

Edgar Filing: CARESCIENCE INC - Form 10-Q

CARESCIENCE INC  
Form 10-Q  
May 11, 2001

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2001

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: 0-30859  
-----

CARESCIENCE, INC.  
-----

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

PENNSYLVANIA  
-----

(STATE OR OTHER JURISDICTION  
OF INCORPORATION OR ORGANIZATION)

23-2703715  
-----

(I.R.S. EMPLOYER  
IDENTIFICATION NO.)

3600 MARKET STREET  
PHILADELPHIA, PA 19104  
-----

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)  
(ZIP CODE)

(215) 387-9401  
-----

(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

(FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR,  
IF CHANGED SINCE LAST REPORT)

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

The number of shares of the registrant's Common Stock outstanding, as of  
May 11, 2001 was 13,016,851.

CARESCIENCE INC.

FORM 10-Q

March 31, 2001

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

CARESCIENCE, INC.  
CONSOLIDATED BALANCE SHEETS

	DECEMBER 31, 2000	MARCH 31, 2001
	-----	-----
	(UNAUDITED)	
ASSETS		
Current assets:		
Cash and cash equivalents .....	\$ 26,702,096	\$ 26,058,580

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Short-term investments .....	3,001,770	--
Interest receivable .....	174,034	55,314
Accounts receivable, net of allowance for doubtful accounts of \$48,794 and \$54,269, respectively .....	865,075	1,175,663
Prepaid expenses and other .....	240,345	278,033
	-----	-----
Total current assets .....	30,983,320	27,567,590
	-----	-----
Property and equipment:		
Computer equipment .....	4,611,573	4,720,124
Office equipment .....	482,385	485,596
Furniture and fixtures .....	397,629	397,629
	-----	-----
	5,491,587	5,603,349
Less--Accumulated depreciation and amortization .....	(2,562,342)	(3,017,211)
	-----	-----
Net property and equipment .....	2,929,245	2,586,138
	-----	-----
Goodwill and other intangibles, net .....	--	1,429,116
	-----	-----
Total assets .....	\$ 33,912,565	\$ 31,582,844
	=====	=====

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Current portion of capital lease obligations and notes payable .....	\$ 250,685	\$ 293,342
Accounts payable .....	1,090,613	481,354
Accrued expenses .....	1,141,662	1,024,142
Deferred revenues .....	3,035,511	4,336,758
	-----	-----
Total current liabilities .....	5,518,471	6,135,596
	-----	-----
Capital lease obligations .....	428,602	368,732
	-----	-----
Shareholders' equity:		
Common stock, no par value, 16,000,000 shares authorized, 14,206,851 and 14,456,851 shares issued and 12,766,851 and 13,016,851 outstanding .....	59,612,380	59,831,130
Additional paid-in capital .....	5,590,620	5,357,717
Deferred compensation .....	(4,010,828)	(3,461,905)
Accumulated other comprehensive income .....	1,770	--
Accumulated deficit .....	(32,328,450)	(35,748,426)
Treasury stock, at cost, 1,440,000 shares .....	(900,000)	(900,000)
	-----	-----
Total shareholders' equity .....	27,965,492	25,078,516
	-----	-----
Total liabilities and shareholders' equity .....	\$ 33,912,565	\$ 31,582,844
	=====	=====

