HMS HOLDINGS CORP
Form 10-Q
November 10, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2008

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission File Number: 0-50194

HMS HOLDINGS CORP.

(Exact name of registrant as specified in its charter)

New York	**11-3656261**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer) Identification No.)
401 Park Avenue South, New York, New York	**10016**
(Address of principal executive offices)	(Zip Code)

(212) 725-7965

(Registrant s telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

The number of shares common stock, $.01 par value, outstanding as of November 3, 2008 was 25,154,029.

HMS HOLDINGS CORP. AND SUBSIDIARIES
QUARTERLY REPORT ON FORM 10-Q
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HMS HOLDINGS CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)
(unaudited)

	September 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 31,598	$ 21,275
Accounts receivable, net of allowance of $662 at September 30, 2008 and December 31, 2007	48,004	39,704
Prepaid expenses	2,328	3,266
Other current assets, including deferred tax assets of $1,263 and $657 at September 30, 2008 and December 31, 2007, respectively	1,291	704
	83,221	64,949
Property and equipment, net	16,492	16,496
Goodwill, net	82,350	80,242
Deferred income taxes, net	3,145	3,111
Intangible assets, net	20,855	22,495
Other assets	682	807
Total assets	$ 206,745	$ 188,100
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable, accrued expenses and other liabilities	$ 19,415	$ 21,539
Current portion of long-term debt	6,300	6,300
Total current liabilities	25,715	27,839
Long-term liabilities:		
Long-term debt	12,600	17,325
Accrued deferred rent	3,302	3,378
Other liabilities	765	809
Total long-term liabilities	16,667	21,512
Total liabilities	42,382	49,351
Commitments and contingencies Shareholders equity:		
Preferred stock $.01 par value; 5,000,000 shares authorized; none issued		
Common stock $.01 par value; 45,000,000 shares authorized; 26,816,875 shares issued and 25,154,029 shares outstanding at September 30, 2008; 26,409,035 shares issued and 24,746,189 shares outstanding at December 31, 2007	268	264

Capital in excess of par value		139,132		127,887
Retained earnings		34,504		20,187
Treasury stock, at cost; 1,662,846 shares at September 30, 2008 and December 31, 2007		(9,397)		(9,397)
Accumulated other comprehensive loss		(144)		(192)
Total shareholders equity		164,363		138,749
Total liabilities and shareholders equity	$	206,745	$	188,100

See accompanying notes to consolidated financial statements.

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HMS HOLDINGS CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
For the Three and Nine-Month Periods Ended September 30, 2008 and 2007
(in thousands, except per share amounts)
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Revenue	$ 48,965	$ 37,684	$ 132,091	$ 104,983
Cost of services:				
Compensation	19,297	14,422	53,122	40,882
Data processing	3,059	2,628	8,796	7,110
Occupancy	2,763	2,172	7,987	6,446
Direct project costs	7,310	5,711	19,749	16,368
Other operating costs	4,560	3,928	13,605	9,973
Amortization of acquisition related software and intangibles	1,205	1,154	3,530	3,480
Total cost of services	38,194	30,015	106,789	84,259
Operating income	10,771	7,669	25,302	20,724
Interest expense	(371)	(492)	(1,137)	(1,743)
Interest income	191	166	520	382
Income before income taxes	10,591	7,343	24,685	19,363
Income taxes	4,448	3,202	10,368	8,443
Net income	$ 6,143	$ 4,141	$ 14,317	$ 10,920
Basic income per share data:				
Net income per basic share	$ 0.24	$ 0.17	$ 0.57	$ 0.46
Weighted average common shares outstanding, basic	25,083	24,028	24,965	23,713
Diluted income per share data:				
Net income per diluted share	$ 0.23	$ 0.16	$ 0.53	$ 0.42

Weighted average common shares, diluted	26,794	26,254	26,778	26,077

See accompanying notes to consolidated financial statements.

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HMS HOLDINGS CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME
(in thousands, except share amounts)
(unaudited)

	Common Stock		Capital In Excess Of Par Value	Retained Earnings/ Accumulated Deficit	Accumulated Other Comprehensive Income/(Loss)	Treasury Stock		Total Shareholders Equity
	# of Shares Issued	Par Value				# of Shares	Amount	
Balance at December 31, 2007	26,409,035	$ 264	$ 127,887	$ 20,187	$ (192)	1,662,846	$ (9,397)	$ 138,749
Comprehensive income:								
Net income				14,317				14,317
Unrealized gain on derivative instrument, net of tax of $30					48			48
Total comprehensive income								14,365
Share-based compensation cost			2,351					2,351
Exercise of stock options	407,840	4	1,643					1,647
Disqualifying dispositions			7,251					7,251
Balance at September 30, 2008	26,816,875	$ 268	$ 139,132	$ 34,504	$ (144)	1,662,846	$ (9,397)	$ 164,363

See accompanying notes to consolidated financial statements.

