CARESCIENCE INC
Form 10-Q
August 09, 2002

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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2002

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from ______ to ______.

COMMISSION FILE NUMBER: 0-30859

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 ý No o

The number of shares of the registrant's Common Stock outstanding, as of August 8, 2002 was 13,300,391.

CARESCIENCE, INC.

FORM 10-Q

June 30, 2002

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

CARESCIENCE, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

	December 31, 2002	June 30, 2001
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 8,860,436	$ 6,032,899
Short-term investments	12,000,950	12,957,277
Interest receivable	83,821	29,928

	December 31, 2002	June 30, 2001
Accounts receivable, net of allowance for doubtful accounts of $68,354 and $74,054, respectively	1,207,094	1,350,332
Prepaid expenses and other	479,696	336,574
Total current assets	22,631,997	20,707,010
Property and equipment:		
Computer equipment	4,707,706	4,964,749
Office equipment	471,754	541,372
Leasehold improvements	169,956	169,956
Furniture and fixtures	508,598	513,961
	5,858,014	6,190,038
Less Accumulated depreciation and amortization	(3,345,267)	(3,987,493)
Net property and equipment	2,512,747	2,202,545
Other assets	155,639	151,493
Goodwill, net	1,245,687	1,245,687
Total assets	$ 26,546,070	$ 24,306,735

LIABILITIES AND SHAREHOLDERS' EQUITY

	December 31, 2002	June 30, 2001
Current liabilities:		
Current portion of capital lease obligations and note payable	$ 207,747	$ 221,604
Accounts payable	529,809	514,476
Accrued expenses	1,196,176	1,233,674
Deferred revenues	3,535,484	2,967,124
Total current liabilities	5,469,216	4,936,878
Capital lease obligations	200,069	137,113
Note payable		247,515
Shareholders' equity:		
Preferred stock, no par value, 20,000,000 shares authorized, no shares issued or outstanding		
Common stock, no par value, 100,000,000 shares authorized, 14,720,016 shares issued and 13,280,016 shares outstanding, and; 14,740,391 shares issued and 13,300,391 shares outstanding, respectively	60,256,012	60,282,656
Additional paid-in capital	5,008,718	4,838,843
Deferred compensation	(2,202,250)	(1,505,160)
Accumulated other comprehensive income	57,852	66,120
Accumulated deficit	(40,923,547)	(43,501,897)
Subscriptions receivable	(420,000)	(295,333)
Treasury stock, at cost, 1,440,000 shares	(900,000)	(900,000)

	December 31, 2002	June 30, 2001
Total shareholders' equity	20,876,785	18,985,229
Total liabilities and shareholders' equity	$ 26,546,070	$ 24,306,735

The accompanying notes are an integral part of these statements.

CARESCIENCE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2001	2002	2001	2002
	(unaudited)			
Revenues	$ 2,976,770	$ 3,503,194	$ 5,492,381	$ 6,766,122
Cost of revenues	1,660,616	1,635,371	3,196,393	3,341,968
Gross profit	1,316,154	1,867,823	2,295,988	3,424,154
Operating expenses:				
Research and development	1,039,079	628,634	2,347,093	1,354,380
Selling, general and administrative	2,868,121	2,383,623	6,321,978	4,809,697
Total operating expenses	3,907,200	3,012,257	8,669,071	6,164,077
Operating loss	(2,591,046)	(1,144,434)	(6,373,083)	(2,739,923)
Interest income	(258,369)	(74,116)	(641,977)	(182,852)
Interest expense	21,171	10,438	42,718	21,279
Net loss	$ (2,353,848)	$ (1,080,756)	$ (5,773,824)	$ (2,578,350)
Net loss per common share:				
Basic and diluted	$ (0.18)	$ (0.08)	$ (0.44)	$ (0.19)
Weighted average shares outstanding:				
Basic and diluted	13,062,435	13,300,391	13,023,194	13,293,749

The accompanying notes are an integral part of these statements.

