CARESCIENCE INC
Form 10-Q
August 09, 2001

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2001

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from ____________ to ________________.

COMMISSION FILE NUMBER: 0-30859

CARESCIENCE, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

PENNSYLVANIA	23-2703715
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(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 [X] No [ ]

The number of shares of the registrant's Common Stock outstanding, as of August 9, 2001 was 13,276,110.

CARESCIENCE INC.

FORM 10-Q

JUNE 30, 2001

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

CARESCIENCE, INC.

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	DECEMBER 31,	JUNE 30,

	2000	2001
ASSETS		
Current assets:		
Cash and cash equivalents	$ 26,702,096	$ 18,842,660
Short-term investments	3,001,770	4,984,980
Interest receivable	174,034	50,309
Accounts receivable, net of allowance for doubtful accounts of $48,794 and $58,769 , respectively	865,075	1,155,815
Prepaid expenses and other	240,345	262,837
Total current assets	30,983,320	25,296,601
Property and equipment:		
Computer equipment	4,611,573	4,841,364
Office equipment	482,385	488,760
Furniture and fixtures	397,629	397,629
	5,491,587	5,727,753
Less--Accumulated depreciation and amortization	(2,562,342)	(3,320,757)
Net property and equipment	2,929,245	2,406,996
Goodwill and other intangibles, net	--	1,394,796
Total assets	$ 33,912,565	$ 29,098,393
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of capital lease obligations	$ 250,685	$ 220,684
Accounts payable	1,090,613	394,418
Accrued expenses	1,141,662	1,217,463
Deferred revenues	3,035,511	3,912,936
Total current liabilities	5,518,471	5,745,501
Capital lease obligations	428,602	296,536
Shareholders' equity:		
Common stock, no par value, 16,000,000 shares authorized, 14,206,851 and 14,716,110 shares issued and 12,766,851 and 13,276,110 outstanding	59,612,380	60,251,130
Additional paid-in capital	5,590,620	5,356,977
Deferred compensation	(4,010,828)	(3,145,477)
Accumulated other comprehensive income	1,770	16,000
Accumulated deficit	(32,328,450)	(38,102,274)
Subscription receivables	--	(420,000)
Treasury stock, at cost, 1,440,000 shares	(900,000)	(900,000)
Total shareholders' equity	27,965,492	23,056,356
Total liabilities and shareholders' equity	$ 33,912,565	$ 29,098,393

The accompanying notes are an integral part of these statements

CARESCIENCE, INC.
CONSOLIDATED STATEMENT OF OPERATIONS

(UNAUDITED)

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	2000	2001	2000	2001
Revenues	$ 1,922,055	$ 2,976,770	$ 3,550,982	$ 5,492,
Cost of revenues (excludes stock-based compensation of $171,045 and $341,175 for the three and six months ended June 30, 2000, respectively, and $163,209 and $326,622 for three and six months ended June 30, 2001, respectively)	1,148,426	1,497,407	2,174,467	2,869,
Gross profit	773,629	1,479,363	1,376,515	2,622,
Operating expenses:				
Research and development (excludes stock-based compensation of $23,900 and $46,865 for the three and six months ended June 30, 2000, respectively, and $9,772 and $19,544 for three and six months ended June 30, 2001, respectively)	806,548	1,029,307	1,405,672	2,327,
Selling, general and administrative (excludes stock-based compensation of $146,723 and $292,652 for the three and six months ended June 30, 2000 respectively, and $142,707 and $285,542 for three and six months ended June 30, 2001, respectively)	1,776,535	2,725,414	3,341,274	6,036,
Stock-based compensation	341,668	315,688	680,692	631,
Total operating expenses	2,924,751	4,070,409	5,427,638	8,995,
Operating loss	(2,151,122)	(2,591,046)	(4,051,123)	(6,373,
Interest income	(24,239)	(258,369)	(66,287)	(641,
Interest expense	23,616	21,171	44,456	42,
Net loss	(2,150,499)	(2,353,848)	(4,029,292)	(5,773,
Accretion of redemption premium on preferred stock	138,360	--	253,731	
Preference distribution on preferred stock	5,716,784	--	5,716,784	
Net loss applicable to common shareholders	$ (8,005,643)	$ (2,353,848)	$ (9,999,807)	$ (5,773,

Net loss per common share:

Basic and diluted	$ (2.23)	$ (0.18)	$ (2.86)	$ (0
Weighted average shares outstanding:				
Basic and diluted	3,593,811	13,062,435	3,490,856	13,023,

The accompanying notes are an integral part of these statements.