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HMS HOLDINGS CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine-Month Periods Ended September 30, 2008 and 2007
(in thousands)
(unaudited)

	Nine months ended September 30,	
	2008	2007
Operating activities:		
Net income	$ 14,317	$ 10,920
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on disposal of fixed assets	53	80
Depreciation and amortization	8,834	7,698
(Increase)/decrease in deferred tax asset	(640)	2,873
Share-based compensation expense	2,351	1,420
Changes in assets and liabilities:		
Increase in accounts receivable	(7,380)	(8,625)
(Increase)/decrease in prepaid expenses and other current assets	985	(135)
Increase in other assets	(18)	(171)
Decrease in accounts payable, accrued expenses and other liabilities	(2,679)	(267)
Net cash provided by operating activities	15,823	13,793
Investing activities:		
Purchases of property and equipment	(4,908)	(6,772)
Acquisition of BSPA		(15,000)
Acquisition of Prudent Rx	(4,030)	
Investment in software	(735)	(473)
Net cash used in investing activities	(9,673)	(22,245)
Financing activities:		
Proceeds from exercise of stock options	1,647	3,840
Tax benefit of disqualifying dispositions	7,251	5,108
Repayment of long-term debt	(4,725)	(6,300)
Net cash provided by financing activities	4,173	2,648
Net increase/(decrease) in cash and cash equivalents	10,323	(5,804)
Cash and cash equivalents at beginning of period	21,275	12,527

Cash and cash equivalents at end of period	$	31,598	$	6,723
Supplemental disclosure of cash flow information:				
Cash paid for income taxes	$	1,813	$	47
Cash paid for interest	$	979	$	1,458
Supplemental disclosure of noncash investing activities:				
Accrued purchase price relating to PrudentRx acquisition	$	466	$	

See accompanying notes to consolidated financial statements.

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HMS HOLDINGS CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008
(unaudited)

1. Unaudited Interim Financial Information

The management of HMS Holdings Corp. (Holdings or the Company) is responsible for the accompanying unaudited interim financial statements and the related information included in the notes to the financial statements. In the opinion of management, the unaudited interim financial statements reflect all adjustments, including normal recurring adjustments necessary for the fair presentation of the Company s financial position and results of operations and cash flows for the periods presented. Results of operations for interim periods are not necessarily indicative of the results to be expected for the entire year.

The Company is managed and operated as one business, with a single management team that reports to the chief executive officer. The Company does not operate separate lines of business with respect to any of its product lines. Accordingly, the Company does not prepare discrete financial information with respect to separate product lines or by location and does not have separately reportable segments.

These unaudited interim financial statements should be read in conjunction with the audited consolidated financial statements of the Company as of and for the year ended December 31, 2007 included in the Company s Annual Report on Form 10-K for such year, as filed with the Securities and Exchange Commission (SEC).

2. Basis of Presentation and Principles of Consolidation

(a) Organization and Business

The Company provides a variety of cost containment and payment accuracy services relating to government healthcare programs. These services are in general designed to help our clients recover amounts due from liable third parties, reduce costs, and ensure regulatory compliance.

(b) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

(b) Recent Accounting Pronouncement

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007, with the exception of the application of the statement to the determination of fair value of nonfinancial assets and liabilities that are recognized or disclosed on a nonrecurring basis, which is effective for fiscal years beginning after November 15, 2008.

SFAS 157 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at

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fair value. A financial asset or liability s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

Effective January 1, 2008, we partially adopted SFAS No. 157 and have applied its provisions to financial assets and liabilities that are recognized or disclosed at fair value on a recurring basis (at least annually). We have not yet adopted SFAS 157 for non-financial assets and liabilities, in accordance with FASB staff position 157-2, which is effective for fiscal years beginning after November 15, 2008.

At September 30, 2008, our interest rate swap contract (see note 8) was being carried at fair value and measured on a recurring basis. Fair value is determined through the use of models that consider various assumptions, including time value, yield curves, as well as other relevant economic measures, which are inputs that are classified as Level 2 in the valuation hierarchy.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS 159), which is effective for fiscal years beginning after November 15, 2007. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. This statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. Unrealized gains and losses on items for which the fair value option is elected would be reported in earnings. We have adopted SFAS 159 and have elected not to measure any additional financial instruments and other items at fair value.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS 141(R)), which replaces SFAS No. 141, Business Combinations. SFAS 141(R) retains the underlying concepts of SFAS 141 in that all business combinations are still required to be accounted for at fair value under the acquisition method of accounting but SFAS 141(R) changed the method of applying the acquisition method in a number of significant aspects. Acquisition costs will generally be expensed as incurred; noncontrolling interests will be valued at fair value at the acquisition date; in-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date; restructuring costs associated with a business combination will generally be expensed subsequent to the acquisition date; and changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense. SFAS 141(R) is effective on a prospective basis for all business combinations for which the acquisition date is on or after the beginning of the first annual period subsequent to December 15, 2008, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies. SFAS 141(R) amends SFAS 109 such that adjustments made to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that closed prior to the effective date of SFAS 141(R) would also apply the provisions of SFAS 141(R). Early adoption is prohibited. Therefore, the impact of the implementation of this pronouncement cannot be determined until the transactions occur.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS No. 161). SFAS No. 161 requires enhanced disclosures about an entity s derivative and hedging activities. Entities will be required to provide enhanced disclosures about how and why an entity uses derivative instruments, how these instruments are accounted for, and how they affect the entity s financial position, financial performance and cash flows. This new standard is effective for our Company as of January 1, 2009 and we are currently evaluating the impact on disclosures associated with our derivative and hedging activities.

In April 2008, the FASB issued FSP No. FAS 142-3, Determination of the Useful Life of Intangible Assets. This FSP amends the factors that should be considered in developing renewal or extension

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assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142). The objective of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141(R), and other generally accepted accounting principles (GAAP). This FSP applies prospectively to all intangible assets acquired after the effective date in fiscal 2009, whether acquired in a business combination or otherwise. Early adoption is prohibited. Therefore, the impact of the implementation of this pronouncement cannot be determined until the transactions occur.

(d) Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reported period. The actual results could differ from those estimates.

(e) Reclassifications

Certain reclassifications were made to prior year and prior quarter amounts to conform to the current presentation. Non-material reclassifications were made between other operating cost and direct project cost to properly classify temporary staffing-related expenses. In conjunction with these reclassifications, there was no impact on total cost of services, operating income and net income for the periods adjusted.

