

WEBMD CORP /NEW/  
Form 10-K  
March 15, 2004

**Table of Contents**

---

---

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

---

**Form 10-K**

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

**For the fiscal year ended December 31, 2003**

or

**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: 0-24975**

---

**WebMD Corporation**

*(Exact name of registrant as specified in its charter)*

**Delaware**  
*(State of incorporation)*

**94-3236644**  
*(I.R.S. employer identification no.)*

**669 River Drive, Center 2  
Elmwood Park, New Jersey**  
*(Address of principal executive office)*

**07407-1361**  
*(Zip code)*

**(Registrant's telephone number including area code): (201) 703-3400**

**Securities registered pursuant to Section 12(b) of the Act: None**

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

**Common Stock, par value \$.0001 per share**

**(Title of each class)**

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 (the Exchange Act) 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  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 definitive proxy or information statements incorporated by reference into Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

## Edgar Filing: WEBMD CORP /NEW/ - Form 10-K

As of June 30, 2003, the aggregate market value of the registrant's common stock held by non-affiliates was approximately \$3,109,441,188 (based on the closing price of the common stock of \$10.87 per share on that date, as reported on the Nasdaq Stock Market's National Market and, for purposes of this computation only, the assumption that all of the registrant's directors and executive officers are affiliates). As of March 1, 2004, there were 309,464,573 shares of WebMD common stock outstanding.

### DOCUMENTS INCORPORATED BY REFERENCE

Certain information in the registrant's definitive proxy statement to be filed with the Commission relating to the registrant's 2004 Annual Meeting of Stockholders is incorporated by reference into Part III.

### TABLE OF CONTENTS

	<u>Page</u>
<u>Cautionary Statement Regarding Forward-Looking Statements</u>	2
<b><u>PART I</u></b>	
<u>Item 1. Business</u>	3
<u>Item 2. Properties</u>	42
<u>Item 3. Legal Proceedings</u>	42
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	46
<b><u>PART II</u></b>	
<u>Item 5. Market for Registrant's Common Equity and Related Stockholder Matters</u>	47
<u>Item 6. Selected Financial Data</u>	49
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	51
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	83
<u>Item 8. Financial Statements and Supplementary Data</u>	83
<u>Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	83
<u>Item 9A. Controls and Procedures</u>	83
<b><u>PART III</u></b>	
<u>Item 10. Directors and Executive Officers of the Registrant</u>	84
<u>Item 11. Executive Compensation</u>	84
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	84
<u>Item 13. Certain Relationships and Related Transactions</u>	84
<u>Item 14. Principal Accountant Fees and Services</u>	84
<b><u>PART IV</u></b>	
<u>Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K</u>	85
<u>Signatures</u>	86
<u>Financial Statements</u>	F-1
<u>Index to Exhibits</u>	E-1
<u>EX-3.2 CERTIFICATE OF DESIGNATIONS</u>	
<u>EX-4.9 CONVERTIBLE REDEEMABLE EXCHANGEABLE</u>	
<u>EX-10.44 EMPLOYMENT AGMT DATED 9/11/2000</u>	
<u>EX-10.46 EMPLOYMENT AGMT 8-20-2001</u>	
<u>EX-10.49 EMPLOYMENT AGMT DATED 12-4-2003</u>	
<u>EX-12.1 COMPUTATION OF RATIO EARNINGS</u>	
<u>EX-21 SUBSIDIARIES OF REGISTRANT</u>	
<u>EX-23.1 CONSENT OF ERNST &amp; YOUNG LLP</u>	
<u>EX-31.1 SECTION 302 CERTIFICATION OF THE CEO</u>	
<u>EX-31.2 SECTION 302 CERTIFICATION OF THE CFO</u>	
<u>EX-32.1 SECTION 906 CERTIFICATION OF THE CEO</u>	
<u>EX-32.2 SECTION 906 CERTIFICATION OF THE CFO</u>	
<u>EX-99.1 AMENDED &amp; RESTATED AUDIT COMMITTEE CHARTER</u>	

Edgar Filing: WEBMD CORP /NEW/ - Form 10-K

EX-99.2 COMPENSATION COMMITTEE CHARTER

EX-99.3 AMENDED & RESTATED NOMINATING COMMITTEE

WebMD®, Web-MD®, WebMD Health®, Digital Office Manager®, DIM<sub>DX</sub>®, Envoy®, ExpressBill®, Intergy®, Medifax®, Medifax-EDI®, Medscape®, MEDPOR®, Medpulse®, POREX®, Publishers Circle®, The Little Blue Book<sup>TM</sup>, The Little Yellow Book<sup>TM</sup>, The Medical Manager®, ULTIA<sup>TM</sup>, WebMD Health Hub<sup>TM</sup> and WellMed® are trademarks of WebMD Corporation or its subsidiaries.

**Table of Contents**

**CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K contains both historical and forward-looking statements. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements. These forward-looking statements are not based on historical facts, but rather reflect management's current expectations concerning future results and events. These forward-looking statements generally can be identified by use of expressions such as believe, expect, anticipate, intend, plan, foresee, likely, will or other similar words or phrases. Statements that describe our objectives, plans or goals are or may be forward-looking statements. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be different from any future results, performance and achievements expressed or implied by these statements. In addition to the risk factors described in

Management's Discussion and Analysis of Financial Condition and Results of Operations—Factors That May Affect Our Future Financial Condition or Results of Operations beginning on page 66, the following important risks and uncertainties could affect future results, causing these results to differ materially from those expressed in our forward-looking statements:

the failure to achieve sufficient levels of customer utilization and market acceptance of new services or newly integrated services,

the inability to successfully deploy new applications or newly integrated applications,

difficulties in forming and maintaining mutually beneficial relationships with customers and strategic partners,

the inability to attract and retain qualified personnel, and

general economic, business or regulatory conditions affecting the healthcare, information technology, Internet and plastic industries being less favorable than expected.

These factors and the risk factors described in Management's Discussion and Analysis of Financial Condition and Results of Operations—Factors That May Affect Our Future Financial Condition or Results of Operations beginning on page 66 are not necessarily all of the important factors that could cause actual results to differ materially from those expressed in any of our forward-looking statements. Other unknown or unpredictable factors also could have material adverse effects on our future results. The forward-looking statements included in this Annual Report on Form 10-K are made only as of the date of this Annual Report. We expressly disclaim any intent or obligation to update any forward-looking statements to reflect subsequent events or circumstances.

**Table of Contents**

**PART I**

**Item 1. Business**

**INTRODUCTION**

**General Information**

WebMD Corporation is a Delaware corporation that was incorporated in December 1995 and commenced operations in January 1996 as Healthon Corporation. Our common stock has traded on the Nasdaq National Market under the symbol HLTH since February 11, 1999.

Our principal executive offices are located at 669 River Drive, Center 2, Elmwood Park, New Jersey 07407-1361 and our telephone number is (201) 703-3400.

We make available free of charge at [www.webmd.com](http://www.webmd.com) (in the About WebMD section) copies of materials we file with, or furnish to, the Securities and Exchange Commission, including our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports, as soon as reasonably practicable after we electronically file such materials with, or furnish them to, the SEC.

**Overview of Our Businesses**

Our business is comprised of four segments. Three of our business segments, Portal Services, Transaction Services and Physician Services, provide various types of healthcare information services and technology solutions. Our fourth business segment is Plastic Technologies. The following overview describes our key products, services and markets:

**Healthcare Information Services and Technology Solutions.** We provide a range of information services and technology solutions for participants across the entire continuum of healthcare, including physicians and other healthcare providers, payers, suppliers and consumers. Our products and services promote administrative efficiency and assist in reducing the cost of healthcare and creating better patient outcomes.

**WebMD Health.** Our Portal Services segment, which is known as WebMD Health, provides online healthcare information, educational services and other resources for consumers and healthcare professionals. Our online offerings for consumers help them become better informed about healthcare choices and assist them in playing an active role in managing their own health. Our offerings for healthcare professionals help them improve their clinical knowledge, as well as their communication with patients regarding treatment options for specific health conditions. We also provide online content for use by media and healthcare partners in their Web sites, in some cases as part of a providing a co-branded site and in some cases on a private label basis under the partner's branding.

We reach a large audience of health-involved consumers and clinically active healthcare professionals. We work closely with pharmaceutical, medical device and other healthcare companies to develop innovative online channels of communication to our audience, or targeted portions of our audience, that complement their offline education, marketing and customer service programs. In addition, through our WebMD Health Services business, we provide employers and health plans with access to a suite of online tools and related services, for use by their employees and plan members. These tools and services provide a framework for better decision-making by healthcare consumers and can assist employers and plans in managing demand while improving quality of care.

We generate the majority of our Portal Services revenue by selling sponsorships of specific pages, sections or events on our portals and related e-mailed newsletters, by selling advertising on our portals and the online and offline properties of our strategic partners and by licensing our content and our online tools and related software and services. The majority of our WebMD

**Table of Contents**

Health revenues come from a small number of customers. Our WebMD Health customers include pharmaceutical, biotech and medical device companies, employers and health plans and media distribution companies. WebMD Health also receives a small portion of its revenues from the sale of paid subscription services. In 2003, WebMD Health revenues were \$110.7 million.

*WebMD Envoy.* Our Transaction Services segment, which is known as WebMD Envoy, provides healthcare reimbursement cycle management services, including transmission of electronic transactions between healthcare payers and physicians, pharmacies, dentists, hospitals, laboratory companies and other healthcare providers. The use of electronic transactions significantly reduces processing time and costs, as compared to mail, fax or telephone, and increases productivity for both payers and providers. The transactions that we facilitate include:

administrative transactions, such as claims submission and status inquiry, eligibility and patient coverage verification, referrals and authorizations, and electronic remittance advice, and

clinical transactions, such as lab test ordering and reporting of results.

We processed more than 2 billion transactions in 2003, for over 200,000 providers and 5,000 hospitals transacting with more than 1,200 commercial and government healthcare payers. We also provide automated patient billing services to providers, including statement printing and mailing services. In addition, through Advanced Business Fulfillment, Inc., which we acquired in July 2003, we provide healthcare paid-claims communications services for third-party administrators and health insurers, including print-and-mail services for the distribution of checks, remittance advice, and explanations of benefits. We are focused on continuing to increase the percentage of healthcare transactions that are handled electronically and on providing electronic reimbursement cycle management solutions that can be used by payers and providers to automate the entire reimbursement process.

We generate Transaction Services revenue by selling our transaction services to healthcare payers and providers, generally on either a per transaction basis or, in the case of some providers, on a monthly fixed fee basis. We also generate revenue by selling our patient statement and paid-claims communication services, typically on a per statement or per communication basis. A significant portion of WebMD Envoy revenues come from the country's leading national and regional healthcare payers. In 2003, WebMD Envoy revenues were \$505.7 million.

*WebMD Practice Services.* Our Physician Services segment, which is known as WebMD Practice Services, develops and markets information technology systems for healthcare providers, primarily under The Medical Manager, Intergy, ULTIA and Medical Manager Network Services brands. Our systems include:

administrative and financial applications that enable healthcare providers and their administrative personnel to manage their practices more efficiently, and

electronic medical record and other clinical applications that assist them in delivering quality patient care.

In addition, through Medical Manager Network Services, we provide integrated access to our WebMD Envoy transaction services for our WebMD Practice Services customers. These systems and services allow physician offices to automate their scheduling, billing and other administrative tasks, to transmit transactions electronically, to maintain electronic medical records and to automate documentation of patient encounters.

WebMD Practice Services systems are scalable to meet the needs of a wide variety of healthcare provider settings, from small physician groups to large clinics, and across various medical specialties. Customers can purchase a base system and then add additional modules and services over time to expand their use of information technology as needed.

## **Table of Contents**

We generate Physician Services revenue from one-time fees for licenses to our software modules, for system hardware and for implementation services and from recurring fees for the maintenance and support of our software and system hardware. Pricing depends on the number and type of software modules to be licensed, the number of users, the complexity of the installation and other factors. Our Medical Manager Network Services and some of our other WebMD Practice Services products and services are priced on a monthly fee per provider basis or a per transaction basis. In 2003, WebMD Practice Services revenues were \$302.6 million.

We believe that the combination, in one company, of WebMD Health, WebMD Envoy and WebMD Practice Services makes us well positioned to create significant improvements in the way that information is used by the healthcare industry, enabling increased efficiency, better decision-making and, ultimately, higher quality patient care at a lower cost.

**Plastic Technologies.** Our Plastic Technologies segment, which is known as Porex, develops, manufactures and distributes proprietary porous plastic products and components used in healthcare, industrial and consumer applications. Our Porex customers include both end-users of our finished products, as well as manufacturers that include our components in their products for the medical device, life science, research and clinical laboratory, surgical and other markets. Porex is an international business with manufacturing operations in North America, Europe and Asia and customers in more than 65 countries. In 2003, Porex revenues from continuing operations were \$71.9 million.

During 2003, our revenues were divided among our segments as follows: 52.5% from WebMD Envoy, 31.4% from WebMD Practice Services, 11.5% from WebMD Health and 7.5% from Porex. The sum of these percentages equals 102.9% of our total revenues of \$964.0 million because \$27.0 million of our revenues are from inter-segment transactions and are eliminated when we consolidate our results.

A more complete description of the products and services of each of our segments begins on page 10 below. For additional information regarding the results of operations of each of our segments, see Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations by Operating Segment and Note 8 to the Consolidated Financial Statements included in this Annual Report.

### **Key Trends Affecting Our Healthcare Information Services and Technology Solutions Business**

Several key trends in the healthcare marketplace are influencing the use of healthcare information services and technology solutions of the types we provide or are developing. Those trends, and the strategies we have developed in response, are described briefly below; the implications for each of our businesses are discussed further in the descriptions of our products and services that follow.

**High Rates of Increase in Healthcare Costs.** According to the Centers for Medicare & Medicaid Services, or CMS, healthcare spending in the United States rose to \$1.6 trillion in 2002, up from \$1.4 trillion in 2001 and \$1.3 trillion in 2000. The CMS report indicated a growth rate in healthcare spending of 9.3% for 2002, compared to 8.5% in 2001, and that the 9.3% rate of increase in 2002 was 5.7 percentage points higher than the 2002 increase in gross domestic product for the United States and marked the sixth consecutive year in which health spending grew at an accelerated rate. CMS projects the healthcare share of gross domestic product will be 15.3% for 2003 and increase to 18.4% by 2013. CMS expects that out-of-pocket healthcare spending by consumers including deductibles, copayments, and payments for medical care not covered by insurance will grow slightly faster in the next few years than during the previous few years, as employers continue to shift healthcare costs to employees. CMS projects that out-of-pocket spending growth will increase to a rate of 7.3% in 2005 from 6.0% in 2002 and will continue to increase as a percentage of consumer disposable personal income, from 2.7% in 2002 to 3.1%



**Table of Contents**

in 2013. The difficulties involved in controlling healthcare costs have resulted in the following key trends:

*Cost-Shifting by Employers to their Employees and Changes in Plan Design.* Employers are seeking to shift a greater portion of healthcare costs onto their employees and to redefine traditional health benefits. People in employer-sponsored health plans have been paying more out of their own pockets each year and are likely to see their share continue to increase significantly in the near future. With the shift in financial burdens, consumers are assuming a more active role in managing their health and need information to make educated benefit, provider and treatment decisions. We are in the process of transforming WebMD Health, our consumer portal, from an online place that consumers go for information to a place they go to actively manage their health. In addition, through our WebMD Health Services business, we help employers and plans provide employees and plan members with answers to healthcare and plan benefit questions and other personalized information and feedback. We intend to make significant investments in WebMD Health's infrastructure, as well as in new products and services, to position ourselves to provide additional interactive online services.

*Increasing Outsourcing by Healthcare Payers.* In order to be more efficient, many healthcare payers are focusing upon core activities—building cost-effective provider networks, marketing their services to employers, and adjudicating claims payment—and outsourcing pre- and post-adjudication administrative activities, such as printing and mailing checks and explanation of benefits. By outsourcing these services to us, payers can reduce operating costs and capital expenditures. In addition, our outsourcing services allow our customers to participate in the use of systems and technologies that would be too expensive for them to acquire for their own use. Our acquisitions of Advanced Business Fulfillment and Medifax-EDI in 2003 support our ability to provide more comprehensive outsourcing services. For more information on the services we provide to payers and on these acquisitions, see Healthcare Information Services and Technology Solutions—WebMD Envoy—below and Note 2 to the Consolidated Financial Statements included in this Annual Report.

*Increased Use of Information Technology for Clinical Purposes.* Governmental and commercial payers continue to exert considerable pricing pressure on providers. As a result, in order to maintain their incomes, providers need to see more patients and increase productivity and/or reduce their operating costs. Use of information technology can assist providers in these efforts. Healthcare providers are also under pressure to increase quality and reduce medical errors. There are currently numerous federal, state and private initiatives seeking ways to increase the use of information technology in healthcare, including in the physician's office. In his State of the Union Address this year, President Bush stated: "By computerizing health records, we can avoid dangerous medical mistakes, reduce costs and improve care." In a radio address the next week, he said "we can control health care costs and improve care by moving American medicine into the information age. My budget for the coming year proposes doubling to \$100 million the money we spend on projects that use promising health information technology. This would encourage the replacement of handwritten charts and scattered medical files with a unified system of computerized records. By taking this action, we would improve care, and help prevent dangerous medical errors, saving both lives and money." There are an increasing number of other governmental and private initiatives in this area.

While information technology systems and electronic transaction services are used by many physician offices for administrative and financial applications, their use in clinical workflow is much more limited, especially in smaller practices. We believe that is changing and we are targeting the market for clinical applications as one of our priorities for the next several years. While it will be a long time before most physicians go to a paperless office, more and more physicians are beginning to incorporate information technology into their clinical workflow and our products allow them to make this shift in a gradual way. See Healthcare Information Services and Technology Solutions—WebMD Practice Services—EMR and Imaging Sys-

**Table of Contents**

tems below. During 2004, we plan to improve the capacity and productivity of the WebMD Practice Services support, service and training infrastructure in order to be able to provide the additional assistance needed by customers as they increase their usage of our clinical solutions.

***Increased Automation of the Healthcare Reimbursement Cycle.*** Government regulations concerning electronic transactions in healthcare are accelerating the shift from telephone and paper claims transactions to electronic ones and have the potential to have a similar effect on other phases of the reimbursement cycle. See Government Regulation Health Insurance Portability and Accountability Act of 1996 HIPAA Transaction Standards.

Submission of claims electronically assists payers in reducing the cost of processing and servicing claims and can expedite the reimbursement process for providers. However, this is just a starting point for how electronic transactions can increase administrative efficiency. Our strategy is to be more than just a clearinghouse connection between payers and providers: we have been positioning our company to provide electronic reimbursement cycle management solutions that can be used by payers and providers to automate the entire reimbursement process. For example, our all payer transaction services include the capture, validation and routing of claims transactions on behalf of not just commercial payers, but also Blue Cross Blue Shield payers, Medicare and Medicaid, and the return electronic remittance from the payers back to the originating provider. We plan to continue to expand, through internal development and acquisitions, the transaction services we provide. See Healthcare Information Services and Technology Solutions WebMD Envoy below and Increased Outsourcing by Healthcare Payers above.

The HIPAA Transaction Standards establish format and data content standards for the most common healthcare transactions. In order to implement the Transaction Standards, WebMD Envoy has made significant changes to its systems and the software it uses internally. Similarly, the implementation has required payers and providers to simultaneously implement changes to their systems and/or internal procedures. As a result, this implementation process and related testing has been an immense challenge for the healthcare industry, including WebMD. However, it also represents a great opportunity for the industry and for us, because it encourages payer/provider connectivity to evolve from its current focus on the sending and receiving of claims to automating ancillary transactions, such as eligibility, status or remittance. As a leading clearinghouse for healthcare transactions and a leading vendor of physician office management information systems, WebMD has been the focus of a great deal of scrutiny in the implementation process and has received some criticism for difficulties encountered by our customers and for delays in our correcting some of those problems. Given the nature and scope of the changes being implemented, the large number of healthcare industry participants involved and our position in the industry, we expected that there would be some processing problems and delays. We continue to work diligently to identify and resolve these problems as they occur, while at the same time committing significant resources to keeping the implementation process moving forward. We are also working to foster communication among healthcare industry participants regarding how to achieve the intended benefits of the Transaction Standards with as little disruption to healthcare payment systems as possible. We have been incurring, and expect to continue to incur, significant expenses relating to the Transaction Standards implementation, including for testing, quality assurance and customer service activities. For more information regarding the challenges involved in such implementation and a description of the HIPAA regulations, see Business Government Regulation Health Insurance Portability and Accountability Act of 1996 Transaction Standards below.

***Increased Use of the Internet by Physicians and as a Source of Health Information for Consumers.*** According to a Pew Internet & American Life Project Survey published in December 2003, approximately seven million American consumers look for health information on the Internet each day. WebMD Health is a leading destination on the Internet for these consumers. See Healthcare Information Services and Technology Solutions WebMD Health below. The Internet allows us

## **Table of Contents**

to offer consumers the resources they are looking for, with immediate access to searchable information and dynamic interactive content. As a result, WebMD Health enables its sponsors, including pharmaceutical and medical device companies, to reach targeted consumers when they are looking for answers to healthcare questions and to reach physicians when they are exploring new treatment options. As recently noted by a Commissioner of the United States Food and Drug Administration: The evidence shows that promotions directed to consumers can play an especially important role in helping patients start a discussion with their health care practitioner about conditions that are often unrecognized and therefore undertreated, such as diabetes, high blood pressure, high cholesterol, and depression. Physicians are also increasingly turning to the Internet for professional activities. In 2003, physicians and healthcare professionals earned 629,000 continuing medical education credits at Medscape, an increase of 93% over 2002. Pharmaceutical companies and medical device manufacturers currently spend only a very small portion of their marketing and educational budgets on online media. Our strategy is to seek a greater portion of these budgets.

As discussed above and in the Business section below, we intend to continue to invest in new products and services and in improving our existing products and services, both through internal development activities and, in certain cases, through acquisitions. We make these investments based on our assessments of the needs of our customers and potential customers, including the trends described above. However, the market for healthcare in the United States is highly complicated, and there can be no assurance that the trends identified above will continue or that the intended benefits to WebMD from our responses to those trends will be achieved. In addition, the markets for healthcare information services and technology solutions are highly competitive and not only are our existing competitors seeking to benefit from these same trends, but the trends may also attract additional competitors. See Healthcare Information Services and Technology Solutions Competition for Our Healthcare Information Services and Technology Solutions below.

## **Recent Developments**

On March 4, 2004, WebMD sold \$100 million of Convertible Redeemable Exchangeable Preferred Stock in a private transaction to CalPERS/PCG Corporate Partners, LLC. CalPERS/PCG is a private equity fund managed by the Pacific Corporate Group and principally backed by California Public Employees Retirement System, or CalPERS. Transfer of the Preferred Stock is subject to restrictions and holders may not engage in hedging transactions with respect to WebMD common stock.

The Preferred Stock ranks senior to WebMD common stock with respect to rights upon liquidation, winding-up or dissolution. The Preferred Stock has a liquidation preference of \$100 million in the aggregate and \$10,000 per share. The Preferred Stock is convertible into 10,638,297 shares of WebMD common stock in the aggregate, representing a conversion price of \$9.40 per share of common stock. We may not redeem the Preferred Stock prior to March 2007. Thereafter, we may redeem any portion of the Preferred Stock at 105% of its liquidation preference; provided that any redemption by us prior to March 2008 shall be subject to the condition that the average closing sale prices of WebMD common stock is at least \$13.16 per share, subject to adjustment. We are required to redeem all shares of the Preferred Stock then outstanding in March 2012, at a redemption price equal to the liquidation preference, payable in cash or, at our option, in shares of WebMD common stock. Upon the occurrence of certain events constituting a change in control of WebMD or certain significant acquisitions by WebMD of businesses that are not related or complementary to its businesses, holders of the Preferred Stock will have the right to put their shares to WebMD at a purchase price equal to the liquidation preference of the Preferred Stock.

If the average closing sales price of WebMD common stock during the three-month period ended on the fourth anniversary of the issuance date is less than \$7.50 per share, holders of the Preferred Stock will have a right to exchange the Preferred Stock into WebMD's 10% Subordinated Notes due March 2010. The Notes may be redeemed, in whole or in part, at any time thereafter at WebMD's option at a price equal to 105% of the principal amount of Notes being redeemed.

**Table of Contents**

Holders of Preferred Stock will not receive any dividends unless the holders of common stock do, in which case holders of Preferred Stock will be entitled to receive ordinary dividends in an amount equal to the ordinary dividends the holders of Preferred Stock would have received had they converted such Preferred Stock into common stock immediately prior to the record date for such dividend distribution. So long as the Preferred Stock remains outstanding, WebMD is required to pay a quarterly fee to CalPERS/PCG of 0.35% of the face amount of the then outstanding Preferred Stock.

We have agreed that we will not, without the prior written consent of holders of 75% of the shares of Preferred Stock then outstanding, issue any additional shares of Preferred Stock or create any other class or series of capital stock that ranks equal or senior to the Preferred Stock. We also have agreed to use our reasonable best efforts to amend our charter at our next Annual Meeting of Stockholders to provide that the holders of the shares of Preferred Stock will have the right to vote, together with the holders of WebMD common stock, on matters that are put to a vote of holders of WebMD common stock, with holders of Preferred Stock having the right to cast the number of votes that could be cast by a holder of the WebMD common stock into which the Preferred Stock would be convertible immediately prior to the record date for the vote.

Holders of the shares of WebMD common stock issued upon conversion of the Preferred Stock and any shares of the WebMD common stock issued upon satisfaction of our right to redeem Preferred Stock will have certain registration rights in respect of their shares of common stock, beginning in March 2006.

WebMD intends to use the net proceeds from the private placement for general corporate purposes, which may include acquisitions.

**Table of Contents**

**HEALTHCARE INFORMATION SERVICES AND TECHNOLOGY SOLUTIONS**

There are many types of transactions, information exchanges and other communications that occur between the various participants in the healthcare industry, including physicians, patients, pharmacies, dentists, hospitals, billing services, commercial health insurance companies, pharmacy benefit management companies, managed care organizations, state and federal government agencies and others. We offer a comprehensive suite of transaction and information services and technology solutions to healthcare industry participants. These integrated and stand-alone products and services are designed to facilitate transactions, information exchange and communication among healthcare industry participants and to operate on various platforms, including the Internet, private intranets and other networks.

---

***WebMD Health***

**Overview**

WebMD Health, our Portal Services segment, offers a variety of online resources and services for consumers and healthcare professionals, including:

WebMD Health, our consumer portal, which is located at *www.webmd.com*. WebMD Health provides access to health and wellness content. We also distribute our content, and reach additional consumers, through AOL Health with WebMD and MSN Health with WebMD. In addition, WebMD Health offers paid subscription services that provide consumers with access to interactive tools, personalized in-depth content and expertise from leaders in their fields.

*Medscape from WebMD*, our portal for physicians and allied healthcare professionals, which is located at *www.medscape.com*. At Medscape, physicians and other healthcare professionals have access to resources that include timely medical news and professional conference coverage, continuing medical education activities, full-text medical journal articles and drug and medical literature databases. We also license our content to health plans and other healthcare partners for use on their Web sites, in some cases as part of providing a co-branded site and in some cases on a private label basis under the partner's branding.

We reach a large audience of health-involved consumers and clinically active healthcare professionals. We work closely with pharmaceutical, medical device and other healthcare companies to develop innovative online channels of communication to our audience, or specific portions of our audience, that complement their offline education, marketing and customer service programs. These companies can sponsor specific pages or sections of our portals or specific events, programs and newsletters, all of which are clearly labeled as sourced from or sponsored by the specific sponsor. In addition, sponsors can reach specific demographic groups, condition-specific groups or specialty-specific groups through our portals and through newsletters that members have requested based on their interests. Performance of our sponsored programs, including the aggregate number of impressions, visitors and actions taken, is tracked and reported to the sponsor on a regular basis.

Through our WebMD Health Services business, we provide web-based tools and applications to employers and health plans for use by their employees and plan members. These tools and services provide a framework for better decision-making by healthcare consumers and can assist employers and plans in managing demand while improving quality of care.

We generate the majority of our Portal Services revenue by selling sponsorships of specific pages, sections or events on our portals and related e-mailed newsletters, by selling advertising on our portals and the online and offline properties of our strategic partners, and by licensing our content and our online tools and related software and services. Historically, the majority of our Portal Services revenues have come from a small number of companies. Our WebMD Health customers include pharmaceutical, biotech and

## **Table of Contents**

medical device companies, employers and health plans and media distribution companies. WebMD Health also receives a small portion of its revenues from the sale of paid subscription services.

### **WebMD Health Consumer Portal**

*General.* Consumer interest in convenient and reliable sources of general information on health and wellness topics continues to grow. In addition, consumers increasingly seek to educate themselves about available treatment options for specific health conditions or injuries. We believe that these trends are likely to continue, as consumers are asked to bear an increasingly large share of their healthcare expenditures due to changes in the design of the medical plans and prescription drug plans being offered by payers and employers. Traditional media have sought to meet this demand by introducing magazines focused on health and wellness and by increasing news coverage of healthcare-related issues. The Internet allows us to offer consumers the resources they are looking for, with immediate access to searchable information and dynamic interactive content.

WebMD Health provides access to health and wellness news and information, support communities, interactive tools and opportunities to purchase health-related products and services. There are no membership fees and no general usage charges for the site; however, we do charge usage or subscription fees for some premium content and services. See [WebMD Health Subscription Services](#) below.

*Content Offerings.* The content and service offerings on WebMD Health include:

*Original and Licensed Content.* We offer proprietary, medically reviewed health and wellness news articles written daily by our staff of journalists. We also offer searchable access to a library of health and wellness articles, reference information and interactive presentations, some of which we own and some of which we have licensed from others. Our articles and other content cover various health-related topics, including: specific diseases and chronic health conditions, medical tests, pregnancy and parenting, diet and nutrition, fitness and sports medicine, and sexuality and relationships.

*Membership.* Consumers can choose to become members of WebMD Health, which allows them to make use of certain WebMD interactive content and services. Members can also select from more than 32 different e-mail newsletters on health-related topics or specific conditions and have access to our communities and events, as described below. We have built a large consumer membership, most of whom have chosen to receive our clinical alerts, newsletters and reports on specific diseases, conditions and other health and wellness topics.

*Communities.* Our communities allow our members to participate in real-time discussions in our chat rooms and on our message boards. Members can share experiences and exchange information with other members who share their health condition or concern. Members can also use our [Ask the Experts](#) service to post their health questions for experts.

*Events.* Our events include one-time programs and series in which experts make presentations and answer questions on specific health-related topics. Our events also include WebMD University programs, which are four week courses, live moderated by experts, on specific subjects. WebMD University programs have included: Take Charge of Your Diabetes; Feeding Your Self, Feeding Your Baby; Alive and Well, Taking Charge of Your Breast Cancer Treatments; and Stories of Survivors, Your Breast Cancer Guide.

*Interactive Personal Health Management Tools and Other Features.* We provide access to interactive tools, calculators, quizzes and illustrated guides and slide shows on health topics. Our interactive tools include a pregnancy calendar, body mass index tool and a calorie counter. Our slide shows cover topics such as mammograms, fetal positions and common visual problems.

*Physician Directory and Related Services.* WebMD Health also has features that allow consumers to search for a physician or clinic in their area. The WebMD Physician Directory contains information on practicing physicians throughout the U.S. Users can search for a doctor by location

## **Table of Contents**

or specialty and based on HMO or hospital affiliations. The WebMD Physician Directory is provided by The Little Blue Book, which was acquired by WebMD in 2003. See Physician Directory Services below.

*WebMD Health Subscription Services.* WebMD Health also offers the following paid subscription services, which provide access to exclusive interactive tools, personalized in-depth content and expertise from leaders in their fields:

*WebMD Health Manager.* We offer, on a subscription basis to individual consumers, a suite of healthcare decision-making tools and related services, which includes some of those we license to health plans and employers for use by their members and employees. See WebMD Health Services Group below.

*WebMD Weight Loss Clinic.* The WebMD Weight Loss Clinic is a subscription service that provides members with a customized eating plan based on individual food preferences and other information and resources relating to weight loss.

*WebMD Fertility Center.* The WebMD Fertility Center provides information, tools and personalized e-mail reminders relating to fertility, conception and pregnancy.

### ***Medscape from WebMD***

*Medscape from WebMD* is designed to meet the information needs of medical professionals. *Medscape from WebMD* is organized by medical specialty area, such as hematology-oncology and cardiology, to make it easier for members to access the information most relevant to them. We also have areas organized by profession or interest area, including sites for nurses, pharmacists, medical students, users interested in medical policy and practice management issues, and members with a particular interest in technology and medicine. Our extensive and up-to-date medical content and easy-to-use search capabilities assist medical professionals in keeping abreast of medical advances and obtaining fast, accurate answers to medical questions online. There are no membership fees and no general usage charges for the site; however, we do charge usage or subscription fees for some premium content and services.

Our content and service offerings, a combination of original material and content licensed from major professional publishers, are generally presented by specialty and include:

*Continuing Medical Education (CME).* More than 30 states and many medical specialty societies require physicians and selected other medical professionals to certify annually that they have accumulated a minimum number of CME hours to maintain licensure or membership. We offer a selection of free, regularly updated CME activities for physicians, registered nurses, pharmacists and other healthcare professionals, including original programs and online multimedia adaptations of live events. In addition, our CME Live offerings provide real time webcasts of CME programs on key topics and conditions, designed to educate healthcare professionals about timely clinical issues. These webcasts combine streaming audio and slide presentations and allow participants to interact with faculty. We also provide services that track CME credits accumulated through our site for our users. Many of our CME-certified programs also carry Continuing Education (CE) credit for nurses and/or pharmacists.

All of our CME activities have been planned and implemented in accordance with the Essential Areas and Policies of the Accreditation Council for Continuing Medical Education, or ACCME, which oversees providers of CME credit, and have been produced in collaboration with ACCME-accredited CME providers. In August 2002, ACCME awarded Medscape a two-year, provisional accreditation as a CME provider, allowing Medscape to certify online CME activities, which Medscape now does for most of its CME programs. We are currently in the process of seeking full accreditation.

In July 2002, Pharmaceutical Research and Manufacturers of America (PhRMA), a trade association of pharmaceutical manufacturers, instituted a new voluntary Code on Interactions with

**Table of Contents**

Healthcare Professionals, which outlined guidelines for how sales representatives and others involved in marketing pharmaceuticals should interact with healthcare professionals. The PhRMA Code is intended to help ensure that these interactions benefit patients and enhance the practice of medicine and to avoid concerns about inappropriate influence on the prescribing practices of physicians. The PhRMA Code provides that these interactions should not consist of entertainment, dining or recreation, but should focus on informing the healthcare professional about scientific and clinical information and supporting research and education. While providing subsidies directly to healthcare professionals for travel, lodging and other expenses of attending CME or scientific conferences is no longer permitted, sponsorship or underwriting of CME programs or conferences continues to be. We believe that the guidelines contained in this Code are likely to benefit providers of online CME and other online informational materials for healthcare professionals, such as Medscape, as pharmaceutical manufacturers seek efficient, effective and appropriate sponsorships and channels of communication.

*Newsletters.* Members receive MedPulse, our weekly e-mail newsletter, which is published in more than 25 specialty-specific editions and highlights new information and CME activities on the Medscape site of interest to each particular specialty. We also provide commercially supported Special Reports newsletters, which contain information on specific conditions and treatments.

*Medical Conference Coverage.* We provide overviews and analysis of key data and presentations from about 150 professional meetings each year, including major conferences in a variety of specialties. This benefits our members who were unable to attend and those who did attend but might not have been able to see all of the presentations of interest to them, as well as the sponsors of the conferences, by increasing the size of the audience exposed to this material. We cover a number of these conferences in collaboration with the societies and organizations that present them.

*Medical News and Clinical Alerts.* We provide original, daily medical news stories written by our staff of journalists and reviewed by our staff of physicians, in addition to news provided by professional wire services. Our news group also regularly produces analytical reports based on interviews with experts and newsmakers. In addition, we provide real-time alerts on such critical clinical issues as pharmaceutical recalls and product advisories.

*Resource Centers.* Resource Centers are regularly updated collections of clinical content, selected by Medscape's editors, focused on a specific topic, condition or theme. Content includes news, journal articles, conference coverage, expert columns and CME programs. Medscape currently has more than 60 Resource Centers across multiple specialties.

*Electronic Journals.* Medscape publishes an original electronic-only journal, *Medscape General Medicine (MedGenMed)*, indexed in the National Library of Medicine's MEDLINE reference database. *MedGenMed*, the world's first online-only, primary source, peer-reviewed general medical journal, was established in April 1999. As of March 2004, it had published more than 1,100 papers. Since December 2002, *MedGenMed* at [www.medgenmed.com](http://www.medgenmed.com) has included specialty sections for HIV-AIDS, Gastroenterology, Hematology-Oncology, Pulmonary Medicine, OB-Gyn and Women's Health, Orthopedics and Sports Medicine and Psychiatry/ Mental Health, Neurology, and Technology and Medicine. Medscape also publishes *Topics in Advanced Practice Nursing*, which is indexed in CINAHL, the Cumulative Index of Nursing and Allied Health Literature.

*Medscape Publishers Circle.* Medscape Publishers Circle is a collection of high-quality clinical information from prominent medical publishers, available free to registered Medscape members.

*Medical Reference Applications.* Our medical reference applications include access to various medically related databases and abstracts.

*Medical Reference Services.* These services include the professional medical reference texts *ACP Medicine* (formerly *WebMD Scientific American® Medicine*) and *ACS Surgery: Principles and Practice* (formerly *Scientific American Surgery*), each available for sale by subscription to individual physicians and to institutions in multiple formats (print, CD-ROM and Online). *ACP Medicine* has



## **Table of Contents**

been a comprehensive and continually updated internal medicine reference for 25 years. *ACP Medicine* and *ACS Surgery* are official publications of the American College of Physicians and the American College of Surgeons, respectively, although wholly owned by WebMD.

Users must register as members to utilize the features of *Medscape from WebMD*. This enables us to deliver targeted medical content based on our members' registration profiles. The registration process enables professional members to choose a home page tailored to their medical specialty or interest. For example, a member registered as a cardiologist is automatically directed to Medscape Cardiology, rather than a more generic home page.

### **WebMD Health Services Group**

Through the WebMD Health Services Group, formerly known as WellMed, we provide employers and healthcare plans with a suite of online tools and related services called the WebMD Health Hub. The WebMD Health Hub integrates health and wellness content, a personal medical record, health assessment tools, decision support tools, health improvement programs and targeted messaging. The WebMD Health Hub provides a framework for better decision-making by healthcare consumers and allows employers and health plans to manage demand, while improving the quality of care and reducing administrative and communication costs. We receive fees from employers for use of our applications and services by their employees, and from health plans for use by their members. The WebMD Health Hub is also distributed through relationships with providers of benefits-related services as a part of their own offerings to employers.

WebMD Health Hub applications are integrated into the client's Intranet or Web site and work with the client's specific health and benefit programs, disease management vendors and other health-related systems and content and can be co-branded or customized to match client branding and look and feel. The core products and applications that make up the WebMD Health Hub are Personal Health Manager, Personal Health Insight, Personal Health Decisions and HubX:

*Personal Health Manager* is a suite of consumer applications that provides a personalized framework to manage health, wellness and benefit information and facilitate healthy behavior, including health risk and condition assessment tools, an online personal health record and health and lifestyle improvement programs.

*Personal Health Insight* is an online service center that provides specialized decision-support for clients, including aggregated information regarding utilization of the WebMD Health Services platform and results of messaging campaigns. With Personal Health Insight, employers and plans can analyze aggregate health data in real time, address population health risks and proactively implement preventive programs.

*Personal Health Decisions* is a set of benefit decision-support applications that explain benefit plan choices and facilitate informed selection and use of those benefits.

*HubX* is a platform that integrates employer or plan applications and data into the WebMD Health Hub. In addition, the HubX Data Interchange option provides functionality to import data, such as healthcare claims and medication claims, for greater personalization and targeted messaging and to export self-reported information from the WebMD Health Hub to care providers.

By educating and encouraging their employees and plan members to take a more active role in their healthcare, employers and plans can realize cost savings from more informed decision-making, while also improving healthcare outcomes. Other potential benefits to an employer or plan include efficiently identifying and enrolling candidates in disease management or other health management programs.

### **Physician Directory Services**

In 2003, we acquired the company that publishes The Little Blue Book, a leading source of practice contact information for physicians since 1988. The pocket-sized reference book is published annually in 146 distinct metropolitan editions. Physicians utilize it for local and up-to-date physician information. All physicians are listed free of charge in their local metropolitan-area edition, along with their specialties,

## **Table of Contents**

HMO affiliations, hospital affiliations, office addresses, telephone numbers and Medicare-assigned Unique Physician Identification Number (UPIN). The database used to create The Little Blue Book contains practice information on approximately 400,000 practicing physicians. WebMD Health receives revenues from sales of The Little Blue Book, as well as from sponsors and advertisers in those books, most of whom are pharmaceutical companies. Pharmaceutical companies also purchase copies of The Little Blue Book for distribution to physicians. In addition, we use the database to provide physician information on the consumer portal. We also publish and sell to physicians The Little Yellow Book, a directory of physicians' fax and e-mail information for 146 metropolitan areas.

## **Sales and Marketing**

A team of sales, marketing and account management personnel represents WebMD Health and *Medscape from WebMD* to pharmaceutical companies, medical device companies, health plans and other healthcare and consumer companies. These individuals work closely with clients and potential clients to develop innovative means of using our portals to bring their companies, and their products and services, to the attention of target groups of consumers and healthcare professionals and to create channels of communication with these audiences.

A separate team of sales, marketing and account management personnel represents WebMD Health Services Group to employers and health plans. These individuals customize our services for each client according to the client's specific plan design and business objectives. We also promote and distribute WebMD Health Services Group through relationships with employee benefits consultants and other companies that assist employers in purchasing or managing employee benefits.

We seek to attract traffic and new members to WebMD Health through a variety of methods, including online and offline media campaigns. The primary focus of our media campaigns has been member registration. We promote WebMD Health's subscription services through our consumer portal and our e-mailed newsletters.

We seek to attract traffic and new members to Medscape through a variety of methods, including advertising on other Internet sites and in medical journals, pharmaceutical and other healthcare publications and other targeted publications. We also promote Medscape at industry conferences, trade shows and medical meetings and by using direct mail.

---

## ***WebMD Envoy***

## **Overview**

To ensure timely reimbursement and comply with managed care requirements, healthcare providers must interact effectively with healthcare payers from the first point of patient contact until final payment has been received. Unfortunately, in these interactions, providers and payers often juggle a confusing combination of electronic and manual processes, phone calls and faxes, and disparate software systems. WebMD Envoy, our Transaction Services segment, provides an electronic link between payers and providers that allows them to conduct medical, pharmacy and dental transactions electronically. However, WebMD Envoy provides much more than just a clearinghouse connection—we provide electronic reimbursement cycle management solutions that can be used by payers and providers to automate the entire reimbursement process. In addition, as a complement to our electronic transmission services, our WebMD ExpressBill operations provide print-and-mail services to providers, including patient statement processing, and, through Advanced Business Fulfillment, Inc., which we acquired in July 2003, we provide healthcare paid-claims communications services for third-party administrators and health insurers, including print-and-mail services for the distribution of checks, remittance advice, and explanations of benefits. We also provide connectivity and tools for automating clinical functions.

The customers for WebMD Envoy's services consist of healthcare providers, such as physician offices, dental offices, billing services, national laboratories, pharmacies, hospitals, and healthcare payers, including Medicare and Medicaid agencies, Blue Cross and Blue Shield organizations, pharmacy benefit management companies, commercial health insurance companies and managed care organizations.

## **Table of Contents**

Healthcare payers and providers pay fees to us for our services, generally on a per transaction basis or, in the case of some providers, as a flat rate per month. Transaction fees vary according to the type of transaction and other factors, such as volume level commitments. We may also charge one-time implementation fees to providers and payers. A significant portion of our WebMD Envoy revenues come from the country's leading national and regional healthcare payers.

We work with numerous medical and dental practice management system vendors, hospital information system vendors and other service providers to provide integrated transaction processing between their systems and our clearinghouse. Most practice management and hospital information systems support, and can be integrated with, WebMD Envoy transaction services. Many practice management system vendors, including WebMD Practice Services, market a private label brand of our transaction services that they have integrated with their systems. We pay a sales commission, based on volume, to some of these vendors as an inducement to use WebMD Envoy. We have long-standing relationships with many vendors of practice management systems. Medifax-EDI, which we acquired at the end of 2003, has similar relationships with vendors of hospital information systems. We work together with these vendors to increase the percentage of healthcare transactions that are handled electronically.

### **EDI Transaction Services**

*General.* We provide our payer and provider customers connectivity and transaction services through an integrated electronic transaction processing system, which includes proprietary software, host computer hardware, network management, switching services and interfaces. We refer to these services as electronic data interchange, or EDI. Our EDI transaction services reduce paperwork and the need for communication by mail, telephone and fax, resulting in cost savings for payers and providers. These services also expedite the reimbursement process, which can result in a lower average number of outstanding accounts receivable days for providers. A further benefit to payers is that they are able to more easily detect fraud and screen for unusual utilization trends.

Providers access our transaction services both directly and through their relationships with integrated delivery networks, clinics, physician and dental practice management system vendors, hospital information management system vendors, and retail pharmacy chains. Providers initiate transactions using our proprietary applications, their practice management systems or other computer systems or networks. Providers submit transactions to our clearinghouse by modem connections using regular telephone lines, using dedicated high speed telecommunications services and over the Internet. At our clearinghouse, the transaction is edited for accuracy, validated for format and completeness, then translated in accordance with the payer's specifications and sent to the payer's claims adjudication and/or real-time database systems.

We maintain direct connections with many healthcare payers, including Medicare contractors and Medicaid agencies, Blue Cross and Blue Shield organizations, commercial health insurance companies, pharmacy benefit management companies and managed care organizations. Our direct payer connectivity facilitates high levels of service by minimizing the number of intermediaries between the provider and the payer. Our direct connections with payers typically consist of dedicated networks between the payer and our clearinghouse. Most transactions are currently transmitted to the payers using our proprietary software and dedicated telephone lines, with some transmitted securely over the Internet. Other clearinghouses also use our services to transmit transactions that they have received from providers to payers. We make payments, based on volume, to some of these clearinghouses as an inducement to use WebMD Envoy to complete the transactions submitted through their systems.

*Medical and Dental Administrative Services.* Our medical and dental administrative services provide the connectivity and transaction processing services needed for providers and payers in the healthcare

## **Table of Contents**

industry to automate key business functions and communicate with each other. WebMD Envoy provides connectivity throughout the healthcare reimbursement cycle:

beginning with insurance eligibility verification,

continuing through the claim submission process,

followed by tracking the reimbursement through claim status inquiries, and

concluding with electronic remittance information and payment posting.

Providers can submit real-time or batch claims to us for processing and reimbursement by payers and inquire as to the status of claims previously submitted. Most claims are submitted to us as batch claims, which are collected by providers throughout the day and submitted to us in bulk. We then sort, format and edit the claims to meet each particular payer's requirements before transmission to the payer. Providers can receive an electronic remittance advice which provides payer payment information and an explanation of the settlement of a related claim. Providers can also use our services to verify patient enrollment and eligibility and to obtain authorization from payers, at the point of care, for services and referrals to other providers. Our acquisition of Medifax-EDI at the end of 2003 has strengthened our service offerings for these types of transactions.

