WEBMD CORP /NEW/
Form 10-Q
November 14, 2003

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 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	**94-3236644**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*

669 River Drive, Center 2

Elmwood Park, New Jersey 07407-1361
(Address of principal executive offices)

(201) 703-3400

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 (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 x No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes x No o

As of November 10, 2003, there were 306,910,104 shares of the

registrant s Common Stock outstanding.

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WEBMD CORPORATION

QUARTERLY REPORT ON FORM 10-Q

For the period ended September 30, 2003

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains both historical and forward-looking statements. All statements other than statements of historical fact are, or may 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. Similarly, statem 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 which 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 35, 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 or updated services,
- the inability to successfully deploy new or updated applications,
- difficulties in forming and maintaining mutually beneficial relationships with customers and strategic partners, some of whom are also competitors,
- difficulties in integrating acquired companies, businesses and technologies,
- 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 35 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 Quarterly Report on Form 10-Q are made only as of the date of this Quarterly Report. We expressly disclaim any intent or obligation to update any forward-looking statements to reflect subsequent events or circumstances.

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PART I

FINANCIAL INFORMATION

ITEM 1. *Financial Statements*

WEBMD CORPORATION

CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

	September 30, 2003	December 31, 2002
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 83,872	$ 175,596
Short-term investments	211,378	10,888
Accounts receivable, net	172,988	163,244
Inventory	11,120	9,976
Current portion of prepaid content and distribution services	23,582	25,406
Assets of discontinued operations		94,056
Other current assets	23,810	25,814
Total current assets	526,750	504,980
Marketable debt securities	678,315	449,289
Marketable equity securities	5,681	7,427
Property and equipment, net	80,264	70,488
Prepaid content and distribution services	32,670	48,532
Goodwill	667,444	586,043
Intangible assets, net	91,806	73,222
Other assets	34,733	26,267
	$ 2,117,663	$ 1,766,248
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 10,389	$ 10,063
Accrued expenses	217,479	208,342
Deferred revenue	83,959	81,179
Liabilities of discontinued operations		12,365
Total current liabilities	311,827	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	1,338	498
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.0001 par value; 900,000,000 shares authorized at September 30, 2003; 600,000,000 shares authorized at December 31, 2002; 382,291,875 shares issued at	38	37

September 30, 2003; 374,661,064 shares issued at December 31, 2002		
Additional paid-in-capital	11,717,401	11,682,443
Deferred stock compensation	(6,216)	(17,805)
Treasury stock, at cost; 76,324,165 shares at September 30, 2003; 74,254,669 shares at December 31, 2002	(345,667)	(327,542)
Accumulated deficit	(10,222,587)	(10,195,048)
Accumulated other comprehensive income	11,530	11,716
Total stockholders equity	1,154,499	1,153,801
	$ 2,117,663	$ 1,766,248

See accompanying notes.

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WEBMD CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data, unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Revenue	$250,635	$217,004	$705,584	$642,220
Costs and expenses:				
Cost of operations	149,270	123,360	410,556	379,101
Development and engineering	11,334	10,869	32,654	32,640
Sales, marketing, general and administrative	72,450	66,883	209,917	218,501
Depreciation, amortization and other	11,097	32,073	52,961	95,575
Legal expense	493		493	
Restructuring and integration benefit		2,100		5,850
Gain on investments	3,039	681	3,222	6,547
Interest income	6,401	5,222	16,434	14,341
Interest expense	4,703	2,819	10,444	5,677
Other income		2,323	1,118	2,323
Income (loss) from continuing operations before income tax provision (benefit)	10,728	(8,674)	9,333	(60,213)
Income tax provision (benefit)	1,273	(12,103)	3,261	(10,700)
Income (loss) from continuing operations	9,455	3,429	6,072	(49,513)
Income (loss) from discontinued operations, net of income taxes	(3,366)	1,109	(33,611)	2,240
Net income (loss)	$ 6,089	$ 4,538	$ (27,539)	$ (47,273)
Basic income (loss) per common share:				
Income (loss) from continuing operations	$ 0.03	$ 0.01	$ 0.02	$ (0.16)
Income (loss) from discontinued operations	(0.01)	0.01	(0.11)	0.01
Net income (loss)	$ 0.02	$ 0.02	$ (0.09)	$ (0.15)
Diluted income (loss) per common share:				
Income (loss) from continuing operations	$ 0.03	$ 0.01	$ 0.02	$ (0.16)
Income (loss) from discontinued operations	(0.01)	0.00	(0.10)	0.01
Net income (loss)	$ 0.02	$ 0.01	$ (0.08)	$ (0.15)
Weighted-average shares outstanding used in computing income (loss) per common share:				
Basic	305,471	297,352	304,121	306,161
Diluted	328,463	308,537	326,396	306,161