The accompanying notes are an integral part of these statements

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	FOR THE THREE MONTHS ENDED MARCH 31,	
	2000	2001
	(UNAUDITED)	
Revenues .....	\$ 1,628,927	\$ 2,515,611
Cost of revenues (excludes stock-based compensation of \$170,131 and \$163,413, respectively) .....	1,026,041	1,372,364
Gross profit .....	602,886	1,143,247
Operating expenses:		
Research and development (excludes stock-based compensation of \$22,965 and \$9,772, respectively) .....	599,123	1,298,242
Selling, general and administrative (excludes stock-based compensation of \$145,928 and \$142,835, respectively) .....	1,564,739	3,311,022
Stock-based compensation .....	339,024	316,020
Total operating expenses .....	2,502,886	4,925,284
Operating loss .....	(1,900,000)	(3,782,037)
Interest income .....	(42,048)	(383,608)
Interest expense .....	20,840	21,547
Net loss .....	(1,878,792)	(3,419,976)
Accretion of redemption premium on preferred stock .....	115,371	--
Net loss applicable to common shareholders .....	\$ (1,994,163)	\$ (3,419,976)
Net loss per common share:		
Basic and diluted .....	\$ (0.59)	\$ (0.26)
Weighted average shares outstanding:		
Basic and diluted .....	3,387,900	12,985,952

The accompanying notes are an integral part of these statements.

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CARESCIENCE, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS ENDED  
MARCH 31,

2000

2001

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	-----	-----
	(UNAUDITED)	
Cash flows from operating activities:		
Net loss .....	\$ (1,878,792)	\$ (3,419,976)
Adjustments to reconcile net loss to net cash used in operating activities--		
Depreciation and amortization .....	146,192	325,468
Loss on disposal .....	--	158,000
Provision for bad debts .....	9,000	5,475
Stock-based compensation .....	339,024	316,020
Changes in assets and liabilities--		
(Increase) decrease in--		
Interest receivable .....	--	118,605
Accounts receivable .....	2,131	(107,121)
Prepaid expenses and other .....	(411,865)	(35,748)
Increase (decrease) in--		
Accounts payable and accrued expenses .....	1,107,632	(870,453)
Deferred revenues .....	(401,348)	890,957
	-----	-----
Net cash used in operating activities .....	(1,088,026)	(2,618,773)
	-----	-----
Cash flows (used in) provided by investing activities:		
Proceeds from the redemption of short-term investments .....	--	3,000,115
Purchase of acquisition, net .....	--	(82,367)
Purchases of property and equipment, net .....	(192,037)	(75,247)
	-----	-----
Net cash (used in) providing by investing activities .....	(192,037)	2,042,501
	-----	-----
Cash flows used in financing activities:		
Payments on capital lease obligations .....	(98,280)	(67,244)
	-----	-----
Net decrease in cash and cash equivalents .....	(1,378,343)	(643,516)
Cash and cash equivalents, beginning of period .....	3,381,600	26,702,096
	-----	-----
Cash and cash equivalents, end of period .....	\$ 2,003,257	\$ 26,058,580
	=====	=====

The accompanying notes are an integral part of these statements.

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CARESCIENCE, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES  
Organization and Basis of Presentation

CareScience, Inc. (formerly Care Management Science Corporation) provides Internet-based tools designed to improve the quality and efficiency of health care. The Company uses its proprietary clinical algorithms and data collection and storage technologies to perform complex clinical analyses. The Company's

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customers use its services to identify clinical inefficiencies and medical errors and monitor the results of implemented solutions. Additionally, the Company facilitates the real-time exchange of clinical information over the Internet among local health care constituents.

The consolidated balance sheet as of March 31, 2001, the consolidated statements of operations for the three months ended March 31, 2000 and 2001 and the consolidated statements of cash flows for the three months ended March 31, 2000 and 2001 have been prepared by the Company without audit. In the opinion of management, all adjustments, consisting of normal and recurring adjustments, necessary to present fairly the financial position, results of operations and cash flows at March 31, 2001 and for all periods presented have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Annual Report on Form 10-K as filed with the Securities and Exchange Commission. The results of operations for the three months ended March 31, 2001 are not necessarily indicative of the operating results for the full year.

### Principles of Consolidation

The accompanying consolidated financial statements include the accounts of CareScience, Inc. and its subsidiary. All significant intercompany transactions and balances have been eliminated.

### Cash and Cash Equivalents and Short-term Investments

The Company invests excess cash in highly liquid investment-grade marketable securities including corporate commercial paper and U.S. government agency bonds. For financial reporting purposes, the Company considers all highly liquid investment instruments purchased with an original maturity of three months or less to be cash equivalents. All investment instruments with maturities greater than three months are available for use in current operations and accordingly are classified as current assets. All investments are considered available-for-sale and accordingly, unrealized gains and losses are included in a separate component of shareholders' equity.