Our all-payer suite of services includes the capture, validation and routing of claims transactions on behalf of not just commercial payers, but also Blue Cross Blue Shield payers, Medicare and Medicaid. Additionally, our all-payer services include the return of an electronic remittance transaction, which is the equivalent of a paper explanation of benefits, or EOB, from all the payers back to the originating provider. The goal is to provide a single source EDI reimbursement cycle management solution for providers and practice management system vendors. A single EDI solution reduces administrative burdens on the provider office in sending claims transactions and receiving electronic remittance advice transactions and, more importantly, allows us to provide a single report back to the provider office regarding those transactions. That, in turn, allows the provider office to determine more easily whether it has been paid on a particular claim and how much. Provider offices without such a solution typically receive five or more different reports that they then have to reconcile in order to manage their accounts receivable. Implementation of our all-payer services has presented technical, operational and customer service challenges and has resulted in a large increase in the amount of transactions we transmit to Blue Cross Blue Shield payers, Medicare and Medicaid which, in certain cases, has caused service delays. In addition, this implementation, happening together with the implementation of the HIPAA Transaction Standards, has required, and continues to require, system upgrades, additional programming and changes in our processes and procedures. We have been incurring, and expect to continue to incur, significant expenses relating to the all-payer implementation, including system upgrades and testing and related quality assurance activities.

We provide various products designed to assist healthcare providers and payers in utilizing our administrative services, including:

*WebMD Office.* Through our WebMD Office Internet-based service, providers can securely access our transaction services through either a standard dial-up or high speed DSL or cable modem. WebMD Office can be used as a stand-alone system or as a complement to a practice management system through an import and data management function that allows transactions to be generated from the practice management system and submitted through WebMD Office. In addition, our practice management system vendor partners may elect to market a private-label brand version of WebMD Office.

*AccuClaim Plus.* Our AccuClaim Plus solution is designed for the claims submission processes of hospitals and large physician practices. AccuClaim Plus interfaces with their existing management systems, importing claim files and subjecting them to payer-specific edits, prompting users to correct claim errors prior to submission to payers in order to minimize the claim rejection rate while increasing the first pass and auto-adjudication rate at the payer's adjudication system.

## **Table of Contents**

*WebMD Empower.* WebMD Empower is an EDI-enabling software and data hosting solution that gives healthcare payers the ability to automate communication with their providers through our network, using our infrastructure. WebMD Empower takes claims data submitted to the WebMD Envoy clearinghouse, applies value-added editing, including checks against payer-specific business rules and data, and sends it directly to the payer's information system. For real-time transactions, WebMD Empower works by downloading appropriate eligibility, provider, benefit, referral/authorization and claims data from the payer's system onto our server. Downloads are performed periodically or in real time as information in the payer's database is updated.

*Medifax Assistant.* Medifax Assistant integrates with hospital information systems (HIS) to automate various registration activities such as insurance eligibility verification, credit checking and address verification. Medifax Assistant can be configured to automatically perform real-time tasks during patient registration. This saves the registration staff time by eliminating the need to use separate systems for registration and for eligibility verification. The eligibility response can be automatically stored within the patient record as a permanent reference.

*Medifax Receivable Analysis.* Medifax Receivable Analysis is an electronic screening service designed to verify Medicaid and other forms of insurance eligibility in an electronic batch format. The healthcare provider submits a file electronically and the file is processed against the Medifax-EDI payer databases to determine eligibility. Medifax customers use this service to identify Medicaid and other forms of eligibility that may apply to patients who have been classified as not having coverage. The resulting reclassification often results in significant reimbursements.

*Pharmacy Administrative Services.* A typical pharmacy benefit transaction takes place in a real-time setting using a pharmacy management system or other claim submission product. The claim is submitted to WebMD Envoy in a standard format and includes all required information about the prescription. The claim is then routed to the appropriate adjudicating processor where the claim is processed within seconds. Response information includes patient coverage, formulary compliance (specific drug coverage), potential drug interactions, patient's co-payment due and anticipated reimbursement amount due to the pharmacy from the payer. Final dollar amounts due to the pharmacy are typically paid by the payer 15-30 days after claim submission.

*Lab Ordering and Reporting Services.* We provide clinical lab ordering and reporting services through WebMD Clinician, our Internet-based product. This product supports the ordering of clinical tests and the reporting of test results between healthcare providers and labs. WebMD Clinician reduces costs and improves the quality of patient care by improving order entry accuracy and expediting the delivery of lab results, while enhancing the ability to share those results with multiple physicians. In addition, we provide similar services to practice management system vendors, hospital information system vendors and electronic medical record vendors through an application programming interface known as Clinician eXT.

## **Other Communications Services**

*ABF.* In July 2003, WebMD Envoy acquired Advanced Business Fulfillment, Inc., which we refer to as ABF, a provider of healthcare paid-claims communication services for healthcare payers. ABF's operations are supported by proprietary software and systems that allow healthcare payers to outsource print-and-mail activities by sending an electronic feed to ABF. By outsourcing these services to ABF, its clients can reduce operating costs and capital expenditures. ABF's systems include a Web-based suite of management tools to facilitate the printing and mailing of checks and remittance advice to providers and EOBs to plan members. These management tools allow clients to control the processes they have outsourced to ABF and to access archived data from their desktops. ABF has worked closely with leading claims processing system vendors to allow its software to interface with their systems. In return for marketing ABF's post-adjudication services and for the creation and maintenance of an ABF-specific data extract, ABF makes periodic payments to vendor partners based on transaction volumes.

Healthpayers USA is ABF's proprietary program to cross-consolidate provider mail in order to create savings in postal costs for its clients. Healthpayers USA screens, sorts and consolidates mail from any

## **Table of Contents**

number of its clients destined for a single provider into one package and automatically produces a recipient cover sheet that itemizes the contents. ABF and its clients share the resulting postal savings.

*WebMD ExpressBill.* Through WebMD ExpressBill, we provide print-and-mail services to healthcare practitioners, hospitals and high volume commercial customers throughout the United States. WebMD ExpressBill accepts client data via modem or the Internet, generates printed materials and prepares them for mailing. Our WebMD ExpressBill services include:

*Patient Mailings.* On behalf of healthcare provider customers, we print invoices, account statements, collection letters, recall notices and other communications and mail them to patients.

*Paper Claims.* Claims that cannot be sent electronically to payers can be sent by healthcare providers electronically to WebMD ExpressBill, where we print and mail them on their behalf.

*Payment Processing.* We process payments on behalf of providers and other customers, receiving and depositing checks, posting payments and transmitting funds in accordance with customer instructions.

*Electronic Payment Services.* Our electronic payment services offer healthcare providers the ability to receive payment via the Internet.

## **HIPAA**

Under the Healthcare Insurance Portability and Accountability Act of 1996, or HIPAA, Congress mandated a package of interlocking administrative simplification rules, including rules to establish standards and requirements for the electronic transmission of certain health information, which we refer to as the Transaction Standards. As a supplier of EDI-enabling products and connectivity services to patients, payers, providers and third party vendors, WebMD Envoy is affected by many of the HIPAA provisions, including the Transaction Standards.

In order to implement the Transaction Standards, WebMD Envoy has made and continues to make significant changes to its systems and the software it uses internally. Similarly, the implementation has required payers and providers to simultaneously implement changes to their systems and/or internal procedures. As a result, this implementation process and related testing has been an immense challenge for the healthcare industry, including WebMD. However, it also represents a great opportunity for the industry and for us, because it encourages payer/provider connectivity to evolve from its current focus on the sending and receiving of claims to automating ancillary transactions, such as eligibility, status or remittance.

We believe that, even though the intent of HIPAA was to make electronic transactions more standardized, the use of clearinghouses will continue to be the most efficient way for most providers to send their electronic claims and related transactions to multiple payers. The standardization resulting from implementation of Transaction Standards is only partial: payer systems and requirements continue to vary in certain respects even after HIPAA implementation and will continue to evolve and change in the future. Payers have published approximately 440 Companion Guides setting forth their individual interpretations of the Transaction Standards and that number can be expected to continue to grow. These payer-specific interpretations require us to perform extensive customized programming and related testing. Another source of the implementation challenges resulting from the Transaction Standards is the increase in computing capacity required. The Transaction Standards formats are much larger than the pre-existing ones. We are utilizing more computing capacity than we had anticipated. As a result, our systems have experienced inefficiencies that have resulted in processing delays. Another difficulty for us and our provider customers results from the fact that the Transaction Standards cover not only transaction formats, but also required content, including some content not previously collected by most providers. We continue to work with payers, providers, practice management system vendors and other healthcare participants to implement the Transaction Standards. For more information regarding challenges involved in such implementation and a description of the HIPAA regulations, see Business Government Regulation Health Insurance Portability and Accountability Act of 1996 below.

## **Table of Contents**

### **Sales and Marketing**

Our WebMD Envoy sales and marketing efforts are conducted by sales, marketing and account management personnel located throughout the United States. We participate in trade shows and use direct mail and various advertising media to promote our services.

We promote our EDI services to organizations that have relationships with or access to a large number of providers, such as practice management systems vendors, hospital information systems vendors, practice management companies and other clearinghouses. In certain cases, we agree to pay a sales commission based on transaction volume to these organizations as an inducement to use WebMD Envoy as the clearinghouse for the transactions made through their systems or by providers with which they have relationships.

We also market our EDI services directly to healthcare payers, as well as to small and large physician practices, dentists, hospitals and other healthcare providers. We offer our payer customers the opportunity to work with us in targeted programs to educate physicians and dentists to increase the utilization of electronic services. When a payer agrees to participate in such a program, WebMD utilizes information supplied by the payer to target providers that may not be sending claims electronically.

In the pharmacy EDI area, WebMD Envoy has established relationships with large retail pharmacy chains and pharmacy software vendors.

In the post-adjudication services area, we have established relationships with vendors of claims processing software. Our ABF account management personnel also market directly to healthcare payers and, as part of their sales effort, provide potential clients with an operational audit and identify the efficiencies that we believe we can help them achieve.

---

### ***WebMD Practice Services***

#### **Overview**

WebMD Practice Services, our Physician Services segment, develops and markets information technology systems for healthcare providers, primarily under The Medical Manager, Intergy, ULTIA and Medical Manager Network Services brands. Our systems include administrative and financial applications that enable healthcare providers and their administrative personnel to manage their practices more efficiently and clinical applications that assist them in delivering quality patient care. These applications and related services:

automate scheduling, billing, receivables management and other administrative and financial management tasks,

enable providers to maintain electronic medical records and to automate the documentation of patient encounters, and

facilitate the use of electronic data interchange for administrative and clinical healthcare transactions.

We expect that most of our future sales of practice management systems will be Intergy systems. However, we intend to continue to develop and support The Medical Manager system, which is currently the most widely used physician practice management system in the United States.

Healthcare providers pay us a one-time license fee for the purchase of a license to our software or to additional software modules and for system hardware and also pay us recurring fees for the maintenance and support of our software. Many providers also pay us recurring fees for the provision of hardware support and maintenance. Pricing depends on several factors, including the number and type of modules to

## **Table of Contents**

be licensed, the number of users per site, the number of practices, the operating system, the hardware to be supported and the complexity of the installation. Healthcare providers pay us fees for our Medical Manager Network Services transactions services, generally on a per provider per month subscription basis or a per transaction basis.

### **Practice Management Systems**

*Intergy.* Intergy, our new practice management software product, is the result of a significant, multi-year commitment to engineering and development of a completely new practice management system. The Intergy system's graphical user interface (GUI) packages complex medical practice functions into easy-to-navigate windows with consistent point-and-click drop down menus and buttons. The Intergy software operates on Windows and UNIX based servers, together with Windows based workstations.

Intergy systems are scalable to meet the needs of a wide variety of healthcare provider settings, from small physician groups to large clinics, and across various medical specialties. Customers can purchase a base system and then add additional modules and services over time to expand their use of technology as needed. The Intergy base package allows an office to automate appointment scheduling and recalls, registration, encounter form management, billing, collections and other administrative and financial functions. The Intergy system also has a customizable security system, with access to functions and features that can be defined for each user based on practice policies and procedures.

One of our optional Intergy administrative and financial modules is the managed care system, which provides functions required to track incoming and outgoing referrals to facilities and specialists and to provide risk management capabilities. The managed care system assists providers in automating referral management, capitation payment posting, and contract management and profitability tracking. The system is designed to work in all managed care scenarios, including primary and specialty care. Optional clinical modules include imaging systems, tools that can be used to create and maintain electronic medical records and automate the documentation of patient encounters at the point of care, manage clinical workflow, write and send electronic prescriptions, and request and review laboratory tests and results. We believe that there is a significant opportunity to increase the use by physician practices of electronic medical record systems and are focusing on cross-selling these products and services to our existing customers and as part of our new systems sales. See *EMR and Imaging Systems* below for descriptions of these products and services. Intergy users can also elect to implement some or all of the integrated products and services described below under

*Additional Products and Services*, including our ULTIA handheld wireless device and our Medical Manager Network Services connectivity services.

*The Medical Manager.* The Medical Manager system provides physician practices with a broad range of patient care and practice management features. We also offer The Medical Manager system in customized versions to meet the functionality needs of public health and community health markets and family planning clinics and intend to continue to market The Medical Manager system in these formats.

The Medical Manager software's base package serves as the foundation of the system and includes an appointment scheduler, billing system, financial management system and other features. Additional modules containing advanced administrative and financial features are also available, including automated collections, advanced billing and multiple resource scheduling and managed care modules. The Medical Manager system also has optional electronic medical record and document and image management system products. See *EMR and Imaging Systems* below. The Medical Manager users can elect to implement some or all of the integrated products and services described below under *Additional Products and Services*, including our ULTIA handheld wireless device and our Medical Manager Network Services connectivity services.

*Other Practice Management Systems.* Through our acquisitions of various businesses, we have also obtained ownership of other practice management systems with smaller user bases, including the practice management systems previously owned by Physician Computer Network, Inc., or PCN. We currently support these other systems and may provide periodic updates to the users of some of these systems. We face competition for the support services we market to users of these practice management systems. See



**Table of Contents**

Competition for Our Healthcare Information Services and Technology Solutions below. In addition, although we seek to market our Intergy practice management system to these customers when they are evaluating the purchase of a new system, we face competition from numerous other vendors of practice management systems. If our existing customers choose a practice management system from a competing vendor, they will no longer need support services from us. Loss of a significant number of these customers could have a material adverse effect on our Practice Services revenues.

**Medical Manager Network Services**

Our practice management systems support integrated use of our WebMD Envoy EDI services through Medical Manager Network Services. For a description of WebMD Envoy s EDI services, see WebMD Envoy above. The administrative transactions supported include electronic claims, claims status inquiry, eligibility verification, electronic referral authorization/status, patient statements and remittances. We also provide connectivity to laboratories, pharmacies, third party connectivity networks and hospitals and credit card authorization services. Users of our practice management systems can also choose third party EDI transaction service providers to transmit their transactions.

Through Medical Manager Network Services, providers have access to EDI functionality that is integrated into their practice management workflow and recordkeeping systems. Integrated EDI allows providers and their staff to send and receive EDI transactions from within the practice management system and to generate reports regarding these transactions, including whether submitted claims have been accepted or rejected. These capabilities can be combined with our all-payer suite of transaction services to provide a single-source electronic reimbursement management solution (see WebMD Envoy above). In addition, our systems allow automated eligibility verification by contacting payers electronically overnight so that the practice can start the day with pre-checked eligibility and benefits for each scheduled patient. This information is stored as part of the patient s record. In addition, eligibility checking for unscheduled patients can be performed in real time.

As discussed more fully under Government Regulation Health Insurance Portability and Accountability Act of 1996 Transaction Standards below, the process of implementing the HIPAA Transaction Standards has been an immense challenge for the healthcare industry, including WebMD. However, it also represents a great opportunity for the industry and for us because it encourages payer/provider connectivity to evolve from its current focus on the sending and receiving of claims to automating ancillary transactions, such as eligibility, status or remittance. Implementation of our all-payer services has also presented technical, operational and customer service challenges. See WebMD Envoy EDI Transaction Services Medical and Dental Administrative Services above. We continue to work diligently to identify and resolve any service problems as they occur. We are also working to foster communication among healthcare industry participants regarding how to achieve the intended benefits of the Transaction Standards with as little disruption to healthcare payment systems as possible. We have been incurring, and expect to continue to incur, significant expenses relating to the Transaction Standards and all-payer implementations, including for testing, quality assurance and customer service activities.

Medical Manager Network Services also provides integrated access to our WebMD ExpressBill print-and-mail services for patient statements, collection notices and recall notices. Practices transmit the required data from Intergy or The Medical Manager systems to our processing center. From there, customized statements, letters and inserts and complete mailing services are provided. Customization options include logos and patient education inserts.

**EMR and Imaging Systems**

Healthcare providers record, use and share various types of clinical data about their patients, including patient histories, examination notes, lab results, medication orders and referrals. Much of this data is currently recorded in handwritten or printed form on paper records, often referred to as patient charts. As the amount of patient information maintained by a practice increases, so do the logistical challenges of

**Table of Contents**

moving paper charts from site to site and physician to physician. Many healthcare organizations are finding that the most promising solution to this challenge is the use of electronic medical record, or EMR, and imaging systems. These systems allow providers to share patient charts and other medical records, access them simultaneously and view them from remote locations. EMR systems not only help healthcare providers enhance clinical processes and patient safety, they also assist them in sharing information appropriately and efficiently and in collecting and managing the data necessary to meet the requirements of third-party billing procedures and contractual requirements.

Our suite of EMR applications allows healthcare providers that use Intergy or The Medical Manager practice management systems to computerize their patient records without disrupting the way they practice medicine. We also provide technical assistance and support that helps the practice transition from the paper chart to the fully electronic medical record. Our encounter documentation module automates the documentation of a patient encounter at the point of care. This product allows healthcare providers to generate progress notes and estimated evaluation and management service levels simply by pointing and clicking on the findings appropriate to a patient exam, reducing the need for transcription services and enhancing the accuracy of documentation of care provided. Customization tools allow the practice to create pre-defined, disease-specific templates, with lists of symptoms or other information that can be easily completed at any workstation.

Our EMR suite includes a prescription module that automates the process of writing and tracking prescriptions, providing improved efficiency with both the clinical and administrative aspects of the prescription process. The resulting prescription can be printed or called in to the patient's preferred pharmacy. With optional services through Medical Manager Network Services, practices can perform full drug utilization review (DUR) screenings, transmit prescriptions electronically to connected pharmacies, and verify formulary compliance with the patient's health plan.

Our Laboratory System module allows providers to access, review and maintain all lab results from within the EMR system. Practices may also arrange a sponsorship through national and regional laboratories to place orders and receive accurate and timely lab test results via a direct, bi-directional link with the sponsoring laboratory. Test results are received electronically from the sponsoring laboratory and are stored directly in the patient's file for viewing, printing and analysis.

Using our EMR applications, healthcare providers can locate all tasks needing their attention. For example, items on the provider's clinical task list are automatically generated whenever a lab report is ready, a transcription needs to be signed, or a prescription refill needs approval. Tasks can then be completed using the system or forwarded to another provider in the practice, accompanied by appropriate notes.

We also offer our Document Image Management (DIM) system, which is fully integrated with our Intergy and The Medical Manager practice management systems. The DIM system allows a practice to scan, store, catalog and retrieve documents, images and sound files in electronic form, which then becomes part of the patient's medical record and can be accessed from multiple workstations simultaneously. DIM<sub>DX</sub>, the diagnostic version of our imaging system, allows a practice to organize and store X-rays and other diagnostic images. Using an imaging system, multiple files can be viewed at the same time making it possible to view diagnostic reports alongside images or compare before-and-after images such as pre- and post-operative X-rays.

Our Digital Office Manager module provides additional capabilities for the scanning and organization of documents that are practice-related rather than patient-specific. Documentation such as contracts and personnel records are easily and efficiently managed with the Digital Office Manager, which can handle video, Adobe® Acrobat® and sound files as well as spreadsheets and word processing documents.

## **Table of Contents**

### **Additional Products and Services**

*Maintenance and Support Services.* We separately sell software support and maintenance services and hardware maintenance services to our customers. Through our software support and maintenance services, we:

provide customers with access to our telephone help desk, typically advising customers in the use and operation of our software and services and remotely accessing customers' systems to provide support, and

in some cases, provide periodic releases to our software to customers.

Through our hardware maintenance services, we typically provide customers with on-site hardware technical service and, if necessary, the replacement of hardware components that fail to function properly. Our contracts for maintenance and support services are generally up to one year in duration. Our customers may decide whether or not to purchase maintenance and support services from us. In addition, some of these services are also available from third party providers. See Competition for Our Healthcare Information Services and Technology Solutions below. We cannot provide assurance regarding the levels at which our customers will continue to purchase maintenance and support services after the expiration of existing contracts.

*ULTIA Handheld Solution.* Healthcare providers are becoming increasingly aware of the benefits of using wireless handheld computers in their practices. ULTIA, our handheld point-of-care solution, combines the power of our clinical and administrative systems with the convenience of mobile handheld connectivity. ULTIA runs on a handheld device, such as a Compaq®iPaq®. From anywhere in the office, healthcare providers can use ULTIA with a wireless local area network, or LAN, to access information stored within, or to enter data into, the Intergy or The Medical Manager system, giving them instant access at the point-of-care to:

appointment schedules, hospital rounds information and clinical tasks needing the provider's attention;

a user-friendly electronic prescription writer, with integrated DUR and formulary checking, which electronically submits prescriptions to the patient's chosen pharmacy and, at the same time, adds prescription information directly to the patient's electronic medical record in the Intergy or The Medical Manager software;

electronic lab ordering and reporting of results that can be viewed using ULTIA, available through the Intergy or The Medical Manager system in the provider's office;

their patients' electronic medical records, including demographic data, progress notes, medications, lab results, procedure histories and other information and transcribed patient documentation; and

a fully customized encounter form for capturing patient charges, which displays procedure and diagnosis codes in customized checklists and automatically posts charge information to the practice management system.

Physicians can also use ULTIA to digitally record dictation and then send the voice file electronically for transcription, reducing the number of devices the physician has to carry and reducing turn-around time.

In addition, ULTIA provides a range of offsite functionality that can be used at hospitals and other remote locations. Using the wireless LAN connection, up to ten days of hospital rounds and patient data can be downloaded to the handheld device. This information is then accessible to the provider when he or she is working at another location. The provider can enter new data and capture patient charges, all of which are then uploaded to The Medical Manager or Intergy system when the provider returns to the office. Using ULTIA Online, providers can access remotely, using a secure Internet connection, the clinical, administrative and financial data on the Intergy or The Medical Manager system in their office. See ULTIA Online below.

## **Table of Contents**

*ULTIA Online.* ULTIA Online allows physicians whose offices use the Intergy or The Medical Manager practice management systems to remotely access, via an encrypted Internet connection through our Medscape portal, information contained in their office's practice management system, including daily schedules, patient records and clinical items that need their attention. This enables physicians to view, in a secure manner, information residing on their office-based computer system from any personal or handheld computer with a connection to the Internet. The physician can use this connection to send and receive secure email messages, to write and send electronic prescriptions, or to create laboratory orders and view test results. ULTIA Online also provides access to Medscape health content and related services. See WebMD Health *Medscape from WebMD* above.

*Remote Monitoring System.* Our Remote Monitoring System, or RMS, allows for a pro-active approach to system support and maintenance. Real-time connections allow us to monitor installations of our Intergy and ULTIA systems for problems that need immediate attention or for potential problems that are likely to need attention in the near future or that are adversely affecting system performance. RMS checks for particular conditions on a fixed schedule. For example, when a server has reached a defined percentage of capacity, an alert is forwarded to us to analyze the situation. This type of monitoring allows the system to be supported regardless of whether our customers become aware of problems or report them. In addition, if a required technical component has failed, we will be alerted to take action without the time it takes for a customer to call our help desk and have a support representative analyze and address the issue. For example, RMS alerts us if a prescription sits in the prescription queue for more than 15 minutes, thus notifying us of a potential system or connection issue. That issue can then be immediately addressed, even if it has not yet come to the attention of, or been reported by, our customer. The RMS infrastructure can also be used as a cost-effective means to deliver software updates and other support.

*InfoPOINT and InfoCENTRAL.* InfoPOINT, our decision support and reporting application, is designed to provide timely access to practice data for informed managerial decision-making and to automate the process of generating reports using data from The Medical Manager and Intergy systems. InfoPOINT also provides access to tools to analyze that data and to export it to other applications. InfoCENTRAL is a flexible data warehouse solution, designed to support ambulatory healthcare organizations such as group practices, managed care organizations and physician services organizations. InfoCENTRAL consolidates financial, administrative, clinical and other data and manages the interface to the practice management system.

## **Sales and Marketing**

We market and distribute our WebMD Practice Services systems and related services nationally through a direct sales organization, who are also supported by field technicians and training and support personnel. We also participate in trade shows and use direct mail and various advertising media to promote our systems and services. In the past few years, we have acquired a significant number of independent dealers of The Medical Manager software and independent dealers no longer constitute a significant sales and marketing channel for our software. We believe that the acquisition of independent dealers and resellers has enabled us to establish direct relationships with end users of our software products, providing us with an opportunity to offer a wider range of products and services to these end users.

---

### ***Competition for Our Healthcare Information Services and Technology Solutions***

The markets for healthcare information services and technology solutions are intensely competitive, continually evolving and, in some cases, subject to rapid technological change. We have many competitors, including:

healthcare information system vendors and support providers, including physician practice management system and EMR system vendors and support providers;

**Table of Contents**

transaction processing companies, including those providing EDI and/or Internet-based services and those providing services through other means, such as paper and fax;

large information technology consulting service providers;

online services, portals or Web sites targeted to the healthcare industry, healthcare consumers and/or physicians generally, including both commercial sites and not-for-profit sites;

consortiums of health insurance companies and of pharmacy benefit management companies that have announced that they are developing electronic transaction services for use by their members and other potential customers;

publishers and distributors of traditional offline media, including those targeted to healthcare professionals, many of which have established or may establish their own Web sites or partner with other Web sites;

general purpose consumer online services and portals and other high-traffic Web sites that provide access to healthcare-related content and services;

public sector and non-profit Web sites that provide healthcare information without advertising or commercial sponsorships; and

vendors of healthcare information, products and services distributed through other means, including direct sales, mail and fax messaging.

We also compete, in some cases, with alliances formed by the above competitors. Major software, hardware and information systems companies, both with and without healthcare companies as their partners, offer or have announced their intention to offer products or services that are competitive with some of ours. Competitors for one or more of our healthcare information services and technology solutions include, among others, Amicore (a joint venture of IBM Corporation, Microsoft Corporation and Pfizer, Inc.), Allscripts Healthcare Solutions, Eclipsys Corporation, First Consulting Group, Inc., General Electric Corporation, IDX Systems Corporation, iVillage Inc., McKesson Corporation, Misys plc, NDCHealth Corporation, Per-Se Technologies, Inc., ProxyMed, Inc., Quality Systems, Inc., Siemens Corporation, TriZetto Group, Inc. and VitalWorks Inc. Many of our competitors have greater financial, technical, product development, marketing and other resources than we do. These organizations may be better known than we are and have more customers than we do. We cannot provide assurance that we will be able to compete successfully against these organizations or any alliances they have formed or may form.

Some of our existing payer and provider customers and some of our strategic partners may compete with us or plan to do so or belong to alliances that compete with us or plan to do so. For example, some payers currently offer, through affiliated clearinghouses, Web portals and other means, electronic data transmission services to healthcare providers that allow the provider to have a direct connection to the payer, bypassing third party EDI service providers such as WebMD Envoy. Any significant increase in the utilization of direct links between healthcare providers and payers could have a material adverse effect on our business and results of operations. We cannot provide assurance that we will be able to maintain our existing links to payers or develop new connections on satisfactory terms, if at all. In addition, some of our other services allow healthcare payers to outsource business processes that they have been or could be performing for themselves and, in order for us to be able to compete, use of our services must be more efficient than use of internal resources.

WebMD Health faces competition both in attracting members and visitor traffic and in generating revenue from sponsors and others. We compete with numerous companies and organizations for the attention of healthcare professionals and consumers including traditional offline media such as network and cable television, print journals, conferences, continuing medical education programs and symposia. We also face significant competition from online information resources. There are many healthcare-related Web sites on the Internet. In addition, there are many companies that provide non- Internet based marketing and advertising services to the healthcare industry. These competitors include advertising agencies, consulting firms, marketing and communications companies and contract sales and marketing organiza-

## **Table of Contents**

tions. In addition, to the extent that we are successful in increasing revenue from our portals, competition for our portals audience and the potential sources of revenue are likely to increase.

WebMD Practices Services faces competition for the support services it markets to owners of The Medical Manager and Intergy practice management systems, as well as for similar services that we market to owners of certain other practice management systems that we have acquired. See WebMD Practice Services Additional Products and Services Maintenance and Support Services and WebMD Practice Services Practice Management Systems Other Practice Management Systems above. Physician practices may seek such support from third parties, including businesses that support or manage information technology for various types of clients and businesses that specialize in physician office management systems, some of whom may formerly have been independent dealers of The Medical Manager software or of practice management systems we have acquired. We cannot provide assurance that we will be able to compete successfully against these service providers. In addition, some physician practices, especially larger ones, may use their own employees and other internal resources to support their practice management systems.

## **POREX**

### **Overview**

Our plastic technologies segment is known as Porex. Through Porex, we develop, manufacture and distribute proprietary porous plastic products and components used in healthcare, industrial and consumer applications. Porex also works with porous structures using other materials such as fiber and membranes. Our Porex customers include both end-users of its finished products as well as manufacturers that include our components in their products, which we refer to as original equipment manufacturers or OEMs.

Porex is an international business with manufacturing operations in North America, Europe and Asia. Porex's global sales and customer service network markets its products to customers in more than 65 countries. In 2003, Porex derived approximately 57% of its revenues from the United States, approximately 29% from Europe, approximately 11% from Asia and approximately 3% from Canada and Latin America.

### **Porex Products**

*Porous Plastics.* Porous plastics are permeable plastic structures having omni-directional (porous in all directions) inter-connecting pores to permit the flow of fluids and gases. These pores, depending upon the number and size, control the flow of liquids and gases. We manufacture porous plastics with pore sizes between approximately 1 and 500 micrometers. One micrometer is equal to one-millionth of a meter; an object of 40 micrometers in size is about as small as can be discerned by the naked eye. Our ability to control pore size provides the opportunity to serve numerous applications, including:

*Filtering.* In filtration applications, the pore structure acts as both a surface filter and a depth filter. The structure acts as a surface filter by trapping particles larger than its average pore size and as a depth filter by trapping much smaller particles deep in its complex channels. Unlike the direct passages in woven synthetic materials and metal screens, the pores in porous plastics join to form many tortuous paths. Examples of these applications include: filters for drinking water purification, air filters, fuel filters for power tools and appliances and other liquid filters for clarification of drugs, blood separation and chemicals.

*Venting.* In venting applications, the pore structure allows gases to easily escape while retaining fluids. Examples of these applications include: vents for medical devices, printers and automotive batteries; and caps and closures.

*Wicking.* When used as a wicking device, the pore structure creates capillary channels for liquid transfer allowing fluid to flow, or wick, from a reservoir. Examples of these applications include: nibs or tips for writing instruments, such as highlighters and coloring markers; fluid delivery components for printers and copiers; fragrance wicks; and absorbent media for diagnostic testing.

## **Table of Contents**

*Diffusing.* When used in diffusion applications, porous plastic components emit a multitude of small, evenly distributed bubbles. Examples of these applications include air diffusers for fermentation, metal finishing and plating.

*Muffling.* In muffling applications, exhaust air is channeled through a tortuous path, causing significant sound reduction by breaking up and diffusing the sound waves. Examples of these applications include industrial mufflers for pneumatic equipment.

We produce porous plastic components and products in our own manufacturing facilities, which are equipped to manufacture products for our customers in custom-molded shapes, sheets, tubes or rods, depending on customer needs.

*Other Porous Media.* We believe that, in some applications, fiber and other porous membranes are preferred over our standard porous plastic materials. We use fiber technology for applications requiring high flow rates. Based on the same principles used in making our standard porous plastic products, fibers are thermally bonded into a matrix. This fiber material is well-suited for use in filtration and wicking applications, including our products for the consumer fragrance market. We also use sub-micron porous polytetrafluoroethylene, or PTFE, membranes to serve product markets where porous plastics do not have the physical properties to meet application demands. PTFE material is commonly known as Teflon®.

*Markets for Our Porous Plastic Products.* Our porous plastic products are used in healthcare, consumer and industrial applications, including the following:

*Healthcare Products.* We manufacture a variety of porous plastic components for the healthcare industry that are incorporated into the products of other manufacturers. These components are used to vent or diffuse gases or fluids and are used as membrane supports, including catheter vents, self-sealing valves in surgical vacuum canisters, fluid filtration components and components for diagnostic devices.

We also use proprietary porous plastic technology to produce Medpor® implants for use in aesthetic and reconstructive surgery of the head and face. These permanent implants, which are composed of biocompatible porous high-density plastics, allow for rapid growth of the patient's tissue and capillary blood vessels. Since the initial product introduction in 1985, we have continued to introduce new products to meet the market's needs for a variety of shapes, sizes and uses of porous plastic implants.

*Consumer Products.* Our porous plastics are used in a variety of office and home products. These products include writing instrument tips, or nibs, which we supply to manufacturers of highlighting pens and children's coloring markers. The porous nib conducts the ink stored in the pen barrel to the writing surface by capillary action. Our porous plastic components are also found in products such as air fresheners, power tool dust canisters and computer printers. We also produce a variety of porous plastic water filters used to improve the taste and safety of drinking water.

*Industrial Products.* We manufacture a variety of custom porous plastic components for industrial applications, designed to customer specifications as to size, rigidity, porosity and other needs, including automobile battery vents and various types of filters and filtration components.

*Operating Room Products.* We also produce two product lines for the operating room supplies market: surgical markers and surgical drainage systems.

## **Competition**

Porex operates in competitive markets and its products are, in general, used in applications that are affected by technological change and product obsolescence. The competitors for Porex's porous plastic products include other producers of porous plastic materials as well as companies that manufacture and sell products made from materials other than porous plastics that can be used for the same purposes as Porex's products. For example, Porex's porous plastic pen nibs compete with felt and fiber tips manufactured by a variety of suppliers worldwide. Other Porex porous plastic products compete, depending

## **Table of Contents**

on the application, with membrane material, porous metals, metal screens, fiberglass tubes, pleated paper, resin-impregnated felt, ceramics and other substances and devices. Porex's competitors include, among others, Pall Corporation, Millipore Corporation, Filtrona (a division of Bunzl plc), Porvair plc and Whatman plc. The MEDPOR® Biomaterial products compete for surgical use against autogenous and allograft materials and alloplastic biomaterials. Porex's surgical drains and markers compete against a variety of products from several manufacturers.

Some of Porex's competitors may have greater financial, technical, product development, marketing and other resources than Porex does. We cannot provide assurance that Porex will be able to compete successfully against these companies or against particular products and services they provide or may provide in the future.

## **Raw Materials**

The principal raw materials used by Porex include a variety of plastic resins that are generally available from a number of suppliers. Some of Porex's products also require high-grade plastic resins with specific properties as raw materials. While Porex has not experienced any material difficulty in obtaining adequate supplies of high-grade plastic resins that meet its requirements, it relies on a limited number of sources for some of these plastic resins. If Porex experiences a reduction or interruption in supply from these sources, it may not be able to access alternative sources of supply within a reasonable period of time or at commercially reasonable rates, which could have a material adverse effect on its business and financial results.

## **Marketing**

Sales and marketing of our porous plastic products are conducted by a sales and marketing team of professionals with in-depth knowledge of plastic technologies. Marketing activities include advertising in various trade publications and directories and participating at tradeshow. Sales to OEM customers in the United States of our porous plastic products are made directly by our sales and marketing team. Internationally, these products are sold by our sales and marketing team and through independent distributors and agents.

We sell our MEDPOR Biomaterial products directly to medical centers, trauma centers, hospitals and private practice surgeons using independent and direct sales representatives. Internationally, these products are sold in over 40 countries through local stock distributors. We provide training, materials and other support to the sales representatives and distributors. Market awareness is primarily achieved through exhibitions in conjunction with medical specialty meetings, presentations by surgeons at medical meetings, journal publication of clinical papers, a group sponsored visiting speaker program and direct mail programs. Journal advertising is placed on a selected basis and we maintain an active database of contacts for targeted direct mail programs.

## **EMPLOYEES**

As of December 31, 2003, we had approximately 5,635 employees, of which approximately 175 work in our corporate headquarters or related functions, approximately 2,230 are WebMD Envoy employees, approximately 430 are WebMD Health employees, approximately 2,200 are WebMD Practice Services employees and approximately 600 are Porex employees.

## **DEVELOPMENT AND ENGINEERING**

We have developed internally and acquired through acquisitions healthcare information services and technology solutions products and services. Our development and engineering expense totaled \$43.0 million in 2003, \$43.5 million in 2002 and \$43.6 million in 2001.



## **Table of Contents**

The markets for some of our products and services are characterized by rapid change and technological advances. Our future success will depend, in part, upon our ability to enhance our existing products and services, to respond effectively to technological changes, and to introduce new and newly integrated applications and technologies that address the changing needs of our customers. Accordingly, we intend to continue to make investments in development and engineering and to recruit and hire experienced development personnel. However, we cannot provide assurance that we will be able to successfully complete the development of new products or services, enhancements to existing products or services. Further, there can be no assurance that products or technologies developed by others will not adversely affect our competitive position or render our products, services or technologies noncompetitive or obsolete.

### **INTELLECTUAL PROPERTY**

We rely upon a combination of patent, trade secret, copyright and trademark laws, license agreements, confidentiality procedures, employee and client nondisclosure agreements and technical measures to protect the intellectual property used in our businesses.

We use numerous trademarks, trade names and service marks for healthcare information services and technology solutions, including WebMD®, Web-MD®, WebMD Health®, Digital Office Manager®, DIM<sub>DX</sub>®, Envoy®, ExpressBill®, Intergy®, Medifax®, Medifax-EDI®, Medscape®, Medpulse®, Publishers Circle®, The Little Blue Book™, The Little Yellow Book™, The Medical Manager®, ULTIA™ and WellMed®. In addition, Porex uses trademarks and trade names, including POREX®, Lateral-Flo™, MEDPOR®, SQUEEZE-MARK®, and TLS®. We also use numerous other registered and unregistered trademarks and service marks for our various products and services. In addition to our trademark registrations and applications, we have registered the domain names webmd.com, my.webmd.com and medscape.com and numerous other domain names that either are or may be relevant to conducting our business. Our inability to protect our marks and domain names adequately could have a material adverse effect on our business and hurt us in establishing and maintaining our brands.

We also rely on a variety of intellectual property rights that we license from third parties, including our Internet server software and healthcare content used on our Web sites, as well as various products incorporated into our physician practice management systems. These third party licenses may not continue to be available to us on commercially reasonable terms. Our loss of or inability to maintain or obtain upgrades to any of these licenses could significantly harm us. In addition, because we license content from third parties, we may be exposed to copyright infringement actions if these parties are subject to claims regarding the origin and ownership of that content.

The steps we have taken to protect our proprietary rights may not be adequate, and we may not be able to secure trademark or service mark registrations for marks in the United States or in foreign countries. Third parties may infringe upon or misappropriate our copyrights, trademarks, service marks and similar proprietary rights. In addition, effective copyright and trademark protection may be unavailable or limited in many foreign countries, and the global nature of the Internet makes it impossible to control the ultimate destination of our services. It is possible that competitors or others will adopt product or service names similar to our names, which could impede our efforts to build brand identity and possibly lead to customer confusion. Moreover, because domain names derive value from the individual's ability to remember such names, our domain name will lose its value if, for example, users begin to rely on mechanisms other than domain names to access online resources. Our inability to protect our marks and domain names adequately would hurt our ability to establish and maintain our brands. In the future, litigation may be necessary to enforce and protect our trade secrets, copyrights and other intellectual property rights. Litigation would divert management resources and be expensive and may not effectively protect our intellectual property.

Substantial litigation regarding intellectual property rights exists in the software industry, and we expect that software products may be increasingly subject to third party infringement claims as the number of competitors in our industry grows and the functionality of products overlaps. Although we believe that

## **Table of Contents**

our products do not infringe on the intellectual property rights of others, we cannot provide assurance that such a claim will not be asserted against us in the future, or that a license or similar agreement will be available on reasonable terms in the event of an unfavorable ruling on any such claim.

We have several patents covering our software technology. Due to the nature of our application software, we believe that patent protection is less significant than our ability to further develop, enhance and modify our current services and products. However, any infringement or misappropriation of our proprietary software and databases could disadvantage us in our efforts to attract and retain customers in a highly competitive market and could cause us to lose revenue or incur substantial litigation expense. Moreover, in recent years, there have been a large number of patents issued in general and numerous patents issued related to Internet business methods. While we are unaware of any patent the loss of which would impact our ability to conduct our business, defense of a patent infringement claim against us could divert management and monetary resources, and an adverse judgment in any such matter may negatively impact our ability to conduct our business in the manner we desire.

Porex relies upon a combination of patent and trade secret laws, license agreements, confidentiality procedures, employee and client nondisclosure agreements and technical measures in its efforts to protect its intellectual property and proprietary rights. For example, Porex seeks to protect its proprietary manufacturing technology by designing and fabricating its own manufacturing equipment and molds. In addition, in some cases, Porex has patented specific products and processes and intends to do so in some instances in the future. The majority of Porex's patents relate to porous plastics and medical devices and medical device components. Porex seeks to take appropriate steps to protect its intellectual property and proprietary rights and intends to defend those rights as may be necessary. However, we cannot provide assurance that the steps it has taken to protect these rights are adequate. In the future, litigation may be necessary to enforce and protect those rights, which would divert management resources, may be expensive and may not effectively protect those rights.

## **GOVERNMENT REGULATION**

The healthcare industry is highly regulated and is subject to changing political, regulatory and other influences. These factors affect the purchasing practices and operations of healthcare organizations as well as the behavior and attitudes of consumers. Federal and state legislatures and agencies periodically consider programs to reform or revise the United States healthcare system. These programs may contain proposals to increase governmental involvement in healthcare, lower reimbursement rates or otherwise change the environment in which healthcare industry participants operate. Healthcare industry participants may respond by reducing their investments or postponing investment decisions, including investments in our products and services. We are unable to predict future proposals with any certainty or to predict the effect they would have on our businesses.

Existing laws and regulations could also create liability, cause us to incur additional cost and restrict our operations. Many healthcare laws are complex, applied broadly and subject to interpretation by courts and other governmental authorities. In addition, many existing healthcare laws and regulations, when enacted, did not anticipate the healthcare information services and technology solutions that we provide. However, these laws and regulations may nonetheless be applied to our products and services. Our failure, or the failure of our business partners, to accurately anticipate the application of these healthcare laws and regulations, or other failure to comply, could create liability for us, result in adverse publicity and negatively affect our businesses.

### **Health Insurance Portability and Accountability Act of 1996**

*General.* Under the Health Insurance Portability and Accountability Act of 1996, or HIPAA, Congress mandated a package of interlocking administrative simplification rules to establish standards and

**Table of Contents**

requirements for the electronic transmission of certain health information. The five rules published in final form are:

the Standards for Electronic Transactions, published August 17, 2000, which we refer to as the Transaction Standards;

the Standards for Privacy of Individually Identifiable Health Information, published December 28, 2000, which we refer to as the Privacy Standards;

the Standard Unique Employer Identifier, published May 31, 2002;

the Health Insurance Reform: Security Standards, published February 20, 2003, which we refer to as the Security Standards; and

the Standard Unique Health Identifier for Health Care Providers, published January 23, 2004, which we refer to as the NPI Standard.

These rules took or will take effect on October 16, 2000, April 14, 2001, July 30, 2002, April 21, 2003 and May 23, 2005, respectively, with compliance by healthcare providers, healthcare clearinghouses and large health plans required under the rules two years following the respective effective dates. Small health plans are given an additional year to comply. On December 27, 2001, President Bush signed into law a one-year extension, to October 16, 2003, of the date for complying with the HIPAA Transaction Standards for any covered entity that submitted to the Secretary of the United States Department of Health and Human Services, or HHS, a plan of how the entity would come into compliance with the requirements by that deadline.

*Transaction Standards.* The Transaction Standards establish format and data content standards for the most common healthcare transactions, using technical standards promulgated by recognized standards publishing organizations. These transactions include healthcare claims, enrollment, payment and eligibility. The Transaction Standards were intended to make it easier for payers and providers to send and receive healthcare transactions electronically, using specified formats. The Transaction Standards are applicable to that portion of our business involving the processing of healthcare transactions among physicians, payers, patients and other healthcare industry participants, including WebMD Envoy and Medical Manager Network Services.

October 16, 2003 was the deadline for covered entities to comply with the Transaction Standards. Failure to comply with the Transaction Standards may subject covered entities, including our WebMD Envoy clearinghouse, to civil monetary penalties and possibly to criminal penalties. However, the ability of each covered entity to comply is dependent on compliance efforts by numerous other covered entities. The Centers for Medicare & Medicaid Services, or CMS, is responsible for enforcing the Transaction Standards. On July 24, 2003, in response to concerns communicated to CMS regarding the readiness of a significant portion of the covered entities for the October 16 deadline and the consequences to the healthcare industry if significant claim processing problems occur at that time, CMS released its *Guidance on Compliance with HIPAA Transactions and Code Sets After the October 16, 2003 Implementation Deadline* (which we refer to as the CMS Guidance). In addition, on July 24, 2003, CMS officials participated in an *Open Door Forum* teleconference during which they provided additional clarification on planned enforcement practices. CMS also urged the adoption of *contingency plans* to help prevent disruptions in the healthcare payment system. Under CMS's contingency plan for Medicare, it will continue to accept claims in both HIPAA standard and legacy formats, with the legacy formats to be accepted for a period to be determined by CMS based upon a regular reassessment of the readiness of its electronic trading partners. In response, WebMD Envoy announced a contingency plan, pursuant to which it continues to process HIPAA standard transactions and, for a limited period of time, will also process legacy transactions as appropriate based on the needs of our business partners.

On February 27, 2004, CMS modified its Medicare contingency plan to delay the payment of electronic claims that are not HIPAA-compliant. Specifically, effective July 1, 2004, only claims that are compliant with the Transaction Standards are to be reported as electronic media claims (EMC), which

**Table of Contents**

may be paid no earlier than after a 13 day waiting period. All other claims (including both electronic claims that are not compliant with the Transaction Standards, as well as paper claims) may be paid no earlier than after a 26 day waiting period. Calling it a measured step toward ending the contingency plan entirely, CMS implemented the change to encourage providers to move more quickly with their efforts to achieve HIPAA compliance. This policy may provide an incentive for providers who cannot send HIPAA standard claims from their desktop to use a clearinghouse, such as WebMD Envoy, to do so.

