EXPENSE>	264
<INCOME-PRETAX>	7,840
<INCOME-TAX>	2,851
<INCOME-CONTINUING>	4,989
<DISCONTINUED>	0
<EXTRAORDINARY>	0
<CHANGES>	0
<NET-INCOME>	4,989
<EPS-PRIMARY>	0.16
<EPS-DILUTED>	0.15

</TABLE>

<TABLE> <S> <C>

<ARTICLE> 5

<S> <C>
<PERIOD-TYPE> 9-MOS
<FISCAL-YEAR-END> SEP-30-1997
<PERIOD-END> SEP-30-1997
<CASH> 16,506
<SECURITIES> 3,973
<RECEIVABLES> 39,270
<ALLOWANCES> 1,123
<INVENTORY> 0
<CURRENT-ASSETS> 60,231
<PP&E> 48,768
<DEPRECIATION> 23,861
<TOTAL-ASSETS> 168,560
<CURRENT-LIABILITIES> 26,523
<BONDS> 0
<PREFERRED-MANDATORY> 0
<PREFERRED> 0
<COMMON> 0
<OTHER-SE> 128,528
<TOTAL-LIABILITY-AND-EQUITY> 168,560
<SALES> 0
<TOTAL-REVENUES> 158,182
<CGS> 0
<TOTAL-COSTS> 123,705
<OTHER-EXPENSES> 21,643
<LOSS-PROVISION> 0
<INTEREST-EXPENSE> 362
<INCOME-PRETAX> 12,472
<INCOME-TAX> 4,573
<INCOME-CONTINUING> 7,899
<DISCONTINUED> 0
<EXTRAORDINARY> 0
<CHANGES> 0
<NET-INCOME> 7,899
<EPS-PRIMARY> 0.25
<EPS-DILUTED> 0.24

</TABLE>

```
<TABLE> <S> <C>

<ARTICLE> 5

<S>                               <C>
<PERIOD-TYPE>                     12-MOS
<FISCAL-YEAR-END>                            DEC-31-1997
<PERIOD-END>                                 DEC-31-1997
<CASH>                                            14,489
<SECURITIES>                                       4,003
<RECEIVABLES>                                     43,117
<ALLOWANCES>                                       1,298
<INVENTORY>                                            0
<CURRENT-ASSETS>                                  63,795
<PP&E>                                            47,949
<DEPRECIATION>                                    22,507
<TOTAL-ASSETS>                                   173,773
<CURRENT-LIABILITIES>                             27,187
<BONDS>                                                0
<PREFERRED-MANDATORY>                                  0
<PREFERRED>                                            0
<COMMON>                                               0
<OTHER-SE>                                       131,373
<TOTAL-LIABILITY-AND-EQUITY>                     173,773
<SALES>                                                0
<TOTAL-REVENUES>                                 216,158
<CGS>                                                  0
<TOTAL-COSTS>                                    169,235
<OTHER-EXPENSES>                                  32,428
<LOSS-PROVISION>                                       0
<INTEREST-EXPENSE>                                   469
<INCOME-PRETAX>                                   14,026
<INCOME-TAX>                                       5,293
<INCOME-CONTINUING>                                8,733
<DISCONTINUED>                                         0
<EXTRAORDINARY>                                        0
<CHANGES>                                              0
<NET-INCOME>                                       8,733
<EPS-PRIMARY>                                       0.28
<EPS-DILUTED>                                       0.26


</TABLE>
```