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As of December 31, 2000 and March 31, 2001 cash and cash equivalents and short-term investments at cost and fair market value consisted of the following:

	DECEMBER 31, 2000		
	ORIGINAL COST	GROSS UNREALIZED GAINS	FAIR MARKET VALUE
	-----	-----	-----
Cash and cash equivalents	\$26,702,096	\$ --	\$26,702,096
Short-term investments	3,000,000	1,770	3,001,770
	-----	-----	-----
	\$29,702,096	\$ 1,770	\$29,703,866

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	=====	=====	=====
	MARCH 31, 2001		
	-----		
	(UNAUDITED)		
	ORIGINAL	GROSS	FAIR
	COST	UNREALIZED	MARKET
		GAINS	VALUE
	-----	-----	-----
Cash and cash equivalents	\$26,058,580	\$ --	\$26,058,580
Short-term investments	--	--	--
	-----	-----	-----
	\$26,058,580	\$	\$26,058,580
	=====	=====	=====

At December 31, 2000 short-term investments consists of one debt instrument maturing November 6, 2002 which was redeemed February 6, 2001.

Supplemental Cash Flow Information

The Company paid interest of \$20,840 and \$21,547 for the three months ended March 31, 2000 and 2001, respectively.

The Company financed \$94,511 and \$0 of property and equipment purchases with capital leases for the three months ended March 31, 2000 and 2001, respectively.

Major Customers

The Company's operations are conducted in one business segment and sales are primarily made to health care payors and providers. The company had one customer for each of the three month periods ended March 31, 2000 and 2001, which accounted for 24% and 15% of total revenues, respectively.

The Company had one customer at March 31, 2001, which accounted for 10% of total accounts receivable.

(2) NET LOSS PER SHARE

Net loss per share is calculated utilizing the principles of SFAS No. 128, "Earnings per Share" ("EPS"). Basic EPS excludes potentially dilutive securities and is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS is computed assuming the conversion or exercise of all dilutive securities such as Preferred stock, options and warrants.

Under SFAS No. 128, the Company's granting of certain stock options, warrants and convertible Preferred stock resulted in potential dilution of basic EPS. The number of incremental shares from the assumed exercise of stock options and warrants is calculated applying the treasury stock method. Stock options, warrants and Preferred stock convertible into common shares were excluded from the calculations as they were anti-dilutive due to the net loss.

(3) COMMON STOCK OPTIONS

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### Equity Compensation Plans

The Company's 1995 Equity Compensation Plan (the "Plan") permits the granting of incentive stock options, nonqualified stock options, stock appreciation rights and restricted stock. The Company has authorized the issuance of up to 2,065,038 shares of Common stock to satisfy grants under the Plan. At March 31, 2001, there were 641,012 shares reserved under the Plan available for grant. A committee of the Board of Directors (the "Committee") administers the Plan and determines the terms of the grants.

In December 1998, the Company adopted the 1998 Time Accelerated Restricted Stock Option Plan (the "Accelerated Plan"). The Accelerated Plan provides for the granting of non-qualified stock options to officers, senior management and employee directors of the Company. The aggregate number of shares of Common stock the Company may issue under the Accelerated Plan is 483,594 shares. At March 31, 2001 there were no shares reserved under the Accelerated Plan available for grant.

The Company accounts for all plans under APB Opinion No. 25, under which compensation expense is recognized based on the amount by which the fair value of the underlying common stock exceeds the exercise price of the stock options on the measurement date. For financial reporting purposes, the Company has determined that the deemed fair market value on the measurement date for certain stock options was in excess of the exercise price. This amount has been recorded as deferred compensation and is being amortized over the vesting period of the applicable options, which range between four and seven years. The Company recorded deferred compensation of \$120,683 and \$0 during the year ended December 31, 2000 and the three months ended March 31, 2001, respectively, and reversed \$154,902 and \$232,903 of deferred compensation in connection with forfeited common stock options during the year ended December 31, 2000 and three months ended March 31, 2001, respectively. The Company recognized \$339,024 and \$316,020 of compensation expense related to options for the three months ended March 31, 2000 and 2001, respectively.