CMS has made clear that it expects each party to every transaction to be accountable for compliance with the new standards as of October 16, 2003. However, the CMS Guidance provides for a flexible, complaint-driven enforcement strategy. CMS indicated that it will respond to complaints regarding non-compliant transactions submitted to it in writing and that, upon receipt of a complaint, CMS will notify the entity that a complaint has been filed and provide an opportunity for the entity to demonstrate compliance or to document its good faith effort to comply with the standards. In evaluating good faith efforts, CMS stated that it will consider not only the entity's efforts on behalf of itself, but its efforts through outreach and testing to ensure that its trading partners are also in compliance. CMS also noted that its expectations regarding compliance efforts will vary with the size and type of covered entity. We understand that CMS expects that larger organizations will have more sophisticated compliance efforts and outreach to their smaller trading partners.

We believe that the CMS enforcement approach assisted in reducing disruptions in the flow of electronic transactions that otherwise could have occurred in connection with the October 16, 2003 deadline and that a smoother transition benefits our company and the entire healthcare industry. We continue to work with payers, providers, practice management system vendors and other healthcare participants to implement the Transaction Standards. Transaction clearinghouses can provide a great deal of support for the healthcare industry in addressing the requirements of the Transaction Standards and in overcoming other connectivity challenges that HIPAA does not eliminate. Even though the goal of HIPAA was to make electronic transactions more standardized, the use of clearinghouses will continue to be the most efficient way for most providers to send their electronic claims and related transactions to multiple payers. The standardization resulting from implementation of HIPAA is only partial: payer systems and requirements continue to vary in certain respects even after HIPAA implementation and will continue to evolve and change in the future. Payers have published approximately 440 Companion Guides setting forth their individual interpretations of the Transaction Standards and that number can be expected to continue to grow. These payer-specific interpretations require us to perform extensive customized programming and related testing.

Healthcare payers and providers who are unable to exchange data in the required standard formats can achieve Transaction Standards compliance by contracting with a clearinghouse, like WebMD Envoy, to translate between standard and non-standard formats. As a result, use of a clearinghouse allows numerous providers and payers to move to the Transaction Standards independently and at different times, reducing transition costs and risks. As various healthcare entities are in different stages of migration during the transition, WebMD Envoy is working to translate claim information from non-standard to standard formats and vice versa. In addition, the Transaction Standards require healthcare providers to collect and supply more information than they have in the past in order to submit a healthcare claim. From October 16, 2003 to the date of this Annual Report, a large majority of the claims we have received from submitters used legacy formats and very few contained the additional data content provided for in the Transaction Standards. Some providers who can submit claims in the HIPAA standard formats cannot yet collect all of the data payers may require to process the claim. In order to assist in claims processing, our clearinghouse software edits the information submitted in a claim using logic, mapping and defaults. A small number of our submitters currently send some additional HIPAA data content that does not yet pass through our clearinghouse.

We cannot provide assurance regarding how CMS will regulate clearinghouses in general or WebMD Envoy in particular. In addition, even though major disruptions in the flow of electronic transactions may be less likely in light of CMS's current approach to enforcement of the Transaction Standards, we have

**Table of Contents**

experienced isolated disruptions and some delays and we expect there will continue to be some problems for a period of time.

Implementation of the Transaction Standards has presented us with significant technical and operational challenges. For example, we are working with our trading partners to complete quality assurance and testing on our enhanced clearinghouse data services for transmitting additional HIPAA data content. We do not plan to place these services into full production until both our systems and payers adjudication systems are capable of handling the production volume of transactions with the additional data content. As with any highly complex data transition involving significant modifications to trading partner systems, we are experiencing some problems during this process. Another aspect of the implementation challenges resulting from the Transaction Standards is the increase in computing capacity required. The Transaction Standards formats are much larger than the pre-existing ones. We are utilizing more computing capacity than we had anticipated. As a result, our systems have experienced inefficiencies that have resulted in processing delays. We seek to resolve all such problems when identified, but testing continues with numerous submitters and payers, and no assurance can be given that we will identify all problems promptly or that we will not continue to experience problems that delay the full implementation of these enhanced data services. The costs to us of dealing with those problems are inherently difficult to estimate and may be more than we expect and/or continue for longer than anticipated. In addition, most of our trading partners are currently operating under their own contingency plans and, accordingly, we would expect that there will be further disruptions during the adjustment period that occurs once CMS requires all applicable parties to perform in accordance with the Transaction Standards. We may not have enough technicians, programmers and customer service personnel to meet the demands placed on those functions by our customers and partners during the adjustment period, which could adversely affect our relationships with them.

*Privacy Standards.* The Privacy Standards establish a set of basic national privacy standards and fair information practices for the protection by health plans, healthcare clearinghouses, healthcare providers and their business associates of individually identifiable health information. This rule became effective on April 14, 2001 and the compliance date for most entities was April 14, 2003. The Privacy Standards apply to the portions of our business that process healthcare transactions or provide certain technical services to other participants in the healthcare industry, and certain of our portal services may be affected through contractual relationships. This rule provides for civil and criminal liability for its breach and requires us, our customers and our partners to use health information in a highly restricted manner, to establish policies and procedures to safeguard the information, to obtain individual authorizations for some activities, and to provide certain access rights to individuals. This rule may require us to incur significant costs to change our products and services, may restrict the manner in which we transmit and use the information, and may adversely affect our ability to generate revenue from the provision of de-identified information to third parties. The effect of the Privacy Standards on our business is difficult to predict and there can be no assurances that we will adequately address the risks created by the Privacy Standards and their implementation or that we will be able to take advantage of any resulting opportunities. In addition, we are unable to predict what changes to the Privacy Standards might be made in the future or how those changes could affect our business.

*Unique Employer Identifier Standard.* The Unique Employer Identifier Standard establishes a standard for identifying employers in healthcare transactions where information about the employer is transmitted electronically, as well as requirements concerning its use by covered entities. This rule requires the use of an employer identification number (EIN) as assigned by the IRS on all standard transactions that require an employer identifier to identify a person or entity as an employer. This standard applies to the portions of our business that process healthcare transactions or provide certain technical services to other participants in the healthcare industry, and certain of our portal services may be affected through contractual relationships. Most participants in the healthcare industry must be in compliance with the Unique Employer Identifier Standard by July 30, 2004. The effect of the Unique Employer Identifier Standard on our business is difficult to predict and there can be no assurances that we will adequately

## **Table of Contents**

address the risks created by the Unique Employer Identifier Standard and its implementation or that we will be able to take advantage of any resulting opportunities.

*Security Standards.* On February 20, 2003, HHS published the final Security Standards. The Security Standards establish detailed requirements for safeguarding patient information that is electronically transmitted or electronically stored. The rule establishes 42 implementation specifications, 20 of which are required, meaning they must be implemented as specified in the rule. Twenty-two are addressable. Complying with addressable implementation specifications requires a business to assess whether they constitute a reasonable and appropriate safeguard for the particular business; if not, an alternative approach must be designed and implemented to achieve the particular standard. The Security Standards apply to the portions of our business that process healthcare transactions, that provide certain technical services to other participants in the healthcare industry, or that enable electronic communications of patient information among healthcare industry participants, and certain of our portal services may be affected through contractual relationships. Most participants in the healthcare industry must be in compliance with the Security Standards by April 21, 2005. Some of the Security Standards are technical in nature, while others may be addressed through policies and procedures for using information systems. The Security Standards may require us to incur significant costs in evaluating our products and in establishing that our systems meet the 42 specifications. We are unable to predict what changes might be made to the Security Standards prior to the 2005 implementation deadline or how those changes might help or hinder our business. The effect of the Security Standards on our business is difficult to predict and there can be no assurances that we will adequately address the risks created by the Security Standards and their implementation or that we will be able to take advantage of any resulting opportunities.

*NPI Standard.* On January 23, 2004, HHS published the final HIPAA standard for a unique health identifier for health care providers, commonly referred to as the National Provider Identifier (NPI) Standard. The NPI Standard requires health care providers that transmit any health information in electronic form in connection with a HIPAA covered transaction to obtain a single, 10 position all-numeric NPI from the National Provider System (NPS), and to use the NPI in standard transactions where a provider identifier is required. The NPI Standard requires health plans and health care clearinghouses to use a provider's NPI to identify the provider on all standard transactions where that provider's identifier is required. The NPI Standard is effective May 23, 2005. Most participants in the healthcare industry must be in compliance with the NPI Standard by May 23, 2007. The effect of the NPI Standard is difficult to predict and there can be no assurances that we will adequately address any business risks created by the NPI rule and its implementation or that we will be able to take advantage of any resulting business opportunities.

## **Other Restrictions Regarding Confidentiality and Privacy of Patient Information**

Numerous state and federal laws other than HIPAA govern the collection, dissemination, use, access to and confidentiality of patient health information. In addition, some states are considering new laws and regulations that further protect the confidentiality of medical records or medical information. These state laws are not in most cases preempted by the HIPAA Privacy Standard and may be subject to interpretation by various courts and other governmental authorities, thus creating potentially complex compliance issues for us and our customers and strategic partners. Definitions in the various state and federal laws concerning what constitutes individually identifiable data sometimes differ and sometimes are not provided, creating further complexity. In addition, determining whether data has been sufficiently de-identified may require complex factual and statistical analyses. The HIPAA Privacy Standards contain a restrictive definition of de-identified information, which is information that is not individually identifiable, that could create a new standard of care for the industry. These other privacy laws at a state or federal level, or new interpretations of these laws, could create liability for us, could impose additional operational requirements on our business, could affect the manner in which we use and transmit patient information and could increase our cost of doing business. In addition, parties may also have contractual rights that provide additional limits on our collection, dissemination, use, access to and confidentiality of patient health information. Claims of violations of privacy rights or contractual breaches, even if we are not found

## **Table of Contents**

liable, could be expensive and time-consuming to defend and could result in adverse publicity that could harm our business.

### **Other Regulation of Transaction Services**

Other state and federal statutes and regulations governing transmission of healthcare information may affect our operations. For example, Medicaid rules require some processing services and eligibility verification to be maintained as separate and distinct operations. Furthermore, the recently-enacted Medicare Prescription Drug, Improvement and Modernization Act of 2003 authorizes the development of an electronic prescription drug program that specifies standards for electronically transmitted prescriptions and other required information related to Medicare-covered prescription drugs. We carefully review our practices with regulatory experts in an effort to ensure that we are in compliance with all applicable state and federal laws. These laws, though, are complex and changing, and the courts and other governmental authorities may take positions that are inconsistent with our practices. See also [Regulation of Healthcare Relationships](#) below.

### **International Data Regulation**

Other countries also have, or are developing, their own laws governing the collection, use, storage and dissemination of personal information or patient data. These laws could create liability for us, impose additional operational requirements or restrictions on our business, affect the manner in which we use or transmit data and increase our cost of doing business.

### **Regulation of Healthcare Relationships**

*Anti-kickback Laws.* There are federal and state laws that govern patient referrals, physician financial relationships and inducements to beneficiaries of federal healthcare programs. The federal healthcare programs anti-kickback law prohibits any person or entity from offering, paying, soliciting or receiving anything of value, directly or indirectly, for the referral of patients covered by Medicare, Medicaid and other federal healthcare programs or the leasing, purchasing, ordering or arranging for or recommending the lease, purchase or order of any item, good, facility or service covered by these programs. Many states also have similar anti-kickback laws that are not necessarily limited to items or services for which payment is made by a federal healthcare program. In 2002, the Office of the Inspector General, or OIG, of HHS, the federal government agency responsible for interpreting the federal anti-kickback law, issued an advisory opinion that concluded that the sale of advertising and sponsorships to healthcare providers and vendors by Web-based information services, such as us, implicates the federal anti-kickback law. However, the advisory opinion suggests that enforcement action will not result if the fees paid represent fair market value for the advertising/sponsorship arrangements, the fees do not vary based on the volume or value of business generated by the advertising and the advertising/sponsorship relationships are clearly identified as such to users. We carefully review our practices with regulatory experts in an effort to ensure that we comply with all applicable laws. However, the laws in this area are both broad and vague and it is often difficult or impossible to determine precisely how the laws will be applied, particularly to new services. Penalties for violating the federal anti-kickback law include imprisonment, fines and exclusion from participating, directly or indirectly, in Medicare, Medicaid and other federal healthcare programs. Any determination by a state or federal regulatory agency that any of our practices violate any of these laws could subject us to civil or criminal penalties and require us to change or terminate some portions of our business. Even an unsuccessful challenge by regulatory authorities of our practices could cause us adverse publicity and be costly for us to respond to.

*False Claims Laws.* We currently provide transaction services to healthcare providers and, therefore, may be subject to state and federal laws that govern the submission of claims for medical expense reimbursement. These laws generally prohibit an individual or entity from knowingly presenting or causing to be presented a claim for payment from Medicare, Medicaid or other third party payers that is false or fraudulent, or is for an item or service that was not provided as claimed. These laws also provide civil and criminal penalties for noncompliance, and can be enforced by individuals through qui tam actions. We

## **Table of Contents**

cannot guarantee that state and federal agencies will regard billing errors processed by us as inadvertent and not in violation of these laws. In addition, changes in these laws could also require us to incur costs or restrict our business operations. As part of our data transmission and claims submission services, we may employ certain edits, using logic, mapping and defaults, when submitting claims to third party payers. Such edits are utilized when the information received from providers is insufficient to complete individual data elements requests by payers for reimbursement claims. We believe our editing processes are consistent with industry practice. However, it is possible that a court or governmental agency might view such practices in a manner that could result in liability and adversely affect our business.

### **Regulation of Medical Devices**

*Overview.* We manufacture and market medical devices subject to extensive regulation by the Food and Drug Administration, or FDA, under the Federal Food, Drug, and Cosmetic Act, or the FDC Act. The FDA's regulations govern, among other things, product development, testing, manufacturing, labeling, storage, premarket clearance (referred to as 510(k) clearance), premarket approval (referred to as PMA approval), advertising and promotion, and sales and distribution. If the FDA finds that we have failed to comply, the agency can institute a wide variety of enforcement actions, ranging from a public warning letter to more severe sanctions such as: fines, injunctions, and civil penalties; recall or seizure of our products; issuance of public notices or warnings; operating restrictions, partial suspension or total shutdown of production; refusal of our requests for 510(k) clearance or PMA approval of new products, withdrawal of 510(k) clearance or PMA approvals already granted, and criminal prosecution.

*Access to U.S. Market.* Each medical device that we wish to commercially distribute in the U.S. will likely require either 510(k) clearance or PMA approval from the FDA prior to commercial distribution, unless exempt. Devices deemed to pose relatively less risk are placed in either class I or II, which requires the manufacturer to submit a premarket notification requesting 510(k) clearance. Some low risk devices are exempted from this requirement. Devices deemed by the FDA to pose the greatest risk, such as life-sustaining, life-supporting or implantable devices, or devices deemed not substantially equivalent to a previously 510(k) cleared device or to a preamendment class III device (in commercial distribution before May 28, 1976) for which PMA applications have not been called, are placed in Class III requiring PMA approval.

*510(k) Clearance Process.* To obtain 510(k) clearance, we must submit a premarket notification demonstrating that the proposed device is substantially equivalent in intended use and in safety and effectiveness to a predicate device either a previously 510(k) cleared class I or class II device or a preamendment class III device for which the FDA has not called for PMA applications. The FDA's 510(k) clearance process usually takes from four to 12 months, but it can last longer. After a device receives 510(k) clearance, any modification that could significantly affect its safety or effectiveness, or that would constitute a major change in its intended use, requires a new 510(k) clearance or could even require a PMA approval. The FDA requires each manufacturer to make this determination in the first instance, but the FDA can review any such decision. If the FDA disagrees with it, the agency may retroactively require the manufacturer to seek 510(k) clearance or PMA approval. The FDA also can require the manufacturer to cease marketing and/or recall the modified device until 510(k) clearance or PMA approval is obtained.

*PMA Approval Process.* If a product is not eligible for 510(k) clearance, the product is placed in class III and must follow the PMA approval process, which requires proof of the safety and effectiveness of the device to the FDA's satisfaction. A PMA approval application must provide extensive preclinical and clinical trial data and also information about the device and its components regarding, among other things, device design, manufacturing and labeling. As part of the PMA approval application review, the FDA will inspect the manufacturer's facilities for compliance with the Quality System Regulation, which requires manufacturers to follow elaborate design, testing, control, documentation and other quality assurance procedures during the manufacturing process. The PMA approval pathway is costly, lengthy and uncertain. It generally takes from one to three years or longer. After approval of a PMA approval application, a new PMA



## Table of Contents

approval or PMA supplement approval may be required in the event of a modification to the device, its labeling or its manufacturing process.

*Clinical Studies.* A clinical study is generally required to support a PMA approval application and is sometimes required for a 510(k) premarket notification. For significant risk devices, such studies generally require submission of an application for an Investigational Device Exemption, or IDE. The IDE application must be supported by appropriate data, such as animal and laboratory testing results, showing that it is safe to test the device in humans and that the testing protocol is scientifically sound. The IDE must be approved in advance by the FDA for a specified number of patients. Clinical studies may begin once the IDE application is approved by the FDA and the appropriate institutional review boards at the study sites. For nonsignificant risk devices, one or more institutional review boards must review the study, but submission of an IDE application to the FDA for advance approval is not required. Both types of studies are subject to record keeping, reporting and other IDE regulation requirements.

*Post-market Regulation.* After the FDA permits a device to enter commercial distribution, numerous regulatory requirements apply. These include the Quality System Regulation, labeling regulations, the FDA's general prohibition against promoting products for unapproved or off-label uses, and the Medical Device Reporting regulation, which requires that manufacturers report to the FDA if their device may have caused or contributed to a death or serious injury or malfunctioned in a way that would likely cause or contribute to a death or serious injury if it were to recur.

*Products.* Certain of Porex's products are FDA-regulated medical devices, such as plastic and reconstructive surgical implants, blood filters, and tissue expanders. In addition, the FDA regulates WebMD Practice Services' DIM<sub>DX</sub> System as a medical image management device. It received 510(k) clearance on August 25, 2000. Subsequently, we have made modifications to certain of Porex's products and to the DIM<sub>DX</sub> System that we believe do not require new 510(k) clearance. If the FDA disagrees with our decisions, it can retroactively require new 510(k) clearance or PMA approval. The FDA also can require us to cease marketing and/or recall the modified device until 510(k) clearance or PMA approval is obtained. Because Porex's medical devices and the DIM<sub>DX</sub> System are in commercial distribution, we are subject to inspection and market surveillance by the FDA to determine compliance with all regulatory requirements. Compliance with these requirements can be costly and time-consuming. Our failure to comply could subject us to FDA enforcement action and sanctions.

The FDA has a long-standing draft software policy exempting computer software products from active regulation as medical devices if they are decision support systems intended to involve competent human intervention before any impact on human health occurs (in other words, where clinical judgment and experience can be used to check, interpret and potentially challenge a system's output). Except for the cleared DIM<sub>DX</sub> System, we believe that, under the draft software policy, the Intergy and The Medical Manager practice management systems are subject to limited FDA regulation and do not require 510(k) clearance or PMA approval. WebMD Practice Services has created an interface between the Intergy and The Medical Manager practice management systems and the image device. We are marketing the interface and the image device as the DIM<sub>DX</sub> System. We believe that the sale of our practice management systems with the DIM<sub>DX</sub> System does not require a new 510(k) clearance or PMA approval. Our ULTIA handheld solution permits access to the Intergy and The Medical Manager practice management systems and makes it available in a wireless handheld format, including allowing access to the medical images stored in the DIM<sub>DX</sub> System. Because any displayed medical images are not intended for diagnostic use, we believe that ULTIA's ability to access such medical images does not subject it to a 510(k) clearance or PMA approval requirement. We cannot assure you, however, that the FDA would agree with any of these conclusions. If the FDA does not agree, we may be required to obtain 510(k) clearance or PMA approval for these products and may be required to cease marketing and/or recall such products until 510(k) clearance or PMA approval is obtained.

The FDA's draft software policy has been under review for several years. A risk exists that the Intergy or The Medical Manager practice management system or other of our software or hardware

## **Table of Contents**

components could in the future become subject to some or all of the medical device regulation requirements. In addition, the FDA may take the position that other products and services we offer, such as ULTIA, are subject to FDA regulation. We also may expand our services in the future to areas that subject us to FDA regulation. Except with respect to WebMD Practice Services and Porex, we have no experience in complying with FDA regulations. We believe that complying with FDA regulations is time consuming, burdensome and expensive and could delay our introduction of new applications or services.

### **FDA and FTC Regulation of Drug and Medical Device Advertising and Promotion**

The FDA and the FTC regulate the form, content and dissemination of labeling, advertising and promotional materials, including direct-to-consumer prescription drug and medical device advertising, prepared by, or for, pharmaceutical or medical device companies. The FTC regulates over-the-counter drug advertising and, in some cases, medical device advertising, as well as general product or service advertising. Generally, based on FDA requirements, regulated companies must limit their advertising and promotional materials to discussions of FDA-approved claims. In limited circumstances, regulated companies may disseminate non-promotional scientific information regarding products or claims not yet approved by the FDA.

Any information that promotes the use of pharmaceutical products or medical devices that is put on our Web site is subject to the full array of the FDA and FTC requirements and enforcement actions and any information regarding other products and services is subject to FTC requirements. Areas of our Web site that could be the primary focus of the FDA and FTC include pages and programs that discuss use of an FDA-regulated product or that the regulators believe may lack editorial independence from the influence of sponsoring pharmaceutical or medical device companies. Television broadcast advertisements by WebMD may also be subject to FTC regulation and FDA regulation depending on the content. The FDA and the FTC place the principal burden of compliance with advertising and promotional regulations on the company that advertises on our Web site to make truthful, substantiated claims. If the FDA or the FTC finds that any information on our Web site violates FDA or FTC regulations, they may take regulatory or judicial action against us or the advertiser or sponsor of that information.

*Drug Advertising.* The FDC Act requires that prescription drugs (including biological products) be approved for a specific medical indication by the FDA prior to their marketing in interstate commerce. It is a violation of the Act and of FDA regulations to market, advertise or otherwise commercialize such products prior to approval. The FDA does allow for preapproval exchange of scientific information, provided it is nonpromotional in nature and does not draw conclusions regarding the ultimate safety or effectiveness of the unapproved drug. Upon approval, the FDA's regulatory authority extends to the labeling and advertising of prescription drugs offered in interstate commerce. Such products may only be promoted and advertised for their approved indications. In addition, the labeling and advertising can be neither false nor misleading, and must present all material information in a balanced manner. Labeling and advertising that violate these legal standards are subject to FDA enforcement action.

The FDA regulates the safety, efficacy, and labeling of over-the-counter drugs or OTC drugs under the FDC Act either through specific product approvals or through regulations that define approved claims for specific categories of such products. The FTC regulates the advertising of OTC drugs under the section of the Federal Trade Commission Act that prohibits unfair or deceptive trade practices. Together, the FDA and FTC regulatory framework requires that OTC drugs be formulated and labeled in accordance with FDA approvals or regulations and promoted in a manner that is truthful, adequately substantiated, and consistent with the labeled uses. OTC drugs that do not meet these requirements are subject to FDA or FTC enforcement action depending on the nature of the violation.

*Continuing Medical Education.* Activities and information provided in the context of a medical or scientific educational program, often referred to as continuing medical education or CME, usually are treated as nonpromotional and fall outside the FDA's jurisdiction. The FDA does however evaluate such CME activities to determine whether they are independent of the promotional influence of the drug or medical device sponsor or whether they are promotional activities subject to FDA's advertising and

## **Table of Contents**

labeling requirements. In order to determine whether a company's activities are sufficiently independent, the FDA looks at a number of factors related to the planning, content, speakers and audience selection of such activities. To the extent that the FDA concludes that such activities are not independent from a manufacturer, such content must fully comply with the FDA's requirements.

There are several administrative, civil and criminal sanctions available to the FDA for violations of the FDC Act or FDA regulations as they relate to labeling and advertising. Administrative sanctions may include a written request that violative advertising or promotion cease and/or that corrective action be taken, such as requiring a company to provide to healthcare providers and/or consumers information to correct misinformation previously conveyed. In addition, the FDA may use publicity, such as press releases, to warn the public about false and misleading information concerning a drug or medical device product. More serious civil sanctions include seizures, as well as injunctions and their resulting consent decrees. Such measures could prevent a company from introducing or maintaining its product in the marketplace. Criminal penalties for severe violations can result in a prison term and/or substantial fines.

Any increase in FDA regulation of the Internet or other media for direct-to-consumer advertisements of prescription drugs could make it more difficult for WebMD Health to obtain advertising and sponsorship revenue. In the last 15 years, the FDA has gradually relaxed its formerly restrictive policies on direct-to-consumer advertising of prescription drugs. Companies can now advertise prescription drugs for serious conditions to consumers in any medium. However, physician groups and others have criticized the FDA's current policies, and have called for restrictions on any advertising of prescription drugs to consumers and increased FDA enforcement. These critics point to both public health concerns and to the laws of many other countries that make direct-to-consumer advertising of prescription drugs a criminal offense. In response to these critics, the FDA or the FTC may alter its present policies on the direct-to-consumer advertising of prescription drugs or medical devices in a way that would materially reduce our advertising and sponsorship revenues. FDA recently issued three draft guidance documents intended to improve communication of: (1) risk information in direct-to-consumer print advertisements, (2) disease awareness information, and (3) risk information in direct-to-consumer advertising of restricted medical devices. These draft guidance documents do not alter existing FDA regulatory requirements, but may lead to future policy changes.

### **Medical Professional Regulation**

The practice of most healthcare professions requires licensing under applicable state law. In addition, the laws in some states prohibit business entities from practicing medicine, which is referred to as the prohibition against the corporate practice of medicine. We do not believe that we engage in the practice of medicine and we have attempted to structure our Web site, strategic relationships and other operations to avoid violating these state licensing and professional practice laws. A state, however, may determine that some portion of our business violates these laws and may seek to have us discontinue those portions or subject us to penalties or licensure requirements. We provide Web site capabilities for our physician customers. Many states regulate the ability of medical professionals to advertise or maintain referral services. We do not represent that a physician's use of our Web site will comply with these or other state laws regulating professional practice and we do not monitor or control the content that physicians post on their individual practice Web sites using our Web site application. It is possible a state or a court may determine we are responsible for any non-compliance with these laws, which could affect our ability to offer this service to our customers. We employ and contract with physicians who provide only medical information to consumers, and we have no intention to provide medical care or advice. Any determination that we are a healthcare provider and acted improperly as a healthcare provider may result in liability to us.

### **Consumer Protection Regulation**

*General.* Advertising and promotional activities presented to consumers on our Web sites are subject to Federal and state consumer protection laws which regulate unfair and deceptive practices. We are also subject to various other federal and state consumer protection laws, including the ones described below.

**Table of Contents**

*Can-Spam Act.* Effective January 1, 2004, the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003, or the Can-Spam Act, became effective. The Can-Spam Act regulates commercial emails and provides a right on the part of the recipient to request the sender to stop sending messages, and establishes penalties for the sending of email messages which are intended to deceive the recipient as to source or content. Under the Can-Spam Act, senders of commercial emails are required to make sure that these do not contain false or misleading transmission information. Commercial emails are required to include a valid return email address and other subject heading information so that the sender and the Internet location from which the message has been sent are accurately identified. Recipients must be furnished with an electronic method of informing the sender of the recipient's decision to not receive further commercial emails. In addition, the email must include a postal address of the sender and notice that the email is an advertisement. We believe that our email practices comply with the requirements of the Can-Spam Act.

*Regulation of Advertisements Sent by Fax.* A recent modification to the Telephone Consumer Protection Act was issued by the Federal Communication Commission that affects advertisements sent to telephone facsimile (fax) machines. Under this new regulation, which is effective as of January 1, 2005, advertisements which advertise the commercial availability or quality of a product or service cannot be sent to the fax machine of a recipient unless the recipient has signed a written statement that includes the fax number to which these advertisements may be sent and clearly indicates the recipient's consent to receive these advertisements by fax from the sender. We do not send advertisements to fax machines in any significant portions of our business. However, in those areas in which we do send advertisements to a recipient's fax machine that are the subject of this new regulation, we intend to be in compliance with this new regulation in advance of January 1, 2005.

*COPPA.* The Children's Online Privacy Protection Act, or COPPA, extends to operators of commercial Web sites and online services directed to U.S. children under the age of 13 that collect personal information from children, and operators of general audience sites with actual knowledge that they are collecting information from U.S. children under 13. WebMD's sites are not directed at children and its general audience site, WebMD Health, states that no one under the applicable age is entitled to use the site. In addition, WebMD Health employs a kick-out procedure whereby anyone identifying themselves as being under the age of 13 during the registration process is not allowed to register for the site's member only services, such as message boards and live chat events. COPPA, however, is a relatively new law, can be applied broadly and is subject to interpretation by courts and other governmental authorities. The failure to accurately anticipate the application or interpretation of this law could create liability to us, result in adverse publicity and negatively affect our business.

*Other Consumer Protection Regulation.* The Federal Trade Commission, or FTC, and many state attorneys general are applying federal and state consumer protection laws to require that the online collection, use and dissemination of data, and the presentation of Web site content, comply with certain standards for notice, choice, security and access. Courts may also adopt these developing standards. In many cases, the specific limitations imposed by these standards are subject to interpretation by courts and other governmental authorities. We believe that we are in compliance with these consumer protection standards, but a determination by a state or federal agency or court that any of our practices do not meet these standards could result in liability and adversely affect our business. New interpretations of these standards could also require us to incur additional costs and restrict our business operations.

In addition, several foreign governments have regulations dealing with the collection and use of personal information obtained from their citizens. Those governments may attempt to apply such laws extraterritorially or through treaties or other arrangements with U.S. governmental entities. We might unintentionally violate such laws, such laws may be modified and new laws may be enacted in the future. Any such developments (or developments stemming from enactment or modification of other laws) or the failure to accurately anticipate the application or interpretation of these laws could create liability to us, result in adverse publicity and negatively affect our businesses.

## **Table of Contents**

### **Item 2. *Properties***

We believe that the offices and other facilities described are, in general, in good operating condition and adequate for our current operations.

#### **Headquarters**

We lease our corporate headquarters offices in Elmwood Park, New Jersey, which consists of approximately 45,000 square feet of space, under leases that expire in, or prior to, March 2006.

#### **WebMD Envoy, WebMD Health and WebMD Practice Services**

We lease important facilities in:

Nashville, Tennessee for WebMD Envoy's headquarters and primary data and call centers and Medifax's operations;

St. Louis, Missouri for Advanced Business Fulfillment's operations;

Scottsdale, Arizona and Toledo, Ohio for ExpressBill's operations;

Tampa, Florida for WebMD Practice Services' headquarters and Alachua, Florida for its development and engineering operations; and

New York, New York for WebMD Health's headquarters and its editorial and marketing operations.

We also use facilities in approximately 130 additional locations throughout the United States, 11 of which are owned and the rest of which are leased. These locations include sales and other offices, production centers, data centers and call centers.

#### **Porex**

We use approximately 380,000 square feet for Porex's headquarters and for office and manufacturing operations related to its porous plastics and other porous media product lines, including: the Porex headquarters and largest plant, which are located in property that we own in Fairburn, Georgia, a suburb of Atlanta; space that we own in Newnan, Georgia, College Park, Georgia and Bautzen, Germany; and space that we lease in Selangor, Malaysia and Alness, Scotland.

### **Item 3. *Legal Proceedings***

#### **Envoy Securities Litigation**

Several years prior to our acquisition of Envoy Corporation, Envoy and some of its officers were named as defendants in three identical lawsuits filed in the United States District Court for the Middle District of Tennessee, Nashville Division. In 1998, the District Court ordered the three cases consolidated under the caption *In re Envoy Corporation Securities Litigation*.

Plaintiffs alleged that the defendants made material misrepresentations and omissions in Envoy's public filings and public statements concerning Envoy's financial statements and Envoy's accounting for some charges taken in connection with acquisitions. In addition, plaintiffs alleged that, as a result of defendants' alleged actions, Envoy's reported earnings during the class period were overstated and the price for Envoy's common stock was artificially inflated.

In April 2002, the court certified a class of plaintiffs consisting of all persons, other than defendants, who purchased shares of Envoy common stock between February 27, 1997 and August 18, 1998.

As previously disclosed, on September 18, 2003, Envoy entered into a definitive Stipulation of Settlement regarding the settlement of this litigation, as contemplated by a Memorandum of Understanding dated July 11, 2003. Pursuant to the Stipulation of Settlement, the defendants

paid into a settlement fund the amount of \$11 million in settlement of the claims asserted in the action and the

## **Table of Contents**

Stipulation of Settlement. On December 17, 2003, the United States District Court for the Middle District of Tennessee, following a hearing, entered an Order granting final approval of the settlement of this litigation on the terms contained in the Stipulation of Settlement. Pursuant to the Court's Order, all members of the plaintiff class released defendants and the litigation was dismissed with prejudice. No appeal from the Court's Order was taken and the Order became final and non-appealable on January 17, 2004. Defendants have denied and continue to deny the allegations asserted in the lawsuit and agreed to the settlement in order to eliminate the burden and expense of further litigation. As previously disclosed, the settlement of this litigation was funded entirely with the proceeds of Envoy's insurance policy.

### **Litigation Regarding Distribution of Shares in Healtheon Initial Public Offering**

In the summer and fall of 2001, seven purported class action lawsuits were filed against Morgan Stanley & Co. Incorporated and Goldman Sachs & Co., underwriters of the initial public offering of the Company (then known as Healtheon) in the United States District Court for the Southern District of New York. Three of these suits also named WebMD and certain former officers and directors of WebMD as defendants. These suits were filed in the wake of reports of governmental investigations of the underwriters' practices in the distribution of shares in certain initial public offerings. Similar suits were filed in connection with over 300 other initial public offerings that occurred in 1999, 2000 and 2001.

The complaints against WebMD and its former officers and directors alleged violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 under that Act and Section 11 of the Securities Act of 1933 because of failure to disclose certain practices alleged to have occurred in connection with the distribution of shares in the Healtheon IPO. Claims under Section 12(a)(2) of the Securities Act of 1933 were also brought against the underwriters. These claims were consolidated, along with claims relating to over 300 other initial public offerings, in the Southern District of New York.

The plaintiffs have dismissed the claims against the four former officers and directors of WebMD without prejudice, pursuant to Reservation of Rights and Tolling Agreements with those individuals.

On July 15, 2002, the issuer defendants in the consolidated action, including WebMD, filed a joint motion to dismiss the consolidated complaints. On February 18, 2003, the District Court denied, with certain exceptions not relevant to WebMD, the issuer defendants' motion to dismiss.

After a lengthy mediation under the auspices of former United States District Judge Nicholas Politan, the issuer defendants in the consolidated action (including WebMD), the affected insurance companies and the plaintiffs reached an agreement on a settlement to resolve the matter among the participating issuer defendants, their insurers and the plaintiffs. The settlement is embodied in a Memorandum of Understanding and a number of related agreements that together set out a comprehensive framework for settlement of the consolidated actions among these parties. The settlement calls for the participating issuers' insurers jointly to guarantee that plaintiffs recover a certain amount in the IPO litigation and certain related litigation from the underwriters and other non-settling defendants. Accordingly, in the event that the guarantee becomes payable, the agreement calls for WebMD's insurance carriers, not WebMD, to pay WebMD's pro rata share.

WebMD has approved the settlement, and we understand that virtually all of the approximately 260 other issuer defendants who are eligible have also elected to participate in the settlement. Although WebMD believes that the claims alleged in the lawsuits were primarily directed at the underwriters and, as they relate to WebMD, were without merit, we believe that the settlement is beneficial to WebMD because it reduces the time, expense and risks of further litigation, particularly since virtually all of the other issuer defendants will participate and our insurance carriers strongly support the settlement.

In order for the settlement to become final, the Memorandum of Understanding must be reduced to a separate settlement agreement as to each issuer, each of which must be approved by the court. Accordingly, we anticipate, though we cannot guarantee, that this settlement will resolve the IPO allocation securities litigation between the plaintiffs and WebMD.

**Table of Contents**

**Merrill Lynch Fundamental Growth Fund, Inc. et al. v. McKesson HBOC, Inc., et al.**

WebMD has been named as a defendant in the action *Merrill Lynch Fundamental Growth Fund, Inc., et al. v. McKesson HBOC, Inc., et al.*, Case No. 405792, in the San Francisco Superior Court. The original complaint in this matter alleged that McKesson HBOC, HBO and Company (which we refer to as HBOC), certain officers and directors of those firms, Arthur Andersen LLP, and Bear Stearns & Co. engaged in a number of practices whereby HBOC and later McKesson HBOC improperly recognized revenues. When these practices were discovered, McKesson HBOC eliminated more than \$327 million in revenues that HBOC had recognized over the prior three years. Plaintiffs claim to have lost more than \$150 million as a result of the decline in McKesson HBOC's share value after the accounting practices came to light in April 1999.

On September 4, 2003, the plaintiffs filed a fourth amended complaint, naming WebMD and two other defendants, General Electric Capital Corporation, Inc. and Computer Associates International, Inc., for the first time. The complaint alleges that WebMD aided and abetted alleged fraud by certain defendants and conspired with those defendants in relation to HBOC's and McKesson HBOC's alleged improper recognition of approximately \$14 million in revenue on two software transactions. Plaintiffs also allege that WebMD made certain negligent misrepresentations with respect to these transactions.

Plaintiffs allege that WebMD, Inc. (then a separate private company and now a subsidiary of WebMD), through its participation in certain transactions with HBOC and McKesson HBOC, learned that officers of HBOC and/or McKesson HBOC, HBOC and McKesson HBOC were breaching duties owed to McKesson HBOC shareholders by making material misstatements and suppressing or omitting facts with respect to HBOC's and McKesson HBOC's financial results for the periods ending December 31, 1998 and March 31, 1999 and that WebMD, Inc. aided and abetted and conspired with these defendants. One of the officers became an officer of WebMD, Inc. on December 1, 1998, after having served as HBOC's representative on the board of WebMD, Inc. and was dismissed by WebMD, Inc. after the accounting fraud at HBOC was disclosed. The other officer served as HBOC's representative on the Board of WebMD, Inc. and ceased to be a director of WebMD, Inc. upon dismissal by McKesson HBOC. Plaintiffs seek unspecified damages against WebMD. The complaint alleges numerous instances of improper accounting by HBOC unrelated to the transactions between WebMD, Inc. and HBOC and/or McKesson HBOC.

WebMD intends to vigorously defend against the plaintiffs' claims against WebMD and WebMD, Inc. On December 16, 2003, WebMD filed a demurrer, seeking dismissal of the two claims against it. This demurrer is pending with the Court.

**Investigations by United States Attorney for the District of South Carolina and the SEC**

The United States Attorney for the District of South Carolina is conducting an investigation of our company, which we first learned about on September 3, 2003. On that date, Federal Bureau of Investigation and Internal Revenue Service agents executed search warrants at our corporate headquarters in Elmwood Park, New Jersey and the offices of Medical Manager Health Systems in Tampa, Florida and Alachua, Florida and delivered subpoenas for documents and financial records. Based on the information available to us as of the date of this Annual Report, we believe that the investigation relates principally to issues of financial reporting for Medical Manager Corporation, a predecessor of WebMD (by its merger into WebMD in September 2000), and our Medical Manager Health Systems subsidiary; however, we cannot be sure of the investigation's exact scope or how long it will continue. Included among the materials removed or subject to subpoena are records relating to a \$5.5 million restatement of revenue by Medical Manager Corporation in August 1999 and to acquisitions by our Medical Manager Health Systems subsidiary of other companies, most of which were dealers of Medical Manager products and services. In August 1999, Medical Manager Corporation announced that it would restate previously reported results of Medical Manager Health Systems, which it had acquired in July 1999, for the six months ended immediately prior to the acquisition. Medical Manager Corporation determined at the time that the accounting treatment previously accorded to five transactions involving the bulk sales of software licenses entered into concurrently with business combinations and other related transactions should be



## **Table of Contents**

restated to reflect the software license revenues as a reduction of the acquisition price of the related transactions. At the time, Medical Manager Corporation also noted that the transactions represented \$5,532,000 of revenue and \$3,502,000 of net income for the six months ended June 30, 1999. WebMD understands that the SEC is also conducting a formal investigation into this matter.

WebMD intends to continue to fully cooperate with the authorities in this matter and our Board of Directors has formed a special committee consisting solely of independent directors to oversee this matter. The special committee has retained independent legal counsel to advise it.

While WebMD is not able to estimate, at this time, the amount of the expenses that it will incur in connection with the investigations, it expects that they may be significant. For the year ended December 31, 2003, those expenses are reflected as Legal Expenses in the Consolidated Statements of Operations included in this Annual Report.

### **At Home Corporation General Unsecured Creditors Trust**

In 1999, WebMD, Inc. entered into an agreement with Excite Corp. concerning placing WebMD content on Excite Corp.'s consumer internet portal. In 2001, WebMD and Excite Corp.'s successor, AtHome Corp., entered into a revised agreement, which terminated the 1999 agreement and included a release of claims under the 1999 agreement. AtHome Corp. later filed for bankruptcy.

On December 4, 2003, WebMD was served with a complaint in an adversary proceeding in the Bankruptcy Court for the Northern District of California brought by the trustee for the At Home Corporation General Unsecured Creditors Trust. The plaintiff alleges that the 2001 agreement provided AtHome Corp. less than reasonably equivalent value for its rights under the 1999 agreement and that the 2001 agreement should be avoided as a fraudulent transfer. The plaintiff also alleges that WebMD breached the 1999 agreement by failing to make required cash payments, and failed to pay AtHome Corp. fair and reasonable value for services that AtHome Corp. provided. The plaintiff has claimed that its damages are in excess of \$8 million. WebMD intends to vigorously defend against the plaintiff's claims.

### **Porex Mammary Implant Litigation**

From 1988 through 1990, Porex distributed silicone mammary implants in the United States pursuant to a distribution arrangement with a Japanese manufacturer. Porex believes that, after accounting for implants returned to Porex, the aggregate number of persons who received implants distributed by Porex totals approximately 2,500. Since March 1991, Porex has been named as one of many co-defendants in a number of actions brought by recipients of mammary implants. The typical case or claim alleges that the individual's mammary implants caused one or more of a wide range of ailments. These implant cases and claims generally raise difficult and complex factual and legal issues and are subject to many uncertainties and complexities, including, but not limited to, the facts and circumstances of each particular case or claim, the jurisdiction in which each suit is brought, and differences in applicable law. Porex does not have sufficient information to evaluate each case and claim.

Certain of the actions against Porex have been dismissed, where it was determined that the implant in question was not distributed by Porex. In addition, as of March 10, 2004, approximately 300 actions have been settled by the manufacturer, or by Porex's insurance carriers, without material cost to Porex. As of March 10, 2004, no implant-related claims were pending against Porex. During calendar year 2003, there were no implant-related claims made against Porex by individuals, as compared to two claims during each of 2002, 2001 and 2000, 39 claims during 1999 and nine claims during 1998. The majority of claims made during 1999 were claims that were filed by individuals following a court ruling in 1999 that cases filed in earlier years would not proceed as class actions, as a result of which such individuals would not be members of a class in such cases.

In 1994, Porex was notified that its insurance carrier would not renew its then-existing insurance coverage after December 31, 1994 with respect to actions and claims arising out of its distribution of implants. However, Porex exercised its right, under such policy, to purchase extended reporting period coverage with respect to such actions and claims. Such coverage provides insurance subject to existing policy limits, but for an unlimited time period with respect to actions and claims made after December 31,

**Table of Contents**

1994 based on events that occurred during the policy period. In addition, Porex has purchased extended reporting period coverage with respect to other excess insurance. This coverage also extends indefinitely, replacing coverage that would, by its terms, have otherwise expired by December 31, 1997. Porex will continue to evaluate the need to purchase further extended reporting period coverage from excess insurers to the extent such coverage is reasonably available.

Porex believes that its present coverage, together with its insurance policies in effect on or before December 31, 1994, should provide adequate coverage against liabilities that could result from actions or claims arising out of Porex's distribution of silicone mammary implants. However, Porex cannot be certain that particular cases and claims will not result in liability that is greater than expected based on Porex's prior experience. If so, Porex's liability could exceed the amount of its insurance coverage. Furthermore, certain actions and claims seek punitive and compensatory damages arising out of alleged intentional torts. If these claims are successful, such damages may or may not be covered, in whole or in part, by Porex's insurance policies.

**Other Legal Proceedings**

In the normal course of business, we are involved in various other claims and legal proceedings. While the ultimate resolution of these matters, and those discussed above, has yet to be determined, we do not believe that their outcome will have a material adverse effect on our financial position or results of operations.

**Item 4. *Submission of Matters to a Vote of Security Holders***

During the fourth quarter of 2003, no matters were submitted to a vote of security holders of WebMD.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity and Related Stockholder Matters**

We completed the initial public offering of our common stock on February 10, 1999. Our common stock has been traded on the Nasdaq National Market under the symbol HLTH since February 11, 1999.

The high and low prices for each quarterly period during the last two fiscal years are as follows:

	<u>High</u>	<u>Low</u>
<b>2002</b>		
First quarter	\$ 8.86	\$6.25
Second quarter	7.78	5.05
Third quarter	6.23	4.25
Fourth quarter	9.30	4.54
<b>2003</b>		
First quarter	\$ 10.28	\$8.25
Second quarter	12.00	8.28
Third quarter	12.49	8.20
Fourth quarter	9.32	7.59

On March 1, 2004, there were approximately 4,470 holders of record of our common stock. Because many of these shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

The market price of our common stock has fluctuated since the date of our initial public offering and is likely to fluctuate in the future. Changes in the market price of our common stock and other securities may result from, among other things:

quarter-to-quarter variations in operating results

operating results being less than analysts' estimates

changes in analysts' earnings estimates

announcements of new technologies, products and services or pricing policies by us or our competitors

announcements of acquisitions or strategic partnerships by us or our competitors

developments in existing customer or strategic relationships

actual or perceived changes in our business strategy

developments in new or pending litigation and claims

sales of large amounts of our common stock

changes in market conditions in the healthcare, information technology, Internet or plastic industries

changes in general economic conditions

fluctuations in the securities markets in general.

In addition, the market prices of Internet and healthcare information technology stocks in general, and of our common stock in particular, have experienced large fluctuations, sometimes quite rapidly. These fluctuations often may be unrelated or disproportionate to the operating performance of these companies.

**Table of Contents**

Any negative change in the public's perception of the prospects of these companies, as well as other broad market and industry factors, may result in changes in the price of our common stock.

We have never declared or paid any cash dividends on our common stock, and we do not anticipate paying cash dividends in the foreseeable future. We intend to retain earnings to finance the expansion of our operations.

**Sales of Unregistered Securities During the Fourth Quarter of 2003**

On December 12, 2003, WebMD issued 288 shares of WebMD common stock to an individual in a transaction exempt from registration under Section 3(a)(9) of the Securities Act. The shares were issued upon exercise of an outstanding warrant originally issued to Gleacher & Co. and transferred by it to the individual.

**Table of Contents****Item 6. Selected Financial Data**

The following selected consolidated financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and with the consolidated financial statements and notes thereto, which are included elsewhere in this Annual Report. On August 1, 2003, we completed the sale of two operating units of our Plastic Technologies segment. Accordingly, the following selected consolidated financial data has been reclassified to reflect the historical results of these two operating units as discontinued operations.