3. Stock-based Compensation

Presented below is a summary of the Company s option activity for the nine months ended September 30, 2008:

Options (in thousands)	Options (in thousands)	Weighted average exercise price	Weighted average remaining contractual terms (in years)	Aggregate intrinsic value (in thousands)
Outstanding at January 1, 2008	4,246	$ 9.23		
Granted	29	25.92		
Exercised	(408)	4.04		
Forfeited	(15)	14.04		
Expired	(34)	6.46		
Outstanding at September 30, 2008	3,818	$ 9.93	5.40	$ 55,442
Vested or expected to vest at September 30, 2008	3,725	$ 9.68	0.47	$ 54,958
Exercisable at September 30, 2008	2,587	$ 5.78	4.93	$ 47,853

The fair value of each option grant was estimated using the Black-Scholes option pricing model. Expected volatilities are calculated based on the historical volatility of the Company s stock. Management monitors share option exercise and employee termination patterns to estimate forfeiture rates within the valuation model. Separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The

expected holding period of options represents the period of time that options granted are expected to be outstanding. The risk-free interest rate for periods within the contractual life of the option is based on the interest rate of a 5-year U.S. Treasury note in effect on the date of the grant. There were 25,000 stock option grants during the three months ended September 30, 2008 and 29,000 options granted during the nine month period ended September 30, 2008. The fair value of options granted for the three months ended September 30, 2008 was $0.2 million, and for the nine month period ended September 30, 2008 was $0.3 million.

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As of September 30, 2008, there was approximately $6.6 million of total unrecognized compensation cost related to stock options outstanding. That cost is expected to be recognized over a weighted-average period of 1.6 years. No compensation cost related to stock options was capitalized for the nine months ended September 30, 2008.

The following table summarizes the weighted average assumptions utilized in developing the Black-Scholes pricing model:

	Nine months ended September 30,	
	2008	2007
Expected dividend yield	0%	0%
Risk-free interest rate	2.6%	4.7%
Expected volatility	39.7%	38.6%
Expected life	5.0 years	5.0 years

4. Acquisition

On September 16, 2008, the Company purchased the net assets of Prudent Rx, Inc., an independent pharmacy audit and cost containment company based in Culver City, California. With this acquisition, the Company further expanded its portfolio of program integrity service offerings for government healthcare programs and managed care organizations, particularly in the pharmacy arena. Prudent Rx s key products and services include audit programs, program design and benefit management, as well as general and pharmacy systems consulting.

The purchase price of Prudent Rx s net assets, inclusive of the acquisition cost, was approximately $4.5 million and was accounted for under the asset purchase accounting model. Additional future payments of $2.3 million ($1.150 million for each of the years ending December 31, 2009 and 2010) will be made contingent upon Prudent Rx meeting certain financial performance milestones and will be recorded as additional Goodwill upon meeting the milestones.

The acquisition of Prudent Rx will not have a material effect on the Company s fiscal year 2008 earnings or liquidity.

The allocation of the purchase price was based upon estimates of the assets and liabilities acquired in accordance with SFAS No. 141 Business Combinations. The acquisition of Prudent Rx was based on management s consideration of past and expected future performance as well as the potential strategic fit with the long-term goals of the Company. The expected long-term growth, market position and expected synergies to be generated by Prudent Rx were the primary factors which gave rise to an acquisition price which resulted in the recognition of goodwill.

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The allocation of the aggregate purchase price of this acquisition is as follows:

Goodwill	$ 2,108
Identifiable intangible assets	1,432
Net assets acquired	955
Total Purchase Price	$ 4,495

Identifiable intangible assets principally include customer relationships and Prudent Rx s trade name.

5. Income Taxes

The Company and its subsidiaries file income tax returns with the U.S. Federal government and various state jurisdictions. The Company is no longer subject to U.S. Federal income tax examinations by tax authorities for years before 2005. The Company operates in a number of state and local jurisdictions, substantially all of which have never audited the Company. Accordingly, the Company is subject to state and local income tax examinations based upon the various statutes of limitations in each jurisdiction.

At September 30, 2008, the Company had approximately $0.5 million of tax positions for which there is uncertainty about the allocation and apportionment of state tax deductions. If recognized, all of this balance would impact the effective tax rate; however the Company does not expect any significant change in unrecognized tax benefits during the next twelve months. The Company recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expense. At September 30, 2008, the Company had accrued liabilities related to uncertain tax positions of approximately $92,000.

At September 30, 2008, the Company had a Federal net operating loss (NOLs) carry forward of $22.6 million from disqualifying dispositions. These tax benefits reduce the Company s income tax payable and will be included in additional paid-in capital when recognized. The amount by which these tax benefits will reduce income tax payable and increase additional paid-in capital when recognized is approximately $9.5 million. Additionally, the amortization of intangible assets has reduced current taxable income. The principal difference between the statutory rate and the Company s effective rate is state income taxes.

At September 30, 2008, the Company had a valuation allowance of $2.7 million. The sale of the Company s Accordis Inc. (Accordis) subsidiary in 2005 resulted in a capital loss of $6.0 million, which can be carried forward for five years and produced a deferred tax asset of $2.5 million. The Company believes the available objective evidence, principally the capital loss carryforward being utilizable to offset only future capital gains, creates sufficient uncertainty regarding the realizability of its capital loss carryforward that it is more likely than not, that substantially all of the capital loss carryforward is not realizable. The remaining valuation allowance of $0.2 million relates to certain state NOLs where the Company doesn t currently operate and there is sufficient doubt about the Company s ability to utilize these NOLs that it is more likely than not that this portion of the state NOLs are not realizable.

6. Earnings Per Share

Basic income per share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted income per share is calculated by dividing net income

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by the weighted average number of common shares and dilutive common share equivalents outstanding during the period. The Company s common share equivalents consist of stock options.