CARESCIENCE, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

	FOR THE SIX MONTHS ENDED JUNE 30,	
	2000	2001
Cash flows from operating activities:		
Net loss	$ (4,029,292)	$ (5,773,824)
Adjustments to reconcile net loss to net cash used in operating activities--		
Depreciation and amortization	338,409	663,333
Loss on disposal	--	158,000
Provision for bad debts	12,000	9,975
Stock-based compensation	680,692	631,708
Changes in assets and liabilities--		
(Increase) decrease in--		
Interest receivable	--	123,610
Accounts receivable	(174,633)	(91,773)
Prepaid expenses and other	(127,790)	(20,552)
Increase (decrease) in--		
Accounts payable and accrued expenses	1,324,451	(764,068)
Deferred revenues	783,027	467,135
Net cash used in operating activities	(1,193,136)	(4,596,456)
Cash flows used in investing activities:		
Proceeds from the redemption of short-term investments	--	3,000,115
Purchases of short-term investments	--	(4,968,980)
Purchase of acquisition, net	--	(882,367)
Purchases of property and equipment, net	(998,263)	(199,650)
Net cash used in investing activities	(998,263)	(3,050,882)
Cash flows from financing activities:		
Payments on capital lease obligations and notes payable	(187,741)	(212,098)
Cost related to the issuance of Common stock	(116,802)	--

Net cash used in financing activities	(304,543)	(212,098)
Net decrease in cash and cash equivalents ..	(2,495,942)	(7,859,436)
Cash and cash equivalents, beginning of period	3,381,600	26,702,096
Cash and cash equivalents, end of period	$ 885,658	$ 18,842,660

The accompanying notes are an integral part of these statements.

CARESCIENCE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated balance sheet as of June 30, 2001, the statements of operations for the three and six months ended June 30, 2000 and 2001 and the statements of cash flows for the six months ended June 30, 2000 and 2001 have been prepared by the Company without audit. In the opinion of management, all adjustments, consisting of normal and recurring adjustments, necessary to present fairly the financial position, results of operations and cash flows at June 30, 2001 and for all periods presented have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto included in the Annual Report on Form 10-K as filed with the Securities and Exchange Commission. The results of operations for the three and six months ended June 30, 2001 are not necessarily indicative of the operating results for the full year.

Principles of Consolidation

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

Cash and Cash Equivalents and Short-term Investments

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

As of June 30, 2001 cash and cash equivalents and short-term investments at cost and fair market value consisted of the following:

	JUNE 30, 2001		
	ORIGINAL COST	GROSS UNREALIZED GAINS	FAIR MARKET VALUE
Cash and cash equivalents	$18,842,660	$ --	$18,842,660
Short-term investments ..	4,968,980	16,000	4,984,980
	$23,811,640	$ 16,000	$23,827,640

At June 30, 2001, short-term investments consisted of a $2 million debt instrument maturing June 13, 2003 and $3 million debt instrument maturing August 17, 2001.

Supplemental Cash Flow Information

The Company paid interest of $44,456 and $42,718 for the six months ended June 30, 2000 and 2001, respectively.

The Company financed $214,872 and $0 of property and equipment purchases with capital leases for the six months ended June 30, 2000 and 2001, respectively.

Major Customers

The Company's operations are conducted in one business segment and sales are primarily made to health care payors and providers. The company had one customer for each of the six month periods ended June 30, 2000 and 2001, which accounted for 22% and 14% of total revenues, respectively. The Company also had one customer for each of the three month periods ended June 30, 2000 and 2001, which accounted for 20% and 13% of total revenues, respectively.

The Company had two customers at June 30, 2001, which accounted for 23% of total accounts receivable.