	Years Ended December 31,				
	2003	2002	2001	2000	1999
(In thousands, except per share data)					
<b>Consolidated Statements of Operations Data:</b>					
Revenue	\$963,980	\$871,696	\$ 842,020	\$ 574,524	\$ 102,149
Costs and expenses:					
Cost of operations	564,939	509,744	568,321	430,296	88,576
Development and engineering	42,985	43,467	43,572	59,867	29,669
Sales, marketing, general and administrative	282,482	283,424	448,082	535,462	82,315
Depreciation, amortization and other	62,434	125,593	2,394,857	2,188,461	193,067
Legal expense	3,959				
Impairment of long-lived and other assets			3,816,115		
Restructuring and integration (benefit) charge		(5,850)	266,755	452,919	
(Gain) loss on investments	(1,659)	(6,547)		40,365	
Interest income	22,901	19,590	30,409	51,467	4,013
Interest expense	15,214	8,491	507	735	527
Other income, net	4,218	3,844			
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Income (loss) from continuing operations before income tax provision (benefit)	20,745	(63,192)	(6,665,780)	(3,082,114)	(287,992)
Income tax provision (benefit)	4,140	(10,079)	2,588	790	
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Income (loss) from continuing operations	16,605	(53,113)	(6,668,368)	(3,082,904)	(287,992)
Income (loss) from discontinued operations, net of income taxes	(33,611)	3,411	(3,950)	1,296	
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net loss	\$ (17,006)	\$ (49,702)	\$ (6,672,318)	\$ (3,081,608)	\$ (287,992)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Basic loss per common share:</b>					
Income (loss) from continuing operations	\$ 0.05	\$ (0.17)	\$ (19.13)	\$ (12.60)	\$ (3.58)
Income (loss) from discontinued operations	(0.11)	0.01	(0.01)	0.01	
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Net loss	\$ (0.06)	\$ (0.16)	\$ (19.14)	\$ (12.59)	\$ (3.58)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Diluted loss per common share:</b>					
Income (loss) from continuing operations	\$ 0.05	\$ (0.17)	\$ (19.13)	\$ (12.60)	\$ (3.58)

Edgar Filing: WEBMD CORP /NEW/ - Form 10-K

Income (loss) from discontinued operations	(0.10)	0.01	(0.01)	0.01	
Net loss	\$ (0.05)	\$ (0.16)	\$ (19.14)	\$ (12.59)	\$ (3.58)
Weighted-average shares outstanding used in computing income (loss) per common share:					
Basic	304,858	304,168	348,570	244,688	80,367
Diluted	325,811	304,168	348,570	244,688	80,367

**Table of Contents**

	As of December 31,				
	2003	2002	2001	2000	1999
	(In thousands)				
<b>Consolidated Balance Sheet</b>					
<b>Data:</b>					
Cash, cash equivalents and short-term investments	\$ 270,681	\$ 186,484	\$ 378,762	\$ 505,793	\$ 291,286
Long-term marketable securities	456,034	456,716	18,769	222,774	
Working capital	202,573	193,031	360,429	528,136	216,304
Total assets	2,135,306	1,766,248	1,601,454	8,487,108	4,123,668
Convertible subordinated notes	649,999	300,000			
Other long-term liabilities	1,182	498	1,226	15,279	2,695
Convertible redeemable preferred stock			10,000	10,000	
Convertible preferred stock				710,746	
Stockholders' equity	1,178,597	1,153,801	1,255,512	8,097,435	3,973,672



## **Table of Contents**

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

This Item 7 contains forward-looking statements with respect to possible events, outcomes or results that are, and are expected to continue to be, subject to risks, uncertainties and contingencies, including those identified in this Item. See Cautionary Statement Regarding Forward-Looking Statements on page 2.

#### **Overview**

Management's discussion and analysis of financial condition and results of operations, or MD&A, is provided as a supplement to the consolidated financial statements and notes thereto included elsewhere in this Annual Report and to provide an understanding of our results of operations, financial condition, and changes in financial condition. Our MD&A is organized as follows:

*Introduction.* This section provides a general description of our business, a brief discussion of our operating segments, summarizes the acquisitions we completed during the last two years and describes the restructuring and integration plans we undertook to eliminate duplication and redundancies that resulted from acquisitions we have made.

*Critical Accounting Policies and Estimates.* This section discusses those accounting policies that both are considered important to our financial condition and results of operations, and require us to exercise subjective or complex judgments in their application. In addition, all of our significant accounting policies, including our critical accounting policies, are summarized in Note 1 to our consolidated financial statements.

*Results of Operations and Results of Operations by Operating Segment.* These sections provide our analysis and outlook for the significant line items on our consolidated statements of operations, on both a company-wide and a segment-by-segment basis.

*Liquidity and Capital Resources.* This section provides an analysis of our liquidity and cash flows, as well as a discussion of our outstanding debt and commitments, that existed as of December 31, 2003.

*Factors That May Affect Our Future Financial Condition or Results of Operations.* This section describes circumstances or events that could have a negative effect on our financial results or operations or that could change, for the worse, existing trends in some or all of our businesses. The factors discussed in this section are in addition to factors that may be described elsewhere in this Annual Report.

#### **Introduction**

WebMD Corporation is a Delaware corporation that was incorporated in December 1995 and commenced operations in January 1996 as Healthon Corporation. We changed our name to Healthon/ WebMD Corporation in November 1999 and to WebMD Corporation in September 2000. Our common stock has traded on the Nasdaq National Market under the symbol HLTH since February 11, 1999.

On August 1, 2003, we completed the sale of two operating units of our Plastic Technologies segment. Accordingly, the historical results of these two operating units, including the loss related to the divestitures, have been reclassified as discontinued operations in our financial statements.

#### **Operating Segments**

We have aligned our business into four operating segments as follows:

*Transaction Services or WebMD Envoy.* We provide healthcare reimbursement cycle management services, including transmission of transactions between healthcare payers and physicians, pharmacies, dentists, hospitals, laboratory companies and other healthcare providers using dial-up, Internet and dedicated communication methods. Our services assist our customers in automating

## **Table of Contents**

key administrative and clinical functions. In addition, we provide automated patient billing services to providers, including statement printing and mailing services, and provide paid-claims communication services to third party administrators and health insurers, including print-and-mail services for the distribution of checks, remittance advice, and explanation of benefits.

*Physician Services or WebMD Practice Services.* We develop and market integrated physician practice management systems, including administrative, financial and clinical applications and services, under The Medical Manager, Intergy, ULTIA and Medical Manager Network Services brands. These systems and services allow physician offices to automate their scheduling, billing and other administrative tasks, to transmit transactions electronically, to maintain electronic medical records and to automate documentation of patient encounters.

*Portal Services or WebMD Health.* We provide online healthcare information, educational services and related resources for consumers and healthcare professionals, both directly and through our relationships with leading general consumer Internet portals. We also provide online content for use by media and healthcare partners in their Web sites. We develop and sell online and offline channels of communication and sponsorship programs to pharmaceutical, biotech, medical device and consumer products companies, particularly those who are interested in influencing healthcare decisions. In addition, we provide a suite of online tools and related services to employers and health plans for use by their employees and plan members.

*Plastic Technologies or Porex.* We develop, manufacture and distribute proprietary porous plastic products and components used in healthcare, industrial and consumer applications, as well as in finished products used in the medical device and surgical markets.

### **Acquisitions**

In 2003, we completed 12 acquisitions. Our Portal Services segment acquired two companies for a total purchase consideration of approximately \$14,612, comprised of \$14,400 in cash and \$212 of estimated acquisition costs. We will pay an additional \$2,500 if certain financial milestones are achieved. In connection with the preliminary allocation of the purchase price, we recorded goodwill of \$12,731 and intangible assets of \$3,525, with estimated useful lives of three to seven years. Our Transaction Services segment acquired three companies for a total purchase price of \$399,138, comprised of \$390,238 in cash and \$8,900 in estimated acquisition costs. Additionally, we will pay up to an additional \$154,200 if certain milestones are achieved in the future. In connection with the preliminary allocation of the purchase price of these three acquisitions, we recorded goodwill of \$244,021 and intangibles assets of \$142,092, with estimated useful lives ranging from nine months to fifteen years. Also, during 2003, our Physician Services segment acquired seven companies for a total cost of \$2,182, which was paid in cash. We will pay an additional \$675 if certain of the acquired companies meet certain financial milestones. In connection with the preliminary allocation of the purchase prices, goodwill of \$1,469 and intangible assets subject to amortization of \$1,054 were recorded. The intangible assets have estimated useful lives from three to nine years.

In 2002, we completed 22 acquisitions. On October 31, 2002, our Portal Services segment acquired one company. The total purchase consideration for this acquisition was approximately \$19,031, comprised of \$18,781 in cash and estimated acquisition costs of \$250. In connection with the allocation of the purchase price, we recorded goodwill of \$18,380 and an intangible asset of \$2,700 with an estimated useful life of three years. Also, throughout 2002, our Physician Services segment acquired 21 companies for a total cost of \$14,400 which was paid in cash. In connection with the allocation of the purchase price, goodwill of \$11,784 and intangible assets subject to amortization of \$4,049 were recorded. The intangible assets have estimated useful lives of one to nine years.

### **Restructuring and Integration Initiatives**

After the mergers with Medical Manager Corporation, CareInsite, Inc. and OnHealth Network Company in 2000, our Board of Directors approved a restructuring and integration plan, with the objective

## **Table of Contents**

of eliminating duplication and redundancies that resulted from these and certain prior acquisitions and consolidating our operational infrastructure into a common platform to more efficiently serve our customers.

Our restructuring and integration efforts continued in 2001, and a plan to include the impact of eliminating functions resulting from our acquisition of Medscape in December 2001 was initiated.

We have substantially completed our restructuring and integration efforts related to the 2000 and 2001 restructuring plans, with the primary exception being remaining lease payments of previously vacated facilities.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of WebMD's financial condition and results of operations are based upon our Consolidated Financial Statements and Notes to Consolidated Financial Statements, which were prepared in conformity with accounting principles generally accepted in the United States. The preparation of the consolidated financial statements requires us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. We base our estimates on historical experience, current business factors, and various other assumptions that we believe are necessary to form a basis for making judgments about the carrying values of assets and liabilities and disclosure of contingent assets and liabilities. Actual results could differ from these estimates.

We evaluate our estimates on an ongoing basis, including those related to revenue recognition, short-term and long-term investments, deferred tax assets, income taxes, collectibility of customer receivables, prepaid content and distribution services, long-lived assets including goodwill and other intangible assets, certain accrued expenses, accruals related to our restructuring program, contingencies and litigation.

We believe the following reflect our critical accounting policies and our more significant judgments and estimates used in the preparation of our consolidated financial statements:

**Revenue** Our revenue recognition policies for each reportable segment are as follows:

*Transaction Services or WebMD Envoy.* Healthcare payers and providers pay us fees for our services, generally on a per transaction basis or monthly basis. We recognize revenue as we perform the service. Healthcare payers and providers also pay us one-time implementation and annual maintenance fees. We recognize revenue from these fees ratably over the term of the respective agreements.

*Physician Services or WebMD Practice Services.* Healthcare providers pay us one-time fees for the purchase of our practice management systems. We recognize revenue from these one-time fees when we enter into noncancelable agreements with our customers, the products have been delivered and there are no uncertainties regarding product acceptance and delivery, no significant future performance obligations exist, fees are fixed and determinable and collectability is probable. Amounts received in advance of meeting these criteria are deferred until we meet these criteria. Revenue from multiple-element software arrangements is recognized using the residual method as vendor specific objective evidence (VSOE) of fair value exists for the undelivered elements, but not for all of the delivered elements. The residual method requires revenue to be allocated to the undelivered elements based on the fair value of such elements, as indicated by VSOE. VSOE is based on the price charged when an element is sold separately. Healthcare providers also pay us fees for maintenance and support of their practice management system, including the hardware and software. We recognize revenue from these fees ratably over the contract period, typically in one year or less. Healthcare providers also pay us fees for transmitting transactions to payers and patients. We recognize revenue from these fees, which are generally paid on a monthly or per transaction basis, as we provide the service.

*Portal Services or WebMD Health.* Customers pay us for advertising, sponsorship, healthcare management tools, continuing medical education (CME), content syndication and distribution,

**Table of Contents**

and e-commerce transactions related to our online distribution channels and the online and offline distribution channels of our strategic partners. Revenue from advertising is recognized as advertisements are delivered. Revenues from sponsorship arrangements and healthcare management tools are recognized ratably over the term of the applicable agreement. Revenue from CME arrangements is recognized over the period we satisfy the minimum credit hour requirements of the applicable agreements. Revenue from fixed fee content license or carriage fees is recognized ratably over the term of the applicable agreement. E-commerce revenue is recognized when a subscriber or consumer utilizes our Internet-based services or purchases goods or services through our Web site or co-branded Web site with one of our strategic partners. Subscription revenue, including subscription revenue from sponsorship arrangements, is recognized over the subscription period. When contractual arrangements contain multiple elements, revenue is allocated to the elements based on their relative fair values, determined using prices charged when elements are sold separately.

*Plastic Technologies or Porex.* We develop, manufacture and distribute porous plastic products and components. For standard products, we recognize revenue upon shipment of product, net of sales returns and allowances. For sales of certain custom products, we recognize revenue upon completion and customer acceptance. Recognition of amounts received in advance of meeting these criteria is deferred until we meet these criteria.

**Long-Lived Assets** Our long-lived assets consist of property and equipment, goodwill and other intangible assets. Goodwill and other intangible assets arise from the acquisitions we have made. The amount assigned to intangible assets is subjective and based on our estimates of the future benefit of the intangible asset using accepted valuation techniques, such as discounted cash flow and replacement cost models. Our long-lived assets are amortized over their estimated useful lives, which we determine based on the consideration of several factors, including the period of time the asset is expected to remain in service. We evaluate the carrying value and remaining useful lives of long-lived assets, excluding goodwill, whenever indicators of impairment are present. We evaluate the carrying value of goodwill annually. We use a discounted cash flow approach to determine the fair value of goodwill. During 2001, we identified certain indicators of possible impairment of our long-lived assets, primarily goodwill and other intangible assets. We evaluated our long-lived assets for impairment by determining identifiable cash flows to related asset groupings, and compared the projected undiscounted cash flows for each asset grouping to its carrying value. Once we determined there was an impairment, we quantified the impairment based on projected discounted cash flows. As a result of this analysis in 2001, we recorded an impairment charge of approximately \$3.8 billion. There was no impairment of goodwill noted as a result of our impairment testing in 2003 or 2002. Other unknown future indications of possible impairment charges, such as a significant downturn in one of our business segments or reporting units or general economic conditions, could result in an additional assessment of our long-lived assets for impairment and could result in an additional impairment charge in the future.

**Investments** Our investments, at December 31, 2003, consisted principally of certificates of deposit, municipal bonds, asset backed securities, Federal Agency Notes, U.S. Treasury Notes and an equity investment in a publicly traded company. For each reporting period, we evaluate the carrying value of our investments and record a loss on investments when we believe an investment has experienced a decline in value that is other than temporary. We do not recognize a gain on an investment until sold. Future changes in market or economic conditions or operating results of our investments could result in gains or losses or an inability to recover the carrying value of the investments that may not be reflected in an investment's carrying value.

**Deferred Tax Assets** Our deferred tax assets are comprised primarily of net operating loss carryforwards. At December 31, 2003, we had net operating loss carryforwards of approximately \$1.9 billion. These loss carryforwards may be used to offset taxable income in future periods, reducing the amount of taxes we might otherwise be required to pay. Due to a lack of a history of generating taxable income, we record a valuation allowance equal to 100% of our net deferred tax

**Table of Contents**

assets. In the event that we are able to generate taxable earnings in the future and determine it is more likely than not that we can realize our deferred tax assets, an adjustment to the valuation allowance would be made which may increase income in the period that such determination was made.

**Restructuring and Integration** In connection with our restructuring and integration efforts, modifications to our strategic relationship with News Corporation resulted in a change in the carrying value of advertising services we have the rights to, classified as prepaid content and distribution services. We estimated the fair value of our rights under the new agreement using a discounted cash flow approach. This estimate also affects the amortization of this asset in future periods over the contractual term. Also, in connection with our restructuring and integration efforts, we recorded charges for estimated future lease obligations and lease cancellation penalties related to exited facilities based on many different variables, such as the term to expiration, contractual rights under the lease agreement and current real estate market conditions. Future changes in any of these variables, such as a change in real estate market conditions, could have an impact on these estimates.

**Results of Operations**

The following table sets forth our consolidated statements of operations data and expresses that data as a percentage of revenue for the periods presented (amounts in thousands):

	Years Ended December 31,					
	2003		2002		2001	
	\$	%	\$	%	\$	%
Revenue	963,980	100.0	871,696	100.0	842,020	100.0
Costs and expenses:						
Cost of operations	564,939	58.6	509,744	58.5	568,321	67.5
Development and engineering	42,985	4.5	43,467	5.0	43,572	5.2
Sales, marketing, general and administrative	282,482	29.3	283,424	32.5	448,082	53.2
Depreciation, amortization and other	62,434	6.5	125,593	14.4	2,394,857	284.4
Legal expense	3,959	0.4				
Impairment of long-lived and other assets					3,816,115	453.2
Restructuring and integration (benefit) charge			(5,850)	(0.7)	266,755	31.7
Gain on investments	1,659	0.2	6,547	0.8		
Interest income	22,901	2.4	19,590	2.3	30,409	3.6
Interest expense	15,214	1.6	8,491	1.0	507	0.0
Other income, net	4,218	0.4	3,844	0.4		
Income (loss) from continuing operations before income tax provision (benefit)	20,745	2.1	(63,192)	(7.2)	(6,665,780)	(791.6)
Income tax provision (benefit)	4,140	0.4	(10,079)	(1.1)	2,588	0.3
Income (loss) from continuing operations	16,605	1.7	(53,113)	(6.1)	(6,668,368)	(791.9)
Income (loss) from discontinued operations, net of income taxes	(33,611)	(3.5)	3,411	0.4	(3,950)	(0.5)
Net loss	(17,006)	(1.8)	(49,702)	(5.7)	(6,672,318)	(792.4)

Revenue is derived from our four business segments: Transaction Services, Physician Services, Portal Services and Plastic Technologies. Our Transaction Services include administrative services, such as transaction processing for medical, dental and pharmacy claims, automated patient statements and clinical



## **Table of Contents**

lab and reporting services, such as lab test orders and results. A significant portion of Transaction Services revenues is generated from the country's largest national and regional healthcare payers. Our Physician Services include sales of practice management systems, including administrative, financial and clinical applications and services, under The Medical Manager, Intergy, ULTIA and Medical Manager Network Services brands. We also sell support and maintenance services related to the hardware and software associated with our practice management systems. Portal Services include advertising, sponsorship, continuing medical education, content syndication and distribution, and e-commerce transactions through our online distribution channels and the online and offline distribution channels of our strategic partners. The majority of Portal Services revenues are derived from a small number of customers. Our customers include pharmaceutical companies, biotech companies, medical device companies and media companies. Our Plastic Technologies revenue includes the sale of porous plastic components used to control the flow of fluids and gases for use in healthcare, industrial and consumer applications, as well as in finished products used in the medical device and surgical markets.

Cost of operations consists of costs related to services and products we provide to customers and costs associated with the operation and maintenance of our networks. These costs include salaries and related expenses for network operations personnel and customer support personnel, telecommunication costs, maintenance of network equipment, cost of hardware related to the sale of practice management systems, a portion of facilities expenses, leased personnel and facilities costs, sales commissions paid to certain distributors of our Transaction Services products, non-cash expenses related to content and distribution services. In addition, cost of operations includes raw materials, direct labor and manufacturing overhead, such as fringe benefits and indirect labor related to our Plastic Technologies segment.

Development and engineering expense consists primarily of salaries and related expenses associated with the development of applications and services. Expenses include compensation paid to development and engineering personnel, fees to outside contractors and consultants, and the maintenance of capital equipment used in the development process.

Sales, marketing, general and administrative expense consists primarily of advertising, product and brand promotion, salaries and related expenses for sales, administrative, finance, legal, information technology, human resources and executive personnel. These expenses include items related to account management and marketing personnel, commissions, costs and expenses for marketing programs and trade shows, and fees for professional marketing and advertising services, as well as fees for professional services, costs of general insurance and costs of accounting and internal control systems to support our operations. Also included are non-cash expenses related to content and distribution services acquired in exchange for our equity securities and stock compensation expense primarily related to the amortization of deferred compensation. Content and distribution services consist of advertising, promotion and distribution services from our arrangements with News Corporation, Microsoft, AOL and other partners. Stock compensation primarily relates to deferred compensation associated with the intrinsic value of the vested portion of stock options issued in exchange for outstanding stock options of companies we acquired in 2000, and the excess of the market price over the exercise price of options granted to employees.

### ***2003 and 2002***

#### ***Revenue***

Our total revenues increased to \$963,980 in 2003 from \$871,696 in 2002. Transaction Services, Physician Services, Portal Services and Plastic Technologies accounted for \$38,919, \$27,334, \$26,369 and \$6,129, respectively, of the revenue increase. This revenue increase was partially offset by an increase in inter-segment eliminations of \$6,467.

Revenue from customers acquired through the 2003 Acquisitions and 2002 Acquisitions contributed \$55,629 to the overall increase in revenue for 2003 of \$92,284. For purposes of this discussion, only revenue from existing customers of the acquired business on the date of the acquisition is considered to be revenue from acquired customers. We integrate acquisitions as quickly as practicable, and only revenue

**Table of Contents**

recognized during the first twelve months following the quarter in which the acquisitions closed is considered to be revenue from acquired customers.

*Costs and Expenses*

*Cost of Operations.* Cost of operations increased to \$564,939 in 2003 from \$509,744 in 2002. Our cost of operations represented 58.6% of revenues in 2003, compared to 58.5% in 2002. While cost of operations as a percentage of revenue has remained relatively consistent from 2003 to 2002, cost of operations increased due to our July 17, 2003 acquisition of ABF, whose products have a lower gross margin. Additionally, cost of operations increased due to higher sales commissions paid to our channel partners and due to higher consulting and personnel costs related to our implementation of the Health Insurance Portability and Accountability Act of 1996, or HIPAA. These increases were offset by lower data communication costs and the costs associated with the lower margin terminated products and relationships exited in May 2002. Cost of operations for 2003 and 2002 includes approximately \$2,356 and \$4,765, respectively, of non-cash expenses related to content and distribution services.

*Development and Engineering.* Development and engineering expense was \$42,985 and \$43,467 in 2003 and 2002, respectively. Development and engineering expense was relatively flat in 2003 compared to 2002, both in the aggregate and at the segment level, reflecting relatively consistent spending throughout all operating segments.

*Sales, Marketing, General and Administrative.* Sales, marketing, general and administrative expense decreased to \$282,482 in 2003, from \$283,424 in 2002, which represents a decrease of \$942. Included in sales, marketing, general and administrative expense are non-cash expenses related to content and distribution services and stock compensation. Non-cash expenses related to content and distribution services were \$21,942 in 2003, compared to \$20,941 in 2002. Non-cash stock compensation was \$12,449 in 2003, compared to \$25,265 in 2002. The decrease in non-cash stock compensation is primarily related to the vesting schedules of options issued and assumed in connection with our 2000 acquisitions. Sales, marketing, general and administrative expense excluding the non-cash expenses discussed above, were \$248,091, or 25.7% of revenue in 2003, compared to \$237,218, or 27.2% of revenue in 2002. The decrease in sales, marketing, general and administrative expense, excluding the non-cash expenses discussed above, as a percentage of revenue, is due to the fixed cost leverage of our increased revenues as well as lower sales and marketing costs, partially offset by higher consulting and personnel costs related to our implementation efforts with respect to the HIPAA Transaction Standards and our all-payer services, higher professional services expenses, and higher insurance expenses.

*Depreciation, Amortization and Other.* Depreciation, amortization and other expense decreased to \$62,434 in 2003 from \$125,593 in 2002. The decrease was primarily the result of intangible assets relating to certain acquisitions made in 1999 and 2000 becoming fully amortized since the beginning of the prior year period.

*Legal Expense.* Legal expense in 2003 was \$3,959 and represents the costs and expenses incurred related to the investigation by the United States Attorney for the District of South Carolina initiated on September 3, 2003. Over the course of the investigation, we expect that these costs and expenses may be significant.

*Impairment of Long-Lived and Other Assets.* During 2003 and 2002, we performed the impairment tests of goodwill, as required by Statement of Financial Accounting Standards ( SFAS ) No. 142, Goodwill and Other Intangible Assets . There was no impairment resulting from these tests.

*Restructuring and Integration (Benefit) Charge.* In connection with our restructuring and integration efforts, we recorded a benefit of \$5,850 in 2002, which related to the settlement of certain contractual obligations. There were no restructuring or integration charges recorded during 2003.

*Gain on Investments.* During 2003, the gain on investments in the amount of \$1,659 consisted of a gain of \$2,973 related to the sale of a portion of our investments in marketable equity securities, offset by a loss of \$1,314 related to the sale of our investments in marketable debt securities. During 2002, we



## **Table of Contents**

recognized a gain on investments of \$6,547, which is comprised of a gain of \$5,866 and \$681 related to the sale of our investment in an available-for-sale and an early redemption call of a held-to-maturity security, respectively.

*Interest Income.* Interest income increased to \$22,901 in 2003, from \$19,590 in 2002. This increase was mainly due to higher average investment balances, partially offset by lower average rates of return, during 2003 as compared to 2002. The higher average investment balances in 2003 were primarily attributable to the proceeds from the issuance of our \$300,000 3 1/4% Convertible Subordinated Notes in April 2002, and the issuance of our \$350,000 1.75% Convertible Subordinated Notes in June and July 2003.

*Interest Expense.* Interest expense increased to \$15,214 in 2003, from \$8,491 in 2002, due to the inclusion of a full year of interest expense and amortization of debt issuance costs related to our \$300,000 3 1/4% Convertible Subordinated Notes issued in April 2002 and the interest expense and amortization of debt issuance costs related to our \$350,000 1.75% Convertible Subordinated Notes issued in June and July of 2003.

*Other Income, Net.* Other income for 2003 of \$4,218 is comprised of a gain of \$3,100 for the sale of property in California and Ohio and a benefit of \$1,118 from a state tax refund which applied to a pre-acquisition tax year of a company we acquired. Other income of \$3,844 in 2002 includes \$5,223 for the settlement of various pre-acquisition issues related to certain companies acquired in 1998 through 2000, partially offset by \$1,379 in expenses related to our disposition plan for our Plastic Technologies business.

*Income Tax Provision (Benefit).* Income tax provision (benefit) in 2003 and 2002 primarily represents taxes from profitable operations in certain states and foreign countries in which we do not have net operating losses to offset that income. Accordingly, we provided for taxes of \$4,140 and \$2,808 related to foreign, state and other jurisdictions during 2003 and 2002, respectively. Also included in the 2002 income tax provision (benefit) is a \$12,887 benefit reflecting the carryback of net operating losses to the prior periods of certain acquired subsidiaries, in which those subsidiaries generated taxable income. The carryback was allowed as a result of the Job Creation and Worker Assistance Act of 2002 that was enacted on March 9, 2002.

*Discontinued Operations.* Loss from discontinued operations in 2003 represents the operating results of the discontinued units of the Plastic Technologies segment as well as the loss of \$3,491 recognized in connection with their disposal on August 1, 2003. Also included in the loss from discontinued operations in 2003 was an impairment charge of \$33,113 to reduce the long-lived assets of the discontinued units to fair value. The income from discontinued operations in 2002 includes the operating results of the discontinued units.

### ***2002 and 2001 Revenue***

Our total revenues increased to \$871,696 in 2002 from \$842,020 in 2001. Transaction Services, Physician Services, Portal Services and Plastic Technologies accounted for \$9,362, \$15,097, \$9,670 and \$3,794, respectively, of the revenue increase. This revenue increase was partially offset by an increase in inter-segment eliminations and other of \$8,247 which included revenue related to technology outsourcing and consulting relationships and other non-core products that the Company exited in 2002 and 2001.

### ***Costs and Expenses***

*Cost of Operations.* Cost of operations decreased to \$509,744 in 2002 from \$568,321 in 2001. Our cost of operations represented 58.5% of revenues in 2002, compared to 67.5% in 2001. This decrease was primarily due to the elimination of costs as a result of our restructuring and integration initiatives, primarily reduced personnel and facilities related costs from consolidating data center operations in our Transaction Services segment as well as in our Portal Services segment. Also contributing to the decrease was the elimination of direct costs associated with residual revenue from technology outsourcing and

**Table of Contents**

consulting relationships and other non-core products that were exited in 2002 and 2001. Cost of operations for 2002 and 2001 includes approximately \$4,765 and \$1,531, respectively, in non-cash expenses related to content and distribution services.

*Development and Engineering.* Development and engineering expense was \$43,467 in 2002 and \$43,572 in 2001. During 2002, we increased our investment in product offerings in both the Transaction Services and Physician Services segments, which was predominantly offset by the impact of cost reductions resulting from our restructuring and integration efforts.

*Sales, Marketing, General and Administrative.* Sales, marketing, general and administrative expense decreased to \$283,424 in 2002 from \$448,082 in 2001, which represents a decrease of 36.7% or \$164,658. Included in sales, marketing, general and administrative expense are non-cash expenses related to content and distribution services and stock compensation. Non-cash expenses related to content and distribution services were \$20,941 in 2002, compared to \$43,943 in 2001. This decrease was primarily due to the expiration of certain content and distribution alliance agreements. Non-cash stock compensation was \$25,265 in 2002, compared to \$78,451 in 2001. The decrease in non-cash stock compensation was primarily related to the vesting schedules of options issued and assumed in connection with our 2000 acquisitions. Sales, marketing, general and administrative expense excluding the non-cash expenses discussed above, decreased to \$237,218 in 2002 from \$325,688 in 2001. This decrease was primarily due to the elimination of costs as a result of our restructuring and integration efforts and, to a lesser extent, due to reduced advertising expenses related to the elimination of barter arrangements and distribution costs in our Portal Services segment, as well as lower personnel related costs and lower bad debt expense.

*Depreciation, Amortization and Other.* Depreciation, amortization and other expense decreased to \$125,593 in 2002 from \$2.4 billion in 2001. The decrease was primarily attributable to the adoption of SFAS No. 142 on January 1, 2002, which eliminates amortization expenses related to goodwill and certain intangibles and requires these assets to be tested for impairment at least annually. We recorded goodwill and intangible amortization of \$2.2 billion in 2001, related to goodwill and certain intangible assets that were not subject to amortization in 2002.

*Impairment of Long-Lived and Other Assets.* During 2002, we performed both the transitional and annual impairment tests of goodwill, as required by SFAS No. 142. There was no impairment resulting from these tests. During 2001, we identified certain indicators of possible impairment of long-lived assets, primarily goodwill and other acquired intangible assets. These indicators included a further decline in the price of our common stock to its lowest price in the previous twelve months accompanied by a significant decline in the volatility of our stock price, a sustained decline in valuations in the e-health, technology and Internet sectors, and the impact of recent trends in general economic conditions. Based on these indicators, we reviewed substantially all of our long-lived assets for impairment. As a result of this review, we determined that our long-lived and other assets, primarily goodwill and other acquired intangibles, were impaired and recorded a write-down of \$3.8 billion during 2001.

*Restructuring and Integration (Benefit) Charge.* In connection with our restructuring and integration efforts, we recorded a net benefit of \$5,850 in 2002, which was primarily due to the settlements of certain contractual obligations. During 2001, we continued our restructuring efforts that began in 2000, with the intention of eliminating duplication and redundancy that resulted from 2000 and 2001 acquisitions. These restructuring efforts resulted in a charge of \$266,755 in 2001.

*Gain on Investments.* Gain on investments of \$6,547 in 2002 represented a \$5,866 gain related to the sale of one of our investments in available-for-sale securities and a \$681 gain related to one of our investments in held-to-maturity securities that was called for early redemption.

*Interest Income.* Interest income decreased to \$19,590 in 2002, from \$30,409 in 2001. This decrease is due to lower average balances available for investment as a result of cash used to settle certain contracts with certain of our strategic partners, repurchases of our stock, acquisitions during 2002 and payments made under our restructuring and integration program combined with lower available rates of return, offset

**Table of Contents**

in part by interest income related to the \$292,000 of net proceeds received from the issuance of our \$300,000 3 1/4% Convertible Subordinated Notes in April 2002.

*Interest Expense.* Interest expense increased to \$8,491 in 2002 from \$507 in 2001, as a result of interest expense and amortization of debt issuance costs related to our \$300,000 3 1/4% Convertible Subordinated Notes issued in April 2002.

*Other Income, Net.* Other income of \$3,844 in 2002 included \$5,223 for the settlement of various preacquisition issues related to certain companies acquired in 1998 through 2000. This income was partially offset by \$1,379 in expenses related to our disposition plan for our Plastic Technologies business.

*Income Tax Provision (Benefit).* Income tax provision (benefit) in 2002 included a \$12,887 benefit reflecting the carryback of net operating losses to the prior periods of certain acquired subsidiaries, in which those subsidiaries generated taxable income. The carryback was allowed as a result of the Job Creation and Worker Assistance Act of 2002 that was enacted on March 9, 2002. In addition, we have operations that are profitable in certain states and foreign countries in which we do not have net operating losses to offset that income. Accordingly, we provided for taxes of \$2,808 and \$2,588 related to foreign, state and other jurisdictions during 2002 and 2001, respectively.

*Discontinued Operations.* Income from discontinued operations in 2002 represents the operating results of the discontinued units of the Plastic Technologies segment. The loss from discontinued operations in 2001 includes the operating results of the discontinued operating units as well as an impairment charge of \$10,778 representing the difference between the carrying value and fair value of the discontinued operating units assets.

**Results of Operations by Operating Segment**

We evaluate the performance of our business segments based upon income or loss before restructuring, taxes, non-cash and other items. Non-cash and other items include depreciation, amortization, accretion of preferred stock, impairment charges, costs and expenses related to the investigation by the United States Attorney for the District of South Carolina and the SEC ( legal expense ), gain on investments, other income, non-cash expenses related to content, advertising and distribution services acquired in exchange for our equity securities in acquisitions and strategic alliances, and stock compensation primarily related to stock options issued and assumed in connection with acquisitions. The accounting policies of the segments are the same as the accounting policies for the consolidated company. We record inter-segment revenues at rates comparable to those charged to third parties for comparable services. Inter-segment revenues are eliminated in consolidation.

The following table presents the results of our operations for each of our reportable segments (amounts in thousands):

	Years Ended December 31,		
	2003	2002	2001
<b>Revenues</b>			
Transaction services	\$ 505,729	\$ 466,810	\$ 457,448
Physician services	302,640	275,306	260,209
Portal services	110,665	84,296	74,626
Plastic technologies	71,940	65,811	62,017
Eliminations and other, net	(26,994)	(20,527)	(12,280)(a)
	<u>\$ 963,980</u>	<u>\$ 871,696</u>	<u>\$ 842,020</u>
<b>Income (loss) before restructuring, taxes, non-cash and other items</b>			
Transaction services	\$ 94,218	\$ 85,154	\$ 41,987
Physician services	20,924	26,685	20,827

**Table of Contents**

	Years Ended December 31,		
	2003	2002	2001
Portal services	24,898	5,574	(79,437)
Plastic technologies	20,532	19,891	17,406
Corporate and other	(50,251)	(51,272)	(94,813)
Interest income	22,901	19,590	30,409
Interest expense	(15,214)	(8,491)	(507)
	<u>\$ 118,008</u>	<u>\$ 97,131</u>	<u>\$ (64,128)</u>
<b>Restructuring, taxes, non-cash and other items</b>			
Depreciation, amortization and other	\$ (62,434)	\$ (125,593)	\$ (2,394,857)
Non-cash content and distribution services and stock compensation	(36,747)	(50,971)	(123,925)
Impairment of long-lived and other assets			(3,816,115)
Restructuring and integration benefit (charge)		5,850	(266,755)
Legal expense	(3,959)		
Gain on investments	1,659	6,547	
Other income, net	4,218	3,844	
Income tax benefit (provision)	(4,140)	10,079	(2,588)
	<u>16,605</u>	<u>(53,113)</u>	<u>(6,668,368)</u>
Income (loss) from discontinued operations, net of income taxes	(33,611)	3,411	(3,950)
	<u>\$ (17,006)</u>	<u>\$ (49,702)</u>	<u>\$ (6,672,318)</u>

- (a) In 2001, includes revenues related to technology outsourcing and consulting relationships and other non-core products that we decided to exit as a result of restructuring and integration efforts that commenced in the third quarter of 2000, as well as the elimination of inter-segment revenues of \$14,061.

**2003 and 2002**

*Transaction Services.* Revenues were \$505,729 in 2003, an increase of \$38,919 or 8.3% from 2002. Revenues from customers acquired through the 2003 Acquisitions contributed \$37,870 to the increase in Transaction Services revenue. Additionally, revenues for 2002 include \$7,460 of revenues associated with terminated laboratory connectivity products and relationships exited. Excluding the impact of the 2003 Acquisitions and terminated products and relationships, revenues for 2003 increased by \$8,509, primarily the result of a postal rate increase that went into effect on July 1, 2002.

Income before restructuring, taxes, non-cash and other items was \$94,218 in 2003, an increase of \$9,064 or 10.6% from 2002. As a percentage of revenue, income before restructuring, taxes, non-cash and other items was 18.6% in 2003, compared to 18.2% in 2002. The slight improvement in income as a percentage of revenue was due to lower data communication costs and the elimination of costs associated with the terminated products and relationship discussed above, offset by higher sales commissions paid to our channel partners, and increased costs related to our implementation efforts with respect to the HIPAA Transaction Standards and our all-payer network services.

*Physician Services.* Revenues were \$302,640 in 2003, an increase of \$27,334 or 9.9% from 2002. The increase was primarily attributable to an increase in Network Services revenues. Systems sales and maintenance revenues also increased, primarily as a result of revenues from customers acquired. Those customers contributed \$8,180 to the increase in revenues in 2003.

## **Table of Contents**

Income before restructuring, taxes, non-cash and other items was \$20,924 in 2003, a decrease of \$5,761 from 2002. As a percentage of revenue, income before restructuring, taxes, non-cash and other items was 6.9% in 2003, compared to 9.7% in 2002. This decrease in income as a percentage of revenue was primarily attributable to increased costs related to our implementation efforts with respect to the HIPAA Transaction Standards and our all-payer network services, as well as a shift in sales focus to larger accounts in 2003, which generally carry lower margins as a percentage of sales.

*Portal Services.* Revenues were \$110,665 in 2003, an increase of \$26,369 or 31.3% from 2002. Revenues from customers acquired through 2003 Acquisitions and 2002 Acquisitions contributed \$9,579 to the increase in Portal Service revenue for 2003. Excluding the 2003 Acquisitions and 2002 Acquisitions, the increase was primarily attributable to growth in advertising and sponsorship revenues on our consumer and professional sites, and, to a lesser extent, an increase in revenues from health plans and employers.

Income before restructuring, taxes, non-cash and other items in 2003 was \$24,898, compared to \$5,574 in 2002. As a percentage of revenue, the income before restructuring, taxes, non-cash and other items improved to 22.5% in 2003, compared to 6.6% in 2002. This improvement was the result of fixed cost leverage related to the increased revenues discussed above and reduced sales and marketing related costs during 2003 compared to 2002. Also included in income before restructuring, taxes, non-cash and other items in 2003 was \$1,863 of expense related to the acquisition of certain resources of Physicians Online.

*Plastic Technologies.* Revenues were \$71,940 in 2003, an increase of \$6,129 or 9.3% from 2002. The increase was primarily due to a favorable impact of foreign exchange rates, higher sales of our computer printing and writing instrument components and higher sales of our surgical products.

Income before restructuring, taxes, non-cash and other items in 2003 was \$20,532, an increase of \$641 from 2002. As a percentage of revenue, income before restructuring, taxes, non-cash and other items was 28.5% in 2003, compared to 30.2% in 2002. This decrease in income as a percentage of revenue was due to higher sales and marketing and product development expenses.

*Corporate and Other.* Corporate and other includes expenses shared across all segments, such as executive personnel, corporate finance, legal, human resources and risk management. Corporate and other expenses declined to \$50,251 or 5.2% of consolidated revenue in 2003 from \$51,272 or 5.9% of consolidated revenue in 2002 due to lower personnel and facility costs, partially offset by higher insurance expenses and higher professional services expenses.

*Eliminations and Other, Net.* The increase of \$6,467 in inter-segment eliminations from 2002 resulted from higher sales of Transaction Services products into the Physician Services customer base.

### ***2002 and 2001***

*Transaction Services.* Revenues were \$466,810 in 2002, an increase of \$9,362 from 2001. The increase was due to higher transaction volumes and the impact of the postal rate increase that was effective July 1, 2002. These increases were partially offset by the net reduction in revenues of \$22,511 in 2002, when compared to 2001. This reduction in revenue related to certain terminated products and relationships, such as hospital and laboratory connectivity relationships and consolidation of duplicate product offerings in 2001 and 2002.

Income before restructuring, taxes, non-cash and other items in 2002 increased by \$43,167 or 102.8% from 2001. As a percentage of revenue, income before restructuring, taxes, non-cash and other items improved to 18.2% in 2002, from 9.2% in 2001. The improvement was a result of our consolidation and integration efforts which resulted in lower personnel and occupancy-related expenses and the elimination of certain unprofitable products and relationships.

*Physician Services.* Revenues were \$275,306 in 2002, an increase of \$15,097 from 2001. The increase was primarily attributable to an increase in Network Services revenues, as well as higher systems sales and maintenance revenues. The higher sales in 2002 reflect the impact of the June 2002 release of Intergy. Revenues from customers acquired through 2002 Acquisitions and 2001 Acquisitions contributed \$6,781 to the increase in revenues in 2002.

## **Table of Contents**

Income before restructuring, taxes, non-cash and other items increased by \$5,858 in 2002 from 2001. As a percentage of revenue, income before restructuring, taxes, non-cash and other items was 9.7% in 2002, compared to 8.0% in 2001. This improvement related to changes in the mix of revenues offset by roll-out costs related to our new products.

*Portal Services.* Revenues were \$84,296 in 2002, an increase of \$9,670 from 2001. The increase was a result of higher levels of sponsorship from our customers, the acquisition of Medscape in late 2001 and WellMed in late 2002, which contributed an aggregate of \$23,449 in revenues during 2002, partially offset by the elimination of arrangements which generated barter revenue of \$19,009 in 2001. No barter revenue was recognized during 2002. Revenue from related parties was \$3,000 in 2001. These revenues consist of services provided to News Corporation. Revenue from News Corporation ceased being considered from a related party as of February 15, 2001 when News Corporation surrendered our Series A Convertible Preferred Stock.

Income before restructuring, taxes, non-cash and other items in 2002 was \$5,574, compared to a loss of \$79,437 in 2001. As a percentage of revenue, the income (loss) before restructuring, taxes, non-cash and other items improved to 6.6% in 2002, compared to (106.4)% in 2001. Our restructuring, integration and cost containment efforts have resulted in substantial reductions in personnel, marketing, advertising, content, distribution and other expenses.

*Plastic Technologies.* Revenues were \$65,811 in 2002, an increase of \$3,794 from 2001. The increase was primarily due to higher sales of medical OEM components, surgical products and computer printing components.

Income before restructuring, taxes, non-cash and other items in 2002 was \$19,891, an increase of \$2,485 from 2001. As a percentage of revenue, income before restructuring, taxes, non-cash and other items was 30.2% in 2002 compared to 28.1% in 2001. This increase was due to higher sales discussed above, partially offset by an increase in certain direct manufacturing and other costs.

*Corporate and Other* includes expenses shared across all segments, such as executive personnel, corporate finance, legal, human resources and risk management as well as the residual costs during the prior year periods related to the exit of discontinued products resulting from our restructuring and integration efforts. Corporate and other expenses declined to \$51,272 in 2002 from \$94,813 in 2001 as a result of consolidating many duplicative corporate functions and the elimination of residual expenses related to discontinued products. These efforts resulted in reduced expenses in occupancy, personnel, outside services and other operating expenses.

*Eliminations and Other, Net.* The increase of \$8,247 in inter-segment eliminations from 2001 resulted from higher sales of Transaction Services products into the Physician Services customer base, offset by the elimination of \$1,781 in revenues from technology outsourcing and consulting relationships and other non-core products exited in 2001.

## **Liquidity and Capital Resources**

We have incurred significant operating and net losses since we began operations and, as of December 31, 2003, we had an accumulated deficit of \$10.2 billion. We plan to continue to invest in acquisitions, strategic relationships, infrastructure and product development.

As of December 31, 2003, we had approximately \$270,681 in cash and cash equivalents and short-term investments and working capital of \$202,573. Additionally, we had long-term investments of \$451,290 in marketable debt securities and \$4,744 in marketable equity securities. We invest our excess cash principally in U.S. Treasury obligations and federal agency notes and expect to do so in the future. During 2003, we reviewed the classification of our marketable securities between available-for-sale and held-to-maturity. As a result of our review, we reclassified all remaining held-to-maturity securities to available-for-sale.

Cash provided by operating activities was \$82,239 in 2003, compared to cash provided by operating activities of \$93,097 in 2002. The cash provided by operating activities in 2003 was primarily attributable to the net loss of \$17,006 and a net decrease in operating assets and liabilities of \$36,164, offset by non-

**Table of Contents**

cash charges of \$101,427 and the loss from discontinued operations of \$33,611. The impact of changes in operating assets and liabilities may change in future periods, depending on the timing of each period end in relation to items such as internal payroll and billing cycles, payments from customers, payments to vendors, interest payments relating to our 3 1/4% Convertible Subordinated Notes and our 1.75% Convertible Subordinated Notes and interest receipts relating to our investments in marketable securities. The cash provided by operating activities in 2002 was primarily attributable to a net loss of \$49,702 and a net decrease in operating assets and liabilities of \$34,828, offset by non-cash charges of \$177,673. The non-cash charges consist of depreciation and amortization, non-cash expenses related to content and distribution services and stock compensation and amortization of debt issuance costs.

Cash used in investing activities was \$556,526 in 2003, compared to cash used in investing activities of \$402,663 in 2002. Cash used in investing activities during 2003 included \$598,367 of purchases of held-to-maturity and available-for-sale securities, partially offset by \$405,213 of proceeds from the maturities, sales and redemptions of available-for-sale and held-to-maturity securities. Cash used in investing activities in 2002 primarily related to purchases of held-to-maturity and available-for-sale securities. The 2003 Acquisitions consumed cash of \$400,491, net of cash acquired, primarily related to the Medifax and ABF acquisitions. Cash paid for the 2002 Acquisitions was \$33,471 and related to the Medscape and Physician Services acquisitions. Investments in property and equipment were \$18,385 in 2003, compared to \$26,267 in 2002. Additionally we received proceeds of \$56,279 related to the sale of our discontinued operations and the sale of certain property, primarily land and buildings.

Cash provided by financing activities was \$356,621 in 2003 compared to cash provided by financing activities of \$201,751 in 2002. Cash provided by financing activities for 2003 principally relates to net proceeds of \$339,125 from the issuance of the 1.75% Convertible Subordinated Notes on June 25, 2003 and July 7, 2003, and \$44,719 related to the issuance of common stock, primarily due to exercises of employee stock options. Cash provided by financing activities for 2002 primarily related to \$292,000 of net proceeds related to the issuance of our 3 1/4% Convertible Subordinated Notes on April 1, 2002. During 2003 and 2002, \$20,316 and \$104,960, respectively, was used for repurchases of our common stock.