The following reconciles the basic to diluted weighted average shares outstanding:

	Three months ending September 30,		**Nine months ending September 30,**	
(Shares in thousands)	**2008**	**2007**	**2008**	**2007**
Weighted average shares outstanding basic	25,083	24,028	24,965	23,713
Potential shares exercisable under stock option plans	1,711	2,226	1,813	2,364
Weighted average shares outstanding diluted	26,794	26,254	26,778	26,077

For the three-month and nine-month periods ended September 30, 2008, 639,000 and 599,000 stock options, respectively, were not included in the diluted earnings per share calculation because the effect would have been antidilutive. For the three-month and nine-month periods ended September 30, 2007, 149,000 and 76,000 thousand stock options, respectively, were not included in the diluted earnings per share calculation because the effect would have been antidilutive.

7. Debt

The Company has a credit agreement (the Credit Agreement) among the Company, the several banks and other financial institutions or entities from time to time parties thereto, and JPMorgan Chase Bank, N.A. (JPMCB), as administrative agent, which was utilized to fund a portion of the purchase price for the Company s 2006 acquisition of the Benefits Solutions Practice Area (BSPA) assets from Public Consulting Group, Inc. The Credit Agreement provides for a term loan of $40 million (the Term Loan) and revolving credit loans of up to $25 million (the Revolving Loan). Borrowings under the Credit Agreement mature on September 13, 2011. The loans are secured by a security interest in favor of the lenders covering the assets of the Company and its subsidiaries. Interest on borrowings under the Credit Agreement is calculated, at the Company s option, at either (i) LIBOR, including statutory reserves, plus a variable margin based on the Company s leverage ratio, or (ii) the higher of (a) the prime lending rate of JPMCB, and (b) the Federal Funds Effective Rate plus 0.50%, in each case plus a variable margin based on the Company s leverage ratio. In connection with the Revolving Loan, the Company agreed to pay a commitment fee, payable quarterly in arrears, at a variable rate based on the Company s leverage ratio, on the unused portion of the Revolving Loan.

Commitments under the Credit Agreement will be reduced and borrowings are required to be repaid with the net proceeds of, among other things, sales or issuances of equity (excluding equity issued under employee benefit plans and equity issued to sellers as consideration in acquisitions), sales of assets by the Company and any incurrence of indebtedness by the Company, subject, in each case, to limited exceptions. The obligations of the Company under the Credit Agreement may be accelerated upon the occurrence of an event of default under the Credit Agreement, which encompasses customary events of default including, without limitation, payment defaults, defaults in the performance of affirmative and negative covenants, the inaccuracy of representations or warranties, bankruptcy and insolvency related defaults, defaults relating to such matters as ERISA, uninsured judgments and the failure to pay certain indebtedness, and a change of control default.

In addition, the Credit Agreement contains affirmative, negative and financial covenants customary for financings of this type. The negative covenants include restrictions on indebtedness, liens, fundamental changes, dispositions of property, investments, dividends and other restricted payments. The financial covenants include a consolidated fixed charge coverage ratio, as defined, of not less than 1.75 to 1.0 and a consolidated leverage ratio as defined not to

exceed 3.0 to 1.0, through September 30, 2008. The Company is in full compliance with these covenants.

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(unaudited)

The Term Loan requires quarterly repayments of $1.575 million, which amount is adjusted each time the Company makes an additional repayment. There have been no borrowings under the Revolving Loan, however, we had outstanding a $4.6 million irrevocable standby letter of credit which relates to contingent, default payment obligations required by a contractual arrangement with a client. As a result of the letter of credit issued, the amount available under the Revolving Loan was reduced by $4.6 million at September 30, 2008. Fees and expenses related to the Credit Agreement of $0.9 million have been recorded as Deferred Financing Costs (included in other assets, non-current) and are amortized to interest expense over the five-year life of the credit facilities using the effective interest method.

Long-term debt consists of the following at September 30, 2008:

(in thousands except percentages)	September 30, 2008
Borrowings under the Credit Agreement:	
$40 million Term Loan, interest at 3.75%	$ 18,900
$25 million Revolving Loan	
Total long-term debt	18,900
Less current portion of long-term debt	6,300
Long-term debt, net of current portion	$ 12,600

8. Derivative Contract

The Company has an interest rate swap agreement to hedge the fluctuations in variable interest rates and does not use derivative instruments for speculative purposes.

In December 2006, the Company entered into a three-year interest rate swap agreement, which is accounted for as a cash flow hedge. This agreement effectively converted $12.0 million of the Company s variable rate debt to fixed-rate debt, reducing the Company s exposure to changes in interest rates. Under this swap agreement, the Company received an average LIBOR variable rate of 3.75% and paid an average LIBOR fixed rate of 5.295% for the period from December 31, 2007 to September 30, 2008. The LIBOR interest rates exclude the Company s applicable interest rate spread under the Company s Credit Agreement. The Company has recognized, net of tax, an unrealized gain of 48,000 for the nine-months ended September 30, 2008 and an unrealized loss of $144,000 as of September 30, 2008 relating to the change in the instrument s fair value. These amount have been included in accumulated other comprehensive income.

The variable to fixed interest rate swap is designated as and is effective as a cash-flow hedge. The fair value of this swap, a liability of $243,000 at September 30, 2008, is recorded on the Consolidated Balance Sheets as an Other Current Liability, with changes in its fair value included in accumulated other comprehensive income (OCI). Derivative gains and losses included in OCI are reclassified into earnings at the time the related interest expense is recognized or the settlement of the related commitment occurs.