(2) NET LOSS PER SHARE

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

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

(3) SHAREHOLDERS'EQUITY

Subscriptions Receivable

On June 15, 2001 the Company issued 259,259 shares of its Common stock to seven of its officers and three of its directors in a private sale at a price of $1.62 per share which is equal to the closing price of its Common stock on the Nasdaq National Market on that date. Concurrent with this sale, full recourse notes bearing interest at a rate of 4.11% compounded semi-annually, were issued to these officers and directors. The total amount of such notes issued was $420,000.

Equity Compensation Plans

The Company's 1995 Equity Compensation Plan (the "Plan") permits the granting of incentive stock options, nonqualified stock options, stock appreciation rights and restricted stock. The Company has authorized the issuance of up to 2,565,038 shares of Common stock to satisfy grants under the Plan. At June 30, 2001, there were 507,238 shares reserved under the Plan available for grant. A committee of the Board of Directors (the "Committee") administers the Plan and determines the terms of the grants.

In December 1998, the Company adopted the 1998 Time Accelerated Restricted Stock Option Plan (the "Accelerated Plan"). The Accelerated Plan provides for the granting of non-qualified stock options to officers, senior management and employee directors of the Company. The aggregate number of shares of Common stock the Company may issue under the Accelerated Plan is 483,594 shares. At June 30, 2001 there were no shares reserved under the Accelerated Plan available for grant.

The Company accounts for all plans under APB Opinion No. 25, under which compensation expense is recognized based on the amount by which the fair value of the underlying common stock exceeds the exercise price of the stock options on the measurement date. For financial reporting purposes, the Company has determined that the deemed fair market value on the measurement date for certain stock options was in excess of the exercise price. This amount has been recorded as deferred compensation and is being

amortized over the vesting period of the applicable options, which range between four and seven years. The Company recorded deferred compensation of $120,683 and $0 during the year ended December 31, 2000 and the six months ended June 30, 2001, respectively and reversed $154,902 and $233,643 of deferred compensation in connection with forfeited common stock options during the year ended December 31, 2000 and the six months ended June 30, 2001, respectively. The Company recognized $341,668 and $680,692 of compensation expense related to options for the three and six months ended June 30, 2000, respectively and $315,688 and $631,708 of compensation expense related to options for the three and six months ended June 30, 2001, respectively.

The following table summarizes the option activity for both plans:

		OPTIONS OUTSTANDING		
	SHARES AVAILABLE FOR GRANT	NUMBER OF SHARES	EXERCISE PRICE PER SHARE	AGGREGATE PRICE
Balance, December 31, 1997............	362,800	251,200	$ 0.25- 1.25	$ 271,200
Authorized..........................	1,134,632	--	--	--
Granted.............................	(472,635)	472,635	1.25- 2.60	895,227
Forfeited/Canceled..................	12,800	(12,800)	0.25- 1.25	(10,800)
Balance, December 31, 1998............	1,037,597	711,035	0.25- 2.60	1,155,627
Authorized..........................	--	--	--	--
Granted.............................	(1,108,150)	1,108,150	1.25- 2.59	2,814,164
Forfeited/Canceled..................	216,413	(216,413)	0.25- 2.59	(291,017)
Balance, December 31, 1999............	145,860	1,602,772	0.25- 2.60	3,678,774
Authorized..........................	800,000	--	--	--
Granted.............................	(817,663)	817,663	0.78- 12.00	6,782,592
Forfeited/Canceled..................	573,298	(573,298)	1.25- 12.00	(4,926,524)
Excercised..........................	--	(10,000)	0.25	2,500
Balance, December 31, 2000............	701,495	1,837,137	0.25- 12.00	5,537,342
Authorized	500,000	--	--	--
Granted	(813,685)	813,685	0.88- 2.81	1,186,130
Forfeited/canceled	119,428	(119,428)	0.78- 6.63	(354,507)
Balance, June 30, 2001	507,238	2,531,394	$ 0.25- 12.00	$6,368,965

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, and 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 exclusive licenses with the University of Pennsylvania and California Health Care Foundation for important parts our technology, and the loss of either 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 products which would adversely affect our financial results;

- because our revenues are dependent on a limited number of product lines, the failure of any one of these product lines 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 products;

- our failure to use new technologies effectively or to adapt emerging industry standards would adversely affect our ability to compete;

- our failure to adapt our technology to our customers' needs or to handle high levels of customer activity would adversely affect our ability to increase revenue;

- failure of our service providers could interrupt our business and damage our customer relationships;

- we may need to obtain additional capital and failure to do so may limit our growth;

- health information is subject to potential government regulation and legal uncertainties and changes may require us to alter our business;

- changes in the health care industry could adversely affect our operations;

- our business will suffer if commercial users do not accept Internet solutions;

- our industry is evolving and we may not adapt successfully.