CARESCIENCE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Six Months Ended June 30, 2001	2002
	(unaudited)	
Cash flows from operating activities:		
Net loss	$ (5,773,824)	$ (2,578,350)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	663,333	642,226
Loss on disposal	158,000	
Provision for bad debts	9,975	6,000
Stock-based compensation	631,708	527,215
Changes in assets and liabilities		
(Increase) decrease in		
Interest receivable	123,610	53,893
Accounts receivable	(91,773)	(149,238)
Prepaid expenses and other	(20,552)	143,122
Other assets		4,146
Increase (decrease) in		
Accounts payable and accrued expenses	(764,068)	146,832
Deferred revenues	467,135	(568,360)
Net cash used in operating activities	(4,596,456)	(1,772,514)
Cash flows from investing activities:		
Purchases of short-term investments	(4,968,980)	(10,891,159)
Proceeds from the redemption of short-term investments	3,000,115	9,943,100
Cash paid for acquisition	(882,367)	
Purchases of property and equipment	(199,650)	(332,024)
Net cash used in investing activities	(3,050,882)	(1,280,083)
Cash flows from financing activities:		
Proceeds from the exercise of common stock options		26,644
Payments on capital lease obligations and note payable	(212,098)	(126,584)
Proceeds from note payable		325,000
Net cash (used in) provided by financing activities	(212,098)	225,060
Net decrease in cash and cash equivalents	(7,859,436)	(2,827,537)
Cash and cash equivalents, beginning of period	26,702,096	8,860,436
Cash and cash equivalents, end of period	$ 18,842,660	$ 6,032,899

The accompanying notes are an integral part of these statements.

CARESCIENCE, INC. AND SUDSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Basis of Presentation

CareScience, Inc. (the "Company") 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 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 June 30, 2002, the consolidated statements of operations for the three and six months ended June 30, 2001 and 2002 and the consolidated statements of cash flows for the six months ended June 30, 2001 and 2002 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 as of June 30, 2002 and for all periods presented have been made.

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. 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 and six months ended June 30, 2002 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.

Recent Accounting Pronouncements

On January 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets." This statement modifies existing generally accepted accounting principles related to the amortization and impairment of goodwill and other intangible assets. Upon adoption of the new standard, goodwill, including goodwill associated with equity method investments, will no longer be amortized. In addition, goodwill, other than goodwill associated with equity method investments, must be assessed at least annually for impairment using a fair-value based approach. The provisions of this statement are required to be adopted as of the beginning of the first fiscal year after December 15, 2001. Impairment losses that arise due to the initial application of this statement are to be reported as a cumulative effect of change in accounting principle. The Company has completed an analysis of the impact of implementing the provisions of this statement as of January 1, 2002 and has determined that there is no impairment loss. With the adoption of this new standard, as of January 1, 2002 the

Company discontinued the amortization of the goodwill balance. The following proforma disclosure is included pursuant to the disclosure requirements of SFAS 142:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2001	**2002**	**2001**	**2002**
Reported net loss	$ (2,353,848)	$ (1,080,756)	$ (5,773,824)	$ (2,578,350)
Add back Goodwill amortization	34,320		62,920	
Adjusted net loss	$ (2,319,528)	$ (1,080,756)	$ (5,710,904)	$ (2,578,350)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
Basic and diluted net loss per Common share:				
Reported net loss	$ (0.18)	$ (0.08)	$ (0.44)	$ (0.19)
Goodwill amortization				
Adjusted net income	$ (0.18)	$ (0.08)	$ (0.44)	$ (0.19)

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets", which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed Of", and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations for a disposal of a segment of a business". SFAS No. 144 is effective for fiscal years beginning after December 15, 2001, with earlier application encouraged. The impact of adopting this accounting standard did not have a material effect on the Company's financial position or results of operations.

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.

As of June 30, 2002 cash and cash equivalents and short-term investments at cost and fair market value consisted of the following:

	June 30, 2002		
	Original Cost	Unrealized Gains	Fair Market Value
Cash and cash equivalents	$ 6,032,899	$	$ 6,032,899
Short-term investments	12,891,157	66,120	12,957,277
	$ 18,924,056	$ 66,120	$ 18,990,176

At June 30, 2002 short-term investments consisted of eleven debt instruments maturing between July 30, 2002 and August 28, 2003.