HMS HOLDINGS CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2008
(unaudited)

9. Subsequent Events

(a) Stock Option Grant

On October 1, 2008, the Compensation Committee of the Board of Directors approved 610,000 stock option awards to officers, executives, management and board members at the exercise price of $23.99 per share, the average of the high and low trading prices for the Company s common stock on the date of the grant. A portion of this stock option grant will be vested over a three-year period, while the balance will vest upon the Company s achievement of certain predefined performance-based criteria.

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Special Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. For this purpose any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words believes, anticipates, plans, expects and similar expressions are intended to identify forward-looking statements. These statements involve unknown risks, uncertainties and other factors, which may cause our actual results to differ materially from those implied by the forward looking statements. Among the important factors that could cause actual results to differ materially from those indicated by such forward-looking statements include those risks identified in Item 1A-Risk Factors and other risks identified in our Form 10-K for the year ended December 31, 2007 and presented elsewhere by management from time to time. There have been no material changes from the risk factors previously disclosed in our Form 10-K for the year ended December 31, 2007. Such forward-looking statements represent management s current expectations and are inherently uncertain. Readers are cautioned that actual results may differ from management s expectations.

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

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with United States generally accepted accounting principles, or U.S. GAAP.

In addition to the information provided below, you should refer to the items disclosed as our critical accounting policies in the Part II, Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the year ended December 31, 2007.

Expense Classifications: The Company s cost of services in its statement of operations is presented in the six categories noted below. All revenue and cost are reported under one operating segment. A description of the primary costs included in each category being presented is provided in the table below:

Line item Caption	Description of Costs
Compensation	Salary, fringe benefit, bonus and stock based compensation costs
Data processing	Hardware, software and data communication cost
Occupancy	Rent, utilities, depreciation, office equipment, repair and maintenance costs
Direct project costs	Variable costs incurred from third party providers that are directly associated with specific revenue generating projects
Other operating costs	Professional fees, temporary staffing, travel and entertainment, insurance and local and property tax costs
Amortization of intangibles	Amortization cost of acquisition-related software and intangible assets

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Current Overview

We provide a variety of cost management services for government-sponsored health and human services programs. These services help customers recover amounts due from third parties, avoid and reduce costs, and ensure regulatory compliance.

Our customers are State Medicaid agencies, government-sponsored managed care plans, child support agencies, the Veterans Health Administration, the Centers for Medicare & Medicaid Services and other public programs. We help these programs contain healthcare costs by identifying third party insurance coverage and recovering expenditures that were the responsibility of the third party, or that were paid in error. The identification of other insurance coverage also helps these programs avoid future expenditures.

Our non-acquisition related revenue has grown at an average rate of approximately 17% per year for the last five years. We anticipate that in 2008 our revenue will approximate $181 million. Our growth has been partly attributable to the growth in Medicaid costs, which has historically averaged approximately 7% annually. State governments also have increased their use of vendors for coordination of benefits and other cost containment functions, and we have been able to increase our revenue through these initiatives. Leveraging our work on behalf of state Medicaid fee for service programs, we have begun to penetrate the Medicaid managed care market, into which more Medicaid lives are being shifted. As of September 30, 2008, we counted 80 Medicaid managed care plans including many of the largest in the nation as our clients. Additionally, we have leveraged our client relationships to grow program integrity related revenue a product area which focuses on payment accuracy services.

It should be noted that the nature of our business sometimes leads to significant variations in revenue flow. For example, since we receive contingency fees for a significant portion of our services, we recognize revenue only after our clients have received payment from a third party. In addition, much of our work occurs on an annual or project-specific basis, and does not necessarily recur monthly or quarterly, as do our operating expenses.

Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007

The following table sets forth, for the periods indicated, certain items in our consolidated statements of operations expressed as a percentage of revenue:

	Three Months Ended September 30,	
	2008	2007
Revenue	100.0%	100.0%
Cost of services:		
Compensation	39.4%	38.2%
Data processing	6.2%	7.0%
Occupancy	5.6%	5.8%
Direct project costs	14.9%	15.2%
Other operating costs	9.3%	10.4%
Amortization of acquisition related intangibles	2.5%	3.1%
Total cost of services	78.0%	79.6%
Operating income	22.0%	20.4%
Interest expense	-0.8%	-1.3%
Interest income	0.4%	0.4%
Income before income taxes	21.6%	19.5%
Income taxes	-9.1%	-8.5%
Net income	12.5%	11.0%

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Revenue for the three months ended September 30, 2008 was $49.0 million, an increase of $11.3 million or 29.9% compared to revenue of $37.7 million in the prior year quarter. The revenue increase reflects the addition of new clients, changes in the yields and scope of client projects, and differences in the timing of when client projects were completed in the current year compared to the prior year.

Compensation expense as a percentage of revenue was 39.4% for the three months ended September 30, 2008 compared to 38.2% for the three months ended September 30, 2007 and for the current quarter was $19.3 million, a $4.9 million or 33.8% increase over the prior year quarter expense of $14.4 million. During the quarter ended September 30, 2008, we averaged 864 employees, a 29.9% increase over our average of 665 employees during the quarter ended September 30, 2007. Increases in compensation expense are partially a result of our acquisition of the business of Peer Review Systems, Inc., doing business as Permedion (Permedion), during the fourth quarter of 2007 and the addition of staff in the areas of customer support, operations, marketing, government relations and administration during 2008.

Data processing expense as a percentage of revenue was 6.2% for the three months ended September 30, 2008 compared to 7.0% for the three months ended September 30, 2007 and for the current quarter was $3.1 million, an increase of $0.5 million or 16.4% over the prior year quarter expense of $2.6 million. The increase resulted from a $0.2 million increase in software expense associated with mainframe and network upgrades, a $0.2 million increase in hardware costs, and a $0.1 million increase in computer related supplies.