See accompanying notes.

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WEBMD CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands, unaudited)

	Nine Months Ended September 30,	
	2003	**2002**
Cash flows from operating activities:		
Net loss	$ (27,539)	$ (47,273)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Loss (income) from discontinued operations	33,611	(2,240)
Depreciation, amortization and other	52,961	95,575
Amortization of debt issuance costs	1,505	740
Non-cash content and distribution services	18,224	19,558
Non-cash stock-based compensation	10,948	21,559
Gain on investments	(3,222)	(6,547)
Changes in operating assets and liabilities:		
Accounts receivable	3,580	5,226
Inventory	(1,144)	711
Federal income tax receivable		(12,887)
Prepaid content and distribution services	(537)	(201)
Other assets	5,685	(8,001)
Accounts payable	(775)	(3,220)
Accrued expenses	(12,174)	(10,216)
Deferred revenue	(2,228)	6,822
Net cash provided by continuing operations	78,895	59,606
Net cash provided by discontinued operations	5,130	5,809
Net cash provided by operating activities	84,025	65,415
Cash flows from investing activities:		
Proceeds from maturities and sales of available-for-sale securities	11,322	106,108
Proceeds from maturities and redemptions of held-to-maturity securities	157,919	59,095
Purchases of available-for-sale securities	(7,754)	(206,983)
Purchases of held-to-maturity securities	(590,113)	(300,970)
Purchases of property and equipment	(13,643)	(20,737)
Proceeds received from sale of discontinued operations	46,500	
Cash paid in business combinations, net of cash acquired	(133,471)	(9,929)
Other changes in equity of discontinued operations	1,754	7,511
Net cash used in continuing operations	(527,486)	(365,905)
Net cash used in discontinued operations	(2,529)	(9,184)
Net cash used in investing activities	(530,015)	(375,089)
Cash flows from financing activities:		
Proceeds from issuance of common stock	35,367	14,313
Purchases of treasury shares	(18,125)	(103,784)
Payments of notes payable and other	(211)	(2,899)
Net proceeds from issuance of convertible debt	339,125	292,000
Redemption of Series B Preferred Stock		(10,000)

Net cash provided by continuing operations	356,156	189,630
Net cash used in discontinued operations	(6,546)	(1,147)
Net cash provided by financing activities	349,610	188,483
Effect of exchange rates on cash	711	765
Net decrease in cash and cash equivalents	(95,669)	(120,426)
Changes in cash attributable to discontinued operations	3,945	4,522
Cash and cash equivalents at beginning of period	175,596	278,513
Cash and cash equivalents at end of period	$ 83,872	$ 162,609

See accompanying notes.

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WEBMD CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except share and per share data, unaudited)

1. Summary of Significant Accounting Policies
Basis of Presentation

The unaudited consolidated financial statements of WebMD Corporation (the Company) have been prepared by management and reflect all adjustments (consisting of only normal recurring adjustments) that, in the opinion of management, are necessary for a fair presentation of the interim periods presented. The results of operations for the nine months ended September 30, 2003 are not necessarily indicative of the results to be expected for any subsequent period or for the entire year ending December 31, 2003. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted under the Securities and Exchange Commission s rules and regulations.