As of December 31, 2003, we did not have any material commitments for capital expenditures. Our principal commitments at December 31, 2003 consisted primarily of our commitments related to the \$350,000 of 1.75% Convertible Subordinated Notes due in June of 2023 and the \$299,999 of 3 1/4% Convertible Subordinated Notes due in April of 2007, obligations under operating leases and potential earnout payments of up to an aggregate of \$157,375 related to completed acquisitions. The following table summarizes our principal commitments as of December 31, 2003, as well as management's estimates of the timing of the cash flows associated with these commitments. Management's estimates of the timing of future cash flows are largely based on historical experience, and accordingly, actual timing of cash flows may vary from these estimates. The potential earnout payments of up to \$157,375 have not been included in the table below as it is impracticable to estimate the timing or amount of any payments related to these commitments.

	<u>Total</u>	<u>Less Than 1 Year</u>	<u>1-3 Years</u>	<u>3-5 Years</u>	<u>More Than 5 Years</u>
	(In thousands)				
Leases	\$ 119,508	\$ 24,082	\$ 36,038	\$ 26,547	\$ 32,841
Strategic Relationships	2,641	1,262	1,254	125	
Long-Term Debt	649,999			299,999	350,000
Purchase Obligations	35,485	20,886	14,599		
Other Long-Term Liabilities	1,182		727	51	404
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total	\$ 808,815	\$ 46,230	\$ 52,618	\$ 326,722	\$ 383,245
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

Purchase obligations include amounts committed under legally enforceable contracts or purchase orders for goods and services with defined terms as to price, quantity and delivery.

## **Table of Contents**

The lease amounts include leases identified in our restructuring and integration efforts and are net of sublease income. Other long-term liabilities primarily include those amounts on the Company's December 31, 2003 balance sheet representing the long term portion of capital leases.

We believe that, for the foreseeable future, we will have sufficient cash resources to meet the commitments described above and our currently anticipated working capital and capital expenditure requirements, including the capital requirements related to the roll-out of new or updated products in 2004 and 2005. Our future liquidity and capital requirements will depend upon numerous factors, including the success of the integration of our businesses, retention of customers at current volume and revenue levels, our existing and new application and service offerings, competing technological and market developments, potential future acquisitions and additional repurchases of our common stock. In addition, we have been incurring, and expect to continue to incur, costs relating to our own implementation of the HIPAA Transaction Standards and for assistance we provide to our customers in their implementation efforts. Our ability to perform our services in compliance with HIPAA and the cost to us of doing so will depend on, among other things, the status of the compliance efforts of our payer and provider customers and the extent of the need to adjust our systems and procedures in response to changes in their systems and procedures. We may need to raise additional funds to support expansion, develop new or enhanced applications and services, respond to competitive pressures, acquire complementary businesses or technologies or take advantage of unanticipated opportunities. If required, we may raise such additional funds through public or private debt or equity financing, strategic relationships or other arrangements. There can be no assurance that such financing will be available on acceptable terms, if at all, or that such financing will not be dilutive to our stockholders.

## **Recent Accounting Pronouncements**

In May 2003, the FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity ( SFAS No. 150 ). SFAS No. 150 requires that certain financial instruments, which under previous guidance were accounted for as equity, must now be accounted for as liabilities. The financial instruments affected include mandatorily redeemable stock, certain financial instruments that require or may require the issuer to buy back some of its shares in exchange for cash or other assets and certain obligations that can be settled with shares of stock. SFAS No. 150 is effective for all financial instruments entered into or modified after May 31, 2003 and must be applied to our existing financial instruments effective July 1, 2003, the beginning of the first fiscal period after June 15, 2003. The adoption of SFAS No. 150 on June 1, 2003 did not have any effect on our consolidated financial position or results of operations.

In November 2002, the Emerging Issues Task Force issued a final consensus on issue 00-21, Accounting for Revenue Arrangements with Multiple Deliverables ( EITF 00-21 ) which addresses how to account for arrangements that may involve the delivery or performance of multiple products, services, and/or rights to use assets. EITF 00-21 is effective prospectively for arrangements entered into in fiscal periods beginning after June 15, 2003. Companies may also elect to apply the provisions of EITF 00-21 to existing arrangements and record the operating statement impact as the cumulative effect of a change in accounting principle. We have adopted EITF 00-21 prospectively for contracts beginning after June 30, 2003. The adoption of EITF 00-21 did not have a material impact on our consolidated financial position or results of operations.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others ( FIN 45 ). The interpretation elaborates on the disclosures to be made in our interim and annual financial statements about obligations under certain guarantees. It also requires us to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements are effective for financial statements of interim and annual periods ending after December 15, 2002. The initial measurement and recognition provisions are required to be applied on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN 45 did not have a material impact on our consolidated financial position or results of operations.



## **Table of Contents**

In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities ( SFAS No. 146 ). SFAS No. 146 requires recording costs associated with exit or disposal activities at their fair values when a liability has been incurred. Under previous guidance, certain exit costs were accrued upon management's commitment to an exit plan, which is generally before an actual liability has been incurred. SFAS No. 146 is effective for exit or disposal activities initiated after December 31, 2002. SFAS No. 146 will have an impact on the timing of the recording of any future restructuring charges.

## **Factors That May Affect Our Future Financial Condition or Results of Operations**

This section describes circumstances or events that could have a negative effect on our financial results or operations or that could change, for the worse, existing trends in some or all of our businesses. The occurrence of one or more of the circumstances or events described below could have a material adverse effect on our financial condition, results of operations and cash flows or on the trading prices of the common stock and convertible notes that we have issued. The risks and uncertainties described below are not the only ones facing WebMD. Additional risks and uncertainties that are not currently known to us or that we currently believe are immaterial may also adversely affect our business and operations.

---

### **Risks Related to Our Relationships with Customers and Strategic Partners**

#### ***WebMD Envoy's transaction volume and financial results could be adversely affected if we do not maintain relationships with practice management system vendors and large submitters of healthcare electronic data interchange, or EDI, transactions***

We have developed relationships with practice management system vendors and large submitters of healthcare claims to increase the usage of our WebMD Envoy transaction services. WebMD Practice Services is a competitor of these practice management system vendors. These vendors, as a result of our ownership of WebMD Practice Services or for other reasons, may choose in the future to diminish or terminate their relationships with WebMD Envoy. Some other large submitters of claims compete with, or may have significant relationships with entities that compete with, WebMD Envoy or WebMD Health. To the extent that we are not able to maintain mutually satisfactory relationships with the larger practice management system vendors and large submitters of healthcare EDI transactions, WebMD Envoy's transaction volume and financial results could be adversely affected.

#### ***WebMD Envoy's transaction volume and financial results could be adversely affected if payers and providers conduct EDI transactions without using a clearinghouse***

There can be no assurance that healthcare payers and providers will continue to use WebMD Envoy and other independent companies to transmit healthcare transactions. Some payers currently offer electronic data transmission services to healthcare providers that establish a direct link between the provider and payer, bypassing third-party EDI service providers such as WebMD Envoy. We cannot provide assurance that we will be able to maintain our existing links to payers and providers or develop new connections on satisfactory terms, if at all. Although the standardization of formats and data standards required by HIPAA is only partial and we believe that use of clearinghouses will continue to be the most efficient way for most providers to transact electronically with multiple payers, such standardization may facilitate additional use of direct EDI links for transmission of transactions between a greater number of healthcare payers and providers without use of a clearinghouse. Any significant increase in the utilization of direct links between healthcare providers and payers could have a material adverse effect on WebMD Envoy's transaction volume and financial results.

**Table of Contents**

***Loss of a small number of sponsors could have a material adverse effect on WebMD Health's revenues***

A substantial portion of WebMD Health's revenues come from a relatively small number of companies. Thus, the loss of a small number of these relationships or a reduction in the purchases by a portion of these sponsors could have a material adverse effect on our Portal Services revenues. We may lose such relationships or experience a reduction in purchases if customers decide not to renew their commitments or renew at lower levels, which may occur if we fail to meet our customers' expectations or needs or fail to keep up with our competition or for reasons outside our control, including changes in economic and regulatory conditions affecting the healthcare industry or changes specific to the businesses of particular customers. For more information, see [Risks Related to Providing Products and Services to the Healthcare Industry](#) [Developments in the healthcare industry could adversely affect our business](#) below and [Business](#) [Government Regulation](#) above.

***Third parties may bring claims as a result of the activities of our strategic partners or resellers of our products and services***

We could be subject to claims by third parties, and to liability, as a result of the activities, products or services of our strategic partners or resellers of our products and services. Even if these claims do not result in liability to us, investigating and defending these claims could be expensive, time-consuming and result in adverse publicity that could harm our business.

---

**Risks Related to the Development and Performance of Our  
Healthcare Information Services and Technology Solutions**

***Our ability to generate revenue could suffer if we do not continue to update and improve our existing products and services and develop new ones***

We must introduce new healthcare information services and technology solutions and improve the functionality of our existing products and services in a timely manner in order to retain existing customers and attract new ones. However, we may not be successful in responding to technological and regulatory developments and changing customer needs. The pace of change in the markets we serve is rapid, and there are frequent new product and service introductions by our competitors and by vendors whose products and services we use in providing our own products and services. If we do not respond successfully to technological and regulatory changes and evolving industry standards, our products and services may become obsolete. Technological changes may also result in the offering of competitive products and services at lower prices than we are charging for our products and services, which could result in our losing sales unless we lower the prices we charge. In addition, there can be no assurance that the products we develop or license will be able to compete with the alternatives available to our customers. For more information about the competition we face, see [Business](#) [Healthcare Information Services and Technology Solutions](#) [Competition for Our Healthcare Information Services and Technology Solutions](#) above.

***Developing and implementing new or updated products and services may take longer and cost more than expected***

We rely on a combination of internal development, strategic relationships, licensing and acquisitions to develop our products and services. The cost of developing new healthcare information services and technology solutions is inherently difficult to estimate. Our development and implementation of proposed products and services may take longer than originally expected, require more testing than originally anticipated and require the acquisition of additional personnel and other resources. If we are unable to develop new or updated products and services on a timely basis and implement them without significant disruptions to the existing systems and processes of our customers, we may lose potential sales and harm our relationships with current or potential customers.

## **Table of Contents**

For example, we have been incurring, and expect to continue to incur, significant expenses relating to implementation of the HIPAA electronic transaction and code sets standards and our all-payer suite of services, including expenses for additional technical and customer service personnel.

Implementation of the HIPAA transaction standards requires us, among other things, to make significant changes to the software WebMD Envoy uses internally, to engage in testing with its customers and to implement additional quality assurance processes. If our reprogramming and testing are not completed on a timely basis, we could lose customers and revenues.

Implementation of our all-payer suite of transaction services requires us to expand our connectivity to support a broader set of transaction services to non-commercial payers in key markets as well as to improve the functional capability of our claims and accounts receivable management solutions. We may not have enough technicians, programmers and customer service personnel to meet the demands placed on those functions by our customers and partners during the implementation period, which could adversely affect our relationships with them. The amount and timing of future expenses for the HIPAA and all-payer implementations are difficult to estimate and may exceed amounts we have budgeted or continue for longer than expected. For more information about HIPAA see Business Government Regulation above. For a description of our all-payer suite of services see Business Healthcare Information Services and Technology Solutions WebMD Envoy EDI Transaction Services Medical and Dental Administrative Services above.

### ***New or updated products and services will not become profitable unless they achieve sufficient levels of market acceptance***

There can be no assurance that healthcare providers and payers will accept from us new or updated products and services or products and services that result from integrating existing and/or acquired products and services. Providers and payers may choose to use similar products and services from our competitors if they are already using products and services of those competitors and have made extensive investments in hardware, software and training relating to those products and services. Even providers and payers who are already our customers may not purchase new or updated products or services, especially when they are initially offered. Providers and payers using our existing products and services may refuse to adopt new or updated products and services when they have made extensive investments in hardware, software and training relating to those existing products and services. In addition, there can be no assurance that any pricing strategy that we implement for any such products and services will be economically viable or acceptable to the target markets. Failure to achieve broad penetration in target markets with respect to new or updated products and services could have a material adverse effect on our business prospects.

For example, we are working to transform WebMD Envoy from a commercial claims clearinghouse to a supplier of a full complement of reimbursement cycle management solutions, including outsourcing of pre- and post-adjudication services for payer customers, sending claims transactions and receiving electronic remittance advice transactions for our provider and vendor customers, and other value-added services. However, there can be no assurance that customers who use our services for sending and receiving claims will use our other services, that our other services will attract additional customers or that such services will generate sufficient revenues to cover the costs of developing, marketing and providing those services.

### ***Achieving market acceptance of new or updated products and services is likely to require significant efforts and expenditures***

Achieving market acceptance for new or updated products and services is likely to require substantial marketing efforts and expenditure of significant funds to create awareness and demand by participants in the healthcare industry. In addition, deployment of new or updated products and services may require the use of additional resources for training our existing sales force and customer service personnel and for hiring and training additional salespersons and customer service personnel. There can be no assurance that

**Table of Contents**

the revenue opportunities from new or updated products and services will justify amounts spent for their development, marketing and roll-out.

***We could be subject to breach of warranty, product liability or other claims if our software products, information technology systems or transmission systems contain errors or experience failures***

Undetected errors in the software and systems we provide to customers or the software and systems we use to provide services could cause serious problems for our customers. For example, errors in our transaction processing systems can result in healthcare payers paying the wrong amount or making payments to the wrong payee. If problems like these occur, our customers may seek compensation from us or may seek to terminate their agreements with us, withhold payments due to us, seek refunds from us of part or all of the fees charged under those agreements or initiate litigation or other dispute resolution procedures. We also provide products and services that assist in healthcare decision-making, including some that relate to patient medical histories and treatment plans. If these products malfunction or fail to provide accurate and timely information, we could be subject to product liability claims. In addition, we could face breach of warranty or other claims or additional development costs if our software and systems do not meet contractual performance standards, do not perform in accordance with their documentation, or do not meet the expectations that our customers have for them. Our software and systems are inherently complex and, despite testing and quality control, we cannot be certain that errors will not be found in prior versions, current versions or future versions or enhancements. See also During times when we are making significant changes to our products and services, there are increased risks of performance problems below.

We attempt to limit, by contract, our liability for damages arising from negligence, errors or mistakes. However, contractual limitations on liability may not be enforceable in certain circumstances or may otherwise not provide sufficient protection to us from liability for damages. We maintain general liability insurance coverage, including coverage for errors and omissions. However, it is possible that claims could exceed the amount of our applicable insurance coverage or that this coverage may not continue to be available on acceptable terms or in sufficient amounts. Even if these claims do not result in liability to us, investigating and defending against them could be expensive and time consuming and could divert management's attention away from our operations. In addition, negative publicity caused by these events may delay market acceptance of our products and services, including unrelated products and services.

***Performance problems with WebMD Envoy's systems or system failures could cause us to lose customers or cause customers to reduce the number of transactions we process for them***

We process payer and provider transactions and data at our own facilities and at a data center in Tampa, Florida that is operated by an independent third party. We have contingency plans for emergencies with our systems; however, we have limited backup facilities to process information if these facilities are not functioning. The occurrence of a major catastrophic event or other system failure at any of our facilities or at the third-party facility could interrupt data processing or result in the loss of stored data, which could have a material adverse impact on our business.

Our payer and provider customer satisfaction and our business could be harmed if WebMD Envoy experiences transmission delays or failures or loss of data in its systems. WebMD Envoy's systems are complex and, despite testing and quality control, we cannot be certain that problems will not occur or that they will be detected and corrected promptly if they do occur. See also During times when we are making significant changes to our products and services, there are increased risks of performance problems below.

***During times when we are making significant changes to our products and services, there are increased risks of performance problems***

If we do not respond successfully to technological and regulatory changes and evolving industry standards, our products and services may become obsolete. See Our ability to generate revenue could suffer if we do not continue to update and improve our existing products and services and develop new

## **Table of Contents**

ones. The software and systems that we sell and that we use to provide services are inherently complex and, despite testing and quality control, we cannot be certain that errors will not be found in any enhancements, updates and new versions that we market or use. Even if new products and services do not have performance problems, our technical and customer service personnel may have difficulties in installing them or in their efforts to provide any necessary training and support to customers.

For example, we have had and may continue to have transmission or processing problems relating to implementation of the HIPAA electronic transaction and code sets standards and our all-payer suite of services. See Developing and implementing new or updated products and services may take longer and cost more than expected above. These problems include: transmission failures resulting from sending large batches of electronic transactions to non-commercial payers who have been accustomed to receiving transactions through a greater number of smaller batches; enrollment and other set-up errors resulting from the implementation of large numbers of customers simultaneously; and various other transmission, processing, interfacing and service problems resulting from the implementation of new software and new business processes.

### ***If our systems or the Internet experience security breaches or are otherwise perceived to be insecure, our business could suffer***

A significant security breach could damage our reputation or result in liability. We retain and transmit confidential information, including patient health information, in our processing centers and other facilities. It is critical that these facilities and infrastructure remain secure and be perceived by the marketplace as secure. We may be required to expend significant capital and other resources to protect against security breaches and hackers or to alleviate problems caused by breaches. Despite the implementation of security measures, this infrastructure or other systems that we interface with, including the Internet and related systems, may be vulnerable to physical break-ins, hackers, improper employee or contractor access, computer viruses, programming errors, attacks by third parties or similar disruptive problems. Any compromise of our security, whether as a result of our own systems or systems that they interface with, could reduce demand for our services. See also Business Government Regulation Health Insurance Portability and Accountability Act of 1996 Security Standards.

### ***Performance problems with WebMD Envoy's systems could affect our relationships with customers of our Practice Services business***

WebMD Envoy provides the transaction services, including the all-payer transaction services, used by the Medical Manager Network Services customers of our Practice Services business. As an increasing number of our WebMD Practice Services customers rely on us to provide our all-payer suite of transaction services, disruptions to those services could cause some of those customers to obtain some or all of their software support requirements from competitors of ours or could cause some customers to switch to a competing physician practice management or billing software solution.

### ***WebMD Envoy's ability to provide transaction services depends on services provided by telecommunications companies***

WebMD Envoy relies on a limited number of suppliers to provide some of the telecommunications services necessary for its transaction services. The telecommunications industry has been subject to significant changes as a result of changes in technology, regulation and the underlying economy. Recently, many telecommunications companies have experienced financial problems and some have sought bankruptcy protection. Some of these companies have discontinued telecommunications services for which they had contractual obligations to WebMD Envoy. WebMD Envoy's inability to source telecommunications services at reasonable prices due to a loss of competitive suppliers could affect its ability to maintain its margins until it is able to raise its prices to its customers and, if it is not able to raise its prices, could have a material adverse effect on its financial results.

**Table of Contents**

**Risks Related to Providing Products and Services to the Healthcare Industry**

***Developments in the healthcare industry could adversely affect our business***

Almost all of the revenues of WebMD Health, WebMD Envoy and WebMD Practice Services come from customers in various parts of the healthcare industry. In addition, a significant portion of Porex's revenues come from products used in healthcare or related applications. Developments that result in a reduction of expenditures by customers or potential customers in the healthcare industry could have a material adverse effect on our business. General reductions in expenditures by healthcare industry participants could result from, among other things:

government regulation or private initiatives that affect the manner in which healthcare providers interact with patients, payers or other healthcare industry participants, including changes in pricing or means of delivery of healthcare products and services (for additional discussion of the potential effects of regulatory matters on our business and on participants in the healthcare industry, see the other Risks Related to Providing Products and Services to the Healthcare Industry described below in this section and Business Government Regulation above);

consolidation of healthcare industry participants;

reductions in governmental funding for healthcare; and

adverse changes in business or economic conditions affecting healthcare payers or providers, pharmaceutical companies, medical device manufacturers or other healthcare industry participants.

Even if general expenditures by industry participants remain the same or increase, developments in the healthcare industry may result in reduced spending on information technology and services or in some or all of the specific segments of that market we serve or are planning to serve. For example, use of our products and services could be affected by:

changes in the billing patterns of healthcare providers;

changes in the design of health insurance plans;

changes in the contracting methods payers use in their relationships with providers; and

decreases in marketing expenditures by pharmaceutical companies or medical device manufacturers, including as a result of governmental regulation or private initiatives that discourage or prohibit promotional activities by pharmaceutical or medical device companies.

In addition, expectations of our customers regarding pending or potential industry developments may also affect their budgeting processes and spending plans with respect to products and services of the types we provide.

The healthcare industry has changed significantly in recent years and we expect that significant changes will continue to occur. However, the timing and impact of developments in the healthcare industry are difficult to predict. We cannot provide assurance that the markets for our products and services will continue to exist at current levels or that we will have adequate technical, financial and marketing resources to react to changes in those markets.

***The HIPAA Transaction and Code Set Standards creates risks and challenges with respect to our compliance efforts, business strategies and customer relationships***

*Application of the Transaction Standards to WebMD.* October 16, 2003 was the deadline for covered entities to comply with HIPAA's electronic transaction and code sets standards (which we refer to as the Transaction Standards). Failure to comply with the Transaction Standards may subject WebMD Envoy to civil monetary penalties, and possibly to criminal penalties. On July 24, 2003, the Centers for Medicare & Medicaid Services, or CMS, released its Guidance on Compliance with HIPAA Transactions and Code Sets After the October 16, 2003 Implementation Deadline (which we refer to as the CMS Guidance). In addition, on July 24, 2003, CMS officials participated in an Open Door Forum teleconference during



**Table of Contents**

which they provided additional clarification on planned enforcement practices. CMS also urged the adoption of contingency plans to help prevent disruptions in the healthcare payment system. Under CMS's contingency plan for Medicare, it will continue to accept claims in both HIPAA standard and legacy formats, with the legacy formats to be accepted for a period to be determined by CMS based upon a regular reassessment of the readiness of its electronic trading partners. In response, WebMD Envoy announced a contingency plan, pursuant to which it continues to process HIPAA standard transactions and, for a limited period of time, will also process legacy transactions as appropriate based on the needs of our business partners.

On February 27, 2004, CMS modified its Medicare contingency plan to delay the payment of electronic claims that are not HIPAA-compliant. Specifically, effective July 1, 2004, only claims that are compliant with the Transaction Standards are to be reported as electronic media claims (EMC), which may be paid no earlier than after a 13 day waiting period. All other claims (including both electronic claims that are not compliant with the Transaction Standards, as well as paper claims) may be paid no earlier than after a 26 day waiting period. Calling it a measured step toward ending the contingency plan entirely, CMS implemented the change to encourage providers to move more quickly with their efforts to achieve HIPAA compliance. This policy may provide an incentive for providers who cannot send HIPAA standard claims from their desktop to use a clearinghouse, such as WebMD Envoy, to do so.

CMS has made clear that it expects each party to every transaction to be accountable for compliance with the new standards. However, the CMS Guidance provides for a flexible, complaint-driven enforcement strategy that will take into consideration good faith efforts to comply with the Transaction Standards. We believe that CMS's enforcement approach assisted in reducing disruptions in the flow of electronic transactions that otherwise could have occurred. However, one short-term effect of CMS's approach and related transition matters may be that, as a result of the extended period of testing and implementation, there could be fewer electronic transactions for us to process in 2004 than would otherwise have been the case.

We cannot provide assurance regarding how CMS will regulate clearinghouses in general or WebMD Envoy in particular. In addition, even though major disruptions in the flow of electronic transactions may be less likely in light of CMS's current approach to enforcement of the Transaction Standards, we have experienced isolated disruptions and some delays and we expect that there will continue to be some problems for a period of time. We continue to work diligently to identify and resolve problems as they occur. The costs to us of dealing with those problems are inherently difficult to estimate and may be more than we expect and/or continue for longer than anticipated. In addition, most of our trading partners are currently operating under their own contingency plans and, accordingly, we would expect that there will be further disruptions during the adjustment period that occurs once CMS requires all applicable parties to perform in accordance with the Transaction Standards. We may not have enough technicians, programmers and customer service personnel to meet the demands placed on those functions by our customers and partners during that adjustment period, which could adversely affect our relationships with them.

*Implementation Challenges.* Implementation of the Transaction Standards has presented us with significant technical and operational challenges. For example, the Transaction Standards cover not only transaction formats, but also required content, including some content not previously collected by most providers. We are working with our trading partners to complete quality assurance and testing on our enhanced clearinghouse data services for transmitting additional data content provided for in the Transaction Standards. We do not plan to place these services into full production until both our systems and payers' adjudication systems are capable of handling the production volume of transactions with the additional data content. As with any highly complex data transition involving significant modifications to trading partner systems, we are experiencing some problems during this process. Another aspect of the implementation challenges resulting from the Transaction Standards is the increase in computing capacity required. The Transaction Standards formats are much larger than the pre-existing ones. We are utilizing more computing capacity than we had anticipated. As a result, our systems have experienced inefficiencies that have resulted in processing delays. We seek to resolve all such problems when identified, but testing



## **Table of Contents**

continues with numerous submitters and payers and no assurance can be given that we will identify all problems promptly or that we will not continue to experience problems that delay the full implementation of these enhanced data services. See also *Developing and implementing new or updated products and services may take longer and cost more than expected* and *During times when we are making significant changes to our products and services, there are increased risks of performance problems* above.

From October 16, 2003 to the date of this Annual Report, a large majority of the claims we have received from submitters used legacy formats and very few contained the additional data content provided for in the Transaction Standards. A small number of our submitters currently send some additional HIPAA data content that does not yet pass through our clearinghouse. In order to facilitate transmission of claims with the standard HIPAA format, our clearinghouse software uses edits, including the use of default data, in the transmission of claims from our clearinghouse and some data received by us is not transmitted by us. To date, our software, editing procedures and production criteria for additional HIPAA content have not had a material effect on our ability to process and transmit transactions.

*Implementation Costs.* We have been incurring, and expect to continue to incur, significant expenses relating to implementation of the Transaction Standards. Implementation of the Transaction Standards requires us, among other things, to make significant changes to the software WebMD Envoy uses internally, to engage in testing with its customers and to implement additional quality assurance processes. If our reprogramming and testing are not completed on a timely basis, we could lose customers and revenues. In addition, our ability to perform our transaction services in compliance with HIPAA and the cost to us of doing so will depend on, among other things, the status of the compliance efforts of our payer and provider customers and the extent of the need to adjust our systems and procedures in response to changes in their systems and procedures. We cannot control when or how payers, providers, practice management system vendors or other healthcare participants will comply with the Transaction Standards or predict how their compliance efforts will affect their relationships with us, including the volume of transactions for which they use our services. Our technological and strategic responses to the Transaction Standards may result in conflicts with, or other adverse changes in our relationships with, some healthcare industry participants, including some who are existing or potential customers for our products and services or existing or potential strategic partners.

*Use of Direct Links.* Although the standardization of formats and data standards required by HIPAA is only partial and we believe that use of clearinghouses will continue to be the most efficient way for most providers to transact electronically with multiple payers, such standardization may facilitate use of direct EDI links, for transmission of transactions between a greater number of healthcare payers and providers without use of a clearinghouse. Any significant increase in the utilization of direct links between healthcare providers and payers could have a material adverse effect on WebMD Envoy's transaction volume and financial results.

For additional information regarding the Transaction Standards and a discussion of the risks and challenges associated with other portions of HIPAA and related regulations, see *Business Government Regulation* above.

### ***Changes in government regulation or industry guidelines could adversely affect our continuing medical education offerings***

WebMD Health's Medscape physician portal is a leading provider of online continuing medical education, or CME, to physicians and other healthcare professionals, offering a wide selection of free, regularly updated online CME activities. We receive funding from pharmaceutical and medical device companies for these CME programs. See *Business Healthcare Information Services and Technology Solutions WebMD Health Medscape from WebMD Continuing Medical Education (CME)* above.

Our CME activities are planned and implemented in accordance with the Essential Areas and Policies of the Accreditation Council for Continuing Medical Education, or ACCME, which oversees providers of CME credit. In August 2002, ACCME awarded Medscape a two-year provisional accreditation as a CME

## **Table of Contents**

provider, allowing Medscape to certify online CME activities. Provision of CME is also subject to government regulation by the FDA and the Office of Inspector General, or OIG, of the United States Department of Health and Human Services, a federal agency responsible for interpreting certain federal laws relating to healthcare. Among the goals of regulation of CME is ensuring that funding of CME programs by pharmaceutical and medical device companies is not a means of providing improper remuneration to physicians or others in a position to generate business for those companies and does not result in improper influence or control of the content of CME programs by the sponsoring companies. See Business Government Regulation Regulation of Healthcare Relationships and FDA and FTC Regulation of Advertising above and Other government regulation of healthcare and healthcare information technology creates risks and challenges with respect to our compliance efforts and our business strategies below.

Increased scrutiny by regulators of CME sponsorship by pharmaceutical or medical device companies, changes to existing regulation or ACCME guidelines or changes in internal compliance procedures of potential sponsors may require Medscape to make changes in the way it offers or provides CME programs, may slow sponsors internal approval processes for CME, and may reduce the volume of sponsored CME programs implemented by Medscape to levels that are lower than expected.

### ***Other government regulation of healthcare and healthcare information technology creates risks and challenges with respect to our compliance efforts and our business strategies***

*General.* The healthcare industry is highly regulated and is subject to changing political, regulatory and other influences. These factors affect the purchasing practices and operations of healthcare organizations. Federal and state legislatures and agencies periodically consider programs to reform or revise the United States healthcare system. These programs may contain proposals to increase governmental involvement in healthcare, lower reimbursement rates or otherwise change the environment in which healthcare industry participants operate. Healthcare industry participants may respond by reducing their investments or postponing investment decisions, including investments in our applications and services. We are unable to predict future proposals with any certainty or to predict the effect they would have on our business. In addition, existing laws and regulations could create liability, cause us to incur additional costs or restrict our operations. Although we carefully review our practices with regulatory experts in an effort to ensure that we are in compliance with all applicable state and federal laws, these laws are complex and subject to interpretation by courts and other governmental authorities, who may take positions that are inconsistent with our practices.

*Healthcare Relationships.* A federal law commonly known as the Federal Healthcare Programs anti-kickback law and several similar state laws prohibit payments that are intended to induce healthcare providers either to refer patients or to acquire or arrange for or recommend the acquisition of healthcare products or services. These laws are broad and may apply to some of our activities or our relationships with our customers, advertisers or strategic partners. Other federal and state laws generally prohibit individuals or entities from knowingly presenting, or causing to be presented, claims for payment from Medicare, Medicaid, or other third-party payers that are false or fraudulent, or are for items or services that were not provided as claimed. Since we provide transaction services to healthcare providers, we cannot provide assurance that the government will regard errors in transactions processed by us as inadvertent and not in violation of these laws. In addition, our transaction services include providing edits, using logic, mapping and defaults, to enhance the information submitted in claims in order to assist in claims processing. We believe that our editing practices are in compliance with industry practice and applicable laws; however, it is possible that a court or governmental agency might interpret these laws in a different manner, which could result in liability and adversely affect our business. In addition, changes in these laws could also require us to incur costs or restrict our business operations. Many anti-kickback and false claims laws prescribe civil and criminal penalties for noncompliance that can be substantial. Even an unsuccessful challenge by regulatory authorities of our practices could cause us adverse publicity and be costly for us to respond to.

## **Table of Contents**

*Regulation of Medical Devices.* Certain of Porex's products are medical devices regulated by the Food and Drug Administration, or FDA, such as plastic and reconstructive surgical implants, intravenous administration sets, blood filters, and tissue expanders. These products are subject to comprehensive government regulation under the Food, Drug and Cosmetic Act and implementing regulations. In addition, the FDA regulates WebMD Practice Services' DIM<sub>x</sub> System as a medical image management device. If the FDA were to find that we have not complied with required procedures, it can bring a wide variety of enforcement actions that could result in severe civil and criminal sanctions. Porex is also subject to similar regulation in international markets, with similar risks. Future products that we wish to bring to market may require clearances or approvals from governmental authorities, which may be expensive, time-consuming and burdensome to obtain or which may never be obtained.

For more information regarding healthcare regulation to which we are or may be subject, see [Business Government Regulation](#) above.

---

### **Risks Related to Our Web Sites and Our Use of the Internet**

#### ***Government regulation of the Internet could adversely affect our business***

The Internet and its associated technologies are subject to government regulation. Our failure, or the failure of our business partners, to accurately anticipate the application of applicable laws and regulations, or any other failure to comply, could create liability for us, result in adverse publicity, or negatively affect our business. In addition, new laws and regulations, or new interpretations of existing laws and regulations, may be adopted with respect to the Internet or other online services covering user privacy, patient confidentiality, consumer protection and other issues, including pricing, content, copyrights and patents, distribution, and characteristics and quality of products and services. We cannot predict whether these laws or regulations will change or how such changes will affect our business. Government regulation of the Internet could limit the effectiveness of the Internet for services that we are providing or developing or even prohibit particular services.

For more information regarding government regulation of the Internet to which we are or may be subject, see [Business Government Regulation](#) above.

#### ***We face potential liability related to the privacy and security of personal information we collect on our Web sites***

Internet user privacy has become a controversial issue both in the United States and abroad. We have privacy policies posted on our consumer portal and our professional portal that we believe comply with applicable laws requiring notice to users about our information collection, use and disclosure practices. However, whether and how existing privacy and consumer protection laws in various jurisdictions apply to the Internet is still uncertain and may take years to resolve. Any legislation or regulation in the area of privacy of personal information could affect the way we operate our Web sites and could harm our business. Further, we can give no assurance that the statements on our portals, or our practices, will be found sufficient to protect us from liability or adverse publicity in this area.

Some of our portal services may, through contractual relationships, be affected by the HIPAA Privacy Standards and Security Standards. For more information regarding the HIPAA Privacy and Security Standards and other regulation of the collection, use and disclosure of personal information to which we may be subject, see [Business Government Regulation](#) above.

#### ***Our ability to maintain or increase our Portal Services sponsorship revenues will depend, in part, on our ability to retain or increase usage of our Portal Services by consumers and physicians***

WebMD Health generates revenues by, among other things, selling sponsorships of specific pages, sections or events on its online physician and consumer portals and related e-mailed newsletters. Our WebMD Health sponsors include pharmaceutical, biotech, medical device and consumer products

## **Table of Contents**

companies that are interested in communicating with and educating our audience or parts of our audience. While we currently attract a large audience of health-involved consumers and clinically active healthcare professionals to our online offerings, we cannot provide assurance that we will continue to do so. Users of our portals have numerous other online and offline sources of healthcare information services. In addition, some of WebMD Health's traffic and new members come to it through relationships with third parties, including MSN and AOL, and, as a result, depends on the amount of traffic to sites of the third parties and other factors outside our control and may cease if the relationship ends.

### ***Implementation of changes in hardware and software platforms used to deliver our Web sites may result in performance problems***

From time to time, we implement changes to the hardware and software platforms we use for creating and delivering our Web sites. During and after the implementation of those changes, a platform may not perform as expected, which could result in interruptions in the operation of our Web sites, an increase in response time of those sites or an inability to track performance metrics.

Any significant interruption in our ability to operate our Web sites could have an adverse effect on our relationship with users and sponsors and, as a result, on our financial results.

### ***Our Internet-based services rely on third-party service providers***

Our Web sites are designed to operate 24 hours a day, seven days a week, without interruption. To do so, we rely on communications and hosting services provided by third parties. We do not maintain redundant systems or facilities for some of these services. To operate without interruption, both we and our service providers must guard against:

damage from fire, power loss and other natural disasters;

communications failures;

software and hardware errors, failures or crashes;

security breaches, computer viruses and similar disruptive problems; and

other potential interruptions.

We have experienced periodic system interruptions in the past, and we cannot guarantee that they will not occur again. In addition, our Web sites may, at times, be required to accommodate higher than usual volumes of traffic. At those times, our Web sites may experience slower response times or system failures. Any sustained or repeated interruptions or disruptions in these systems or increase in their response times could result in reduced usage of our Web sites and could damage our relationships with strategic partners, advertisers and sponsors. Although we maintain insurance for our business, we cannot guarantee that our insurance will be adequate to compensate us for all losses that may occur or to provide for costs associated with business interruptions.

### ***Our Internet-based services are dependent on the development and maintenance of the Internet infrastructure***

Our ability to deliver our Internet-based services is dependent on the development and maintenance of the infrastructure of the Internet by third parties. This includes maintenance of a reliable network backbone with the necessary speed, data capacity and security, as well as timely development of complementary products such as high-speed modems, for providing reliable Internet access and services. The Internet has experienced, and is likely to continue to experience, significant growth in the number of users and the amount of traffic. If the Internet continues to experience increased usage, the Internet infrastructure may be unable to support the demands placed on it. In addition, the performance of the Internet may be harmed by increased usage.

## **Table of Contents**

The Internet has experienced a variety of outages and other delays as a result of damages to portions of its infrastructure, and it could face outages and delays in the future. These outages and delays could reduce the level of Internet usage as well as the availability of the Internet to us for delivery of our Internet-based services. In addition, our customers who utilize our Web-based services depend on Internet service providers, online service providers and other Web site operators for access to our Web site. All of these providers have experienced significant outages in the past and could experience outages, delays and other difficulties in the future due to system failures unrelated to our systems. Any significant interruptions in our services or increases in response time could result in a loss of potential or existing users of and advertisers and sponsors on our Web site and, if sustained or repeated, could reduce the attractiveness of our services.

### ***Third parties may challenge the enforceability of our online agreements***

The law governing the validity and enforceability of online agreements and other electronic transactions is evolving. We could be subject to claims by third parties that our online agreements with consumers and physicians that provide the terms and conditions for use of our portal services are unenforceable. A finding by a court that these agreements are invalid could harm our business and require costly changes to our portals.

### ***Third parties may bring claims against us as a result of content provided on our Web sites, which may be expensive and time consuming to defend***

We could be subject to third-party claims based on the nature and content of information supplied on our Web sites by us or third parties, including content providers, medical advisors or users. We could also be subject to liability for content that may be accessible through our Web sites or third-party Web sites linked from our Web sites or through content and information that may be posted by users in chat rooms, bulletin boards or on Web sites created by professionals using our Web site application. Even if these claims do not result in liability to us, investigating and defending against these claims could be expensive and time consuming and could divert management's attention away from our operations.

---

## **Risks Related to Porex's Business and Industry**

### ***Porex's success depends upon demand for its products, which in some cases ultimately depends upon end-user demand for the products of its customers***

Demand for our Porex products may change materially as a result of economic or market conditions and other trends that affect the industries in which Porex participates. In addition, because a significant portion of our Porex products are components that are eventually integrated into or used with products manufactured by customers for resale to end-users, the demand for these product components is dependent on product development cycles and marketing efforts of these other manufacturers, as well as variations in their inventory levels, which are factors that we are unable to control. Accordingly, the amount of Porex's sales to manufacturer customers can be difficult to predict and subject to wide quarter-to-quarter variances.

### ***Porex's success may depend on satisfying rapidly changing customer requirements***

A significant portion of our Porex products are integrated into end products used in various industries, some of which are characterized by rapidly changing technology, evolving industry standards and practices and frequent new product introductions. Accordingly, Porex's success depends to a substantial degree on our ability to develop and introduce in a timely manner products that meet changing customer requirements and to differentiate our offerings from those of our competitors. If we do not introduce new Porex products in a timely manner and make enhancements to existing products to meet the changing needs of our Porex customers, some of our products could become obsolete over time, in which case our customer relationships, revenue and operating results would be negatively impacted.

**Table of Contents**

***Potential new or enhanced Porex products may not achieve sufficient sales to be profitable or justify the cost of their development***

We cannot be certain, when we engage in Porex research and development activities, whether potential new products or product enhancements will be accepted by the customers for which they are intended. Achieving market acceptance for new or enhanced products may require substantial marketing efforts and expenditure of significant funds to create awareness and demand by potential customers. In addition, sales and marketing efforts with respect to these products may require the use of additional resources for training our existing Porex sales forces and customer service personnel and for hiring and training additional salespersons and customer service personnel. There can be no assurance that the revenue opportunities from new or enhanced products will justify amounts spent for their development and marketing. In addition, there can be no assurance that any pricing strategy that we implement for any new or enhanced Porex products will be economically viable or acceptable to the target markets.

***Porex may not be able to source the raw materials it needs or may have to pay more for those raw materials***

Some of Porex's products require high-grade plastic resins with specific properties as raw materials. While Porex has not experienced any material difficulty in obtaining adequate supplies of high-grade plastic resins that meet its requirements, it relies on a limited number of sources for some of these plastic resins. If Porex experiences a reduction or interruption in supply from these sources, it may not be able to access alternative sources of supply within a reasonable period of time or at commercially reasonable rates, which could have a material adverse effect on its business and financial results.

***Disruptions in Porex's manufacturing operations could have a material adverse effect on its business and financial results***

Any significant disruption in Porex's manufacturing operations, including as a result of fire, power interruptions, equipment malfunctions, labor disputes, material shortages, earthquakes, floods, computer viruses, sabotage, terrorist acts or other force majeure, could have a material adverse effect on Porex's ability to deliver products to customers and, accordingly, its financial results.

***The nature of Porex's products exposes it to product liability claims that may not be adequately covered by indemnity agreements or insurance***

The products sold by Porex, whether sold directly to end-users or sold to other manufacturers for inclusion in the products that they sell, expose it to potential risk of product liability claims, particularly with respect to Porex's life sciences, clinical, surgical and medical products. Some of Porex's products are designed to be permanently implanted in the human body. Design defects and manufacturing defects with respect to such products sold by Porex or failures that occur with the products of Porex's manufacturer customers that contain components made by Porex could result in product liability claims and/or a recall of one or more of Porex's products. Porex also manufactures products that are used in the processing of blood for medical procedures and the delivery of medication to patients. Porex believes that it carries adequate insurance coverage against product liability claims and other risks. We cannot assure you, however, that claims in excess of Porex's insurance coverage will not arise. In addition, Porex's insurance policies must be renewed annually. Although Porex has been able to obtain adequate insurance coverage at an acceptable cost in the past, we cannot assure you that Porex will continue to be able to obtain adequate insurance coverage at an acceptable cost.

In most instances, Porex enters into indemnity agreements with its manufacturing customers. These indemnity agreements generally provide that these customers would indemnify Porex from liabilities that may arise from the sale of their products that incorporate Porex components to, or the use of such products by, end-users. While Porex generally seeks contractual indemnification from its customers, any such indemnification is limited, as a practical matter, to the creditworthiness of the indemnifying party. If Porex does not have adequate contractual indemnification available, product liability claims, to the extent

## **Table of Contents**

not covered by insurance, could have a material adverse effect on its business, operating results and financial condition.

Since March 1991, Porex has been named as one of many co-defendants in a number of actions brought by recipients of mammary implants distributed by Porex in the United States. For a description of these actions, see the information under **Legal Proceedings** **Porex Mammary Implant Litigation** above.

### ***Economic, political and other risks associated with Porex's international sales and geographically diverse operations could adversely affect Porex's operations and results***

Since Porex sells its products worldwide, its business is subject to risks associated with doing business internationally. In addition, Porex has manufacturing facilities in the United Kingdom, Germany and Malaysia. Accordingly, Porex's operations and financial results could be harmed by a variety of factors, including:

changes in foreign currency exchange rates;

changes in a specific country's or region's political or economic conditions, particularly in emerging markets;

trade protection measures and import or export licensing requirements;

potentially negative consequences from changes in tax laws;

difficulties in managing international and geographically diverse operations;

differing protection of intellectual property; and

unexpected changes in regulatory requirements.

### ***Environmental regulation could adversely affect Porex's business***

Porex is subject to foreign and domestic environmental laws and regulations and is subject to scheduled and random checks by environmental authorities. Porex's business involves the handling, storage and disposal of materials that are classified as hazardous. Although Porex's safety procedures for handling, storage and disposal of these materials are designed to comply with the standards prescribed by applicable laws and regulations, Porex may be held liable for any environmental damages that result from Porex's operations. Porex may be required to pay fines, remediation costs and damages, which could have a material adverse effect on its results of operations.

---

## **Risks Applicable to Our Entire Company**

### ***The ongoing investigations by the United States Attorney for the District of South Carolina and the SEC could negatively impact our company and divert management attention from our business operations***

The United States Attorney for the District of South Carolina is conducting an investigation of our company. As more fully described in **Legal Proceedings** above, based on the information available to WebMD as of the date of this Annual Report, we believe that the investigation relates principally to issues of financial reporting for Medical Manager Corporation, a predecessor of WebMD (by its merger into WebMD in September 2000), and our Medical Manager Health Systems subsidiary; however, we cannot be sure of the investigation's exact scope or how long it may continue. In addition, WebMD understands that the SEC is conducting a formal investigation into this matter. Adverse developments in connection with the investigations, if any, including as a result of matters that the authorities or WebMD may discover, could have a negative impact on our company and on how it is perceived by investors and potential investors and customers and potential customers. In addition, the management effort and

**Table of Contents**

attention required to respond to the investigations and any such developments could have a negative impact on our business operations.

WebMD intends to continue to fully cooperate with the authorities in this matter. While we are not able to estimate, at this time, the amount of the expenses that we will incur in connection with the investigations, we expect that they may be significant.

***We face significant competition for our products and services***

The markets in which we operate are intensely competitive, continually evolving and, in some cases, subject to rapid technological change. Many of our competitors have greater financial, technical, product development, marketing and other resources than we do. These organizations may be better known than we are and have more customers than we do. We cannot provide assurance that we will be able to compete successfully against these organizations or any alliances they have formed or may form. For more information about the competition we face, see Business Healthcare Information Services and Technology Solutions Competition for Our Healthcare Information Services and Technology Solutions and Business Porex Competition above.

***The performance of our businesses depends on attracting and retaining qualified executives and employees***

Our performance depends on attracting and retaining key personnel, including executives, product managers, software developers and other technical personnel and sales and marketing personnel. Failure to do so could have a material adverse effect on the performance of our business and the results of our operations.

***We may not be successful in protecting our intellectual property and proprietary rights***

Our intellectual property is important to all of our businesses. We rely on a combination of trade secret, patent and other intellectual property laws and confidentiality procedures and non-disclosure contractual provisions to protect our intellectual property. We believe that our non-patented proprietary technologies and business and manufacturing processes are protected under trade secret, contractual and other intellectual property rights. However, those rights do not afford the statutory exclusivity provided by patented processes. In addition, the steps that we take to protect our intellectual property, proprietary information and trade secrets may prove to be inadequate and, whether or not adequate, may be expensive.

There can be no assurance that we will be able to detect potential or actual misappropriation or infringement of our intellectual property, proprietary information or trade secrets. Even if we detect misappropriation or infringement by a third party, there can be no assurance that we will be able to enforce our rights at a reasonable cost, or at all. In addition, our rights to intellectual property, proprietary information and trade secrets may not prevent independent third-party development and commercialization of competing products or services.

***Third parties may claim that we are infringing their intellectual property, and we could suffer significant litigation or licensing expenses or be prevented from selling products or services***

We could be subject to claims that we are misappropriating or infringing intellectual property or other proprietary rights of others. These claims, even if not meritorious, could be expensive to defend and divert management's attention from our operations. If we become liable to third parties for infringing these rights, we could be required to pay a substantial damage award and to develop non-infringing technology, obtain a license or cease selling the products or services that use or contain the infringing intellectual property. We may be unable to develop non-infringing products or services or obtain a license on commercially reasonable terms, or at all. We may also be required to indemnify our customers if they become subject to third-party claims relating to intellectual property that we license or otherwise provide to them, which could be costly.



**Table of Contents**

***We have incurred and may continue to incur losses***

We began operations in January 1996 and have incurred net losses in each year since our inception and, as of December 31, 2003, we had an accumulated deficit of approximately \$10.2 billion. Although we generated net income, determined in accordance with generally accepted accounting principles, in the quarters ended December 31, 2003, September 30, 2003 and September 30, 2002, we incurred a net loss for the year ended December 31, 2003. We currently intend to continue to invest in infrastructure development, applications development, sales and marketing, and acquisitions and whether we continue to incur losses in a particular period will depend on, among other things, the amount of such investments and whether those investments lead to increased revenues.