Occupancy expense as a percentage of revenue was 5.6% for the three months ended September 30, 2008 compared to 5.8% for the three months ended September 30, 2007 and for the current quarter was $2.8 million, a $0.6 million or 27.2% increase compared to the prior year quarter expense of $2.2 million. This increase reflected approximately $0.2 million of additional rent expense, $0.2 million of additional depreciation of leasehold improvements, furniture and fixtures and telephone systems, and $0.1 million increase in each for utilities expense and loss on disposal of fixed assets.

Direct project expense as a percentage of revenue was 14.9% for the three months ended September 30, 2008 compared to 15.2% for the three months ended September 30, 2007 and for the current quarter was $7.3 million, a $1.6 million or 28.0% increase compared to prior year quarter expense of $5.7 million. This increase resulted from higher transaction volumes during the current quarter.

Other operating costs as a percentage of revenue were 9.3% for the three months ended September 30, 2008 compared to 10.4% for the three months ended September 30, 2007 and for the current quarter were $4.6 million, an increase of $0.7 million or 16.1% compared to the prior year quarter expense of $3.9 million. This increase resulted primarily from increases of $0.2 million for travel expenses, $0.1 million for additional temporary help and consulting fees, and $0.1 million each for legal expenses and postage and delivery costs.

Amortization of acquisition-related software and intangibles as a percentage of revenue was 2.5% for the three months ended September 30, 2008 compared to 3.1% for the three months ended September 30, 2007 and for the current quarter was $1.2 million, equivalent to prior year quarter expense of $1.2 million.

Operating income for the three months ended September 30, 2008 was $10.8 million, an increase of $3.1 million or 40.4%, compared to $7.7 million for the three months ended September 30, 2007 primarily due to increased revenue partially offset by incremental operating cost incurred during the quarter ended September 30, 2008.

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Interest expense was $0.4 million for the three months ended September 30, 2008 compared to $0.5 million for the prior year quarter. In both periods, interest expense was attributable to borrowings under the Term Loan and amortization of deferred financing costs. The decrease in interest expense is due to both lower variable interest rates and a reduction in the principal balance in the current period compared to the prior period. Interest income was $0.2 million for the three months ended September 30, 2008, equivalent to prior year period interest income of $0.2 million.

Income tax expense of $4.4 million was recorded in the quarter ended September 30, 2008 compared to $3.2 million for the three months ended September 30, 2007, an increase of $1.2 million. Our effective tax rate decreased to 42.0% in 2008 from 43.6% for the year ended December 31, 2007 primarily due to a change in state apportionments. The Company s tax provision in 2008 is principally a deferred provision as Federal income taxes payable have been offset by the benefit of net operating loss carryforward from disqualifying dispositions recognized in additional paid in capital. Additionally, the amortization of intangible assets has reduced current taxable income. The principal difference between the statutory rate and the Company s effective rate is state taxes.

Net income of $6.1 million in the current quarter represents an increase of $2.0 million, or 48.8%, compared to net income of $4.1 million in the prior year quarter.

Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007

The following table sets forth, for the periods indicated, certain items in our consolidated statements of operations expressed as a percentage of revenue:

	Nine Months Ended September 30,	
	2008	2007
Revenue	100.0%	100.0%
Cost of services:		
Compensation	40.2%	38.9%
Data processing	6.7%	6.8%
Occupancy	6.0%	6.1%
Direct project costs	14.9%	15.7%
Other operating costs	10.3%	9.5%
Amortization of acquisition related intangibles	2.7%	3.3%
Total cost of services	80.8%	80.3%
Operating income	19.2%	19.7%
Interest expense	-0.9%	-1.7%
Interest income	0.4%	0.4%
Income before income taxes	18.7%	18.4%
Income taxes	-7.9%	-8.0%
Net income	10.8%	10.4%

Revenue for the nine months ended September 30, 2008 was $132.1 million, an increase of $27.1 million or 25.8% compared to revenue of $105.0 million in the prior year period. The revenue increase reflects organic growth in existing client accounts, the addition of new clients, changes in the yields and scope of client projects, and differences in the timing of when client projects were completed in the current year compared to the prior year.

Compensation expense as a percentage of revenue was 40.2% for the nine months ended September 30, 2008 compared to 38.9% for the nine months ended September 30, 2007 and for the current period was $53.1 million, a $12.2 million or 29.9% increase over the prior year period expense of $40.9 million. During the nine-month period ended September 30, 2008, we averaged 824 employees, a 29.4% increase over our average of 637 employees during the period ended September 30, 2007. Increases in compensation expense are partially a result of our acquisition of Permedion during the fourth quarter of 2007 and added staff in the areas of customer support, operations, marketing, government relations and administration during 2008.

Data processing expense as a percentage of revenue was 6.7% for the nine months ended September 30, 2008 compared to 6.8% for the nine-months ended September 30, 2007 and for the current period was $8.8 million, an increase of $1.7 million or 23.7% over the prior year period expense of $7.1 million. The increase resulted from a $0.8 million increase in software expense associated with mainframe and network upgrades, a $0.5 million increase in hardware costs, $0.2 million for network communication expenses resulting from our increased number of field offices, and a $0.2 million increase in computer related supplies.

Occupancy expense as a percentage of revenue was 6.0% for the nine months ended September 30, 2008 compared to 6.1% for the nine months ended September 30, 2007 and for the current period was $8.0 million, a $1.6 million or 23.9% increase compared to the prior year period expense of $6.4 million. This increase resulted primarily from increases in $0.7 million in additional depreciation for leasehold improvements, furniture and fixtures and telephone systems, $0.5 million for additional rent, $0.2 million for additional utilities costs, and $0.1 million each for higher building services costs and moving expenses.

Direct project expense as a percentage of revenue was 14.9% for the nine months ended September 30, 2008 compared to 15.7% for the nine months ended September 30, 2007 and for the current period was $19.8 million, a $3.4 million or 20.7% increase compared to prior year period expense of $16.4 million. This increase resulted from higher transaction volumes during the current period.