The following table summarizes the option activity for both plans:

	SHARES AVAILABLE FOR GRANT	OPTIONS OUTSTANDING		
		NUMBER OF SHARES	EXERCISE PRICE PER SHARE	AGGREGATE PRICE
Balance, December 31, 1997.....	362,800	251,200	\$0.25- 1.25	\$271,200
Authorized.....	1,134,632	--	--	--
Granted.....	(472,635)	472,635	1.25- 2.60	895,227
Forfeited/Canceled .....	12,800	(12,800)	0.25- 1.25	(10,800)
Balance, December 31, 1998.....	1,037,597	711,035	0.25- 2.60	1,155,627
Authorized.....	--	--	--	--
Granted.....	(1,108,150)	1,108,150	1.25- 2.59	2,814,164
Forfeited/Canceled.....	216,413	(216,413)	0.25- 2.59	(291,017)
Balance, December 31, 1999.....	145,860	1,602,772	0.25- 2.60	3,678,774
Authorized.....	800,000	--	--	--
Granted.....	(817,663)	817,663	0.78-12.00	6,782,592
Exercised.....	--	(10,000)	0.25	2,500
Forfeited/Canceled .....	573,298	(573,298)	1.25-12.00	(4,926,524)



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Balance, December 31, 2000.....	701,495	1,837,137	0.25-12.00	5,537,342
Authorized (unaudited).....	--	--	--	--
Granted (unaudited).....	(144,236)	144,236	0.88- 2.81	156,443
Forfeited/Canceled (unaudited).....	83,753	(83,753)	0.78- 6.63	(284,153)
Balance, March 31, 2001 (unaudited).....	641,012	1,897,620	\$0.25-12.00	\$5,409,632

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(4) Acquisition of Business

On January 12, 2001, the Company acquired substantially all of the assets and certain liabilities of Strategic Outcomes Services, Inc. (SOS), a pharmacoeconomic consulting company located in North Carolina. The total purchase price was approximately \$1.3 million which included a cash payment of \$1.1 million and 250,000 shares of Common stock valued at \$218,750 or \$0.88 a share. The purchase agreement also provides for additional contingent payments based on achieving revenue and profitability milestones as defined. The transaction was accounted for using the purchase method of accounting. A summary of the assets acquired and liabilities assumed in the acquisition follows:

Estimated fair values:	
Cash	\$ 217,632
Other current assets	210,882
Equipment	36,515
Current Liabilities	(603,995)
Goodwill and other intangibles	1,457,715
-----	
Purchase price	1,318,749
Less cash acquired and stock issued	(436,382)
-----	
Net cash paid	\$ 882,367
=====	

The allocation of the purchase price is preliminary. The Company is currently amortizing goodwill and other intangibles on a straight-line basis over a period of eight years. The Company is in the process of allocating the excess purchase price, including the determination of the useful lives of the intangible assets.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

This report includes a number of forward-looking statements that reflect our current views with respect to future events and financial performance. We use words such as anticipates, believes, expects, future, intends, and similar expressions to identify forward-looking statements. For these statements we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. There are important factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements, including:

- the difficulty in evaluating our business because we operate in a new industry and our operating history is limited;
- we have a history of losses and expect our losses to continue;

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- the proprietary technology we own or license may be subjected to infringement claims or disagreements with the licensor which could be costly to resolve;
- we depend on an exclusive license with the University of Pennsylvania for our technology, and the loss of this license would impair our ability to develop our business;
- we could be liable for information retrieved from our Web sites and incur significant costs from resulting claims;
- we may experience system failures which could interrupt our service and damage our customer relationships;
- the health care industry may not accept our solutions or buy our services which would adversely affect our financial results;
- because our revenues are dependent on a limited number of services, the failure of any one of these services would significantly decrease our revenues;
- termination of one or more of our significant contracts would cause a significant decline in our revenue;