***We may be subject to litigation***

Our business and operations may subject us to claims, litigation and other proceedings brought by private parties and governmental authorities. For information regarding certain proceedings to which we are currently a party, see [Legal Proceedings](#) above.

***Business combinations and other transactions may be difficult to complete and, if completed, may have negative consequences for our business and our securityholders***

We intend to seek to acquire or to engage in business combinations with companies engaged in complementary businesses. In addition, we may enter into joint ventures, strategic alliances or similar arrangements with third parties. These transactions may result in changes in the nature and scope of our operations and changes in our financial condition. Our success in completing these types of transactions will depend on, among other things, our ability to locate suitable candidates and negotiate mutually acceptable terms with them, as well as the availability of financing. Significant competition for these opportunities exists, which may increase the cost of and decrease the opportunities for these types of transactions. Financing for these transactions may come from several sources, including:

cash and cash equivalents on hand and marketable securities,

proceeds from the incurrence of indebtedness, and

proceeds from the issuance of additional common stock, preferred stock, convertible debt or other securities.

Our issuance of additional securities could:

cause substantial dilution of the percentage ownership of our stockholders at the time of the issuance,

cause substantial dilution of our earnings per share, and

adversely affect the prevailing market price for our outstanding securities.

We do not intend to seek securityholder approval for any such acquisition or security issuance unless required by applicable law or regulation or the terms of existing securities.

***Our business will suffer if we fail to successfully integrate acquired businesses and technologies or to assess the risks in particular transactions***

We have in the past acquired, and may in the future acquire, businesses, technologies, services, product lines and other assets. The successful integration of the acquired businesses and assets into our operations, on a cost-effective basis, can be critical to our future performance. The amount and timing of the expected benefits of any acquisition, including potential synergies between WebMD and the acquired

**Table of Contents**

business, are subject to significant risks and uncertainties. These risks and uncertainties include, but are not limited to, those relating to:

our ability to maintain relationships with the customers of the acquired business;

our ability to cross-sell products and services to customers with which we have established relationships and those with which the acquired businesses have established relationships;

our ability to retain or replace key personnel;

potential conflicts in payer, provider, strategic partner, sponsor or advertising relationships;

our ability to coordinate organizations that are geographically diverse and may have different business cultures; and

compliance with regulatory requirements.

We cannot guarantee that any acquired businesses will be successfully integrated with our operations in a timely or cost-effective manner, or at all. Failure to successfully integrate acquired businesses or to achieve anticipated operating synergies, revenue enhancements or cost savings could have a material adverse effect on our business, financial condition and results of operations.

Although our management attempts to evaluate the risks inherent in each transaction and to value acquisition candidates appropriately, we cannot assure you that we will properly ascertain all such risks or that acquired businesses and assets will perform as we expect or enhance the value of our company as a whole. In addition, acquired companies or businesses may have larger than expected liabilities that are not covered by the indemnification, if any, we are able to obtain from the sellers.

***We may not be able to raise additional funds when needed for our business or to exploit opportunities***

Our future liquidity and capital requirements will depend upon numerous factors, including the success of the integration of our businesses, our existing and new applications and service offerings, competing technologies and market developments, potential future acquisitions and additional repurchases of our common stock. We may need to raise additional funds to support expansion, develop new or enhanced applications and services, respond to competitive pressures, acquire complementary businesses or technologies or take advantage of unanticipated opportunities. If required, we may raise such additional funds through public or private debt or equity financing, strategic relationships or other arrangements. There can be no assurance that such financing will be available on acceptable terms, if at all, or that such financing will not be dilutive to our stockholders.

**Table of Contents**

**Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***  
**Interest Rate Sensitivity**

The primary objective of our investment activities is to preserve principal and maintain adequate liquidity, while at the same time maximizing the yield we receive from our investment portfolio. This objective is accomplished by adherence to our investment policy, which establishes the list of eligible types of securities and credit requirements for each investment.

Changes in prevailing interest rates will cause the principal amount of the investment to fluctuate. To minimize this risk, we maintain our portfolio of cash equivalents, short-term investments and marketable securities in commercial paper, non-government debt securities, money market funds and highly liquid United States Treasury notes. We view these high grade securities within our portfolio as having similar market risk characteristics.

Principal amounts expected to mature are \$204.0 million, \$23.0 million, \$319.1 million and \$102.0 million during 2004, 2005, 2006 and 2007, respectively. These include investments totaling \$358.0 million in federal agency notes that are callable subjecting us to interest rate risk on the reinvestment of these securities. We believe that the impact of any call and resulting reinvestment of proceeds would not have a material effect on our financial condition or results of operations.

We have not utilized derivative financial instruments in our investment portfolio.

**Exchange Rate Sensitivity**

Currently, substantially all of our sales and expenses are denominated in United States dollars; however, Porex is exposed to fluctuations in foreign currency exchange rates, primarily the rate of exchange of the United States dollar against the Euro. This exposure arises primarily as a result of translating the results of Porex's foreign operations to the United States dollar at exchange rates that have fluctuated from the beginning of the accounting period. Porex has not engaged in foreign currency hedging activities to date. Foreign currency translation gains (losses) were \$3.3 million, \$2.5 million and \$(0.7) million, in 2003, 2002 and 2001, respectively. We believe that future exchange rate sensitivity related to Porex will not have a material effect on our financial condition or results of operations.

**Item 8. *Financial Statements and Supplementary Data***

Our financial statements required by this item are contained on pages F-1 through F-44 of this Annual Report on Form 10-K. See Item 15(a)(1) for a listing of financial statements provided.

**Item 9. *Changes in and Disagreements With Accountants on Accounting and Financial Disclosure***

None.

**Item 9A. *Controls and Procedures***

As required by Exchange Act Rule 13a-15(b), WebMD management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of WebMD's disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e), as of December 31, 2003. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that WebMD's disclosure controls and procedures provided reasonable assurance that all material information required to be filed in this Annual Report has been made known to them in a timely fashion.

In connection with the evaluation required by Exchange Act Rule 13a-15(d), WebMD management, including the Chief Executive Officer and Chief Financial Officer, concluded that no changes in WebMD's internal control over financial reporting occurred during the fourth quarter of 2003 that have materially affected, or are reasonably likely to materially affect, WebMD's internal control over financial reporting.

**Table of Contents**

**PART III**

Information required by Items 10, 11, 12, 13 and 14 of Part III is omitted from this Annual Report and will be filed in a definitive proxy statement or by an amendment to this Annual Report not later than 120 days after the end of the fiscal year covered by this Annual Report.

**Item 10. *Directors and Executive Officers of the Registrant***

We will provide information that is responsive to this Item 10 in our definitive proxy statement or in an amendment to this Annual Report not later than 120 days after the end of the fiscal year covered by this Annual Report, in either case under the caption *Directors and Executive Officers*, and possibly elsewhere therein. That information is incorporated in this Item 10 by reference.

**Item 11. *Executive Compensation***

We will provide information that is responsive to this Item 11 in our definitive proxy statement or in an amendment to this Annual Report not later than 120 days after the end of the fiscal year covered by this Annual Report, in either case under the caption *Executive Compensation*, and possibly elsewhere therein. That information is incorporated in this Item 11 by reference.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

We will provide information that is responsive to this Item 12 in our definitive proxy statement or in an amendment to this Annual Report not later than 120 days after the end of the fiscal year covered by this Annual Report, in either case under the caption *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*, and possibly elsewhere therein. That information is incorporated in this Item 12 by reference.

**Item 13. *Certain Relationships and Related Transactions***

We will provide information that is responsive to this Item 13 in our definitive proxy statement or in an amendment to this Annual Report not later than 120 days after the end of the fiscal year covered by this Annual Report, in either case under the caption *Certain Relationships and Related Transactions*, and possibly elsewhere therein. That information is incorporated in this Item 13 by reference.

**Item 14. *Principal Accountant Fees and Services***

We will provide information that is responsive to this Item 14 in our definitive proxy statement or in an amendment to this Annual Report not later than 120 days after the end of the fiscal year covered by this Annual Report, in either case under the caption *Principal Accountant Fees and Services*, and possibly elsewhere therein. That information is incorporated in this Item 14 by reference.

**Table of Contents**

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K**

**(a)(1)-(2) Financial Statements and Schedules**

The financial statements and schedules listed in the accompanying Index to Consolidated Financial Statements and Supplemental Data on page F-1 are filed as part of this Report.

**(a)(3) Exhibits**

See Index to Exhibits beginning on page E-1, which is incorporated by reference herein. The Index to Exhibits lists all exhibits filed with this Report and identifies which of those exhibits are management contracts and compensation plans.

**(b) Reports on Form 8-K**

During the last quarter of the fiscal year ended December 31, 2003, the registrant filed or furnished the following Reports on Form 8-K:

Report on Form 8-K filed on October 14, 2003 pursuant to which the registrant announced preliminary results for the quarter ended September 30, 2003.

Report on Form 8-K filed on October 24, 2003 pursuant to which the registrant announced that it had entered into a definitive agreement to acquire Medifax-EDI.

Report on Form 8-K filed on November 6, 2003 pursuant to which the registrant announced results for the quarter ended September 30, 2003.

Report on Form 8-K filed on December 1, 2003 pursuant to which the registrant announced that the Medifax-EDI acquisition agreement had been amended.

Report on Form 8-K filed on December 24, 2003 pursuant to which the registrant announced that the Medifax-EDI acquisition had been completed.





**Table of Contents**

<u>Signature</u>	<u>Capacity</u>	<u>Date</u>
/s/ MICHAEL A. SINGER	Director	March 11, 2004
Michael A. Singer		
/s/ JOSEPH E. SMITH	Director	March 11, 2004
Joseph E. Smith		
/s/ MARTIN J. WYGOD	Director	March 11, 2004
Martin J. Wygod		



**Table of Contents****WebMD Corporation****Index to Consolidated Financial Statements and Supplemental Data**

The following financial statements of the Company and its subsidiaries required to be included in Item 15(a)(1) of Form 10-K are listed below:

	<b>Page</b>
	<b><u>        </u></b>
<b>Historical Financial Statements:</b>	
Report of Independent Auditors	F-2
Consolidated Balance Sheets at December 31, 2003 and 2002	F-3
Consolidated Statements of Operations for the Years Ended December 31, 2003, 2002 and 2001	F-4
Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2003, 2002 and 2001	F-5
Consolidated Statements of Cash Flows for the Years Ended December 31, 2003, 2002 and 2001	F-6
Notes to Consolidated Financial Statements	F-8
<b>Supplemental Financial Data:</b>	
The following supplementary financial data of the Registrant and its subsidiaries required to be included in Item 15(a)(2) of Form 10-K are listed below:	
Schedule II Valuation and Qualifying Accounts	S-1

All other schedules not listed above have been omitted as not applicable or because the required information is included in the Consolidated Financial Statements or in the notes thereto. Columns omitted from schedules filed have been omitted because the information is not applicable.

**Table of Contents**

**REPORT OF INDEPENDENT AUDITORS**

The Board of Directors and Stockholders

WebMD Corporation

We have audited the accompanying consolidated balance sheets of WebMD Corporation as of December 31, 2003 and 2002, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of WebMD Corporation at December 31, 2003 and 2002, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 10 to the financial statements, the Company changed its accounting for goodwill and other indefinite lived intangible assets in 2002.

/s/ ERNST & YOUNG LLP

MetroPark, New Jersey  
February 27, 2004, except for Note 22,  
as to which the date is March 4, 2004

**Table of Contents****WebMD Corporation****Consolidated Balance Sheets**

(In thousands, except share and per share data)

	December 31,	
	2003	2002
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 63,298	\$ 175,596
Short-term investments	207,383	10,888
Accounts receivable, net of allowance for doubtful accounts of \$20,500 in 2003 and \$22,417 in 2002	181,173	163,244
Inventory	12,158	9,976
Current portion of prepaid content and distribution services	18,116	25,406
Assets of discontinued operations		94,056
Other current assets	25,973	25,814
	<u>508,101</u>	<u>504,980</u>
Total current assets	508,101	504,980
Marketable debt securities	451,290	449,289
Marketable equity securities	4,744	7,427
Property and equipment, net	77,278	70,488
Prepaid content and distribution services	31,992	48,532
Goodwill	844,448	586,043
Intangible assets, net	184,130	73,222
Other assets	33,323	26,267
	<u>\$ 2,135,306</u>	<u>\$ 1,766,248</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 10,390	\$ 10,063
Accrued expenses	208,430	208,342
Deferred revenue	86,708	81,179
Liabilities of discontinued operations		12,365
	<u>305,528</u>	<u>311,949</u>
Total current liabilities	305,528	311,949
3 1/4% convertible subordinated notes due 2007	299,999	300,000
1.75% convertible subordinated notes due 2023	350,000	
Other long-term liabilities	1,182	498
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.0001 par value; 5,000,000 shares authorized and no shares issued at December 31, 2003 and December 31, 2002		
Common stock, \$.0001 par value; 900,000,000 shares authorized at December 31, 2003; 600,000,000 shares authorized at December 31, 2002; 384,751,705 shares issued at December 31, 2003; 374,661,064 shares issued at December 31, 2002	38	37
Additional paid-in capital	11,726,734	11,682,443
Deferred stock compensation	(4,683)	(17,805)
Treasury stock, at cost; 76,576,865 shares at December 31, 2003; 74,254,669 shares at December 31, 2002	(347,858)	(327,542)

Edgar Filing: WEBMD CORP /NEW/ - Form 10-K

Accumulated deficit	(10,212,054)	(10,195,048)
Accumulated other comprehensive income	16,420	11,716
	<u>                    </u>	<u>                    </u>
Total stockholders' equity	1,178,597	1,153,801
	<u>                    </u>	<u>                    </u>
	\$ 2,135,306	\$ 1,766,248
	<u>                    </u>	<u>                    </u>

See accompanying notes.

F-3

---

**Table of Contents****WebMD Corporation****Consolidated Statements of Operations****(In thousands, except per share data)**

	Years Ended December 31,		
	2003	2002	2001
Revenue	\$963,980	\$871,696	\$ 842,020
Costs and expenses:			
Cost of operations	564,939	509,744	568,321
Development and engineering	42,985	43,467	43,572
Sales, marketing, general and administrative	282,482	283,424	448,082
Depreciation, amortization and other	62,434	125,593	2,394,857
Legal expense	3,959		
Impairment of long-lived and other assets			3,816,115
Restructuring and integration (benefit) charge		(5,850)	266,755
Gain on investments	1,659	6,547	
Interest income	22,901	19,590	30,409
Interest expense	15,214	8,491	507
Other income, net	4,218	3,844	
	<u>          </u>	<u>          </u>	<u>          </u>
Income (loss) from continuing operations before income tax provision (benefit)	20,745	(63,192)	(6,665,780)
Income tax provision (benefit)	4,140	(10,079)	2,588
	<u>          </u>	<u>          </u>	<u>          </u>
Income (loss) from continuing operations	16,605	(53,113)	(6,668,368)
Income (loss) from discontinued operations, net of income taxes	(33,611)	3,411	(3,950)
	<u>          </u>	<u>          </u>	<u>          </u>
Net loss	\$ (17,006)	\$ (49,702)	\$ (6,672,318)
	<u>          </u>	<u>          </u>	<u>          </u>
Basic loss per common share:			
Income (loss) from continuing operations	\$ 0.05	\$ (0.17)	\$ (19.13)
Income (loss) from discontinued operations	(0.11)	0.01	(0.01)
	<u>          </u>	<u>          </u>	<u>          </u>
Net loss	\$ (0.06)	\$ (0.16)	\$ (19.14)
	<u>          </u>	<u>          </u>	<u>          </u>
Diluted loss per common share:			
Income (loss) from continuing operations	\$ 0.05	\$ (0.17)	\$ (19.13)
Income (loss) from discontinued operations	(0.10)	0.01	(0.01)
	<u>          </u>	<u>          </u>	<u>          </u>
Net loss	\$ (0.05)	\$ (0.16)	\$ (19.14)
	<u>          </u>	<u>          </u>	<u>          </u>
Weighted-average shares outstanding used in computing income (loss) per common share:			
Basic	304,858	304,168	348,570
	<u>          </u>	<u>          </u>	<u>          </u>
Diluted	325,811	304,168	348,570
	<u>          </u>	<u>          </u>	<u>          </u>

See accompanying notes.



Table of Contents

## WebMD Corporation

## Consolidated Statements of Stockholders Equity

(In thousands, except share data)

	Stockholders Equity							
	Convertible Redeemable Preferred Stock		Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Deferred Stock Compensation
	Shares	Amount	Shares	Amount	Shares	Amount		
<b>Balances at December 31, 2000</b>	100	\$ 10,000	155,951	\$ 710,746	361,233,643	\$ 36	\$11,028,461	\$(144,467)
Net loss								
Net increase in unrealized gains on securities								
Foreign currency translation adjustment								
Comprehensive loss								
Issuance of common stock for option exercises, ESPP, 401(k) and other issuances					3,722,517	1	12,994	
Issuance, net of reductions, and exercise of warrants in connection with strategic alliances and services					2,000,000		24,739	
Reacquisition of convertible preferred stock and issuance of warrants in connection with revision of			(155,951)	(710,746)			559,575	

strategic alliance Stock compensation expense						40,909	88,359
Purchase of treasury stock							
Adjustment to deferred stock compensation for terminations						(13,935)	13,935
<hr/>							
<b>Balances at December 31, 2001</b>	100	10,000		366,956,160	37	11,652,743	(42,173)
Net loss							
Net decrease in unrealized gains on securities							
Foreign currency translation adjustment							
Comprehensive loss							
Issuance of common stock for option exercises, ESPP, 401(k) and other issuances				7,704,904		28,774	
Issuance, net of repurchase, of warrants in connection with strategic alliances and services						29	
Redemption of convertible redeemable preferred stock	(100)	(10,000)					
Deferred stock compensation						2,500	(2,500)
Stock compensation expense						392	24,873
Purchase of treasury stock						(1,995)	1,995



Adjustment to deferred stock compensation for terminations							
<b>Balances at December 31, 2002</b>				374,661,064	37	11,682,443	(17,805)
Net loss							
Net increase in unrealized gains on securities							
Foreign currency translation adjustment							
Comprehensive loss							
Issuance of common stock for option exercises, ESPP, 401(k) and other issuances				10,090,641	1	44,718	
Issuance of warrants in connection with strategic alliances and services						67	
Deferred stock compensation						25	(25)
Stock compensation expense						335	12,293
Purchase of treasury stock							
Adjustment to deferred stock compensation for terminations						(854)	854
<b>Balances at December 31, 2003</b>		\$	\$	384,751,705	\$ 38	\$ 11,726,734	\$ (4,683)

[Table continued below]

[Table continued from above]

**Stockholders Equity**

	Treasury Stock		Accumulated		Total Stockholders' Equity
	Shares	Amount	Accumulated Deficit	Other Comprehensive Income	
<b>Balances at December 31, 2000</b>	5,163,509	\$ (30,759)	\$ (3,473,028)	\$ 6,446	\$ 8,097,435
Net loss			(6,672,318)		(6,672,318)
Net increase in unrealized gains on securities				7,097	7,097
Foreign currency translation adjustment				(710)	(710)
Comprehensive loss					(6,665,931)
Issuance of common stock for option exercises, ESPP, 401(k) and other issuances					12,995
Issuance, net of reductions, and exercise of warrants in connection with strategic alliances and services					24,739
Reacquisition of convertible preferred stock and issuance of warrants in connection with revision of strategic alliance					(151,171)
Stock compensation expense					129,268
Purchase of treasury stock	50,928,426	(191,823)			(191,823)
Adjustment to deferred stock compensation for terminations					

<b>Balances at</b>					
<b>December 31, 2001</b>	56,091,935	(222,582)	(10,145,346)	12,833	1,255,512
Net loss			(49,702)		(49,702)
Net decrease in unrealized gains on securities				(3,640)	(3,640)
Foreign currency translation adjustment				2,523	2,523
					<hr/>
Comprehensive loss					(50,819)
Issuance of common stock for option exercises, ESPP, 401(k) and other issuances					28,774
Issuance, net of repurchase, of warrants in connection with strategic alliances and services					29
Redemption of convertible redeemable preferred stock					
Deferred stock compensation					
Stock compensation expense					25,265
Purchase of treasury stock	18,162,734	(104,960)			(104,960)
Adjustment to deferred stock compensation for terminations					
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
<b>Balances at</b>					
<b>December 31, 2002</b>	74,254,669	(327,542)	(10,195,048)	11,716	1,153,801
Net loss			(17,006)		(17,006)
Net increase in unrealized gains on securities				1,419	1,419
Foreign currency translation adjustment				3,285	3,285
					<hr/>
Comprehensive loss					(12,302)
Issuance of common stock for option exercises, ESPP, 401(k) and other issuances					44,719

Issuance of warrants in connection with strategic alliances and services					67
Deferred stock compensation					
Stock compensation expense					12,628
Purchase of treasury stock	2,322,196	(20,316)			(20,316)
Adjustment to deferred stock compensation for terminations					
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
<b>Balances at December 31, 2003</b>	<b>76,576,865</b>	<b>\$(347,858)</b>	<b>\$(10,212,054)</b>	<b>\$ 16,420</b>	<b>\$ 1,178,597</b>
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

See accompanying notes.

F-5

---

**Table of Contents****WebMD Corporation****Consolidated Statements of Cash Flows****(In thousands)**

	<b>Years Ended December 31,</b>		
	<b>2003</b>	<b>2002</b>	<b>2001</b>
<b>Cash flows from operating activities:</b>			
Net loss	\$ (17,006)	\$ (49,702)	\$ (6,672,318)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Loss (income) from discontinued operations	33,611	(3,411)	3,950
Depreciation, amortization and other	62,434	125,593	2,394,857
Impairment of long-lived and other assets			3,816,115
Amortization of debt issuance costs	2,246	1,109	
Non-cash content and distribution services	24,298	25,706	45,474
Non-cash stock based compensation	12,449	25,265	78,451
Non-cash portion of restructuring and integration charge			185,498
Gain on investments	(1,659)	(6,547)	
Gain on sale of property and equipment	(3,100)		
Changes in operating assets and liabilities:			
Accounts receivable	5,515	(2,631)	46,908
Inventory	(2,176)	(872)	927
Prepaid content and distribution services	(467)	753	(7,609)
Other assets	4,259	(4,416)	20,318
Accounts payable	(651)	(7,541)	(5,815)
Accrued expenses	(42,419)	(32,651)	(45,124)
Deferred revenue	(225)	12,530	11,508
Net cash provided by (used in) continuing operations	77,109	83,185	(126,860)
Net cash provided by discontinued operations	5,130	9,912	12,591
Net cash provided by (used in) operating activities	82,239	93,097	(114,269)
<b>Cash flows from investing activities:</b>			
Proceeds from maturities and sales of available-for-sale securities	247,294	108,991	124,725
Proceeds from maturities and redemptions of held-to-maturity securities	157,919	59,095	1,014
Purchases of available-for-sale securities	(8,254)	(207,833)	
Purchases of held-to-maturity securities	(590,113)	(300,970)	(1,014)
Purchases of property and equipment	(18,385)	(26,267)	(27,256)
Proceeds received from sale of discontinued operations	46,500		
Proceeds received from sale of property and equipment	9,779		
Other changes in equity of discontinued operations	1,754	10,369	2,496
Cash paid in business combinations, net of cash acquired	(400,491)	(33,471)	(17,334)
Net cash provided by (used in) continuing operations	(553,997)	(390,086)	82,631
Net cash used in discontinued operations	(2,529)	(12,577)	(6,238)
	(556,526)	(402,663)	76,393

Net cash provided by (used in) investing  
activities

F-6

---

**Table of Contents**

	Years Ended December 31,		
	2003	2002	2001
<b>Cash flows from financing activities:</b>			
Proceeds from issuance of common stock	44,719	28,765	12,995
Purchase of treasury shares	(20,316)	(104,960)	(191,823)
Payment of notes payable and other	(361)	(2,904)	(2,911)
Net proceeds from issuance of convertible debt	339,125	292,000	
Redemption of Series B Preferred Stock		(10,000)	
	_____	_____	_____
Net cash provided by (used in) continuing operations	363,167	202,901	(181,739)
Net cash used in discontinued operations	(6,546)	(1,150)	(456)
	_____	_____	_____
Net cash provided by (used in) financing activities	356,621	201,751	(182,195)
Effects of exchange rates on cash	1,423	1,083	(312)
	_____	_____	_____
Net decrease in cash and cash equivalents	(116,243)	(106,732)	(220,383)
Changes in cash attributable to discontinued operations	3,945	3,815	(5,897)
	_____	_____	_____
Cash and cash equivalents at beginning of year	175,596	278,513	504,793
	_____	_____	_____
Cash and cash equivalents at end of year	\$ 63,298	\$ 175,596	\$ 278,513
	_____	_____	_____

See accompanying notes.

**Table of Contents**

**WebMD Corporation**

**Notes to Consolidated Financial Statements**

**December 31, 2003**

**(In thousands, except share and per share data)**

**1. Summary of Significant Accounting Policies**

**Basis of Presentation**

WebMD Corporation was incorporated in Delaware in December 1995 and commenced operations in January 1996 as Healthcon Corporation. The Company changed its name to Healthcon/ WebMD Corporation in November 1999 and to WebMD Corporation in September 2000. The accompanying consolidated financial statements include the consolidated accounts of WebMD Corporation and its subsidiaries (the Company ) and have been prepared in United States dollars, and in accordance with accounting principles generally accepted in the United States ( GAAP ). As described in Note 6, on August 1, 2003 the Company completed the sale of two operating units of its Plastic Technologies segment. Accordingly, the results of these two operating units, including the loss related to the divestitures, have been presented as discontinued operations in the accompanying consolidated financial statements.

**Business**

The Company has aligned its business into four operating segments as follows:

*Transaction Services or WebMD Envoy* provides healthcare reimbursement cycle management services, including transmission of transactions between healthcare payers and physicians, pharmacies, dentists, hospitals, laboratory companies and other healthcare providers using dial-up, Internet and dedicated communication methods. WebMD Envoy s services assist its customers in automating key administrative and clinical functions. In addition, WebMD Envoy provides automated patient billing services to providers, including statement printing and mailing services, and provides paid-claims communication services to third party administrators and health insurers, including print-and-mail services for the distribution of checks, remittance advice, and explanations of benefits.

*Physician Services or WebMD Practice Services* develops and markets integrated physician practice management systems, including administrative, financial and clinical applications and services, under The Medical Manager, Intergy, ULTIA and Medical Manager Network Services brands. These systems and services allow physician offices to automate their scheduling, billing and other administrative tasks, to transmit transactions electronically, to maintain electronic medical records and to automate documentation of patient encounters.

*Portal Services or WebMD Health* provides online healthcare information, educational services and related resources for consumers and healthcare professionals, both directly and through its relationships with leading general consumer Internet portals. WebMD Health also provides online content for use by media and healthcare partners on their Web sites. WebMD Health develops and sells online and offline channels of communication and sponsorship programs to pharmaceutical, biotech, medical device and consumer products companies, particularly those who are interested in influencing healthcare decisions. In addition, WebMD Health provides a suite of online tools and related services to employers and health plans for use by their employees and plan members.

*Plastic Technologies or Porex* develops, manufactures and distributes proprietary porous plastic products and components used in healthcare, industrial and consumer applications, as well as in finished products used in the medical device and surgical markets.

**Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries. The results of operations for companies acquired or disposed of are included in the



**Table of Contents**

**WebMD Corporation**

**Notes to Consolidated Financial Statements (Continued)**

consolidated financial statements from the effective date of acquisition or up to the date of disposal. All material intercompany accounts and transactions have been eliminated in consolidation.

**Accounting Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The Company is subject to uncertainties such as the impact of future events, economic, environmental and political factors and changes in the Company's business environment; therefore, actual results could differ from these estimates. Accordingly, the accounting estimates used in the preparation of the Company's financial statements will change as new events occur, as more experience is acquired, as additional information is obtained and as the Company's operating environment changes. Changes in estimates are made when circumstances warrant. Such changes in estimates and refinements in estimation methodologies are reflected in reported results of operations; if material, the effects of changes in estimates are disclosed in the notes to the consolidated financial statements. Significant estimates and assumptions by management affect: the Company's allowance for doubtful accounts, the carrying value of inventory, the carrying value of prepaid content and distribution services, the carrying value of long-lived assets (including goodwill and intangible assets), the amortization period of long-lived assets (excluding goodwill), the carrying value, capitalization and amortization of software development costs, the carrying value of short-term and long-term investments, the provision for taxes and related deferred tax accounts, certain accrued expenses, revenue recognition, restructuring costs, contingencies, litigation and the value attributed to warrants issued for services.

**Cash and Cash Equivalents**

All highly liquid investments with an original maturity from the date of purchase of three months or less are considered to be cash equivalents. These short-term investments are stated at cost, which approximates market. The Company's cash and cash equivalents are invested in various investment-grade commercial paper, money market accounts and federal agency notes.

**Marketable Securities**

Management determines the appropriate classification of its investments in debt securities at the time of purchase and re-evaluates such determinations at each balance sheet date. Debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. Held-to-maturity securities are carried at amortized cost. Debt securities that the Company does not have the intent or ability to hold to maturity are classified as available-for-sale. Investments in marketable equity securities are classified as available-for-sale. Available-for-sale securities are carried at fair value as of the balance sheet date. The Company uses specific identification to determine the cost basis of a security sold.

**Allowance for Doubtful Accounts**

The allowance for doubtful accounts receivable reflects the Company's best estimate of probable losses inherent in the Company's receivable portfolio determined on the basis of historical experience, specific allowances for known troubled accounts and other currently available evidence.

**Inventory**

Inventory is stated at the lower of cost or market value using the first-in, first-out basis. Cost includes raw materials, direct labor, and manufacturing overhead. Market value is based on current replacement

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

cost for raw materials and supplies and on net realizable value for work-in-process and finished goods. Inventory consisted of the following as of December 31, 2003 and 2002:

	<u>2003</u>	<u>2002</u>
Raw materials and supplies	\$ 3,142	\$3,019
Work-in-process	1,394	1,308
Finished goods and other	7,622	5,649
	<u>\$ 12,158</u>	<u>\$9,976</u>

**Long-Lived Assets*****Property and Equipment***

Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful life of the related asset, generally three to twelve years for equipment and up to forty years for buildings. Leasehold improvements and equipment acquired under capital leases are depreciated over the shorter of the lease term or the estimated useful life of the related asset. Expenditures for maintenance, repair and renewals of minor items are charged to expense as incurred. Major betterments are capitalized.

***Goodwill and Intangible Assets***

Goodwill and intangible assets result from acquisitions accounted for under the purchase method. Goodwill is no longer being amortized but is subject to impairment by applying a fair value based test. Intangible assets related to acquired technology, customer lists, trademarks and other intangibles are being amortized on a straight-line basis over the estimated useful life of the related asset, generally one to nine years, with the exception of certain technology and trademarks that have estimated useful lives of nineteen to forty years.

***Recoverability***

In accordance with Statement of Financial Accounting Standards ( SFAS ) No. 142, Goodwill and Other Intangible Assets ( SFAS No. 142 ), the Company reviews the carrying value of goodwill and intangible assets with indefinite lives annually. The Company measures impairment losses by comparing carrying value to fair value. Fair value is determined using discounted cash flow methodology.

In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, long-lived assets used in operations are reviewed for impairment whenever events or changes in circumstances indicate that carrying amounts may not be recoverable. For long-lived assets to be held and used, the Company recognizes an impairment loss only if its carrying amount is not recoverable through its undiscounted cash flows and measures the impairment loss based on the difference between the carrying amount and fair value. Long-lived assets held for sale are reported at the lower of cost or fair value less costs to sell.

Prior to January 1, 2002, the Company accounted for its long-lived assets under SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. In accordance with SFAS No. 121, the Company reviewed the recoverability of long-lived assets using an undiscounted cash flow methodology, whenever events or changes in circumstances indicated that carrying amounts may not be recoverable. The Company measured impairment losses using a discounted cash flow methodology.

**Table of Contents**

**WebMD Corporation**

**Notes to Consolidated Financial Statements (Continued)**

**Software Development Costs**

***Software to be Sold, Leased or Otherwise Marketed***

SFAS No. 86, Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed, requires the capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based upon the Company's product development process, technological feasibility is established upon the completion of a working model. The costs incurred from the time a working model is available until general release are immaterial.

***Internal Use Software***

The Company accounts for internal use software development costs in accordance with Statement of Position (SOP) No. 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use (SOP 98-1). Software development costs that are incurred in the preliminary project stage are expensed as incurred. Once the specified criteria of SOP 98-1 have been met, internal and external direct costs incurred in developing or obtaining computer software are capitalized. Training and data conversion costs are expensed as incurred. Capitalized software costs are amortized over a three-year period.

**Revenue Recognition**

Revenue is derived from the Company's Transaction Services, Physician Services, Portal Services and Plastic Technologies segments.

The Company's transaction services include administrative services, such as transaction processing for medical, dental and pharmacy claims, automated patient statements, and clinical lab and reporting services, such as lab test orders and results. In addition, the Company provides paid-claims communication services to third party administrators and health insurers, including print-and-mail services for the distribution of checks, remittance advice, and explanation of benefits. Healthcare payers and providers pay fees to the Company for these services, generally on a per transaction basis. Transaction fees vary according to the type of transaction and other factors, such as volume level commitments. The Company also charges one-time implementation fees to providers and payers that are recognized ratably over the contract term. Revenue from transaction services, which are generally priced on a per transaction or monthly per provider basis, is recognized when the services are provided.

The Company's physician services include sales of The Medical Manager and Intergy practice management systems and related hardware, as well as the support and maintenance of these systems. Revenue from software licenses is recognized in accordance with SOP No. 97-2, Software Revenue Recognition, as amended by SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions. Software license fee revenue is recognized when a customer enters into a noncancelable license agreement, the software product has been delivered, there are no uncertainties surrounding product acceptance, there are no significant future performance obligations, the license fees are fixed or determinable and collection of the license fee is considered probable. Amounts received in advance of meeting these criteria are deferred. Revenue from multiple-element software arrangements is recognized using the residual method as vendor specific objective evidence (VSOE) of fair value exists for the undelivered elements, but not for all the delivered elements. The residual method requires revenue to be allocated to the undelivered elements based on the fair value of such elements, as indicated by VSOE. VSOE is based on the price charged when an element is sold separately. Revenue from the sale of hardware is recognized upon delivery to the customer. Revenue from support and maintenance contracts is recognized ratably over the contract period, which typically does not exceed one year. The Company also markets a variety of transaction processing services to physician practices, such as medical claim

**Table of Contents**

**WebMD Corporation**

**Notes to Consolidated Financial Statements (Continued)**

processing and automated patient statements. Payment for these services is typically monthly on a per transaction or fixed fee basis. Revenues are recognized when these services are provided.

The Company's portal services include advertising, sponsorship, healthcare management tools, continuing medical education ( CME ), content syndication and distribution, and e-commerce transactions related to the Company's online distribution channels and the online and offline distribution channels of the Company's strategic partners. Revenue from advertising is recognized as advertisements are delivered. Revenues from sponsorship arrangements and healthcare management tools are recognized ratably over the term of the applicable agreement. Revenue from CME arrangements is recognized over the period the Company satisfies the minimum credit hour requirements of the applicable agreements. Revenue from fixed fee content license or carriage fees is recognized ratably over the term of the applicable agreement. E-commerce revenue is recognized when a subscriber or consumer utilizes the Company's Internet-based services or purchases goods or services through the Company's Web site or co-branded Web site with one of its strategic partners. Subscription revenue, including subscription revenue from sponsorship arrangements, is recognized over the subscription period. Subscription fees to the Company's physician portal were discontinued as of December 31, 2000. When contractual arrangements contain multiple elements, revenue is allocated to the elements based on their relative fair values, determined using prices charged when elements are sold separately.

The Company's Plastic Technologies segment develops, manufactures and distributes porous plastic products and components. For standard products, revenue is recognized upon shipment of product, net of sales returns and allowances, in accordance with Staff Accounting Bulletin ( SAB ) No. 101, Revenue Recognition in Financial Statements and SFAS No. 48 Revenue Recognition When Right of Return Exists. These statements establish that revenue can be recorded when persuasive evidence of an arrangement exists, delivery has occurred and all significant obligations have been satisfied, the fee is fixed or determinable and collection is considered probable. Appropriate reserves are established for anticipated returns and allowances based on past experience. For sales of certain custom products, revenue is recognized upon completion and customer acceptance. The amount of cash received at the time a customer's order is placed is recorded as a liability. The liability is reversed at the time revenue is recognized.

The Company recognizes revenue related to the nonmonetary exchange of advertising for advertising ( Barter ) when such exchanges are objectively determinable based on the criteria set forth in Accounting Principles Board Opinion No. 29, Accounting for Nonmonetary Transactions for contractual agreements entered into prior to January 20, 2000. Revenues from these exchanges are recorded at the fair value of the products and services provided or received, whichever is more clearly evident. For contractual arrangements after January 20, 2000, the Company recognizes revenue based on the criteria set forth in EITF Issue No. 99-17, Accounting for Advertising Barter Transactions ( EITF 99-17 ). EITF 99-17 requires that an entity recognize revenue and expenses from advertising barter transactions at the fair value of the advertising surrendered only when an entity received cash for similar transactions. There were no revenues recognized from Barter transactions in 2003 or 2002. Revenue recognized from arrangements deemed to be Barter transactions totaled approximately \$19,009 in 2001. The costs related to these transactions were equal to the revenues and are included in sales, marketing, general and administrative expenses in the accompanying consolidated statement of operations.

**Foreign Currency**

The financial statements and transactions of the Company's foreign manufacturing facilities are maintained in their local currency. In accordance with SFAS No. 52, Foreign Currency Translation, the translation of foreign currencies into United States dollars is performed for balance sheet accounts using current exchange rates in effect at the balance sheet date and for revenue and expense accounts using an average exchange rate for the period. The gains or losses resulting from translation are included as a

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

component of accumulated other comprehensive income within stockholders' equity. Foreign currency transaction gains and losses are included in net loss and were not material in any of the periods presented.

**Concentration of Credit Risk**

None of the Company's customers individually accounted for more than 10% of the Company's consolidated revenues in 2003, 2002 or 2001.

The Company's revenues are principally generated in the United States. An adverse change in economic conditions in the United States could negatively affect the Company's revenues and results of operations.

The Company places its short-term investments in a variety of financial instruments and, by policy, limits the amount of credit exposure through diversification and by restricting its investments to highly rated securities.

**Income Taxes**

Income taxes are accounted for using the liability method in accordance with SFAS No. 109, Accounting for Income Taxes. Under this method, deferred income taxes are recognized for the future tax consequence of differences between the tax and financial reporting basis of assets and liabilities at each year end. A valuation allowance is established to reduce deferred tax assets to the amounts expected to be realized.

**Accounting for Stock-Based Compensation**

As discussed more fully in Note 15, the Company accounts for its stock-based employee compensation plans using the intrinsic value method under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25), and related interpretations. No stock-based employee compensation cost is reflected in net loss with respect to options granted with an exercise price equal to the market value of the underlying common stock on the date of grant. Stock-based awards to non-employees are accounted for based on provisions of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123), and EITF 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services. The following table illustrates the effect on net loss and net loss per common share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation:

	Years Ended December 31,		
	2003	2002	2001
Net loss as reported	\$(17,006)	\$ (49,702)	\$(6,672,318)
Deduct: Stock-based employee compensation expense included in reported net loss (including stock-based employee compensation expense related to discontinued operations)	12,629	25,265	129,268
Add: Total stock-based employee compensation expense determined under fair value based method for all awards	(76,484)	(119,670)	(317,166)
Pro forma net loss	<u>\$(80,861)</u>	<u>\$(144,107)</u>	<u>\$(6,860,216)</u>
Net loss per common share:			
Basic as reported	\$ (0.06)	\$ (0.16)	\$ (19.14)

Edgar Filing: WEBMD CORP /NEW/ - Form 10-K

Diluted as reported	\$ (0.05)	\$ (0.16)	\$ (19.14)
Basic and diluted pro forma	\$ (0.27)	\$ (0.47)	\$ (19.68)

F-13

---

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

The pro forma results above are not intended to be indicative of or a projection of future results. Refer to Note 15 for assumptions used in computing the fair value amounts above.

**Net Loss Per Common Share**

Basic loss per common share and diluted loss per common share are presented in conformity with SFAS No. 128, Earnings Per Share. In accordance with SFAS No. 128, basic loss per common share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted loss per common share has been computed using the weighted-average number of shares of common stock outstanding during the period, increased to consider the effect of potentially dilutive securities. The following table presents the calculation of basic and diluted loss per common share (shares in thousands):

	Years Ended December 31,		
	2003	2002	2001
Income (loss) from continuing operations	\$ 16,605	\$ (53,113)	\$ (6,668,368)
Income (loss) from discontinued operations	(33,611)	3,411	(3,950)
Net loss attributable to common stockholders	<u>\$ (17,006)</u>	<u>\$ (49,702)</u>	<u>\$ (6,672,318)</u>
Weighted-average shares Basic	304,858	304,168	348,570
Effect of dilutive securities:			
Employee stock options and warrants	<u>20,953</u>	<u>          </u>	<u>          </u>
Adjusted weighted-average shares after assumed conversions Diluted	<u>325,811</u>	<u>304,168</u>	<u>348,570</u>
Basic loss per common share:			
Income (loss) from continuing operations	\$ 0.05	\$ (0.17)	\$ (19.13)
Income (loss) from discontinued operations	<u>(0.11)</u>	<u>0.01</u>	<u>(0.01)</u>
Net loss	<u>\$ (0.06)</u>	<u>\$ (0.16)</u>	<u>\$ (19.14)</u>
Diluted loss per common share:			
Income (loss) from continuing operations	\$ 0.05	\$ (0.17)	\$ (19.13)
Income (loss) from discontinued operations	<u>(0.10)</u>	<u>0.01</u>	<u>(0.01)</u>
Net loss	<u>\$ (0.05)</u>	<u>\$ (0.16)</u>	<u>\$ (19.14)</u>

The Company has excluded convertible subordinated notes and restricted stock, as well as certain outstanding warrants and stock options from the calculation of diluted loss per common share because such securities were either anti-dilutive or were not convertible to common stock in accordance with their terms during the periods presented. The following table presents the total number of shares that could potentially dilute basic loss per common share in the future that were not included in the computation of diluted loss per common share during the periods presented (shares in thousands):

Years Ended December 31,

---

Edgar Filing: WEBMD CORP /NEW/ - Form 10-K

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Options, warrants and restricted stock	82,267	136,147	159,058
Convertible notes	55,129	32,387	—
	<u>137,396</u>	<u>168,534</u>	<u>159,058</u>

F-14

---



**Table of Contents**

**WebMD Corporation**

**Notes to Consolidated Financial Statements (Continued)**

**Recent Accounting Pronouncements**

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity* ( SFAS No. 150 ). SFAS No. 150 requires that certain financial instruments, which under previous guidance were accounted for as equity, must now be accounted for as liabilities. The financial instruments affected include mandatorily redeemable stock, certain financial instruments that require or may require the issuer to buy back some of its shares in exchange for cash or other assets and certain obligations that can be settled with shares of stock. SFAS No. 150 is effective for all financial instruments entered into or modified after May 31, 2003 and must be applied to the Company's existing financial instruments effective July 1, 2003, the beginning of the first fiscal period after June 15, 2003. The adoption of SFAS No. 150 on June 1, 2003 did not have any effect on the Company's consolidated financial position or results of operations.

In November 2002, the Emerging Issues Task Force issued a final consensus on issue 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables* ( EITF 00-21 ) which addresses how to account for arrangements that may involve the delivery or performance of multiple products, services, and/or rights to use assets. EITF 00-21 is effective prospectively for arrangements entered into in fiscal periods beginning after June 15, 2003. Companies may also elect to apply the provisions of EITF 00-21 to existing arrangements and record the operating statement impact as the cumulative effect of a change in accounting principle. The Company has adopted EITF 00-21 prospectively for contracts beginning after June 30, 2003. The adoption of EITF 00-21 did not have a material impact on the Company's consolidated financial position or results of operations.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* ( FIN 45 ). The interpretation elaborates on the disclosures to be made in the Company's interim and annual financial statements about obligations under certain guarantees. It also requires the Company to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements are effective for financial statements of interim and annual periods ending after December 15, 2002. The initial measurement and recognition provisions are required to be applied on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN 45 did not have a material impact on the Company's consolidated financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 requires recording costs associated with exit or disposal activities at their fair values when a liability has been incurred. Under previous guidance, certain exit costs were accrued upon management's commitment to an exit plan, which is generally before an actual liability has been incurred. SFAS No. 146 is effective for exit or disposal activities initiated after December 31, 2002. SFAS No. 146 will have an impact on the timing of the recording of any future restructuring charges.

**Reclassifications**

Certain reclassifications have been made to the financial statements to conform with the current year presentation.

**2. Business Combinations**

**2003 Acquisitions**

On December 22, 2003, the Company completed its acquisition of Medifax-EDI, Inc. ( Medifax ), a privately held company based in Nashville, Tennessee. Medifax provides real-time medical eligibility transaction services and other claims management solutions to hospitals, medical centers, physician practices and other medical organizations throughout the United States. These services enable healthcare

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

providers to verify insurance coverage for their patients on a real-time basis. The total purchase consideration was approximately \$280,065, comprised of \$276,065 in cash and \$4,000 of estimated acquisition costs, for all of the outstanding capital stock of Medifax. Prior to closing, Medifax distributed its Pharmacy Services companies to its owner and these companies were not included in the transaction. The acquisition was accounted for using the purchase method of accounting and, accordingly, the purchase price was allocated to the tangible and intangible assets acquired and the liabilities assumed on the basis of their respective fair values. In connection with the preliminary allocation of the purchase price, goodwill of \$179,090 and intangible assets subject to amortization of \$92,700 were recorded. The Company does not expect that the goodwill or intangible assets will be deductible for tax purposes. The intangible assets are comprised of \$72,600 relating to customer relationships with estimated useful lives of fifteen years, \$8,600 relating to acquired technology with an estimated useful life of five years, \$8,400 relating to payer connections with estimated useful lives of fifteen years and \$3,100 relating to a tradename with an estimated useful life of one year. The results of operations of Medifax will be included in the Transaction Services segment. The results of operations of Medifax since the closing date of the acquisition were not material.

On September 25, 2003, the Company completed its acquisition of a privately held dental clearinghouse based in Hartford, Connecticut. The Company paid \$5,805 in cash for all of the outstanding capital stock of the acquired company and agreed to pay up to an additional \$4,200 beginning in 2005 if certain revenue related milestones are achieved. The additional payment may be made over a three-year period by issuing shares of the Company's common stock or in cash. The additional payment may exceed \$4,200 if all or a portion of the additional payment is made by issuing shares of the Company's stock and if the value of the Company's stock exceeds certain price levels. The acquisition was accounted for using the purchase method of accounting and, accordingly, the purchase price was allocated to the tangible and intangible assets acquired and the liabilities assumed on the basis of their respective fair values. In connection with the preliminary allocation of the purchase price, goodwill of \$3,478 and an intangible asset subject to amortization of \$2,392 were recorded. The Company does not expect that the goodwill or intangible assets will be deductible for tax purposes. The intangible asset is acquired technology with an estimated useful life of five years. The results of operations of the acquired company have been included in the financial statements of the Company from September 25, 2003, the closing date of the acquisition, and are included in the Transaction Services segment.