Other operating costs as a percentage of revenue were 10.3% for the nine months ended September 30, 2008 compared to 9.5% for the nine months ended September 30, 2007 and for the current period were $13.6 million, an increase of $3.6 million or 36.4% compared to the prior year period expense of $10.0 million. This increase resulted primarily from increases of $1.3 million for additional temporary help and consulting fees, $0.7 million for travel expenses, $0.3 million each for staff relocation expenses and legal expenses, and $0.2 million each for supplies and printing expenses, marketing expenses, and postage and delivery costs.

Amortization of acquisition-related software and intangibles as a percentage of revenue was 2.7% for the nine months ended September 30, 2008 compared to 3.3% for the nine months ended September 30, 2007 and for the current period was $3.5 million, equivalent to prior year period expense of $3.5 million.

Operating income for the nine months ended September 30, 2008 was $25.3 million, an increase of $4.6 million or 22.1%, compared to $20.7 million for the nine months ended September 30, 2007 primarily due to increased revenue partially offset by incremental operating cost incurred during the period ended September 30, 2008.

Interest expense was $1.1 million for the nine months ended September 30, 2008 compared to $1.7 million for the prior year period. In both periods, interest expense was attributable to borrowings under the Term Loan and amortization of deferred financing costs. The decrease in interest expense is due to both lower variable interest rates and a reduction in the principal balance in the current period compared to the prior period. Interest income was $0.5 million for the nine months ended September 30, 2008 compared to interest income of $0.4 million for the nine months ended September 30, 2007, principally due to higher cash balances partially offset by lower interest rates.

Income tax expense of $10.4 million was recorded in the period ended September 30, 2008 compared to $8.4 million for the period ended September 30, 2007, an increase of $2.0 million. Our effective tax rate decreased to 42.0% in 2008 from 43.6% for the year ended December 31, 2007 primarily due to a change in state apportionments. The Company s tax provision in 2008 is principally a deferred provision as Federal income taxes payable have been offset by the benefit of net operating loss carryforward from disqualifying dispositions recognized in additional paid in capital. Additionally, the amortization of intangible assets has reduced current taxable income. The principal difference between the statutory rate and the Company s effective rate is state taxes.

Net income of $14.3 million in the current period represents an increase of $3.4 million, or 31.1%, compared to net income of $10.9 million in the prior year period.

Off-Balance Sheet Financing Arrangements

We do not have any off-balance sheet financing arrangements, other than our irrevocable standby letter of credit previously discussed, and the operating leases discussed below.

Liquidity and Capital Resources

Historically, our principal source of funds has been operations and we have had cash, cash equivalents and short-term investments significantly in excess of our operating needs. At September 30, 2008, our cash and cash equivalents and net working capital were $31.6 million and $57.5 million, respectively. During the current quarter, we utilized approximately $4.0 million of our existing cash to fund the Prudent Rx. acquisition. Although we expect that operating cash flows will continue to be a primary source of liquidity for our operating needs, we also have a $25.0 million Revolving Credit facility available for future cash flow needs. There have been no borrowings under the Revolving Loan, however, we have outstanding a $4.6 million irrevocable standby letter of credit which relates to contingent, default payment obligations required by a contractual arrangement with a client. In addition, at September 30, 2008, we had $18.9 million of debt outstanding from the $40.0 million Term Loan originally borrowed to fund the acquisition of BSPA in September 2006. The Term Loan requires us to make quarterly repayments of $1.575 million.

Operating cash flows could be adversely affected by a decrease in demand for our services. The majority of our client relationships have been in place for several years, and as a result, we do not expect any decrease in the demand for our services in the near term.

For the nine months ended September 30, 2008, cash provided by operations was $15.8 million compared to $13.8 million in the prior year period. The current year period s difference between net income of $14.3 million and cash provided by operations of $15.8 million was principally due to an increase in accounts receivable of $7.4 million and a decrease in accounts payable, accrued expenses and other liabilities of $2.7 million. These were partially offset by non-cash charges, including depreciation and amortization expense of $8.8 million, share-based compensation expense of $2.4 million, a decrease in prepaid expenses of $1.0 million, and an increase in our deferred tax asset of $0.6 million. During the current year period, cash used in investing activities was $9.7 million, reflecting $5.6 million in investments in property, equipment and software development and the $4.0 million purchase price paid for the acquisition of Prudent Rx. Cash provided by financing activities of $4.2 million consisted of a $7.3 million tax benefit from disqualifying dispositions, and $1.6 million received from stock option exercises partially offset by $4.7 million of principal payments on the Term Loan. We anticipate that our existing cash balances and funds generated by operations will be sufficient for all our 2008 cash needs.

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The number of days sales outstanding (DSO) at September 30, 2008 decreased to 88 days compared to 91 days at June 30, 2008. A substantial portion of the decrease in the current quarter s DSO levels resulted from the timing of the monthly distribution of revenue during the quarter.

At September 30, 2008, our primary contractual obligations, which consist principally of amounts due under future lease payments and payments of principal and interest on long-term debt, are as follows (in thousands):

		Primary Contractual Payments due by period			
Contractual obligations	Total	Less than 1 year	2-3 years	4-5 years	More than 5 years
Operating leases	$27,694	$ 6,641	$12,236	$8,272	$545
Long-term debt	18,900	6,300	12,600		
Interest expense [1]	1,526	833	693		
Total	$48,120	$13,774	$25,529	$8,272	$545

[1] Future interest payments are estimates of amounts due on our long-term debt and credit facility at current interest rates and is based on scheduled repayments of principal.