Overview

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

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

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

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

CareScience was incorporated in 1992 with the purpose of commercializing intellectual property that was developed at the University of Pennsylvania School of Medicine and The Wharton School of Business. In 1993, we exclusively licensed the intellectual property underlying our core technology in a 30-year agreement with the University of Pennsylvania. In 1996, we launched our first Internet-based commercial offering based on this proprietary technology under our Care Management System-TM- (formerly called CaduCIS) service line. In 1999, we launched our Care Data Exchange-TM-, and Technology Assessment Tools-TM-, as well as our Lifecycle Decision System-TM- service line, which is aimed at the pharmaceutical and biotechnology industries. To date, we have signed more than 50 contracts covering more than 150 hospitals, health systems and pharmaceutical companies. On March 7, 2000, we changed our name from Care Management Science Corporation to CareScience, Inc.

We generate revenues from subscriptions to our Internet-based proprietary technology applications and hosting of customer data, as well as from training, implementation and consulting services. We sell our services individually or as an integrated suite of services. Our contracts are fixed price based on estimates of certain variables, such as the number of a hospital's patient admissions or outpatient visits.

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

Our contracts generally provide for payment in advance of services rendered. Therefore, we record these payments as deferred revenues and recognize these payments when earned in accordance with our revenue recognition policy. Our deferred revenue balances were $3.0 million and $3.9 million at December 31, 2000 and June 30, 2001, respectively.

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

On June 28, 2000 we completed an initial public offering of 4,000,000 shares of Common stock at a price of $12.00 per share. We received aggregate net cash proceeds of approximately $43.2 million from the initial public offering on July 5, 2000.

RESULTS OF OPERATIONS

THREE MONTHS ENDED JUNE 30, 2001 AND JUNE 30, 2000

REVENUES

Total revenues increased 55% to $3.0 million for the three months ended June 30, 2001 from $1.9 million for the three months ended June 30, 2000. The increase was primarily related to revenues generated from newly signed customer contracts.

Unrecognized revenues related to customer contracts as of June 30, 2001 totaled $19.0 million.

COST OF REVENUES

Cost of revenues include customer product and service-related costs including personnel and facility costs, depreciation and maintenance. Cost of revenues for the three months ended June 30, 2001

was $1.5 million (excluding stock-based compensation of $163,000), an increase of $349,000 or 30%, compared to $1.1 million (excluding stock-based compensated of $171,000) for the three months ended June 30, 2000. The increase was primarily a result of additional costs necessary to service new customers.

GROSS PROFIT

Our gross profit margin increased from 40% for the three months ended June 30, 2000, to 50% for the three months ended June 30, 2001. The increase in gross profit margin is primarily due to increased revenues spread over a fixed cost base.

RESEARCH AND DEVELOPMENT

Research and development costs include technology and product development costs. Research and development costs for the three months ended June 30, 2001 were $1.0 million (excluding stock-based compensation of $10,000), an increase of $223,000 or approximately 28%, compared to $807,000 (excluding stock-based compensation of $24,000) for the three months ended June 30, 2000. This increase is primarily due to expenditures made related to new product development.

As a percentage of revenue, research and development costs were 35% for the three months ended June 30, 2001 as compared to 42% for the three months ended June 30, 2000.

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, 2001 were $2.7 million (excluding stock-based compensation of $143,000), an increase of $949,000, or 53% compared to $1.8 million (excluding stock-based compensation of $147,000) for the three months ended June 30, 2000. The increase was primarily related to hiring of additional sales and management personnel and marketing expenditures to increase and support customer growth.

As a percentage of revenues, selling, general, and administrative expenses were 92% for each of the three month periods ended June 30, 2001 and June 30, 2000.