Porex Corporation and the Company s other Plastic Technologies subsidiaries (collectively referred to as Porex) had previously been reported 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 for Porex. Accordingly, the assets, liabilities and operations of Porex were reclassified as a continuing operation since September 12, 2000, its date of acquisition. The operations of Porex have been included in a separate operating segment, Plastic Technologies. On August 1, 2003, the Company completed the sale of two operating units of its Plastic Technologies segment (see Note 2). Accordingly, the historical results of these two operating units, including the loss related to the divestitures, have been reclassified as discontinued operations in the Company s financial statements.

The unaudited consolidated financial statements and notes included herein should be read in conjunction with the Company s audited consolidated financial statements and notes for the year ended December 31, 2002, which were included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission.

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. 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.

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WEBMD CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 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 September 30, 2003 and December 31, 2002:

	September 30, 2003	December 31, 2002
Raw materials and supplies	$ 3,246	$ 3,834
Work-in-process	1,338	493
Finished goods and other	6,536	5,649
	$ 11,120	$ 9,976

Accounting for Stock-Based Compensation

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 income (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. In accordance with SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure An Amendment of FASB Statement No. 123, the following table illustrates the effect on net income (loss) and net income (loss) per common share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Net income (loss) as reported	$ 6,089	$ 4,538	$ (27,539)	$ (47,273)
Deduct: Stock-based employee compensation expense included in reported net income (loss) (including stock-based employee compensation expense related to discontinued operations)	3,570	6,669	11,128	21,559
Add: Total stock-based employee compensation expense determined under fair value based method for all awards	(23,024)	(31,506)	(60,403)	(99,616)
Pro forma net loss	$ (13,365)	$ (20,299)	$ (76,814)	$ (125,330)
Net income (loss) per common share:				
Basic as reported	$ 0.02	$ 0.02	$ (0.09)	$ (0.15)
Diluted as reported	$ 0.02	$ 0.01	$ (0.08)	$ (0.15)

Basic and diluted pro forma	$ (0.04)	$ (0.07)	$ (0.25)	$ (0.41)

The pro forma results above are not intended to be indicative of or a projection of future results. Pro forma information regarding net income (loss) 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 options granted in 2003 was estimated at the date of grant using the Black-Scholes option

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WEBMD CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

pricing model employing weighted-average assumptions consistent with the assumptions used in determining the fair value of options granted in 2002, which assumptions were included in Note 15 to the Consolidated Financial Statements contained in the Company s 2002 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

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 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.

Reclassifications

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

2. Discontinued Operations

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 since 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. 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. While the determination of the loss on disposal is substantially complete, the purchase price is subject to customary post-closing adjustments which have not been finalized. Also included in income (loss) from discontinued operations for the three months ended September 30, 2003 is $125 representing the income from the operations of the discontinued units through

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WEBMD CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the date of their sale on August 1, 2003. Summarized operating results for the discontinued units through August 1, 2003 were as follows:

	For the Period July 1, 2003 through August 1, 2003	For the Three Months Ended September 30, 2002	For the Period January 1, 2003 through August 1, 2003	For the Nine Months Ended September 30, 2002
Revenue	$ 4,739	$13,951	$ 31,004	$42,252
Income (loss) from operations	$ 125	$ 1,109	$(30,120)	$ 2,240
Loss on disposal	(3,491)		(3,491)	
Income (loss) from discontinued operations, net of income taxes	$(3,366)	$ 1,109	$(33,611)	$ 2,240

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
Total assets of discontinued operations	$94,056
Liabilities of discontinued operations:	
Accounts payable and accrued expenses	$ 5,700
Debt	6,665
Total liabilities of discontinued operations	$12,365

3. Business Combinations
2003 Acquisitions

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 $5,860 was recorded. The Company expects that substantially all of the goodwill recorded will be deductible for tax purposes. 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

WEBMD CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 $61,657 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 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 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 this company 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 the acquired company 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 $8,811 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 the acquired company 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 $4,075, comprised of $4,000 in cash and estimated acquisition costs of $75. 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 $4,083 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.