We have entered into sublease arrangements for some of our facility obligations and expect to receive the following rental receipts (in thousands):

Total	Less than 1 Year	2-3 Years	4-5 Years	More than 5 years
$2,775	$550	$1,194	$965	$ 66

On May 28, 1997, the Board of Directors authorized us to repurchase such number of shares of our common stock that have an aggregate purchase price not in excess of $10 million. On February 24, 2006, the Board of Directors increased the authorized aggregate purchase price by $10 million to an amount not to exceed $20 million. During the nine months ended September 30, 2008, we made no repurchases. Cumulatively since the inception of the repurchase program, we have repurchased 1,662,846 shares having an aggregate purchase price of $9.4 million.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007, with the exception of the application of the statement to the determination of fair value of non-financial assets

and liabilities that are recognized or disclosed on a nonrecurring basis, which is effective for fiscal years beginning after November 15, 2008.

SFAS 157 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value. A financial asset or liability s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

Effective January 1, 2008, we partially adopted SFAS No. 157 and have applied its provisions to financial assets and liabilities that are recognized or disclosed at fair value on a recurring basis (at least annually). We have not yet adopted SFAS 157 for non-financial assets and liabilities, in accordance with FASB staff position 157-2, which is effective for fiscal years beginning after November 15, 2008.

At September 30, 2008, our interest rate swap contract (see note 8 of the Notes to Consolidated Financial Statements) was being carried at fair value and measured on a recurring basis. Fair value is determined through the use of models that consider various assumptions, including time value, yield curves, as well as other relevant economic measures, which are inputs that are classified as Level 2 in the valuation hierarchy.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS 159), which is effective for fiscal years beginning after November 15, 2007. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. This statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. Unrealized gains and losses on items for which the fair value option is elected would be reported in earnings. We have adopted SFAS 159 and have elected not to measure any additional financial instruments and other items at fair value.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS 141(R)), which replaces SFAS No. 141, Business Combinations. SFAS 141(R) retains the underlying concepts of SFAS 141 in that all business combinations are still required to be accounted for at fair value under the acquisition method of accounting but SFAS 141(R) changed the method of applying the acquisition method in a number of significant aspects. Acquisition costs will generally be expensed as incurred; noncontrolling interests will be valued at fair value at the acquisition date; in-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date; restructuring costs associated with a business combination will generally be expensed subsequent to the acquisition date; and changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense. SFAS 141(R) is effective on a prospective basis for all business combinations for which the acquisition date is on or after the beginning of the first annual period subsequent to December 15, 2008, with the exception of the accounting for valuation allowances on deferred taxes and acquired tax contingencies. SFAS 141(R) amends SFAS 109 such that adjustments made to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that closed prior to the effective date of SFAS 141(R) would also apply the provisions of SFAS 141(R). Early adoption is prohibited. Therefore, the impact of the implementation of this pronouncement cannot be determined until the transactions occur.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS No. 161). SFAS No. 161 requires enhanced disclosures about an entity s derivative and hedging activities. Entities will be required to provide enhanced disclosures about how and why an entity uses derivative instruments, how these instruments are accounted for, and how they affect the entity s financial position, financial performance and cash flows. This new standard is effective for our Company

as of January 1, 2009 and we are currently evaluating the impact on disclosures associated with our derivative and hedging activities.

In April 2008, the FASB issued FSP No. FAS 142-3, Determination of the Useful Life of Intangible Assets. This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142). The objective of this FSP is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141(R), and other GAAP. This FSP applies prospectively to all intangible assets acquired after the effective date in fiscal 2009, whether acquired in a business combination or otherwise. Early adoption is prohibited. Therefore, the impact of the implementation of this pronouncement cannot be determined until the transactions occur.

Item 3. Quantitative and Qualitative Disclosures About Market Risks

We are exposed to changes in interest rates, primarily from our Term Loan, and use an interest rate swap agreement to fix the interest rate on a portion of this variable debt and reduce certain exposures to interest rate fluctuations. Since entering into this swap agreement, interest rates have declined and the required payments exceed those based on current market rates on the long-term debt. Our risk management objective in entering into such contracts and agreements is only to reduce our exposure to the effects of interest rate fluctuations and not for speculative investment. At September 30, 2008, we had total bank debt of $18.9 million. Our interest rate swap effectively converted $12.0 million of this variable rate debt to fixed rate debt, leaving approximately $6.9 million of the total long-term debt exposed to interest rate risk. If the effective interest rate for all of our variable rate debt were to increase by 100 basis points (1%), our annual interest expense would increase by a maximum of $69,000 based on the balances outstanding at September 30, 2008.

Item 4. Controls and Procedures

Based on management s evaluation (with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO)), as of the end of the period covered by this report, our CEO and CFO have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)), are effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2007. In addition to the other information set forth in this report, you should carefully consider the risk factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K, are not the only risks facing our Company. Additional risks and uncertainties not currently known to us, or that we currently deem to be immaterial, may also materially adversely affect our business, financial condition and/or operating results.

Item 6. Exhibits

31.1 Certification pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, executed by Robert M. Holster, Chief Executive Officer of HMS Holdings Corp.

31.2 Certification pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, executed by Walter D. Hosp, Chief Financial Officer of HMS Holdings Corp.

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by Robert M. Holster, Chief Executive Officer of HMS Holdings Corp.

32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by Walter D. Hosp, Chief Financial Officer of HMS Holdings Corp.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 7, 2008

HMS HOLDINGS CORP.
(Registrant)

By: **/s/ Robert M. Holster**
Robert M. Holster
Chief Executive Officer
(Principal Executive Officer)

By: **/s/ Walter D. Hosp**
Walter D. Hosp
Chief Financial Officer (Principal Financial Officer and Accounting Officer)

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Exhibit Index

Exhibit Number	Description
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