STOCK-BASED COMPENSATION

We granted certain stock options to our officers and employees with exercise prices deemed to be below the fair market value of the underlying stock. The remaining cumulative difference between the fair value of the underlying stock at the date the options were granted and the exercise price of the granted options was $3.1 million at June 30, 2001. We expect to amortize this amount over the four to seven year vesting periods of the granted options. Accordingly, our results from operations will include stock-based compensation expense at least through 2006. We recognized $342,000 and $316,000 of this expense during the three months ended June 30, 2000 and 2001, respectively.

INTEREST INCOME AND EXPENSE

Net interest income for the three months ended June 30, 2001 was $237,000, an increase of $236,000 compared to $1,000 for the three months ended June 30, 2000. The increase is primarily due to higher investable cash balances as a result of the initial public offering.

SIX MONTHS ENDED JUNE 30, 2001 AND JUNE 30, 2000

REVENUES

Total revenues increased 55% to $5.5 million for the six months ended June 30, 2001 from $3.6 million for the six months ended June 30, 2000. The increase was primarily related to revenues generated from newly signed customer contracts.

COST OF REVENUES

Cost of revenues include customer product and service-related costs including personnel and facility costs, depreciation and maintenance. Cost of revenues for the six months ended June 30, 2001 was $2.9 million (excluding stock-based compensation of $327,000), an increase of $700,000 or 32%, compared to $2.2 million (excluding stock-based compensation of $341,000 for the six months ended June 30, 2000. The increase was primarily a result of additional costs necessary to service new customers.

GROSS PROFIT

Our gross profit margin increased from 39% for the six months ended June 30, 2000, to 48% for the six months ended June 30, 2001. The increase in gross profit margin is primarily due to increased revenues spread over a fixed cost base.

RESEARCH AND DEVELOPMENT

Research and development costs include technology and product development costs. Research and development costs for the six months ended June 30, 2001 were $2.3 million (excluding stock-based compensation of $20,000), an increase of $900,000 or approximately 66%, compared to $1.4 (excluding stock-based compensation of $47,000) for the six months ended June 30, 2000. This increase is primarily due to expenditures made related to new product development.

As a percentage of revenue, research and development costs were 42% of revenue for the six months ended June 30, 2001 as compared to 40% for the six months ended June 30, 2000.

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, 2001 were $6.0 million (excluding stock-based compensation of $286,000); an increase of $2.7 million, or 81% compared to $3.3 million (excluding stock based compensation of $293,000) for the six months ended June 30, 2000. The increase was primarily related to hiring of additional sales and management personnel and marketing expenditures to increase and support customer growth.

As a percentage of revenues, selling, general, and administrative expenses were 110% for the six months ended June 30, 2001 as compared to 94% for the six months ended June 30, 2000.

STOCK-BASED COMPENSATION

We granted certain stock options to our officers and employees with exercise prices deemed to be below the fair market value of the underlying stock. The remaining cumulative difference between the fair value of the underlying stock at the date the options were granted and the exercise price of the granted options was $3.1 million at June 30, 2001. We expect to amortize this amount over the four to seven year vesting periods of the granted options. Accordingly, our results from operations will include stock-based compensation expense at least through 2006. We recognized $681,000 and $632,000 of this expense during the six months ended June 30, 2000 and June 30, 2001, respectively.

INTEREST INCOME AND EXPENSE

Net interest income for the six months ended June 30, 2001 was $599,000, an increase of $577,000 compared to $22,000 for the six months ended

June 30, 2000. The increase is primarily due to higher investable cash balances as a result of the initial public offering.

LIQUIDITY AND CAPITAL RESOURCES - JUNE 30, 2001

Since inception, we have financed our operations and funded our capital expenditures through the private sale of equity securities, supplemented by debt and equipment leases. We believe that proceeds from our initial public offering will be sufficient to fund anticipated capital expenditures and working capital requirement into at least 2002. As of June 30, 2001, we had $23.8 million in cash and short term investments and working capital of $19.6 million.

Net cash used in operating activities was $4.6 million for the six months ended June 30, 2001 and $1.2 million for the six months ended June 30, 2000. For those periods, net cash used in operating activities was primarily to fund losses from operations which was partially offset by a $1.3 million increase in accounts payable and accrued expenses for the six months ended June 30, 2000.