During the nine months ended September 30, 2003, the Company acquired six physician services companies for an aggregate cost of $1,782, which was paid in cash. These acquisitions were accounted for

WEBMD CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 $1,109 and intangible assets subject to amortization of $870 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 years and $519 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 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 preliminary 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 with an estimated 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, and are included in the Portal Services segment.

In 2002, the Company acquired 21 physician services companies for an aggregate cost of $14,400, which was paid in cash. 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 $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.

Unaudited Pro Forma Information

The following unaudited pro forma financial information for the three and nine months ended September 30, 2003 and 2002 gives effect to the acquisition of ABF, including amortization of intangible assets, as if it 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 transaction had been consummated at the date indicated, nor is it necessarily indicative of future operating results of ABF, and should not be construed as representative of these results

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for any future period. The remaining acquisitions in 2003 and 2002 have been excluded as the pro forma impact of such acquisitions was not significant in any of the periods presented.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Revenue	$254,128	$233,743	$748,627	$687,646
Income (loss) from continuing operations	9,637	3,980	10,161	(47,381)
Net income (loss)	6,271	5,089	(23,450)	(45,141)
Basic income (loss) per common share:				
Income (loss) from continuing operations	$ 0.03	$ 0.01	$ 0.03	$ (0.15)
Net income (loss)	$ 0.02	$ 0.02	$ (0.08)	$ (0.15)
Diluted income (loss) per common share:				
Income (loss) from continuing operations	$ 0.03	$ 0.01	$ 0.03	$ (0.15)
Net income (loss)	$ 0.02	$ 0.02	$ (0.07)	$ (0.15)

4. Restructuring and Integration

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 in December 2001 was initiated.

The Company has substantially completed its restructuring and integration efforts. The balance of the restructuring and integration accrual as of September 30, 2003 is primarily related to remaining lease payments of previously vacated facilities. The following table presents cash activity in the restructuring and integration accrual:

Balance at December 31, 2002.	$33,535
Cash payments	(5,978)
Balance at September 30, 2003	$27,557

5. Stockholders Equity

Repurchase Program

On March 29, 2001, the Company announced a stock repurchase program (the Program). Under the Program, as amended, the Company was authorized to use up to a total of $150,000 to purchase shares of its common stock from time to time, subject to market conditions. As of September 30, 2003, the Company had repurchased a total of 22,060,656 shares at a cost of approximately $104,167 under the Program, of which 2,069,496 shares were repurchased during the nine months ended September 30, 2003 for an aggregate purchase price of $18,125. No shares were repurchased during the three months ended September 30, 2003. The Company repurchased 3,237,207 shares and 3,882,734 shares of its common stock for an aggregate purchase price of $15,037 and $19,043 during the three and nine months ended September 30, 2002. These repurchased shares are reflected as treasury stock in the accompanying consolidated balance sheets. As of September 30, 2003, the Company had $45,833 available to repurchase shares of its common stock under the Program.

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During the three months ended June 30, 2002, the Company repurchased 14,100,000 shares of its common stock from a stockholder at a purchase price of $6.01 per share, or an aggregate purchase price of $84,741. The repurchase of the shares was separately approved by the Executive Committee of the Company s Board of Directors and, accordingly, was not part of the Program.

Series B Convertible Redeemable Preferred Stock

In connection with the acquisition of CareInsite, the Company issued 100 shares of Series B Convertible Redeemable Preferred Stock in exchange for all the outstanding shares of CareInsite s preferred stock. In March 2002, the Company redeemed the outstanding Series B Convertible Redeemable Preferred Stock for $10,000 in accordance with its terms.

6. 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 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,

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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 September 30, 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.

7. 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, gain on investments, other income, legal expense related to the investigation by the United States Attorney for the District of South Carolina (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.

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

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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 and solid 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.