Supplemental Cash Flow Information

The Company paid interest of $42,718 and $21,279 for the six months ended June 30, 2001 and 2002, respectively.

Revenue Recognition

The Company generates revenue from subscriptions to its internet based proprietary technology applications and hosting of customer data, as well as development agreements and consulting services.

The Company's agreements for its internet based tools, which typically cover an initial period of one-to-five years and are fixed priced, provide to customers, among other things, a software license, project management services, data management services, data storage and computer server maintenance and software support and maintenance. Revenues under these contracts are recognized ratably over the contract period. Any additional consulting fees, outside of the initial contract, are recognized as the service is delivered.

The Company's development agreements, with periods ranging from three-to-five years, provide for customer funding for the development of new solutions and services. In accordance with Staff Accounting Bulletin (SAB) No. 101, "Revenue Recognition in Financial Statements", the Company is treating revenue on these agreements as a single element contract and is recognizing total revenue on a cost-to-cost basis over the entire agreement period.

The Company's various consulting services are delivered either as a single program or as a project whose completion normally occurs over a several month period. Consulting revenues from program services are recorded as the program is completed. Consulting revenues from projects are recorded on a percentage of completion basis over the term of the project.

Major Customers

The Company's operations are conducted in one business segment and sales are primarily made to health care payors and providers. One customer accounted for 13% and 14%, respectively, of total revenues for the three months and six months ended June 30, 2001. As of December 31, 2001, a different customer represented 12% of accounts receivable. Two customers accounted for 24% of total revenues for both the three and six months ended June 30, 2002. Two different customers accounted for 28% of total accounts receivable as of June 30, 2002.

Comprehensive Income

Accumulated other comprehensive income consists of unrealized gains and losses on available for sale securities as follows:

Balance, December 31, 2001	$	57,852
Current-period change		8,268
Balance, June 30, 2002	$	66,120

Use of 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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from those estimates.

Reclassifications

Certain amounts have been reclassified in the prior years consolidated financial statements to conform to the 2002 presentation.

(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 options and warrants.

Under SFAS No. 128, the Company's granting of certain stock options and warrants 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 and warrants and convertible into common shares were excluded from the calculations as they were anti-dilutive due to the net loss. Stock options to purchase 2,090,947 shares of common stock at exercise prices ranging from $0.25 to $12.00 were outstanding as of June 30, 2002, but were excluded from the computation of diluted net loss per share since the inclusion would be anti-dilutive due to the net loss.

(3) COMMITMENTS AND CONTINGENCIES

Litigation

The Company and certain of its officers are defendants in a purported class action litigation pending in the United States District Court for the Eastern District of Pennsylvania. The complaints purport to bring claims on behalf of all persons who allegedly purchased Company common stock between June 29, 2000 and November 1, 2000, for alleged violations of the federal securities laws, including Sections 11, 12(a)(2) and 15 of the Securities Act of 1933 by issuing a materially false and misleading Prospectus and Registration Statement with respect to the initial public offering of Company common stock. Specifically, the complaints allege, among other things, that the Company's Prospectus and Registration Statement misrepresented and omitted to disclose material facts concerning the Company's competitors, two of the Company's prospective products and the Company's contract with the California HealthCare Foundation. The actions seek compensatory and other damages, and costs and expenses associated with litigation. Although the Company cannot predict the ultimate outcome of the case or estimate the range of any potential loss that may be incurred in the litigation, management believes the lawsuits are frivolous and without merit, strenuously denies all allegations of wrongdoing asserted by plaintiffs, and believes it has meritorious defenses to plaintiffs' claims. The Company intends to vigorously defend the lawsuits. Management believes that the resolution of this litigation will not have a material effect on our consolidated financial position or results of operations.