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- failure to manage our growth would adversely affect our operations;
- we face intense competition and may be unable to compete successfully which would adversely effect our financial results;
- the loss of any of our key personnel could adversely affect our operations;
- our failure to develop strategic relationships could adversely affect our ability to develop new services;
- our failure to use new technologies effectively or to adapt emerging industry standards would adversely affect our ability to compete;
- our failure to adapt our technology to our customers' needs or to handle high levels of customer activity would adversely affect our ability to increase revenue;
- failure of our service providers could interrupt our business and damage our customer relationships;
- we may need to obtain additional capital and failure to do so may limit our growth;
- health information is subject to potential government regulation and legal uncertainties and changes may require us to alter our business;
- changes in the health care industry could adversely affect our operations;
- our business will suffer if commercial users do not accept Internet solutions;
- our industry is evolving and we may not adapt successfully.

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### Overview

CareScience, Inc. is a provider of online care management services. Our mission is to transform the quality and efficiency of care delivery by providing innovative clinical information technology to the health care industry. We market our services to hospitals, health systems and pharmaceutical and biotechnology manufacturers, and support more than 150 customers in 40 states and in Europe.

We work with health care providers to manage clinical processes surrounding the point of care so that fundamental reductions in errors and operating cost can be achieved. Our products collect, share, store and analyze clinical data generated by more than 100 widely used health information systems. Our services allow customers to apply this data to the management of care, including quality monitoring, practice improvement, credentialing, profiling, error tracking, case management and clinical guidelines. We provide consulting services to healthcare providers that support strategic planning and clinical operations, with a special emphasis on mentoring physicians and other clinical leaders in operational and executive roles.

For the pharmaceutical and biotechnology industry, we provide tools and services that shorten the drug development cycle and improve development yield. Our offerings include a suite of Internet-based data analysis and workflow management tools, consulting services, customized research and strategic development support. These tools and services are aimed at the specialized drug development needs of pharmaceutical industry clinicians, product managers, market strategists, health economists and outcomes researchers.

We have pioneered and commercialized numerous clinical information technologies. We have developed one of the nation's first online quality measurement and management tools, one of the first clinically based outcome risk assessment algorithms, one of the first health care application service providers, and, most recently, the first peer-to-peer clinical data sharing technology. We have developed these tools in collaboration with leading public organizations, including the Wharton School of Business at the University of Pennsylvania, the National Library of Medicine, Los Alamos National Laboratory and The California HealthCare Foundation.

CareScience was incorporated in 1992 with the purpose of commercializing intellectual property that was developed at the University of Pennsylvania School of Medicine and The Wharton School of Business. In 1993, we exclusively licensed the intellectual property underlying our core technology in a 30-

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year agreement with the University of Pennsylvania. In 1996, we launched our first Internet-based commercial product based on this proprietary technology under our Care Management System-TM- (formerly called CaduCIS) product line. In 1999, we launched our Care Data Exchange-TM-, and Technology Assessment Tools-TM-, as well as our Lifecycle Decision System-TM- product line, which is aimed at the pharmaceutical and biotechnology industries. To date, we have signed more than 50 contracts covering more than 150 hospitals, health systems and pharmaceutical companies. On March 7, 2000, we changed our name from Care Management Science Corporation to CareScience, Inc.

We generate revenues from subscriptions to our Internet-based proprietary technology applications and hosting of customer data, as well as from training, implementation and consulting services. We sell our services individually or as

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an integrated suite of services. Our contracts are fixed price based on estimates of certain variables, such as the number of a hospital's patient admissions or outpatient visits.

