CARESCIENCE INC
Form 10-Q
May 07, 2002

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 MARCH 31, 2002

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 May 6, 2002 was 13,300,391.

CARESCIENCE, INC.

FORM 10-Q

March 31, 2002

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

CARESCIENCE, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

	DECEMBER 31, 2001	MARCH 31, 2002
		(UNAUDITED)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 8,860,436	$ 10,528,083
Short-term investments	12,000,950	9,975,278
Interest receivable	83,821	30,224
Accounts receivable, net of allowance for doubtful accounts of $68,354 and $71,354, respectively	1,207,094	1,187,158
Prepaid expenses and other	479,696	309,006

Total current assets	22,631,997	22,029,749
Property and equipment:		
Computer equipment	4,707,706	4,780,955
Office equipment	471,754	471,754
Leasehold improvements	169,956	167,672
Furniture and fixtures	508,598	513,961
	5,858,014	5,934,342
Less--Accumulated depreciation and amortization	(3,345,267)	(3,663,500)
Net property and equipment	2,512,747	2,270,842
Other assets	155,639	151,493
Goodwill, net	1,245,687	1,245,687
Total assets	$ 26,546,070	$ 25,697,771

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Current portion of capital lease obligations and note payable	$ 207,747	$ 248,697
Accounts payable	529,809	239,576
Accrued expenses	1,196,176	1,370,094
Deferred revenues	3,535,484	3,754,121
Total current liabilities	5,469,216	5,612,488
Capital lease obligations	200,069	166,057
Note payable	--	263,205
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	4,859,859
Deferred compensation	(2,202,250)	(1,787,964)
Accumulated other comprehensive income	57,852	42,611
Accumulated deficit	(40,923,547)	(42,421,141)
Subscriptions receivable	(420,000)	(420,000)
Treasury stock, at cost, 1,440,000 shares	(900,000)	(900,000)
Total shareholders' equity	20,876,785	19,656,021
Total liabilities and shareholders' equity	$ 26,546,070	$ 25,697,771

The accompanying notes are an integral part of these statements

CARESCIENCE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS

	FOR THE THREE MONTHS ENDED MARCH 31,	
	2001	2002
	(UNAUDITED)	
Revenues	$ 2,515,611	$ 3,262,928
Cost of revenues	1,535,777	1,706,597
Gross profit	979,834	1,556,331
Operating expenses:		
Research and development	1,308,014	725,746
Selling, general and administrative	3,453,857	2,426,074
Total operating expenses	4,761,871	3,151,820
Operating loss	(3,782,037)	(1,595,489)
Interest income	(383,608)	(108,736)
Interest expense	21,547	10,841
Net loss	$ (3,419,976)	$ (1,497,594)
Net loss per common share:		
Basic and diluted	$ (0.26)	$ (0.11)
Weighted average shares outstanding:		
Basic and diluted	12,985,952	13,287,034

The accompanying notes are an integral part of these statements.

CARESCIENCE, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	FOR THE THREE MONTHS ENDED MARCH 31,	
	2001	2002
	(UNAUDITED)	
Cash flows from operating activities:		
Net loss	$ (3,419,976)	$ (1,497,594)
Adjustments to reconcile net loss to net cash used in operating activities--		
Depreciation and amortization	325,468	318,233
Loss on disposal	158,000	--

Provision for bad debts	5,475	3,000
Stock-based compensation	316,020	265,427
Changes in assets and liabilities--		
(Increase) decrease in--		
Interest receivable	118,605	53,597
Accounts receivable	(107,121)	16,936
Prepaid expenses and other	(35,748)	170,690
Other assets	--	4,146
Increase (decrease) in--		
Accounts payable and accrued expenses	(870,453)	(116,315)
Deferred revenues	890,957	218,637
Net cash used in operating activities	(2,618,773)	(563,243)
Cash flows from investing activities:		
Purchases of short-term investments	--	(4,955,154)
Proceeds from the redemption of short-term investments	3,000,115	6,965,585
Cash paid for acquisition	(882,367)	--
Purchases of property and equipment	(75,247)	(76,327)
Net cash provided investing activities	2,042,501	1,934,104
Cash flows from financing activities:		
Proceeds from the exercise common stock options	--	26,644
Payments on capital lease obligations	(67,244)	(54,858)
Proceeds from notes payable	--	325,000
Net cash (used in) provided by financing activities	(67,244)	296,786
Net (decrease) increase in cash and cash equivalents	(643,516)	1,667,647
Cash and cash equivalents, beginning of period	26,702,096	8,860,436
Cash and cash equivalents, end of period	$ 26,058,580	$ 10,528,083

The accompanying notes are an integral part of these statements.

CARESCIENCE, INC. AND SUDSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Basis of Presentation

CareScience, Inc. (formerly Care Management Science Corporation) (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 March 31, 2002, the consolidated statements of operations for the three months ended March 31, 2001 and 2002 and the consolidated statements of cash flows for the three months ended March 31, 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 at March 31, 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 months ended March 31, 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 MARCH 31,	
	2001	2002
	(UNAUDITED)	
Reported net loss	$(3,419,976)	$ (1,497,594)
Add back--Goodwill amortization	28,600	--
Adjusted net loss	$(3,391,376)	$ (1,497,594)

Basic and diluted net loss per Common share:		
Reported net loss	$ (0.26)	$ (0.11)
Goodwill amortization	--	--
Adjusted net income	$ (0.26)	$ (0.11)

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 is not expected to 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 March 31, 2002 cash and cash equivalents and short-term investments at cost and fair market value consisted of the following:

	MARCH 31, 2002 (UNAUDITED)		
	ORIGINAL COST	UNREALIZED GAINS	FAIR MARKET VALUE
Cash and cash equivalents...	$10,528,083	$ --	$10,528,083
Short-term investments	9,932,667	42,611	9,975,278
	$20,460,750	$ 42,611	$20,503,361

At March 31, 2002 short-term investments consisted of eight debt instruments maturing between April 4, 2002 and August 28, 2003.