(4) INCOME TAXES

The Company has incurred operating losses and generated a significant accumulated deficit through June 30, 2002, therefore, no tax provisions have been recorded. As of June 30, 2002 the Company had federal net operating loss carryforwards of approximately $34 million which expire from 2010 through 2021. As of June 30, 2002 and June 30, 2001, a valuation allowance was recorded for 100% of the Company's deferred tax asset as realization of the tax benefit was not considered more likely than not under the provisions of SFAS No. 109.

The Tax Reform Act of 1986 contains certain provisions that limit the utilization of net operating losses and tax credit carryforwards if there has been a cumulative ownership change greater than 50% within a three-year period. Such limitation could result in the expiration of the net operating losses before such losses are fully utilized.

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;
- 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 and an exclusive license with the California HealthCare Foundation for some of our technology, and the loss of these licenses 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;

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 by 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.

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.

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 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 also provide consulting services to healthcare providers that support strategic planning and clinical operations.

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 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-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- product line. In 1999, we initiated our Care Data Exchange-TM-, as well as our Lifecycle Decision System-TM-, which is aimed at the pharmaceutical and biotechnology industries. 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 consulting services and development agreements. We sell our services individually or as an integrated suite of solutions and services. We price our subscription services on a per-encounter basis, such as the number of a hospital's patient admissions or outpatient visits.

Our agreements for our internet based tools, which typically cover an initial period of one-to-five years and are fixed priced, provide to customers, among other things, a software license, project management services, data management services, data storage and computer server maintenance and software support and maintenance. Revenues under these contracts are recognized ratably over the contract period.

Our development agreements, with periods ranging from one-to-five years, provide for customer funding for the development of new solutions and services. In accordance with Staff Accounting Bulletin (SAB) No. 101, "Revenue Recognition in Financial Statements", the Company is treating revenue on these agreements as a single element contract and is recognizing total revenue on a cost-to-cost basis over the entire agreement period.

Our various consulting services are delivered either as a single program or as a project whose completion normally occurs over a several month period. Consulting revenues from program services are recorded as the program is completed. Consulting revenues from projects are recorded on a percentage of completion basis over the term of the project.

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 $3.5 million and $3.0 million at December 31, 2001 and June 30, 2002, 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 at historic or greater levels as we further our product development and sales and marketing efforts. Accordingly, we expect to continue to incur quarterly net losses for the foreseeable future.

Since inception, we have incurred cumulative net losses for federal and state tax purposes and have not recognized any tax provision or benefit. As of December 31, 2001, we had net operating loss carryforwards of approximately $32.0 million for federal income tax purposes. The net operating loss carryforwards, if not utilized, expire from 2010 through 2021. Federal tax laws impose significant restrictions on the utilization of net operating loss carryforwards in the event of an ownership change as defined in Section 382 of the Internal Revenue Code.

Results of Operations

Three Months Ended June 30, 2002 and June 30, 2001

Revenues

Total revenues increased 18% to $3.5 million for the three months ended June 30, 2002 from $3.0 million for the three months ended June 30, 2001. The increase was primarily related to revenues generated from additional customer and development contracts.

Unrecognized revenues related to customer and development contracts (backlog) as of June 30, 2002 totaled $25.7 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 June 30, 2002 was $1.6 million a decrease of $25,000 or 2% compared to $1.7 million for the three months ended June 30, 2001. We have been able to service an increasing revenue base while keeping cost of revenues relatively constant as a result of cost control initiatives.

Gross Profit

Our gross profit margin increased from 44% for the three months ended June 30, 2001, to 53% for the three months ended June 30, 2002. The increase in gross profit margin is primarily due to increased revenues spread over a partially fixed cost base, as well as the results of our cost control initiatives.

Research and Development

Research and development costs include technology and product development costs. Research and development costs for the three months ended June 30, 2002 were $629,000, a decrease of $410,000 or approximately 40%, compared to $1.0 million for the three months ended June 30, 2001. This decrease is primarily due to lowering costs as certain development projects near completion.

As a percentage of revenue, research and development costs were 18% for the three months ended June 30, 2002 as compared to 35% for the three months ended June 30, 2001. We expect the growth in revenue to exceed the growth in research and development costs. Therefore, we expect these costs will decrease as a percentage of revenue in the future.