On July 17, 2003, the Company completed its acquisition of Advanced Business Fulfillment, Inc. ( ABF ), a privately held company based in St. Louis, Missouri. ABF provides healthcare paid-claims communications services for third-party administrators and health insurers. ABF's services allow its customers to outsource print-and-mail activities for the distribution of checks, remittance advice and explanations of benefits. The total purchase consideration for ABF was approximately \$113,268, comprised of \$108,368 in cash and \$4,900 of estimated acquisition costs for all of the outstanding capital stock of ABF. Additionally, the Company will pay up to an additional \$150,000 beginning in April 2004 if certain financial milestones are achieved. The additional payment may be made over a three-year period by issuing shares of the Company's common stock or, at the Company's option in certain circumstances, in cash. The additional payment may exceed \$150,000 if all or a portion of the additional payment is made by issuing shares of the Company's stock and if the value of the Company's stock exceeds certain price levels at the time of payment. The acquisition was accounted for using the purchase method of accounting and, accordingly, the purchase price was allocated to the tangible and intangible assets acquired and the liabilities assumed on the basis of their respective fair values. In connection with the preliminary allocation of the purchase price, goodwill of \$61,453 and intangible assets subject to amortization of \$47,000 were recorded. The Company expects that substantially all of the goodwill recorded will be deductible for tax purposes. The intangible assets are comprised of \$41,000 relating to customer relationships with estimated useful lives of ten years, \$4,900 relating to acquired unpatented technologies with estimated useful lives of

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

nine months to six years and \$1,100 relating to a trade name with an estimated useful life of three years. The results of operations of the acquired company have been included in the financial statements of the Company from July 17, 2003, the closing date of the acquisition, and are included in the Transaction Services segment.

On May 29, 2003, the Company acquired The Little Blue Book ( LBB ), a company which maintains a database containing practice information for over 380,000 physicians, and publishes a pocket-sized reference book containing physician information. The total purchase consideration for LBB was approximately \$10,550, comprised of \$10,400 in cash and estimated acquisition costs of \$150. Additionally, the Company will pay up to \$2,500 if LBB meets certain financial milestones during the years ending December 31, 2003 and 2004. The acquisition was accounted for using the purchase method of accounting and, accordingly, the purchase price was allocated to the tangible and intangible assets acquired and the liabilities assumed on the basis of their respective fair values. In connection with the preliminary allocation of the purchase price, goodwill of \$8,661 and intangible assets subject to amortization of \$2,815 were recorded. The Company expects that substantially all of the goodwill recorded will be deductible for tax purposes. The intangible assets are comprised of \$1,787 relating to a trade name with an estimated useful life of seven years, \$761 relating to customer relationships with estimated useful lives of five years and \$267 relating to acquired technology with an estimated useful life of three years. The results of operations of LBB have been included in the financial statements of the Company from May 29, 2003, the closing date of the acquisition, and are included in the Portal Services segment.

On April 30, 2003, the Company acquired the assets and assumed certain liabilities of a company which provides healthcare benefit decision support tools and solutions to its clients through online technology. The total purchase consideration for this acquisition was approximately \$4,062, comprised of \$4,000 in cash and estimated acquisition costs of \$62. The acquisition was accounted for using the purchase method of accounting and, accordingly, the purchase price was allocated to the tangible and intangible assets acquired and the liabilities assumed on the basis of their respective fair values. In connection with the allocation of the purchase price, goodwill of \$4,070 and an intangible asset subject to amortization of \$710 were recorded. The Company expects that substantially all of the goodwill recorded will be deductible for tax purposes. The intangible asset represents the fair value of customer relationships with estimated useful lives of five years. The results of operations of the acquired business have been included in the financial statements of the Company from April 30, 2003, the closing date of the acquisition, and are included in the Portal Services segment.

In 2003, the Company acquired seven practice services companies for an aggregate cost of \$2,182, which was paid in cash. Additionally, the Company will pay up to \$675 beginning in 2004 if some of the acquired companies meet certain financial milestones. These acquisitions were accounted for using the purchase method of accounting and, accordingly, the purchase prices were allocated to assets acquired and liabilities assumed based on their respective fair values. In connection with the preliminary allocation of the purchase prices, goodwill of \$1,469 and intangible assets subject to amortization of \$1,054 were recorded. The Company expects that substantially all of the goodwill recorded will be deductible for tax purposes. The intangible assets are comprised of \$351 related to non-compete agreements with estimated useful lives of three to five years and \$703 related to customer relationships with estimated useful lives of nine years. The results of operations of these companies have been included in the financial statements of the Company from the respective acquisition closing dates and are included in the Physician Services segment.

**2002 Acquisitions**

On October 31, 2002, the Company acquired WellMed, Inc. ( WellMed ), which develops and markets healthcare information technology applications, including online healthcare decision support and

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

health management tools for use by consumers. The total purchase consideration for WellMed was approximately \$19,031, comprised of \$18,781 in cash and estimated acquisition costs of \$250. The acquisition was accounted for using the purchase method of accounting and, accordingly, the purchase price was allocated to the tangible and intangible assets acquired and the liabilities assumed on the basis of their respective fair values. In connection with the allocation of the purchase price, goodwill of \$18,380 and an intangible asset subject to amortization of \$2,700 were recorded. The Company expects that substantially all of the goodwill recorded will be deductible for tax purposes. The intangible asset represents the fair value of acquired unpatented technology and has a useful life of three years. The results of operations of WellMed have been included in the financial statements of the Company from October 31, 2002, the closing date of the acquisition. WellMed's results of operations are included in the Portal Services segment.

In 2002, the Company acquired 21 physician services companies for a total cost of \$14,400, which was paid in cash. These acquisitions were accounted for using the purchase method of accounting with the purchase price being allocated to assets acquired and liabilities assumed based on their fair values. In connection with the preliminary allocation of the purchase price, goodwill of \$11,784 and intangible assets subject to amortization of \$4,049 were recorded. The Company expects that substantially all of the goodwill recorded will be deductible for tax purposes. The intangible assets are comprised of \$1,281 related to non-compete agreements with estimated useful lives of one to five years and \$2,768 related to customer relationships with estimated useful lives of nine years. The results of operations of these companies have been included in the financial statements of the Company from the respective acquisition closing dates and are included in the Physician Services segment.

**2001 Acquisitions**

On December 26, 2001, the Company completed its acquisition of the portal assets of MedicaLogic/ Medscape, Inc. ( Medscape ). Medscape operates both consumer and professional websites. The total purchase consideration for these assets was approximately \$9,852, comprised of \$9,242 in cash and acquisition costs of \$610. The acquisition was accounted for using the purchase method of accounting and, accordingly, the purchase price was allocated to the tangible and intangible assets acquired and the liabilities assumed on the basis of their respective fair values. In connection with the allocation of the purchase price, goodwill of \$5,732 and intangible assets subject to amortization totaling \$2,420 were recorded. The Company expects that substantially all of the goodwill recorded will be deductible for tax purposes. The intangible assets are comprised of \$800 related to a tradename and \$1,620 related to customer relationships with useful lives of three and five years, respectively. The results of operations of Medscape have been included in the financial statements of the Company from December 26, 2001, the closing date of the acquisition. Medscape's results of operations are included in the Portal Services segment.

In 2001, the Company acquired ten physician services companies for a total cost of \$8,159, which was paid primarily in cash. These acquisitions were accounted for using the purchase method of accounting with the purchase price being allocated to assets acquired and liabilities assumed based on their fair values. In connection with the allocation of the purchase price, goodwill of \$9,879 and intangible assets subject to amortization of \$3,453 were recorded. The Company expects that substantially all of the goodwill recorded will be deductible for tax purposes. Amortization of goodwill related to business combinations completed prior to June 30, 2001 has been provided based on an estimated useful life of three years. The intangible assets are comprised of \$886 related to non-compete agreements with estimated useful lives of one to five years and \$2,567 related to customer relationships with estimated useful lives of nine years. The results of operations of these companies have been included in the financial statements of the Company from the respective acquisition closing dates and are included in the Physician Services segment.

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)****Unaudited Pro Forma Information**

The following unaudited pro forma financial information for the years ended December 31, 2003 and 2002 gives effect to the acquisitions of ABF and Medifax, including the amortization of intangible assets, as if they had occurred as of the beginning of the earliest period presented. The information is provided for illustrative purposes only and is not necessarily indicative of the operating results that would have occurred if the transactions had been consummated at the dates indicated, nor is it necessarily indicative of future operating results of the consolidated companies, and should not be construed as representative of these results for any future period. The remaining acquisitions in 2003, 2002 and 2001 have been excluded as the pro forma impact of such acquisitions was not significant in any of the periods presented.

	Years Ended December 31,	
	2003	2002
Revenue	\$ 1,067,936	\$ 981,168
Income (loss) from continuing operations	28,867	(47,628)
Net loss	(4,744)	(44,217)
Basic loss per common share:		
Income (loss) from continuing operations	\$ 0.09	\$ (0.16)
Net loss	\$ (0.02)	\$ (0.15)
Diluted loss per common share:		
Income (loss) from continuing operations	\$ 0.09	\$ (0.16)
Net loss	\$ (0.01)	\$ (0.15)

### 3. Significant Transactions

#### Quintiles Transnational Corporation

As part of the transaction in which the Company acquired Envoy from Quintiles Transnational Corp. in May 2000, Quintiles and the Company entered into a Data Rights Agreement and an Internet Product Development and Marketing Agreement. In February 2000, Quintiles filed an action for breach of the Data Rights Agreement against the Company. On October 12, 2001, the Company and Quintiles entered into an agreement to settle this litigation ( Settlement Agreement ). Pursuant to the Settlement Agreement, the Company and Quintiles terminated the Data Rights Agreement and the Internet Product Development and Marketing Agreement and all other agreements between them. Pursuant to the court order in the litigation, Quintiles continued to receive de-identified data from the Company until February 28, 2002. The Company and Envoy have no further obligation to provide, and no longer provide, any data to Quintiles.

In accordance with the terms of the Settlement Agreement, the Company purchased from Quintiles all 35,000,000 shares of WebMD common stock held by Quintiles for \$185,000 in cash. The fair market value of the repurchased shares on the date of settlement was \$126,000 and has been recorded as treasury stock. The excess of the purchase price of the shares over their fair market value was \$59,000 and has been recorded as a component of restructuring and integration charges along with a benefit of \$7,000 related to the release from certain obligations in relation to the Company's acquisition of Envoy.

The Settlement Agreement also provides that Quintiles will have the right to receive a payment (payable at the Company's option in cash, stock, or a combination of cash and stock) in the event that, on or before June 30, 2004, a transaction closes in which the Company is acquired at

a price per the Company's common share greater than \$4.00 or in which Envoy is sold at an aggregate price of greater

**Table of Contents**

**WebMD Corporation**

**Notes to Consolidated Financial Statements (Continued)**

than \$500,000. The Company is under no obligation to pursue either of these types of transactions. In the event an acquisition of the Company closes on or before June 30, 2004, the payment to Quintiles will equal 80% of the amount by which the price paid in the acquisition exceeds \$4.00 per share, multiplied by 35,000,000. In the event a sale of Envoy closes on or before June 30, 2004, the payment to Quintiles will equal 80% of the amount by which the price received in the sale exceeds \$500,000.

**America Online, Inc.**

In May 2001, the Company entered into an agreement for a strategic alliance with Time Warner, Inc. ( Time Warner ). The term of the agreement is three years expiring May 2004. Under the agreement, the Company is the primary provider of healthcare content, tools and services for use on America Online ( AOL ) properties that include AOL, AOL.com, CompuServe and Netscape.com. In addition, the Company created a co-branded personalized health service for AOL that features the Company s personalized news, health assessment and monitoring tools, communities and newsletters, integrated with AOL s calendaring and reminders. The Company and AOL intend, through the co-branded services, to provide users with the ability to communicate with their health plans, physicians, pharmacies and other providers. The Company and AOL share revenue from advertising (whether or not related to healthcare), commerce and programming on the health channels of the AOL properties and on the co-branded service, with the Company receiving 80% of revenues up to an agreed-upon annual threshold and 60% thereafter. In connection with the strategic alliance, the Company issued to Time Warner a warrant to purchase 2,408,908 shares of the Company s common stock at an exercise price of \$9.25 per share. The warrant was valued at approximately \$17,500 using the Black-Scholes option pricing model and is being amortized over the term of the strategic alliance as a non-cash distribution expense included in sales, marketing, general and administrative expense.

**News Corporation**

Pursuant to an agreement signed and publicly announced in December 1999 and closed in January 2000, the Company entered into a strategic relationship with News Corporation. On December 29, 2000, this strategic alliance was revised by the parties. On February 15, 2001, the Company completed all transactions related to its revised strategic relationship with News Corporation. The original relationship and the new relationship are each described below.

***Original Relationship***

The financial terms of the strategic relationship included: \$700,000 in media services by News Corporation, comprised of \$400,000 domestically and \$300,000 internationally over 10 years; \$100,000 cash investment commitment by News Corporation in an international joint venture; a \$60,000 five-year licensing agreement for syndication of WebMD daily broadcast content; and the transfer to the Company of 50% interests in The Health Network, a health-focused cable network, and thehealthnetwork.com. The Company issued an aggregate of 155,951 shares of Series A preferred stock, convertible into 21,282,645 shares of the Company s common stock. In addition, affiliates of News Corporation purchased 2,000,000 shares of the Company s common stock for an aggregate purchase price of \$100,000 in cash.

***Current Relationship***

The Company retained the right to receive \$205,000 in domestic media services from News Corporation over ten years expiring in 2010 and will continue to license its content for use across News Corporation s media properties for four years for cash payments totaling \$12,000 annually expiring in 2004. The remaining portion of the domestic media services is included in prepaid content and distribution services in the accompanying consolidated balance sheets. News Corporation transferred its 50% interest in

**Table of Contents**

**WebMD Corporation**

**Notes to Consolidated Financial Statements (Continued)**

the international joint venture to the Company and was relieved of its commitment to provide any future capital to the international joint venture and its commitment to provide any international media services. The Company transferred its interest in The Health Network to News Corporation. The Company was also relieved of all future capital commitments to The Health Network. In connection with the revisions to the relationship, News Corporation surrendered 155,951 shares of WebMD's Series A convertible preferred stock. The Company granted to News Corporation a warrant to acquire 3,000,000 shares of its common stock at an exercise price of \$15 per share. The Company included approximately \$17,759, determined using the Black-Scholes option pricing model, as a non-cash restructuring charge related to this issuance.

**Microsoft**

The Company entered into a five-year strategic alliance with Microsoft in May 1999. In March 2001, the Company executed a non-binding letter of intent with Microsoft with respect to a new relationship. In April 2001, the Company entered into definitive agreements with Microsoft to implement the new relationship, which was effective as of January 1, 2001. In connection with the original strategic relationship, Microsoft acquired shares of common stock and a warrant to purchase shares of common stock of WebMD, Inc. These securities were converted into securities of the Company as a result of the merger of the Company and WebMD, Inc. in November 1999. As of December 31, 2003, Microsoft had a warrant to purchase 13,676,389 shares of the Company's common stock at an exercise price of \$30.16 per share. The warrant is fully vested and expires on May 12, 2004. The original relationship and the new relationship are each described below.

***Original Relationship***

Under the terms of the original strategic relationship, the Company developed, hosted and maintained on its servers a health channel for MSN and was required to pay Microsoft an aggregate of \$162,000 in carriage fees for the distribution of that content. In addition, Microsoft and the Company each committed co-marketing funds of \$50,000 over the first two years of the term. As of December 31, 2000, the Company had recorded \$30,562 as sales, marketing, general and administrative expense related to the carriage fees.

Microsoft was required to remit to the Company 100% of the net revenue over the term of the agreement from banner and other advertising and e-commerce transactions generated on the health channel or advertising that Microsoft placed on WebMD.com each year during the term until the Company received an amount equal to that year's carriage fees, including guaranteed minimum amounts of \$22,500 in each of the first two years of the term, and was required to share revenue equally with the Company after that. The Company was required to pay Microsoft a 25% commission on the portion of the revenue received up to the annual guaranteed minimum amounts for all advertisements placed by Microsoft. The Company recognized this advertising revenue when Microsoft notified it that advertisements had been placed on the health channel and billed by Microsoft, not based on the guaranteed minimum amounts. During 2000, the Company recognized \$5,996, net of commissions, related to health channel advertising.

Microsoft agreed to sponsor up to 5.0 million subscriber months, for \$29.95 per month, of subscriptions to the Company's physician Web site over the term of the agreement. The Company was required to pay a \$5 per month commission on all subscriptions placed by Microsoft. During 2000, the Company recorded \$16,114 as revenue, net of commissions, related to subscriptions sponsored by Microsoft.

The Company was required to share with Microsoft 50% of net revenue from banner and other advertising on the Company's physician Web site generated by sponsored subscriptions until Microsoft received the amount it had incurred for its sponsored subscriptions. Thereafter, the Company was required



**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

to share 25% of this revenue with Microsoft. In addition, the Company was required to share with Microsoft 15% of the Company's net revenue from e-commerce transactions and additional services not included in the basic subscription to the Company's physician Web site generated by these sponsored subscriptions. There were no obligations to Microsoft as of December 31, 2000 relating to this provision.

***Current Relationship***

The parties entered into two definitive agreements to implement the new relationship. The first agreement related to technology matters and was terminated by the parties on September 14, 2001. No payments were made by either party under the terminated agreement. Under the second agreement, the Company programs the majority of the MSN health channel, and the Company and MSN share revenues derived from advertising, sponsorship and e-commerce on the MSN health channel site, with the Company receiving 100% of revenues up to an agreed upon annual threshold (or until an agreed upon maximum for the contract period is reached) and 60% thereafter. The Company no longer pays carriage fees to Microsoft. The term of this agreement is scheduled to expire on June 30, 2004. In connection with the new relationship, the parties agreed that Microsoft would no longer be responsible for funding the sponsorship of subscriptions to the Company's physician portal, and the Company would no longer be required to share with Microsoft revenue generated by physician usage of the Company's healthcare portals.

**4. Impairment of Long-Lived and Other Assets**

During 2001, the Company identified certain indicators of possible impairment of its long-lived assets, primarily goodwill and other acquired intangible assets. The indicators of possible impairment that were identified included a decline in the price of the Company's common stock to its lowest price in the previous twelve months accompanied by a significant decline in the volatility of the Company's stock price, a sustained decline in valuations in the e-health, technology and Internet sectors and the impact of recent trends in general economic conditions. As a result of these indicators, the Company reviewed substantially all of its long-lived assets for impairment. The Company's long-lived assets primarily related to goodwill and other acquired intangible assets recorded in connection with the acquisitions of WebMD, Inc., MedE America and Medcast in November 1999 and the acquisitions of Kinetra, Envoy, Medical Manager, CareInsite and OnHealth during 2000. The Company utilized its common stock as the primary consideration for the acquisitions. The Company evaluated its long-lived assets for impairment by determining identifiable cash flows of related asset groupings at the lowest level that were largely independent of the cash flows of other asset groupings. The projected undiscounted cash flows for each asset grouping was compared to the related carrying value. As a result of these comparisons, the Company determined its long-lived assets were impaired.

The Company determined the amount of the impairment by comparing the fair value of each asset grouping to the related carrying value. The fair value for each asset grouping was determined primarily using a discounted cash flow approach. As a result of these comparisons, the Company recorded a write-down of \$3,816,115 related to its long-lived assets reflecting the difference between the carrying value and fair value of the asset groupings. The write-down consisted of \$3,678,950 of goodwill, \$94,186 of other acquired intangibles and \$42,979 of other long-lived assets consisting of computer equipment, leasehold improvements, office equipment and furniture and fixtures. In addition to this write-down, the Company recorded a write-down in 2001 of \$10,778 of goodwill related to one of the discontinued operating units of the Company's Plastic Technologies segment. Accordingly, this write-down has been included as a component of discontinued operations during the year ended December 31, 2001.

During 2003 and 2002, the Company performed the impairment tests of goodwill, as required by SFAS No. 142. There was no impairment resulting from these tests.

**Table of Contents**

**WebMD Corporation**

**Notes to Consolidated Financial Statements (Continued)**

**5. Restructuring and Integration Charges**

After the mergers with Medical Manager Corporation, CareInsite, Inc. and OnHealth Network Company in September 2000, the Company's Board of Directors approved a restructuring and integration plan, with the objective of eliminating duplication and redundancies that resulted from these and certain prior acquisitions and consolidating the Company's operational infrastructure into a common platform to more efficiently serve its customers.

The Company's restructuring and integration efforts continued in 2001, and a plan to include the impact of eliminating functions resulting from the Company's acquisition of Medscape (Medscape Restructuring) in December 2001 was initiated. As a result of the Medscape Restructuring, 115 employees were notified of termination in December 2001. In connection with the continuing restructuring and integration efforts, a charge was recorded in 2001 of \$266,755, that consisted of: (i) \$123,206 primarily relating to the restructuring of the original strategic relationship with Microsoft, of which \$133,500 represented non-cash charges for the write-off of intangible assets associated with the Company's original Microsoft agreement recorded as part of the Company's acquisition of WebMD, Inc. in 1999 offset by a \$15,610 cash benefit for the settlement of certain obligations from the original strategic relationship with Microsoft, as well as net cash payments of \$5,316 made to exit contractual obligations, (ii) \$52,000 cash charge associated with the settlement of the original Quintiles agreements, of which \$59,000 was a cash charge recorded for the difference between the purchase price and fair value of the 35,000,000 shares of the Company's common stock acquired in October 2001, offset by a \$7,000 cash benefit related to the release of the Company from certain obligations in relation to the Company's acquisition of Envoy, (iii) personnel-related costs of \$67,604, of which \$51,998 primarily represented non-cash stock option compensation charges related to the resignation or termination of certain employees pursuant to the applicable employment and separation arrangements, with the remaining personnel-related charge relating to severance and outplacement services for approximately 615 employees that the Company identified and notified of termination during 2001, of which \$2,777 related to 115 employees notified of termination as a result of the Medscape Restructuring, (iv) \$15,538 of cash charges related to estimated future lease obligations and lease cancellation penalties related primarily to additional anticipated costs of exiting previously vacated facilities as a result of declines in rental values in certain markets and vacating additional facilities identified during 2001, and (v) \$8,407 of cash charges related to integration costs, consisting of employee retention arrangements related to exit activities, moving and relocation expenses, as well as outside professional fees related to the integration of the Company's business.

During 2002, the Company recorded a benefit of \$5,850 relating to its restructuring and integration activity resulting from the settlements of certain contractual obligations.

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

The Company has substantially completed its restructuring and integration efforts related to the 2000 and 2001 restructuring plans. The balance of the restructuring and integration accrual as of December 31, 2003 is primarily related to remaining lease payments of previously vacated facilities. The following table presents cash activity in the restructuring and integration accrual:

	<u>Severance</u>	<u>Facilities</u>	<u>Other</u>	<u>Total</u>
Balance at December 31, 2000	\$ 8,599	\$ 35,843	\$ 8,683	\$ 53,125
Accrual	15,606	15,538	50,113	81,257
Cash payments	(20,749)	(10,484)	(58,796)	(90,029)
Balance at December 31, 2001	\$ 3,456	\$ 40,897	\$	\$ 44,353
Accrual			(5,850)	(5,850)
Cash payments	(3,212)	(7,606)	5,850	(4,968)
Balance at December 31, 2002	\$ 244	\$ 33,291	\$	\$ 33,535
Cash payments	(70)	(7,550)		(7,620)
Balance at December 31, 2003	\$ 174	\$ 25,741	\$	\$ 25,915

**6. Discontinued Operations**

The Company's Plastic Technologies segment, Porex, had been accounted for as an asset held for sale during the period from September 12, 2000 to September 12, 2001, and as a discontinued operation from September 13, 2001 to September 30, 2002. During February 2003, the Company terminated its formal divestiture plan relating to Porex and, accordingly, the assets, liabilities and operations of Porex were reclassified as a continuing operation from September 12, 2000, its date of acquisition.

On August 1, 2003, the Company completed the sale of two operating units of Porex, Porex Bio Products, Inc. ( Porex Bio ) and Porex Medical Products, Inc. ( Porex Medical ) to enable Porex to focus on its porous materials businesses. Accordingly, the historical financial information of these operating units has been reclassified as discontinued operations in the accompanying consolidated financial statements for all periods presented. The operating units were sold in two separate transactions for an aggregate sales price of \$46,500. An impairment charge of \$33,113 was recorded in the results for the quarter ended June 30, 2003 to reduce the long-lived assets of Porex Bio and Porex Medical to fair value. The write-down consisted of \$27,564 of goodwill, \$4,162 of trade name and patent intangibles and \$1,387 of other long-lived assets consisting primarily of manufacturing equipment. The impairment charge was based on the fair value of the divested businesses as determined by the expected proceeds from disposition. During the three months ended September 30, 2003, the Company recorded a loss on disposal of \$3,491, primarily representing certain costs related to the disposition, which is included in income (loss) from discontinued operations in the accompanying consolidated statements of operations. Summarized operating results for the discontinued units through August 1, 2003 were as follows:

	<u>For the Period January 1, 2003 through August 1, 2003</u>	<u>For the Year Ended December 31, 2002</u>	<u>For the Year Ended December 31, 2001</u>
Revenue	\$ 31,004	\$ 54,181	\$ 59,008
Income (loss) from operations	\$ (30,120)	\$ 3,411	\$ (3,950)
Loss on disposal	(3,491)		

Edgar Filing: WEBMD CORP /NEW/ - Form 10-K

Income (loss) from discontinued operations, net of income taxes	_____ \$(33,611) _____	_____ \$ 3,411 _____	_____ \$ (3,950) _____
--	------------------------------	----------------------------	------------------------------

F-24

---

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

The following table presents summary balance sheet information for the discontinued operations as of December 31, 2002:

Assets of discontinued operations:	
Cash and cash equivalents	\$ 3,945
Accounts receivable, net	7,223
Inventory, net	8,828
Property and equipment, net	24,249
Goodwill and intangible assets, net	49,326
Other assets	485
	\$94,056
Liabilities of discontinued operations:	
Accounts payable and accrued expenses	\$ 5,700
Debt	6,665
	\$12,365

**7. Convertible Subordinated Notes*****\$350,000 1.75% Convertible Subordinated Notes due 2023***

On June 25, 2003, the Company issued \$300,000 aggregate principal amount of 1.75% Convertible Subordinated Notes due 2023 (the 1.75% Notes ) in a private offering. On July 7, 2003, the Company issued an additional \$50,000 aggregate principal amount of the 1.75% Notes. Unless previously redeemed or converted, the 1.75% Notes will mature on June 15, 2023. Interest on the 1.75% Notes accrues at the rate of 1.75% per annum and is payable semiannually on June 15 and December 15, commencing December 15, 2003. The Company will also pay contingent interest of 0.25% per annum of the average trading price of the 1.75% Notes during specified six month periods, commencing on June 20, 2010, if the average trading price of the 1.75% Notes for specified periods equals 120% or more of the principal amount of the 1.75% Notes.

The 1.75% Notes are convertible into an aggregate of 22,742,040 shares of the Company's common stock (representing a conversion price of \$15.39 per share) if the sale price of the Company's common stock exceeds 120% of the conversion price for specified periods and in certain other circumstances. The 1.75% Notes are redeemable by the Company after June 15, 2008 and prior to June 20, 2010, subject to certain conditions, including the sale price of the Company's common stock exceeding certain levels for specified periods. If the 1.75% Notes are redeemed by the Company during this period, the Company will be required to make additional interest payments. After June 20, 2010, the 1.75% Notes are redeemable at any time for cash at 100% of their principal amount. Holders of the 1.75% Notes may require the Company to repurchase their 1.75% Notes on June 15, 2010, June 15, 2013 and June 15, 2018, for cash at 100% of the principal amount of the 1.75% Notes, plus accrued interest. Upon a change in control, holders may require the Company to repurchase their 1.75% Notes for, at the Company's option, cash or shares of the Company's common stock, or a combination thereof, at a price equal to 100% of the principal amount of the 1.75% Notes being repurchased.

The Company incurred issuance costs related to the 1.75% Notes of approximately \$10,875 which are included in other assets in the accompanying consolidated balance sheets. The issuance costs are being amortized to interest expense in the accompanying consolidated statements of operations, using the

**Table of Contents**

**WebMD Corporation**

**Notes to Consolidated Financial Statements (Continued)**

effective interest method over the period from issuance through June 15, 2010, the earliest date on which holders can demand redemption.

***\$300,000 3 1/4% Convertible Subordinated Notes due 2007***

On April 1, 2002, the Company issued \$300,000 aggregate principal amount of 3 1/4% Convertible Subordinated Notes due 2007 (the 3 1/4% Notes ) in a private offering. Interest on the 3 1/4% Notes accrues at the rate of 3 1/4% per annum and is payable semiannually on April 1 and October 1. Unless previously redeemed or converted, the 3 1/4% Notes will mature on April 1, 2007. At the time of issuance, the 3 1/4% Notes were convertible into an aggregate of approximately 32,386,916 shares of the Company's common stock (representing a conversion price of \$9.26 per share), subject to adjustment in certain circumstances. During the three months ended June 30, 2003, \$1 principal amount of the 3 1/4% Notes was converted into 107 shares of the Company's common stock in accordance with the provisions of the 3 1/4% Notes. As of December 31, 2003, the 3 1/4% Notes were convertible into an aggregate of approximately 32,386,808 shares of the Company's common stock. The 3 1/4% Notes are redeemable at the Company's option, at any time on or after April 5, 2005. The redemption price, as a percentage of principal amount, is 101.3% beginning April 5, 2005 and 100.65% beginning April 1, 2006. The Company incurred issuance costs related to the 3 1/4% Notes of \$8,000, which are included in other assets in the accompanying consolidated balance sheets. The issuance costs are being amortized using the effective interest method over the term of the 3 1/4% Notes. The amortization of the issuance costs is included in interest expense in the accompanying consolidated statements of operations.

**8. Segment Information**

Segment information has been prepared in accordance with the Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information ( SFAS No. 131 ). The accounting policies of the segments are the same as the accounting policies for the consolidated Company. Inter-segment revenues represent sales of Transaction Services products into the Physician Services customer base and are reflected at rates comparable to those charged to third parties for comparable products. The performance of the Company's business is monitored based on income or loss before restructuring, taxes, non-cash and other items. Non-cash and other items include depreciation, amortization, accretion of preferred stock, impairment charges, gain on investments, other income, costs and expenses related to the investigation by the United States Attorney for the District of South Carolina and the SEC ( legal expense ), non-cash expenses related to content, advertising and distribution services acquired in exchange for the Company's equity securities in acquisitions and strategic alliances, and stock compensation expense primarily related to stock options issued and assumed in connection with acquisitions.

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

Summarized financial information for each of the Company's operating segments and a reconciliation to net loss are presented below:

	Years Ended December 31,		
	2003	2002	2001
<b>Revenues</b>			
Transaction services	\$ 505,729	\$ 466,810	\$ 457,448
Physician services	302,640	275,306	260,209
Portal services	110,665	84,296	74,626
Plastic technologies	71,940	65,811	62,017
Eliminations and other, net	(26,994)	(20,527)	(12,280)(a)
	<u>\$ 963,980</u>	<u>\$ 871,696</u>	<u>\$ 842,020</u>
<b>Income (loss) before restructuring, taxes, non-cash and other items</b>			
Transaction services	\$ 94,218	\$ 85,154	\$ 41,987
Physician services	20,924	26,685	20,827
Portal services	24,898	5,574	(79,437)
Plastic technologies	20,532	19,891	17,406
Corporate and other	(50,251)	(51,272)	(94,813)
Interest income	22,901	19,590	30,409
Interest expense	(15,214)	(8,491)	(507)
	<u>\$ 118,008</u>	<u>\$ 97,131</u>	<u>\$ (64,128)</u>
<b>Restructuring, taxes, non-cash and other items</b>			
Depreciation, amortization and other	\$ (62,434)	\$ (125,593)	\$ (2,394,857)
Non-cash content and distribution services and stock compensation	(36,747)	(50,971)	(123,925)
Impairment of long-lived and other assets			(3,816,115)
Restructuring and integration benefit (charge)		5,850	(266,755)
Legal expense	(3,959)		
Gain on investments	1,659	6,547	
Other income, net	4,218	3,844	
Income tax benefit (provision)	(4,140)	10,079	(2,588)
	<u>16,605</u>	<u>(53,113)</u>	<u>(6,668,368)</u>
Income (loss) from continuing operations			
Income (loss) from discontinued operations, net of income taxes	(33,611)	3,411	(3,950)
	<u>\$ (17,006)</u>	<u>\$ (49,702)</u>	<u>\$ (6,672,318)</u>
Net loss			

- (a) In 2001, includes revenues related to technology outsourcing and consulting relationships and other non-core products that the Company decided to exit as a result of restructuring and integration efforts that commenced in the third quarter of 2000, as well as the elimination of inter-segment revenues of \$14,061.

The Company does not disaggregate assets for internal management reporting and, therefore, such information is not presented.





**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

Revenues generated from foreign customers of the continuing operations of the Company's Plastic Technologies segment were \$31,320, \$26,674 and \$24,282 in 2003, 2002 and 2001, respectively. Long-lived assets based in foreign facilities of the Plastic Technologies segment were \$13,798 and \$11,745 as of December 31, 2003 and 2002, respectively.

**9. Prepaid Content and Distribution Services**

In connection with obtaining Web site content and distribution services, the Company paid cash or issued equity instruments to certain service providers, in conjunction with business combinations or strategic alliances. The amount of payments made or the fair value of equity instruments issued has been capitalized and is being amortized over the term of the related agreement. Prepaid content and distribution services are summarized as follows:

	<b>December 31,</b>	
	<b>2003</b>	<b>2002</b>
<b>Current Portion</b>		
Content	\$ 479	\$ 334
Services	15,693	19,239
Distribution	1,944	5,833
	<u>\$ 18,116</u>	<u>\$ 25,406</u>
<b>Long-Term Portion</b>		
Content	\$ 25	\$ 83
Services	31,967	46,504
Distribution		1,945
	<u>\$ 31,992</u>	<u>\$ 48,532</u>

**10. Long-Lived Assets**

In 2001, the Company recorded an impairment charge of \$3,816,115 related to the write-down of the carrying value of long-lived and other assets. See Note 4.

***Property and Equipment***

Property and equipment consists of the following:

	<b>December 31,</b>	
	<b>2003</b>	<b>2002</b>
Computer equipment	\$ 52,968	\$ 42,220
Land and buildings	17,136	15,447
Office equipment, furniture and fixtures	38,612	26,430

Edgar Filing: WEBMD CORP /NEW/ - Form 10-K

Software	27,219	17,427
Leasehold improvements	9,050	8,494
Construction in process	3,819	8,648
	<u>148,804</u>	<u>118,666</u>
Less: accumulated depreciation	(71,526)	(48,178)
	<u>\$ 77,278</u>	<u>\$ 70,488</u>

F-28

---

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

Depreciation expense was \$25,926, \$23,255 and \$33,675 in 2003, 2002 and 2001, respectively.

**Goodwill and Intangible Assets**

Effective July 1, 2001 and January 1, 2002, the Company adopted SFAS No. 141, Business Combinations ( SFAS No. 141 ) and SFAS No. 142, respectively. SFAS No. 141 requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting. It also specifies the types of acquired intangible assets that are required to be recognized and reported separately from goodwill. SFAS No. 142 requires that goodwill and certain intangibles no longer be amortized, but instead tested for impairment at least annually. SFAS No. 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives and reviewed for impairment in accordance with SFAS No. 144. Based on the Company's analysis, there was no impairment of goodwill upon adoption of SFAS No. 142 on January 1, 2002, or in connection with the annual impairment tests that were performed during the quarters ended December 31, 2003 and 2002.

The changes in the carrying amount of goodwill during the years ended December 31, 2003 and 2002 are as follows:

	Transaction Services	Physician Services	Portal Services	Plastic Technologies	Total
Balance as of January 1, 2002	\$ 333,412	\$ 166,002	\$ 7,347	\$ 37,481	\$ 544,242
Adjustment for acquired workforce intangibles	8,555	8,089			16,644
Goodwill recorded during the period		11,784	17,973		29,757
Adjustments to finalize purchase price allocations		(3,790)	(1,615)	356	(5,049)
Effects of exchange rates				449	449
Balance as of January 1, 2003	341,967	182,085	23,705	38,286	586,043
Goodwill recorded during the period	244,021	1,469	12,731		258,221
Adjustments to finalize purchase price allocations		(745)	407		(338)
Effects of exchange rates				522	522
Balance as of December 31, 2003	\$ 585,988	\$ 182,809	\$ 36,843	\$ 38,808	\$ 844,448

Intangible assets subject to amortization consist of the following:

	December 31, 2003			December 31, 2002		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Customer lists	\$ 325,160	\$(206,163)	\$ 118,997	\$ 209,386	\$(179,127)	\$ 30,259
Trade names	30,316	(19,756)	10,560	24,329	(14,013)	10,316
Technology and patents	191,318	(146,905)	44,413	175,159	(144,485)	30,674
Non-compete agreements and other	11,019	(859)	10,160	2,268	(295)	1,973

Edgar Filing: WEBMD CORP /NEW/ - Form 10-K

Total	\$557,813	\$(373,683)	\$184,130	\$411,142	\$(337,920)	\$73,222
-------	-----------	-------------	-----------	-----------	-------------	----------

F-29

---

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

Amortization expense was \$35,763, \$102,338 and \$2,361,182 in 2003, 2002 and 2001, respectively. Aggregate amortization expense for intangible assets is estimated to be:

Year ending December 31,	
2004	\$23,056
2005	18,565
2006	15,584
2007	14,772
2008	14,286
Thereafter	97,867

The pro forma results of operations for 2001, assuming the provisions of SFAS No. 142 were applied, are as follows:

	<b>Year Ended December 31, 2001</b>
Net loss (as reported)	\$(6,672,318)
Add back amortization for:	
Goodwill	2,204,138
Workforce	14,050
Adjusted net loss	\$(4,454,130)
Basic and diluted net loss per common share:	
Net loss (as reported)	\$ (19.14)
Add back amortization for:	
Goodwill	6.32
Workforce	.04
Adjusted net loss	\$ (12.78)

**11. Accrued Expenses**

Accrued expenses consist of the following:

	<b>December 31,</b>	
	<b>2003</b>	<b>2002</b>
Accrued outside services	\$ 26,841	\$ 26,386
Accrued restructuring costs	25,915	33,535
Accrued compensation	39,320	47,918
Accrued customer deposits	16,539	5,926
Other accrued liabilities	99,815	94,577

Edgar Filing: WEBMD CORP /NEW/ - Form 10-K

Total accrued expenses	\$208,430	\$208,342
------------------------	-----------	-----------

F-30

---

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)****12. Commitments and Contingencies****Legal Matters*****Porex Mammary Implant Litigation***

From 1988 through 1990, Porex distributed silicone mammary implants in the United States pursuant to a distribution arrangement with a Japanese manufacturer. Porex believes that, after accounting for implants returned to Porex, the aggregate number of persons who received implants distributed by Porex totals approximately 2,500. Since March 1991, Porex has been named as one of many co-defendants in a number of actions brought by recipients of mammary implants. The typical case or claim alleges that the individual's mammary implants caused one or more of a wide range of ailments. These implant cases and claims generally raise difficult and complex factual and legal issues and are subject to many uncertainties and complexities, including, but not limited to, the facts and circumstances of each particular case or claim, the jurisdiction in which each suit is brought, and differences in applicable law. Porex does not have sufficient information to evaluate each case and claim.

Certain of the actions against Porex have been dismissed, where it was determined that the implant in question was not distributed by Porex. In addition, as of March 10, 2003, approximately 300 actions have been settled by the manufacturer, or by Porex's insurance carriers, without material cost to Porex. As of March 10, 2003, no implant-related claims were pending against Porex. During calendar year 2003, there were no implant-related claims made against Porex by individuals, as compared to two claims during each of 2002, 2001 and 2000, 39 claims during 1999 and nine claims during 1998. The majority of claims made during 1999 were claims that were filed by individuals following a court ruling in 1999 that cases filed in earlier years would not proceed as class actions, as a result of which such individuals would not be members of a class in such cases.

In 1994, Porex was notified that its insurance carrier would not renew its then-existing insurance coverage after December 31, 1994 with respect to actions and claims arising out of its distribution of implants. However, Porex exercised its right, under such policy, to purchase extended reporting period coverage with respect to such actions and claims. Such coverage provides insurance subject to existing policy limits, but for an unlimited time period with respect to actions and claims made after December 31, 1994 based on events that occurred during the policy period. In addition, Porex has purchased extended reporting period coverage with respect to other excess insurance. This coverage also extends indefinitely, replacing coverage that would, by its terms, have otherwise expired by December 31, 1997. Porex will continue to evaluate the need to purchase further extended reporting period coverage from excess insurers to the extent such coverage is reasonably available.

The Company believes that Porex's present coverage, together with Porex's insurance policies in effect on or before December 31, 1994, should provide adequate coverage against liabilities that could result from actions or claims arising out of Porex's distribution of silicone mammary implants. However, Porex cannot be certain that particular cases and claims will not result in liability that is greater than expected based on Porex's prior experience. If so, Porex's liability could exceed the amount of its insurance coverage. Furthermore, certain actions and claims seek punitive and compensatory damages arising out of alleged intentional torts. If these claims are successful, such damages may or may not be covered, in whole or in part, by Porex's insurance policies.

***Merrill Lynch Fundamental Growth Fund, Inc. et al. v. McKesson HBOC, Inc., et al.***

The Company has been named as a defendant in the action *Merrill Lynch Fundamental Growth Fund, Inc., et al. v. McKesson HBOC, Inc., et al.*, Case No. 405792, in the San Francisco Superior Court. The original complaint in this matter alleged that McKesson HBOC, HBO and Company (which the Company refers to as HBOC), certain officers and directors of those firms, Arthur Andersen LLP, and

**Table of Contents**

**WebMD Corporation**

**Notes to Consolidated Financial Statements (Continued)**

Bear Stearns & Co. engaged in a number of practices whereby HBOC and later McKesson HBOC improperly recognized revenues. When these practices were discovered, McKesson HBOC eliminated more than \$327 million in revenues that HBOC had recognized over the prior three years. Plaintiffs claim to have lost more than \$150 million as a result of the decline in McKesson HBOC's share value after the accounting practices came to light in April 1999.

On September 4, 2003, the plaintiffs filed a fourth amended complaint, naming the Company and two other defendants, General Electric Capital Corporation, Inc. and Computer Associates International, Inc., for the first time. The complaint alleges that the Company aided and abetted alleged fraud by certain defendants and conspired with those defendants in relation to HBOC's and McKesson HBOC's alleged improper recognition of approximately \$14 million in revenue on two software transactions. Plaintiffs also allege that the Company made certain negligent misrepresentations with respect to these transactions.

Plaintiffs allege that WebMD, Inc. (then a separate private company and now a subsidiary of the Company), through its participation in certain transactions with HBOC and McKesson HBOC, learned that officers of HBOC and/or McKesson HBOC, HBOC and McKesson HBOC were breaching duties owed to McKesson HBOC shareholders by making material misstatements and suppressing or omitting facts with respect to HBOC's and McKesson HBOC's financial results for the periods ending December 31, 1998 and March 31, 1999 and that WebMD, Inc. aided and abetted and conspired with these defendants. One of the officers became an officer of WebMD, Inc. on December 1, 1998, after having served as HBOC's representative on the board of WebMD, Inc. and was dismissed by WebMD, Inc. after the accounting fraud at HBOC was disclosed. The other officer served as HBOC's representative on the Board of WebMD, Inc. and ceased to be a director of WebMD, Inc. upon dismissal by McKesson HBOC. The complaint alleges numerous instances of improper accounting by HBOC unrelated to the transactions between WebMD, Inc. and HBOC and/or McKesson HBOC.

The Company intends to vigorously defend against the plaintiffs' claims against the Company and WebMD, Inc. On December 16, 2003, the Company filed a demurrer, seeking dismissal of the two claims against it. This demurrer is pending with the Court.

***Investigations by United States Attorney for the District of South Carolina and the SEC***

The United States Attorney for the District of South Carolina is conducting an investigation of the Company, which it first learned about on September 3, 2003. On that date, Federal Bureau of Investigation and Internal Revenue Service agents executed search warrants at the Company's corporate headquarters in Elmwood Park, New Jersey and the offices of Medical Manager Health Systems in Tampa, Florida and Alachua, Florida and delivered subpoenas for documents and financial records. Based on the information available to the Company as of the date of this Annual Report, it believes that the investigation relates principally to issues of financial reporting for Medical Manager Corporation, a predecessor of WebMD (by its merger into the Company in September 2000) and the Company's Medical Manager Health Systems subsidiary; however, the Company cannot be sure of the investigation's exact scope or how long it will continue. Included among the materials removed or subject to subpoena are records relating to a \$5,532 restatement of revenue by Medical Manager Corporation in August 1999 and to acquisitions by the Company's Medical Manager Health Systems subsidiary of other companies, most of which were dealers of Medical Manager products and services. In August 1999, Medical Manager Corporation announced that it would restate previously reported results of Medical Manager Health Systems, which it had acquired in July 1999, for the six months ended immediately prior to the acquisition. Medical Manager Corporation determined at the time that the accounting treatment previously accorded to five transactions involving the bulk sales of software licenses entered into concurrently with business combinations and other related transactions should be restated to reflect the software license revenues as a reduction of the acquisition price of the related transactions. At the time, Medical Manager



**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

Corporation also noted that the transactions represented \$5,532 of revenue and \$3,502 of net income for the six months ended June 30, 1999. The Company understands that the SEC is also conducting a formal investigation into this matter.

The Company intends to continue to fully cooperate with the authorities in this matter and the Company's Board of Directors has formed a special committee consisting solely of independent directors to oversee this matter. The special committee has retained independent legal counsel to advise it.

While the Company is not able to estimate, at this time, the amount of costs and expenses that it will incur in connection with the investigations, it expects that they may be significant. For the year ended December 31, 2003, those expenses are reflected as legal expense in the consolidated statements of operations.

***At Home Corporation General Unsecured Creditors Trust***

In 1999, WebMD, Inc. entered into an agreement with Excite Corp. concerning placing the Company's content on Excite Corp.'s consumer internet portal. In 2001, the Company and Excite Corp.'s successor, AtHome Corp., entered into a revised agreement, which terminated the 1999 agreement and included a release of claims under the 1999 agreement. AtHome Corp. later filed for bankruptcy.

On December 4, 2003, the Company was served with a complaint in an adversary proceeding in the Bankruptcy Court for the Northern District of California brought by the trustee for the AtHome Corporation General Unsecured Creditors Trust. The plaintiff alleges that the 2001 agreement provided AtHome Corp. less than reasonably equivalent value for its rights under the 1999 agreement and that the 2001 agreement should be avoided as a fraudulent transfer. The plaintiff also alleges that the Company breached the 1999 agreement by failing to make required cash payments, and failed to pay AtHome Corp. fair and reasonable value for services that AtHome Corp. provided. The plaintiff has claimed that its damages are in excess of \$8 million. The Company intends to vigorously defend against the plaintiff's claims.