Net cash used in investing activities was $3.1 million for the six months ended June 30, 2001 and consisted of purchases of short-term investments (net of proceeds), purchase of an acquisition and purchases of property and equipment. For the six months ended June 30, 2000 net cash used in investing activities was $1.0 million and consisted of purchases of property and equipment.

Net cash used in financing activities was $212,000 for the six months ended June 30, 2001 and $305,000 for the six months ended June 30, 2000. Financing activities for these periods consisted primarily of payments on capital lease obligations.

As we execute our strategy, we expect significant increases in our operating expenses to fund development of current and new divisions and product lines. Presently, we anticipate that our existing capital resources will meet our operating and investing needs through the end of 2002. After that time, additional funding may not be available on acceptable terms or at all. If we require additional capital resources to grow our business, execute our operating plans 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. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Most of our cash equivalents 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, 2001 all of our cash equivalents matured within 1 day and we had the ability to immediately liquidate our investments. Therefore, we believe that we are exposed to immaterial levels of market risk.

PART II. OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

SALES OF UNREGISTERED SECURITIES

On June 15, 2001, we issued 259,259 shares of our Common stock to 7 of our executive officers and 3 of our directors in a private sale at a price per share equal to the closing price of our Common stock on the Nasdaq National Market on that date. Such sales were made in reliance upon the exemption provided by Section 4(2) of the Securities Act for transactions not involving a public offering and/or Rule 701 under the Securities Act.

USE OF PROCEEDS

On June 28, 2000 the Securities and Exchange Commission declared effective our Registration Statement on Form S-1 (File number 333-32376), relating to the initial public offering of our Common Stock, no par value per share. The net offering proceeds to us after total expenses were $43.2 million. As of June 30, 2001, we have used approximately $20.0 million of the net proceeds from our initial public offering of which approximately $10.4 million was used for working capital and other general corporate purposes, approximately $6.5 million was used for dividends on and the redemption of preferred stock, approximately $2.0 million was used for the purchase of property plant and equipment and $1.1 million was used for the acquisition of Strategic Outcomes Services, Inc..

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

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ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On May 23, 2001, the Company held its 2001 Annual Meeting of Stockholders, at which the stockholders approved (i) the election of 2 directors; (ii) the approval of an amendment to the Company's Amended and Restated 1995 Equity Compensation Plan to increase the authorized shares of Company Common stock issuable under the plan from 2,065,038 shares to 2,565,038 shares; and (iii) the ratification of the selection of Arthur Andersen LLP as the Company's independent public accountants for the year 2001. At the date of record, April 23, 2001, there were 13,016,851 shares outstanding. The vote on such matters was as follows:

1. Election of directors:

Name of Nominee	Total Vote for Each Nominee	Total Vote Withhel Each Nominee
Ronald A. Paulus	9,841,710	73,500
Christopher R. McCleary	9,841,710	73,500

The terms of office of the following directors continued after the Annual Meeting: David J. Brailer, Edward N. Antoian, C. Martin Harris, Jeffrey R. Jay and William Winkenwerder.

2. The approval of an amendment to the Company's Amended and Restated 1995 Equity Compensation Plan to increase the authorized shares of Company Common stock issuable under the plan from 2,065,038 shares to 2,565,038 shares:

FOR	AGAINST	ABSTAIN
9,638,510	0	161,075

3. The the ratification of the selection of Arthur Andersen LLP as the Company's independent public accountants for the year 2001:

FOR	AGAINST	ABSTAIN
9,774,085	0	141,125

ITEM 5. OTHER INFORMATION

On May 23, 2001, our board of directors approved the amendment and restatement of the Company's Amended and Restated 1998 Time Accelerated Restricted Stock Option Plan in order to amend the change of control provisions of that plan. The amendment and restatement of the plan became effective upon approval by our board of directors. The amended and restated plan is attached as an exhibit to this Form 10-Q and is incorporated by reference herein.

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 9, 2001

By: /s/ Ronald A. Paulus
Ronald A. Paulus, President

Date: August 9, 2001

By: /s/ Steven Bell
Steven Bell, Chief Financial Officer and Treasurer

EXHIBIT INDEX

EXHIBIT NO.	DESCRIPTION
10.1	Amended and Restated 1998 Time Accelerated Restricted Stock Option Plan.