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 June 30, 2002 were $2.4 million, a decrease of $484,000, or 17% compared to $2.9 million for the three months ended June 30, 2001. The decrease was primarily related to a planned reduction in marketing and other administrative expenditures in 2002 as part of the company's efforts of reducing costs.

As a percentage of revenues, selling, general, and administrative expenses were 68% for the three months ended June 30, 2002 as compared to 96% for the three months ended June 30, 2001. We expect the percentage of selling, general and administrative costs to continue to decrease as a percentage of revenues in the future as our fixed costs are spread over an increasing revenue base.

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 $1.5 million at June 30, 2002. We expect to amortize this amount over the remaining one to four year vesting periods of the granted options. Accordingly, our results from operations will include stock-based compensation expense at least through 2006. We recognized $262,000 and $316,000 of this expense during the three months ended June 30, 2002 and 2001, respectively.

Interest Income and Expense

Net interest income for the three months ended June 30, 2002 was $64,000, a decrease of $174,000, compared to $237,000 for the three months ended June 30, 2001. The decrease is primarily due to lower investable cash balances and a decrease in investment interest rates.

Six Months Ended June 30, 2002 and June 30, 2001

Revenues

Total revenues increased 23% to $6.8 million for the six months ended June 30, 2002 from $5.5 million for the six months ended June 30, 2001. The increase was primarily related to revenues generated from additional customer and development contracts.

Unrecognized revenues related to customer and development contracts (backlog) as of June 30, 2002 totaled $25.7 million.

Cost of Revenues

Cost of revenues includes customer and service-related costs including personnel and facility costs, depreciation and maintenance. Cost of revenues for the six months ended June 30, 2002 was $3.3 million a decrease of $146,000 or 5%, compared to $3.2 million for the six months ended June 30, 2001. We have been able to service an increasing revenue base while keeping cost of revenues relatively constant as a result of cost control initiatives.

Gross Profit

Our gross profit margin increased from 42% for the six months ended June 30, 2001, to 51% for the six months ended June 30, 2002. The increase in gross profit margin is primarily due to increased revenues spread over a partially fixed cost base, as well as the results of our cost control initiatives

Research and Development

Research and development costs include technology and product development costs. Research and development costs for the six months ended June 30, 2002 were $1.4 million, a decrease of $993,000 or approximately 42%, compared to $2.3 million for the six months ended June 30, 2001. This decrease is primarily due to lowering costs as certain development projects near completion.

As a percentage of revenue, research and development costs were 20% for the six months ended June 30, 2002 as compared to 43% for the six months ended June 30, 2001. We expect the growth in revenue to exceed the growth in research and development costs. Therefore, we expect these costs will decrease as a percentage of revenue in the future.

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 six months ended June 30, 2002 were $4.8 million, a decrease of $1.5 million, or 24% compared to $6.3 million for the six months ended June 30, 2001. The decrease was primarily related to a planned reduction in marketing and other administrative expenditures in 2002 as part of the company's efforts of reducing costs.

As a percentage of revenues, selling, general, and administrative expenses were 71% for the six months ended June 30, 2002 as compared to 115% for the six months ended June 30, 2001. We expect the percentage of selling, general and administrative costs to continue to decrease as a percentage of revenues in the future as our fixed costs are spread over an increasing revenue base.

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 $1.5 million at June 30, 2002. We expect to amortize this amount over the remaining one to four year vesting periods of the granted options. Accordingly, our results from operations will include stock-based compensation expense at least through 2006. We recognized $527,000 and $632,000 of this expense during the six months ended June 30, 2002 and 2001, respectively.

Interest Income and Expense

Net interest income for the six months ended June 30, 2002 was $162,000, a decrease of $438,000, compared to $599,000 for the six months ended June 30, 2001. The decrease is primarily due to lower investable cash balances and a decrease in investment interest rates.

Liquidity and Capital Resources June 30, 2002

Since inception, we have financed our operations and funded our capital expenditures through the public offering and private sale of equity securities, supplemented by private debt and equipment leases. We believe that current capital resources will be sufficient to fund anticipated capital expenditures and working capital requirements for at least the next 12 months. As of June 30, 2002, we had $19.0 million in cash and cash equivalents and short-term investments and working capital of $15.8 million.