***Other Legal Proceedings***

In the normal course of business, the Company is involved in various other claims and legal proceedings. While the ultimate resolution of these matters, and those discussed above, has yet to be determined, the Company does not believe that their outcome will have a material adverse effect on the Company's consolidated financial position, results of operations or liquidity.

**Strategic Relationships**

The Company has agreements with various content providers and strategic partners whereby the Company is committed to pay certain amounts in connection with content and distribution services obtained for use on its Web site and certain distribution arrangements. The Company's non-cancelable future commitments under these agreements are as follows:

	Year Ending December 31,	
2004		\$ 1,262
2005		754
2006		500
2007		125
		<hr/>
		\$2,641
		<hr/>

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)****Leases**

The Company leases its offices and other facilities under operating lease agreements that expire at various dates through February 2013. Total rent expense for all operating leases was approximately \$19,486, \$18,700 and \$20,609 in 2003, 2002 and 2001, respectively. Future minimum lease commitments under non-cancelable lease agreements (including leases identified as part of the Company's restructuring and integration efforts) at December 31, 2003 were as follows:

Year Ending December 31,	Gross Operating Leases	Sublease Income	Net Operating Leases
2004	\$ 24,306	\$(224)	\$ 24,082
2005	20,062	(175)	19,887
2006	16,184	(33)	16,151
2007	14,166		14,166
2008	12,381		12,381
Thereafter	32,841		32,841
	<hr/>	<hr/>	<hr/>
Total minimum lease payments	\$ 119,940	\$(432)	\$ 119,508
	<hr/>	<hr/>	<hr/>

**13. Retirement Plan**

The Company maintains various defined contribution retirement plans covering substantially all of its employees. Certain of these plans provide for Company matching and discretionary contributions. The Company has recorded expenses related to these plans of \$1,531, \$3,485 and \$5,963 for 2003, 2002 and 2001, respectively.

**14. Stockholders Equity****Common Stock**

On March 29, 2001, the Company announced a stock repurchase program (the Program). Under the Program, the Company was authorized to use up to \$50,000 to purchase shares of its common stock from time to time beginning on April 2, 2001, subject to market conditions. On November 2, 2001, the maximum aggregate amount of purchases under the Program was increased to \$100,000 and on November 7, 2002 it was increased to \$150,000. As of December 31, 2003 and 2002, the Company has repurchased 22,313,356 and 19,991,160 shares, respectively, at a cost of approximately \$106,358 and \$86,042 under the Program. These shares are reflected as treasury shares in the accompanying consolidated balance sheets. As of December 31, 2003, the Company had \$43,642 available to repurchase shares of its common stock under the Program.

On October 12, 2001, the Company and Quintiles Transnational Corporation settled the litigation between the two companies. Under the terms of the settlement, the companies agreed to terminate all of their business agreements and the Company agreed to purchase from Quintiles for \$185,000 in cash all 35,000,000 shares of the Company's common stock held by Quintiles. These shares are reflected as treasury shares in the accompanying consolidated balance sheets. The fair market value of these shares on the date of the settlement was \$126,000 and has been recorded as treasury stock. The excess of the purchase price of the shares over their fair market value was \$59,000 and has been recorded as a component of restructuring and integration charges.

During 2002, the Company repurchased 14,100,000 shares of its common stock from Cerner Corporation at a purchase price of \$6.01 per share, or an aggregate purchase price of \$84,741. The



**Table of Contents**

**WebMD Corporation**

**Notes to Consolidated Financial Statements (Continued)**

repurchase of the shares from Cerner Corporation was separately approved by the Executive Committee of the Company's Board of Directors and, accordingly, was not part of the Stock Repurchase Program.

During 2002, the Company adopted the 2002 Restricted Stock Plan for the benefit of its employees. The shares of restricted stock are generally granted at prices not less than the fair market value on the date of grant and vest 25% per year over four years. At December 31, 2003, 688,669 shares of restricted stock remain reserved for issuance under the 2002 Restricted Stock Plan. In connection with the 2002 acquisitions, the Company recorded deferred compensation of \$2,500 related to grants of restricted stock. At December 31, 2003, the Company had approximately \$785 remaining to be amortized on a graded vesting method over a period of three years.

**Preferred Stock**

***Series A Convertible Preferred Stock***

In January 2000, the Board of Directors authorized 213,000 shares of Series A Convertible Preferred Stock ( 2000 Series A Preferred ) with a par value of \$0.0001 per share and a face value of \$5,000 per share. The 2000 Series A Preferred was entitled to quarterly dividends at a per annum rate of 10.5% of the face amount plus any accrued and unpaid dividends, payable in additional shares of 2000 Series A Preferred. With respect to dividend rights, other than the right to receive additional shares of 2000 Series A Preferred, rights on liquidation, winding up or dissolution, whether voluntary or involuntary, the Series A Preferred ranked on a parity with the Company's common stock and junior to the Series B Preferred. The 2000 Series A Preferred was convertible into common stock automatically on the third anniversary of the date of issuance. The 2000 Series A Preferred holders were entitled to vote with common stockholders on an as converted basis.

At December 31, 2000, there were 155,951 shares of 2000 Series A Preferred stock outstanding, convertible into 21,282,645 shares of the Company's common stock. In connection with the revised strategic alliance during 2001 with News Corporation, the 155,951 shares of 2000 Series A Preferred were surrendered to the Company and therefore at December 31, 2003 and 2002 no shares of 2000 Series A Preferred stock were outstanding.

In November 2003, the Board of Directors eliminated the designation of 2000 Series A Preferred and restored all the shares to the status of authorized and unissued shares of preferred stock.

***Series B Convertible Redeemable Preferred Stock***

In September 2000, the Board of Directors authorized 200 shares of Series B Convertible Redeemable Preferred Stock ( Series B Preferred ). In connection with the acquisition of CareInsite, the Company issued 100 shares of Series B Preferred in exchange for all the outstanding shares of CareInsite's preferred stock. In March 2002, the Company redeemed the outstanding Series B Preferred for \$10,000 in accordance with its terms.

In November 2003, the Board of Directors eliminated the designation of the Series B Preferred and restored all the shares to the status of authorized and unissued shares of preferred stock.

**Warrants**

The Company has warrants outstanding to purchase 25,562,697 shares of common stock at prices ranging from \$0.67 to \$74.22 per share, with a weighted average exercise price of \$20.35 per share. Substantially all of the outstanding warrants are currently vested and exercisable and expire at various dates through January 1, 2009.

**Table of Contents**

**WebMD Corporation**

**Notes to Consolidated Financial Statements (Continued)**

In January 2000, in connection with an Internet marketing and services agreement entered into with a distributor, the Company issued a warrant to purchase 4,376,445 shares of the Company's common stock at \$1.00 per share. The warrant vests over a four-year period, subject to certain performance thresholds. As of December 31, 2000, the Company estimated that the performance thresholds were not achieved and no value was assigned to the warrants. As of December 31, 2001, the Company estimated the distributor was entitled to a warrant for 2,000,000 shares and recorded \$13,418, determined using the Black-Scholes option pricing model, as a non-cash distribution services expense included in sales, marketing, general and administrative expense. In January 2002, the Internet marketing and services agreement was terminated and the distributor retained the warrant to purchase 2,000,000 shares of the Company's common stock at \$1.00 per share. The warrant is fully vested and expires on January 24, 2007. As of December 31, 2003, 1,333,333 shares remain unexercised as part of this warrant agreement.

During 2003 and 2002, warrants to purchase a total of 1,729,713 shares and 1,090,121 shares, respectively, of the Company's common stock at a weighted average exercise price of \$5.33 per share and \$3.04 per share, respectively, were exercised. Also during 2002, the Company repurchased warrants to purchase 8,419,736 shares of the Company's common stock, with a weighted average exercise price of \$38.00 per share, for a cash payment of \$10.

**15. Stock Option Plans**

The Company has various stock option plans (collectively, the Plans) for directors, officers and key employees that provide for non-qualified and incentive stock options and restricted stock grants. Generally, options become exercisable ratably over a three to five year period based on their individual grant dates. Options are generally granted at prices not less than the fair market value on the date of grant. Options granted under the Plans expire within four to fifteen years from the date of grant. An aggregate of 21,579,838 shares of common stock remain reserved for issuance under the Plans at December 31, 2003.

In addition to the Plans, the Company has granted options to certain directors, consultants and key employees. At December 31, 2003, there were options to purchase 6,030,500 shares of common stock outstanding to these individuals. The terms of these grants are similar to the terms of the options granted under the Plans.

In connection with the mergers with Medical Manager, CareInsite and OnHealth, the Company assumed all the outstanding options issued under the respective stock option plans and arrangements and, after the application of the exchange ratio, reserved 76,640,029 shares for Medical Manager and CareInsite and 1,354,482 shares for OnHealth of common stock for issuance upon exercise of the assumed options. No further options can be granted under these plans. At the time of these acquisitions, options for 21,265,330 and 1,067,796 shares, respectively, were fully vested. The remainder of the shares vest based upon the terms of the original plans ranging from three to five years.

In 1999, the Company assumed all outstanding options issued under the respective stock option plans and arrangements and, after application of the exchange ratio, reserved the following shares of common stock per merger: 14,734,986 for WebMD, Inc., 468,584 for MedE America, and 164,036 for Medcast, for issuance upon exercise of the assumed options. No further options can be granted under these plans. At the time of these acquisitions, the number of fully vested options were: 8,637,406 for WebMD, Inc., 60,136 for MedE America, and 83,626 for Medcast. The remainder of the options vest based upon the terms of the original plans, generally four years.

The Company records deferred stock compensation related to stock options as a component of stockholders' equity when the exercise price is lower than the deemed fair value of common stock on the date stock options are granted. No deferred stock compensation related to stock options was recorded in

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

2003, 2002 or 2001. At December 31, 2003, the Company had a total of approximately \$3,898 remaining to be amortized on a graded vesting method over the remaining two years.

The Company recorded stock compensation expense, primarily related to deferred stock compensation recorded in connection with acquisitions, of \$12,629, \$25,265 and \$129,268 in 2003, 2002 and 2001, respectively, of which \$51,998 was included in restructuring and integration charges in 2001. No stock compensation expenses were included in restructuring and integration charges for 2003 or 2002.

A summary of the status of the Company's stock option plans for the three year period ended December 31, 2003 is presented below:

	Years Ended December 31,					
	2003		2002		2001	
	Number of Shares	Weighted Average Exercise Price per Share	Number of Shares	Weighted Average Exercise Price per Share	Number of Shares	Weighted Average Exercise Price per Share
Outstanding at the beginning of the year	108,232,050	\$ 12.73	121,184,501	\$ 12.99	128,045,133	\$ 15.79
Granted	12,326,350	9.88	4,946,459	6.58	23,057,311	4.39
Assumed						
Exercised	(8,773,510)	4.73	(5,316,668)	3.26	(2,701,776)	3.17
Cancelled	(7,024,164)	15.82	(12,582,242)	16.49	(27,216,167)	19.34
Outstanding at the end of the year	104,760,726	12.86	108,232,050	12.73	121,184,501	12.99
Exercisable at the end of the year	73,927,473	\$ 14.03	70,764,983	\$ 13.86	65,352,769	\$ 14.15

The following table summarizes information with respect to options outstanding and options exercisable at December 31, 2003:

Exercise Prices	Outstanding			Exercisable	
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (In Years)	Shares	Weighted Average Exercise Price
\$0.25-\$3.43	12,452,583	\$ 3.33	7.55	6,874,423	\$ 3.24
\$3.55-\$6.04	13,470,264	5.11	4.96	11,327,809	5.06
\$6.12-\$9.56	13,604,017	8.29	7.91	3,966,664	8.01
\$9.57-\$11.55	14,865,774	11.33	6.68	10,281,298	11.49
\$11.56-\$13.38	12,712,858	12.39	7.24	7,662,493	12.67
\$13.50-\$15.60	10,836,113	14.10	5.89	9,967,774	14.10
\$15.81-\$21.69	13,833,019	17.85	6.37	12,542,191	17.73
\$22.12-\$105.00	12,986,098	30.68	5.04	11,304,821	30.76

Edgar Filing: WEBMD CORP /NEW/ - Form 10-K

<u>104,760,726</u>	<u>\$ 12.86</u>	<u>6.47</u>	<u>73,927,473</u>	<u>\$ 14.03</u>
--------------------	-----------------	-------------	-------------------	-----------------

The Company has elected to follow APB No. 25 and related interpretations in accounting for employee stock options because the alternative fair value accounting method provided for under SFAS No. 123 requires the use of option valuation models that were not developed for use in valuing

F-37

---

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

employee stock options. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimates, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of the Company's employee stock options.

The pro forma information presented in Note 1 has been determined as if employee stock options granted subsequent to December 31, 1994 were accounted for under the fair value method of SFAS No. 123. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Expected dividend yield	0%	0%	0%
Expected volatility	0.85	0.9	0.9
Risk free interest rate	1.33%	1.85%	3.04%
Expected option lives (years)	0.75-3.0	0.75-3.0	0.5-3.5
Weighted fair value of options granted during the year	\$ 5.64	\$ 4.06	\$ 2.70

**Employee Stock Purchase Plan**

The Company's 1998 Employee Stock Purchase Plan, as amended from time to time (the 1998 Purchase Plan), became effective upon the completion of the initial public offering on February 10, 1999. The 1998 Purchase Plan allows eligible employees the opportunity to purchase shares of the Company's common stock through payroll deductions, up to 15% of a participant's annual compensation with a maximum of 5,000 shares available per participant during each purchase period. Prior to an amendment to the 1998 Purchase Plan on November 1, 2002, the purchase price of the stock was 85% of the lesser of the fair market value on the first and last day of each purchase period. Effective with the November 1, 2002 amendment, the purchase price of the stock is 85% of the fair market value on the last day of each purchase period. A total of 3,995,447 shares of common stock remain reserved for issuance under the 1998 Purchase Plan. The 1998 Purchase Plan, as amended in connection with the 2000 mergers, provides for annual increases equal to the lesser of 1,500,000 shares, 0.5% of the outstanding common shares, or a lesser amount determined by the Board of Directors. A total of 345,575, 640,172 and 876,960 shares were issued under this plan during 2003, 2002 and 2001, respectively.



**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)****16. Income Taxes**

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets (liabilities) were as follows:

	December 31,	
	2003	2002
Deferred tax assets:		
Net operating loss carryforwards	\$ 729,963	\$ 691,303
Restructuring costs	9,943	13,092
Research and development tax credits	15,274	13,136
Other accrued expenses	33,589	38,816
Allowance for doubtful accounts	7,692	8,401
Depreciation	4,846	8,007
Intangible assets	131,979	175,824
Other	2,482	1,506
	<u>935,768</u>	<u>950,085</u>
Total deferred tax assets	935,768	950,085
Valuation allowance	(926,767)	(941,507)
	<u>9,001</u>	<u>8,578</u>
Net deferred tax assets	9,001	8,578
Deferred tax liabilities:		
Tax basis	(2,582)	(1,278)
Other	(6,419)	(7,300)
	<u>(9,001)</u>	<u>(8,578)</u>
Total deferred tax liabilities	(9,001)	(8,578)
Net deferred tax assets and liabilities	<u>\$</u>	<u>\$</u>

The reconciliation between the federal statutory rate and the effective income tax rate is as follows:

	2003	2002	2001
United States federal statutory rate	34.0%	(34.0)%	(34.0)%
State income taxes (net of federal benefit)	3.3	(3.6)	(0.8)
Impairment and restructuring expenses	0.0	(3.1)	16.0
Goodwill amortization	(12.3)	5.6	11.0
Valuation allowance	(2.0)	21.0	7.8
Other	(3.0)	(1.9)	0.0
	<u>20.0%</u>	<u>(16.0)%</u>	<u>0.0%</u>
Effective income tax rate	20.0%	(16.0)%	0.0%

## Edgar Filing: WEBMD CORP /NEW/ - Form 10-K

A valuation allowance equal to 100% of the net deferred tax assets has been established because of the uncertainty of realization of the deferred tax assets due to the lack of earnings history. Approximately \$339,416 and \$151,129 of these deferred tax assets and related valuation allowances were recorded through additional paid in capital and goodwill, respectively. Therefore, if in the future the Company believes that it is more likely than not that these deferred tax benefits will be realized, this portion of the valuation allowances will be reversed against additional paid in capital and goodwill, respectively. The valuation allowance for deferred tax assets increased (decreased) by (\$14,740) and \$1,743 in 2003 and 2002, respectively.

F-39

---

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

At December 31, 2003, the Company had net operating loss carryforwards for federal income tax purposes of approximately \$1,920,956, that expire in 2004 through 2023, and federal tax credits of approximately \$15,274, which expire in 2006 through 2023.

A portion of net operating loss carryforwards and tax credit carryforwards may be subject to an annual limitation regarding their utilization against taxable income in future periods due to the change of ownership provisions of the Internal Revenue Code and similar state provisions. A portion of these carryforwards may expire before becoming available to reduce future income tax liabilities.

The income tax provision (benefit) for 2002 included a \$12,887 benefit reflecting the carryback of net operating losses to the prior periods of certain acquired subsidiaries, in which those subsidiaries generated taxable income. The carryback was allowed as a result of the Job Creation and Worker Assistance Act of 2002 that was enacted on March 9, 2002. In addition, some of the Company's operating companies are profitable in certain states and foreign countries in which the Company does not have net operating losses to offset that income. Accordingly, the Company provided for taxes of \$4,140, \$2,808 and \$2,588 related to foreign, state and other jurisdictions during 2003, 2002 and 2001, respectively.

The income tax provision (benefit) for 2003, 2002 and 2001 includes \$2,228, \$1,756 and \$1,496, respectively, related to non-U.S. income taxes. The non-U.S. income included in income (loss) from continuing operations before income tax provision (benefit) was \$5,879, \$4,310 and \$3,756 for 2003, 2002 and 2001, respectively. Accumulated net earnings of foreign subsidiaries are intended to be permanently reinvested in those subsidiaries. Accordingly, no federal taxes have been provided on those earnings.

**17. Related Party Transactions**

In 2001, the Company recorded \$3,000 in revenue from related parties attributable to News Corporation (until February 15, 2001, the date News Corporation ceased being considered a related party when it surrendered its Series A Convertible Preferred Stock) and Microsoft (until October 22, 2001, the date Microsoft ceased being considered a related party when a representative of Microsoft resigned from the Board of Directors).

**18. Fair Value of Financial Instruments**

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of SFAS No. 107, Disclosures about Fair Value of Financial Instruments. The estimated fair values have been determined using available market information. However, considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

	December 31, 2003		December 31, 2002	
	Cost Basis	Fair Value	Cost Basis	Fair Value
<b>Assets:</b>				
Cash and cash equivalents	\$ 63,298	\$ 63,298	\$ 175,596	\$ 175,596
Short-term investments	205,962	207,383	10,865	10,897
Marketable securities - long term	447,583	456,034	448,286	464,638
<b>Liabilities:</b>				
Convertible subordinated notes	\$ 649,999	\$ 657,812	\$ 300,000	\$ 348,000

As of December 31, 2003, the Company's short-term investments consisted of certificates of deposit, municipal bonds and asset backed securities, marketable debt securities consisted of Federal Agency Notes

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

and U.S. Treasury Notes and marketable equity securities consisted of equity investments in publicly traded companies. As of December 31, 2002, the Company's short-term investments consisted principally of U.S. Treasury Notes and certificates of deposit, marketable debt securities consisted of municipal bonds and marketable equity securities represented an equity investment in a publicly traded company.

In accordance with the requirements of SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, below is a summary of the fair value, gains and losses relating to the Company's investments in debt and equity securities:

	December 31, 2003				December 31, 2002			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Short-Term</b>								
Held-to-maturity:								
Certificate of deposits and marketable debt securities	\$	\$	\$	\$	\$ 2,919	\$ 9	\$	\$ 2,928
Available-for-sale:								
Certificate of deposits and marketable debt securities	205,962	1,421		207,383	7,946	23		7,969
<b>Total</b>	<b>\$205,962</b>	<b>\$1,421</b>	<b>\$</b>	<b>\$207,383</b>	<b>\$ 10,865</b>	<b>\$ 32</b>	<b>\$</b>	<b>\$ 10,897</b>
<b>Long-Term</b>								
Held-to-maturity:								
Marketable debt securities	\$	\$	\$	\$	\$243,475	\$ 7,922	\$	\$251,397
Available-for-sale:								
Marketable debt securities	445,810	6,043	563	451,290	201,641	4,173		205,814
Equity securities	1,773	2,971		4,744	3,170	4,257		7,427
<b>Total</b>	<b>\$447,583</b>	<b>\$9,014</b>	<b>\$563</b>	<b>\$456,034</b>	<b>\$448,286</b>	<b>\$16,352</b>	<b>\$</b>	<b>\$464,638</b>

The amortized cost and estimated fair value by maturity of securities are shown in the following table. Securities are classified according to their contractual maturities without consideration of principal amortization, potential prepayments or call options. Accordingly, actual maturities may differ from contractual maturities. During the quarter ended December 31, 2003, the Company reviewed the classification of its held-to-maturity and available-for-sale securities. The Company considered its acquisition activity in 2003, and its plan to continue to invest in acquisitions, strategic relationships, infrastructure and product development in the future. As a result of its review, the Company determined it no longer had the positive intent to hold certain of its securities to maturity, and accordingly, all remaining held-to-maturity securities were reclassified to available-for-sale.

	Cost or Amortized Cost	Fair Value
--	------------------------	------------

Edgar Filing: WEBMD CORP /NEW/ - Form 10-K

Available-for-sale:		
Due in one year or less	\$205,962	\$207,383
Due after one year through five years	445,810	451,290
	<u>          </u>	<u>          </u>
Total	\$651,772	\$658,673
	<u>          </u>	<u>          </u>

F-41

---

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)**

During 2003, three of the Company's investments in held-to-maturity debt securities were called for early redemption by the issuer for net proceeds of \$155,000. As a result of the redemption, the Company realized a gain of \$285 reflecting the difference between the proceeds received and the related carrying amount of the investment. In addition, during 2003, the Company sold its investments in available-for-sale marketable debt securities for proceeds of \$242,907. The majority of these proceeds were used to finance the Medifax acquisition on December 22, 2003. The Company realized a loss of \$1,599 in connection with the sales. Additionally, during 2003, the Company sold a portion of its investments in marketable equity securities for proceeds of \$4,387, which resulted in a gain of \$2,973. The proceeds from these sales have been included in proceeds from maturities and sales of available-for-sale securities and proceeds from maturities and redemptions of held-to-maturity securities in the accompanying consolidated statements of cash flows and the gain and losses have been included in gain on investments in the accompanying consolidated statements of operations.

During 2002, one of the Company's investments in Federal Agency Notes was called for early redemption by the issuer for net proceeds of \$56,000. As a result of the redemption, the Company realized a gain of \$681 reflecting the difference between the proceeds received and the related carrying amount of the investment. The proceeds from this redemption have been included in proceeds from maturities and redemptions of held-to-maturity securities in the accompanying consolidated statements of cash flows and the gain has been included in gain on investments in the accompanying consolidated statements of operations. Additionally, during 2002, the Company sold one of its investments in marketable equity securities for proceeds of \$7,026, which resulted in a gain of \$5,866. The proceeds from this sale have been included in proceeds from maturities and sales of available-for-sale securities in the accompanying consolidated statements of cash flows and the gain has been included in gain on investments in the accompanying consolidated statements of operations for 2002.

**19. Comprehensive Loss**

Comprehensive loss is comprised of net loss and other comprehensive income (loss). Other comprehensive income (loss) includes certain changes in equity that are excluded from net loss, such as changes in unrealized holding gains (losses) on available-for-sale marketable securities and foreign currency translation adjustments. The following table presents the components of other comprehensive income (loss) for the years ended December 31, 2003, 2002 and 2001:

	<u>2003</u>	<u>2002</u>	<u>2001</u>
Foreign currency translation gains (losses)	\$ 3,285	\$ 2,523	\$ (710)
Unrealized gains (losses) on securities:			
Unrealized holding gains	3,078	2,907	7,097
Less: reclassification adjustment for net gains realized in net income (loss)	(1,659)	(6,547)	
Net unrealized gains (losses) on securities	<u>1,419</u>	<u>(3,640)</u>	<u>7,097</u>
Other comprehensive income (loss)	<u>4,704</u>	<u>(1,117)</u>	<u>6,387</u>
Net loss	<u>(17,006)</u>	<u>(49,702)</u>	<u>(6,672,318)</u>
Comprehensive loss	<u>\$ (12,302)</u>	<u>\$ (50,819)</u>	<u>\$ (6,665,931)</u>

The foreign currency translation gains (losses) are not currently adjusted for income taxes as they relate to permanent investments in non-U.S. subsidiaries.

**Table of Contents****WebMD Corporation****Notes to Consolidated Financial Statements (Continued)****20. Supplemental Disclosures of Cash Flow Information**

Supplemental information related to the consolidated statements of cash flows is summarized below:

	Years Ended December 31,		
	2003	2002	2001
<b>Supplemental Disclosure of Cash Flow Information:</b>			
Interest paid	\$ 12,714	\$ 5,021	\$ 479
Taxes paid	\$ 7,215	\$ 1,090	\$ 1,822
<b>Supplemental Schedule of Non-Cash Investing and Financing Activities:</b>			
Issuance of equity securities in connection with business combinations, strategic alliances and services, and asset purchases	\$ 67	\$ 39	\$ 24,739
Reacquisition of convertible preferred stock and issuance of warrants in connection with revision of strategic alliances	\$	\$	\$ (151,171)
Equipment acquired under capital lease obligations	\$	\$	\$ 168
Deferred stock compensation and options granted in connection with acquisitions	\$ 25	\$ 2,500	\$

**21. Quarterly Financial Data (Unaudited)**

The following table summarizes the quarterly financial data for 2003 and 2002. Net income (loss) per share calculations for each of the quarters are based on the weighted average number of shares for each period; therefore, the sum of the quarters may not necessarily be equal to the full year per share amount.

	Revenue	Net Income (Loss)	Income (Loss) from Continuing Operations (Basic)	Income (Loss) from Discontinued Operations (Basic)	Net Income (Loss) per Share (Basic)	Income (Loss) from Continuing Operations (Diluted)	Income (Loss) from Discontinued Operations (Diluted)	Net Income (Loss) per Share (Diluted)
<b>2003</b>								
March 31, 2003	\$ 221,531	\$ (7,358)	\$ (0.03)	\$ 0.01	\$ (0.02)	\$ (0.03)	\$ 0.01	\$ (0.02)
June 30, 2003	233,418	(26,270)	0.02	(0.11)	(0.09)	0.02	(0.10)	(0.08)
September 30, 2003	250,635	6,089	0.03	(0.01)	0.02	0.03	(0.01)	0.02
December 31, 2003	258,396	10,533	0.03	(0.11)	0.03	0.03	(0.10)	0.03
	963,980	(17,006)	0.05	(0.11)	(0.06)	0.05	(0.10)	(0.05)

Edgar Filing: WEBMD CORP /NEW/ - Form 10-K

Year Ended December 31,

2003

<b>2002</b>								
March 31, 2002	\$ 211,961	\$(29,602)	\$ (0.10)	\$ 0.01	\$(0.09)	\$(0.10)	\$ 0.01	\$(0.09)
June 30, 2002	213,255	(22,209)	(0.07)	(0.00)	(0.07)	(0.07)	(0.00)	(0.07)
September 30, 2002	217,004	4,538	0.01	0.01	0.01	0.01	0.00	0.01
December 31, 2002	229,476	(2,429)	(0.01)	0.00	(0.01)	(0.01)	0.00	(0.01)
Year Ended December 31, 2002	871,696	(49,702)	(0.17)	0.01	(0.16)	(0.17)	0.01	(0.16)

As a result of certain reclassifications related to the discontinued operations of our Plastic Technologies segment, the above amounts may vary from amounts previously reported in the Company's quarterly filings.

F-43

---



**Table of Contents**

**WebMD Corporation**

**Notes to Consolidated Financial Statements (Continued)**

**22. Subsequent Event**

On March 4, 2004, the Company sold \$100,000 of Convertible Redeemable Exchangeable Preferred Stock ( Preferred Stock ) in a private transaction to CalPERS/PCG Corporate Partners, LLC ( CalPERS/PCG ). CalPERS/PCG is a private equity fund managed by the Pacific Corporate Group and principally backed by California Public Employees Retirement System, or CalPERS.

The Preferred Stock has a liquidation preference of \$100,000 in the aggregate and is convertible into 10,638,297 shares of the Company s common stock in the aggregate, representing a conversion price of \$9.40 per share of common stock. The Company may not redeem the Preferred Stock prior to March 2007. Thereafter, the Company may redeem any portion of the Preferred Stock at 105% of its liquidation preference; provided that any redemption by the Company prior to March 2008 shall be subject to the condition that the average closing sale prices of the Company s common stock is at least \$13.16 per share, subject to adjustment. The Company is required to redeem all shares of the Preferred Stock then outstanding in March 2012, at a redemption price equal to the liquidation preference of the Preferred Stock, payable in cash or, at the Company s option, in shares of the Company s common stock.

If the average closing sales price of the Company s common stock during the three-month period ended on the fourth anniversary of the issuance date is less than \$7.50 per share, holders of the Preferred Stock will have a right to exchange the Preferred Stock into the Company s 10% Subordinated Notes ( 10% Notes ) due March 2010. The 10% Notes may be redeemed, in whole or in part, at any time thereafter at the Company s option at a price equal to 105% of the principal amount of the 10% Notes being redeemed.

Holders of Preferred Stock will not receive any dividends unless the holders of common stock do, in which case holders of Preferred Stock will be entitled to receive ordinary dividends in an amount equal to the ordinary dividends the holders of Preferred Stock would have received had they converted such Preferred Stock into common stock immediately prior to the record date for such dividend distribution. So long as the Preferred Stock remains outstanding, the Company is required to pay a quarterly fee to CalPERS/PCG of 0.35% of the face amount of the then outstanding Preferred Stock.

**Table of Contents****Schedule II. Valuation and Qualifying Accounts****Years Ended December 31, 2003, 2002 and 2001**

	<b>Balance at Beginning of Year</b>	<b>Charged to Costs and Expenses</b>	<b>Acquired</b>	<b>Write-offs</b>	<b>Other(a)</b>	<b>Balance at End of Year</b>
<b>(In thousands)</b>						
<b>December 31, 2003</b>						
Allowance for Doubtful Accounts	\$ 22,417	\$ 6,328	\$ 768	\$ (9,013)	\$	\$ 20,500
Valuation Allowance for Deferred Tax Assets	941,507	(1,423)	(33,277)		19,960	926,767
<b>December 31, 2002</b>						
Allowance for Doubtful Accounts	26,972	11,305	34	(15,894)		22,417
Valuation Allowance for Deferred Tax Assets	939,764	10,471	(17,355)		8,627	941,507
<b>December 31, 2001</b>						
Allowance for Doubtful Accounts	26,746	26,752	484	(27,010)		26,972
Valuation Allowance for Deferred Tax Assets	281,392	519,864	135,511		2,997	939,764

(a) Represents valuation allowance created through equity as a result of stock option and warrant exercises.

S-1

**Table of Contents****INDEX TO EXHIBITS**

Exhibit No.	Description
2.1	Stock Purchase Agreement dated as of June 15, 2003 between WebMD Corporation and Joseph Q. DiMartini, individually and as Trustee U/A dated February 6, 1998 f/b/o Joseph Q. DiMartini, and as Trustee of the Joseph Q. DiMartini 2002 Irrevocable Trust dated October 14, 2002, Eric J. Schaefer, an individual, Daniel A. Schmitt, individually and as Trustee of the Daniel A. Schmitt Revocable Trust dated March 26, 1999, and as Trustee of the Daniel Schmitt 2002 Irrevocable Trust dated September 24, 2002, and Dru A. Schmitt, individually and as Trustee U/A dated October 20, 1997 f/b/o Dru A. Schmitt (incorporated by reference to Exhibit 2.1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003)
2.2	Stock Purchase Agreement dated as of October 21, 2003 between TPG Holding Company Limited and Envoy Corporation (incorporated by reference to Exhibit 2.1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003)
2.3	Amendment No. 1, dated as of November 28, 2003, to the Stock Purchase Agreement dated as of October 21, 2003 between TPG Holding Company Limited and Envoy Corporation (incorporated by reference to Exhibit 2.1 to Registrant's Current Report on Form 8-K filed December 1, 2003)
2.4	Amendment No. 2, dated as of December 22, 2003, to the Stock Purchase Agreement dated as of October 21, 2003 between TPG Holding Company Limited and Envoy Corporation (incorporated by reference to Exhibit 2.1 to Registrant's Current Report on Form 8-K filed December 24, 2003)
3.1	Eleventh Amended and Restated Certificate of Incorporation of Registrant (incorporated by reference to Exhibit 3.1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003)
3.2	Certificate of Designations for Convertible Redeemable Exchangeable Preferred Stock
3.3	Amended and Restated Bylaws of Registrant, as currently in effect (incorporated by reference to Exhibit 3.2 to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003)
4.1	Specimen Common Stock certificate (incorporated by reference to Exhibit 4.1 to Registrant's Registration Statement on Form S-1 (No. 333-70553) filed January 14, 1999)
4.2	Indenture between WebMD Corporation and The Bank of New York, dated as of April 1, 2002 (incorporated by reference to Exhibit 4.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2002)
4.3	Registration Rights Agreement dated as of April 1, 2002 between WebMD Corporation and UBS Warburg LLC (incorporated by reference to Exhibit 4.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2002)
4.4	Form of 3 1/4% Convertible Subordinated Note Due 2007 (included in Exhibit 4.2)
4.5	Indenture, dated as of June 25, 2003, between WebMD Corporation and The Bank of New York (incorporated by reference to Exhibit 4.1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003)
4.6	Form of 1.75% Convertible Subordinated Note Due 2023 (included in Exhibit 4.5)
4.7	Registration Rights Agreement dated as of June 25, 2003 between WebMD Corporation and Banc of America Securities LLC (incorporated by reference to Exhibit 4.2 to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003)

**Table of Contents**

Exhibit No.	Description
4.8	Registration Rights Agreement dated as of July 17, 2003 between WebMD Corporation and Joseph Q. DiMartini, individually and as Trustee U/A dated February 6, 1998 f/b/o Joseph Q. DiMartini, and as Trustee of the Joseph Q. DiMartini 2002 Irrevocable Trust dated October 14, 2002, Eric J. Schaefer, an individual, Daniel A. Schmitt, individually and as Trustee of the Daniel A. Schmitt Revocable Trust dated March 26, 1999, and as Trustee of the Daniel Schmitt 2002 Irrevocable Trust dated September 24, 2002, and Dru A. Schmitt, individually and as Trustee U/A dated October 20, 1997 f/b/o Dru A. Schmitt (incorporated by reference to Exhibit 4.3 to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003)
4.9	Convertible Redeemable Exchangeable Preferred Stock Purchase Agreement, dated as of March 4, 2004, between CalPERS/PCG Corporate Partners, LLC and WebMD Corporation
4.10	Form of Stock Certificate for Convertible Redeemable Exchangeable Preferred Stock (included in Exhibit 3.2)
4.11	Form of Indenture for 10% Subordinated Notes due 2010 (included in Exhibit 3.2)
4.12	Form of 10% Subordinated Note due 2010 (included in Exhibit 3.2)
10.1	Form of Indemnification Agreement to be entered into by Registrant with each of its directors and officers (incorporated by reference to Exhibit 10.1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2002)
10.2	Domestic Assignment Agreement dated as of February 15, 2001 among Registrant, Healthon/WebMD Cable Corporation, Healthon/WebMD Internet Corporation, The News Corporation Limited, Fox Entertainment Group, Inc. AHN/FIT Cable, LLC and AHN/FIT Internet, LLC (incorporated by reference to Exhibit 10.3 to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001)
10.3	International Assignment Agreement dated as of February 15, 2001 among Registrant, HW International Holdings, Inc., The News Corporation Limited, Eastrise Profits Limited and IJV Holdings Inc. (incorporated by reference to Exhibit 10.4 to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001)
10.4	Healthon/WebMD Corporation Registration Rights Agreement dated January 26, 2000 among Registrant, Eastrise Profits Limited, AHN/FIT Cable, LLC, AHN/FIT Internet, LLC, News America Incorporated and Fox Broadcasting Company (incorporated by reference to Exhibit 10.4 to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2000), as amended by Amendment dated February 15, 2001 (incorporated by reference to Exhibit 10.1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001)
10.5	Healthon/WebMD Media Services Agreement dated January 26, 2000 among Registrant, Eastrise Profits Limited and Fox Entertainment Group, Inc. (incorporated by reference to Exhibit 10.5 to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2000), as amended by Amendment dated February 15, 2001 (incorporated by reference to Exhibit 10.2 to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001)
10.6	Content License Agreement dated January 26, 2000 between The News Corporation Limited and Registrant (incorporated by reference to Exhibit 10.6 to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2000)
10.7	Letter Agreement dated December 29, 2000 between Registrant and The News Corporation Limited (incorporated by reference to Exhibit 10.17 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2000)
10.8	Settlement Agreement dated October 12, 2001 between Registrant and Quintiles Transnational Corp. (incorporated by reference to Exhibit 10.01 to Quintiles Transnational Corp.'s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2001, filed with the Securities and Exchange Commission on November 1, 2001)
10.9	Warrant to Purchase Shares of Common Stock of WebMD, Inc. dated May 12, 1999 issued to Microsoft Corporation (incorporated by reference to Exhibit 10.9 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2000)

**Table of Contents**

Exhibit No.	Description
10.10*	Employment Agreement dated as of February 1, 1998 between Registrant and K. Robert Draughon (incorporated by reference to Exhibit 10.51 to Registrant's Form 10-K to Annual Report on Form 10-K for the year ended December 31, 2000, as amended by Amendment No. 1 on Form 10-K/A)
10.11*	Letter Agreement dated as of September 12, 2000 between Registrant and K. Robert Draughon (incorporated by reference to Exhibit 10.52 to Registrant's Form 10-K to Annual Report on Form 10-K for the year ended December 31, 2000, as amended by Amendment No. 1 on Form 10-K/A)
10.12*	Agreement dated as of October 8, 2001 between Registrant and Martin J. Wygod (incorporated by reference to Exhibit 10.55 to Registrant's Form 10-K to Annual Report on Form 10-K for the year ended December 31, 2001)
10.13*	Amended and Restated Stock Option Agreement dated August 21, 2000 between the Registrant (as successor to Medical Manager Corporation) and Martin J. Wygod (incorporated by reference to Exhibit 10.21 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2000, as amended by Amendment No. 1 on Form 10-K/A)
10.14*	Employment Agreement dated as of October 23, 2002 between the Registrant and Roger C. Holstein (incorporated by reference to Exhibit 10.14 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2002)
10.15*	Employment Agreement dated as of May 16, 1999 between the Registrant (as successor to Syntetic, Inc.) and Michael A. Singer (incorporated by reference to Exhibit 10.26 to Medical Manager Corporation's Annual Report on Form 10-K for the fiscal year ended June 30, 1999)
10.16*	Letter Agreement dated as of September 5, 2000 between Registrant (as successor to Medical Manager Corporation) and Michael A. Singer (incorporated by reference to Exhibit 10.50 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2001, as amended by Amendment No. 1 on Form 10-K/A)
10.17*	Employment Agreement dated as of July 1, 2000 between Registrant (as successor to Medical Manager Corporation) and Charles A. Mele, as amended (incorporated by reference to Exhibit 10.51 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2001, as amended by Amendment No. 1 on Form 10-K/A)
10.18*	Employment Agreement dated as of July 1, 2000 between Registrant (as successor to Medical Manager Corporation) and Anthony Vuolo, as amended (incorporated by reference to Exhibit 10.52 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2001, as amended by Amendment No. 1 on Form 10-K/A)
10.19*	Form of Amended and Restated Stock Option Agreement dated August 21, 2000, between Registrant (as successor to Medical Manager Corporation) and each of Charles A. Mele and Anthony Vuolo (incorporated by reference to Exhibit 10.54 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2001, as amended by Amendment No. 1 on Form 10-K/A)
10.20*	WebMD Corporation 2001 Employee Non-Qualified Stock Option Plan, as amended (incorporated by reference to Exhibit 10.46 to Registrant's Form 10-K for the year ended December 31, 2001, as amended by Amendment No. 1 on Form 10-K/A)
10.21*	WebMD Corporation 2002 Restricted Stock Plan and Form of Award Agreement (incorporated by reference to Exhibit 10.21 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2002)
10.22*	Healthon Corporation 1996 Stock Plan and Form of Stock Option Agreement (incorporated by reference to Exhibit 10.2 to Amendment No. 2 to Registrant's Registration Statement on Form S-1 (No. 333-70553) filed February 10, 1999)
10.23*	WebMD Corporation Amended and Restated 1998 Employee Stock Purchase Plan (incorporated by reference to Exhibit 99.27 to Registrant's Registration Statement on Form S-8 (No. 333-47250) filed October 4, 2000)

**Table of Contents**

Exhibit No.	Description
10.24*	WebMD Corporation 2000 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 to Amendment No. 1 to Registrant's Registration Statement on Form S-4 (No. 333-39592) filed August 1, 2000)
10.25*	WebMD, Inc. Amended and Restated 1997 Stock Incentive Plan, as amended (incorporated by reference to Exhibit 10.2 to Registrant's Registration Statement on Form S-8 (No. 33-90795) filed November 12, 1999)
10.26*	Envoy Stock Plan (incorporated by reference to Exhibit 99.1 to Registrant's Registration Statement on Form S-8 (No. 333-42616) filed July 31, 2000)
10.27*	Amended and Restated 1989 Class A Non-Qualified Stock Option Plan of Syntec, Inc. (incorporated by reference to Exhibit 10.1 to Syntec, Inc.'s Registration Statement on Form S-1 (No. 333-28654) filed May 18, 1989)
10.28*	Amended and Restated 1989 Class B Non-Qualified Stock Option Plan of Syntec, Inc. (incorporated by reference to Exhibit 10.2 to Syntec, Inc.'s Registration Statement on Form S-1 (No. 333-28654) filed May 18, 1989)
10.29*	1991 Director Stock Option Plan of Syntec, Inc. (incorporated by reference to Exhibit 4.2 to Syntec, Inc.'s Registration Statement on Form S-8 (No. 333-46640) filed March 24, 1992)
10.30*	Amended and Restated 1991 Special Non-Qualified Stock Option Plan of Syntec, Inc. (incorporated by reference to Exhibit 4.3 to Syntec, Inc.'s Registration Statement on Form S-8 (No. 333-36041) filed September 19, 1997)
10.31*	Form of Stock Option Agreement made as of December 7, 1994 between Syntec, Inc. and certain individuals (incorporated by reference to Exhibit 4.5 to Syntec, Inc.'s Registration Statement on Form S-8 (No. 333-21555) filed February 11, 1997)
10.32*	Medical Manager Corporation's 1996 Amended and Restated Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 to Medical Manager Corporation's (Commission File No. 0-29090) Quarterly Report on Form 10-Q for the quarter ended September 30, 1998)
10.33*	Medical Manager Corporation's 1996 Amended and Restated Non-Employee Director's Stock Plan (incorporated by reference to Exhibit 10.2 to Medical Manager Corporation's (Commission File No. 0-29090) Annual Report on Form 10-K for the fiscal year ended December 31, 1997)
10.34*	1996 Class C Stock Option Plan of Syntec, Inc. (incorporated by reference to Exhibit 4.1 to Syntec, Inc.'s Registration Statement on Form S-8 (No. 333-36041) filed September 19, 1997)
10.35*	1997 Class D Stock Option Plan of Syntec, Inc. (incorporated by reference to Exhibit 4.2 to Syntec, Inc.'s Registration Statement on Form S-8 (No. 333-36041) filed September 19, 1997)
10.36*	1998 Class E Stock Option Plan of Syntec, Inc. (incorporated by reference to Exhibit 4.1 to Syntec, Inc.'s Registration Statement on Form S-8 (No. 333-72517) filed February 17, 1999)
10.37*	The 1999 Medical Manager Corporation Stock Option Plan for Employees of Medical Manager Systems, Inc. (incorporated by reference to Exhibit 10.28 to Medical Manager Corporation's Annual Report on Form 10-K for the year ended June 30, 1999)
10.38*	Form of Stock Option Agreement between the Corporation and each of John H. Kang and Michael A. Singer (incorporated by reference to Exhibit 99.5 to Amendment No. 1 to Medical Manager Corporation's Registration Statement on Form S-4 (No. 333-81123) filed June 24, 1999)
10.39*	1998 Porex Technologies Corp. Stock Option Plan of Syntec, Inc. (incorporated by reference to Exhibit 4.2 to Syntec, Inc.'s Registration Statement on Form S-8 (No. 333-72517) filed February 17, 1999)
10.40*	CareInsite, Inc. 1999 Officer Stock Option Plan (incorporated by reference to Exhibit 10.18 to Amendment No. 6 to CareInsite, Inc.'s Registration Statement on Form S-1 (No. 333-75071) filed June 11, 1999)

**Table of Contents**

Exhibit No.	Description
10.41*	CareInsite, Inc. 1999 Employee Stock Option Plan (incorporated by reference to Exhibit 10.17 to Amendment No. 6 to CareInsite, Inc. s Registration Statement on Form S-1 (No. 333-75071) filed June 11, 1999)
10.42*	CareInsite, Inc. 1999 Director Stock Option Plan (incorporated by reference to Annex G to the Proxy Statement/Prospectus included in Registrant s Registration Statement on Form S-4 (No. 333-39592) filed June 19, 2000)
10.43*	Amendment to the Company Stock Option Plans of Medical Manager Corporation and CareInsite, Inc. (incorporated by reference to Exhibit 99.28 to Registrant s Registration Statement on Form S-8 (No. 333-47250) filed October 4, 2000)
10.44*	Employment Agreement, dated as of September 11, 2000, between the Registrant and Kirk Layman
10.45*	2003 Non-Qualified Stock Option Plan for Employees of Advanced Business Fulfillment, Inc. (incorporated by reference to Exhibit 10.2 to Registrant s Quarterly Report on Form 10-Q for the quarter ended September 30, 2003)
10.46*	Employment Agreement, dated as of August 20, 2001, between the Registrant and Wayne Gattinella
10.47*	Stock Option Agreement between the Registrant and Wayne Gattinella dated August 20, 2001 (incorporated by reference to Exhibit 4.8 to Registrant s Registration Statement on Form S-8 (No. 333-88420) filed May 16, 2002)
10.48*	Employment Agreement, dated as of September 23, 2003, between the Registrant and Andrew Corbin (incorporated by reference to Exhibit 10.1 to Registrant s Quarterly Report on Form 10-Q for the quarter ended September 30, 2003)
10.49*	Employment Agreement, dated as of December 4, 2003, between Envoy Corporation and Tony Holcombe
12.1	Computation of Ratio of Earnings to Fixed Charges
14.1**	Code of Business Conduct
21	Subsidiaries of Registrant
23.1	Consent of Ernst & Young LLP, Independent Auditors
24.1	Power of Attorney (see page 85)
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer of Registrant
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer of Registrant
32.1	Statement of Chief Executive Officer of Registrant Pursuant to 18 U.S.C. § 1350
32.2	Statement of Chief Financial Officer of Registrant Pursuant to 18 U.S.C. § 1350
99.1	Amended and Restated Audit Committee Charter
99.2	Compensation Committee Charter
99.3	Amended and Restated Nominating Committee Charter

\* Agreement relates to executive compensation.

\*\* To be filed by amendment.