Our subscription and development agreements typically cover an initial three-to five-year period with provisions for automatic renewals. We recognize training and implementation fees, as well as subscriptions and related hosting revenues, on a pro-rata basis over the life of the contract. We recognize consulting fees on a percentage-of-completion basis or as the program or service is delivered.

Our contracts generally provide for payment in advance of services rendered. Therefore, we record these payments as deferred revenues and recognize these payments when earned in accordance with our revenue recognition policy. Our deferred revenue balances were \$3.0 million and \$4.3 million at December 31, 2000 and March 31, 2001, respectively.

We have incurred substantial research and development costs since inception and have also invested in our corporate infrastructure to support our long-term growth strategy. We expect that our operating expenses will continue to increase as we expand our product development and sales and marketing efforts. Accordingly, we expect to continue to incur quarterly net losses for the foreseeable future.

On June 28, 2000 we completed an initial public offering of 4,000,000 shares of Common stock at a price of \$12.00 per share. We received aggregate net cash proceeds of approximately \$43.4 million from the initial public offering on July 5, 2000.

### RESULTS OF OPERATIONS

#### THREE MONTHS ENDED MARCH 31, 2001 AND MARCH 31, 2000

##### REVENUES

Total revenues increased 54% to \$2.5 million for the three months ended March 31, 2001 from \$1.6 million for the three months ended March 31, 2000. The increase was primarily related to revenues generated from newly signed customer and development contracts.

Unrecognized revenues related to customer and development contracts as of March 31, 2001 totaled \$16.3 million.

##### COST OF REVENUES

Cost of revenues include customer and service-related costs including personnel and facility costs, depreciation and maintenance. Cost of revenues for the three months ended March 31, 2001 was \$1.3 million (excluding stock-based compensation of \$163,000), an increase of \$346,000 or 34%, compared to \$1.0 million (excluding stock-based compensation of \$170,000) for the three months ended March 31, 2000. The increase was primarily a result of additional costs necessary to service new customers.

##### GROSS PROFIT

Our gross profit margin increased from 37% for the three months ended March 31, 2000, to 45% for the three months ended March 31, 2001. The increase in gross profit margin is primarily due to increased revenues spread over a fixed base of costs.

## RESEARCH AND DEVELOPMENT

Research and development costs include technology and product development costs. Research and development costs for the three months ended March 31, 2001 were \$1.3 million (excluding stock-based compensation of \$10,000), an increase of \$699,000 or approximately 117%, compared to \$599,000 (excluding stock based compensation) for the three months ended March 31, 2000. This increase is primarily due to expenditures made related to new development efforts.

As a percentage of revenue, research and development costs were 52% for the three months ended March 31, 2001 as compared to 37% for the three months ended March 31, 2000. This increase for 2000 to 2001 reflects increased expenditures made related to new development efforts.

## SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses include costs associated with our sales, marketing, finance, human resource and administrative functions. Selling, general and administrative expenses for the three months ended March 31, 2001 were \$3.3 million (excluding stock-based compensation of \$143,000), an increase of \$1.7 million, or 112% compared to \$1.6 million (excluding stock based compensation of \$146,000) for the three months ended March 31, 2000. The increase was primarily related to hiring of additional sales and management personnel and marketing expenditures to increase and support customer growth.

As a percentage of revenues, selling, general, and administrative expenses were 132% for the three months ended March 31, 2001 as compared to 96% for the three months ended March 31, 2000. The increase from 2000 to 2001 reflects the additional expenditures related to personnel and other marketing activities.

## STOCK-BASED COMPENSATION

We granted certain stock options to our officers and employees with exercise prices deemed to be below the fair market value of the underlying stock. The remaining cumulative difference between the fair value of the underlying stock at the date the options were granted and the exercise price of the granted options was \$3.5 million at March 31, 2001. We expect to amortize this amount over the four to seven year vesting periods of the granted options. Accordingly, our results from operations will include stock-based compensation expense at least through 2006. We recognized \$339,000 and \$316,000 of this expense during the three months ended March 31, 2000, and 2001, respectively.