Supplemental Cash Flow Information

The Company paid interest of $21,547 and $10,841 for the three months ended

March 31, 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. The company had one customer and two customers for the three month periods ended March 31, 2001 and 2002 respectively, which accounted for 15% and 24 % of total revenues, respectively.

The Company had two customers at March 31, 2002, which accounted for 29% of total accounts receivable.

Comprehensive Income (Loss)

The components of accumulated comprehensive income (loss) are as follows:

Balance, December 31, 2001......	$ 57,852
Change in unrealized gain on available for sales securities..................	(15,241)
Balance, March 31, 2002.........	$ 42,611

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 2,187,821 shares of common stock at exercise prices ranging from $0.25 to $12.00 were outstanding as of March 31, 2002, but were excluded from the computation of diluted net loss per share since the inclusion would be anti-dilutive.

(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 two of the Company's prospective products. 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.

Note Payable

In December 2001, the Company entered into a loan agreement with PIDC Local Development Corporation, whereby it would borrow up to $325,000 with an interest rate of 2.5%, a term of five years, and secured by an interest in certain property and equipment and investments. The balance due on this note payable was $0 and $325,000 at December 31, 2001 and March 31, 2002, respectively.

(4) INCOME TAXES

The Company has incurred operating losses and generated a significant accumulated deficit through March 31, 2002, therefore, no tax provisions have been recorded. As of March 31, 2002 the Company had federal net operating loss carryforwards of approximately $32 million which expire from 2010 through 2021. As of March 31, 2002 and March 31, 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.

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 regardless of the timing of the required delivery of services to the customer or the related cost to the Company of delivering such services.

The Company's 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.

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.

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 $3.8 million at December 31, 2001 and March 31, 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 to 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 material tax provision or benefit. As of December 31, 2001, we had net operating loss carryforwards of approximately $30.8 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 MARCH 31, 2002 AND MARCH 31, 2001

REVENUES

Total revenues increased 30% to $3.3 million for the three months ended March 31, 2002 from $2.5 million for the three months ended March 31, 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 March 31, 2002 totaled $18.3 million.

COST OF REVENUES

Cost of revenues include customer and service-related costs including personnel and facility costs, depreciation and maintenance. Cost of revenues for the three months ended March 31, 2002 was $1.7 million an increase of $171,000 or 11%, compared to $1.5 million for the three months ended March 31, 2001. The increase was primarily a result of additional costs necessary to service new contracts.

GROSS PROFIT

Our gross profit margin increased from 39% for the three months ended March 31, 2001, to 48% for the three months ended March 31, 2002. The increase in gross profit margin is primarily due to increased revenues spread over a partially 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 March 31, 2002 were $726,000, a decrease of $582,000 or approximately 45%, compared to $1.3 million for the three months ended March 31, 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 22% for the three months ended March 31, 2002 as compared to 52% for the three months ended March 31, 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 March 31, 2002 were $2.4 million, an decrease of $1.0 million, or 30% compared to $3.5 million for the three months ended March 31, 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 74% for the three months ended March 31, 2002 as compared to 137% for the three months ended March 31, 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 $1.8 million at March 31, 2002. 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 $265,000 and $316,000 of this expense during the three months ended March 31, 2002 and 2001, respectively.

INTEREST INCOME AND EXPENSE

Net interest income for the three months ended March 31, 2002 was $98,000, a decrease of $264,000, compared to $362,000 for the three months ended March 31, 2001. The decrease is primarily due to lower investable cash balances and a decrease in investment interest rates.

LIQUIDITY AND CAPITAL RESOURCES--MARCH 31, 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 requirement for at least the next 12 months. As of March 31, 2002, we had $20.5 million in cash and cash equivalents and short-term investments and working capital of $16.4 million.

Net cash used in operating activities was $563,000 for the three months ended March 31, 2002 and $2.6 million for the three months ended March 31, 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 provided by investing activities was $1.9 million for the three months ended March 31, 2002 and consisted primarily of proceeds from the redemption of short-term investments, net of purchases of short-term investments and property and equipment. Net cash provided by investing activities was $2.0 million for the three months ended March 31, 2001 and consisted primarily of proceeds from the redemption of short-term investments, net of funding of an acquisition and purchases of property and equipment.

Net cash provided by financing activities was $297,000 for the three months ended March 31, 2002 and consisted of proceeds from a note payable and the exercise of common stock options net of payments on capital lease obligations. Net cash used in financing activities consisted of $67,000 for three months ended March 31, 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 March 31, 2002 all of our cash equivalents mature within 17 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.

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 two of our prospective products and our planned disposition of the offering proceeds. 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 March 31, 2002, we have used approximately $23.7 million of the net proceeds from our initial public offering of which approximately $13.4 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 $2.7 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: May 6, 2002

By: /s/ RONALD A. PAULUS

Ronald A. Paulus, President

Date: May 6, 2002

By: /s/ STEVEN BELL

Steven Bell, Chief Financial Officer and Treasurer

EXHIBIT INDEX

EXHIBIT NO.	DESCRIPTION