Summarized financial information for each of the Company s operating segments and a reconciliation to net income (loss) are presented below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	**2002**	**2003**	**2002**
Revenues				
Transaction services	$131,977	$115,026	$365,491	$350,157
Physician services	75,487	70,581	224,295	202,738
Portal services	31,164	19,851	79,882	54,991
Plastic technologies	19,093	16,803	55,015	49,552
Inter-segment eliminations	(7,086)	(5,257)	(19,099)	(15,218)
	$250,635	$217,004	$705,584	$642,220
Income (loss) before restructuring, taxes, non-cash and other items				
Transaction services	$ 21,767	$ 24,327	$ 68,160	$ 60,129
Physician services	3,686	7,174	16,342	19,660
Portal services	8,712	3,577	18,922	(3,479)
Plastic technologies	5,690	5,125	15,857	15,526
Corporate	(12,809)	(11,493)	(37,652)	(38,741)
Interest income	6,401	5,222	16,434	14,341
Interest expense	(4,703)	(2,819)	(10,444)	(5,677)
	28,744	31,113	87,619	61,759
Restructuring, taxes, non-cash and other items				
Depreciation, amortization and other	(11,097)	(32,073)	(52,961)	(95,575)
Non-cash content and distribution services and stock compensation	(9,465)	(12,818)	(29,172)	(41,117)
Restructuring and integration benefit		2,100		5,850
Legal expense	(493)		(493)	
Gain on investments	3,039	681	3,222	6,547
Income tax (provision) benefit	(1,273)	12,103	(3,261)	10,700
Other income		2,323	1,118	2,323
Income (loss) from continuing operations	9,455	3,429	6,072	(49,513)
Income (loss) from discontinued operations, net of income taxes	(3,366)	1,109	(33,611)	2,240
Net income (loss)	$ 6,089	$ 4,538	$ (27,539)	$ (47,273)

8. 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

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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 values.

	September 30, 2003		December 31, 2002	
	Cost Basis	Fair Value	Cost Basis	Fair Value
Assets:				
Cash and cash equivalents	$ 83,872	$ 83,872	$175,596	$175,596
Short-term investments	208,624	211,378	10,865	10,897
Marketable securities long-term	680,104	692,452	448,286	464,638
Liabilities:				
Convertible subordinated notes	$649,999	$646,812	$300,000	$348,000

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 values and unrealized gains relating to the Company s investments in debt and equity securities:

	September 30, 2003			December 31, 2002		
	Cost or Net Carrying Amount	Gross Unrealized Gains	Fair Value	Cost or Net Carrying Amount	Gross Unrealized Gains	Fair Value
Short-Term						
Held-to-maturity:						
Certificates of deposit and marketable debt securities	$	$	$	$ 2,919	$ 9	$ 2,928
Available-for-sale:						
Certificates of deposit and marketable debt securities	208,624	2,754	211,378	7,946	23	7,969
Total	$208,624	$ 2,754	$211,378	$ 10,865	$ 32	$ 10,897
Long-Term						
Held-to-maturity:						
Marketable debt securities	$678,315	$ 8,456	$686,771	$243,475	$ 7,922	$251,397
Available-for-sale:						
Marketable debt securities				201,641	4,173	205,814
Equity securities	1,789	3,892	5,681	3,170	4,257	7,427
Total	$680,104	$12,348	$692,452	$448,286	$16,352	$464,638

As of September 30, 2003, the Company s short-term investments consisted of certificates of deposit, U.S. Treasury Notes, municipal bonds and asset-backed securities, marketable debt securities consisted of Federal Agency Notes 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 of certificates of deposit, municipal bonds and asset-backed securities, marketable debt securities consisted of Federal Agency Notes and U.S. Treasury Notes and marketable equity securities consisted of an equity investment in a publicly traded company.

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The net carrying amount 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.

	Cost or Net Carrying Amount	Fair Value
Held-to-maturity:		
Due after one year through five years	$678,315	$686,771
Available-for-sale:		
Due in one year or less	$208,624	$211,378

During the three months ended September 30, 2003, the Company sold a portion of an investment in equity securities for proceeds of $4,335, which resulted in a gain of $2,937. 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.