## INTEREST INCOME AND EXPENSE

Net interest income for the three months ended March 31, 2001 was \$362,000, an increase of \$341,000, compared to \$21,000 for the three months ended March 31, 2000. The increase is primarily due to higher investable cash balances as a result of the initial public offering.

## LIQUIDITY AND CAPITAL RESOURCES - MARCH 31, 2001

Since inception, we have financed our operations and funded our capital expenditures through the private sale of equity securities, supplemented by private debt and equipment leases. We believe that proceeds from our initial public offering will be sufficient to fund anticipated capital expenditures and working capital requirement for at least the next 12 months. As of March 31, 2001, we had \$26.1 million in cash and working capital of \$21.4 million.

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Net cash used in operating activities was \$2.6 million for the three months ended March 31, 2001 and \$1.1 million for the three months ended March 31, 2000. For those periods, net cash used in operating activities was primarily to fund losses from operations.

Net cash provided by investing activities was \$2.0 million for the three months ended March 31, 2001 and consisted primarily of proceeds from the redemption of short-term investments net of purchases of property and equipment. Net cash used in financing activities was \$192,000 for the three months ended March 31, 2000 and consisted of purchases of property and equipment.

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Net cash used in financing activities was \$67,000 for the three months ended March 31, 2001 and \$98,000 for three months ended March 31, 2000, and consisted primarily of payments on capital lease obligations.

As we execute our strategy, we expect significant increases in our operating expenses to fund development of current and new divisions and product lines. Presently, we anticipate that our existing capital resources and the proceeds from the offering will meet our operating and investing needs through the end of 2002. After that time, additional funding may not be available on acceptable terms or at all. If we require additional capital resources to grow our business, execute our operating plans for acquire complementary businesses as any time in the future, we may seek to sell additional equity or debt securities or secure additional lines of credit, which may result in ownership dilution to our shareholders.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our cash equivalents, short-term investments and capital lease obligations are at fixed interest rates and therefore the fair market value of these instruments is affected by changes in market interest rates. As of March 31, 2001 all of our cash equivalents matured within 6 months and we had the ability to immediately liquidate our investments. Therefore, we believe that we are exposed to immaterial levels of market risk.

## PART II. OTHER INFORMATION

### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

#### SALES OF UNREGISTERED SECURITIES

On January 12, 2001, in connection with the acquisition of Strategic Outcomes Services, Inc. ("SOS"), we issued 250,000 shares of our Common stock to the 19 shareholders of SOS. Such sales were made in reliance upon the exemption provided by Section 4(2) of the Securities Act for transactions not involving a public offering and/or Rule 701 under the Securities Act.

#### USE OF PROCEEDS

On June 28, 2000 the Securities and Exchange Commission declared effective our Registration Statement on Form S-1 (File number 333-32376), relating to the initial public offering of our Common Stock, no par value per share. The net offering proceeds to us after total expenses were \$43.2 million. As of March 31, 2001, we have used approximately \$17.8 million of the net proceeds from our initial public offering of which approximately \$8.4 million was used for working

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capital and other general corporate purposes, approximately \$6.5 million was used for dividends on and the redemption of preferred stock, approximately \$1.8 million was used for the purchase of property plant and equipment and \$1.1 million was used for the acquisition of Strategic Outcomes Services, Inc.,

None of the net proceeds from the offering were used to pay, directly or indirectly, directors, officers, persons owning ten percent or more of the Company's equity securities, or affiliates of the Company.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

See Exhibit Index

(b) Reports on Form 8-K

January 22, 2001 to report Other Events under Item 5 of Form 8-K.

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

CARESCIENCE, INC.

Date: May 11, 2001

By: /s/ RONALD A. PAULUS

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Ronald A. Paulus, President

Date: May 11, 2001

By: /s/ STEVEN BELL

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Steven Bell, Chief Financial  
Officer and Treasurer

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EXHIBIT INDEX

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EXHIBIT NO.  
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DESCRIPTION  
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