Net cash used in operating activities was $1.8 million for the six months ended June 30, 2002 and $4.6 million for the six months ended June 30, 2001. For those periods, net cash used in operating activities was primarily to fund losses from operations offset by changes in current assets and liabilities.

Net cash used in investing activities was $1.3 million for the six months ended June 30, 2002 and consisted primarily of the purchase of short-term investments, net of redemption of short-term investments and purchases of property and equipment. Net cash used in investing activities was $3.1 million for the six months ended June 30, 2001 and consisted primarily of the purchase of short-term investments net of the redemption of short-term investments, funding of an acquisition and purchases of property and equipment.

Net cash provided by financing activities was $225,000 for the six months ended June 30, 2002 and consisted of proceeds from a note payable and the exercise of common stock options net of payments on capital lease obligations and the note payable. Net cash used in financing activities consisted of $212,000 for six months ended June 30, 2001, and consisted 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 will meet our operating and investing needs for at least the next 12 months. 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 or acquire complementary businesses at 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. QUANTITIATIVE 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 June 30, 2002 all of our short-term investments mature within 14 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 1. LEGAL PROCEEDINGS

We and certain of our officers are defendants in a purported shareholder class action lawsuit litigation pending in the United States District Court for the Eastern District of Pennsylvania described below for alleged violations of federal securities laws. Although we cannot predict the ultimate outcome of the case or estimate the range of any potential loss that may be incurred in the litigation, we believe

the lawsuits are frivolous and without merit, strenuously deny all allegations of wrongdoing asserted by plaintiffs, and believe we have meritorious defenses to plaintiffs' claims. We intend to vigorously defend the lawsuits. We believe that the resolution of this litigation will not have a material effect on our business, financial condition or results of operations.

The class action litigation is the result of several complaints filed with the court beginning on October 17, 2001. These actions were consolidated on November 16, 2001. The court approved the selection of the lead plaintiff in the litigation on March 12, 2002. These complaints purport to bring claims on behalf of all persons who allegedly purchased our common stock between June 29, 2000 and November 1, 2000, for alleged violations of the federal securities laws, including Sections 11, 12(a)(2) and 15 of the Securities Act of 1933 by issuing a materially false and misleading Prospectus and Registration Statement with respect to the initial public offering of our common stock. Specifically, the complaints allege, among other things, that our Prospectus and Registration Statement misrepresented and omitted to disclose material facts concerning our competitors, two of our prospective products and our contract with the California HealthCare Foundation. The actions seek compensatory and other damages, and costs and expenses associated with litigation.

We are not involved in any other legal proceedings that either individually or taken as a whole would have a material adverse effect on our business, financial condition or results of operations.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

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 $43.4 million. As of June 30, 2002, we have used approximately $25.2 million of the net proceeds from our initial public offering of which approximately $14.6 million was used for working capital and other general corporate purposes, including expansion of our sales and marketing efforts as well as development of our solutions and services, approximately $6.5 million was used for dividends on and the redemption of preferred stock, approximately $3.0 million was used for the purchase of property plant and equipment, including technology and equipment expenditures required to support our product development infrastructure 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

None

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 August 8, 2002 By: /s/ RONALD A. PAULUS

Ronald A. Paulus,
President

Date August 8, 2002 By: /s/ STEVEN BELL

Steven Bell,
Chief Financial Officer
and Treasurer

EXHIBIT INDEX

Exhibit No.	Description
99.1	Certification Pursuant to 18 U.S.C Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.2	Certification Pursuant to 18 U.S.C Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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CARESCIENCE, INC. AND SUBSIDIARY CONSOLIDATED STATEMENTS OF OPERATIONS
CARESCIENCE, INC. AND SUBSIDIARY CONSOLIDATED STATEMENTS OF CASH FLOWS
CARESCIENCE, INC. AND SUDSIDIARY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.
ITEM 3. QUANTITIATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
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