9. Income (Loss) Per Common Share

Basic income (loss) per common share and diluted income (loss) per common share are presented in conformity with SFAS No. 128, Earnings Per Share. In accordance with SFAS No. 128, basic income (loss) per common share has been computed using the weighted-average number of shares of common stock outstanding during the period. Diluted income (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 income (loss) per common share (shares in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Income (loss) from continuing operations	$ 9,455	$ 3,429	$ 6,072	$ (49,513)
Income (loss) from discontinued operations	(3,366)	1,109	(33,611)	2,240
Net income (loss) attributable to common stockholders	$ 6,089	$ 4,538	$ (27,539)	$ (47,273)
Weighted-average shares Basic	305,471	297,352	304,121	306,161
Effect of dilutive securities:				
Employee stock options and warrants	22,992	11,185	22,275	
Adjusted weighted-average shares after assumed conversions Diluted	328,463	308,537	326,396	306,161
Basic income (loss) per common share:				
Income (loss) from continuing operations	$ 0.03	$ 0.01	$ 0.02	$ (0.16)

Income (loss) from discontinued operations		(0.01)		0.01		(0.11)		0.01
Net income (loss)	$	0.02	$	0.02	$	(0.09)	$	(0.15)
Diluted income (loss) per common share:								
Income (loss) from continuing operations	$	0.03	$	0.01	$	0.02	$	(0.16)
Income (loss) from discontinued operations		(0.01)		0.00		(0.10)		0.01
Net income (loss)	$	0.02	$	0.01	$	(0.08)	$	(0.15)

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The Company has excluded convertible subordinated notes and restricted stock, as well as certain outstanding warrants and stock options from the calculation of diluted income (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 income (loss) per common share in the future that were not included in the computation of diluted income (loss) per common share during the periods presented (shares in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Options, warrants and restricted stock	81,973	115,911	83,133	148,175
Convertible notes	55,129	32,387	55,129	32,387
	137,102	148,298	138,262	180,562

10. Comprehensive Income (Loss)

Comprehensive income (loss) is comprised of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes certain changes in equity that are excluded from net income (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) during the three and nine months ended September 30, 2003 and 2002:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Foreign currency translation gains (losses)	$ 109	$ (207)	$ 1,621	$ 1,683
Unrealized gains (losses) on securities:				
Unrealized holding gains	3,043	3,556	1,415	11,600
Less: reclassification adjustment for gains realized in net income	3,039	681	3,222	6,547
Net unrealized gains (losses) on securities	4	2,875	(1,807)	5,053
Other comprehensive income (loss)	113	2,668	(186)	6,736
Net income (loss)	6,089	4,538	(27,539)	(47,273)
Comprehensive income (loss)	$ 6,202	$ 7,206	$ (27,725)	$ (40,537)

11. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the nine months ended September 30, 2003 are as follows:

	Transaction Services	Physician Services	Portal Services	Plastic Technologies	Total
Balance as of January 1, 2003.	$341,967	$182,085	$23,705	$38,286	$586,043
Goodwill recorded during the period	67,517	1,109	12,894		81,520
Adjustments to finalize purchase price allocations		(745)	407		(338)
Effects of exchange rates				219	219
Balance as of September 30, 2003.	$409,484	$182,449	$37,006	$38,505	$667,444

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Intangible assets subject to amortization consist of the following:

	September 30, 2003			December 31, 2002		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Customer lists	$252,376	$(204,885)	$47,491	$209,386	$(179,127)	$30,259
Trade names	27,216	(18,840)	8,376	24,329	(14,013)	10,316
Non-compete agreements	2,619	(713)	1,906	2,268	(295)	1,973
Technology and patents	180,326	(146,293)	34,033	175,159	(144,485)	30,674
Total	$462,537	$(370,731)	$91,806	$411,142	$(337,920)	$73,222

Amortization expense was $3,553 and $32,811 for the three and nine months ended September 30, 2003, respectively, and $26,179 and $78,276 for the three and nine months ended September 30, 2002, respectively. Aggregate amortization expense for intangible assets is estimated to be:

Year Ending December 31,	
2003 (October 1st to December 31st)	$ 2,949
2004	12,313
2005	10,922
2006	7,940
2007	7,129
Thereafter	50,553

12. 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